111 Research Paper
May 2020

National Measures on Taxing the Digital Economy

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SOUTH CENTRE

RESEARCH PAPER

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MAY 2020

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ABSTRACT

The Organisation for Economic Co-operation and Development (OECD)'s Inclusive Framework is considering a two-pillar approach on taxing the digital economy. Preliminary estimates about the impact of its recommendations show a modest increase in corporate income tax collection, the benefits of which are expected to go mostly to the developed countries. At the same time, there is a rise in national measures on taxing the digital economy, a move spurred by the onset of the COVID-19 pandemic. This is also fully within the rights of countries under international law, despite labels of 'unilateralism'. This research paper highlights the direct tax measures being taken by various countries and finds three key approaches to tax the digital economy: (1) digital service taxes; (2) nexus rules based on significant economic presence ;(3) withholding tax on digital transactions.

Le Cadre inclusif sur le BEPS de l'Organisation de coopération et de développement économiques (OCDE) envisage une approche fondée sur deux piliers en matière de taxation de l'économie numérique. Les premières estimations concernant l'impact de ses recommandations montrent une modeste augmentation de la collecte de l'impôt sur les sociétés, dont les bénéfices devraient revenir principalement aux pays développés. Dans le même temps, les mesures nationales de taxation de l'économie numérique se multiplient, en conséquence de la pandémie de COVID-19. Le droit international reconnaît pleinement ce droit aux pays, bien que cette approche soit considérée comme une forme d'unilatéralisme. Ce document de recherche met en lumière les mesures de fiscalité directe prises par différents pays et présente les trois approches clés retenues pour taxer l'économie numérique : (1) l'imposition de taxes sur les services numériques ; (2) l'élaboration de règles permettant d'établir un lien fiscal pour les entreprises numériques qui opère par l'intermédiaire d'une présence numérique significative ; (3) des retenues à la source sur les transactions numériques.

El Marco Inclusivo de la Organización de Cooperación y Desarrollo Económicos (OCDE) está considerando un enfoque de dos pilares en relación con el cobro de impuestos sobre la economía digital. Las estimaciones preliminares acerca de la repercusión de sus recomendaciones indican un modesto incremento en la recaudación de impuestos sobre la renta de las sociedades, cuyos beneficios se prevén que se dirijan principalmente a los países desarrollados. Al mismo tiempo, están proliferando las medidas nacionales en materia de cobro de impuestos sobre la economía digital, un cambio estimulado por el comienzo de la pandemia de COVID-19. Los países también tienen plenos derechos a aplicarlas en virtud del derecho internacional, pese a las etiquetas de "unilateralismo". En este documento de investigación se ponen de relieve las medidas en materia de impuestos directos que están adoptando diversos países y se exponen tres enfoques fundamentales con respecto al cobro de impuestos sobre la economía digital: 1) impuestos sobre los servicio digitales; 2) normas sobre un nexo en base a una presencia digital significativa; y 3) retenciones en origen sobre las transacciones digitales.

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INTRODUCTION: RECENT DEVELOPMENTS IN THE INCLUSIVE FRAMEWORK

In January 2020, members of the Organisation for Economic Co-operation and Development (OECD)/Group of Twenty (G20) Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) released a statement on the two-pillar solution to the tax challenges arising from the digitalization of the economy.[1] The statement reiterated the IF members' commitment to reach an agreement on a consensus-based solution by the end of 2020. The IF also agreed upon an "outline of the architecture of a Unified Approach on Pillar One as the basis for negotiations", intending to reach by July 2020 agreement on the key policy features of the solution which would form the basis for a political agreement.

The Unified Approach to Pillar One seeks to create new taxing rights which would allow for taxable presence (nexus) even in the absence of physical presence of a company. Pillar Two seeks to establish a global minimum corporate tax rate and enforce it through four interlocking rules, which would allow both source and residence countries to ensure multinational enterprises (MNEs) pay the minimum rate.

There has been much controversy over the procedure through which the Unified Approach was arrived at. The OECD Secretariat claimed to integrate 'common elements' from three competing proposals – user participation, marketing intangibles and significant economic presence – but the resulting Unified Approach to Pillar One seems biased towards the US' proposal of marketing intangibles. Similarly, the sole proposal put forth by developing countries, the Group of Twenty-Four (G24)'s concept of Significant Economic Presence, has been removed from further consideration. Hence, the Unified Approach to Pillar One has been strongly influenced by the policy approach of the US.

Pillar Two, also known as the Global Anti-Base Erosion (GloBE) proposal, is also largely influenced by US domestic legislation, specifically the US Tax Cuts and Jobs Act (TCJA) of 2017.[2] TCJA's Base Erosion and Anti-Abuse Tax (BEAT) and the Global Intangible Low-Taxed Income (GILTI) measures bear close resemblance to the undertaxed payments and income inclusion rules of Pillar Two.

Hence, the OECD's two-pillar approach mostly reflects the policy proposals of the US, something which has been acknowledged by the OECD Secretary-General himself.[3] It is questionable to what extent the interests of developing countries have been taken into consideration.[4] This is yet another instance of the issues developing countries face

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[1] OECD, Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy, January 2020, Paris. Available from www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf.

[2] Monica Victor, "Addressing Developing Countries' Tax Challenges of the Digitalization of the Economy", Tax Cooperation Policy Brief, No. 10 (Geneva, South Centre, 2019). Available from https://www.southcentre.int/tax-cooperation-policy-brief-10-november-2019/.

[3] See: http://www.oecd.org/tax/Letter-from-OECD-Secretary-General-Angel-Gurria-for-the-attention-of-The-Honorable-Steven-T-Mnuchin-Secretary-of-the-Treasury-United-States.pdf.

[4] Alvin Mosioma, Lidy Nacpil, Luis Moreno, Pooja Rangaprasad and Dereje Alemayehu, "Time for developing countries to go beyond the OECD-led tax reform!", Global Alliance for Tax Justice, 12 February 2020. Available from https://www.globaltaxjustice.org/en/latest/time-developing-countries-go-beyond-oecd-led-tax-reform.

in articulating their interests in the OECD's international tax framework,[5] and is arguably profoundly undemocratic. Further, it remains unclear how the two-pillar approach will be implemented, and what would be the extent of voice available to non-OECD members of the Inclusive Framework. One observer has stated, "what is unified in the OECD approach is its commitment to an exclusive process of consensus building that replicates that of the founders of the international tax order, apparently unchanged by developments like inclusive participation and equal footing."[6]

Accordingly, what followed was unsurprising. In February 2020, the OECD presented the results of an analysis on the expected revenue gains from implementing the two-pillar approach. The estimates showed the combined effects of the two-pillar solution would result in an annual increase in revenue collection of USD 100 billion, or up to 4% of global corporate income tax (CIT).[7] While this figure may seem large, it pales in comparison with the estimated USD 600 billion[8] in revenue lost each year due to tax avoidance. Further, as seen in Figure 1, the distributive implications are problematic as high-income countries are expected to benefit marginally more than middle- and low-income countries, though middle- and low-income countries proportionally face the highest losses from corporate tax avoidance under the current rules.[9]

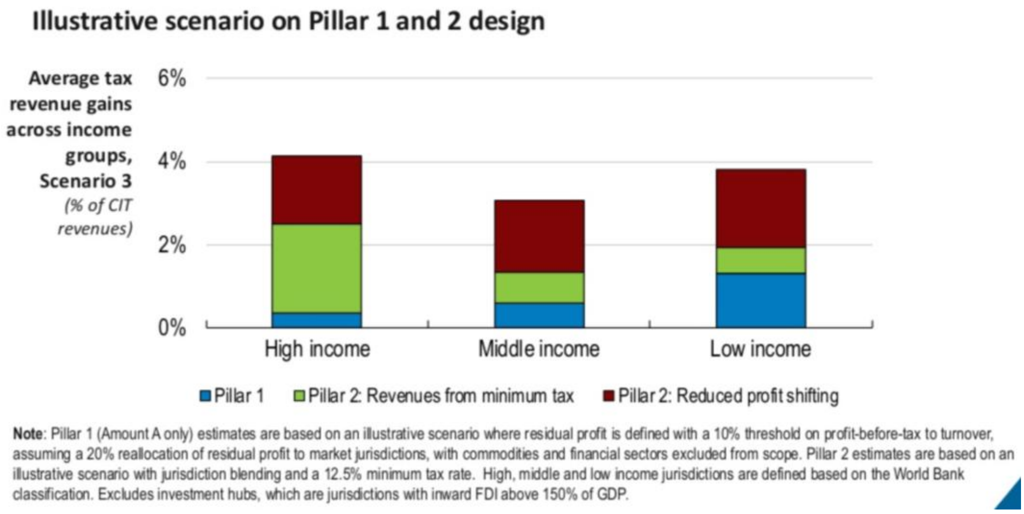

Figure 1: Combined revenue effects of Pillar 1 and 2
Source: OECD, "Tax Challenges Arising from the Digitalisation of the Economy, Update on the Economic Analysis and Impact Assessment", Webcast, 15 February 2020

[5] Irma Johanna Mosquera Valderrama, "About the BEPS Inclusive Framework and the role of the OECD", GLOBTAXGOV, 19 November 2019. Available from https://globtaxgov.weblog.leidenuniv.nl/2019/11/19/about-the-beps-inclusive-framework-and-the-role-of-the-oecd/.

[6] Allison Christians, "OECD Secretariat's Unified Approach: How to get things on a truly Equal Footing", International Centre for Tax and Development, 5 November 2019. Available from https://www.ictd.ac/blog/oecd-secretariat-unified-approach-equal-footing/.

[7] See: http://www.oecd.org/tax/beps/oecd-presents-analysis-showing-significant-impact-of-proposed-international-tax-reforms.htm.

[8] Nicholas Shaxson, "Tackling Tax Havens", *Finance and Development*, vol. 56, No. 3 (September 2019). Available from https://www.imf.org/external/pubs/ft/fandd/2019/09/tackling-global-tax-havens-shaxon.htm.

[9] Independent Commission for the Reform of International Corporate Taxation (ICRICT), "The OECD's proposed reform will fail to generate meaningful additional tax revenue, especially for developing countries", 13 February 2020. Available from https://www.icrict.com/press-release/2020/2/13/the-oecds-proposed-reform-will-fail-to-generate-meaningful-additional-tax-revenue-especially-for-developing-countries.

The OECD's estimates were pre-empted by prior independent studies that showed the Unified Approach to Pillar One in its current form would disproportionately benefit the US and developed countries. Assessments by Cobham, Faccio and FitzGerald[10] show that the Unified Approach, which has only sales in its formulary allocation key, would yield over USD 8 per capita for the United States, around USD 4 per capita for other Group of Seven (G7) members and USD 2 per capita for the OECD without the United States. For non-OECD members of the G20, and for the G24 and Group of Seventy-Seven (G77), the projected benefit is between USD 0.08 and USD 0.18 per capita, respectively. By contrast, including employment in the formula would increase those projected benefits to between USD 0.80 and USD 1 for the G24 and the G77. Figure 2 shows the contrast.

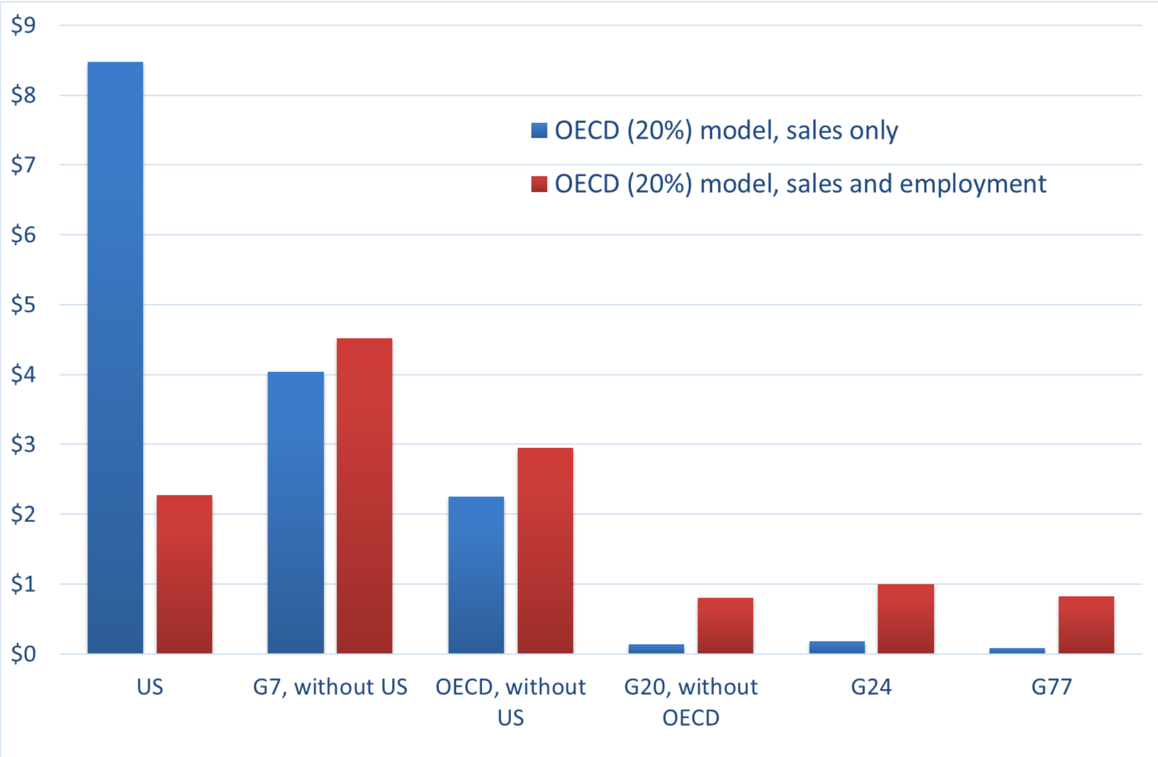

Figure 2: Projected per capita revenue increases
Source: Cobham, Faccio and FitzGerald, "Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals"

Hence, the Unified Approach to Pillar One has questionable benefits for developing countries. It in fact seems to be increasing global inequality, a direct contravention of Sustainable Development Goal (SDG) 10, which seeks to reduce inequalities between countries. That said, even developed countries do not stand to significantly benefit, given the small increase in overall revenue. This combined with the slow pace of multilateral negotiations and increasing public anger over the inability of governments to tax the ever-growing profits of digital giants has led to a proliferation of national tax measures. A recent study estimated that just six prominent companies avoided taxes of

[10] Alex Cobham, Tommaso Faccio, Valpy FitzGerald, "Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals", SocArXiv, October 2019. Available from https://osf.io/preprints/socarxiv/j3p48/.

an estimated USD 100 billion between 2010-2019.[11] Post COVID-19, Nasdaq, the US stock exchange that is dominated by digital firms, saw the price to earnings (P/E) ratio of the top 100 companies actually go up and cross a 10-year average of 19 and increase to 28 in April, following the March crash in equity markets worldwide. The so-called FAANG companies (Facebook, Apple, Amazon, Netflix, Google) have all seen increased sales and subscribers post the COVID 19 lockdown, with the exception of Amazon which reported less profit than anticipated, though that was because of higher delivery costs due to increased sales.[12] [13] Amazon in fact even announced plans to hire 100,000 new staff to keep up with higher e-commerce orders, implying it expects sales to increase much further.[14]

An increasing number of both developed and developing countries have brought out legislation, several of which involve Digital Service Taxes (DSTs), to tax the profits of these companies. This has been met with severe criticism from the United States, home to some of the world's biggest digital companies such as the Silicon Six (Facebook, Amazon, Apple, Netflix, Google and Microsoft). The US has accused some of these countries of unfairly targeting American companies[15], and in some cases, has even threatened retaliatory trade tariffs.[16] DSTs have been attacked for seeking to tax gross revenues, rather than net income. Further, the US has expressed disapproval[17] over the Unified Approach, arguing that it has a discriminatory impact on US-based businesses and has called for "safe harbor" regime to Pillar One, essentially making it optional.

The OECD has been deeply alarmed at these developments and has voiced concerns, appealing to countries to arrive at a multilateral solution and warning that failure to do so would result in a "cacophony and a mess" and "tensions rising all over the place".[18] It has repeatedly urged countries to withdraw or at least delay implementation of these national measures. Nevertheless, despite sustained pressure, both developed and developing countries are going ahead with bringing out legislative measures on taxing digital companies.

These measures have arguably played a highly positive role in the discourse: they have spurred the OECD into action, and given it a (somewhat extreme) commitment to arrive at a solution at the earliest. Further, they have possibly strengthened countries' bargaining positions, as they are no longer beholden to the OECD alone for delivering a solution. These measures take on new importance in the current context, where the Inclusive Framework is aiming at coming out with a consensus solution by July 2020 on the "key policy features of the solution which would form the basis for a political agreement."

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[11] See: https://fairtaxmark.net/wp-content/uploads/2019/12/Silicon-Six-Report-5-12-19.pdf.
[12] See: https://www.cnbc.com/2020/05/04/big-techs-earnings-prove-its-immune-to-the-coronavirus.html.
[13] See: https://www.cnbc.com/2020/04/30/amazon-amzn-q1-2020-earnings.html.
[14] See: https://www.economist.com/leaders/2020/04/04/big-techs-covid-19-opportunity.
[15] United States Trade Representative, *Section 301 Investigation Report on France's Digital Services Tax* (2 December 2019). Available from in: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.
[16] Andrea Shalal, Leigh Thomas, "U.S. floats 'safe harbor' proposal in global taxation reform drive", *Reuters*, 4 December 2019. Available from https://www.reuters.com/article/us-usa-tax-digital/u-s-floats-safe-harbor-proposal-in-global-taxation-reform-drive-idUSKBN1Y82F8.
[17] See: https://www.orbitax.com/news/archive.php/U.S.-Treasury-Secretary-Sends--40283.
[18] See: https://www.cityam.com/oecd-tells-uk-to-hold-fire-on-new-tech-giants-tax/.

Hence, given the importance of these measures, it is necessary to examine them in detail, so developing countries both within the Inclusive Framework and outside of it know what are the options available to them to safeguard their tax base in case the negotiations within the OECD fail to safeguard the interests of developing countries.

The paper groups these options into three: (1) Digital Service Taxes (2) New nexus based on Significant Economic Presence and profit allocation through Fractional Apportionment (3) Withholding Taxes on Digital Transactions. The broad description of each policy option is outlined followed by country-wise specifics, with an emphasis on legal details and revenue obtained, if any. A compilation of all revenue estimates and actuals is given towards the end, followed by a conclusion with the key findings.

UNILATERAL MEASURES TAKEN BY THE UNITED STATES

It is important to begin this review by examining what the United States itself is doing on unilaterally taxing the digital economy. Though it has condemned countries that have brought out DSTs on the grounds that these tax gross revenues rather than net income, at least three US States – Maryland, Nebraska and New York – have brought out legislations that seek to do the exact same thing and tax the gross revenues of digital companies. Further, other US states and at least one local government, such as Oregon[19] and San Francisco[20] have brought out proposals that seek to tax the gross revenues of all companies, not just digital ones. This is interesting given that the United States Trade Representative (USTR) report on France's DST devotes large sections to criticizing even the conceptual basis of a tax on gross revenues stating that it goes against "prevailing tax principles".

Part of this shift may be attributed towards a recent judicial development. In June 2018, the United States Supreme Court decided the case *South Dakota vs Wayfair*, *Inc*., ruling that "*a business does not need a physical presence in a State to meet the requirements of due process which call for some definite link, some minimum connection, between a state and the person, property or transactions it seeks to tax.*"[21] This may have encouraged unilateral measures by the United States, but also oriented the US towards a possible solution to come from the Inclusive Framework.

Maryland

On 8 January 2020, SB 2 was introduced in the Maryland Senate.[22] The Bill has the purpose of "imposing a tax on certain annual gross revenues derived from certain digital advertising services" and goes on to term it a 'digital advertising gross revenues tax' and prescribes criminal penalties for failure to comply. This is the first attempt by a US state to impose a targeted tax on the gross revenue of digital advertising services.[23] The tax applies at a sliding scale with a 2.5% rate for global annual gross revenues of USD 100 million or more up to 10% for global annual gross revenues of USD 15 billion or more.

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[19] Stephen P. Kranz, Diann Smith & Joe Bishop-Henchman, "Gross Receipts Taxes Face Policy and Legal Challenges", Inside Salt, 24 September 2019. Available from https://www.insidesalt.com/2019/09/gross-receipts-taxes-face-policy-and-legal-challenges/.

[20] Stephen P. Kranz, Diann Smith & Joe Bishop-Henchman, "New Trend Developing? Another Digital Advertising Tax Proposal", Inside Salt, 15 January 2020. Available from https://www.insidesalt.com/2020/01/new-trend-developing-another-digital-advertising-tax-proposal/.

[21] Dalton Dallazem and Natália Brasil Dib, "Is *South Dakota v Wayfair, Inc.* case relevant to the digital economy taxation?", Central European Political Science Review, vol. 20, No. 76 (Summer 2019).

[22] See: http://mgaleg.maryland.gov/2020RS/bills/sb/sb0002f.pdf.

[23] Stephen P. Kranz, Diann Smith & Joe Bishop-Henchman, "Maryland Proposes (French) Tax on Advertising – Digital Platforms and Advertisers Beware!", Inside Salt, 10 January 2020. Available from https://www.insidesalt.com/2020/01/breaking-news-maryland-proposes-french-tax-on-advertising-digital-platforms-and-advertisers-beware/.

Nebraska

A few days after Maryland, on 14 January 2020, LB 989[24] was introduced in the Nebraska Legislature which seeks to impose sales and use tax on “the retail sale of digital advertisements.” The state sales tax rate is 5.5% with local sales taxes up to an additional 2%.[25] The proposal seeks to come into effect from 1 October 2020.

New York

Following suit from Nebraska, on 20 January 2020, A. 9112 was introduced in the New York Assembly.[26] A Senate companion bill, S. 6102, has been referred to the Senate Budget & Revenues Committee after being introduced in May 2019. The bills seek to impose an additional 5% tax on the gross income of “every corporation which derives income from the data individuals of this state share with such corporations.” The bills would also establish a six-member Data Fund Board, to invest the tax revenue collected and distribute net earnings “to each taxpayer of the state”.[27]

Thus, while the US’ Federal government has been vehement in its criticism of taxes on gross revenues, several states are moving ahead with those very same taxes.

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[24] See: https://us.eversheds-sutherland.com/portalresource/LB989.pdf.

[25] See: https://www.insidesalt.com/2020/01/new-trend-developing-another-digital-advertising-tax-proposal/.

[26] See: https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=A09112&term=2019&Summary=Y&Text=Y.

[27] Stephen P. Kranz, Diann Smith & Joe Bishop-Henchman, “New York Considers 5% Gross Receipts Tax on Almost Every Corporation”, Inside Salt, 22 January 2020. Available from https://www.insidesalt.com/2020/01/breaking-news-new-york-considers-5-gross-receipts-tax-on-almost-every-corporation/.

DIGITAL SERVICE TAXES

On 21 March 2018, the European Commission (EC) proposed new rules to ensure that digital business activities are taxed in a fair and growth-friendly way in the European Union (EU). This laid the basis for the DSTs which have subsequently been adopted by an increasing number of countries, within and outside the EU. The European proposal included two different options. The first one was developed as a long-term solution and consisted of laying down rules relating to the corporate taxation of a significant digital presence.[28] The second proposal was designed as an interim measure. It consisted of implementing a 3% tax on revenues arising from the provision of digital services.[29] The actual level of the tax was originally proposed at 3% because it was understood that the effective corporate tax rate of the digital companies was 9.5%, and this tax was thought of as a corporate tax with the particularity that it is not possible, or it would be very difficult, to obtain information on costs and expenses to charge it at the net operating margin level.

The proposal aimed at protecting the integrity of the Single Market and ensuring its proper functioning. The EC considered that such a proposal will "close the gaps that currently exist in the international rules allowing some digital companies to escape taxation in countries where they operate and create value,"[30] and guaranteeing that the public finances within the Union are sustainable and national tax bases are not eroded.[31]

Although the EC proposal was not adopted by the European Union, and certain Member States showed a number of concerns, mainly that it could have unintended effects on the economy of the Union,[32] the DST has been the basis for a number of national measures adopted by Member States of the EU with certain modifications.[33]

The directive in Article 3(1) sets the digital tax rate at 3% of total gross revenues arising from the following services:

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[28] European Commission, Council Directive 2018/0072 (CNS), COM(2018) 147 Final (2018). Available from https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf (accessed 05.03.2020).

[29] European Commission, Council Directive 2018/0073 (CNS), COM(2018) 148 Final (2018). Available from https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf (accessed 05.03.2020).

[30] European Commission, Council Directive 2018/0073 (CNS), COM(2018) 148 Final (2018), p. 3. Available from https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf (accessed 05.03.2020).

[31] European Commission, Council Directive 2018/0073 (CNS), COM(2018) 148 Final (2018), pp. 2-3. Available from https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf (accessed 05.03.2020).

[32] See: https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Ministry/Advisory_Board/taxing-digital-economy-anl.pdf?__blob=publicationFile&v=3.

[33] See: Reuters, "Factbox: State of play in closing digital revenue tax loophole", 11 July 2019. Available from https://www.reuters.com/article/us-france-tax-tech-factbox/factbox-state-of-play-in-closing-digital-revenue-tax-loophole-idUSKCN1U61HF (accessed 06.03.2020).

a. placing on a digital interface of advertising targeted at users of that interface;

b. making available to users of a multi-sided digital interface which allows users to find other users and to interact with them to facilitate the provision of underlying supplies of goods or services directly between users;

c. sale of data collected about users and generated from users' activities on digital interfaces.

The proposal also defines *Taxable person* under Article 4(1), as an entity meeting both the following:[34] (i) the total amount of worldwide revenues reported by the entity for the latest complete financial year for which a financial statement is available exceeds EUR 750 million; and (ii) the total amount of taxable revenues obtained by the entity within the Union during that financial year exceeds EUR 50 million.

Similarly, according to Article 5, the proportion of taxable revenues obtained by an entity is considered under the concept of *user value creation*. This concept implies that EU Member States will be able to tax the income generated domestically based on where the user is located, whether or not a company has a permanent establishment in that country.[35] The need to focus on the *user* is based on the fact that the value of the digital economy is "often created from a combination of algorithms, user data, sales functions and knowledge."[36] The user data creates value as it could be used in the future for advertisement.

Although the European Parliament voted on the draft of the report on 13 December 2018, proposing to lower the threshold from EUR 50 million to EUR 40 million and to broaden the tax base by including "content on a digital interface such as video, audio, games, or text using a digital interface."[37] As a special legislative procedure, the proposal required unanimity by the Council for its adoption.

On 12 March 2019, the Economic and Financial Affairs Council could not reach an agreement.[38] The Council requested the new Executive Vice-President for A Europe Fit for the Digital Age of the new Commission to support achieving an international solution or propose a fair European tax if a solution is not found.[39] Nevertheless, several

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[34] European Commission, Council Directive 2018/0073 (CNS), COM(2018) 148 Final (2018), p. 10. Available from https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf (accessed 05.03.2020).

[35] See: https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Ministry/Advisory_Board/taxing-digital-economy-anl.pdf?__blob=publicationFile&v=3.

[36] European Commission, "Questions and Answers on a Fair and Efficient Tax System in the EU for the Digital Single Market" (21 March 2018). Available from https://ec.europa.eu/commission/presscorner/detail/en/MEMO_18_2141.

[37] See: https://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-digital-services-tax-on-revenues-from-certain-digital-tax-services.

[38] See: https://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-digital-services-tax-on-revenues-from-certain-digital-tax-services.

[39] Mission Letter to Executive Vice-President Commissioner for "A Europe Fit for the Digital Age". See : https://ec.europa.eu/commission/commissioners/sites/comm-cwt2019/files/commissioner_mission_letters/mission-letter-margrethe-vestager_2019_en.pdf.

European countries have adopted, or are in the process to adopt and implement, national measures based on the *Fair Taxation of the Digital Economy* proposal.

Austria

Since the year 2000, Austria has been levying a tax on classic advertising (i.e. on radio, TV, print media or posters); and as of 1 January 2020, Austria has implemented an interim solution levying a 5% tax on the turnover from online advertising if provided by online advertisers in Austria.[40]

An online advertising service is deemed to have been provided domestically if it is received on a user's device having a domestic Internet Protocol (IP) address and is addressed (also) to domestic users in terms of its content and design. The location of the provision of an online advertising service may be determined on the basis of the IP address or by using other technologies for geolocation. In this understanding, advertisements placed on a digital interface, in particular in the form of banner advertising, search engine advertising and comparable advertising services, are considered online advertising services.

The taxpayers are deemed to be the online advertisers entitled to a remuneration, generating within one business year a worldwide turnover of at least EUR 750 million; and a turnover in Austria of at least EUR 25 million from the provision of online advertising services. Intermediate inputs by other online advertisers that are not part of the taxpayers' multinational group of companies are not included in the calculation of the thresholds, nor in the estimation of the tax base.

If online advertisers do not have a registered office nor a place of management or permanent establishment in the European Union or the wider European Economic Area, they are required to appoint a fiscal representative.

Belgium

The digital service tax proposed in Belgium has not yet been approved by Parliament. The initiative consists of 2 proposals, both largely modelled on the EC proposal.[41]

(i) Proposal 1: 3% tax on revenue from activities such as the selling of user data by companies with annual worldwide revenues of EUR 750 million and EU revenue of EUR 50 million. Such taxation would be on revenues from three main activities: publishing online advertisements directed at users of a digital platform; selling of user data; offering digital platforms that expedite the interaction between users and the transfer of goods and services between users[42].

(ii) Proposal 2: making digital companies subject to corporate income tax in Belgium when they provide digital services in the country regardless of no physical presence.

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[40] See https://www.bmf.gv.at/en/topics/taxation/digital-tax-act.html, Austrian Digital Tax Act 2020, Federal Law Gazette I № 91/2019 (DiStG 2020), and ordinance of the Federal Minister of Finance, the DiStG 2020-UmsetzungsV, Federal Law Gazette II № 378/2019.

[41] See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

[42] See: https://www.lexology.com/library/detail.aspx?g=b2f512f2-3244-4a4f-880e-1bae4ff85ed9.

Canada

The introduction of a DST was part of Prime Minister Justin Trudeau's Liberal Party campaign manifesto in 2019. The proposal consisted of a 3% DST to be applicable to companies with worldwide revenues of at least CAD 1 billion and Canadian revenues of more than CAD 40 million[43]; and was expected to raise CAD 540 million in the 2020-2021 period.[44] The DST was meant to be implemented by April 2020. However, US threats to national measures of this type has put this proposal on hold, and Canadian authorities are now waiting for the OECD's Inclusive Framework discussions to be finalized before making any moves.[45]

Czech Republic

In November 18, 2019, the Czech Ministry of Finance passed a legislation, that is still awaiting to be voted by the Parliament, to introduce a 7% digital services tax on placing targeted advertising on digital interfaces by corporations with a global turnover exceeding EUR 750 million and turnover in the Czech Republic of at least CZK 100 million.[46] This bill is expected to be "a temporary measure until a global consensus on taxing internet giants could be reached".[47]

Denmark

The Finance Ministers of Denmark, Finland, and Sweden released a joint statement[48] on digital taxation which was critical of the DSTs, repeating the US' line that it deviated from 'international tax principles'. The statement also called for any solution reached to be a consensus-based solution, "with a substantial part done by the OECD."[49] However, if a solution were not to be reached by the OECD, Denmark would support a European-wide agreement[50].

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[43] See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.
[44] See also: https://taxfoundation.org/canada-digital-tax-proposal/.
[45] See: https://www.cbc.ca/news/politics/davos-digital-tax-wednesday-1.5436372.
[46] See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.
[47] See: https://thenextweb.com/facebook/2019/11/19/czech-gov-wants-to-slap-a-7-ad-tax-on-internet-giants-like-google-and-facebook/ and https://www.intellinews.com/us-government-files-official-protest-against-the-czech-digital-tax-175421/?source=czech-republic.
[48] See: https://www.government.se/statements/2018/06/global-cooperation-is-key-to-address-tax-challenges-from-digitalization/.
[49] See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.
[50] See https://www.bloomberg.com/news/articles/2020-01-28/frederiksen-says-denmark-supports-eu-wide-deal-on-digital-tax.

France

In July 2019, France published Law 2019-759, which introduced amendments to the General Tax Code, creating a tax on digital services.[51] It consists of a 3% levy applicable to French and foreign companies for which the annual revenue for taxable services exceed both of the following conditions: (i) EUR 750 million of worldwide revenues; (ii) EUR 25 million generated in France.

Services using digital interfaces to supply goods or services between users and targeted advertising on a digital interface in France will be taxable by the new law. Such services will be considered provided in France when the terminal used for accessing such services is located in France following its IP address in compliance with the EU personal data protection rules.[52]

The implementation of the tax was suspended by the French Government until discussions with their counterparts from the United States are over. Such negotiations were initiated due to the possible imposition of tariffs on French products by the United States, as countermeasures for this tax.[53] According to American Officials, the French Digital Tax would have been 'discriminatory' and 'unreasonable', allowing them to increase tariffs on French products.[54]

Israel

The Israel Tax Authority has reportedly planned to draft legislation that would introduce a DST with a 3-5% rate on gross income. The law is supposedly modeled on the French proposal and may be introduced once a new Finance Minister is appointed, and is estimated to garner up to NIS 1 billion.[55]

Italy

On December 2018, the Italian Parliament approved the Budget Law 2019,[56] which introduced a new tax on digital transactions. The tax is a variation of the European DST, applying a 3% rate of the "taxable income realized in each quarter, assumed

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[51] See: Journal Officiel "Lois et Décrets" No. 0171 (2019), Bill n° 2019-759 of July 24th, 2019 on the creation of a tax on digital services in https://www.impots.gouv.fr/portail/files/media/1_metier/5_international/french_dst_en_v2.pdf?l=en (accessed 10.03.2020).

[52] European Parliament and the Council, Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (2016). Available from https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1532348683434&uri=CELEX:02016R0679-20160504 (accessed 09.03.2020).

[53] Ana Swanson and Alan Rappeport, "U.S. and France Race to Conclude Digital Tax Talks as Tariff Threat Looms", *The New York Times*, 7 January 2020. Available from https://www.nytimes.com/2020/01/07/business/economy/us-france-digital-tax.html (accessed 09.3.2020).

[54] Ana Swanson and Alan Rappeport, "U.S. and France Race to Conclude Digital Tax Talks as Tariff Threat Looms", *The New York Times*, 7 January 2020. Available from https://www.nytimes.com/2020/01/07/business/economy/us-france-digital-tax.html (accessed 09.3.2020).

[55] Ela Levi-Weinrib, "Google, Facebook could face huge Israel tax bill", *Globes*, 28 April 2019. Available from https://en.globes.co.il/en/article-israel-tax-authority-to-demand-huge-tax-payments-from-google-facebook-1001283596.

[56] Parliament of Italy, Law No. 145 (the "2019 Budget Law"), published in the Official Gazette No. 302 (31 December 2018).

gross of costs and net of VAT."[57] The law identifies those companies that have a permanent establishment (PE) in Italy, as well as those that do not, as a subject of the tax if they fulfill the following criteria: (i) a total amount of worldwide revenues of at least EUR 750 million; (ii) a total amount of revenues from qualifying digital services in Italy of at least EUR 5.5 million. Qualifying digital services are largely in line with the EC proposal.

Nevertheless, it incorporates an exception of services rendered to related parties, for example, deemed to be parent, subsidiary, or sister companies. Similar to the other cases, a device will be considered to be used in Italy by the identification of the IP address.

According to the Italian Government negotiations for defining the 2019 Italian budget, the DST was identified as a revenue raiser estimated at EUR 150 million for 2019 and EUR 600 million for each of 2020 and 2021.[58]

Poland

On April 2019, Poland had announced a digital service tax to be introduced by January 2020 in their long-term financial planning report. Such tax would be based on the EU DST proposal, and was expected to raise PLN 217.5 million in 2020. However, subsequently Poland rejected the proposal, after talks between the US Vice President and the Polish President.[59]

Spain

On 18 February 2020, the Spanish government approved a new legislative act providing for a tax on certain digital services (the "Spanish Digital Tax").[60] The scope of the new tax is mostly in line with the one proposed by the European Commission. The bill recognizes that the current international tax rules are based primarily on the physical presence of the taxed subjects, but it is not designed to deal with business models based on intangibles, in particular from data and knowledge exchange.[61] Article 4 of the law establishes that exclusively those services related to online advertising, online intermediation, and data transmission will be considered as taxable digital services (see Box 1). Similarly, it establishes that only the provision of digital services by users located in Spain will be taxable. For determining where the user is located, tax

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[57] CHIOMENTI, "2019 Budget Law No. 145/2018 (Published in the Official Gazette No. 302 of 31 December 2018)" *Newsletter, Tax Department* (8 January 2019). Available from https://www.chiomenti.net/public/files/2456/Newsletter-2019-Budget-Law.pdf (accessed 10 March 2020).

[58] PricewaterhouseCoopers (PwC), "Italy's 2019 budget law introduces a digital service tax", Tax Insights from International Tax Services (February 19, 2019). Available from https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-italy-2019-budget-law-introduces-a-digital-service-tax.pdf (accessed 10.03.2020).

[59] See also: https://wts.com/global/publishing-article/poland-20191112-cee-tax-bridge~publishing-article?language=en; https://taxfoundation.org/digital-tax-europe-2020/ and https://www.lexology.com/library/detail.aspx?g=b2f512f2-3244-4a4f-880e-1bae4ff85ed9.

[60] La Moncloa, "Proyecto de ley de los impuestos sobre servicios digitales y sobre transacciones financieras", 18 February 2020. Available from https://www.lamoncloa.gob.es/consejodeministros/Paginas/enlaces/180220-enlace_impuestos_d.aspx (accessed 09.03.2020).

[61] Proyecto de Ley del Impuesto sobre Determinados Servicios Digitales, Boletín Oficial De las Cortes Generales, Congreso de los Diputados, Serie A. No. 1-1, 28 Febrero 2020.

authorities will generally refer to the IP addresses of the devices used unless other evidence is used, e.g., other tools for geolocation of the devices.

Box 1. Spain's Definitions for Digital Services

Online advertising: *Inclusion in a digital interface, owned or from third parties, of advertisements directed to the users of said interface. When the entity that includes the advertising does not own the digital interface, it will be considered a provider of advertising service to that entity and not the entity that owns the interface.*

Online intermediation services: *Services available to users of a digital interface that allows interacting with different users concurrently, and facilitates deliveries of underlying goods or services directly between the users, or that allows them to locate and interact with other users.*

Data transmission services: *Services that include the transfer and sale of data collected from users generated by activities carried out by the use of digital interfaces.*

The tax will be imposed on legal entities independently of their tax residency when the following requirements are fulfilled: (i) the net amount of its global turnover in the previous calendar year exceeds EUR 750 million (as established in the EU Proposed Directive); and (ii) the total amount of their taxable revenues corresponding to users located in Spanish territory and corresponding to the previous calendar year exceeds EUR 3 million.

The Government of Spain has estimated that tax collection derived from this tax will arise to EUR 968 million. [62] However, implementation will begin from the end of 2020, ostensibly in deference to ongoing Inclusive Framework negotiations.

Turkey

The Turkish DST has broadly the same scope as the EU proposal, a rate of 7.5% and applies to taxpayers with global revenue of more than EUR 750 million and local revenues of TRY 20 million. The tax, contained in Law No. 7194[63] was enacted by the Turkish parliament on December 5, 2019, and went into effect on 1 March 2020.[64] An interesting feature is that the President is authorized to reduce the rate downward to 1% or increase it up to two times the applicable rate of 7.5% on digital services of his/her choosing.[65]

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[62] La Moncloa, "Proyecto de ley de los impuestos sobre servicios digitales y sobre transacciones financieras", 18 February 2020. Available from https://www.lamoncloa.gob.es/consejodeministros/Paginas/enlaces/180220-enlace_impuestos_d.aspx (accessed 09.03.2020).

[63] See: https://www.resmigazete.gov.tr/eskiler/2019/12/20191207-1.htm.

[64] See: https://www.tax-news.com/news/Turkey_Introduces_New_Digital_Services_Tax____97563.html.

[65] See: https://mnetax.com/turkey-enacts-7-5-percent-digital-service-tax-37161.

United Kingdom

In July 2019, the Government of the United Kingdom proposed to introduce new legislation on taxing Digital Services.[66] The law has been implemented from April 2020 and consists of introducing a 2% tax on the revenues of search engines, social media platforms, and online marketplaces (see Box 2) deriving value from users located in the United Kingdom. For purposes of the implementation of the law, the meaning of 'user' is: (i) any person who is reasonable to assume is generally in the United Kingdom; (ii) is established in the United Kingdom.

Box 2. UK's Definitions for Digital Services

Social media platform: *means an online platform that meets the following conditions*

(a) the main purpose, or one of the main purposes, of the platform is to promote interaction between users (including interaction between users and content on the platform provided by other users);

(b) the platform enables content to be shared with other groups of users (or with other users).

Online marketplace: *means an online platform that meets the following conditions*

(a) the main purpose, or one of the main purposes, of the platform is to facilitate the sale by users of particular things;

(b) the platform enables users to sell particular things on the platform to other users, or to advertise or otherwise offer to other users particular things for sale.

Legal entities providing such services to UK users will be liable to Digital Services Tax when the group's worldwide revenues from these digital activities reach more than GBP 500 million, and more than GBP 25 million of these revenues are derived from UK users. According to UK authorities, the tax will apply an alternative calculation under the 'safe harbour' principle, intended to avoid disproportionate effects on businesses. It will consider the reduction of 50% of the revenues when one of the users of a transaction is located in a country operating similar taxes on digital services (e.g. Spain or France).

Similarly, the legislation imposes restrictions on 'operating expenses,' meaning that a corporate group will not be able to deduct expenses: (a) in respect of interest (or anything equivalent, from a commercial perspective, to interest), (b) attributable to the acquisition of a business or part of a business, (c) occurring otherwise than in the normal course of business, (d) resulting from a change in the valuation of any tangible or intangible asset, or (e) in respect of any tax (arising under the law of any territory).

The study prepared by the UK estimates that the impact on tax collection from this measure will go from GBP 280 million in 2020, to 515 million by 2024.[67]

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[66] See: https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax.

[67] See: https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax.

SIGNIFICANT ECONOMIC PRESENCE

This concept expands the definition of "business connection" to incorporate a new digital nexus to tax business profits of foreign businesses based on "significant economic presence" (SEP). In other words, nexus would exist even without physical presence. This would be determined using 'revenue generated on a sustained basis' as the basic factor, and in combination with one or more of the following factors: "(1) the existence of a user base and the associated data input; (2) the volume of digital content derived from the jurisdiction; (3) billing and collection in local currency or with a local form of payment; (4) the maintenance of a website in a local language; (5) responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services such as after-sales service or repairs and maintenance; or (6) sustained marketing and sales promotion activities, either online or otherwise, to attract customers".[68]

The SEP was one of the three proposals considered by the Inclusive Framework for addressing the tax challenges arising from the digitalization of the economy and was put forth by the G24. It was also mentioned in the Action 1 Report of BEPS as one of three original measures that could be adopted on taxing the digital economy and subsequently included in the EC's proposal as significant digital presence.

India

India was the first country to introduce SEP into its legislation. In February 2018, the annual Budget amended[69] Section 9 of the country's Income-tax (IT) Act, 1961 and clarified that SEP of a non-resident would constitute a business connection. It would mean (a) transactions of goods, services or property carried out by a non-resident in India including provision of download of data or software, if the aggregate of payments arising from such transactions exceeded prescribed amounts (b) systematic and continuous soliciting of business activities or engaging in interaction with a prescribed number of users in India through digital means.

It was further clarified that it was irrelevant whether (i) the agreement for such transactions or activities is entered in India (ii) the non-resident has a residence or place of business in India; or (iii) the non-resident renders services in India.

In the 2020 Union Budget, the implementation of SEP was deferred to 2021, ostensibly for the conclusion of the Inclusive Framework discussions. The thresholds have not yet been prescribed.

Indonesia

GR-80 of 2019[70] came into force on 25 November 2019 and states that international e-commerce businesses that actively offer activities to consumers domiciled in Indonesia may be deemed to have a physical presence and carry out business activities in

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[68] See: http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf.

[69] See: https://incometaxindia.gov.in/Pages/acts/income-tax-act.aspx.

[70] See: https://foresight-id.com/wp-content/uploads/2019/12/PP-80-Tahun-2019-Compressed-1.pdf.

Indonesia if they exceed certain thresholds with respect to: (1) Number of transactions (2) Transaction value (3) Number of shipping packages (4) Amount of traffic or access.[71] If the thresholds are exceeded, the business is required to appoint a tax representative. Businesses that were conducting operations before the regulation came into effect have to comply by 25 November 2021. This is seen as a step towards Indonesia's proposal of implementing SEP in its New Tax Law.[72] [73] Such businesses will be subject to local rules, and will also have to pay 10% value-added tax (VAT). Finance Minister Mulyani Indrawati cited Spotify and Netflix as examples of companies that might be in this category.

Israel

In April 2016, the Israeli Tax Authority through Circular No. 4/2016 clarified that a PE could be determined in Israel when "the economic activity of the foreign company in a permanent place of business in Israel is conducted mainly through the Internet and additional conditions exist, such as: representatives of the foreign company are involved in identifying Israeli customers, in gathering information and managing customer relations of the foreign company, the Internet service provided by the foreign company is adapted to Israeli customers (language, style, currency, etc.)."[74] [75] Profit attribution implications of this meant a 25% tax on the income of the foreign companies that fulfilled these criteria.[76]

Nigeria

On 13 January 2020, a Finance Bill was passed introducing, in relation to corporate income taxation, a taxation on "foreign companies involved in the digital economy, including those transmitting or receiving signals in respect of, inter alia, electronic commerce, high frequency trading, electronic data storage, online adverts, participative network platform and online payments, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity"[77] (Finance Act, Section 4a.ii).[78]

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[71] Ernst & Young (EY), "Indonesia issues e-commerce trading regulation", 15 January 2020. Available from https://www.ey.com/gl/en/services/tax/international-tax/alert--indonesia-issues-e-commerce-trading-regulation.

[72] EY, "Indonesia announces plan for key tax changes", 10 September 2019. Available from https://globaltaxnews.ey.com/news/2019-6103-indonesia-announces-plan-for-key-tax-changes.

[73] See: https://www.reuters.com/article/us-indonesia-economy-tax-factbox/factbox-indonesias-parliament-debates-sweeping-new-tax-bill-idUSKBN2040O0.

[74] See: https://taxes.gov.il/English/About/SpokesmanAnnouncements/Pages/Ann_11042016.aspx.

[75] EY, "Israeli Tax Authorities publish official circular on internet activity of foreign companies in Israel", 15 April 2016. Available from https://www.ey.com/Publication/vwLUAssets/Israeli_Tax_Authorities_publish_official_circular_on_internet_activity_of_foreign_companies_in_Israel/$FILE/2016G_00570-161Gbl_Israeli%20TAs%20publish%20official%20circular%20on%20internet%20activity%20of%20foreign%20companies%20in%20Israel.pdf..

[76] See: https://en.globes.co.il/en/article-israel-tax-authority-to-demand-huge-tax-payments-from-google-facebook-1001283596.

[77] See: https://mnetax.us8.list-manage.com/track/click?u=3a302422cfa8f59909a958bbd&id=0d7681da47&e=29046946c2.

[78] See: http://giftedanalysts.com/wp-content/uploads/2020/01/Finance-Act-2020.pdf.

FRACTIONAL APPORTIONMENT

This is a profit attribution method that was part of the SEP proposal put forth by the G24 in the Inclusive Framework in early 2019. Profit would be allocated to the SEP through three successive steps: (1) defining a tax base to be divided (2) determining allocation keys to divide that base (3) weighting of these allocation keys.[79] The suggested tax base was the global profit rate of the MNE group applied to the sales revenue in a particular jurisdiction. The allocation keys were Sales, Assets, Manpower and Users (SAMU), the last key applicable for those businesses for which users meaningfully contribute to the value creation process.

India

In April 2019, India's Central Board of Direct Taxes came out with a proposal on amending the Rules on Profit Attribution to Permanent Establishments.[80] It sought to amend Rule 10 of the Income Tax Rules, 1962 in order to bring in more tax certainty on the methodology to be used for profit attribution. The proposal defined the tax base to be divided as 'profits derived from India' (PD). This was to be the higher of the following amounts: (1) amount arrived at by multiplying the revenue derived from India x global operational profit margin, or (2) two percent of the revenue derived from India. The global operational profit margin was defined as Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA).

The same SAMU allocation keys were suggested to divide the base, with slightly differing weights for the keys under three different contexts. The first would apply to businesses where the number of users did not exceed the SEP threshold, and hence profit attribution would use three equally weighted (30%) factors of Sales, Assets and Manpower (Number of Employees and Wages). Profits attributable to operations in India (PA) would accordingly be calculated by multiplying the Profits Derived from India (PD) with a formula using the three factors.

$$PA = PD \times \left[\frac{Si}{3 \times St} + \left(\frac{Ni}{6 \times Nt}\right) + \left(\frac{Wi}{6 \times Wt}\right) + \left(\frac{Ai}{3 \times At}\right)\right]$$

Box 3: Factors Used in India's Fractional Apportionment Proposal

Si = sales revenue derived by Indian operations from sales in India	Wi = wages paid to employees employed with respect to Indian operations and located in India
St = total sales revenue derived by Indian operations from sales in India and outside India	Wt = total wages paid to employees employed with respect to Indian operations and located in India and outside India
Ni = number of employees employed with respect to Indian operations and located in India	Ai = assets deployed for Indian operations and located in India

[79] See: http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf.
[80] See: https://www.indianembassyusa.gov.in/pdf/taxcorner/Public_consultation_apr18.pdf.

Nt = total number of employees employed with respect to Indian operations and located in India and outside India	At = total assets deployed for Indian operations and located in India and outside India

For enterprises where the number of users exceeded the SEP threshold, the fourth factor of users would be added to the formula. This was further subdivided into (1) low and medium user intensity, with a user weightage of 10%, where each of the other factors would be assigned a weight of 30% and (2) high user intensity with a weightage of 20%, with 30% for sales and 25% for assets and employees.

Accordingly, profit attributable to operations in India (PA) for low and medium user intensity business models is as follows,

$$PA = PD \times \left[\left(0.3 \times \frac{Si}{St}\right) + \left(0.15 \times \frac{Ni}{Nt}\right) + \left(0.15 \times \frac{Wi}{Wt}\right) + \left(0.3 \times \frac{Ai}{3 \times At}\right) + 0.1\right]$$

For high user intensity business models it is,

$$PA = PD \times \left[\left(0.3 \times \frac{Si}{St}\right) + \left(0.125 \times \frac{Ni}{Nt}\right) + \left(0.125 \times \frac{Wi}{Wt}\right) + \left(0.25 \times \frac{Ai}{3 \times At}\right) + 0.2\right]$$

The major advantage of fractional apportionment is that it does not require any renegotiation of double taxation treaties that were based on the pre-2010 model conventions (United Nations (UN) and OECD both).[81] Article 7 of the model conventions allowed the option of indirect apportionment, hence giving the Contracting States the right to adopt it. It is also a measure that is simple to implement as it requires only revenue within the jurisdiction and hence does away with the complex task of consolidating the global profit of a multinational corporation (MNC).[82] The G24 has stated that "a combination of non-physical nexus like Significant Economic Presence, along with flexible profit attribution approaches based on a formula (like a fractional apportionment method), coupled with a *withholding tax mechanism*, can be a possible simple solution for addressing the nexus challenge related to digitalisation."[83]

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[81] Dr. Vinay Kumar Singh, "Interaction of Transfer Pricing & Profit Attribution: Conceptual and Policy Issues for Developing Countries", Tax Cooperation Policy Brief, No. 3 (Geneva, South Centre, 2019). Available from https://www.southcentre.int/tax-cooperation-policy-brief-3-august-2018/.

[82] See: https://www.g24.org/wp-content/uploads/2019/12/G-24_Comments-on-OECD-Secretariat-Proposal-for-a-Unified-Approach.pdf.

[83] Ibid.

WITHHOLDING TAX ON DIGITAL TRANSACTIONS

In such an approach, countries have been expanding the definition of taxable income sourced from their country to include income generated from providing digital services. Withholding taxes (WHTs) are then imposed on such transactions. Countries have adopted different approaches to defining digital services, with most going for broad and all-encompassing definitions that cover almost any conceivable service delivered electronically or over the internet such as advertising, website maintenance, movies, music, games, data storage, processing, etc. Others take a narrower approach which is usually targeted at income from advertising.

This is accompanied by source rules which lay out the criteria under which the income will be deemed as derived from the jurisdiction. These typically include payment for the service being made by resident persons or PEs of a non-resident person and association with activities in that jurisdiction. The responsibility for withholding the tax tends to be either on the buyer directly or on the financial institution facilitating the transaction. Non-resident digital businesses that do not have a PE in the jurisdiction are required to register for tax purposes, or authorize a representative to perform those duties.

Costa Rica

Costa Rica has adopted two different approaches aiming at taxing the digital economy. First, it has passed a bill with the objective of regulating the provision of non-traditional housing service providers for tourism (e.g. houses, apartments, villas, chalets, and others), and the digital platforms serving as intermediaries (such as Airbnb).[84] The law required the registration of both the non-traditional housing service provider as well as the digital platforms in the Costa Rican Institute for Tourism and the General Directorate of Taxes.

In principle, the law included a 5% tax rate on net revenues on non-traditional housing service providers which had to be paid on a monthly basis.[85] For sponsors of the legislation, this tax was not something new, as traditional services have paid similar taxes since 1986.[86] Nevertheless, the approved bill did not include such tax, instead it established the payment of 13% rate of value added tax (VAT) to such services, providing that intermediary digital platforms and credit card companies shall serve as tax withholding agents, and the establishment of a municipal tax for non-traditional housing service providers.[87] Currently, a new proposal is being discussed to extend the

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[84] Asamblea Legislativa de Costa Rica, "Ley Marco para la Regularización del Hospedaje no Tradicional y su intermediación a través de Plataformas Digitales," Ley No. 9742 adoptada el 1 de Junio de 2019. Available from http://www.pgrweb.go.cr/scij/Busqueda/Normativa/Normas/nrm_texto_completo.aspx?param1=NRTC&nValor1=1&nValor2=90073 (accessed 16 March 2020).

[85] See: Asamblea Legislativa de Costa Rica, Project No. 20865 (17 July 2018), Art. 18 in http://www.aselex.cr/boletines/Proyecto-20865.pdf (accessed 16 March 2020).

[86] See: Asamblea Legislativa de Costa Rica, Project No. 20865 (17 July 2018), Explanation of the Project of Law in http://www.aselex.cr/boletines/Proyecto-20865.pdf (accessed 16 March 2020).

[87] Diario La Nación, "Diputados quitan impuesto especial para hospedajes tipo Airbnb, pero les fija pago municipal", 27 March 2019. Available from https://www.nacion.com/el-pais/politica/diputados-quitan-impuesto-especial-para-hospedajes/UNGWK56SFVBTPAVLISAAT2VY7U/story/.

Public Entertainment Tax to streaming service providers (e.g. Netflix, Hulu, Amazon Prime). The proposal is now under review and could be approved in 2020.[88]

India

The 2020 Union Budget proposed source rules for revenue from advertisement targeted to Indian customers and revenue from sale of Indian sourced data.[89] The Finance Bill has introduced these source rules via explanation 3A in Section 9 of the IT Act[90] as an amendment on "income attributable to operations carried out in India."

India also introduced an equalisation levy at a rate of 6% on online advertisements which came into effect from June 2016. A Chapter titled "Equalisation Levy" was inserted through the *Finance Act 2016*, comprising sections 163-180. The levy was chosen as it would be a tax on digital transactions, not income, and would hence not require any change in existing Double Tax Avoidance Agreements (DTAAs). The levy is applicable only on the gross amount of online advertising payments made for business or profession purposes exceeding INR 100,000 made by a person resident in India or a permanent establishment of a non-resident person to a non-resident enterprise.[91] Income arising from payments subjected to the levy will be exempted from income-tax.[92] From its inception in 2016 to 2018, the levy fetched India approximately USD 137 million.[93]

Kenya

After an announcement from Kenya's Finance Minister during the 2019/2020 Budget Statement to Parliament, on the introduction of tax measures that are aimed at providing the platform for taxation of income generated from the digital economy,[94] on 7 November 2019, Kenya modified it's Income Tax Act in order to consider the gains or profits from 'income accruing through a digital marketplace' as subject to tax (Income Tax Act, Section 3(2)(a); Finance Act No. 23 of 2019, Part II, 3).

Kenya's Finance Act defines 'digital marketplace' as "a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means" (Finance Act No. 23 of 2019, Part II, 3.c).

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88 Asamblea Legislativa, Project No. 20661 (6 December 2019). Available from https://www.imprentanacional.go.cr/pub/2019/12/06/ALCA272_06_12_2019.pdf (accessed 16 March 2020).

89 See: https://www.indiabudget.gov.in/doc/Budget_Speech.pdf.

90 See: https://www.indiabudget.gov.in/doc/Finance_Bill.pdf.

91 See: https://incometaxindia.gov.in/Pages/acts/equalisation-levy.aspx.

92 KPMG, "Taxation of the digitalized economy" (2020). Available from https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

93 Sumit Jha, "Equalisation levy: 'Google tax' revenue goes past Rs 1,000 crore", *Financial Express*, 23 May 2018 Available from https://www.financialexpress.com/economy/equalisation-levy-google-tax-revenue-goes-past-rs-1000-crore/1177595/.

94 See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

As of February 2020, guidelines for the implementation of these modifications had not yet been issued.[95]

Malaysia

Income from e-commerce transactions has been deemed to be derived from Malaysia if it is associated with any activities in the country, regardless of whether that income is received in Malaysia or elsewhere.[96] Accordingly, it would be subject to income tax rules. A non-resident person deriving income from e-commerce transactions is also deemed to derive that income from the country in relation to "special classes of income" and royalty, which cover most types of payments for digital services. Withholding taxes are imposed on these transactions under section 109B of the IT Act 1967. These details are contained in the 'Guidelines on Taxation of Electronic Commerce Transactions' issued by the Inland Revenue Board of Malaysia on 13 May 2019.[97] These were built on a 2018 practice note[98] on the tax treatment on digital advertisement provided by a non-resident.

Mexico

From 1 January 2020, Mexico will be implementing a new reform of their tax legal framework.[99] The decision adopted by the tax authorities includes withholding taxes on VAT and income tax arising from services provided by digital platforms. In the case of income tax, the resolution considers a different rate depending on monthly income reported by each digital platform. The rate starts from 2% for monthly incomes of USD 5,500, to 8% for monthly incomes of more than USD 21,000.[100]

According to the National Institute of Statistics and Geography (INEGI in Spanish), digital services have invoiced almost USD 40 million in 2017.[101] According to the Mexican Institute of Public Accountants, the new provision taxing digital services follows the proposal developed by the European Parliament, which considers taxing profits generated by Mexican users using services located outside of the Mexican territory.[102]

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[95] See: https://www.mondaq.com/Tax/896852/What-New-Digital-Taxes-Contemplated-In-The-Finance-Act-Mean-For-Digital-Trade-And-Services-In-Kenya.

[96] See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

[97] See: http://lampiran1.hasil.gov.my/pdf/pdfam/guidelines_e_commerce_13052019.pdf.

[98] See: http://lampiran1.hasil.gov.my/pdf/pdfam/PN_NO_1_2018.pdf.

[99] Secretariat of Finance and Public Credit, Miscellaneous Tax Resolution for 2020. Available from https://dof.gob.mx/20191228-2.pdf (accessed 18.03.2020).

[100] See: https://www2.deloitte.com/mx/es/pages/tax/articles/resolucion-miscelanea-fiscal-2020.html (accessed 18 March 2020).

[101] Entrepreneur, "Esto es lo que debes saber sobre los impuestos a Netflix y Airbnb en México", 15 January 2020. Available from https://www.entrepreneur.com/article/345009 (accessed 17.03.2020).

[102] Instituto Mexicano de Contadores Públicos, "¿Qué es el impuesto digital propuesto por legisladores en México?". Available from http://imcp.org.mx/servicios/que-es-el-impuesto-digital-propuesto-por-legisladores-en-mexico/ (accessed 19.03.2020).

Pakistan

Through the Finance Act, 2018, Pakistan introduced a 5% withholding tax[103] on fees (payments) for offshore digital services performed by non-resident persons.[104] The definition of digital services is wide-ranging and applies to "online advertising including digital advertising space, designing, creating, hosting or maintenance of websites, digital or cyber space for websites, advertising, e-mails, online computing, blogs, online content and online data, providing any facility or service for uploading, storing or distribution of digital content including digital text, digital audio or digital video, online collection or processing of data related to users in Pakistan, any facility for online sale of goods or services or any other online facility."[105]

The fee shall be chargeable to tax to a non-resident person on behalf of any resident or a permanent establishment of a non-resident in Pakistan. Every banking company or financial institution remitting the fee outside the country has to deduct the 5% tax from the gross amount paid.[106] Further, the Act states that the fee shall be deemed Pakistan-source income if it is paid by a resident person or borne by a permanent establishment in Pakistan of a non-resident person.

Slovakia

The Tax Reform Law for 2018 brought in new PE norms for digital platforms providing transport and accommodation services. These oblige the platforms to register a PE in Slovakia. If they do not do so, Slovak taxpayers using these platforms to facilitate the sale of their services are required to withhold tax on mediation fees.[107] [108]

Turkey

In addition to a DST, in January 2019[109] Turkey has also implemented a 15% WHT on digital advertising payments made to service providers and intermediaries. The Revenue Administration issued Communique No. 17[110] which is a guidance that clarified the operation of the WHT introduced by Presidential Decision No. 476.[111]

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[103] See: http://download1.fbr.gov.pk/Docs/2019430124658611IncometaxOrdinanceAmendedupto11-03-2019.pdf.

[104] Deloitte, "Finance Act makes tax changes for corporations" , 1 July 2018. Available from https://www.taxathand.com/article/10278/Pakistan/2018/Finance-Act-makes-tax-changes-for-corporations.

[105] See: http://download1.fbr.gov.pk/Docs/2018528155415616FinalFinanceAct2018.pdf.

[106] Ibid.

[107] See: https://www.financnasprava.sk/sk/pre-media/novinky/archiv-noviniek/detail-novinky/_zdan-dig-platfor.

[108] See: https://www.orbitax.com/news/archive.php/Slovak-Republic-Publishes-Rele-30507.

[109] Robert Sledz, "Turkey Finalizes Guidance on New Withholding Tax on Payments Relating to Online Advertising Services", *Thomson Reuters*, 28 February 2019. Available from https://tax.thomsonreuters.com/blog/turkey-finalizes-guidance-on-new-withholding-tax-on-payments-relating-to-online-advertising-services/.

[110] See: https://www.resmigazete.gov.tr/eskiler/2019/02/20190215-6.htm.

[111] See: https://www.gib.gov.tr/sites/default/files/fileadmin/user_upload/Cumhurbaskani_Karari/476_vuk_ck.pdf.

Uruguay

In 2017, Uruguay passed Law No. 19.535, which approved the Rendering of Accounts and Balancing of Budget Execution of Exercise 2016 (Annual National Budget Law) and included a reform of the tax legislative framework. Article 243 of the law incorporated new subparagraphs to paragraph B of Article 48, Title 4 of the tax legislation in Uruguay (*Texto Ordenado 1996*), extending application of a 30% levy on net Income of Non Residents for services rendered through the "use of internet, technological platforms, or software."

In addition, Article 246 of Law No. 19.535 established that the application of such tax levy would depend on the place where both the service provider and the user are located. If both are located in Uruguay, the income will be considered entirely of Uruguayan source, but if only one of them (the client or the provider) is located in Uruguay, only 50% of the income will be considered as from Uruguayan source.[112] Similarly, it also included a presumption of 'permanent establishment' when the payment of the service is made through electronic means or the payments are managed from Uruguay.

Under Decree 144/018,[113] adopted for the implementation of Law No. 19.535, the Uruguayan Ministry of Economy and Finance introduced additional tax regulations for these digital services and intermediation of services. In particular, the factors used to identify the location of parties receiving the services include the internet protocol (IP) of the device used for purchasing the service and the invoicing address of the client.

Similarly, non-residents providing these services to users located in Uruguay should pay income tax and VAT via self-assessment, in cases when no withholding agent is located in Uruguay. The implementation of the law has already raised USD 18.4 million from income tax and VAT from digital platforms rendering intermediation services in lodging and transport, and those rendering audiovisual services from January to May 2019.[114]

Vietnam

The National Assembly passed a law in June 2019 targeting non-residents undertaking digital and e-commerce operations in Vietnam who are not registered for tax and do not declare and/or pay taxes in Vietnam. These foreign enterprises who do not have a PE must register, declare, and pay tax in Vietnam or authorize another to complete these duties. The law is to come into effect from July 2020. Financial institutions have been tasked with withholding the tax.[115]

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[112] The Investment and Export Promotion Agency of Uruguay, "Uruguay leads taxation in digital industry", 23 October 2018. See: https://www.uruguayxxi.gub.uy/en/news/article/uruguay-leads-taxation-in-digital-industry/, accessed 05.03.2020.

[113] Published on 29 May 2018.

[114] El País, "Impuestos a la economía digital: DGI ya recaudó US$ 18,4 millones de Uber, Netflix y otras" , 18 June 2019. Available from https://negocios.elpais.com.uy/noticias/impuestos-economia-digital-dgi-recaudo-millones-uber-netflix.html (accessed 05.03.2020).

[115] See: https://home.kpmg/content/dam/kpmg/vn/pdf/tax-alert/2019/Taxation%20of%20e-commerce%20in%20Vietnam%20July%20EN.pdf.

Zimbabwe

Zimbabwe has introduced rules for the taxation of non-resident e-commerce platforms effective from January 2019.[116] The tax applies on[117]: (a) income from foreign domiciled satellite broadcasting services in respect of the provision or delivery of television or radio programmes, and (b) electronic commerce operators in respect of the provision or delivery of goods or services in Zimbabwe.

The tax is 5% on revenues (a gross tax), and is applicable if the revenue exceeds ZWL 500,000 per annum. As per the 2020 Budget proposal presented to Parliament on December 2019, foreign companies/entities providing digital services would be required to appoint a Zimbabwean representative if liable to tax.[118] However, it must be noted that there is no WHT imposed.

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[116] See: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

[117] See: https://mnetax.com/more-highlights-on-zimbabwes-proposed-5-percent-digital-tax-36974.

[118] See: https://www.bdo.global/en-gb/microsites/tax-newsletters/world-wide-tax-news/issue-53-december-2019/zimbabwe-2020-budget.

DIVERTED PROFITS TAX - UNITED KINGDOM

Since 2015, the United Kingdom has implemented the “Diverted Profits Tax” (DPT), which aims at tackling abusive tax planning practices designed to erode the UK tax base.[119] The Financial Act of 2015[120] established this tax to deter the diversion of profits for the UK by large groups that either:

i. Seek to avoid creating a UK permanent establishment that would bring a foreign company under the UK Corporate Tax; or,
ii. Use arrangements or entities to exploit tax mismatches either through expenditure or diversion of income within the corporate group.[121]

The DPT is set a higher rate than corporation tax and it is imposed on the amount of taxable diverted profits and interest, setting the rate at 25% of that identified sum. This percentage increases to 55% where taxable diverted profits are ring-fence profits or notional ring-fence profits in the oil sector.[122] The burden to establish the possible existence of DPT fall on the company when:

i. it is a company resident in the UK that enters into a transaction where either the transaction or an entity which is party to the transaction lacks economic substance and that results in a tax mismatch, or
ii. it is a non-UK company which has a UK-taxable presence (a permanent establishment) that enters into a transaction where either the transaction or an entity which is party to the transaction lacks economic substance and that results in a tax mismatch, or
iii. it is a non-UK company which has sought to avoid creating a taxable presence in the UK.

The net amount received from the tax is the following: GBP 138 million (2016-17), GBP 219 million (2017-18), GBP 12 million (2018-19). Thus, the tax has fetched a total of GBP 369 million as of January 2020.

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[119] Her Majesty Revenue and Customs, “Diverted Profits Tax: Guidance” (December 2018). Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/768204/Diverted_Profits_Tax_-_Guidance__December_2018_.pdf (accessed 17.03.2020).

[120] United Kingdom Finance Act 2015. Available from http://www.legislation.gov.uk/ukpga/2015/11/pdfs/ukpga_20150011_en.pdf.

[121] Her Majesty Revenue and Customs, “Diverted Profits Tax: Guidance” (December 2018). Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/768204/Diverted_Profits_Tax_-_Guidance__December_2018_.pdf (accessed 17.03.2020).

[122] Her Majesty Revenue and Customs, “Diverted Profits Tax: Guidance” (December 2018). Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/768204/Diverted_Profits_Tax_-_Guidance__December_2018_.pdf (accessed 17.03.2020).

SUMMARY OF REVENUE ESTIMATES

A summary of the revenue estimates and actuals from some of these measures is given in Table 1.

Country	Measure	Revenue Collection (USD million)		Years
		Estimate	Actual	
Canada	DST	372		2020
India	Equalisation Levy		137	2016-2018
Israel	DST	269		NA
Italy	DST	1.45 billion		2019-2021
Poland	DST	51		2020
Spain	DST	1043		NA
UK	Diverted Profits Tax		426	2015-2018
UK	DST	323 (2020) to 594 (2024)		
Uruguay	Expanded source rules		18.4	January – May 2019

Table 1: Expected revenue collection from national measures on taxing the digital economy.
Source: Authors' compilation using exchange rates as of 23 March 2020.

CONCLUSIONS

The analysis made in this paper allows us to draw four main conclusions:

#1: Many OECD countries are at the forefront of taking national measures

As discussed above, countries such as the US, Canada, Israel and EUmembers, are taking national measures, much to the chagrin and dismay of the OECD. Despite the Two-Pillar approach favoring OECD countries, they seem dissatisfied with its solution. Notwithstanding their professed faith in multilateralism and a "rules-based international order", there seem to be a contrary set of actions. Developing countries are being asked to adhere to the negotiations when OECD countries themselves do not seem too keen on doing so, and may in fact even outnumber the number of developing countries taking national measures.

However, most of them have also agreed to defer implementation till the end of 2020 when the multilateral negotiations come to an end. One of the reasons for European support for the OECD-led process is possibly because it would allow greater flexibility in solving tax related problems. The EU's decision making structure suffers from certain limitations, as it requires unanimity on tax matters within the EU Council. This makes it easy for tax havens and other countries to block progressive proposals. Hence, it is easier for EU countries to arrive at solutions within the Inclusive Framework. Similarly, US threats are another reason for delayed implementation.

#2: Even Inclusive Framework Members have the right to take national measures

Developed and developing countries both have sought to introduce national measures when it comes to taxing the ever-increasing profits of digital companies.

The measures introduced can be broadly categorized into three: (a) Digital Service Taxes (b) New Nexus Rules, mainly Significant Economic Presence (c) Withholding Taxes on Digital Transactions. These measures have often been criticized as 'unilateral' by the OECD but the reality is that this is fully within the States' rights under international law. Members of the Inclusive Framework exercised their rights to take national measures to address the tax challenges of the digital economy, in the absence of a multilateral solution. This has also been laid out in Chapter 7 of the BEPS Action 1 2015 final report.[123] It states that till a consensus solution has been arrived at, Inclusive Framework members can consider implementing three options as a BEPS safeguard. These are: (1) equalization levy (2) new nexus based on significant economic presence (3) withholding tax on digital transactions. As discussed above, the existing national measures are based on the three options laid out in the Action 1 report. Countries outside the Inclusive Framework – which includes half of Africa - on the other hand are fully within their rights to undertake whatever tax measures they see fit.

Thus, developing countries have all the right to undertake these national measures –as many developed countries have also done- and can reject the charge of 'unilateralism'.

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[123] See: https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#page1.

If they find that the Two-Pillar Approach fails to satisfy their requirements, they have alternative options which can be used to safeguard their vital revenue interests. This becomes all the more important in a fiscally stressed global economy affected by the coronavirus.

#3: National measures have positively impacted the multilateral discussion

It is also important to mention the constructive role national measures have played in spurring multilateral negotiations. After 2015, the Inclusive Framework discussions on taxing the digital economy dragged on endlessly and this well suited the digital companies, who continued to benefit from tax avoidance practices under the existing system. However, as more and more countries began taking national measures on taxing the digital economy, the OECD was forced to take steps to hasten the multilateral discussions. This was perhaps motivated by the need to prevent unilateral measures, which would imply its own weakening.[124] Nevertheless, these have ensured that the global tax order has taken seriously the need to effectively tax digital companies. Hence, rather paradoxically, national measures have strengthened the multilateral system by accelerating the pace of reform.

#4: The Two-Pillar Approach must be just and equitable to be sustainable

As seen, developing countries have a range of options to safeguard their revenue interests, apart from the Two-Pillar solution. For it to be genuinely acceptable, it must reflect the interests and needs of all countries, not just the OECD members. Legitimate demands of the developing countries must be heeded in the negotiations and reflect in the solution. Failure to do so would mean the Two-Pillar approach is ignored. It would also bolster the long-standing demand of the developing world that the UN must be the forum where international tax discussions take place, with all countries on a genuinely equal footing.[125]

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[124] See: https://www.taxjustice.net/taxcast/edition-90-june-2019-the-corporate-tax-haven-index-solving-the-worlds-broken-tax-system/.

[125] The G77 has for long demanded that the UN Committee of Experts on International Cooperation in Tax Matters be upgraded into an intergovernmental committee. A draft resolution outlining the structure and function of such a body was introduced in 2010: https://digitallibrary.un.org/record/685632?ln=en#record-files-collapse-header.

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ISSN 1819-6926