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Lower-Income Countries' Ongoing Quest for International Tax Justice: A Case Study of the OECD's Tax Allocation Proposal

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Abstract

The viability of our international tax system hinges on two things: (1) safeguarding the effective flow of international activities and (2) ensuring that countries can adequately collect tax on the income derived from those activities. Each of these fundamentals relies on a defensible/fair allocation of taxing rights between countries with competing tax jurisdiction (inter-nation equity).

The recent Organisation for Economic Co-operation and Development (OECD)-led multilateral effort to transform international tax rules to ensure that countries can adequately tax multinational enterprises (MNEs) operating in the global digital economy (OECD proposal) has reignited inter-nation equity conversations. Although important to all countries, inter-nation equity is a special consideration for lower-income countries because of: (1) pre-existing perceptions that the subsisting regime is skewed against them; (2) their greater reliance on corporate taxation, including of MNEs, and (3) their limited capacity to give up taxing rights.

This paper examines the OECD proposal from an inter-nation equity perspective. We contend that the deal does not adequately address the inter-nation equity concerns of lower-income countries. We, however, conclude that the path to a stable and fair outcome lies in adjusting aspects of the deal rather than invoking alternatives – e.g., withholding taxes on gross revenue – that may further distort international business. While this paper focuses on the consequences of the OECD proposal for lower-income countries, higher-income countries (like Canada) are parties to the arrangements. So, Canada has a stake in the conversations and could experience negative distortions to international activities if inter-nation equity concerns are not adequately addressed.

1. Introduction

Multilateral assemblage of countries is a common feature of international relations. However, it is not often that countries converge to agree fundamental changes to the rules that govern a certain sphere of international relations. One can instantly point to the Paris Agreement on Climate Change as a resounding recent example.[1] Shortly after that agreement was concluded, over a hundred countries

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[1] The *United Nations Framework Convention on Climate Change* (New York: United Nations, 2015). In modern history, we can look back to the Bretton Woods Conference of July 1 to 22, 1944, officially known as the United Nations Monetary and Financial Conference: a gathering of delegates from 44 nations that met in Bretton Woods, New Hampshire, United States, to agree on a series of new rules for the post-WWII international monetary system. Two major accomplishments of the conference were the creation of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). See U.S. Department of State, "Bretton Woods Conference, 1944", online: https://2001-2009.state.gov/r/pa/ho/time/wwii/98681.htm; Ellen Terrell, "Bretton Woods Conference & the Birth of the IMF and World Bank" *Guides LOC* (July 2021) online: https://guides.loc.gov/this-month-

(and jurisdictions) again converged to try to agree another deal – one that would bring fundamental changes to the way countries tax international business income (specifically, taxing the digital economy).[2] However, it took five years of negotiation (from 2016 to 2021) to reach a tentative deal.[3] This deal is important in maintaining a stable and efficient international tax system. Without it, a torrent of unilateral – and inefficient – taxes could be unleashed on multinational enterprises (MNEs).[4] So, why did it take countries that long to agree? Perhaps, because they could not come to a consensus on what was fair.[5] More concerning, why are some countries – lower-income countries especially – still unhappy and some ready to leave the table, even after a "consensus" has been found?[6][7] Because the deal is unfair. Because it forces lower-income countries – the likes of Nigeria and Kenya – to give up taxing rights to a degree that they consider unfair. We agree with them. We form this view based on a review of the literature, including the economic assessments of the deal. We, however, also appreciate that the path to a stable and fair outcome lies in adjusting impugned aspects of the deal

in-business-history/july/bretton-woods-conference. Another prominent example, the General Agreement on Trade and Tariffs (GATT), also traces its origins to the Bretton Woods Conference but was ultimately signed at the United Nations Conference on Trade and Employments (UNCTE) of 1947. See Rorden Wilkinson & James Scott, "Developing Country Participation in the GATT: A Reassessment" (2008) 7 World Trade Rev. 473.

[2] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).

[3] OECD, "OECD/G20 Inclusive Framework on BEPS", online: https://www.oecd.org/tax/beps/flyer-inclusive-framework-on-beps.pdf.

[4] KPMG, "Taxation of the Digitalized Economy: Direct Taxes", *KPMG Tax* (January 15, 2021), online: https://perma.cc/KJX6-GSUZ.

[5] See Julie Martin, "OECD report reveals disagreement on taxation of digital firms", *MNE Tax* (March, 16 2018) online: https://mnetax.com/oecd-interim-report-reveals-disagreement-among-nations-on-taxation-of-digital-firms-26655; Bjarke Smith-Meyer & Elisa Braun, "France reinstates digital tax, courting trade war", *Politico* (October 14, 2020) online: https://www.politico.eu/article/france-reinstates-digital-tax-courting-trade-war/; Silvia Amaro, "A deal to tax tech giants is still possible this year, Irish finance minister claims", *CNBC* (August, 28 2020) online: https://www.cnbc.com/2020/08/28/digital-tax-deal-at-the-oecd-possible-in-2020-says-irelands-donoghoe.html; John V Aksak & Jason Carter, " Will the US Withdrawal from the OECD Project on Digital Services Taxation Lead to A Trade War and A Missed deadline?" *True Partners Consulting* (June 22, 2020): https://www.tpctax.com/insights/will-the-us-withdrawal-from-the-oecd-project-on-digital-services-taxation-lead-to-a-trade-war-and-a-missed-deadline/; Aaron Lorenzo, "5 things that could stop a global tax deal", *Politico* (June 8, 2021) online: https://www.politico.eu/article/tax-reform-g7-oecd/; PWC, "US compromises with the UK, France, Italy, Spain and Austria on digital services taxes and trade actions" (October 25, 2021) online: https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-us-compromises-on-dsts-and-trade-actions.pdf.

[6] Jorge Liboreiro, "Ireland, Hungary and Estonia opt out of OECD tax deal and cast shadow over EU's unified position", *Euro News* (August 26, 2021) online: https://www.euronews.com/my-europe/2021/07/02/ireland-hungary-and-estonia-opt-out-of-oecd-tax-deal-and-cast-shadow-over-eu-s-unified-pos.

[7] For drafting convenience, we use the term "low-income country" as a reference term for similar terms such as "developing", "(net) capital-importing", "Global South", "least developed", "less developed", "lower-income" country, etc. The United Nations provides three country classifications, based on certain economic indices: developed economies, economies in transition, and developing economies. See UN, "World Economic Situation and Prospects" (2020) online: https://perma.cc/U5GF-N6LX. We also use "high-income country" as a term of convenience for countries on the more positive side of the development index. Our use of this phrase encompasses terms like "developed country", "(net) capital-exporting country", and "Global North" country.

rather than in embracing other visible options – e.g., withholding taxes on gross revenue – that tend to impede the flow of international business or disrupt the efficiency of tax design and revenue collection. For this reason, all stakeholders, including higher-income countries like Canada, must engage to ensure that outstanding fairness concerns are adequately addressed.

We begin this review with a pacesetting question: how much tax revenue should we expect countries to sacrifice to ensure a stable, functional, and efficient international tax system that works for nations as well as for taxpayers engaged in international activities? International and national tax policymakers confront this question in real time given the ongoing international tax reforms being coordinated by the Organisation for Economic Co-operation and Development (OECD). The question highlights the, sometimes, uneasy interaction between two important international tax policy norms: efficiency and (inter-nation) equity. Efficiency demands that we design international tax rules in a way that supports the flow of international activities.[8] It is about ensuring that tax does not constitute a barrier or impediment to cross-border economic activities.[9] The goal of facilitating international trade and investment was one of the driving reasons behind the early efforts to better coordinate the interaction of countries' tax systems.[10] It was this motivation that led to the elimination of some international double taxation using a network of bilateral tax treaties based on a common model that reduced the rates of source-based withholding taxes for non-residents, guaranteed that business profits would not be taxed at source unless a defined level of activity was undertaken in the source country, and provided tax credits and deductions to residents for taxes paid at countries of source.[11]

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[8] Richard M. Bird & J. Scott Wilkie, "Designing Tax Policy: Constraints and Objectives in an Open Economy" (2013) 11 e.J.T.R. 284; David Gliksberg, "The Effect of the Statist-Political Approach to International Jurisdiction of the Income Tax Regime – the Israeli Case" (1994) 15 Mich J. Intl L. 459.

[9] David Gliksberg, "The Effect of the Statist-Political Approach to International Jurisdiction of the Income Tax Regime – the Israeli Case" (1994) 15 Mich J. Intl L. 459.

[10] See Bruins, Einaudi, Seligman and Stamp, *Report on Double Taxation submitted to the Financial Committee, Economic and Financial Commission Report by the Experts on Double Taxation*, League of Nations Doc. E.F.S. 73. F. 19, (1923), at pp. 22–23; Philipp Genschel and Thomas Rixen, "Settling and Unsettling the Transnational Legal Order of International Taxation", in TC Halliday and G Shaffer, eds, *Transnational Legal Orders* (Cambridge University Press, 2015), p. 154; Sunita Jogarajan, *Double Taxation and the League of Nations* (Cambridge: Cambridge University Press, 2018).

[11] See, e.g., Canada - Nigeria: *1992 Income and Capital Gains Tax Agreement and Final Protocol*, articles 7 and 23.

As demonstrated by this simple overview, ensuring that domestic tax systems do not unduly hamper international economic activities requires countries to come to bargains. Generally, assuming the income-producing activity is located in two countries, one of them sacrifices their ability to tax that income or the two countries agree that instead of each collecting tax on the income, they will split it. Giving up taxing rights or agreeing to share tax revenues has equity considerations. If one country gives up a greater share of its rights (or revenue) than the other, the bargain may be felt to be uneven (inequitable). Potential inequities arguably impose greater burdens on lower-income countries for several reasons, including their greater reliance on corporate taxation of residents and MNEs[12], their limited scope for alternative revenue mobilization,[13] and their unique revenue needs, as reflected in the often-touted sustainable development goals.[14][15]

In the international tax literature, "inter-nation equity" has come to represent an overarching conceptual benchmark for evaluating international tax justice (the fairness of international taxing rights allocation

[12] Richard M Bird and Eric M Zolt, "Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries" (2005) 52 UCLA L. Rev. 1627 at p. 1656; Ernesto Crivelli, Ruud De Mooij & Michael Keen, *Base Erosion and Profit Shifting and Developing Countries* (2015) IMF WP/15/118; Reuven S. Avi-Yonah, "Hanging Together: A Multilateral Approach to Taxing Multinationals" (2016) 6 Mich Bus & Ent. L. Rev. 137 at p. 139; Michael C. Durst, "Developing Country Revenue Mobilisation: A Proposal to Modify the 'Transactional Net Margin' Transfer Pricing Method" (2016) ICTD Working Paper 44.

[13] Martin Hearson, "The Challenges for Developing Countries in International Tax Justice" (2018) 54 The J. Dev. Stud. 1932 at p. 1933.

[14] Sarah Ganter, "Digital Taxes for Sustainable Development?" (2021) 38 Digitalization & Sustainability 49; IJ Mosquera Valderrama, D. Lesage and W. Lips, eds, *Taxation, International Cooperation and the 2030 Sustainable Development Agenda,* United Nations Series on Regionalism 19 (Cham: Springer, 2021).

[15] Every reference to "lower-income country(ies)" herein includes a reference to "low-income", "middle income", "developing" or "capital-importing" country(ies). The choice phrase is used only for textual convenience.

arrangements, as reflected in bilateral tax treaties and the OECD tax allocation proposal).[16][17] However, in the context of lower-income countries, the concept is often used to highlight two related but distinguishable ideas: (1) preservation of the normatively-justifiable taxing rights of lower-income countries and (2) the transfer of taxing rights (tax revenue) as a form of aid from high-income countries to lower-income countries.[18] The first mentioned analytical framework aims to ensure that the taxing rights of lower-income countries are not unfairly restricted (from a normative tax perspective) by bargains that emerge from the international tax system while the latter perspective enables scholars and policymakers to more squarely grapple with the degree to which the distribution of income and wealth (and related tax revenue) to countries around the world is "distinctly evil or unlovely" (inter-

[16] See, for instance, Ilan Benshalom, "The New Poor at Our Gates: Global Justice Implications for International Trade and Tax Law" (2010) 85 N.Y.U. L. Rev 1; Tsilly Dagan, "International Tax and Global Justice" (2017) 18 Theoretical Inquiries in L. 1; Irma Johanna Mosquera Valderrama, Dries Lesage and Wouter Lips, "Tax and Development: The Link between International Taxation, The Base Erosion Profit Shifting Project and the 2030 Sustainable Development Agenda" (2018) United Nations University ICRIS Working Paper Series W-2018/4; Miranda Stewart, "Redistribution Between Rich and Poor Countries" (2018) 72 I.B.F.D. Bull. Intl. Tax'n 297; Tatiana Falcão, "Linking Policies: Inter-Nation Equity, Overseas Development Assistance, And Taxation" (2018) 19 Tax Notes Intl. 1211; Alex Cobham, Tommaso Faccio and Valpy Fitzgerald, "Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals" (2019) SocArXiv Paper; Laurens van Apeldoorn, "Exploitation, International Taxation, and Global Justice" (2019) 77 Rev. Soc. Econ. 163; Peter Hongler, *Justice in International Tax Law: A Normative Review of the International Tax Regime* (Amsterdam: IBFD: 2019); Alexander Ezenagu, "Unitary Taxation of Multinationals: Implications for Sustainable Development" (2019) CIGI Policy Brief No. 4; Allison Christians and Tarcisio D Magalhaes, "A New Tax Deal for the Digital Era" (2019) 67 C.T.J. 1153; Martin Hearson, Joy W Ndubai and Tovony Randriamanalina, "The Appropriateness of International Tax Norms to Developing Country Contexts" (2020) FACTI Background Paper 3; Dirk Broekhuijsen and Henk Vording, "What May We Expect of a Theory of International Tax Justice?", in D. de Cogan and P. Harris, eds, *Tax Justice and Tax Law: Understanding Unfairness in Tax Systems* (Oxford: Hart Publishing, 2020) 155; Ivan Ozai, "Origin and Differentiation in International Income Allocation" (2021) 44:1 Dal LJ 129; Tarcísio Diniz Magalhães & Ivan Ozai, "A Different Unified Approach to Global Tax Policy: Addressing the Challenges of Underdevelopment" (2021) 4 Nordic J.L. & Soc. 1 at p. 18; Sarah Ganter, "Digital Taxes for Sustainable Development?" (2021) 38 Digitalization & Sustainability 49; IJ Mosquera Valderrama, D. Lesage and W. Lips, eds, *Taxation, International Cooperation and the 2030 Sustainable Development Agenda,* United Nations Series on Regionalism 19 (Cham: Springer, 2021).

[17] The allocation of taxing rights and the distribution of the burden of eliminating double taxation are two sides of a coin. While "allocation of taxing rights" is a phrase of common use, the distribution of burdens or obligations best describes what takes place in international tax arrangements: countries with competing or concurrent tax jurisdiction come together to decide how to and when to not exercise those rights. In other words, each country undertakes to not exercise its taxing rights in certain circumstances or until a certain threshold is met.

[18] See Kim Brooks, "Internation Equity: The Development of an Important but Underappreciated International Tax Value" in J.G. Head & R. Krever, eds, *Tax Reform in the 21st Century: A Volume in Memory of Richard Musgrave* (The Netherlands: Kluwer Law International, 2009) 471 at p. 473; Ivan Ozai, "Inter-nation Equity Revisited" (2020) 12:58 Columbia J Tax L 58 at pp. 59 and 61.

nation redistributive justice).[19] This paper rests exclusively on the first mentioned analytical framework, which, for distinction, we label “allocative justice”.[20]

Allocative justice stresses the view that the taxing rights of countries, especially lower-income countries, should not be unduly fettered by the prescriptions of international tax bargains. Thus, allocative justice projects inter-nation equity from the angle of preservation of the right of lower-income countries to tax income over which they have a normative justification to tax, as well as the pragmatic capacity to do so. Such normative justification arises as an attribute of the sovereign fiscal power of the state.[21] The starting point, therefore, is an explicit affirmation of the principle that a state’s tax jurisdiction arises from that state’s sovereign connection with either the subject (person) or object (activity or property) of taxation.[22] Typically, the subject (taxpayer) would connect to a state by virtue of their residence in that state while the object (activity) connects to the state because the state provides the circumstances that enable the earning of income.[23] Once such a connection – commonly captured by the concept of “economic allegiance” – exists and the state has the pragmatic capacity to tax, the requirements for tax jurisdiction are met.[24] However, because most states tax their residents (often on income earned anywhere in the world) as well as non-residents (on income with a geographic source in the state), it is common for two states (or more) to have a defensible normative claim to tax

[19] Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938) at pp. 18-19. See, e.g., Reuven S Avi-Yonah, “Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State” (2000) 113 Harvard L Rev 1573 at p. 1650; JD Blum, “Distributive Justice and Global Health: A Call for a Global Corporate Tax” (2007) 26 Med. & L. 203; Yariv Brauner, “Brain Draft Taxation as Development Policy” (2010) 55 St Louis Uni. L.J. 221; Ilan Benshalom, “How to Redistribute Critical Examination Mechanisms Promote Global Wealth Redistribution” (2014) 64 Uni Toronto L.J. 317 at p. 320; Anthony Infanti, “Internation Equity and Human Development” in Y Brauner & M Stewart, eds, *Tax Law and Development* (Edward Edgar Publishing, 2013), p. 209.

[20] For an in-depth discussion of the distinctiveness of the two perspectives of inter-nation equity and the policy implications of conflating them, see Okanga Ogbu Okanga & Kim Brooks, “Avoiding the Pitfalls of Fiscal Colonialism: The Importance of Allocative Justice as Inter-Nation Tax Equity” (Working Paper).

[21] Joseph H. Beale, “Jurisdiction to Tax” (1919) 32 Harvard L Rev 587; A R Albrecht, “The Taxation of Aliens under International Law” (1952) 29 Brit Y.B. Intl L. 145.

[22] See Rutsel Silvestre J Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1989); Peter Harris & David Oliver, *International Commercial Tax* (Cambridge, UK: Cambridge University Press, 2010).

[23] Rutsel Silvestre J Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1989); Peter Harris & David Oliver, *International Commercial Tax* (Cambridge, UK: Cambridge University Press, 2010).

[24] Rutsel Silvestre J Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1989); Peter Harris & David Oliver, *International Commercial Tax* (Cambridge, UK: Cambridge University Press, 2010).

the same income.[25] Where this overlapping jurisdiction results in "double taxation" (taxation in excess of the taxation that would be imposed in a single state) the conventional view is that some form of compromise or inter-nation coordination in the exercise of taxing rights should be sought so that the interaction of tax systems does not cause activities to cease.[26]

A state that prioritizes efficiency may unilaterally choose to not exercise its tax jurisdiction (for example, by granting a foreign tax credit).[27] However, states often coordinate (negotiate) with one another to streamline their respective exercise of tax jurisdiction.[28] This coordination may be expressed in domestic tax legislation and or bilateral tax treaties.[29] As noted earlier, tax treaties generally limit the source country's ability to impose tax (whether by raising the threshold for the imposition of that tax or providing for maximum rates).[30] The question of how much such limitation is defensible is sometimes understood as an administrative issue (where the countries have roughly even trade flows) and a fairness issue (where they do not).[31] In the latter case, significant distributional implications (losses)

[25] This occurs, for instance, where one state is the "source" of the income while the other state is the residence of the state of the income earner (taxpayer). It may also occur where the taxpayer is resident in one state but earns a single income from a chain of activities that take place in two or more other states.
[26] Diane Ring, "International Tax Relations: Theory and Implications" (2007) 60 Tax L. Rev 83.
[27] Michael J. Graetz & Michael M. O'Hear, "The "Original Intent" of U.S. International Taxation (1997) 46 Duke L.J. 1021.
[28] Diane Ring, "International Tax Relations: Theory and Implications" (2007) 60 Tax L. Rev 83. These negotiations often take place in an atmosphere of economic and political inequality. Thus, the influence of more powerful states can overbear upon the outcome of such bargains. See, e.g., Richard Eccleston, *The Dynamics of Global Economic Governance: The Financial Crisis, the OECD and the Politics of International Tax Cooperation* (Cheltenham: Edward Elgar Pub, 2013); Sergio A Rocha, "The Other Side of BEPS: "Imperial Taxation" and "International Tax Imperialism" in S.A. Rocha & A. Christians, eds, *Tax Sovereignty in the BEPS Era* (Alphen aan den Rijn: Wolters Kluwer, 2017), p. 179; Philipp Genschel and Thomas Rixen, "Settling and Unsettling the Transnational Legal Order of International Taxation", in TC Halliday and G Shaffer, eds, *Transnational Legal Orders* (Cambridge University Press, 2015), p. 154; Tarcisio Diniz Magalhães, "What Is Really Wrong with Global Tax Governance and How to Properly Fix It" (2018) 10:4 WTJ 499; Martin Hearson, *Imposing Standards: The North-South Dimension to Global Tax Politics* (New York: Cornell University Press, 2021); Cassandra Vet, Danny Cassimon, & Anne Van de Vijver, "Getting the Short End of the Stick: Power Relations and Their Distributive Outcomes for Lower-Income Countries in Transfer Pricing Governance" in IJ Mosquera Valderrama, D Lesage & W Lips, eds, *Taxation, International Cooperation and the 2030 Sustainable Development Agenda,* United Nations Series on Regionalism 19 (Cham: Springer, 2021), p. 3.
[29] Diane Ring, "International Tax Relations: Theory and Implications" (2007) 60 Tax L. Rev 83.
[30] See, e.g., OECD Model Tax Convention on Income and on Capital, Article 12(1) [excluding the taxation of royalties by the source country]. See also Tsilly Dagan, "The Tax Treaties Myth" (2000) 32:4 NYU J. Int'l L & Politics 939.
[31] Diane Ring, "Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation" (2009) 9 Fla Tax Rev 555 at p. 584 ["Bilateral double tax treaties face scrutiny as inappropriately favoring capital exporting nations through their allocation of primary and residual taxing rights. Developing countries reportedly have made "concessions" in tax treaties without a full awareness of their implications because they believed the provisions were standard and because the provisions were formally reciprocal (enhancing their appearance of mutuality and comparable impact)".]

for government revenue can flow from a given bargain.[32] Where one, or more, of the countries is a lower-income country, we measure allocative justice based on the revenue implications of a bargain , i.e., based on the degree to which the bargain restricts the taxing rights – thus, scope for tax revenue mobilization – of the (lower-income) country.

It is against this evaluative framework that we assess the fairness of the recent OECD tax allocation proposal (Pillar 1) for lower-income countries. To the extent that Pillar 1 purports to (re)allocate taxing rights between countries, including lower-income countries like Nigeria and Kenya, to be deemed fair, the deal must be seen to not unduly fetter the taxing rights of these countries. In the ensuing sections, we examine different elements of Pillar 1 and then, relying on available literature and data, assess its allocative justice implications. The rest of the paper, therefore, proceeds as follows: Part 2 provides a brief history and textual outline of the various elements of Pillar 1. The elements in focus are the scope, nexus, and profit allocation rules. These elements determine the extent to which a country may exercise its tax jurisdiction. If they are defined narrowly, they significantly constrain a country's ability to tax. The discussion in Part 2 will be of interest to readers who have had exposure to Canada's approach to allocating revenue under its transfer pricing regime (e.g., tax and corporate (especially securities) lawyers and policymakers) and tax treaties network.[33] Part 3 delves explicitly into how we effectively evaluate international agreements when we attend to inter-nation justice issues. We demonstrate that the scope, nexus, and profit allocation rules in the OECD Pillar 1 proposal are defined too narrowly from the perspective of lower-income countries. They tremendously shrink the tax base of these countries and, therefore, diminish their potential for tax revenue mobilization. Even though countries are said to be negotiating on an equal footing, we show that these rules are heavily influenced by high-income countries, in this case to the disadvantage of lower-income countries. While

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[32] Charles R Irish, "International Double Taxation Agreements and Income Taxation at Source" (1974) 23 Intl & Comp L. Qtly 292; Alex J. Easson, *International Tax Reform and the Inter-Nation Allocation of Tax Revenue* (Wellington, NZ: Victoria University Press, 1991); Kimberly Brooks & Richard Krever, "The Troubling Role of Tax Treaties" in Geerten Michielse and Victor Thuronyi, eds, *Tax Design Issues Worldwide*, (The Netherlands: Kluwer Law International, 2015) 159.

[33] See Kim Brooks, "Canada's Evolving Tax Treaty Policy toward Low-Income Countries" in AJ Cockfield, ed, *Globalization and the Impact of Tax on International Investments: Essays in Honour of Alex Easson* (Toronto: University of Toronto Press, 2010), p. 189; Jinyan Li, "The Global Tax Agreement: Some Truths and Legal Realities" (2022) Osgood Hall Law School Research Papers, online: https://perma.cc/Q6RS-9U6W.

the OECD Pillar 1 proposal is the focus of our analysis, readers who care more generally about the geo-economic tensions that explain international agreements' design, how we might analytically approach evaluating the fairness of international agreements, as well as how our concept of economic value is changing should find this part of significance.[34] Part 3 also offers a caution about the ramifications of the current OECD Pillar 1 proposal for international business. We demonstrate that the absence of a fair deal for lower-income countries could result in broader negative consequences for businesses in all countries, including Canada. Businesses could find it difficult to access foreign markets because of additional taxes by countries that are not satisfied with the deal. It is the classic case of elephants fighting and the ground suffering.

2. The OECD Pillar 1 Tax Deal

The OECD coordinates a, perhaps, surprisingly elaborate international community of states engaged in discussions of international tax policy – called the "Inclusive Framework". The aim is to further develop the international tax bargain so that it more effectively addresses the taxation of the digital economy.[35] The multilateral effort is in response to identified gaps in the subsisting rules – especially the permanent establishment rule – which sets the threshold for when a business has sufficient presence in a foreign country to justify being taxed on the income that it earns in that country – that leave the existing regime inadequate to capture the taxation of profits in the digital economy.[36] In October 2021, the OECD published a consensus solution on the subject: "Two-Pillar Solution to

[34] Lorraine Eden, "Canada and the United States: Winners or Losers from Pillar One Amount A?" (2021) 50:3 T.M.I.J. 1; Stephanie Soong Johnston, "USTR Must push Back If Canada Moves on Digital Tax, Senators Say", *Tax Analysts* (January 14, 2022) online: https://www.taxnotes.com/tax-notes-international/digital-economy/ustr-must-push-back-if-canada-moves-digital-tax-senators-say/2022/01/17/7d37x.

[35] See, e.g., OECD, *Tax Challenges Arising from Digitalization—Interim Report 2018:* OECD, *Inclusive Framework on BEPS* (Paris: OECD, 2018); OECD, *Public Consultation Document Secretariat Proposal for a "Unified Approach" Under Pillar One 9 October-12 November 2019* (Paris: OECD, 2019); OECD, *Public Consultation Document Addressing the Tax Challenges of the Digitalization of the Economy 13 February-6 March 2019* (Paris: OECD, 2019); OECD, *Programme of Work To Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy: Inclusive Framework on BEPS* (Paris: OECD, 2019); OECD, *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprint OECD/G20 Base Erosion and Profit Shifting Project* (Pari: OECD, 2020).

[36] Cassandra Vet, Danny Cassimon, & Anne Van de Vijver, "Getting the Short End of the Stick: Power Relations and Their Distributive Outcomes for Lower-Income Countries in Transfer Pricing Governance" in IJ Mosquera Valderrama, D Lesage & W Lips, eds, *Taxation, International Cooperation and the 2030 Sustainable Development Agenda,* United Nations Series on Regionalism 19 (Cham: Springer, 2021), p. 3.

Address the Tax Challenges Arising from the Digitalization of the Economy" (OECD Agreement).[37] As the name suggests, the OECD Agreement comprises two subjects. Pillar 1 deals with the allocation of taxing rights to "market jurisdictions" in the digital economy, while Pillar 2 attempts to curtail the negative trend of international tax competition – the "race to the bottom" – by establishing a global minimum effective tax rate – 15% – payable by MNEs regardless of where and how they operate.[38] Pillar 2 raises allocative justice concerns for lower-income countries, albeit in an indirect way. However, our focus here is on Pillar 1, which deals more directly with the allocation of taxing rights between countries.[39]

Pillar 1 has three core components to be considered in determining taxing rights allocation. Amount A – the main component of Pillar 1 – proposes to allocate the "residual profits" of the largest and most profitable MNEs to "market jurisdictions", i.e., the jurisdictions where the MNEs' customers are located or where goods and services are sold or consumed.[40] Put simply, Amount A allocates a "new" taxing right to market jurisdictions. Amount B, designed to simplify some aspects of transfer pricing administration, reflects a "fixed return" to related party distributors that perform "baseline marketing and distribution activities" in the market jurisdiction.[41] The market jurisdiction would be entitled to tax this fixed return in accordance with its own laws.[42] The third component of Pillar 1 introduces a mandatory dispute resolution mechanism to address emerging issues relating to the application of Amount A.[43]

[37] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).
[38] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).
[39] For reflections on the distributional implications of Pillar 2, see, e.g., Noam Noked, "Potential Response to GloBE: Domestic Minimum Taxes In Countries Affected by the Global Minimum Tax" 102:7 Tax Notes Int'l 943; Afton Titus, "Global Minimum Corporate Tax: A Death Knell for African Country Tax Policies?" *SSRN* (2022) online: https://perma.cc/T2X6-APDD; John Vella, Michael P Devereux and Heydon Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition" (2022) Oxford University for Business Taxation Policy Brief.
[40] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) at p. 5.
[41] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).
[42] "The definition of baseline marketing and distribution activities covers distributors that (i) buy from related parties and resell to unrelated parties; and (ii) have a routine distributor functionality profile". . OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).
[43] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021). All subsequent references to "the OECD Agreement" or "Pillar 1" are limited to Amount A.

Nearly 140 countries (and jurisdictions) have signed up to the OECD Agreement[44], even though more work is being done on the technical aspects of the new regime.[45] There are, however, holdouts among lower-income countries, including Kenya and Nigeria, who protest the allocative justice of Pillar 1.[46] Nigeria is of particular interest because, as reported in April 2022, the country made a decisive choice to withdraw from the global deal.[47] Is there merit in these countries' concerns? Is the OECD Agreement unfair? To respond to these questions, from an allocative justice perspective, we must first examine, in principle, whether these countries have jurisdiction to tax the relevant tax base and then assess whether the scope, nexus, and profit allocation rules reflected in the OECD Agreement demand undue taxing rights concessions from lower-income countries. Is the Pillar 1 bargain déjà vu for countries that have long felt the ramifications of agreeing to high-income country-designed limits to their taxing rights (e.g., through tax treaties)?

2.1 Scope

The OECD Agreement proposes to tax the "residual profits" of in-scope MNEs in their market jurisdictions. The regime applies to MNEs with "global turnover above €20 billion and profitability above 10% (i.e., profit before tax/revenue) calculated using an averaging mechanism."[48] The Agreement does not apply to extractive companies and regulated financial services companies.[49] The Agreement

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[44] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" (October 8, 2021) online: https://perma.cc/M5BE-QGAJ.

[45] See OECD, *Progress Report on Amount A of Pillar One: Two-Pillar Solution to the Tax Challenges of the Digitalisation of the Economy: Public Consultation 11 July – 19 August 2022* (Paris: OECD, 2022).

[46] Orria Goni & Luckystar Miyandazi, "The Global Corporate Tax Deal – An African Perspective", *UNDP blog* (January 5, 2022) online: https://perma.cc/86W9-UQGK.

[47] Ndubuisi Francis, "Nigeria Opts Out of Global Tax Deal, Cites Economic Impact", *This Day* (20 April 2022) online: https://perma.cc/JT3Y-WBZS.

[48] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) at p. 6. The plan is to reduce the turnover threshold to €10 billion, following a successful implementation of the deal, including the tax certainty provisions on Amount A. A review of the implementation status will begin 7 years after the agreement comes into force and should be completed within a year.

[49] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) at 20 ["The aim of the Two-Pillar Solution is to make sure that MNEs can't take advantage of the old rules on international tax to avoid paying their fair share and the new rules are designed to capture and address this problem. The exclusions provided for relate to types of profit and activities that are not part of this problem either because the profit is already tied to the place where it is earned (for example, regulated financial services and mining companies will have to have their operations in the place where they earn their income) or the activity benefits from different taxation regimes due to their specific nature (such as shipping companies and pension funds). These types of businesses are still subject to all the other international tax standards on transparency and BEPS to ensure that tax authorities can tax them effectively."]. The carveouts for extractives and financial services companies were introduced during negotiations, following the U.S. intervention. The carveout for regulated financial services was mainly championed by the U.K. to shield the City of London banks (Britain's huge financial hub) from more taxes arising from

captures MNEs in a wide variety of businesses, including: location-specific services; advertising services; online intermediation services; transport services; customer reward programs; other business to business (B2B) and business to customer (B2C) services, including financing, license or alienation of intangible property, real property, and non-customer revenues.[50] A non-resident MNE that earns income from any of these sources would be taxable in its market state regardless of whether the MNE has a physical presence there.

2.2 Nexus

Pillar 1 introduces a "special purpose nexus rule" that enables the allocation of taxing rights to a market state even absent a permanent establishment in that state. However, Pillar 1 contemplates a qualified nexus – a threshold – which crystalizes only when the in-scope MNE derives revenue of at least €1 million in the taxing state. This nexus threshold drops to €250,000 for "smaller jurisdictions", i.e., states with GDP lower than €40 billion.[51] This special purpose nexus rule applies only for the purpose of determining whether a state qualifies for Amount A allocation.[52]

2.3 Profit Allocation

Pillar 1 will split 25% of the residual profit – profit in excess of 10% of revenue – between a MNE's market jurisdictions. Each market state would be allocated a share of the MNE's residual profit that is proportionate to the share of total revenue that is sourced from that jurisdiction.[53]

These are the components of Pillar 1 that touch directly on the allocation of taxing rights. It is evident that each of the components examined in this part limits the extent to which each state that is party to

their overseas operations. See Paul Withers, "Rishi Sunak Secures Global Tax Win for UK as US Counterpart Backs Down in Crunch Talks", *Express* (July 1, 2021) online: https://perma.cc/89E8-CJ8N; Chris Giles and George Parker, "Financial Services Sector Set for Carve-out from New Global Tax Rules", *Financial Times* (June 30, 2021) online: https://perma.cc/C7FL-FU3A ["The UK believed financial services would be carved out from the new global tax rules because regulation forces banks to be separately capitalized in every jurisdiction they operate in, so that they declare profits and pay tax in the countries in which they do business."].

[50] OECD, *Public Consultation Document: Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing* (Paris: OECD, 2022) [Pillar 1 Draft Model Rules 2022].

[51] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).

[52] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).

[53] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021).

the deal may exercise its tax jurisdiction. The restrictions are introduced to protect businesses from excessive taxation. The nature of the jurisdiction and the extent to which the restrictions may be considered fair are subject to further analysis; and we do so in the next part.

3. Situating Allocative Justice in the Pillar 1 Tax Deal

This part critically examines the Pillar 1 tax deal to ascertain the extent to which it may be considered fair from the perspective of lower-income countries, including those countries that have yet to endorse the deal. It is important to examine why some lower-income countries are so skeptical about the deal, whether there is merit in their objections, and the potential implications of their unwillingness to get onboard, especially for the stability of the international tax system and the confidence of non-resident businesses who may have some market presence in these countries.

The scope, nexus, and profit allocation specifications of Pillar 1 raise concrete allocative justice questions for lower-income countries like Kenya, Nigeria, Pakistan, and Sri Lanka, all of whom have been skeptical to embrace the deal.[54] The starting point of addressing these questions is to examine, in principle, whether these countries have some normative justification (entitlement) to tax the profits of non-resident MNEs as market states. It is only when such normative justification is established, in principle, that one can debate whether the allocative specifications in the deal can be deemed fair to these countries.

3.1 The "Market Jurisdiction" Question

Historically, countries have limited source taxation of the business profits of non-residents to supply side activities, i.e., pre-market production activities, carried on through a permanent establishment.[55]

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[54] Isabel Gottlieb, "Nigeria Opted Out of Global Tax Deal Seeing Little Gain: Official", *Bloomberg Tax* (November 30, 2021) online: https://news.bloombergtax.com/daily-tax-report-international/nigeria-opted-out-of-global-tax-deal-seeing-little-gain-official.

[55] Vikram Chand, "Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method" (2019) 47 Intertax 1023.

This limit, which has been reaffirmed in recent history,[56] can be attributed to the political compromise between residence and source states, perhaps, influenced by the historical infeasibility of assessing the taxable profits of non-residents.[57] This historical position rendered the market jurisdiction a dormant component of source jurisdiction. Notwithstanding, it is well established within economic thought that the market is – has always been – an integral part of wealth creation and, therefore, that the market state is, in principle, entitled to tax the income of a non-resident entity. This has been a settled position since the League of Nations' 1923 report, which traces an MNE's wealth production chain to the point where goods (or services) "*are put where the consumer can use them*'; and 'these stages, up to the point where wealth reaches fruition, may be shared in by different territorial authorities."[58] The 1923 report recognized the production of wealth as involving four elements, comprising the supply and demand of goods and services,[59] and asserts that "no one of these four elements can be omitted without ruining the efforts of the other three and spoiling the whole apparatus for the production of wealth."[60]

It is evident that the state where customers are located is an integral part of the wealth creation chain of MNEs. Without customers, the non-resident MNE's goods or services may bear no economic value.[61] After all, it is possible to not have a market for a product or service in its country of production and yet have a great market for it elsewhere.[62] It is, therefore, beyond doubt that the concept of market

[56] OECD*, Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention on Art. 5* (Paris: OECD Publishing, 2000); OECD, *Implementation of the Ottawa Taxation Framework Conditions: The 2003 Report* (Paris: OECD Publishing, 2003); OECD*, E-Commerce: Transfer Pricing and Business Profits Taxation* (Paris: OECD Publishing, No. 10, 2005).
[57] On the historical compromise, see Ke Chin Wang, "International Double Taxation of Income: Relief through International Agreement 1921–1945" (1945) 59 Harv L. Rev. Assoc. 73; Sol Picciotto, *International Business Taxation*, 2nd ed (Cambridge: Cambridge University Press, 2013).
[58] Bruins, Einaudi, Seligman and Stamp, *Report on Double Taxation submitted to the Financial Committee, Economic and Financial Commission Report by the Experts on Double Taxation*, League of Nations Doc. E.F.S. 73. F. 19, (1923) at pp. 22–23.
[59] Bruins, Einaudi, Seligman and Stamp, *Report on Double Taxation submitted to the Financial Committee, Economic and Financial Commission Report by the Experts on Double Taxation*, League of Nations Doc. E.F.S. 73. F. 19, (1923) at pp. 23-24.
[60] Bruins, Einaudi, Seligman and Stamp, *Report on Double Taxation submitted to the Financial Committee, Economic and Financial Commission Report by the Experts on Double Taxation*, League of Nations Doc. E.F.S. 73. F. 19, (1923).
[61] Wolfgang Schon, "Ten Questions about Why and How to Tax the Digitalized Economy" (2018) 72 Bulletin for Int'l Taxation 278 at p. 285.
[62] Jonatan Kanervo, "Allocation of taxing rights in international corporate income taxation Comparing the current system, residual profit allocation, and OECD Pillar One" (2021) University of Helsinki LLM Thesis at p. 35.

jurisdiction – a component of source jurisdiction – is an important component of assessing the value that each country contributes to the ability of an activity (or MNE) to yield income.[63]

Pillar 1 deviates from the historical compromise of not allocating taxing rights to a country on the basis that the country provides only a ready market for the sale or consumption of goods and services.[64] The policy rationale for this shift is the recognition that the market jurisdiction contributes to value creation for MNEs through engagement with and the provision of access to users and customers.[65] However, the timing of the explicit recognition of the value that the market state provides is primarily the consequence of a change in political will: many high-income states recognize the "tax gap" created by the inadequate coverage of the current international tax system. They are no longer as willing to tolerate the non-taxation of income, particularly by highly mobile businesses. Consequently, OECD countries (mainly higher-income, politically powerful states) have become keener to consider the expansion of the tax system through restating the rationale for allocating taxing rights to the market jurisdiction. This radical adjustment is an adaptation to the new "economic reality" of digitalisation.[66]

It is worth elaborating, since the advent of digitalisation, the significance of the market to MNEs has increased rapidly, not just in terms of sales, but also because MNEs are enabled to extract and collect customer data, which they can use either to improve their business activities or to sell to other businesses.[67] The market jurisdiction provides a benefit to MNEs through maintaining a market for

[63] Michael P Devereux and John Vella, "Taxing the Digitalised Economy: Targeted or System-Wide Reform?" (2018) 2018 BTR 387 at p. 394 ["The income being allocated among countries owes as much to the market as it owes to the various parts of the supply chain. Income depends on the price charged at the point where supply and demand meet: it simply would not have arisen in the absence of a market. It is not entirely clear why the international corporate tax system should depart from a simple and uncontroversial economic understanding of value creation".].
[64] Another view, perhaps, is that the market jurisdiction is a component of the wealth creation chain of MNEs and, if there is an administratively feasible way for a market state to participate in the income of the non-resident MNE, through taxation, then it should be entitled to do so.
[65] See Michael P Devereux and John Vella, "Taxing the Digitalised Economy: Targeted or System-Wide Reform?" (2018) 2018 BTR 387; Victoria Plenkhanova, "Value Creation within Multinational Platform Firms: A Challenge for the International Corporate Tax System" (2020) 17 eJournal of Tax Res 280.
[66] U.S. Supreme Court in *South Dakota v Wayfair Inc* 138 S. Ct. 2080 (2018).
[67] Vikram Chand, "Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method" (2019) 47 Intertax 1023 at p. 1027; Johannes Becker & Joachim Englisch, "Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?" (2019) 47 Intertax 161; John Vella, "Digital Services Taxes: Principles as a Double-Edged Sword" (2019) 72 National Tax J 821 at p. 827; Svitlana Buriak, "A New Taxing Right for the Market Jurisdiction: Where Are the Limits?" (2020) 48 Intertax 301.

goods and services.[68] MNEs derive profit by taking advantage of the market that is maintained by states through investment in the legal, physical, and other infrastructures.[69] Digitalization has also enabled MNEs to penetrate foreign markets in unprecedented ways, to conduct significant business (including sales of goods and services to customers) without having to meet the physical presence threshold that is traditionally required to form a taxable nexus in the source state.[70] The mobility of digitalised businesses (in particular), combined with our changed appreciation of the value attributed by the market state, has led to concerns about both untaxed income and unfair or uneven allocation of tax revenue between states based on their level of contribution to the income earned.[71] Penetration of local markets by non-resident enterprises has also contributed to the displacement of locally based businesses that would ordinarily contribute to a state's revenue coffers.[72] States – but importantly high-income, powerful states – have grown discontent with the distributional implications of the subsisting regime[73] and have, thus, summoned the political will to take action, in various ways, to assert their fiscal sovereignty.[74]

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[68] Sophie Chatel & Jinyan Li, "Repurposing Pillar One into an Incremental Global Tax for Sustainability: A Collective Response to a Global Crisis" (2021) 75 Bull. Intl Tax'n 1 at p. 13; Qiang Cai and Xiaorong Li, "The New Taxing Right and Its Scope Limitations: A Theoretical Reflection" (2021) 49 Intertax 210 at p. 215 ["a market jurisdiction can, by all means, tax foreign exporting companies on the grounds that those companies benefit from its market accesses"].
[69] Sophie Chatel & Jinyan Li, "Repurposing Pillar One into an Incremental Global Tax for Sustainability: A Collective Response to a Global Crisis" (2021) 75 Bull. Intl Tax'n 1 at p. 68; Dale Pinto, *E-Commerce and Source-based Income Taxation* (Amsterdam: IBFD Publications, 2003) at p. 22–23.
[70] See Reuven S. Avi-Yonah, "Three Steps Forward, One Step Back? Reflections on "Google Taxes" and the Destination-Based Corporate Tax", (2016) 2 Nordic Tax J 69; Jean-Louis Medus, "Proposals to Regulate Digital Business: Some Critical Comments", (2017) J. Int'l Tax 35 ["One main characteristic of digital business is the cross-border dissemination of assets through various jurisdictions and a sort of fragmentation of activities entailing a tax-optimized location of profits and permitting digital companies through treaty shopping to avoid establishing a permanent establishment (PE) (thus subject to taxation) in consumer markets, and to attribute the main part of profits to specific entities and jurisdictions (especially those providing IP (intellectual property)-favorable tax regimes"]; Ana Paula Dourado, "The OECD Report on Pillar One Blueprint and Article 12B in the UN Report" (2021) 49 Intertax 1 at p. 1 ["Enterprises of one contracting state are increasingly providing substantial services to customers in the other contracting state and maintaining a significant economic presence there without having any fixed place of business and without being present in that state for any substantial period of time".].
[71] Arthur J. Cockfield, "Tax Wars: How to End the Conflict Over Taxing Global Digital Commerce" (2020) 17 Berkeley Bus L.J. 347 at p. 354.
[72] See Christopher Mims, "A Surprisingly Long List of Everything Smartphones Replaced," *MIT Technology Review* (July 22, 2012), online: https://perma.cc/7YEP-48AM; Nathaniel Meyersohn, "American Retailers Already Announced 6,000 Store Closures this Year. That's More Than All of Last Year," *CNN Business* (April 6, 2019), online: https://perma.cc/7RFF-HMG6. This point is not presented as a normative justification for taxation, but an added reason why states are no longer willing to forego income taxation of non-resident sales.
[73] Lilian V. Faulhaber, "Taxing Tech: The Future of Digital Taxation" (2019) 39 Va Tax Rev 145.
[74] For a review of the many tax strategies that states are using to capture the revenue that is derived by MNEs in the modern economy, see Allison Christians & Tarcisio Diniz Magalhaes, "The Rise of Cooperative Surplus Taxation" *SSRN* (2020) online: https://perma.cc/JJ4A-8BJ9. Many countries, including Austria, Canada, France, Hungary, India, Italy, Kenya, New Zealand, Sierra Leone, Spain, Tunisia, Turkey, and the United Kingdom, have proposed or adopted

It is this convergence of economic and political realities that led to the formation of a multilateral compromise on taxing rights allocation. The expansion of the normative framework for the allocation of taxing rights to include the value contributed by the market states, reflected in the Pillar 1 proposal, is consistent with the original normative justification for the allocation of taxing rights.[75] The market state was, however, generally ignored in the past because of underappreciation of the value contributed by the market state, concerns over administrative practicality of taxation, and a lack of political will on the part of higher-income countries to embrace international tax rules that support allocating a greater share of the taxing rights (and ultimately tax revenue) to states on the basis *only* of an available market. Although, countries have the option of unilaterally designing rules to impose market-based income tax on MNEs that penetrate their territory, their preference for multilateral coordination ensures relative uniformity and consistency. This collective approach is more desirable for MNEs, as it minimizes the risk of double taxation and inconsistent compliance obligations. With this background, the next section returns to our fundamental question: to what extent should countries, especially lower-income countries like the "rebellious" Kenya, Nigeria, Pakistan, and Sri Lanka, be willing to cooperate (i.e., give up taxing rights)?[76]

3.2 The Allocative Justice of Pillar 1's Limits on the "Market Jurisdiction" of Lower-Income States

Scope

Although Pillar 1 better reflects the value contributed by the market state than the current international tax framework, it nevertheless imposes extensive limits on the exercise of that jurisdiction. These limits

a digital tax, which indicates widespread approval of "non-physical" trading as sufficient nexus for taxation. See KPMG, "Taxation of the Digitalized Economy: Direct Taxes", *KPMG Tax* (January 15, 2021), online: https://perma.cc/KJX6-GSUZ; Elke Asen, "What European OECD Countries Are Doing About Digital Services Taxes", *Tax Foundation* (March 25, 2021) online: https://perma.cc/JXH5-JMP3.

[75] See Bruins, Einaudi, Seligman and Stamp, *Report on Double Taxation submitted to the Financial Committee, Economic and Financial Commission Report by the Experts on Double Taxation*, League of Nations Doc. E.F.S. 73. F. 19, (1923).

[76] The choice of cooperation or dissent is especially difficult for lower-income countries, in a global economic order that is dominated by high-income countries. Tarcísio Diniz Magalhães, "International Tax Law Between Loyalty, Exit, and Voice" (2021) 44 Dal LJ 49; Philipp Genschel and Thomas Rixen, "Settling and Unsettling the Transnational Legal Order of International Taxation", in TC Halliday and G Shaffer, eds, *Transnational Legal Orders* (Cambridge University Press, 2015), p. 154.

have disparate impacts on countries, mainly based on their market size. Indeed, there is a likelihood that due to these limits on scope, nexus, and profit attribution, only a few big market economies – mostly OECD countries – would benefit from the Agreement, while some smaller market economies may lose significant revenue.[77]

Positively, Pillar 1 has a broad sectoral scope, in the sense that it covers MNEs engaging in every form of economic activity, except for extractive companies and regulated financial services providers. This enhances administrative simplicity for lower-income countries compared to previous iterations where it was debated whether Pillar 1 should apply to only "automated digital services" ("highly digitalized businesses") or include taxation of "consumer facing businesses".[78] This broader scoping dispenses with uncertainties about whether an MNE's activities qualify as automated digital services.

Nevertheless, a combination of the €20 billion global turnover threshold and the above-10% profitability ratio significantly limits the number of in-scope MNEs. It has been demonstrated elsewhere that the number of in-scope MNEs is well below 100.[79] The high scoping threshold has one main advantage: It limits compliance costs for MNEs, as well as for tax authorities who may otherwise expend limited resources tracing small amounts of sales.[80] However, the €20 billion global turnover is still a radical leap from a previously contemplated €750 million,[81] and appears to be a capitulation to the U.S.'s desire to insulate most of its MNEs from the scope of Pillar 1.[82] While such a high global turnover threshold may be satisfactory for big market jurisdictions like the OECD countries and the BRICS[83], it

[77] Allison Christians and Tarcisio D Magalhaes, "A New Tax Deal for the Digital Era" (2019) 67 C.T.J. 1153; IMF, *Digitalization and Taxation in Asia* (2021) DP/2021/017.
[78] Defined as "those businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, including those selling indirectly through intermediaries and by way of franchising and licensing". OECD, *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprint OECD/G20 Base Erosion and Profit Shifting Project* (Pari: OECD, 2020) at p. 21, para 33.
[79] Michael Devereux & Martin Simmler, "Who Will Pay Amount A" (2021) EconPol Policy Brief 36/2021.
[80] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021). See also OECD, *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprint OECD/G20 Base Erosion and Profit Shifting Project* (Pari: OECD, 2020) at p. 22, para 37.
[81] OECD, *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprint OECD/G20 Base Erosion and Profit Shifting Project* (Pari: OECD, 2020) at p. 22, para 37.
[82] Julie Martin, "U.S. Offers New "Pillar One" Compromise plan for Taxing Large Multinationals", *MNE Tax* (April 8, 2021) online: https://perma.cc/Q7ZA-LAGE; Aitor Navarro, "The Allocation of Taxing Rights under Pillar One of the OECD Proposal" in F Haase and G Kofler, eds, *OUP Handbook of International Tax Law* (2021) at p. 11 (forthcoming) [examining overwhelming U.S. influence on the OECD Agreement].
[83] World Bank, "Final Consumption Expenditure (current US$)" (2020) online: https://perma.cc/4GNQ-ZTP2.

can unfairly strip some lower-income countries of taxing rights.[84] An example is Kenya, which may see its number of in-scope entities drop from 89 to 11, compared to the country's existing digital tax legislation.[85] If a lower-income country has the normative justification to tax the income of a certain number of MNEs (and there is here), and the capacity to in fact impose and enforce the tax, we believe that it would be unjust for a deal that is marshalled by high-income countries to allocate the taxing rights in a way that hampers the lower-income country from taxing, especially to the extent reflected in the OECD Agreement.

Some argue that a global turnover threshold is entirely unnecessary for Pillar 1 and urge its abandonment in favour of a country-specific threshold that better reflects an MNE's level of engagement with a particular market state.[86] While attempting to keep the focus on the largest MNEs, the OECD Agreement's global turnover threshold seems to ignore the reality that even a relatively "small" global MNE may enjoy a huge market presence in a particular (lower-income) country. It does not seem fair to deprive that country of the right to tax simply because the MNE's global turnover is not considered large enough by other (high-income) countries.

Another implication of Pillar 1's numerical narrowness is that most of the world's MNEs would continue to be taxed entirely under the existing permanent establishment rules. The fact that those rules heavily favour residence-based taxation and that the large digital companies mostly reside in high-income countries, does not augur well for lower-income countries.[87]

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[84] Allison Christians and Tarcisio D Magalhaes, "A New Tax Deal for the Digital Era" (2019) 67 C.T.J. 1153 at pp. 1175–1176 ["A focus on the OECD consumer base as the market is a metric that, by definition, tends to favour the biggest consumer markets in relation to small-market, low-income countries—for example, those that heavily rely on exports of natural resources—which stand to be apportioned the least. Given the disparate levels of consumption across the globe, a market-based system would mostly benefit relatively more affluent countries and, in the best-case scenario, some emerging ones. Accordingly, no matter which of the proposals prevails, the result will be the reinforcement of a new global consensus on tax allocation that seems destined to favour the companies and governments of relatively affluent states."].

[85] Carlos Mureithi, "Why Kenya and Nigeria Haven't Agreed to a Historic Global Corporate Tax Deal", *Quartz Africa* (November 2, 2021) online: https://perma.cc/ER3K-NT93.

[86] Assaf Harpaz, "The OECD's Unified Approach: Nexus, Scope, and Coexisting with DSTs" (2019) 96 Tax Notes Intl 909 at p. 910.

[87] Elma Hadzovic, "Taxing the Digital Economy in Developing Countries: A Legal Comparison Between OECD's Pillar One and UN's Article 12B" (Lund University LLM Thesis, 2021) at pp. 54–55.

Nexus

The OECD Agreement implies that a country can only tax an in-scope MNE that has sufficient market connection to it. Pillar 1 specifies the minimum nexus as €1 million revenue. This figure drops to €250,000 if the country is deemed a "small jurisdiction", i.e., a country whose GDP does not exceed €40 billion. The inclusion of a *de minimis* threshold is portrayed as a necessary cost saver for businesses and tax authorities.[88] However, some lower-income countries or, more precisely small market jurisdictions, might consider even the small jurisdictions threshold too high. An example is Nigeria, which has a much lower nexus specification (N25 million (€54,000)) in its domestic tax legislation.[89] Despite a 2020 GDP of over $430 billion,[90] Nigeria is a small market jurisdiction – which means that the country's scope for market-based taxation is relatively low.[91] Thus, subjecting a country like Nigeria to Pillar 1's €1 million nexus threshold may unjustly limit the country's tax base.[92]

Profit Allocation

Profit allocation raises additional allocative justice concerns for lower-income countries. Pillar 1 allocates 25% of an MNE's residual profit to its market jurisdictions. Residual profit is somewhat arbitrarily defined as profit in excess of 10% of revenue.[93] The framework denotes the existence of two classes of profit: routine profit and residual profit.[94] Conceptually, routine profit refers to the profit

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[88] Martin Hearson, "Africa Responds to the Inclusive Framework's Digital Tax Agenda", *ICTD Blog* (August 7, 2019) online: https://perma.cc/84T5-YNG5.

[89] Kenya does not stipulate such a revenue threshold.

[90] See: World Bank: https://perma.cc/A358-ERYQ; Statista: https://perma.cc/F7EJ-ZDT4.

[91] See statement by Nigeria's lead negotiator in the OECD Inclusive Framework, Matthew Gbonjubola: "The economic impact assessment that was carried out on Pillar 1 and 2 were founded on an unreliable premise. The country-specific impact assessment that was done was top-down. Somebody just looked at the GDP of Nigeria, and says Nigeria's GDP is this much and then they should be able to buy this number of shoes and things like that. And you and I know, in that kind of postulation, the margin of error is usually very wide. That exactly was what happened with this. Particularly for Nigeria, when we ran the numbers it was way off the figures that the OECD gave us." Johannes Oluwatobi, "Nigeria is not in Hurry to Sign OECD Corporate Tax Agreement – FIRS", *PR Nigeria* (November 30, 2021) online: https://perma.cc/Q7FK-DBYP.

[92] See West African Tax Administrative Forum, "WATAF Commentary on the OECD/G20Inclusive Framework Two-Pillar Solution to Address the Tax Challenges" (October 8, 2021) online: https://perma.cc/AK9Y-JANW ["The scope threshold has left out key MNEs exploiting the markets of our members from the scope of Pillar 1, while most of the in-scope MNEs have no significant engagement with our markets."]

[93] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) at p. 6.

[94] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021); Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497; Sebastian Beer *et al,* "Exploring Residual Profit Allocation" (2020) IMF WP/20/49.

that a (presumed) third party would expect to earn for the performance of a specified set of non-risk functions.[95] Ordinarily, routine profit may be ascertained by use of transfer pricing techniques[96] or by formulary apportionment.[97] Either approach aims to reward an MNE member enterprise for the functions that it performs as part of the integrated business of the group.[98] Thus, routine profit is deemed to emanate from the place where functions and activities take place, i.e., where the group's economic activities occur.[99] Such functions and activities may include R&D, general and administrative activities (G&A), manufacturing, marketing, and sales.[100] It is, therefore, implicit that routine profits are allocated for the supply side functions and activities in an MNE's value chain and can be calculated as a mark-up on the relevant entity's costs – based on the availability of data from comparable businesses.[101] Once profit is so allocated, it can be taxed in the state where the relevant functions and activities are performed.[102] Pillar 1 retains a traditional policy of allocating MNEs' routine profits by transfer pricing. This leaves in place the transfer pricing allocation with which MNEs are familiar.[103]

Residual profit is simply defined as profit earned by an MNE that exceeds routine earnings.[104] It may also be defined as the portion of total profits that exceeds a threshold that, usually, is designed to isolate a minimum level of profit from taxation.[105]

[95] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 201.
[96] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021).
[97] Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497; Sebastian Beer *et al,* "Exploring Residual Profit Allocation" (2020) IMF WP/20/49 at p. 5. In this case, a mark-up on the cost incurred by the relevant entity in performing its designated functions.
[98] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 203; Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021); Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497 at p. 511.
[99] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 203; Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497 at p. 511.
[100] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 189.
[101] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 203.
[102] Sebastian Beer *et al,* "Exploring Residual Profit Allocation" (2020) IMF WP/20/49 at p. 8.
[103] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at pp. 191 & 195.
[104] Sebastian Beer *et al,* "Exploring Residual Profit Allocation" (2020) IMF WP/20/49 at p. 5.
[105] Stephen E. Shay, "The Deceptive Allure of Taxing "Residual Profits" (2021) 75:11/12 Bulletin for Int'l Tax'n 1. Residual profit allocation is a transfer pricing derived concept. On the transfer pricing origins of the concept, see Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497; Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 195; Sebastian Beer *et al,* "Exploring Residual Profit Allocation" (2020) IMF WP/20/49 at p. 5.

A few arguments are made in favour of limiting Pillar 1 to residual profit allocation. The obvious one – based on efficiency – is that the limitation preserves the reign of the familiar transfer pricing system for the allocation of routine profits.[106] However, both efficiency and equity considerations disfavour such a limitation. First, there is no clear line between routine and non-routine profits and the OECD's attempted distinction creates complexities and uncertainties in the ascertainment of respective profit categories.[107] Considering capacity concerns, an extra layer of administrative complexity is unwelcome for lower-income countries. Second, limiting the allocation of taxing rights to residual profits may stoke discontent because the tax challenges posed by digitalization are by no means limited to residual profits.[108] As a result, the limitation may tempt some market states to introduce unilateral levies on digital services in order to ensure adequate taxation of business profits attributable to their market jurisdiction.[109] This could result in more disparate taxes for businesses operating overseas. Third, from an inter-taxpayer equity perspective, the distinction discriminates between a non-resident business that has a taxable physical presence in the market state – e.g., distribution activities – and one that does not.[110] Fourth, the arbitrary limitation implies that a market state contributes to the earnings of an MNE only when those earnings exceed 10% of turnover. Does it mean that when an MNE's total profit does not exceed 10% of turnover – regardless of the actual nominal value of total profit – then none of that profit can be attributed to the demand side? Attributing a fraction of the total profits to the market jurisdiction – rather than waiting until there is "residual profit" – seems more consistent with the notion that the market is an integral component of an MNE's value chain and, therefore, a source of total profit. Finally, it seems within the realm of possibility to allocate

[106] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at pp. 191–195.
[107] See Michael J. Graetz, "A Major Simplification of the OECD Pillar 1 Proposal" (2021)101:2 Tax Notes Intl 199 at p. 219; Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 190 ["RPAI should also create less economic inefficiency and be less susceptible to tax avoidance than other RPA schemes, including that proposed by Avi- Yonah et al, although this does come at the price of greater complexity"].
[108] Pasquale Pistone, *et al,* "Comments by The International Bureau of Fiscal Documentation (IBFD) Task Force on the Digital Economy on the OECD Public Consultation Document "Secretariat Proposal for a 'Unified Approach' under Pillar One" (2019) at p. 3.
[109] Pasquale Pistone, *et al,* "Comments by The International Bureau of Fiscal Documentation (IBFD) Task Force on the Digital Economy on the OECD Public Consultation Document "Secretariat Proposal for a 'Unified Approach' under Pillar One" (2019).
[110] ATAF, "ATAF Sends Revised Pillar One Proposals to the Inclusive Framework" (May 12, 2021) online: https://perma.cc/Y7NG-LXQA.

the total profit to both the demand and supply side without the complex classification into routine and residual profits. One scholar has demonstrated that the limitation of Amount A to residual profits has no efficiency effect in itself, and that the same results can be attained by allocating a smaller percentage of total profits.[111] There, therefore, seems to be no tangible justification for this dichotomy.[112] Instead, the residual profit allocation policy increases the complexity of Pillar 1, "yields little or no net benefit", and might be motivated by an effort to shore up the tax revenue yield of high-income states at the expense of lower-income ones.[113]

The more agitating question for lower-income countries is whether allocable residual profits should be limited and, if so, whether to 25%. Some scholars, largely for efficiency reasons, advocate that the entire residual profit should be allocated to market states.[114] Residual profit allocation (especially by the sale formular) is appealing for its presumed efficiency vis-à-vis the separate entity allocation that is inherent in the current system.[115] This method is most attractive because the third party purchasers or consumers are less mobile (especially in the case of individuals), which means that the formula is less susceptible to manipulation for tax avoidance, compared to other allocation formulas that rely on

[111] Stephen E. Shay, "The Deceptive Allure of Taxing "Residual Profits" (2021) 75:11/12 Bulletin for Int'l Tax'n 1 at p. 6.
[112] Michael J. Graetz, "A Major Simplification of the OECD Pillar 1 Proposal" (2021)101:2 Tax Notes Intl 199 at p. 219.
[113] Stephen E. Shay, "The Deceptive Allure of Taxing "Residual Profits" (2021) 75:11/12 Bulletin for Int'l Tax'n 1 at p. 7 ["A cynic might take the view that the reason the OECD looked to residual profits was to make the allocation to market countries look like more than it is and to make it harder to expand the proposal to a broader group of companies. Irrespective of the allocation method, the small ambition of Pillar One is striking. Assuming that the average profitability of firms within the scope of Pillar One is 25%, a 25% reallocation percentage would reallocate no more than 3.75% of corporate profits to market countries. For these modest amounts, Pillar One should be drafted to be as straightforward as possible in implementation"]. See also Michael J. Graetz, "A Major Simplification of the OECD Pillar 1 Proposal" (2021)101:2 Tax Notes Intl 199 at p. 219 [arguing that the OECD's decision to allocate only a portion of residual profit may be motivated by a reluctance to move swiftly – rather than incrementally – from existing profit splits, under the arm's length method that sometimes entitle the market state to only a share of the revenue from residual profits"].
[114] Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497 at p. 509; Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 192.
[115] Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497 at p. 509; Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 190.

yardsticks like assets and employment.[116] After all, it has been argued, even in high-tax states, companies have an incentive to maximize sales.[117]

There is limited information at this point on how much revenue individual market states can expect to retain by virtue of Pillar 1's 25% residual profit allocation scheme. While the OECD has claimed that Pillar 1 will realize revenues of up to $125 billion yearly,[118] the OECD has not provided a distributional chart for this aggregate revenue. Independent research by Michael Devereux and Martin Simmler, economists at the Saïd Business School, puts the aggregate distributable amount at $87 billion, which is significantly lower than the OECD projection.[119] The civil society organization (CSO) Oxfam reckons that, using GDP as an indicator of market size, only about $0.6 billion of this estimated sum would be allocated to "low-income countries", while $31 billion would go to "middle-income countries".[120] If these amounts are taxed at an average rate of 25%, the tax revenue that accrues to low-income countries and middle-income countries is $140 million and $8 billion respectively (equivalent to 0.03% of their respective GDP).[121] Apparently, these are generous estimates in the case of low- and middle-income countries because much of the profit derives from information technology MNEs, for most of whom low- and middle-income countries represent a smaller consumption share.[122]

These are remarkably small amounts, especially when accepting the deal means that lower-income countries must give up their unilateral digital taxes, even on MNEs outside the scope of the deal.[123]

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[116] Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497 at p. 509; Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021) at p. 190.

[117] Reuven S. Avi-Yonah, Kimberly Clausing and Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497 at p. 509.

[118] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) at p. 2.

[119] Michael Devereux & Martin Simmler, "Who Will Pay Amount A" (2021) EconPol Policy Brief 36/2021.

[120] Didier Jacobs, "Are the Global Tax Proposals in the Interests of Low- and Middle-income Countries?", *Oxfam* (August 16, 2021) online: https://perma.cc/S6F9-TNBD.

[121] Didier Jacobs, "Are the Global Tax Proposals in the Interests of Low- and Middle-income Countries?", *Oxfam* (August 16, 2021) online: https://perma.cc/S6F9-TNBD. .

[122] Didier Jacobs, "Are the Global Tax Proposals in the Interests of Low- and Middle-income Countries?", *Oxfam* (August 16, 2021) online: https://perma.cc/S6F9-TNBD. .

[123] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) at p. 7. In a bid to allay raging concerns amongst developing countries especially, the OECD has stressed that the termination does not apply to withholding taxes and other measures that are not equivalent to DSTs. It is, however, not been made clear where to draw the line of difference. Stephanie Soong Johnston, "Saint-Amans Rules Out 'Fantasies' on Digital Tax Rollback's Scope", *Tax Notes* (November 19, 2021) online: https://perma.cc/D24R-37Y2.

African countries, through the African Tax Administration Forum (ATAF), proposed 35% residual profit allocation,[124] while lower-income countries under the G24 have stressed that anything short of a 30% residual profit allocation to market jurisdictions would not yield any palpable benefits to them.[125] These demands were not acceded.[126]

In October 2021, Oxfam produced an independent impact assessment of the potential revenue distribution of Pillar 1 for 52 lower-income countries.[127] Oxfam compared three different profit allocation rates under Pillar 1 with a 3% digital services tax (DST) rate. The report shows that adopting a 35% reallocation (favoured by African countries) would produce a net gain of $857 million for lower-income countries – a significant improvement on the OECD's 25% allocation.[128] The analysis reveals that for Kenya, Nigeria, Argentina and Mexico:

> The single largest improvement to Pillar 1 would be to abolish the distinction between routine and non-routine profits, and instead apply the reallocation percentage to all profits and not just profits above 10% as suggested by the OECD July statement. For the four countries the removal of the 10% profitability threshold could increase the revenue by more than four times if the 35% reallocation percentage was used.[129]

Oxfam's assessment demonstrates that the negative revenue impact of Pillar 1 for most lower-income countries does not seem too significant, compared to DSTs. However, for countries like Kenya, Nigeria, Argentina, and Mexico, halving the global turnover threshold would curtail potentially substantial tax revenue losses. If halving the global turnover threshold would double the revenue for

[124] ATAF, "130 Inclusive Framework countries and jurisdictions join a new two-pillar plan to reform international taxation rules – What does this mean for Africa?" (July 1, 2021) online: https://perma.cc/6NFB-BTTA.
[125] G24, "Comments of the G-241 on the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy agreed by 134 jurisdictions of the Inclusive Framework on the 1st of July 2021" (September 19, 2021) online: https://perma.cc/Y8QM-54V9.
[126] ATAF, "A New Era of International Taxation Rules – What Does This Mean for Africa?" (October 8, 2021) online: https://perma.cc/UD4M-UYUL.
[127] Oxfam, "The Effect of the OECD's Pillar 1 Proposal on Developing Countries – An Impact Assessment" (October 2021) online: https://perma.cc/4MWH-2LWD.
[128] Oxfam, "The Effect of the OECD's Pillar 1 Proposal on Developing Countries – An Impact Assessment" (October 2021) online: https://perma.cc/4MWH-2LWD. .
[129] Oxfam, "The Effect of the OECD's Pillar 1 Proposal on Developing Countries – An Impact Assessment" (October 2021) online: https://perma.cc/4MWH-2LWD. .

these countries, it is safe to imagine that eliminating the global revenue threshold would have significant impact on their taxing rights.

Already, both Nigeria and Kenya have enacted laws that enable them to tax non-residents that do businesses in these countries through digital platforms.[130] This suggests that they do not view administrative feasibility as a barrier to their respective tax competences. Indeed, it has been observed that countries that structure their domestic legislation on a significant economic presence model would find it relatively easy to administer the tax on a formulary apportionment basis or deemed profit method and may collect such taxes by withholding.[131] The latter is a simple and effective enforcement mechanism that lower-income countries are accustomed to in taxing non-residents.[132] Both Nigeria and Kenya appear to be willing and able to tax at least some of the income outflows that would be lost under the multilateral bargain.

However, one apparent downside of that approach, especially if a withholding tax mechanism is adopted, is the impact that it could have on business and, potentially, customers.[133] A withholding tax on gross revenue does not account for expenses incurred by taxpayers. Thus, it is conventionally considered viable only in respect of enforcing passive income taxes (e.g., royalties, interest, and dividends).[134] Using it to enforce a tax on business income may induce excessive taxation, stultify innovation and discourage businesses from venturing into markets where they could be exposed to

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[130] Nigeria: Finance Act 2019, section 4(a)(ii) and Finance Act 2021, section 4, both amending the Companies Income Tax Act 1961, No. 22, Cap C21 LFN 2004, section 13(2); Companies Income Tax (Significant Economic Presence) Order 2020, subsection 1(1). Kenya: Finance Act No. 23 of 2019, section 3 and Finance Act No. 8 of 2020, section 9, both amending the Income Tax Act 1975, section 3; Income Tax (Digital Service Tax) Regulations, 2020, subsection 4(3).

[131] Adriana Sanchez Castro, "Administrative Capability Analysis of OECD Proposals from the Perspective of Developing Countries" (2020) 48 Intertax 218 at pp. 225–226.

[132] Withholding tax on business profits is, however, discouraged because it has a greater risk of double taxation and may also be passed on to consumers. This kind of enforcement mechanism is more suitable for passive income rather than active business income, which requires net basis assessment. See Barry Larking, "A Review of Comments on the Tax Challenges of the Digital Economy" (2018) Tax Notes Intl 17; Ayush Tripathi and Shefali Mehta, "Taxation of Digitalized Economy: Analysing the United Nations Article 12B", *ELP Associates & Solicitors* (2021) online: https://perma.cc/2XDY-2TXV; Danish Mehboob, "UN Digital Tax Proposal Diverges from OECD Two-pillar Solution", *Int'l Tax Rev* (August 17, 2020) online: https://perma.cc/RV3B-Q42V.

[133] Danish Mehboob, "UN Digital Tax Proposal Diverges from OECD Two-pillar Solution", *Int'l Tax Rev* (August 17, 2020).

[134] Ayush Tripathi and Shefali Mehta, "Taxation of Digitalized Economy: Analysing the United Nations Article 12B", *ELP Associates & Solicitors* (2021) online: https://perma.cc/2XDY-2TXV at p. 1.

withholding tax on gross revenue.[135] This is precisely the kind of outcome that countries strive to avert through a coordinated international tax system. That approach could be especially hurtful to young and low-margin businesses that are incapable of absorbing potential losses attributable to tax losses.[136] Unfortunately, unjust deals can become the catalyst for such distortive unilateral tax policies. It is ominous that lower-income countries – including those that accepted the OECD Agreement – continue to reject a provision in the deal that would bar them from enacting digital tax legislation in the future.[137] Policymakers must endeavour to make international bargains like the OECD Agreement fair and truly inclusive to avert such spiralling discontent. A multilateral deal like Pillar 1 can enhance efficiency and effective taxation, provided that its potential for doing so is not undermined by a lack of allocative justice, as we see in this case.

Conclusion

More than a century since such an endeavour was first undertaken on a broad multilateral scale, the crafting of international tax rules remains a vital – and controversial – subject that occupies the thinking of tax policymakers and scholars. This is unsurprising because of the known and potential implications of such system design on the allocation of taxing rights (and tax revenue) between countries. Because of its implicit revenue ramifications – more so for lower-income countries – the allocation of taxing rights is often framed as a justice issue (inter-nation equity). In this piece, we have sought to present a streamlined case of inter-nation equity (allocative justice) for lower-income countries in the context of the OECD-coordinated international agreement for taxation of the digital economy. This piece begins by presenting a normative case for the entitlement of lower-income countries to tax the income of MNEs in the digital economy. This normative entitlement to tax as a market state predates the emergence of digitalisation or the current OECD work. However, the current Pillar 1 bargain acknowledges changing conditions, i.e., an evolving understanding of what creates value for

[135] Jack Purcher, "U.S. Chamber of Commerce Urges the Trump Administration to Block Canada's Proposed France-Styled Tax on U.S. Tech Companies", *Patently Apple* (November 15, 2019) online: https://perma.cc/P3E8-4N94.
[136] Barry Larking, "A Review of Comments on the Tax Challenges of the Digital Economy" (2018) Tax Notes Intl 17 at pp. 20–21.
[137] FE Bureau, "India, others oppose OECD plan on future digital taxes", *Financial Express* (August 19, 2022) online: https://www.financialexpress.com/economy/india-others-oppose-oecd-plan-on-future-digital-taxes/2635574/.

businesses and the fact that we can do better to enforce tax rules. We stress the point that the OECD Agreement is a compromise that limits the taxing rights of countries with the aim of achieving efficiency objectives, i.e., better taxing MNEs without distorting and discouraging their engagement in cross-border economic activities. The question is how far reaching should the restrictions be, especially in the case of lower-income countries? We contend that while some of the Pillar 1 scope, nexus and profit allocation thresholds may be well-intended, thinking in terms of efficiency, they are unduly restrictive on the taxing rights of some lower-income countries – who can, therefore, not be expected to swallow the deal as it is. While there are visible attempts within the OECD Agreement to address allocative justice concerns (e.g., the "small jurisdictions" nexus carveout), it is evident that these tweaks are inadequate to address the issue for at least some lower-income countries (e.g., Kenya and Nigeria). Indeed, the proposed constraints (scope, nexus and profit allocation percentage) reflect what is a familiar problem: the ability of high-income countries to impose standards, mediated through the OECD, that may not work given a more "inclusive" approach to international relations. This problem is part of what has generated some of the revenue deficits (and as a result, development deficits) in lower-income countries.

In our view, the OECD and high-income countries, including Canada, need to do better to address these concerns. They cannot on the one hand claim to be interested in advancing sustainable development goals while at the same time imposing new "consensus" approaches on lower-income countries that research reveals will limit lower-income countries fair share (normatively speaking) of the tax revenue associated with the activities of MNEs. This analysis is not predicated on redistribution or tax aid. Rather, it is about (1) recognizing (a) the normative claim that market states have to the allocation of both taxing rights and associated value of contribution/revenue from the provision of consumers and a market, (b) the ability of those states to, in fact, enforce those taxing rights; and (2) preserving those accrued taxing rights. When high-income countries demand lower-income countries accede to concessions of those rights, they knowingly continue to hold lower-income countries in positions of relative impoverishment, potentially to their own detriment.

More dramatically, while most countries have, in principle, signed up to the OECD Agreement, the deal's extensive limits in scope, nexus, and profit allocation, as well as the OECD's attempt to impose an unduly restrictive bargain on lower-income countries, could pose substantial risks for the stability of the international tax system – and, by extension, international business. The risk that some countries may find the accruable taxes inadequate – vis-à-vis their normative entitlement – could see them pivot back to imposing unilateral taxes, which would not augur well for businesses. It is worth stressing that many of the Inclusive Framework members, including high-income countries like France and Canada, have in place a unilateral digital tax legislation that may be applied under certain circumstances, while lower-income countries like Nigeria and Kenya already have active legislation. The prospect of dissatisfied countries jettisoning the OECD Agreement and doing things their own way is a concern for international businesses because of the potential exposure to double taxation, gross income taxation (withholding taxes) and multiple compliance burdens that may in some cases involve small amounts of sales. A multilateral solution that delivers allocative justice for all countries is, undoubtedly, the preferred outcome.