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A New Framework for Digital Taxation

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The international tax regime has wide implications for business, trade, and the international political economy. Under current law, multinational enterprises do not pay their fair share of taxes to market countries where profits are generated because market countries are only allowed to tax companies with a physical presence there. Digital companies, like Google and Amazon, can operate entirely online, thereby avoiding market country taxes. Multinationals can also exploit existing tax rules by shifting their profits to low-tax jurisdictions, thereby avoiding taxes in the residence country where their headquarters are located.

Recently, a global tax deal was reached to tackle these issues. Proposed by the OECD/G20 Inclusive Framework and endorsed by nearly 140 countries, this global tax deal sets forth two Pillars that reform the outdated international tax regimes. Pillar One addresses digital taxation while Pillar Two addresses a global minimum tax. However, it is doubtful that the global tax deal will be successfully implemented, especially with respect to Pillar One. As the details of Pillar One have become increasingly complex and degraded by political compromises and carveouts, it risks being a framework without substance. Also, countries are unlikely to repeal an established tax instrument, Digital Services Taxes ("DSTs"), which is an adamant requirement of the United States in adopting Pillar One.

This Article offers the first comprehensive critique of the global tax deal and assesses its prospects and problems. It evaluates the U.S. response to the proposed global deal and to DSTs. It presents the challenges, such as treaty overrides, that will occur if the United States implements Pillar One by executive agreement so as to bypass the treaty ratification. This Article suggests separating the two Pillars to preserve the global minimum tax. Regarding DSTs, the Article provides several empirical studies that demonstrate the harm retaliatory tariffs cause. Finally, it endorses the U.N. digital taxation proposal and proposes a new Data Excise Tax as normative alternatives.

INTRODUCTION

On October 8, 2021, 136 countries signed on to the Organisation for Economic Co-operation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") statement ("the Statement") for reforming international corporate taxation in the digitalized economy.[1] There are now 137

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1. OECD, OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT, STATEMENT ON A TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGTIALISATION OF THE ECONOMY (2021) [hereinafter STATEMENT].

signatories, including not only the OECD/G20 members, but also most developing countries.[2] Directed towards bringing the international tax regime into the twenty-first century, the global tax deal is the culmination of over a decade of work and diplomacy. However, the outcome is still dependent on plan specifics in upcoming discussions and national implementation legislations.

The existing international tax regime was developed during the 1920s and 1930s for a brick-and-mortar world. This outdated system has been unable to address two key problems in today's global, digitalized world. First, multinational enterprises are currently only obligated to pay corporate income tax in foreign market countries (or source countries) where they have a physical presence, such as an office or factory. Because tech giants such as Google, Facebook, and Amazon are now able to generate revenue from market countries entirely online, without ever establishing a physical presence, they can avoid paying sufficient taxes to those market countries. Second, multinational enterprises also avoid taxes in residence countries by shifting profits to subsidiaries in low-tax jurisdictions. The intangible nature of modern assets such as trademarks, software, and other intellectual property allows multinationals to shift earnings and profits away from the higher-tax residence countries where their headquarters are located. The OECD estimates that the resulting corporate tax avoidance costs $100 billion to $240 billion annually, which amounts to four to ten percent of global corporate tax revenue.[3]

The global tax deal, as articulated in the Statement announced in October 2021, addresses today's tax challenges with two pillars that are distinct from each other. To solve the problem of market country taxation in the global, digitalized world, Pillar One modifies existing profit allocation and nexus rules. Pillar One allocates part of a multinational's residual profits to market jurisdictions even if the multinational has no physical presence in those market countries.[4] Pillar Two aims to curtail profit shifting and tax base erosion by leveling the playing field with a fifteen percent global minimum tax.[5] This Article examines the details of this monumental new tax framework and critically assesses its mixed prospects of success. It offers guidelines for U.S. international tax policy and highlights alternative proposals for global policymakers to consider.

Pillar One of the Statement features a new taxing right, namely Amount A. Amount A eliminates the physical presence requirement and, by allocating part of a multinational's residual profits to market countries based on a formula, permits those countries to tax the multinational. Incorporating a

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2. OECD, *International Collaboration to End Tax Avoidance*, http://www.oecd.org/tax/beps/.

3. OECD, OECD/G20 Inclusive Framework on BEPS, 5th Meeting of the Inclusive Framework in Lima, Peru (June 27–28, 2018) [hereinafter OECD, IF Flyer].

4. *See infra* Section I.B.1.

5. *See infra* Section I.B.2.

recent proposal of the Biden Administration, the Statement limits the application of Amount A to multinational enterprises with global revenue above twenty billion euros and profitability above ten percent (that is, profit before tax divided by revenue).[6] For a multinational within scope, a new special purpose nexus rule permits allocation of Amount A to market countries when the company derives at least one million euros in revenue from that jurisdiction.[7] But the information revealed so far envisages far-reaching changes to the international tax regime by partially abandoning the arm's length principle and the physical presence requirement in order to provide greater taxing rights to market countries. Pillar One will be implemented by a multilateral tax treaty coming into effect in 2023.

Pillar Two envisages the implementation of a global minimum tax levied on multinational enterprises that meet a threshold of €750 million in revenue—regardless of the jurisdiction where the multinationals are headquartered or operate.[8] If a subsidiary's income is taxed below the minimum tax rate, which is currently proposed at fifteen percent, the parent entity will be required to include such income as parent company income and pay the difference in additional taxes to its residence country. If the residence country has not enacted this rule, either the affiliated entity's deduction would be denied or an equivalent adjustment would be made. Pillar Two will therefore result in the single tax principle or full taxation.[9] Because Pillar Two may be implemented by individual countries through domestic legislation, a formal treaty agreement is not required. The OECD expects that it will be implemented by 2023. As Pillar Two is examined in a companion article, this Article will not discuss it in detail.[10]

The successful enactment of the global tax deal, especially Pillar One concerning digital taxation, is in peril. First, Pillar One requires a multilateral treaty for global implementation, which is expected to amend articles on physical presence and business profits of all existing bilateral tax treaties. It would be logistically and politically challenging to bring almost 140 countries on board to the multilateral treaty. Furthermore, in the United States, it would be very hard to get this through the Senate for ratification. Even if the United States relies on an executive agreement, it would be challenging

6. For in-scope companies, residual profit—defined as profit in excess of ten percent of revenue—will be allocated to market jurisdictions with nexus using a revenue-based allocation key. STATEMENT, *supra* note 1, at 1.

7. For smaller jurisdictions with GDP lower than €40 billion, the nexus will be set at €250,000. *Id.*

8. Such tax base will be determined by reference to financial accounting income. *Id.* at 2.

9. The single tax principle provides that corporate profits should be subject to a minimum tax and that if the country with the primary right to tax such income (source or residence) does not impose tax at the minimum level, the other country involved should tax it. For the single tax principle, *see* Reuven Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy*, 59 N.Y.L. SCH. L. REV. 305 (2015); for full taxation, *see* Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353 (2020).

10. Reuven Avi-Yonah and Young Ran (Christine) Kim, *Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax*, 43 MICH. INT'L L.J. 505 (2022).

to obtain majority support in Congress and would invite many legal issues relating to treaty overrides by executive agreements, which is largely uncharted legal territory.[11]

Second, countries may be unwilling to relinquish an established tax instrument, the Digital Services Taxes ("DSTs"). DSTs have been unilaterally developed and implemented over the past couple of years by countries seeking to tax the digital service activities of the world's tech giants. DSTs are currently in effect in the United Kingdom, France, and fifteen other countries. The European Union ("E.U.") has proposed a similar tax for its entire twenty-seven-member bloc. These DSTs are imposed on companies' gross revenue, as opposed to net income, at relatively low rates. Because the tax is assessed on gross revenue, U.S. companies are unable to utilize the foreign income tax credit to offset this tax from their U.S. tax liabilities. DSTs are imposed on the provision of digital services, regardless of whether they are provided for free (like Google and Facebook) or for payment (like Amazon and Uber). They have been criticized as discriminatory towards U.S. tech giants, and the July 2021 Inclusive Framework Statement called for the removal of unilateral DSTs in exchange for the new Pillar One tax regime.

However, the E.U. announced that it still intends to implement its own digital levy in 2023.[12] The United Nations has also announced that it is considering adding special provisions for income from automated digital services to Article 12B of the U.N. Model Tax Convention.[13]

The continued use and further enactment of DSTs by individual countries and governing entities presents a perilous obstacle to the successful implementation of the Pillar One tax regime. A previous attempt, the OECD Base Erosion and Profit Shifting Project ("BEPS 1.0"), failed because the United States resisted what it felt were discriminatory taxes against its tech industry.[14] Ironically perhaps, it was the very failure of the BEPS 1.0 tax proposal that served as a catalyst for individual countries to begin imposing new digital taxes unilaterally.

This Article argues that the claim that DSTs represent discriminatory taxation against U.S. tech giants is baseless, even ironic. U.S. tech giants dominate the world market in digital services and the primary reason that they are more predominantly affected by DSTs is because they have no real foreign competition. If and when an Alibaba or a Tencent becomes a truly

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11. *See infra* Section III.A.

12. Eur. Comm'n, *A Fair & Competitive Digital Economy – Digital Levy*, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12836-A-fair-&-competitive-digital-economy-digital-levy_en [https://perma.cc/7KS2-ZXE8] [hereinafter *EU Digital Levy*].

13. Comm'n of Experts on Int'l Cooperation in Tax Matters, Twenty-Second Session, Item 3(i) of the Provisional Agenda, Tax Consequences of the Digitalized Economy–Issues of Relevance for Developing Countries, U.N. Doc. E/C.18/2021/CRP.1 (Apr. 6, 2021) [hereinafter U.N. Proposal].

14. *See generally* OECD, Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report (2015) [hereinafter OECD, Action 1] (describing the implementation of Action 1).

global digital service provider, they would instantly be subject to the same DSTs. Furthermore, DSTs cannot be dismissed solely because they are unilateral. Sovereign countries cannot be prevented from imposing taxes on income that they can show has been derived from their jurisdiction. The unilateral move to implement a DST is not contrary to the "first bite at the apple" rule of international taxation, whereby source countries have primacy in taxation because source comes before residence in time.[15] The United States has carried out unilateral moves in international tax for decades, without seeking or awaiting consent from any other country.[16] Demonizing DSTs simply because they are "unilateral" is unjustified.

Moreover, the United States' response to the DSTs has been particularly unsettling. The United States Trade Representative ("USTR") adopted trade sanctions on France (currently suspended due to the pending global negotiations) and is threatening to adopt similar sanctions against other countries implementing DSTs. However, the USTR investigation report on France's DST contains many biases and exaggerations that directly influenced its conclusion that France's DST is discriminatory. This Article scrutinizes the USTR report, unpacks its notable errors, and focuses on its selective bias and revenue threshold analysis.[17] More importantly, the Article asserts that tariffs are inefficient, regressive, and cause a net harm to economies by raising costs for companies and consumers.[18]

To demonstrate this point and build a case against retaliatory tariffs, this Article conducts the first empirical analysis of the DST tariff imposed on the import of French sparkling wine.[19] The U.S. sparkling wine importers were chosen by the USTR as "sacrificial companies" to protect Google, Apple, Facebook, and Amazon ("GAFA"), arguably harmed by France's enactment of DST. The DST tariff increased the costs to importers, and thus reduced their profit margins, creating negative effects to the sacrificial companies that were mostly small and medium in size. Worse yet, this Article reveals that the DST retaliatory tariffs have neither caused financial harm to the French wine industry nor have pressured France to discard its DST, therefore failing to accomplish their intended objectives.

Built upon this discussion, this Article offers policy criteria for digital taxation.[20] Reflecting the tax challenges in the digital economy, any policy proposal should be able to overcome the outdated physical presence nexus

15. Reuven Avi-Yonah & Gianluca Mazzoni, *Taking The First Bite: Who Should Tax Apple's $187 Billion In Ireland?*, 3–4 (Univ. Mich. L. & Econ., Working Paper No. 16-033, 2017).

16. Examples include foreign tax credits, controlled foreign corporations, and denying treaty benefits to hybrid entities. *See* Reuven Avi-Yonah, *Constructive Unilateralism: U.S. Leadership and International Taxation* 2–9 (U. Mich. Pub. L. & Legal Theory Rsch. Paper Ser., Paper No. 463, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2622868.

17. *See infra* Section III.A.2.

18. Kimberly Clausing, *The Progressive Case Against Protectionism*, 98 FOREIGN AFF. 109, 115 (2019).

19. *See infra* Section III.A.4.

20. *See infra* Section IV.A.

and fairly allocate the appropriate tax revenue to market countries. Furthermore, an effective policy proposal should be free from any indicia of discrimination towards companies based on their nationality. Finally, a policy proposal needs to be administrable by both tax administrations and taxpayers alike. A simple, targeted approach may in fact work better and more efficiently than an ambitious, comprehensive approach that inevitably invites political compromises.

The Article next details two compatible digital taxation proposals: a multilateral solution and a unilateral measure. First, this Article endorses the U.N. proposal for Article 12B of the U.N. Model Tax Convention for income from automated digital services.[21] This multilateral proposal eliminates the physical presence requirement only for certain digital services, defined as automated digital services. Market countries can tax income from automated digital services on a "gross basis" at a modest rate (three or four percent) with an option to the taxpayer to pay tax on a "net basis." The U.N. proposal is a much more simplified approach compared to Pillar One. It reflects the needs of many developing countries with limited administrative capacity. Hence, this Article believes that the U.N. proposal can serve as a simple, reliable, and efficient method to upgrade income taxation for the digital economy, while also identifying issues that can be improved.

Second, as a unilateral measure, this Article proposes a new data excise tax inspired by several existing proposals.[22] The tax base would be calculated by the volume of collected data, measured in gigabytes. It would only apply to for-profit data collectors, with a safe harbor threshold rule to prevent taxation of individual users and small businesses. Because the proposed tax would not be measured in gross revenue or profits, it would likely avoid the suspicion currently directed at DSTs and accusations that it is a disguised income tax or discriminatory tax based on the nationality of the businesses. As an excise tax, it would be easy to administer, and could be implemented either independently by a market jurisdiction or together with a multilateral solution. The proposed digital excise tax could serve as a model for foreign countries as well as the E.U., which is preparing to implement a new digital levy. As an excise tax, it is also a potential option that states and localities could adopt.

The multilateral and unilateral proposals are compatible with each other so that policymakers may adopt them individually or collectively. In addition, the diversified designs provide more options for policymakers with different propensities; the multilateral measure is based on an income tax regime, whereas the unilateral proposal is an excise tax, which is a subcategory of consumption tax. Such diversified designs may provide more options to a wide array of policymakers.

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21. *See infra* Section IV.B.

22. *See infra* Section IV.C.

This Article is the first extensive critique of the potential impacts of the monumental global tax deal in October 2021, and assesses the prospects and problems of reforming the international tax regime. In particular, this Article makes several contributions.

First, by addressing the encompassing issues, this Article contributes not only to the scholarship of international tax law and policy, but also to trade policy, international law, and the political economy. Hence, it may resonate with broad audiences in each field and interdisciplinary readers interested in this topic. In the same vein, this Article offers insights into both the global minimum tax of Pillar Two, as well as the digital taxation in Pillar One, which is the main theme of this Article.

Second, this Article evaluates the current U.S. response to the proposed global deal and DSTs, and offers a possible action guide at both the international and domestic levels. The United States maintains the position that the two Pillars are inseparable and should be dealt with as a package deal. Yet the Pillar One proposal is not promising because it reflects too many conflicting voices. Due to the multiple compromises, the proposal deviates from the original goal, which is to address the tax challenges in the digital economy. It has become too complex and has degenerated into a framework without substantive solutions. However, the global minimum tax proposals in Pillar Two conform to the U.S. policy goal of leveling the playing field for the purpose of promoting free trade and fair competition. Most of the Pillar Two proposals can be implemented by domestic legislation. Thus, it is worth considering the two Pillars separately, and pursuing Pillar Two alone if Pillar One becomes unachievable or too politically time-consuming to complete at this time.

Third, this Article provides a balanced view towards the DSTs. It criticizes the prevalent view of DSTs as being discriminatory and warns of the harms that engaging in a global trade war entails. However, it also notes the possible flaws of DSTs.

Finally, the Article provides normative alternative proposals for U.S. and international policymakers considering digital taxation. By exploring such proposals and evaluating them under criteria developed for a good digital tax policy, this Article will offer valuable insights to policymakers seeking to develop better tax policies.

The remainder of this Article proceeds as follows. Part I provides an overview of the history of digital tax reforms and DSTs. It also examines the Pillar One and Two proposals in the global tax deal with greater details. Part II reveals the legal, political, and economic challenges of the proposed global deal. It indicates the complexity caused by multiple rounds of political compromises and the lack of concrete solutions. Part III advises guidelines that the United States should consider with regards to the global deal and DSTs. It explains the dilemma that the United States might face if it uses executive agreements to implement Pillar One and suggests severing

the two pillar proposals and maintaining an objective perspective for DSTs. The case studies in this Part support the argument that the United States should avoid a harmful trade war. Part IV offers normative proposals for digital taxation. It develops important policy criteria, endorses the U.N. proposal as a multilateral measure, and proposes a new data excise tax as a unilateral alternative. The Article concludes that the international tax reform represents both a revolution and an evolution, to which the Article aims to contribute.

I. The Evolution of Digital Tax Reform Proposals

This Part describes the history of international tax reform proposals to deal with the tax challenges in the global, digitalized economy in the twenty-first century. It starts with the BEPS 1.0 project in the first half of the 2010s, which failed to achieve complete success due to the project's limitation in digital taxation, which in turn stimulated market countries to adopt unilateral tax measures. In response, the global community launched the BEPS 2.0 project, consisting of the two Pillars, producing the Statement in October 2021. Part II provides for a critical assessment of its results.

A. BEPS 1.0 and the Rise of Digital Services Taxes (DSTs)

Over the past decade, a revolution has begun in international taxation. International taxation rules were developed in the 1920s and 1930s.[23] They have been criticized as being outdated—for example, by requiring physical presence for nexus—and as vulnerable to tax competition, tax base erosion, and profit shifting. Countries that had previously been content to live with such outdated rules came to a collective understanding after the financial crisis of 2008–10 that the rules must be changed.

Under political pressure, the G20, comprised of the twenty largest economies in the world, forced the OECD to begin redrafting the ground rules of international taxation. The result was the Base Erosion and Profit Shifting ("BEPS") project—BEPS 1.0—which from 2013 to 2015 advanced fifteen actions designed to counter multinational corporations' ability to engage in tax avoidance through profit shifting and other accounting measures.[24] In 2015, OECD Secretary General Angel Gurria declared that

> The measures we are presenting today represent the most fundamental changes to international tax rules in almost a century: they will put an end to double non-taxation, facilitate a better alignment of taxation with economic activity and value creation, and

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23. Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 Duke L.J. 1021, 1023–24 (1997).

24. *BEPS Actions*, OECD, https://www.oecd.org/tax/beps/beps-actions/ [https://perma.cc/T5PW-GSCV].

> when fully implemented, these measures will render BEPS-inspired tax planning structures ineffective.[25]

This declaration was overly optimistic: The G20 and OECD failed to reach a consensus on a number of issues, the most critical of which was Action 1, addressing the digital economy.[26] While France and other E.U. members pushed for changes to existing "permanent establishment" ("PE") tax rules—that is, physical presence requirement for tax nexus—to enable more source-based taxation of profits from the digital economy, the United States resisted any attempts that would impose additional taxation on its tech giants, such as Amazon, Apple, Facebook, Google, and Netflix.[27]

Given the failure to achieve consensus in the OECD or a multilateral, international system of taxation, countries unilaterally started to adopt their own measures. The pioneer was the United Kingdom, which in 2015 adopted a diverted profits tax ("DPT"), which taxed the tech giants on the profits of the "avoided PE" that would have been subject to taxation if the permanent establishment rules were different.[28] The United Kingdom was followed by Australia, which adopted the "Netflix tax,"[29] and India, which adopted the first "digital services tax,"[30] a tax on the provision of digital services as well as the use of local consumer data to sell targeted advertising (thus applying to the business models of Amazon, Facebook, and Google). France then adopted its own DST, which was followed by fifteen other jurisdictions passing various iterations of a DST.[31] A broad, multilateral tax in the form of a digital levy implemented across the entire twenty-seven-member E.U. bloc was also proposed.[32] DSTs are widespread (as shown in Chart

25. OECD, *OECD Presents Outputs of OECD/G20 BEPS Project for Discussion at G20 Finance Ministers Meeting* (May 5, 2015), https://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm [https://perma.cc/PV7F-9SXR].

26. OECD, ACTION 1, *supra* note 14.

27. Mason, *supra* note 9, at 397–98 (2020); *U.S. Sees Unilateral Taxes on Web Giants As 'Discriminatory': Treasury Official*, REUTERS (Mar. 12, 2019), https://reuters.com/article/us-usa-tax-harter-idUSKBN1QT1CT [https://perma.cc/NLP5-SQQ6].

28. Finance Act 2020, c. 39-72 (UK); Stephanie Soong Johnston, *U.K. Digital Services Tax Becomes Law, Stoking Trade Tensions*, TAX NOTES TODAY INT'L (July 23, 2020), https://www.taxnotes.com/tax-notes-international/digital-economy/uk-digital-services-tax-becomes-law-stoking-trade-tensions/2020/07/27/2crds?highlight=stephanie%20Soong%20Johnston%2C%20U.K.%20Digital%20Services%20Tax%20Becomes%20Law%2C%20Stoking%20Trade%20Tensions (last visited Apr. 14, 2022).

29. Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016 (Austl.); *see also* Lance Cunningham & Meera Pillai, *Insight: 2019 Australian "Election" Budget-Significant International Tax Measures*, BLOOMBERG TAX (Apr. 22, 2019), https://news.bloombergtax.com/transfer-pricing/insight-2019-australian-election-budget-measures-of-international-significance?context=search&index=8 [https://perma.cc/L6N8-EBJ4].

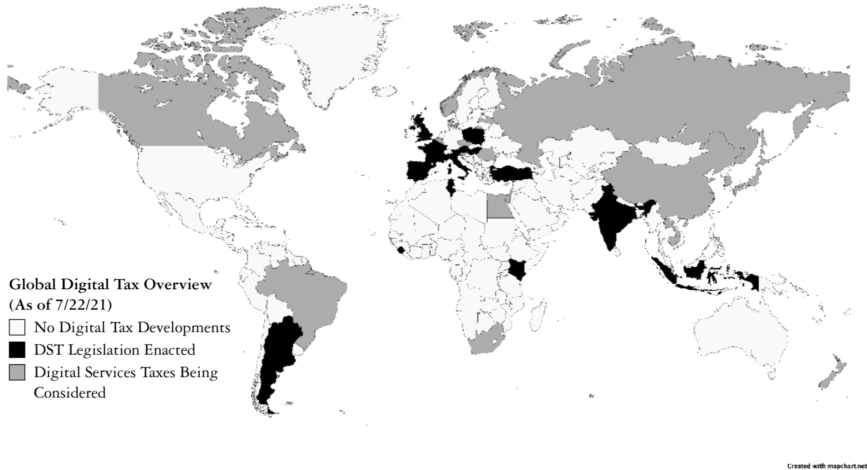
30. The Finance Act, 2016 (India).

31. *See e.g.*, Liz Alderman, *France Moves to Tax Tech Giants, Stoking Fight with White House*, N.Y. TIMES (July 11, 2019), https://www.nytimes.com/2019/07/11/business/france-digital-tax-tech-giants.html [https://perma.cc/W939-G5JS].

32. *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, COM (2018) 147 final (Mar. 21, 2018).

1) and are now considered the status quo in international tax, as Michael Graetz of Columbia Law School commented in 2019.[33]

Chart 1. Countries Enacted or Proposed DSTs[34]



The United States responded to the implementation of unilateral DSTs by adopting trade sanctions against France—which are currently suspended pending OECD negotiations—and threatening to do the same to other jurisdictions.[35] More detailed analysis of DSTs, the U.S. response of tariffs, and a potential trade war is discussed *infra* Section III.C.

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33. Michael Graetz, Professor of Tax Law, Columbia Law School, Speech at the 2019 USCIB/OECD International Tax Conference (June 3, 2019).

34. Chart 1 is created by the author based on the data released by KPMG. KPMG, Taxation of the Digitalized Economy 5 (July 22, 2021), https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf. Below is the list of countries in Chart 1.

1) Countries where a DST has been implemented (marked in BLACK): Argentina, Austria, France, Hungary, India (Equalisation Levy), Indonesia (Electronic Transaction Tax), Italy, Kenya, Paraguay, Poland, Portugal (Exhibition Levy & Annual Levy), Sierra Leone, Spain, Tunisia, Turkey, and the United Kingdom.
2) Countries that have proposed or publicly considered a DST (marked in GRAY): Belgium (to enact in 2023 if OECD consensus fails), Brazil, Cambodia, Canada, China, Czech Republic, Denmark, Egypt, Israel, Japan, Latvia, New Zealand, Norway, Romania, Russia, Singapore (to enact if OECD proposal fails), Slovenia, South Africa (to enact if OECD proposal fails), and South Korea.
3) Jurisdictions that have enacted or are considering income-tax based digital tax approaches, such as digital PE, are not included in Chart 1: Costa Rica, Greece, Hong Kong, Malaysia, Mexico, Nigeria, Pakistan, Slovakia, Taiwan, Thailand, Uruguay, Vietnam, and Zimbabwe.

35. Press Release, United States Trade Representative, USTR Announces Initiation of Section 301 Investigation into France's Digital Services Tax (July 10, 2019), https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/july/ustr-announces-initiation-section-301 [https://perma.cc/58C7-GFMU].

B. The Global Tax Deal Statement as BEPS 2.0

The G20 and the OECD responded to these developments in 2018 by beginning work on BEPS 2.0. Notably, the BEPS 2.0 project has expanded the discussion group to include both developed and developing countries, because the international tax reform consisting of two pillars would only succeed if they were supported by the global community. As a result, 139 countries are now participating in the OECD/G20 Inclusive Framework on BEPS 2.0 towards the development of consensus-based, long-term solutions.[36]

BEPS 2.0 consists of two pillars.[37] Pillar One concerns modifying profit allocation and nexus rules.[38] It aims to allocate a part of corporations' residual profits to market countries even if the corporation has no physical presence in those countries.[39] Pillar Two's provisions are a direct extension of the "global intangible low-taxed income (GILTI)" and "base erosion and anti-abuse tax (BEAT)," enacted as part of the U.S. Tax Cuts and Jobs Act ("TCJA") of 2017.[40] It aims to introduce a global minimum tax to level the playing field.[41] Several rounds of proposals have been circulated, but this subsection will discuss the three most important developments: (1) the Report on Pillar One Blueprint (hereinafter, Pillar One Blueprint),[42] (2) the U.S. proposals by the Biden Administration,[43] and (3) the most recent Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the Statement), released in October 2021.[44]

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36. OECD, IF Flyer, *supra* note 3. For the composition of the Steering Group, see OECD, Composition Of The Steering Group Of The Oecd/G20 Inclusive Framework On Beps (2021). Mitchell Kane and Adam Kern note this expansive group of Inclusive Framework that has led the global tax deal and argue that Pillar One has cleared for a more progressive international tax reform, called "progressive formulary apportionment." They propose to create an additional item, called "Amount D," in the Pillar One regime, which would apportion certain amounts of nonroutine profit to developing countries based on the economic needs rather than tax nexus to the profits. Mitchell Kane & Adam Kern, *Progressive Formulary Apportionment: The Case for 'Amount D,'* 171 Tax Notes Fed. 1713 (2021). Although we agree that international tax policy needs to consider "equitable" allocation of profits more seriously, the concept of Amount D would need further discussion on why the tax system, instead of the foreign aid program for example, should be used to support developing countries that lack tax nexus to the profits.

37. *See* OECD, Tax Challenges Arising from Digitalisation – Interim Report 2018 (2018); *see also* OECD, Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note (2019); OECD, Public Consultation Document, Secretariat Proposal for a "Unified Approach" under Pillar One (2019).

38. OECD, Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint 3 (2020) [hereinafter OECD, Pillar One Blueprint].

39. *Id.* at 8.

40. OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint (2020) [hereinafter OECD, Pillar Two Blueprint].

41. *Id.* at 3.

42. OECD, Pillar One Blueprint, *supra* note 38.

43. U.S. Department of the Treasury, Presentation by the United States to the Steering Group of the Inclusive Framework Meeting (Apr. 8, 2021).

44. Statement, *supra* note 1.

1. *Pillar One for the Digital Economy*

At the start of the BEPS 2.0 discussion, Pillar One aimed to offer new nexus and profit allocation rules for the digital economy. It recognized that, especially with digital platforms where participation of users in market countries is important, the allocation of taxing rights with respect to business profits could no longer be determined solely by physical presence.[45] The new rules developed through BEPS 2.0 are based on net basis taxation to avoid double taxation and be as simple as possible.[46]

However, after several rounds of proposals for discussion and the release of the Pillar One Blueprint, Pillar One no longer solely targets the digital economy, especially digital platforms where the new tax challenges were significant. It rather targets any business sector that meets its revenue threshold and profitability, even if the business is not part of the digital sector.[47] This is especially odd considering that the title of the Statement still declares that its purpose is "to address the tax challenges arising from the digitalization of the economy."[48] This Article suggests that the initial focus of Pillar One, which is the digital economy, ought to be emphasized. Below are the key developments of Pillar One.

a. Pillar One Blueprint

The Pillar One Blueprint, released in October 2020, is the first comprehensive proposal to expand the taxing rights of market countries.[49] The new concepts revealed in the Blueprint, called Amounts A and B, were devised for this purpose. Amount A focuses on the new taxing right of market countries by eliminating physical presence requirements,[50] whereas Amount B allocates certain amounts of fixed returns arising from marketing and distribution activities to market countries where businesses have physical presence.[51] In addition to these two concepts, the other goals of Pillar One are to

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45. Young Ran (Christine) Kim, *Digital Services Tax: A Cross-Border Variation of the Consumption Tax Debate*, 72 Ala. L. Rev. 131, 155–58 (2020).

46. OECD, Pillar One Blueprint, *supra* note 38, at 10.

47. *See e.g.*, Comment from Katherine Amos, Louise Weingrod & Kris Bodson, Johnson & Johnson, to OECD Centre for Tax Policy and Administration on OECD Tax Challenges Arising from Digitalisation—Report on the Pillar One Blueprint 2–3 (Dec. 14, 2020) (on file with authors).

48. Statement, *supra* note 1.

49. Before the Pillar One Blueprint, the OECD released several rounds of discussion drafts. *See, e.g.*, OECD, Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, *supra* note 37; OECD, Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy (2019); OECD, Public Consultation Document, Secretariat Proposal for a "Unified Approach" under Pillar One (2019).

50. OECD, Pillar One Blueprint, *supra* note 38, at 8.

51. Unlike Amount A, Amount B still requires physical presence, and the results are intended to simplify the administration of traditional transfer pricing rules based on the arm's length principle. *Id.* at 15.

significantly improve tax certainty and dispute resolution mechanisms, and to have relevant unilateral measures (such as DSTs) removed.[52]

Below are the key design elements of Amount A, which have shown the most dramatic development in the subsequent negotiations.

Scope: Amount A applies only to consumer-facing businesses ("CFB") and businesses performing automated digital services ("ADS").

A CFB is "a business that supplies goods or services, directly or indirectly, that are of a type commonly sold to consumers, and/or licenses or otherwise exploits intangible property that is connected to the supply of such goods and services."[53] The Blueprint does not offer examples, but Chanel (supplying luxury goods), Starbucks (supplying branded foods and refreshments), Johnson & Johnson (supplying pharmaceuticals), and Mercedes-Benz (supplying automobiles) would be included.[54]

An ADS is a service that is either: (i) on the positive list, such as online advertising services, online search engines, social media platforms, and digital content services;[55] or (ii) is automated (that is, once the system is set up the provision of the service to a particular user requires minimal human involvement on the part of the service provider), digital (that is, provided over the Internet or an electronic network), and not on the negative list.[56]

Revenue Threshold: Amount A applies to businesses only if they meet a global and local revenue threshold. The specific amounts of these thresholds have not been finalized, with little information provided except for a comment stating that "there may be little advantage in using a threshold below the current €750 million threshold . . . ."[57] At that threshold, an estimated 2,300 multinational enterprise groups would be within the scope of Amount A.[58] The local in-scope revenue threshold is considered to exclude largely domestic businesses.

Nexus: The new nexus rule identifies which market jurisdictions qualify for Amount A without considering the business's physical presence. The Amount A nexus will be recognized if local revenue from in-scope busi-

52. *Id.* at 15–17.

53. *Id.* at 39.

54. *See* Glenn DeSouza, *Blueprint on Pillar One—What's New and Important*, BLOOMBERG TAX (Nov. 3, 2020), https://news.bloombergtax.com/transfer-pricing/blueprint-on-pillar-one-whats-new-and-important [https://perma.cc/VCZ3-EYYF].

55. The positive list includes online advertising services, sale or other alienation of user data, online search engines, social media platforms, online intermediation platforms, digital content services, online gaming, standardized online teaching services, and cloud computing services. OECD, PILLAR ONE BLUEPRINT, *supra* note 38, at 25.

56. The negative list includes customized professional services, customized online teaching services, online sale of goods and services other than ADS, revenue from the sale of a physical good, irrespective of network connectivity ("Internet of things"), and services providing access to the Internet or another electronic network. *Id.* at 33.

57. *Id.* at 62.

58. U.S. Department of the Treasury, *supra* note 43, at 11.

nesses exceeds a certain amount.[59] However, a specific amount has not yet been proposed.[60]

Profit Allocation: The Pillar One Blueprint lays out a 3-step process for calculating the quantum of Amount A.[61]

1. Calculate the amount of "residual profit," defined as profit that exceeds a profitability threshold (that is, pre-tax profit divided by revenue).[62] This amount is subject to profit allocation.
2. Multiply a "reallocation percentage" to residual profit. This amount is reallocated mostly from residence countries to market countries because physical presence requirement is eliminated.[63]
3. If there are multiple market countries, an "allocation key" based on local in-scope revenues applies to divide Amount A among eligible jurisdictions.

b. U.S. Comprehensive Scoping Proposal

During the Trump Administration, the United States was not supportive of Pillar One, just as it opposed Action 1 of BEPS 1.0, because it considered the new tax regime to be discriminatory against U.S. tech giants, putting them at a competitive disadvantage.[64] Furthermore, the United States would lose revenue due to the expected revenue reallocation. U.S. resistance to Pillar One was best epitomized by its safe harbor proposal, essentially making the tax regime elective.[65] The global community has criticized this attitude as harmful to the effectiveness of the proposal.[66]

However, the Biden Administration appears to be more sympathetic to the global effort, as shown by its decision to offer an alternative plan called the "comprehensive scoping proposal," and to withdraw the Trump Admin-

59. OECD, Pillar One Blueprint, *supra* note 38, at 65.

60. For ADS, nexus is determined solely by the business's in-scope revenue in the market jurisdiction. The threshold is expected to be set at less than €5 million. In comparison, a CFB is less able to participate remotely in market jurisdictions, and thus, could be subject to a higher standard. *Id*. at 65–68.

61. *Id.* at 120.

62. The profitability threshold has not been set at that time. Assuming that it is fixed at ten percent, an estimated 780 multinationals and $500 billion will be subject to Amount A. *Id.* at 123.

63. The reallocation percentage has not been set. Assuming that it is fixed at twenty percent, the allocable tax base will be approximately $98 billion. *Id.* at 124.

64. Channing Flynn & Jennifer Cooper, *BEPS Action 1 - Where Are We?*, Int'l Tax Rev. (Oct. 26, 2017), http://www.internationaltaxreview.com/Article/3762337/BEPS-Action-1Where-are-we.html [https://perma.cc/2RWJ-375W].

65. Andrea Shalal et al., *U.S. Drops 'Safe Harbor' Demand, Raising Hopes for Global Tax Deal*, Reuters (Feb. 26, 2021), https://www.reuters.com/article/us-g20-usa-oecd/u-s-drops-safe-harbor-demand-raising-hopes-for-global-tax-deal-idUSKBN2AQ2E6 [https://perma.cc/4ARA-6JGT].

66. *US Suggests Safe Harbour Regime for OECD Pillar One Proposal*, Tax J. (Dec. 11, 2019), https://www.taxjournal.com/articles/us-suggests-safe-harbour-regime-for-oecd-pillar-one-proposal (last visited Apr. 14, 2022).

istration's safe harbor proposal.[67] The comprehensive scoping proposal uses quantitative criteria based on revenues and profit margins to identify the world's largest and most profitable multinational groups, regardless of industry classification or business model.[68] Assuming that the profitability threshold is fixed at ten percent, the U.S. proposal drastically cuts the number of businesses within scope from 780 to 100 or fewer.[69]

The comprehensive scoping approach has significant merits because it simplifies the business line segmentation in the Pillar One Blueprint. This segmentation is considered "the most complicated and difficult building block" of Pillar One.[70] However, some major market players have criticized the arbitrariness of the cut-off, which would only include 100 multinational enterprises, regardless of the type of business. Non-digital multinationals, like Johnson & Johnson, have argued that they would be included in the top 100 multinationals. Yet there is no reason for them to be subjected to the Pillar One regime, because the misalignment between value creation and taxation does not occur in their type of business.[71] The purpose of Pillar One is to recognize a new tax nexus for digital businesses that do not have any physical presence in market countries and to reallocate the profits to market countries accordingly. Therefore, requiring non-digital companies with physical presence in major market countries to comply with the new regime would waste time and money.

c. The Global Tax Deal Statement

On July 1, 2021, the Inclusive Framework ("IF") Statement was released as a preview of the global tax deal,[72] followed by the final Statement released on October 8, 2021. The global tax deal is now supported by 137 countries and jurisdictions, and their support represents more than ninety percent of global GDP.[73] The noticeable difference in the Statement from the previously released Pillar One Blueprint was the scope of Amount A. The Statement abandons the industry-based approach, and instead adopts a

67. Stephanie Soong Johnston, *U.S. Offers Key to Unlock Scope Issue in Global Tax Reform Talks*, 102 Tax Notes Int'l 147 (2021).

68. U.S. Department of the Treasury, *supra* note 43, at 12.

69. *Id.* at 11.

70. *Id.* at 18.

71. *See e.g.*, Johnson & Johnson Comments on OECD Tax Challenges Arising from Digitalisation—Report on the Pillar One Blueprint 2 (2020); Michael J. Graetz, *A Major Simplification of the OECD's Pillar 1 Proposal*, 101 Tax Notes Int'l 199, 203 (2021) (criticizing that the exclusion of financial services is likely political).

72. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, (July 1, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.htm [https://perma.cc/F3NX-FB2B] [hereinafter IF Statement].

73. Statement, *supra* note 1; OECD, 130 Countries and Jurisdictions Join Bold New Framework for International Tax Reform (July 1, 2021), https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm [https://perma.cc/3AVR-NYAC] [hereinafter OECD, *Press Release*].

quantitative approach based on the gross revenue and profitability of businesses. Although its language differs from that of the U.S. comprehensive scoping proposal, the result effectively follows the U.S. proposal by drastically cutting the number of in-scope businesses from 780 to seventy-eight of the world's largest companies.[74] Amount A will be implemented by a multilateral instrument (treaty) that is expected to be developed and opened for signature in 2022, and be effective in 2023.[75]

After examining the Statement's Amount A, Table 1 compares the Statement to its previous incarnation under the Pillar One Blueprint.[76]

Scope:[77] A multinational is within the scope of Amount A if its global turnover exceeds twenty billion euros and its profitability exceeds ten percent. Profitability is determined by dividing pre-tax profit by revenue. Pillar One is to be reviewed seven years after it takes effect. If its implementation is found to be successful, the turnover threshold will be reduced to ten billion euros.

The Statement excludes extractives (non-renewable resources such as petroleum and minerals) and regulated financial services (banking, insurance, and asset management).

Nexus:[78] A market jurisdiction has nexus when an in-scope business derives at least one million euros in revenue from that jurisdiction. For a smaller jurisdiction (those with a GDP of less than forty billion euros), the nexus threshold is €250,000.

Profit Allocation (Quantum):[79] Twenty-five percent of the residual profit of an in-scope business will be allocated to market jurisdictions with nexus, whereby residual profit is defined as profit in excess of ten percent of revenue. A revenue-based allocation key will determine the specific allocation.

Revenue Sourcing:[80] The source rules determine when revenues of an in-scope business arise in, and thus are sourced to, the end market jurisdictions—that is, the place where goods and services are used or consumed. The OECD has subsequently released the Draft Model Rules for detailed source rules concerning specific categories of transactions. Notably, revenue

74. U.S. Department of the Treasury, *supra* note 43, at 11; Michael Devereux & Martin Simmler, *Who Will Pay Amount A?*, EconPol Pol'y Brief, Oxford Univ. Ctr. Bus. Tax'n, 3 (2021).

75. Statement, *supra* note 1, at 3.

76. Technical elements, such as revenue sourcing, tax base, and elimination of double taxation are omitted here, but included in Table 1.

77. Statement, *supra* note 1, at 1.

78. *Id.* The OECD has released draft model rules for nexus and revenue sourcing, where the nexus test remains as set out in the Statement. OECD, Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing, Organization for Economic Co-operation and Development 5 (2022) [hereinafter OECD, Draft Model Rules].

79. OECD, Draft Model Rules, *supra* note 78, at 2.

80. Statement, *supra* note 1, at 2.

is sourced on a transaction-by-transaction basis,[81] and all revenues must be sourced using reliable indicators.[82]

TABLE 1. KEY DIFFERENCES BETWEEN THE PILLAR ONE BLUEPRINT AND THE STATEMENT.

	Pillar One Blueprint	**Statement**
Scope	Automated digital services (ADS) and Consumer-facing business (CFB)	Global turnover > €20 billion; Profitability >10%; Excludes extractives and regulated financial services
Nexus	Based on local revenue from in-scope; Specific amount not proposed	Revenue of in-scope business from jurisdiction > €1 million (€250,000 for smaller jurisdictions)
Profit Allocation/ Quantum	Three-step calculation; Specific ratio or threshold not proposed	25% of residual profit; Revenue-based allocation key
Revenue Sourcing	Sourced to end-market jurisdictions where goods or services are used or consumed; Source rules to be developed for specific categories of transactions	The same; The Draft Model Rules proposing that revenue is sourced on a transaction-by-transaction basis
Tax Base	Determined by reference to financial accounting income; Loss carry-forward	The same; Segmentation to occur only in exceptional circumstances, in which disclosed segments meet the scope rules
Elimination of Double Taxation	Exemptions or credits	The same; Safe harbor for marketing and distribution profits to be developed
Amount B	Standardize arms-length principle to in-country baseline marketing and distribution activities	To be simplified and streamlined by the end of 2022
Tax Certainty	Mandatory and binding dispute prevention and resolution mechanisms for Amount A-related issues.	Elective for certain developing countries

81. The Draft Model Rules define a "transaction" as an item that generates income, such as an individual item of inventory or a "click" on an online advertisement. However, further guidance on the transaction-by-transaction approach is left to the Commentary to the Model Rules, which has not been released. OECD, DRAFT MODEL RULES, *supra* note 78, at 5.

82. *Id.* at 6.

2. *Pillar Two for Global Minimum Tax*

Pillar Two builds on the TCJA's GILTI and BEAT taxes in implementing the single tax principle,[83] where multinational enterprises that meet the revenue threshold of 750 million euros are subject to a global minimum tax regardless of the jurisdiction in which they are headquartered or operating.[84] Pillar Two consists of (1) two interlocking domestic rules requiring income inclusion ("Income Inclusion Rule" or "IIR") and denial of deduction ("Undertaxed Payment Rule" or "UTPR"), together referred to the Global anti-Base Erosion ("GLoBE") rules, and (2) a treaty-based rule ("Subject to Tax Rule" or "STTR").[85]

The Income Inclusion Rule requires the residence country of multinationals to impose a top-up tax on a parent entity at a minimum rate (fifteen percent) if the source country where the parent entity's subsidiary operates imposes a tax below such a minimum rate on the subsidiary's income. If the residence country does not impose such a minimum tax, the subsidiary's deduction for payment to the parent entity would be denied or an equivalent adjustment would be required, as per the Undertaxed Payment Rule, to the extent the low tax income of a subsidiary is not subject to tax under an IIR. For example, suppose that a subsidiary in the source country earns $100 of income and the source country imposes tax at ten percent, which is below the fifteen percent global minimum tax rate. Then the residence country of the subsidiary's parent entity would include the $100 with the parent's income and impose tax at a rate that is equal to the difference between the global minimum rate and the ten percent tax rate the subsidiary paid on the $100 in its low-tax jurisdiction. Suppose further that the subsidiary pays the $100 to the parent in a deductible form, such as royalty. If the residence country does not have the IIR, the subsidiary's deduction for the $100 royalty payment will be denied.

The Subject to Tax Rule, on the other hand, is a standalone treaty rule and specifically targets intercompany payments that exploit treaties to shift profits to low-tax jurisdictions.[86] Therefore, this rule applies to certain categories of payments that present a greater risk of base erosion, such as interest and royalties.[87] For example, suppose that a subsidiary in the source country pays $100 of royalty to a parent, and the parent's $100 of royalty income is subject to a nominal tax rate below the minimum rate (currently suggested at 7.5–9%) in the residence country. Then, the source country is allowed to impose a withholding tax on the royalty payment at a rate that is equal to

83. Lilian V. Faulhaber, *Taxing Tech: The Future of Digital Taxation*, 39 VA. TAX REV. 145, 175 (2019).
84. STATEMENT, *supra* note 1, at 3–5.
85. OECD, PILLAR TWO BLUEPRINT, *supra* note 40, ¶ 8.
86. *Id.* ¶ 566.
87. *Id.* ¶ 568.

the difference between the minimum rate provided for under the STTR and the nominal tax rate.[88]

The Pillar Two tax regime is quite complex, and much work still needs to be done to determine the details.[89] However, Pillar Two is expected to reduce profit shifting by multinationals. If enough large economies agree to implement Pillar Two, there will be no incentive for companies to put their businesses in low-tax jurisdictions.

In short, Pillar One is a reform to strengthen source-based taxation. It is the most effective way to eliminate profit shifting and tax competition given the location of customers. Pillar Two takes a different approach by strengthening residence-based taxation. Firms would no longer have incentive to change their place of residence or location of headquarters.

II. Problems of the Proposed Global Deal

The world seems to agree that the OECD's tax reform plan is an overdue and necessary update for the digital age.[90] On July 11, finance ministers from the G20 announced the G20's endorsement of the OECD's changes to international tax rules.[91] As of November 4, 2021, 137 out of 141 IF member countries and jurisdictions have agreed to the two-pillar proposal for reforming the international tax system.[92] The response from world leaders, journalists, tax organizations, business leaders, and public interest groups has remained overwhelmingly positive. According to U.S. Treasury Secretary Janet Yellen, there is growing consensus that the OECD plan is the right path to establishing a tax regime that is fair for all.[93]

However, the United States, the E.U., and other proponents of the global tax deal must first address several major obstacles to the global tax deal. Crucially, many sensitive and substantive issues regarding Pillar One have been deferred to a potential multilateral instrument, a draft of which will not be ready until later in 2022. It is less likely that the supportive press coverage would continue as more specific details of the tax plan are negotiated, and compromises must inevitably be made. The following are some of the key problems of the proposed global deal.

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88. *Id.* ¶ 650.

89. *See e.g.*, Avi-Yonah & Kim, *supra* note 10; Reuven S. Avi-Yonah, *The New International Tax Framework: Evolution or Revolution?*, 25 Am. Soc. Int'l L. 1 (2021).

90. *OECD Sees Global Minimum Accord Improving Tax System: Cormann*, Bloomberg TV (July 8, 2021), https://www.bloomberg.com/news/videos/2021-07- 08/oecd-sees-global-minimum-accord-improving-tax-system-cormann-video [https://perma.cc/E4JE-LFGA].

91. Natalie Olivo, *New Global Tax Rules May Face Old Treaties, Other Hurdles*, Law360 (July 12, 2021), https://www.law360.com/tax-authority/articles/1402215/new-global-tax-rules-may-face-old-treaties-other-hurdles (last visited Apr. 14, 2022).

92. Statement, *supra* note 1, at 1.

93. Christopher Condon, *G-20 Finance Chiefs Back Tax Deal and Vow to Clear Hurdles*, Bloomberg (July 10, 2021), https://www.bloomberg.com/news/articles/2021-07-10/yellen-optimistic-congress-will-back-part-of-global-tax-deal [https://perma.cc/9D7V-XLDJ].

A. An Agreement, Not a Solution

The Statement is an eight-page document discussing both pillars, whereas the combined Blueprint for both pillars is about five hundred pages long. Section I.B introduces only the key elements of both documents, but the Statement, especially with regards to Pillar One, is no more than a general statement that leaves details to be determined in a future multilateral instrument that *will* be developed later in 2022. There have been major developments since the Blueprint, such as the dramatic change in the scope of Amount A. The Pillar One Blueprint was criticized as a compromise of too many previous proposals, for being too complex, and for deviating from the original tax problem of the digital, global economy. Given that the Statement makes yet another major shift, it needs to provide a policy explanation for doing so. However, the Statement is silent on the reason for the change, not to mention its implications for tax authorities and taxpayers, inviting this Article's critical assessment.

The general nature of the Statement may reflect a political and diplomatic desire to encourage as many countries as possible to join in. However, if the world reaches an agreement on the Statement only because it dodges sensitive issues, it can hardly be considered a long-awaited solution for international tax reform. Such an agreement would be a mere political event to boast a nominal achievement to domestic constituents, and would only invite more discord among the IF member states. As details of the plan are negotiated and compromises inevitably made, support from the member states and the press is likely to wane. The following sections identify and discuss grounds for discord.

B. Logistical and Political Challenges of Pillar One

Pillar One will be implemented by a multilateral instrument—a treaty—that is expected to be signed later in 2022, and take effect in 2023.[94] However, multilateral instruments and the tax treaty ratification process are plagued by various challenges, such as achieving consensus between nearly 140 countries, reconciling the distinct rules and political realities of each country's legal system, and overcoming logistical challenges to implementation and adherence.

Achieving consensus among the global community has proved to be a challenge in the past. For example, international negotiations regarding the BEPS 1.0 project were ongoing for nearly eight years without consensus as to how the international tax regime should change.[95] There are relatively

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94. Statement, *supra* note 1, at 3.

95. Gary B. Wilcox & Warren Payne, *Hitching Biden's Corporate Tax Proposals to the Global Tax Bandwagon*, Tax Notes (June 21, 2021), https://www.taxnotes.com/tax-notes-today-federal/corporate-taxation/hitching-bidens-corporate-tax-proposals-global-tax-bandwagon/2021/06/21/76lr5 (last visited Apr. 14, 2022).

few successful multilateral tax conventions, and those that do exist are typically smaller in scope and have fewer party signatories.[96]

The immense logistical challenges of implementing a multilateral tax agreement between nearly 140 countries is exacerbated by the reality that the OECD international tax plan would control relationships between countries that may not have relationships governed by existing bilateral treaties.[97] This raises complex concerns related to binding dispute resolution, introducing another element of political tension among some in the global community.[98]

In addition, even after consensus is reached, it takes time for each country to ratify treaty amendments. In the case of the 2015 BEPS 1.0 tax treaty amendment, many countries took months or years to sign the multilateral instrument, and others, including the United States, have never ratified it.[99]

Furthermore, political realities in the United States illustrate the complexities of ratifying a multilateral tax instrument. There is little likelihood that the U.S. Congress will pass the global tax deal in a single bill, increasing the difficulty of ratification in the U.S. Senate. Additionally, the United States has yet to ratify the 2015 BEPS tax treaty amendments,[100] indicating that despite executive intent to comply with international agreements, it is not always possible under the constraints of the U.S. legal system.

The Pillar One multilateral treaty will alter U.S. bilateral treaties with other countries, and therefore will need to be ratified by two thirds of the U.S. Senate.[101] However, getting seventeen Republicans to support a treaty measure that many view as penalizing U.S. companies may be a non-starter in the current economic and political climate.[102] Senate approval of the Pil-

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96. Mary C. Bennett, *Contemplating a Multilateral Convention to Implement OECD Pillars 1 and 2*, Tax Notes (June 16, 2021), https://www.taxnotes.com/tax-notes-federal/base-erosion-and-profit-shifting-beps/contemplating-multilateral-convention-implement-oecd-pillars-1-and-2/2021/06/14/76l74 (last visited Apr. 14, 2022).

97. *See id.* ("The new multilateral treaty will also need to govern relationships between countries that do not have any existing treaty relationship, which means its drafters will need to think about the ancillary issues that might otherwise be left to the bilateral treaty.").

98. Developing countries typically oppose mandatory binding arbitration but developed countries with large multinationals subject to Pillar One largely support mandatory binding dispute resolution. These conflicts are not directly related to the substantive tax reforms but impact the probability of reaching a consensus.

99. For a graphic indicating the length of time, see (@DanNeidle), Twitter (July 2, 2021), https://web.archive.org/web/20210702095624/https://twitter.com/DanNeidle/status/1410900061740011521 (showing that the following countries failed to ratify the 2015 BEPS amendments: Andorra, Argentina, Armenia, Bulgaria, China, Columbia, Fiji, Gabon, Hong Kong, Italy, Kuwait, Mexico, Romania, Senegal, Seychelles, South Africa, Spain, Turkey, Cameroon, Nigeria, Côte d'Ivoire, Jamaica, Tunisia, Peru, Belize, Papua new Guinea, Morocco, Kenya, North Macedonia, Bahrain, and the United States).

100. OECD, Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2021) (showing that the United States is not listed as a signatory).

101. Lilian Faulhaber, *Will the OECD Plan Fix International Taxation?*, Law360 (July 7, 2021), https://www.law360.com/articles/1400693 (last visited Apr. 14, 2022).

102. Mindy Herzfeld, *Pushing Pillar 1 Past Congress*, Int'l Tax Pol'y F. (July 19, 2021) https://itpf.org/itpf_blog?article_id=11363 (last visited Apr. 14, 2022).

lar One treaty in any form will almost certainly require the inclusion of a ban on all current and future DSTs, including the proposed E.U. digital levy.[103]

Pillar Two, on the other hand, is generally compatible with existing tax treaties and the GLoBE rules, the main part of Pillar Two, and can likely be implemented through amendments to domestic tax legislation.[104] However, the Biden Administration's attempt to use the reconciliation process, which only requires a majority vote, to push through changes related to Pillar Two's tax reform plan in the Build Back Better Act and negotiate with the Senate on Pillar One at a later time, has not been successful.[105] Furthermore, a potential treaty override issue is expected as to the Pillar One implementation, which is discussed further in Section II.A.

The OECD global tax reform has the public support and momentum to take it over the finish line. However, the piecemeal implementation of the plan likely to happen in the United States means that good faith and trust between the United States and the E.U. will unfortunately be required if the plan is to be fully implemented. If the E.U. and United Kingdom make the good faith gesture of abandoning the digital tax levy and immediately repealing their DSTs, there might be at least a possibility that the U.S. Senate would ratify Pillar One, and that the OECD tax plan would be fully implemented throughout much of the world. However, if the E.U. continues to claim that a digital levy is not a digital tax, and the E.U. member states engage in brinkmanship with the United States regarding DST repeal, the U.S. Senate will likely reject or decline to vote on Pillar One, and there will be only partial worldwide implementation of the OECD plan.

C. Repeal of Existing DSTs and Potential Digital Levy

The possibility of delayed U.S. passage of Pillar One adds further murkiness to the issue of the E.U. digital tax levy and the unilateral DSTs currently enacted by a number of countries. Pillar One could be in jeopardy if the E.U. moves forward with its digital tax levy and its individual members drag their feet in repealing their unilateral DSTs.

Many commentators expect that countries that currently have DSTs—for example, France, Canada, Italy, and India—may be reluctant to repeal them,

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103. Stephanie Soong Johnston, *Crapo and Brady Urge Yellen to Push for Immediate End to DSTs*, Tax Notes (July 12, 2021), https://www.taxnotes.com/tax-notes-today-federal/fundamental-tax-system-structure/pushing-pillar-1-past-congress/2021/07/19/76vyv (last visited Apr. 14, 2022); Theodoric Meyer & Jacqueline Alemany, *BBB Negotiations Stall in the Senate, Could Drag into Next Year*, Wash. Post (Dec. 17, 2021), https://www.washingtonpost.com/politics/2021/12/17/bbb-negotiations-stall-senate-could-drag-into-next-year/ [https://perma.cc/EB8B-ZYLR].

104. Faulhaber, *supra* note 83.

105. Stephanie Soong Johnston, *U.S. Reconciliation Bill May Have Global Minimum Tax Provisions*, Tax Notes (July 12, 2021), https://www.taxnotes.com/tax-notes-today-international/politics-taxation/us-reconciliation-bill-may-have-global-minimum-tax-provisions/2021/07/07/76rh7 (last visited Apr. 14, 2022).

at least until the United States actually implements Pillar One.[106] In fact, the United States has entered into individual agreements with the United Kingdom, France, Italy, Spain, and Austria that resulted in these countries retaining their digital taxes for now.[107] If the OECD-brokered global overhaul is implemented by 2023, the countries will offer a credit to refund any taxes collected in excess of what corporations would pay under the global tax deal.[108] This means that the five major advanced economies will preserve DSTs if the global tax deal eventually fails, and that taxpayers have to deal with DSTs for the time being. In that case, the world might have partial implementation of the two-Pillar tax plan. Also, if DSTs are still in place, the United States may end up imposing punitive tariffs again, the ramifications of which are discussed *infra* Section III.C.

Furthermore, the E.U. is preparing a new digital levy, asserting that it will be compatible with the two-pillar proposal.[109] If the E.U. goes forward with a digital levy after the global tax deal is finalized, it is likely that the United States will reject Pillar One.[110]

Despite the Statement's mandate to repeal DSTs and refrain from introducing others in the future, U.S. lawmakers remain skeptical. Two top Republican senators sent a letter to Treasury Secretary Yellen on July 8, 2021, asserting that Congress will not support an OECD tax reform deal unless it protects the U.S. economy, including the instant repeal of DSTs.[111]

D. Revenue Competition from Benefits of Tax Reform

The need to reform the century-old international tax system and the revenue benefits resulting from such reform have been the main drivers behind nearly 140 countries agreeing to the proposed global tax reform plan. It is estimated that Pillar One, the new nexus and profit allocation rules, will reallocate profits of $100 billion to market countries annually.[112] The vast majority of states joining the global tax deal would likely see a revenue

106. Natalie Olivo, *Digital Taxes May Linger After Global Deal, Panelists Say*, LAW360 (July 14, 2021), https://www.law360.com/tax-authority/articles/1402957/digital-taxes-may-linger-after-global-deal-panelists-say (last visited Apr. 14, 2022).

107. Press Release, Office of the United States Trade Representative, USTR Welcomes Agreement with Austria, France, Italy, Spain, and the United Kingdom on Digital Services Taxes (Oct. 21, 2021), https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/october/ustr-welcomes-agreement-austria-france-italy-spain-and-united-kingdom-digital-services-taxes [https://perma.cc/B95S-QBYJ] (indicating DSTs will be removed once Pillar One is in effect).

108. *Id.*

109. *EU Digital Levy*, *supra* note 12.

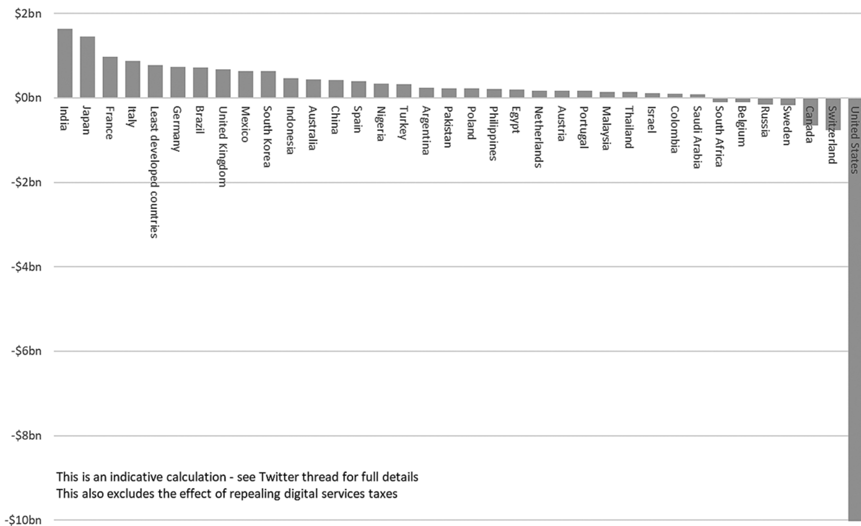
110. Elodie Lamer, *Growing Unease in EU Over Global Tax Deal's Next Steps*, TAX NOTES (July 12, 2021), https://www.taxnotes.com/tax-notes-today-international/corporate-taxation/growing-unease-eu-over-global-tax-deals-next-steps/2021/07/12/76rz4?highlight=OECD (last visited Apr. 14, 2022).

111. Letter from Mike Crapo and Kevin Brady, U.S. Senators, to Janet Yellen, U.S. Treasury Secretary (July 8, 2021).

112. OECD, *Press Release*, *supra* note 73.

increase as a result of Pillar One.[113] Simultaneously, Pillar Two, with its global minimum corporate income tax of fifteen percent, is expected to generate approximately $150 billion in additional global tax revenues each year.[114] Hence, from a global perspective, the global tax reform will benefit the world.[115] The IMF, representing an additional fifty-one countries, also backs the plan.[116]

CHART 2. APPROXIMATE NET REVENUE GAIN FROM PILLAR ONE[117]



However, individual counties' interests may not exactly align with the collective benefits. Each country would like to secure net revenue gain rather than loss. Chart 2 shows a preliminary, back-of-a-napkin estimate based on calculations completed by Dan Neidle, a Clifford Chance tax attorney from London. Countries like the United Kingdom and China would essentially break even under Pillar One's profit reallocation regime after factoring in

113. Robert Goulder, *The Cost of Change: Pillar 1 Reduced to the Back of a Napkin*, 103 TAX NOTES 111 (July 1, 2021) https://www.taxnotes.com/tax-notes-today-international/international-taxation/cost-change-pillar-1-reduced-back-napkin/2021/07/06/76qdb?highlight=Global%20Minimum%20TaX (last visited Apr. 14, 2022).

114. *Id.*

115. William Horobin, *Global Tax Overhaul Endorsed by 130 Nations as Deal Gets Closer*, BLOOMBERG (July 1, 2021), https://www.bloomberg.com/news/articles/2021-07-01/global-tax-overhaul-endorsed-by-130-nations-as-deal-gets-closer [https://perma.cc/DUU2-MXGQ].

116. Eric Martin, *IMF Sees Room to Simplify Global Tax Deal to Boost Participation*, BLOOMBERG (July 10, 2021), https://www.bloomberg.com/news/articles/2021-07-10/imf-sees-room-to-simplify-global-tax-deal-to-boost-participation [https://perma.cc/JM8S-Y7FR].

117. Dan Neidle (@DanNeidle), TWITTER (June 16, 2021), https://web.archive.org/web/20210616124055/https://twitter.com/DanNeidle/status/1405143274403270662 (underlying data available at https://github.com/DanNeidle/pillar_one).

the cost of crediting.[118] Notably, the United States will experience the greatest loss under Pillar One's profit reallocation regime: $10.3 billion each year despite a revenue increase of $12.6 billion.[119] This estimation may be obvious considering that the U.S. corporate community disproportionately consists of in-scope taxpayers, namely tech companies. The question thus arises as to why the United States would go along with Pillar One unless there is a quid pro quo, namely other countries repealing DSTs and adopting Pillar Two.

On the contrary, Treasury Secretary Yellen contends that Pillar One would be revenue neutral for the United States.[120] To reconcile Secretary Yellen's statement with Neidle's calculations, a tax commentator Robert Goulder explores the idea that Yellen made different assumptions regarding foreign tax credits, or that she meant the operation of Pillars One and Two jointly would create a revenue-neutral result for the United States.[121] Another interpretation may be that acceptance of Pillar One by other countries with the mandate that they repeal DSTs and reduce discrimination against U.S. multinationals may offset losses under Pillar One. Nonetheless, these are all speculations, and the U.S. government has not disclosed its own calculation.

Putting aside the revenue competition among countries, let us turn to the taxpayers. Who will be liable for the new tax under the tax reform? In other words, is Pillar One free from the criticism that it is discriminatory against U.S. tech giants? A calculation focusing on the composition of Pillar One's Amount A implies that the answer is no. Michael Devereux and Martin Simmler of Oxford University indicate that the extent of Pillar One will only apply to seventy-eight of the world's 500 largest companies.[122] The aggregate Amount A allocation for the seventy-eight companies subject to Pillar One is approximately $87 billion.[123] Strikingly, sixty-four percent of Amount A profits will come from companies headquartered in the United States.[124] Contrast this with the fact that the United States only comprises twenty to twenty-five percent of world GDP.[125] Furthermore, around forty-five percent of the aggregate Amount A allocation will come from technol-

118. *See* Goulder, *supra* note 113. This calculation considers the cost of foreign tax credit.

119. *Id.* This calculation considers the cost of foreign tax credits which, if offered, would be extensive and result in the U.S. experiencing a net loss under Pillar One.

120. *See* Letter from Janet Yellen, U.S. Treasury Secretary, to Mike Crapo, U.S. Senator (June 4, 2021) ("[O]ur Pillar 1 comprehensive scope proposal will be largely revenue neutral for the United States since we will be on both the receiving and giving end of the proposed profit reallocation.").

121. Goulder*, supra* note 113; Robert Goulder, *The Cost of Change, Part II: Rethinking U.S. Exposure to Pillar 1*, TAX NOTES (July 20, 2021), https://www.taxnotes.com/tax-notes-international/tax-avoidance-and-evasion/cost-change-part-ii-rethinking-us-exposure-pillar-1/2021/07/19/76vqp (last visited Apr. 14, 2022).

122. Devereux & Simmler, *supra* note 74.

123. *Id.* at 1.

124. *Id.* at 4.

125. THE WORLD BANK, *GDP (current US$)*, (July 30, 2021), https://data.worldbank.org/indicator/NY.GDP.MKTP.CD [https://perma.cc/SQ53-T429].

ogy companies, with approximately thirty-two percent coming from Apple, Microsoft, Alphabet, Intel, and Facebook.[126] Consequently, the discrimination issue may persist under the Pillar One regime.

III. How Should the U.S. Respond?

This Part evaluates the current U.S. response to the proposed global deal for digital tax reform and DSTs and offers a possible action guide at both the international and domestic level. Section A explains various legal issues that the United States might face if it uses executive agreements to implement Pillar One while bypassing the treaty ratification in the Senate. Section B then suggests severing the two pillar proposals to at least save Pillar Two and the global minimum tax. Section C suggests avoiding a global trade war even if Pillar One fails and DSTs survive, by offering a case study on France's DST.

A. *The Inherent Difficulty with Treaty Override*

Section II.B. expects that the Pillar One tax regime will have difficulty passing Congress. The United States may not expect to implement Pillar One as a multilateral tax treaty as proposed by the OECD because, without Republican support, it would be impossible to get two-thirds of the votes in the Senate. The United States may try a congressional executive agreement with a majority vote in both houses,[127] but that still needs to be an override of articles 5 (permanent establishment), 7 (business profits), and 9 (associated enterprises) of the existing bilateral tax treaties.

Unfortunately, use of "treaty override" to implement Pillar One in the United States is a double-edged sword for proponents of international tax law.[128] While enactment by the United States is essential for the effective-

126. Devereux & Simmler, *supra* note 74, at 1.

127. Letter from Mike Crapo, James E. Risch & Pat Toomey, U.S. Senators, to Janet Yellen, U.S. Treasury Secretary (Oct. 8, 2021), [hereinafter Letter Oct. 8]; Letter from U.S. Senators to Janet Yellen, U.S. Treasury Secretary (Dec. 22, 2021) [hereinafter Letter Dec. 22]; *see also* Senate Office of Mike Crapo, *Finance Republicans Demand Treasury Analysis of OECD Agreement* (Dec. 22, 2021), https://www.crapo.senate.gov/media/newsreleases/finance-republicans-demand-treasury-analysis-of-oecd-agreement [https://perma.cc/J73G-A28S]; Senate Office of Rob Portman, *Portman, Senate Finance Republicans Demand Treasury Analysis of OECD Agreement* (Dec. 23, 2021), https://www.portman.senate.gov/newsroom/press-releases/portman-senate-finance-republicans-demand-treasury-analysis-oecd-agreement [https://perma.cc/V2SC-LC2D].

128. *See generally* C De Pietro, *Tax Treaty Override and the Need for Coordination between Legal Systems: Safeguarding the Effectiveness of International Law*, 73 World Tax J. (2015); Craig Elliffe, *Preventing Unacceptable Tax Treaty Overrides*, British Tax Rev. (forthcoming 2022); Rebecca M. Kysar, *Interpreting Tax Treaties*, 101 Iowa L. Rev 1387, 1397–1404 (2016); OECD, Recommendation of the Council Concerning Tax Treaty Override, OECD/LEGAL/0253 (Oct. 2, 1989), https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0253 [hereinafter OECD 1989 Report]; Georg Kofler, *Legislative Tax Treaty Overrides in Austrian, German, and EU Law*, British Tax Rev. (forthcoming); Nicola Sartori, *Tax Treaty Override and Pacta Sunt Servanda: The Italian* Perspective, British Tax Rev. (forthcoming).

ness of Pillar One, the foundation of international law would be weakened with each treaty override.[129]

1. *Overview of Treaty Overrides*

a. Definition

In 1989, the OECD issued its report on "Tax Treaty Override."[130] It defined a "treaty override" as a "situation where the domestic legislation of a State overrules provisions of either a single treaty or all treaties hitherto having had effect in that State," and recommended States to "avoid enacting legislation which is intended to have effects in clear contradiction to international treaty obligations."[131]

However, such a traditional definition would be too narrow to explain a more recent phenomenon in international law. The expected executive agreement to implement Pillar One is a good example. If the United States implements the Pillar One tax regime by an executive agreement, that will override existing bilateral tax treaties. Will it also be a "treaty override"? Another definition that better encompasses the ways in which an override can occur describes a treaty override as "when a contracting state [to a treaty] intentionally applies domestic law or regulation to accomplish specifically what a treaty forbids."[132] According to this definition, executive agreements that contradict the existing tax treaties would be considered treaty overrides as well.

b. Monist/Dualist Distinction

The possibility of a treaty override is also state-specific. It depends on the specific constitutional system and the legal mechanisms in each country. States that legally permit treaty overrides are labeled *dualist* States and those that do not are labeled *monist* States.[133]

In many countries, treaties (including tax treaties) have a legal status superior to that of ordinary domestic laws (for example, France, Italy, Netherlands).[134] These countries are considered monist states. The monist view sees both international and domestic law as intrinsically part of the legal system, and international law becomes automatically a part of the domestic legal

129. OECD 1989 Report, *supra* note 128 at 4; *see* Reuven S. Avi-Yonah, *Sunt Pacta Servanda? The Problem of Tax Treaty Overrides*, British Tax Rev. (forthcoming 2022) (manuscript at 8) (on file with authors). *See generally* Richard E. Andersen, Analysis of United States Income Tax Treaties (2010); Nicolas M. Traut, *Tax Treaty Overrides And Friendliness Towards International Law: A Comparative Approach To Put The Later-Intime-Rule To The Test*, 48 Capital U. L. Rev. 403, 411–2 (2020); Klaus Vogel, Tax Treaties and Domestic Law (2006).

130. OECD 1989 Report, *supra* note 128.

131. *Id.*

132. Richard L. Doernberg, *Overriding Tax Treaties: The U.S. Perspective*, 9 Emory Int'l L. Rev. 71, 74 (1995).

133. Elliffe, *supra* note 128, at 4; De Pietro, *supra* note 128, at 85–87; Sachin Sachdeva, *Tax Treaty Overrides: A Comparative Study of the Monist and the Dualist Approaches*, 41 Intertax 180 (2013).

134. Avi-Yonah, *supra* note 129, at 6–7.

system. This means that a treaty which is validly executed in the international legal sense automatically takes full legal effect within domestic law. Subsequent general domestic tax legislation would not normally override a treaty.[135]

However, some countries like the United States and the United Kingdom view domestic legislation and international treaties as separate regimes of law.[136] International law (the treaty) regulates the relationship between sovereign states, but domestic law regulates legal matters relevant to that country.[137] These so-called dualist states only apply treaty provisions to domestic law when they are expressly incorporated into domestic legislation.[138]

The United States is noted by many scholars as being the classic example of a dualist overriding state.[139] The U.S. Constitution lays out that "[l]aws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land."[140] This Supremacy Clause was intended to ensure the supremacy of both U.S. federal laws and treaties to state laws, and was one of the major innovations in the Constitution.[141] Accordingly, when treaties and state law conflict, treaties trump. However, the Constitution is less clear about the relationship between federal laws and treaties. Despite the lack of clarity in the Constitution, the U.S. Supreme Court has established the principle of *lex posterior*, meaning that the later law prevails. In other words, the U.S. system operates on the notion that the most recent expression of the sovereign is the governing law.[142] This mechanism has allowed the United States to override several international treaties.

c. When has an Override Occurred?

An important distinction to note with treaty override is that unlike the termination of a treaty, a treaty override unilaterally changes provisions in a treaty for one party but keeps the treaty in effect.

There are two ways that a treaty override can take place. First are explicit overrides, where the legislative intent to override a specific treaty is clear.[143] This usually comes with an explicit statement.[144] Second, implicit overrides are more challenging for courts to decipher. In these cases, it largely comes

135. *Id.* at 6–7.

136. Elliffe, *supra* note 128, at 5–6; De Pietro, *supra* note 128, at 85–87 (2015); Sachdeva, *supra* note 133.

137. Sachdeva, *supra* note 133.

138. *Id.*

139. *See* Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 [hereinafter VCLT]; *see e.g.*, Avi-Yonah, *supra* note 129, at 11.

140. U.S. Const. art. VI, cl. 2.

141. Reuven S. Avi-Yonah & Brett Wells, *The Beat and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen*, 7 (Univ. Mich. L. & Econ., Working Paper No. 157, 2018).

142. *Id.*

143. *See* Avi-Yonah, *supra* note 129, at 7; Traut, *supra* note 129.

144. *See* Avi-Yonah, *supra* note 129, at 7; Traut, *supra* note 129; Omri Marian, *Unilateral Responses to Tax Treaty Abuse: A Functional Approach*, 41 Brook. J. Int'l L. 1157 (2016).

down to interpretation.[145] For example, "[r]ecently, the issue of implicit treaty overrides has become 'hot' again because of the debate over whether some provisions of the [TCJA] were an override."[146]

Accordingly, given that treaty overrides can occur both explicitly and implicitly, it is unclear in many dualist states exactly when an override has occurred and whether the legislature must be explicit about it or not.[147] To add some clarity, the OECD has put out two examples for the discussion to build on in its 1989 Report.

Example 1 is a straightforward case of a material breach of the treaty, in which a state introduces a new withholding tax on interest or royalties when these should be exempt from source-based taxation under the treaty. The OECD 1989 Report states that "[t]he breach being a material one, the treaty partners of State A would be justified in terminating their tax treaty relationship with State A. However, termination could do even more harm economically and endanger the possibility of finding an acceptable solution in the future."[148] However, it is hard to find an actual example on which this scenario is based, and thus, this example is not helpful to clarify the situation when an override has occurred.[149]

Example 2 is a more realistic one: State B taxes capital gains from the sale of real property, but under its tax treaties is precluded from taxing capital gains on sales of stock. Taxpayers interpose a State B corporation between themselves and the real property and sell the shares in the corporation instead. State B legislates that the sale of the stock is deemed to be a sale of the real property for purposes of its treaties.[150] This example is based on the U.S. Foreign Investors in Real Property Tax Act of 1980, which explicitly overrode Article 13 (capital gains) of most U.S. tax treaties in order to impose a tax on the sale of shares in U.S. real property holding companies.[151] In short, there is no guidance that helps clarify the implicit overrides.

145. *See e.g.*, Kofler, *supra* note 128 (providing a discussion on when domestic legislation becomes an override). This was a topic of discussion during the symposium and almost all the scholars highlighted that overrides are largely a matter of interpretation.

146. Avi-Yonah, *supra* note 129, at 14.

147. *See* Kysar, *supra* note 128, at 1397–1404.

148. OECD 1989 Report, *supra* note 128, at 9.

149. Note that the BEAT, which arguably partially imposes tax on interest and royalties paid by the U.S. taxpayer to related foreign parties by partially denying deductibility, does not violate Arts. 11 and 12 of U.S. tax treaties (reducing to zero the U.S. withholding tax on interest and royalties). This is because the BEAT is imposed on the U.S. payor and Art. 1(4) (the saving clause) of all U.S. tax treaties states that the treaty will not affect U.S. taxation of its residents. But the BEAT does arguably violate Art. 24 (non-discrimination), which is not subject to the saving clause. According to this argument, the BEAT must necessarily be a treaty override in order to have effect in treaty situations. *See* Avi-Yonah & Wells, *supra* note 141, at 6.

150. OECD 1989 Report, *supra* note 128, at 9–10.

151. Avi-Yonah, *supra* note 129, at 9–10; 26 U.S.C. § 897 (2018).

d. International Law on Treaty Overrides

It is commonly recognized that if a state overrides a treaty, it is a violation of international law according to the Vienna Convention on the Law of Treaties ("VCLT").[152] This is true even in countries that have not formally ratified the VCLT, as the VCLT is considered customary international law even in countries such as the United States.[153] To elaborate, Article 26 of the VCLT articulates the pacta sunt servanda principle.[154] It states that "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith."[155] Moreover, Article 27 adds that "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."[156] Combining these two articles, "it is clear that treaty overrides constitute a violation of international law."[157]

This interpretation has been confirmed by the OECD, which strongly condemns any treaty overrides: "The OECD Report [also] clarifies that such treaty overrides violate international law (citing the VCLT), although they may still be binding as a matter of domestic law."[158] In addition, the OECD Report specifically stated that "[t]he certainty that tax treaties bring to international tax matters has, in the past few years, been called into question, and to some extent undermined, by the tendency in certain countries for domestic legislation to be passed or proposed which may override provisions of tax treaties."[159]

However, in the event of an override, there are few remedies for foreign countries other than termination of the entire treaty, which is a rarely-taken step.[160] In the event of a tax treaty dispute, it can only be adjudicated and remedied if both countries agree to submit the dispute to the International Court of Justice.[161] As a result, dualist countries such as the United States are unlikely to end their policy of treaty overrides through domestic legislation.

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152. *See e.g.*, Avi-Yonah, *supra* note 129, at 6–7.

153. *Id.* at 7.

154. VCLT, *supra* note 139, art. 26 ("Every treaty in force is binding upon the parties to it and must be performed by them in good faith."); *see also* Avi-Yonah, *supra* note 129, at 7; Craig Macfarlane Elliffe, *The Lesser of Two Evils: Double Tax Treaty Override or Treaty Abuse?*, 1 British Tax Rev. 62, 70 (2016).

155. VCLT, *supra* note 139, arts. 26, 27; *see also* Elliffe, *supra* note 154, at 71; Traut, *supra* note 129, at 411–12.

156. VCLT, *supra* note 139, art. 27.

157. Avi-Yonah, *supra* note 129, at 8; *see also* OECD 1989 Report, *supra* note 128, at 4.

158. Avi-Yonah, *supra* note 129, at 9; *see* OECD 1989 Report, *supra* note 128, at 4.

159. OECD 1989 Report, *supra* note 128, at 2; *see* Avi-Yonah, *supra* note 129, at 8. *See generally* Richard E. Andersen, Analysis of United States Income Tax Treaties (2010); Traut, *supra* note 129, at 411–2; Vogel, *supra* note 129.

160. Avi-Yonah, *supra* note 129, at 9–10.

161. Elliffe, *supra* note 128, at 15.

2. *Implementation in Other Jurisdictions*

As discussed in Section II.B. and the Statement, Pillar One is intended to be implemented through a multilateral treaty.[162] The multilateral treaty "will be developed to introduce a multilateral framework for all jurisdictions that join, regardless of whether a tax treaty currently exists between those jurisdictions."[163]

Given this intended strategy, it is unlikely that there will be many major obstacles, outside of the United States, for implementing the global tax deal. Most OECD member countries signed the multilateral instrument for BEPS 1.0, except for the United States, and it proved a success not only for implementing new tax policy but for how treaties in general might be implemented in other areas of international law.[164] However, it is still useful to investigate how implementation in other OECD countries would work as well.

a. Common Law Countries

Common law countries tend to be dualist states. These states include: the United Kingdom, Australia, New Zealand, Canada, Israel, India, and South Africa.[165] In each of these countries, Pillar One can only take domestic legal effect after additional domestic legislation is adopted by the respective parliaments.[166] In other words, when these states sign the multilateral treaty, the international obligations associated with Pillar One will be in effect, but additional steps are required on the domestic front to implement Pillar One. The OECD and the Inclusive Framework, however, mandated the Task Force on the Digital Economy to develop model rules by early 2022 as a reference for domestic legislation if members to the multilateral treaty "need to make changes to domestic law to implement the new taxing rights over Amount A . . . [to] facilitate consistency in the approach taken by jurisdictions and to support domestic implementation consistent with the agreed timelines and their domestic legislative procedures."[167] In addition, "the model rules will be supplemented by commentary that describes the purpose and operation of the rules."[168] Therefore, implementation in each of these states should be fairly smooth.

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162. Statement, *supra* note 1, at 3.

163. *Id.*

164. OECD, Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2022); *see also* David Kleist, *The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS—Some Thoughts on Complexity and Uncertainty*, 2018 Nordic Tax J. 31.

165. David Sloss, *Domestic Application of Treaties*, *in* The Oxford Guide to Treaties 3 (Duncan B. Hollis ed., 2012).

166. *Id.*

167. Statement, *supra* note 1, at 7.

168. *Id.*

b. Continental European/Civil Law Jurisdictions

Most Continental European states and most civil law jurisdictions are monist states, making implementation through the multilateral treaty streamlined in these jurisdictions. Prominent examples include Belgium, France, Greece, Luxembourg, the Netherlands, Russia, and Spain.[169] In the E.U., the analysis of implementation is slightly different, but any involvement by the E.U. would only make implementation within the European block more likely.

In fact, on December 22, 2021, the E.U. Commission ("Commission") published a legislative proposal for a directive to implement the rules of Pillar Two.[170] By presenting the draft directive, the Commission is essentially proposing a binding instrument ensuring the implementation of Pillar Two by all twenty-seven E.U. Member States. The Commission proposes that the Member States adopt the Directive into their domestic legal systems by December 31, 2022 for the rules to come into effect as of January 1, 2023, with the exception of the UTPR, for which the application will be deferred to January 1, 2024.[171]

The question now is whether there will also be a directive to implement Pillar One. This would seem entirely unnecessary if there is a multilateral treaty, as proposed by the OECD, but the E.U. Commission has indicated that they may propose such a directive anyway.[172] This may be helpful in the case there is an unresolved conflict between the multilateral treaty and any given bilateral tax treaties. In such a case, a directive could create an umbrella treaty override for all member states. Therefore, based on these developments, it seems likely that Pillar One will be implemented fairly smoothly in most monist jurisdiction, especially within the European block.

3. *Implementing Pillar One from the U.S. Perspective*

Given the current international legal climate and the rules regarding treaty overrides, what are the ways in which the United States might implement Pillar One and what are the consequences of a particular path? As mentioned, the United States would also have to override several bilateral tax treaties in order to implement Pillar One. What are the options?

a. Ways Treaties Are Implemented

Implementation analysis in the United States, and override analysis in this case, is somewhat complicated. As discussed above, there are different

169. *See* Sachdeva, *supra* note 133.

170. Eur. Comm'n, *Proposal for a Council Directive Laying Down Rules to Prevent the Misuse of Shell Entities for Tax Purposes and Amending Directive 2011/16/EU*, COM (2021) 565 final (Dec. 22, 2021).

171. *Id.*

172. Charlotte Kies, *Agreement on Pillar One and Pillar Two global tax reform*, Loyens & Loeff (Oct. 11, 2021), https://www.loyensloeff.com/lu/en/news/articles-and-newsflashes/agreement-on-pillar-one-and-pillar-two-global-tax-reform-n23713/ [https://perma.cc/M6MJ-WYAU].

types of international agreements the United States makes from a domestic perspective, even though the obligation is all the same from an international perspective. Therefore, determining the domestic status of an international agreement requires looking at the type of agreement the United States is entering. The United States distinguishes between three types of international agreements: (1) treaties, (2) executive agreements, and (3) non-legal agreements, which involve the making of so-called "political commitments" (which are less relevant in this Article).[173]

i. Treaties:

Under U.S. law, "a treaty is an agreement negotiated and signed by a member of the executive branch that enters into force if it is approved by a two-thirds majority of the Senate and is subsequently ratified by the President."[174] The Treaty Clause—Article II, Section 2, Clause 2 of the Constitution—vests the power to make treaties in the President, acting with the "advice and consent" of the Senate. There is much debate about exactly what "advice" and "consent" mean, but the "advice" aspect has generally come to require the President to consult with the Senate during the treaty negotiation process before the Senate votes with its final "consent."[175] Moreover, under established U.S. practice, the President cannot ratify a treaty unless the President accepts the Senate's conditions. In other words, the Constitution allocates primary responsibility for entering into treaties to the executive branch, but Congress also plays an essential role in the process.

In addition, treaties can be self-executing or non-self-executing. A self-executing treaty may be enforced in the courts without prior legislation by Congress, whereas a non-self-executing treaty may not be enforced in the courts without prior legislative "implementation." Self-executing treaties, for example, have a status equal to federal statute, superior to U.S. state law, and inferior to the Constitution. Courts generally have understood treaties that are not self-executing to have limited status domestically; rather, the legislation or regulations implementing these agreements are controlling.

In particular, U.S. tax treaties have been regarded as self-executing since the first treaty (with France) was ratified in 1932, but there is debate regard-

173. Curtis A. Bradley & Jack L. Goldsmith, *Presidential Control Over International Law*, 131 HARV. L. REV. 1201, 1207–09 (2018); CONG. RSCH. SERV., COMM. OF FOREIGN RELS., TREATIES AND OTHER INTERNATIONAL AGREEMENTS: THE ROLE OF THE UNITED STATES SENATE 4 (2001) [hereinafter TREATIES AND OTHER INTERNATIONAL AGREEMENTS].

174. STEPHEN P. MULLIGAN, CONG. RSCH. SERV., RL32528, INTERNATIONAL LAW AND AGREEMENTS: THEIR EFFECT UPON U.S. LAW 3 (2018); *see also* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES, § 101 (1987) [hereinafter THIRD RESTATEMENT].

175. MULLIGAN, *supra* note 174, at 3; *see also* LOUIS HENKIN, FOREIGN AFFAIRS AND THE U.S. CONSTITUTION 177 (2d ed. 1996) ("As originally conceived, no doubt, the Senate was to be a kind of Presidential council, affording him advice throughout the treaty-making process and on all aspects of it . . . ."); Arthur Bestor, *"Advice" from the Very Beginning, "Consent" When the End Is Achieved*, 83 AM. J. INT'L L. 718, 726 (1989) ("[T]he use of the phrase 'advice and consent' to describe the relationship between the two partners clearly indicated that the Framers' conception was of a council-like body in direct and continuous consultation with the Executive on matters of foreign policy.").

ing whether they should not be self-executing.[176] In addition, Section 894(a) of the Internal Revenue Code requires that "[t]he provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer,"[177] which, many scholars argue, indicates that legislation is not required to bring tax treaties into force.[178]

ii. Executive Agreements:

Most international agreements that the United States enters into are not treaties, but executive agreements—"agreements entered into by the executive branch that are not submitted to the Senate for its advice and consent."[179] These agreements can be categorized into three sub-categories based on the source of the President's authority to conclude the agreement.[180]

First are *congressional-executive agreements*. The constitutionality of congressional-executive agreements is well-settled.[181] Essentially, they are different from treaties, where only Senate approval is required, in that "both houses of Congress are involved in the authorizing process for congressional-executive agreements."[182] In other words, both houses of Congress are involved in passing a statute implementing the provisions of the international agreement that was made by the President/Executive with prior approval from Congress.[183]

Second are *agreements made pursuant to treaties*. These are agreements made in harmony with existing treaties. These types of agreements are also well established as constitutional,[184] "though controversy occasionally arises as to whether a particular treaty actually authorizes the Executive to conclude an agreement in question."[185] Because the Supremacy Clause includes treaties

176. *See generally* Reuven S. Avi-Yonah, *Tax Treaties, the Constitution, and the Noncompulsory Payment Rule* (Univ. Mich. L. & Econ., Working Paper No. 178, 2021).

177. 26 U.S.C. § 894(a) (2021).

178. Columbia Marine Servs., Inc. v. Reffet Ltd., 861 F.2d 18 (2d Cir. 1988) (assuming that a tax treaty is self-executing); Boris Bittker & Lawrence Lokken, Federal Taxation Of Income, Estates And Gifts (2012) ("Tax treaties are ratified by the Senate alone and are regarded as self-executing, which means that they have the force of law even though not enacted as a statute."); Michael P. Van Alstine, *Federal Common Law in the Age of Treaties*, 89 Cornell L. Rev. 892, 923 (2004).

179. Mulligan, *supra* note 174, at 6.

180. *Id.*

181. Third Restatement, *supra* note 174, at §303(2).

182. Mulligan, *supra* note 174, at 7.

183. Treaties And Other International Agreements, *supra* note 173, at 5.

184. *See* Third Restatement, *supra* note 174, § 303(3); Treaties And Other International Agreements, *supra* note 173, at 86; *see also* Wilson v. Girard, 354 U.S. 524, 528–29 (1957) (giving effect to an executive agreement defining jurisdiction over U.S. forces in Japan that was concluded pursuant to a treaty).

185. Mulligan, *supra* note 174, at 7; *see also* Treaties And Other International Agreements, *supra* note 173, at 86–87, n.117 (2001) (discussing examples in which Members of the Senate contended that certain executive agreements did fall within the purview of an existing treaty and required Senate approval).

among the sources of the "supreme Law of the Land,"[186] the power to enter into an agreement required or contemplated by the treaty lies within the President's executive function.[187]

Third are *sole executive agreements.* These are agreements when the President acts without any approval from Congress. The agreements rely on neither treaty nor congressional authority to provide their legal basis, but are instead based on the executive authority of the President outlined in the Constitution.[188] "The Constitution may confer limited authority upon the President to promulgate such agreements on the basis of his foreign affairs power."[189] One prominent example that the Supreme Court has recognized is the Presidential power to conclude *sole executive agreements* in the context of settling claims with foreign nations. Conversely, if the President acts under authority that he does not have, or his constitutional authority over the subject matter is unclear, "a reviewing court may consider Congress's position in determining whether the agreement is legitimate."[190] In the Court's analysis of such cases, when "Congress has given its implicit approval to the President entering the agreement, or is silent on the matter, it is more likely that the agreement will be deemed valid."[191]

In sum, both treaty implementation and treaty override could occur through domestic legislation, ratification through the Senate, or through an executive agreement, depending on the President's constitutional authority. These aspects make the U.S. system both unique and complicated for discussing treaty implementation and treaty overrides.

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186. U.S. Const. art. VI, § 2 ("[T]he laws of the United States . . . [and] all treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land . . . .").

187. Mulligan, *supra* note 174, at 7.

188. *See, e.g.*, Am. Ins. Ass'n v. Garamendi, 539 U.S. 396, 415 (2003) ("[O]ur cases have recognized that the President has authority to make 'executive agreements' with other countries, requiring no ratification by the Senate . . . this power having been exercised since the early years of the Republic."); Dames & Moore v. Regan, 453 U.S. 654, 680 (1981) (recognizing presidential power to settle claims of U.S. nationals and concluding "that Congress has implicitly approved the practice of claim settlement by executive agreement"); United States v. Belmont, 301 U.S. 324, 330 (1937) ("[A]n international compact . . . is not always a treaty which requires the participation of the Senate.").

189. Mulligan, *supra* note 174, at 7–8; *see also* Treaties And Other International Agreements, *supra* note 173, at 5 (citing U.S. Const.. art. II, § 1 (executive power), § 2 (commander-in-chief power, treaty power), § 3 (receiving ambassadors)).

190. Mulligan, *supra* note 174, at 8; *see e.g.,* Dames & Moore v. Regan, 453 U.S. 654, 686 (1981) (upholding sole executive agreement concerning the handling of Iranian assets in the United States, despite the existence of a potentially conflicting statute, given Congress's historical acquiescence to these types of agreements); Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635–38 (1952) (Jackson, J., concurring) ("When the President acts pursuant to an express or implied authorization of Congress, his powers are at their maximum . . . . Congressional inertia, indifference or quiescence may . . . invite, measures of independent Presidential responsibility . . . . When the President takes measures incompatible with the expressed or implied will of Congress, his power is at its lowest ebb, for then he can rely only upon his own constitutional powers minus any constitutional powers of Congress over the matter.").

191. Mulligan, *supra* note 174, at 8.

b. Pillar One: Executive Agreement?

There has been long-standing scholarly debate over whether certain types of international agreements may only be entered into as treaties, subject to the advice and consent of the Senate, or whether a congressional-executive agreement may serve as a constitutionally permissible alternative.[192] In the scholarly debates, "[a] central legal question . . . concerns whether the U.S. federal government, acting pursuant to a treaty, may regulate matters that could not be reached by a statute enacted by Congress pursuant to its enumerated powers under Article I of the Constitution."[193] Moreover, it appears that tradition also plays a role in determining which direction implementation goes.

Bringing this discussion into the context of Pillar One, tax agreements have traditionally been implemented as self-executing *treaties*.[194] Therefore, based on current scholarly and political debates, implementing Pillar One and overriding other bilateral tax treaties via another mechanism, like a congressional-executive act, would be highly irregular and raise constitutional questions.

There is concern surrounding the feasibility of implementing Pillar One, however, given that treaties require Senate ratification with a two-thirds majority. With a narrow Democratic majority in the Senate and Republican opposition to Pillar One, implementing Pillar One in the current political climate seems difficult, if not impossible. The Treasury, recognizing the

192. *Compare* Bradford C. Clark, *Domesticating Sole Executive Agreements*, 93 VA. L. REV. 1573, 1661 (2007) (arguing that the text and drafting history of the Constitution support the position that treaties and executive agreements are not interchangeable, and also arguing that the Supremacy Clause should be read to generally preclude sole executive agreements from overriding existing law), Laurence H. Tribe, *Taking Text and Structure Seriously: Reflections on Free-Form Method in Constitutional Interpretation*, 108 HARV. L. REV. 1221, 1249–67 (1995) (arguing that the Treaty Clause is the exclusive means for Congress to approve significant international agreements), *and* John C. Yoo, *Laws as Treaties?: The Constitutionality of Congressional-Executive Agreements*, 99 MICH. L. REV. 757, 852 (2001) (arguing that treaties are the constitutionally required form for congressional approval of an international agreement concerning action lying outside of Congress's constitutional powers, including matters with respect to human rights, political/military alliances, and arms control, but they are not required for agreements concerning action falling within Congress's powers under Art. I of the Constitution, such as agreements concerning international commerce), *with* THIRD RESTATEMENT, *supra* note 174, § 303 n.8 ("At one time it was argued that some agreements can be made only as treaties, by the procedure designated in the Constitution . . . Scholarly opinion has rejected that view."), LOUIS HENKIN, FOREIGN AFFAIRS AND THE U.S. CONSTITUTION 217 (1996) ("Whatever their theoretical merits, it is now widely accepted that the Congressional-Executive agreement is available for wide use, even general use, and is a complete alternative to a treaty. . . ."), Oona A. Hathaway, *Treaties' End: The Past, Present, and Future of International Lawmaking in the United States*, 117 YALE L.J. 1236, 1244 (2008) (claiming that "weight of scholarly opinion" since the 1940s has been in favor of the view that treaties and congressional-executive agreements are interchangeable), *and* Bruce Ackerman & David Golove, *Is NAFTA Constitutional?,* 108 HARV. L. REV. 799, 861–96 (1995) (arguing that developments in the World War II era altered historical understanding of the Constitution's allocation of power between government branches so as to make congressional-executive agreement a complete alternative to a treaty).

193. MULLIGAN, *supra* note 174, at 9.

194. *See, e.g.*, *United States Income Tax Treaties - A to Z*, IRS, https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z [https://perma.cc/G6TF-LYNG].

current political obstacles, commented on this issue on behalf of the Administration in October 2021, suggesting it might push to implement Pillar One by other means.[195] Yellen specifically noted at a Senate Banking Committee hearing that the Administration is considering alternative means for significantly modifying existing bilateral tax treaties that would bypass Senate approval.[196] Yellen said that implementing Pillar One via a treaty "would be one way" to do it, but there are also "a number of ways" it could be implemented.[197] Expanding on the potential direction of the Treasury, another Treasury official stated that implementation "could occur through several means, such as through an Article II treaty, congressional-executive agreement or through legislation overriding the existing treaties."[198]

As indicated, perhaps the Executive could implement the treaty via a congressional-executive agreement, which would only require a simple majority in the House and the Senate. However, Democrats control the Senate with a simple majority of fifty seats, making treaty implementation uncertain. Furthermore, several members of the Senate Foreign Relations and Finance Committees sent letters to the Treasury expressing their concern about these discussions. In one letter dated October 8, 2021, the Senators stated that the changes brought by Pillar One would be a:

> fundamental change in taxing rights [and] would require provisions within all of the United States' existing bilateral tax treaties to be modified or overridden. Each of these bilateral tax treaties was approved in the same manner—by a two-thirds vote of the Senate. Sweeping changes to modify these treaties and alter long-established protocols under these agreements must be processed through the same constitutionally mandated process. Bypassing this process to override our bilateral tax treaties would irreparably erode the exclusive treaty authority the Constitution provides to the Senate.[199]

In addition, the Senators stated that they were not aware of any prior congressional approval to make such an agreement, and they had not been involved in any steps of the Pillar One negotiation process.[200]

c. Analysis/Conclusion

These responses from Senators raise questions regarding the treaty implementation process in the United States, but there are no clear answers. The

195. Letter Oct. 8, *supra* note 127; Letter Dec. 22, *supra* note 127; *see also* Senate Office of Mike Crapo, *supra* note 127; Senate Office of Rob Portman, *supra* note 127.

196. Letter Oct. 8, *supra* note 127.

197. *Id.*

198. *Id.*

199. *Id.*; Letter Dec. 22, *supra* note 127; *see also* Senate Office of Mike Crapo, *supra* note 127; Senate Office of Rob Portman, *supra* note 127.

200. Senate Office of Rob Portman, *supra* note 127.

only real plausible alternative to treaty ratification would be a congressional-executive agreement. The Constitution likely does not give the President sole power to implement a tax treaty and no existing treaties would give the President the power to unilaterally implement such a substantive tax overhaul. Furthermore, Pillar One is not simply a "political commitment" to improve the international tax regime, but requires a number of serious changes to the tax code. Based on this analysis, pursuing a congressional-executive agreement as an alternative method of implementation looks more like a political calculation than a legal determination.

If the Administration does try to implement Pillar One with a congressional-executive agreement, there are two major political considerations that must be taken into account. First, implementing Pillar One through a congressional-executive agreement would be a break from precedent. This would be the first time a substantive tax treaty would be implemented outside of the formal treaty ratification process. The Administration needs to determine if implementing Pillar One and overriding existing bilateral treaties via alternative means is worth the benefits of the global tax deal in spite of likely domestic political backlash. The backlash could make it harder to implement other international agreements in the future.

Second, it is uncertain whether a congressional-executive agreement is a practical alternative, considering that Democrats control the Senate with a simple majority. Furthermore, if the President moves forward with overriding existing bilateral treaties and implementing Pillar One via a congressional-executive agreement, given the *lex posterior* rule and the letters from conservative members of the Senate, bypassing the traditional treaty process would likely put Pillar One on precarious ground. If the Administration does not work in a bipartisan fashion now, there would be little to stop conservatives from passing legislation that overrides Pillar One the next time the Republican Party controls Congress. In addition, all signs indicate that Republicans would not be concerned with overriding Pillar One, despite the United States' international obligations.

Overall, this Article is skeptical about the successful implementation of Pillar One by the United States. This Article is sympathetic about the government's frustration over the treaty ratification process, which has been unfruitful for over a decade. Yet, if an executive agreement is used to bypass the treaty ratification process, there may be doubts as to the legality of this implementation method. Unfortunately, this Article cannot find a way to resolve this dilemma when it comes to Pillar One. However, there may still be guidelines or alternatives if we are willing to curb our commitment to Pillar One. The remainder of this Article offers some ideas.

B. Sever the Two Pillars

One objective of the OECD and the United States is to adopt both Pillars One and Two as a packaged deal. Both pillars address the tax challenges in

the digitalized economy and combat base erosion and profit shifting by multinationals. However, Pillars One and Two are conceptually distinct from each other—Pillar One strengthens source-based taxation, whereas Pillar Two reinforces residence-based taxation. Unlike what the United States argues, there is no logical reason to treat the two Pillars as "linked by more than just politics."[201]

More practically, the formulae for successful implementation are quite different from each other. Pillar One is proposed to be implemented by a multilateral instrument. Therefore, even if consensus is reached, each country will likely need to amend its local laws to adhere to Pillar One. Making these changes within existing political and legal systems will take time and may raise difficult issues of complexity and implementation, especially for developing countries with limited tax administration resources. Moreover, Pillar One requires all countries to give up on existing DSTs, and, as noted above, it may be politically onerous to persuade countries to abandon an established, prevalent tax.[202] The United States, on the other hand, is unlikely to adopt Pillar One unless all countries abandon the DSTs.

Although the multilateral solution to Pillar One orchestrated by the OECD is not promising, there are in fact alternatives to Pillar One. The United Nations offers another multilateral solution for taxing the digital economy in article 12B of the U.N. Model Tax Convention.[203] Large market jurisdictions from which most of the profits are derived can implement a unilateral measure to deal with the tax challenges relating to Pillar One—namely, tax nexus and profit allocation. With its fractional apportionment proposal, India has shown that a large market jurisdiction has the requisite data to singlehandedly adopt this alternative measure.[204] DSTs or other digital levies, such as a Data Excise Tax discussed *infra* Section IV.C., are viable unilateral alternatives to Pillar One.

Pillar Two, on the other hand, can be implemented by domestic legislation alone—at least the GLoBE rule, which is the main part of Pillar Two. It is a much better condition for initial implementation than Pillar One. Still, further international cooperation is required to make Pillar Two truly effective and successful, because if a country unilaterally adopts a minimum tax that is too high, it risks driving multinationals to establish their headquarters in other residence countries that do not have such a minimum tax.

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201. U.S. Department of the Treasury, *supra* note 43, at 7.

202. *See supra* Section I.A.

203. *See infra* Section IV.B.

204. Under the fractional apportionment proposal, the market jurisdiction calculates the profit margin of a multinational based on publicly available financial data, and then allocates the requisite percentage of that profit to itself using a formula. This formula can be either wholly sales based or (as India has proposed) a balanced formula that takes into account both demand and supply factors in generating profits. No other country needs to cooperate and, in the case of large markets, multinationals are unlikely to respond by pulling out. The risk of double taxation can be alleviated by a balanced formula, but such a move will also put pressure on other countries to adopt similar formulas.

That is why the United States, when it adopted GILTI unilaterally in the TCJA of 2017, applied a very low tax rate (10.5%) which is much too low as a minimum tax.[205] Moreover, over ninety percent of large multinationals are headquartered in the G20, so only a relatively small number of countries need to agree to implement an effective minimum tax.

In short, Pillar Two, compared to Pillar One, is a low-hanging fruit to combat the international tax challenges in the digital era. But Pillar Two still requires international cooperation, which can be obtained by the forthcoming global deal. In contrast, Pillar One faces copious obstacles that are unlikely to be resolved by the forthcoming global deal and subsequent implementation process. However, there are alternatives worth considering.

For these reasons, this Article contends that the two Pillars should be separated. The United States seems to push the repeal of DSTs not only as a condition of U.S. support for Pillar One, but also as a condition for Pillar Two, essentially making the two Pillars indivisible.[206] However, risking Pillar Two to salvage Pillar One is unwise. The United States should proceed with negotiations to adopt Pillar Two even if Pillar One fails.

C. *Avoid a Trade War*

The United States is the loudest voice against DSTs, claiming that DSTs violate international law because they are designed specifically to target U.S. companies.[207] The United States has signaled several times that it is willing to start a global trade war to protect U.S. multinationals from discriminatory DSTs. However, will starting a global trade war accomplish the United States' goal or protect U.S. multinationals from DSTs? This section provides a case study about a 2019 dispute between the United States and France. It concludes that some of the USTR's claims are flawed and that a trade war should be avoided.

1. *The U.S. Trade Representative's Investigation*

When the United States believes a foreign country has engaged in discriminatory or objectionable trade practices that disadvantage U.S. companies, its first course of action is to begin an investigation under Section 301 of the Trade Act of 1974.[208] Section 301 essentially grants the United States the authority to engage in a trade war with countries who have discriminatory policies.[209] Alternatively, the United States can file a complaint with

205. 28 U.S.C. § 250 (2017).

206. U.S. Department of the Treasury, *supra* note 43, at 7.

207. *See* Ruth Mason & Leopoldo Parada, *Company Size Matters*, 2019 Brit. Tax Rev. 610, 646–49 (2019); Ruth Mason & Leopoldo Parada, *Digital Battlefront in the Tax Wars*, 92 Tax Notes Int'l 1183, 1193–96 (2018).

208. 19 U.S.C. §§ 2411–2420 (2018).

209. 19 U.S.C. § 2411. Under Section 301, the USTR is to first determine whether one of three types of acts, policies, or practices of a foreign country are present: (1) trade agreement violations, (2) acts,

the World Trade Organization ("WTO") and utilize the WTO's forum to settle trade disputes with foreign governments.[210]

One contentious U.S. move against foreign DSTs began in 2019, against France. The USTR initiated its investigation of France's DST under Section 301 in July 2019, focusing on the discriminatory and unreasonable elements of the tax policy,[211] and determined that France's DST was "unreasonable or discriminatory" and "particularly burdensome for U.S. companies."[212] Based on this finding, the USTR initially proposed a 100% tariff on a variety of French products, including luxury goods and sparkling wine in December 2019,[213] with an import trade value of $2.4 billion.[214] After subsequent public comments and hearings, the USTR concluded that appropriate action was a twenty-five percent tariff on goods with a trade value of $1.3 billion.[215] This amount was intended to be "comparable, though somewhat lower," than France's "expected collections of approximately $450 million in [DST] taxes from U.S. companies for activities during 2020."[216] However, the USTR immediately suspended the tariffs until January 6, 2021 "to allow additional time for bilateral and multilateral discussions [on the global tax deal] that could lead to a satisfactory resolution."[217] Six days after the suspension expired, the USTR determined "that the imposition of duties on the current effective date of January 6, 2021 no longer is appropriate."[218] Thus, the retaliatory tariff for the DST was suspended indefinitely, retroactive to its effective date.[219] The timeline of this investigation is summarized in Chart 3.

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policies, or practices that are unjustifiable and burden or restrict U.S. commerce, and (3) acts, policies, or practices that are unreasonable or discriminatory and burden or restrict U.S. commerce. If a discriminatory practice is found, the United States has authority to engage in trade war tactics, such as imposing tariffs on imports, to prevent or stop the foreign country from imposing a discriminatory measure against the United States and its companies.

210. *Dispute Settlement*, World Trade Org. (Aug. 2, 2021), https://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm [https://perma.cc/J26D-4CDK].

211. Initiation of a Section 301 Investigation of France's Digital Services Tax, 84 Fed. Reg., 34042, 34043 (July 16, 2019).

212. Notice of Determination and Request for Comments Concerning Action Pursuant to Section 301: France's Digital Services Tax, 84 Fed. Reg., 66956, 66957 (Dec. 6, 2019).

213. *Id.*

214. *Id.*

215. Notice of Action in the Section 301 Investigation of France's Digital Services Tax, 85 Fed. Reg., 43292, 43293 (July 16, 2020).

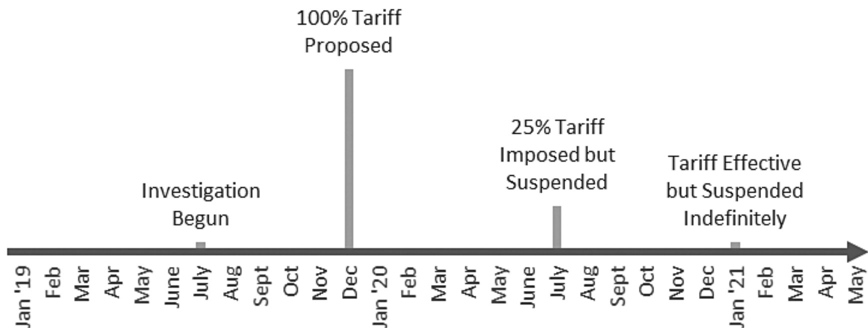
216. *Id.*

217. *Id.*

218. Notice of Modification of Section 301 Action: Investigation of France's Digital Services Tax, 86 Fed. Reg., 2479, 2479 (Jan. 12, 2021).

219. *Id.* at 2479–80.

CHART 3: FRANCE'S DST TIMELINE



In addition to the France case, the USTR imposed tariffs on certain goods from Austria, India, Italy, Spain, Turkey, and the United Kingdom in June 2021, arguing that the DSTs adopted by those countries discriminate against U.S. digital companies.[220] However, the USTR terminated the investigations against Brazil, the Czech Republic, the E.U., and Indonesia in March 2021, as these four jurisdictions have not yet adopted or implemented DSTs.[221]

2. *Is There Real Discrimination Against American Tech Giants?*

On December 2, 2019, the USTR released an investigative report on France's DST (the "USTR Report"). The Report concluded that the French DST is both intentionally and effectually discriminatory.[222] This Subpart explores in greater detail the USTR's conclusions on the French DST and examines the accuracy of the conclusions drawn.

Discrimination can be found in two different ways: 1) "where there is an intent to discriminate" and 2) "where the effect of the measure is discriminatory."[223] Intent discrimination "may be found in the expressed views of the legislators or regulators to put in place the measure or in the overall motive of the government in putting in place the measure, as gleaned from the wordings of the measure itself."[224] Effect discrimination "looks at whether the measure has a discriminatory effect or impact."[225]

220. *USTR Announces, and Immediately Suspends, Tariffs in Section 301 Digital Services Taxes Investigations*, OFF. OF THE U.S. TRADE REPRESENTATIVE (June 2, 2021), https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/june/ustr-announces-and-immediately-suspends-tariffs-section-301-digital-services-taxes-investigations [https://perma.cc/CHC3-9AVW].

221. Termination of Section 301 Digital Services Tax Investigations of Brazil, the Czech Republic, the European Union, and Indonesia, 86 Fed. Reg. 16,828 (Mar. 31, 2021).

222. ROBERT E. LIGHTHIZER, OFF. OF THE U.S. TRADE REPRESENTATIVE, REPORT ON FRANCE'S DIGITAL SERVICES TAX 76–77 (2019) [hereinafter USTR REPORT].

223. *See* Ogbu Okanga, *Testing for Consistency: Certain Digital Tax Measures and WTO Non-discrimination*, 55 J. WORLD TRADE 101, 108 (2021).

224. *Id.*

225. *Id.*

It is generally well-accepted that for a DST to be found discriminatory, there must be strong evidence of discriminatory effect, not just intentional discrimination.[226] Ruth Mason of the University of Virginia and Leopoldo Parada explain that "establishing discriminatory intent is not a necessary component of every fundamental-freedoms case" but "may be relevant . . . in cases involving facially neutral rules that have a discriminatory impact."[227] A finding of discriminatory intent may be used to "trigger impact analysis" or may even be used to "lower the quantum impact required to establish nationality discrimination."[228] Therefore, a discrimination claim against a DST must include evidence of a discriminatory impact, and can be strengthened with evidence of intent to discriminate.

a. Intent Discrimination

The USTR Report found intent discrimination in public statements made by French leaders.[229] For example, 1) "French officials repeatedly referred to the French DST, and the EU proposal on which it was based, as the 'GAFA tax,' which stands for Google, Apple, Facebook, and Amazon, or the 'GAFAM tax,' which also includes Microsoft;" and 2) "French officials have expressed that the DST should cover the U.S. 'digital giants' and not French and European companies, in order to make the latter group more competitive against the former."[230]

Read together, these statements by French officials paint the picture that France purposefully designed their DST to discriminate against U.S. companies. However, an alternative interpretation posits that France simply is tired of digital companies not paying their fair share of taxes to the appropriate sovereigns.[231] From France's standpoint, digital companies have avoided existing corporate tax rules because current tax laws do not account for the absence of physical presence based on these companies' digital nature.[232] As proof that digital companies are avoiding current corporate taxation rules, the European Commission announced that "on average digital companies pay an effective tax rate of just 9.5%, whilst traditional enterprises pay an effective rate of 23.2%."[233]

226. *See* Young Ran (Christine) Kim, *Will Digital Services Taxes Start a Global Trade War?*, *in* THINKER, TEACHER, TRAVELER, REIMAGINING INTERNATIONAL TAX, ESSAYS IN HONOR OF H. DAVID ROSENBLOOM 287 (Georg Kofler et al., eds., 2021).

227. Ruth Mason & Leopoldo Parada, *The Legality of Digital Taxes in Europe*, VA. TAX REV. 18, 18–19 (2020).

228. *Id.*

229. USTR REPORT, *supra* note 222, at 31–35.

230. *Id.* The USTR Report goes on to provide a substantive list of statements made by French officials to back their two reasons for finding intent discrimination.

231. French officials also complained about digital companies' ability to escape fair taxes. *See, e.g.*, Alderman, *supra* note 31.

232. Venetia Argyropoulou, *Digital Tax, Making Enterprises Pay Their 'Fair' Share?* (TILEC Discussion Paper No. DP 2019-007, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3383389.

233. *Id.*

Although France may have used American companies as scapegoats, the French statements indicate a desire to address a broader problem with the DST. Namely, that digital companies be made to pay their fair share of taxes and to prevent them from manipulating existing corporate income tax rules because of their digital nature. Thus, while the USTR Report finds intent discrimination, there is a plausible alternative argument for France.

b. Effect Discrimination

It is presently unclear whether the United States or France will win the argument pertaining to intent discrimination. However, as discussed above, pervasive discriminatory intent alone is insufficient "to build a successful tax discrimination case in international tribunals."[234] There must also be evidence of discriminatory impact.[235] This section examines two notable reasons the USTR Report uses to claim effective discrimination resulting from France's DST: (1) selective bias, and (2) revenue thresholds.[236]

i. Selective Bias

The United States argues that France's DST is discriminatory because of the selection of the services it encompasses. The DST covers two types of services where U.S. companies are very competitive: (a) internet advertising, and (b) digital interfaces. Meanwhile, it excludes areas where French and other European companies are successful.[237]

Internet Advertising Sector

France characterizes internet advertising under its DST by three conditions: 1) services marketed to advertisers or their agents; 2) advertising messages placed on a digital interface; and 3) messages targeted based on users' data.[238]

The USTR Report found that "U.S.-based company groups are highly successful in the internet advertising sector in France, and the French DST does not apply to other related sectors like traditional advertising, where French companies are more successful."[239] As evidence, the USTR Report notes that eight of the nine groups of internet advertising companies expected to be covered by France's DST are U.S.-based, while none are French-based companies.[240] Thus, the USTR concluded that "the evidence on the record . . . suggests that the DST's focus on targeted Internet advertising reflects, and achieves, French policymakers' desire to focus the DST on U.S.

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234. Kim, *supra* note 226, at 20.1.1.1.

235. *Id.*

236. The other two reasons are the deductibility of DST payments and retroactivity. For deductibility, see *id.* at 3.1.1.4.

237. USTR Report, *supra* note 222, at 35.

238. Ernst & Young, France Issues Comprehensive Draft Guidance on Digital Services Tax (2020).

239. USTR Report, *supra* note 222, at 35.

240. *Id.*

companies and not French companies."[241] In summary, France is discriminating against U.S. companies by choosing to only tax internet advertising, while ignoring traditional advertising.[242]

However, the USTR's analysis is flawed in its assumption regarding the exclusion of traditional advertising companies. The purpose of enacting a *digital* services tax is to make sure *digital* companies are paying their fair share of taxes. There is no evidence that traditional advertising companies can similarly manipulate existing corporate income tax rules. Traditional advertising companies are not exclusively digital in nature, which is the key component digital companies rely on to avoid paying market country corporate income taxes. Conversely, U.S.-based traditional advertising companies that are successful in France, would have a physical presence in France and would have already paid their fair share of French taxes. Additional tax rules would not be needed. The USTR's claim of discrimination is not convincing because it ignores the origin of the problems.

A better analysis would be determining whether French internet advertising companies are taking advantage of physical presence corporate income taxation rules, and, if so, whether those French companies are being excluded from the tax. Or more broadly, if there are non-U.S. internet advertising companies taking advantage of French corporate income tax laws, and they are excluded from the DST, there is a stronger argument for discrimination against U.S. companies.

The USTR Report states that "[t]here are French companies that provide Internet advertising services" and cites to the French Interactive Advertising Bureau to illustrate the fact that these companies exist.[243] A recent article published by The Manifest provides the "Top 20 Digital Marketing Companies in France,"[244] Criteo is a large, successful, French internet advertising company. The companies on the list illustrate that French internet advertising companies also have the potential to take advantage of corporate income taxation rules due to their digital nature, just like GAFA.

<u>*Digital Interfaces*</u>

France's DST only applies to digital platforms or marketplaces where users can connect with other users for social purposes or to buy and sell goods or services between themselves. It does not apply to "digital interface" providers (i.e., a company operating an online marketplace whereby they sell their own product online in addition to their physical store, such as Walmart or Target).[245]

241. *Id.* at 37.
242. *Id.* at 31–35.
243. *Id.* at 36.
244. *List of the Best France Online Marketing Agencies*, MANIFEST (Apr. 2022), https://themanifest.com/fr/digital-marketing/agencies [https://perma.cc/GG4J-9CB5].
245. USTR REPORT, *supra* note 222, at 14, 38.

The USTR claims that this "distinction has the effect of excluding French companies from the scope of the DST while covering their U.S.-based competitors."[246] The USTR Report lists several French companies they claim are successful in e-commerce and should be subject the DST, including Carrefour (sp), Le Redoute, Cdiscount, Fnac, Vente-Privee, Auchan, and Showroomprive, but are not covered because of this distinction.[247] In fact, on the digital interfaces side, twelve of the twenty-one company groups that will be subject to the French DST are U.S.-based; not one French company group is expected to be covered by the tax.[248] The USTR Report noted that "U.S. companies do not dominate the French market" in the digital interfaces space and so while there was an opportunity to include French companies who use a digital interface, France purposefully defined "digital interface services" in a way to exclude French companies and discriminate against U.S. companies.[249] Thus, the USTR believes that France's definition of digital services is effectually discriminatory against U.S. companies.

The USTR Report also notes that the French DST and E.U. DST proposal carve out types of digital interfaces where European or French companies are particularly successful, such as online music sales.[250] When the E.U. DST proposal carved out "digital content," commentators suggested that this was to avoid covering the Swedish music streaming giant Spotify. France also carved out "digital content," allowing them to avoid taxing Spotify and the French company Deezer. However, France eliminated the "digital content" carve-out as applied to apps, where two U.S. companies (Apple and Google) are the dominant sellers globally.[251] Therefore, this aspect of the French DST seems discriminatory toward U.S. companies.

However, one pitfall in the USTR's analysis is that many of the French companies described in the USTR Report are primarily traditional retailers and are not digital platform companies. These traditional retailers may have online components for selling products carried in-store, but they are not operating a digital interface in the way that Google, Amazon, Facebook, and Apple are. As noted earlier, the problem DSTs are attempting to solve arises through these companies' ability to engage in profit-shifting activities and tax nexus avoidance in foreign countries based on the absence of physical presence. The French companies mentioned in the USTR Report already have tax nexus with France because they are physically located within the country. Because there is no tax nexus issue, France reasonably excluded these types of companies from their DST.

246. *Id*. at 38.
247. *Id*.
248. *Id*.
249. *Id*.
250. *Id*. at 39–40.
251. *Id*.

ii. Revenue Thresholds

The USTR argues that the revenue thresholds of France's DST are effectively discriminatory because "the revenue thresholds focus the DST on U.S.-based companies and exclude many non-U.S.-based companies that supply the covered services in France."[252]

France's DST only applies to companies that earn annual revenues of 750 million euros globally and twenty-five million euros in France from supplying the covered services.[253] The rationale for such high revenue thresholds in a DST is seemingly "to target tech giants that enjoy monopoly power and yet do not pay enough tax in the market countries."[254] Therefore, the USTR claims that the high revenue thresholds effectively discriminate against U.S. companies by excluding French companies from DST liability while subjecting U.S. companies to the tax.[255]

A possible counter to this argument is that the threshold requirements are not selectively targeting U.S. companies, as any country's digital company above the threshold is subject to the tax. In terms of effect discrimination, however, there is a good argument to be made that France was aware that setting high thresholds would limit the effect of its DST to prominent American digital companies.

The USTR notes that there are non-U.S.-based companies that supply covered targeted advertising services.[256] A majority of the corporate members of the French Interactive Advertising Bureau are French.[257] Additionally, there are many traditional French advertising companies that also provide internet advertising services as part of their business, such as Publicis and Havas.[258] However, neither business meets both of France's DST revenue thresholds.[259]

The USTR Report concludes that because of the revenue thresholds "twelve of the twenty-one company groups expected to be covered by the DST with respect to 'digital interface' services are U.S.-based" and no French companies are expected to be covered.[260] The USTR Report provides examples of French companies that supply digital interface services in the French market,[261] yet despite their substantial revenues, are excluded from the DST.

As an initial observation, it is doubtful that the purpose of the DST is to target French companies that provide some internet advertising services as

252. *Id.* at 41.
253. *Id.*
254. *See* Kim, *supra* note 226, at 20.3.1.1.3.
255. USTR Report, *supra* note 222, at 41; Kim, *supra* note 226, at 20.3.1.1.2.
256. USTR Report, *supra* note 222, at 41.
257. *Id.*
258. *Id.* at 42–43.
259. *Id.*
260. *Id.* at 44.
261. *Id.*

non-primary parts of their business. These companies already have tax nexus with France and the USTR has provided no evidence that these businesses are able to avoid their fair share of tax compared to digital companies. Therefore, the USTR's claim that the French DST is effectively discriminatory is weakened by the fact that French companies providing internet advertising services cannot avoid taxes like other digital companies, since tax nexus is already established by their physical presence in France.

For example, the USTR Report states that Orange S.A., a French multinational telecommunications company, should and would be subject to the DST if it were not for the revenue thresholds.[262] However, Orange S.A. provides telecommunication services similar to the U.S. companies Verizon and AT&T. Its internet advertising services performed are programmatic targeted internet advertising services similar to those offered by Verizon and AT&T in the U.S. in the form of commercials and ads. These telecommunication companies are not providing the same type of internet platform services like Google offers and are therefore less likely to engage in profit shifting activities.

However, some examples provided by the USTR provide a strong argument in favor of discrimination. For example, the Report listed SoLocal Group, a group of digital advertising companies that works with over 700,000 advertisers to reach individuals across Europe.[263] SoLocal Group's business is more in line with the internet advertising the DST attempts to tax because their digital nature allows them to provide services in foreign countries without physical presence, which creates opportunities for profit shifting.[264] In 2017, SoLocal Group recorded 755.8 million euros in total revenue, including 635.8 million euros in Internet revenues. SoLocal Group escapes DST because their Internet revenues were less than the French threshold of 750 million euros required to subject them to the tax. The USTR may further investigate why France set the revenue threshold at 750 million euros, although France is expected to respond that it merely followed the global trend—that is, most DSTs either currently in effect or in consideration offer similar amounts as global revenue thresholds.[265] Nonetheless, this point is more effective than the case of Orange S.A.

In short, despite some merit, the Article notes the USTR Report's biases and exaggerations to reach the conclusion that France's DST is discriminatory.

3. *The Case Against Retaliatory Tariffs*

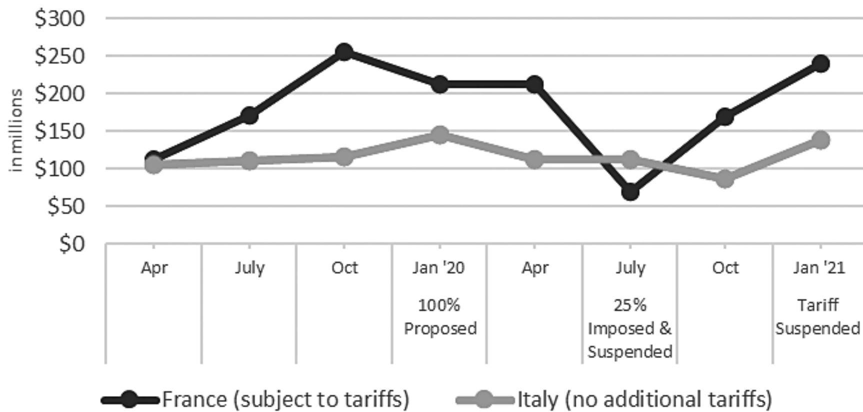
Retaliatory tariffs will likely harm the United States without having a deterring effect. This section examines a case where tariffs were imposed on

262. *Id.* at 42.
263. *Id.*
264. SoLocal, https://www.solocal.com/en [https://perma.cc/A2ET-6M52].
265. *See* Kim, *supra* note 226, at 20.3.1.1.3.

French sparkling wine to retaliate against France's proposed DST, and demonstrates that such retaliatory tariffs have neither caused financial harm to the French wine industry nor have pressured France to discard its DST.

Economists consistently indicate that international free trade and the elimination of protectionist measures benefit every nation involved and that tariffs are inefficient and harmful to economies.[266] In particular, economist Kimberly Clausing of UCLA provides four reasons that tariffs "add insult to injury" for American workers.[267] Her four reasons are: (1) Tariffs act as regressive taxes on consumption, (2) tariffs and trade wars wreak havoc on U.S. labor markets by raising costs for American companies, (3) trading partners often retaliate when tariffs are raised on their imports, and (4) trade wars harm the global economy resulting in weakened alliances.[268] In addition to economists supporting free trade, Clausing argues that open economic policies are in the best interest of American workers.[269]

Chart 4: Sparkling Wine Imports



The four reasons against tariffs manifest in DST tariffs as well. To illustrate, consider the U.S. importers of French sparkling wine affected by the retaliatory DST tariffs.[270] The U.S. sparkling wine importers are chosen by the USTR as "sacrificial companies" to protect GAFA (Google, Apple, Facebook, and Amazon), or "protected companies" arguably harmed by foreign nation discrimination. Theoretically, importers of French sparkling

266. *See, e.g.*, Matthew Nolte, *Causes and Casualties of History's Largest Trade War*, 38 ARIZ. J. INT'L & COMP. L. 81, 84 (2021).

267. Clausing, *supra* note 18, at 115.

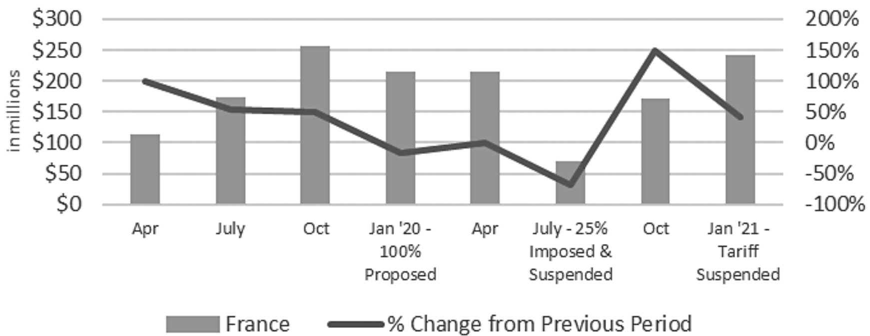
268. *Id.* at 115–16.

269. *Id.* at 110.

270. Data for this case study was collected and analyzed by Laura Kent-Jensen (B.S. Stanford University, J.D. University of Utah, Founder and former CEO of a wine import company, Bon Vivant Imports, Inc.) (data used with permission, on file with the authors).

wine would suffer no economic impact because tariffs related to France's DST were immediately suspended. However, Chart 4 shows the increased imports prior to an anticipated tariff and decreased imports coinciding with the actual tariff, compared to the constant quantity of import of Italian sparkling wine where no additional duties were threatened.[271] Chart 5 confirms this observation, and shows that a twenty-five percent tariff proposal can result in a seventy percent reduction in import, meaning reduced profits.

Chart 5: Change in Sparkling Wine Imports



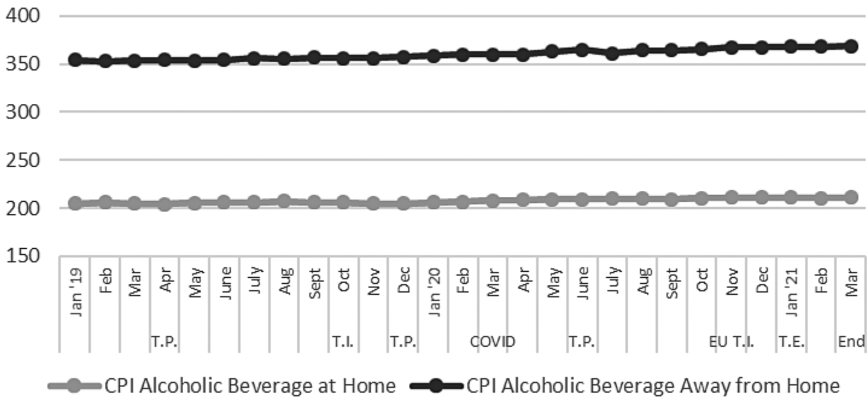
In addition, wine that an importer continues to purchase suddenly costs twenty-five percent more than it had before the tariff. If the importer absorbs some of that cost, profit margins are reduced. If the importer passes along the increased cost, that impacts companies downstream in the value chain.[272] It may take time for the tariff incidence to reach its ultimate destination, the consumer. However, given a stable consumer price index for alcoholic beverages throughout the period shown in Chart 6,[273] it is reasonable to conclude that the DST tariff creates negative effects for sacrificial companies that will ripple throughout the supply chain.

271. The rebound effect after July 2020 was because importers were certain at that time of the 6-month suspension.

272. To evaluate the effect on downstream businesses, the most applicable data to measure the adverse effects would be *lost sales* and *lost jobs*. However, the authors did not find the results to have sufficient merit to exhibit here, given that the timeline of the DST tariff significantly overlapped with the COVID-19 pandemic. The pandemic's effects on data are so pronounced that it is difficult to draw conclusions about the lost sales and lost jobs. For sales, Federal Reserve Economic Data (FRED) tracks retail sales for wine at liquor store and restaurant sales (data on file with authors), but the increase in retail sales and sharp decrease of restaurant sales in March 2020 coincides with the start of the pandemic. As such, the trend is much more likely explained by the pandemic changing consumers' alcohol purchasing habits. For employment, restaurant employment plummeted sixty-seven percent during the initial COVID-19 outbreak and remained more than forty percent below pre-COVID-19 rates. However, the effects of the COVID-19 pandemic again overwhelm any discernible pattern.

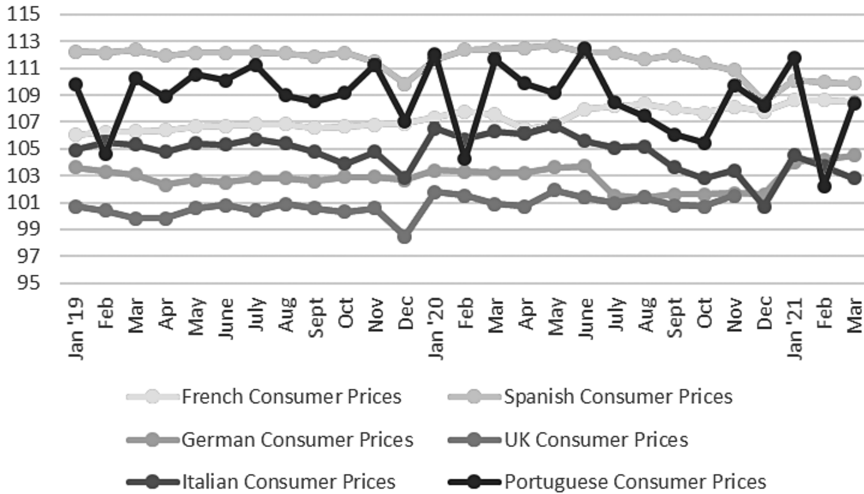
273. FRED provides information on consumer pricing. The data does not distinguish wine pricing within the category of alcoholic beverages, but it provides a record of pricing for consumption in the home and at bars and restaurants, using an index set to 100 in 1983.

Chart 6: Consumer Prices for Alcoholic Beverages



Another critical question is whether the tariff has its intended effect on the foreign country—in this case, France. Again, the implied objective of retaliatory tariffs is to create an adverse financial effect on the foreign nation's market significant enough to induce the country to eliminate its discriminatory trade practices. However, DST tariffs neither caused discernable financial harm to the French wine industry nor has France abandoned its DST. First, Chart 7 is Eurostat's consumer price index for wine in Europe by country of origin. One might expect that intended consequences of DST tariffs would result in a decrease in U.S. import from targeted countries, such as France, Spain, and the United Kingdom (as opposed to Italy and Portugal, which were not targeted), and thus a decrease in prices of the targeted wines in the months after October 2019, and again after January 2021 when tariffs were implemented. However, despite the decrease in U.S. imports of wines from the targeted countries like France, there is no corresponding decrease in pricing in the home country. This means that countries like France were able to sell their wines in other markets.

Chart 7: Wine Consumer Price Index for Foreign Markets



Second, DST tariffs did not effectively motivate France to abandon its DST. The underlying issue of how to collect tax revenues from companies that provide value within France but do not meet physical presence requirements continues. Hence, as the USTR acknowledges, France intends to continue with its DST. Not only was France's DST still in effect in 2021, but several other countries considered DSTs of their own.[274] Ultimately, retaliatory tariffs failed to eliminate France's DST, and they failed to discourage other countries from enacting similar measures. Perhaps in recognition of its ineffectiveness in halting DSTs, the United States postponed the retaliatory tariff in July 2020,[275] before permanently suspending it in January 2021.[276]

As such, the tariffs failed to achieve the primary stated objective of causing foreign countries to eliminate their objectionable trade practices. The most favorable view is that the tariff encouraged foreign countries to consider changes to their practices and to continue discussions with the United States to achieve better solutions. However, the option to negotiate modified or improved agreements with foreign nations is a statutory action available to the USTR even without tariffs.[277] In the worst case, the tariffs can be seen as an aggressive, noncooperative act that may encourage a nonproductive trade war and exacerbate the harmful effects of the tariff itself.

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274. *See supra* Section I.A.

275. Notice of Action in the Section 301 Investigation of France's Digital Services Tax, 85 Fed. Reg., 43292, 43292 (July 16, 2020).

276. Notice of Modification of Section 301 Action: Investigation of France's Digital Services Tax, 86 Fed. Reg., 2479, 2479 (Jan. 12, 2021).

277. 19 U.S.C. § 2411(c) (2018).

Even when additional objectives are considered, such as "pressuring affected countries into broader negotiations,"[278] the lack of economic impact on those foreign countries calls the effectiveness into question. Perhaps it is not the actual economic impact of tariffs, but the threat of the tariffs and the prospect of an escalating trade war that serves as the pressure.

Furthermore, additional negative impacts from tariffs may arise when countries retaliate with their own tariffs, such as impacting unrelated industries.[279] For example, former President Trump's steel and aluminum tariffs resulted in retaliatory Chinese tariffs against exported American goods, specifically soybeans.[280] This retaliatory measure affected a U.S. industry that is otherwise removed from both the steel and aluminum industries. To combat this industry-shifting burden created by tariffs, Trump offered to cease future tariffs on automobiles and automobile parts in exchange for the E.U. Commissioner's agreement to lower their own retaliatory tariffs and expand imports of liquified natural gas and soybeans.[281]

In brief, although the USTR claims of discrimination may justify starting a trade war, some of their claims are flawed. Hence, before taking trade-war actions, policymakers must consider the potential radiating effects. Retaliatory actions may have a far-reaching impact beyond initial concerns of sacrificing the value of free trade and may expand into a multi-party trade war. Throughout the course of a trade war, the harm falls on U.S. consumers. When the trade war escalates, U.S. consumers as well as small- and medium-sized businesses—sacrificial companies—will suffer from higher prices due to tariffs on imported goods and services. From an electoral perspective, it is unlikely that American consumers will be sympathetic to policymakers starting a trade war to protect tech giants who are thriving in the wake of COVID-19.

IV. Alternatives to Pillar One

Previous Parts demonstrated the limitations of current digital tax reform proposals and advised guidelines for the U.S. reaction. This Part provides normative proposals for digital taxation, first offering policy criteria and then developing multilateral and unilateral alternatives to Pillar One.

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278. Cong. Rsch. Serv., RL45529, Trump Administration Tariff Actions: Frequently Asked Questions 2 (2019).

279. Csongor István Nagy, *World Trade, Imperial Fantasies and Protectionism: Can You Really Have Your Cake and Eat It Too?*, 26 Ind. J. Glob. Legal Stud. 87, 96 (2019) ("Retaliatory measures may target an industry other than the protected sector.").

280. Jacob Ely, *The "National Security" of Nations: President Trump's Pretextual Tariff Rationale and How to Overcome It*, 3 Int'l Comp. Pol'y & Ethics L. Rev. 241, 257 (2019).

281. *Id.*

A. Criteria for Digital Taxation Policy

To solve the problems identified by this Article, a proposal for digital taxation must meet three goals. First, a policy proposal should overcome the outdated physical presence nexus rule and fairly allocate appropriate tax revenue to market countries. Furthermore, the proposal should be free from any indicia that can be viewed as discriminating against companies based on nationality. Finally, the proposal needs to be administrable by tax authorities and taxpayers alike. A simple, targeted approach may in fact work better and more efficiently than an ambitious, comprehensive approach which inevitably invites political compromises.

The traditional criteria for evaluating tax policy are equity (or fairness), economic efficiency, and administrability (or simplicity).[282] What criteria, if any, for sound digital tax policy can be derived from them? After we discuss the traditional criteria, we will look at the policy rationales stated in the Pillar One Blueprint for additional criteria.

A proposal for the fair reallocation of tax revenue seems to implicate the *equity* prong. However, economists tend to explain this issue under the *efficiency* prong, because proposals to reallocate taxing rights to markets address taxpayers' incentives to shift profits and avoid taxes. In fact, fairness in the context of digital taxation has at least two dimensions—fairness amongst the countries that receive the tax revenue and fairness amongst the taxpayers who bear the economic burden of the tax. Evaluating fairness amongst taxpayers thus requires identifying the incidence of such a tax.[283] A group of scholars at Oxford University argues that the incidence of such tax depends on the conditions in each market where multinationals operate, and, as such, that identifying the tax incidence is "almost impossible."[284] Thus, instead of fairness, they emphasize economic efficiency and ease of administration in assessing digital tax proposals. It is also argued that taxation of business profit generally cannot be assessed in terms of fairness. Businesses adjust their behavior in response to taxation. Taxation affects the prices of goods and services sold, as well as the prices of inputs used, including employee wages. Where the burden falls on the income distribution is difficult to determine. Without identifying its incidence, we cannot assess its progressivity or regressivity.[285]

Economic efficiency and administrability have inconsistent implications for digital tax policy. To maximize the profits allocation to market coun-

282. For an early statement of the traditional criteria, see Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations (1776). For a comprehensive discussion of tax policy criteria, see Michael J. Graetz et al., Federal Income Taxation Principles and Policies 28–32 (8th ed., 2018); Allison Christians, Introduction to Tax Policy Theory (2018).

283. *See, e.g.*, Richard Collier et al., *Comparing Proposals to Tax Some Profit in the Market Country*, World Tax J. 405, 415 (2021).

284. *Id.*

285. *See* Michael P. Devereux et al., Taxing Profit in A Digital Economy 34–37 (1st ed. 2021).

tries, the scope of the new digital tax proposal should be as broad as possible. However, where scope is defined by sector, the administrability prong suggests limiting the number of sectors—fewer complex revenue sourcing rules have to be designed and implemented.[286] To prevent companies from reclassifying their activities to avoid market taxation, tax authorities will need to police the boundary between activities that are within and without scope.[287] Defining scope by a very high threshold amount, as the Statement does, "offers unambiguous administrative advantages."[288] This can make the proposal simple, but it may be less precise and too generalizing.

Under the principle of economic efficiency, a tax should be neutral. It should not distort economic outcomes. This has implications for the definition of "market" countries. In the context of digital taxation, efficiency requires minimizing distortion to the location choices of multinationals. To do so, the location of the tax base should be determined by immobile factors.[289] Indirect purchasers or users will not move in response to the multinational's new tax liability. Therefore, the "market" should be defined to include the location of indirect purchasers or users, as opposed to direct purchasers alone. However, defining the "market" as such will increase administrative costs. Revenue sourcing rules will be made even more complex by the need to look through sets of transactions for indirect purchasers or users.

Let us now connect the discussion above to the policy rationale of the Pillar One Blueprint. The Blueprint provides the foundation for an agreement "that would adhere to the concept of net taxation of income, avoid double taxation and be as simple and administrable as possible."[290] Should the new tax be on a net basis, specifically residual profit? Residual profit is similar to economic rent, although not equivalent, and thus, a net basis tax targeting residual profit would be less distortionary. However, tax on a *gross basis* is easier to collect. Since it does not take costs into account, revenue is easier to identify. While net basis taxation is more efficient, gross basis taxation is easier to administer with less opportunity to manipulate revenue sourcing rules.[291] Although that tips the scale slightly, the choice between net and gross basis taxation is not clear enough to declare one a criterion of "digital tax" policy. The prevention of double taxation (and of double non-taxation) is the purpose of the tax treaty network. Thus, any digital tax proposal should have a mechanism to eliminate double taxation.

286. The proposed source rules are in preliminary form. Key details on each of their general principles have been left to the forthcoming Commentary. If the source rules are complex now, imagine what their next iteration will look like. *See, e.g.*, Stephanie Soong Johnston, *OECD Working to Cut Revenue Sourcing Complexity, Tax Chief Says*, 105 Tax Notes Int'l 936 (2022).

287. *See* Collier et al., *supra* note 283, at 424.

288. *Id.*

289. *See* Devereux et al., *supra* note 285, at 34–37.

290. OECD, Pillar One Blueprint, *supra* note 38, at 8.

291. Collier et al., *supra* note 283, at 425.

The next two sections propose multilateral and unilateral alternatives to Pillar One and evaluate them using the criteria discussed in this section.

B. The U.N. Proposal as a Multilateral Alternative

Article 12B of the U.N. Model Tax Convention is the U.N.'s response to the taxation of the digital economy. Approved in April 2021, article 12B eliminates the physical presence requirement and expands the taxing rights of market countries to income from Automated Digital Services.[292]

The scope of article 12B is limited to Automated Digital Services, defined as "any service provided on the internet or an electronic network requiring minimal human involvement from the service provider."[293] Note that this definition is substantially similar to the definition in the Pillar One Blueprint. Unlike the Pillar One Blueprint version, however, no minimum threshold is prescribed for revenue or profitability.

According to the Model Tax Convention, the country where income from Automated Digital Services arises may tax the income on a gross basis, possibly via a withholding tax, unless the income constitutes royalties or fees for technical services. Here, the source jurisdiction is the country from which payments for Automated Digital Services are made, either by a resident or by a person with a permanent establishment or fixed base which bears the payments. If the income from Automated Digital Services is attributable to a permanent establishment or fixed base in the source jurisdiction, it is excluded. Tax on gross income is capped at a rate to be negotiated between treaty partners.[294] The U.N.'s Commentary to article 12B suggests a modest rate of three or four percent.[295]

In addition, taxpayers may elect to be taxed on a net basis.[296] This option provides relief when either: (i) the taxpayer's tax liability is lower than it would be under gross basis taxation subject to the withholding tax mechanism; or (ii) the taxpayer has a global business loss or a loss in the relevant business segment during a taxable year.

Article 12B has noteworthy merits and this Article believes it superior to Pillar One. It dispenses with the physical presence requirement for tax nexus and allocates more profits to market countries. It cannot be accused of discriminating against companies of certain nationalities. Article 12B's option of gross or net basis taxation is its most striking feature and may be its greatest strength. As discussed in the previous Section, neither gross nor net basis taxation is a clear criterion of digital tax policy. However, article 12B

292. U.N. Proposal, *supra* note 13, ¶¶ 1, 2.

293. *Id.* ¶¶ 5, 20.

294. *Id.* ¶ 2.

295. *Id.* ¶ 28.

296. For net basis taxation, the taxpayer may require the source country to tax its qualified profits, defined as thirty percent of the amount resulting from applying the profitability ratio to the gross annual revenue from automated digital services. *Id.* ¶¶ 3, 26–27.

preserves the choice between the two, which may satisfy those who believe that income, not gross revenue, is the appropriate basis for corporate taxation. Article 12B is also simpler to administer than Pillar One. The withholding tax mechanism is a reliable and efficient method for collecting tax, because taxpayers are not required to compute their net profits or file tax returns. Furthermore, because article 12B builds on established foundations, it may be easier to introduce than Pillar One. For instance, article 23 (methods for the elimination of double taxation) is already in place to deal with double taxation. A caveat for the United States is that it needs to offer a foreign tax credit against the U.S. tax even though the tax paid to market countries is on a gross basis. However, Pillar One also has such foreign tax credit issues, as long as the new tax imposed by market countries is regulated by tax treaties.

Article 12B is technically a bilateral proposal. Because it is a part of the U.N. Model Tax Convention, it is supposed to be included in, and implemented by, a bilateral tax treaty between countries who want to model this approach. For the reasons adduced in this Section, however, article 12B may also serve as a proposal for a multilateral instrument, which would be a stronger model for a multilateral agreement than Pillar One's approach.

C. A Data Excise Tax as a Unilateral Alternative

This section proposes a unilateral alternative to Pillar One. After evaluating two data tax proposals, the New York Data Mining Tax and Omri Marian's Data Tax Proposal, and identifying the benefits and detriments of both, it proposes its own proposal, a Data Excise Tax.

1. *Existing Proposals*

In a perfect storm of jurisdictional need for revenue and tech giants bursting at the seams with cash during an otherwise devastating time for businesses, various countries have enacted DSTs.[297] As part of the desire to harness the growth of the digital economy, not less than ten states in the United States are also enacting or proposing various types of DSTs, using these countries as models.[298] Maryland's Digital Advertising Tax, effective on January 1, 2022, is the frontrunner.[299] There is a novel Data Mining Tax by New York,[300] which provides insight into how to improve not only subnational DSTs, but also international DSTs.

297. *See supra* Section I.A.

298. Andrew Appleby, *Subnational Digital Services Taxation*, 81 MD. L. REV. 1, 7–8 (2021); Darien Shanske & Young Ran (Christine) Kim, *Taxing Digital Platforms*, 98 NOTRE DAME L. REV., 19–20 (forthcoming 2022–23).

299. HB 732, 2020 Leg., Reg. Sess. (Md. 2020); Timothy Vermeer, *State Tax Changes Effective January 1, 2022*, TAX FOUND. (Jan. 11, 2022), https://taxfoundation.org/publications/recent-state-tax-changes/ [https://perma.cc/63QZ-93D5].

300. SB 4959, 2021 Leg., Reg. Sess. (N.Y. 2021) (introduced Feb. 19, 2021); AB 6199, 2021 Gen. Assemb., Reg. Sess. (N.Y. 2021) (introduced Mar. 10, 2021).

New York's Data Mining Tax is an excise tax on the collection of New York consumer data measured by the number of New York residents from whom data is collected.[301] The taxpayer is the *commercial data collector*, not the user.[302] The rate structure of this tax is progressive: Commercial data collectors who collect data from between one to two million New York residents will pay $0.05 per resident per month.[303] At the far end of the progressive structure, the tax rate increases to $0.50 per New York resident plus $2.25 million where commercial data collectors are collecting data from more than ten million New York residents each month.

This proposal has been praised for several aspects of its design. First, the tax is less discriminatory due to the application threshold being based on *users* rather than gross receipts.[304] Second, the conventional progressive rate structure eliminates severe "notch" or "cliff" effects. Taxpayers pay the same amount of tax based on how many users' data is collected within the taxable period, subjecting the largest collectors to a higher rate; but higher rates are only paid on each New York resident beyond the specified threshold. Third, because this tax directly taxes data collection, some commentators recommend this tax if jurisdictions want to impose a tax on the value associated with collecting and monetizing user data, whereas using digital advertising as a proxy for that value is ineffective.[305]

Despite the many positive features, there are a few drawbacks. First, given the tax's extreme effectiveness at raising revenue, businesses facing exorbitant tax bills may withdraw from jurisdictions or pass portions of the tax burden onto customers.[306] Furthermore, there are generally some reservations to excise taxes. As a result, the Council on State Taxation warned New York lawmakers that they are generally opposed to excise taxes on business inputs and that they believed subjecting commercial data collectors to this tax would result in double taxation.[307] Additionally, commentators argue that this tax would result in significant record-keeping issues for commercial data collectors, citing concerns of double-counting the same New York resident, the difficulty of determining New York resident status, and data anonymity issues.[308]

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301. Matt Hunsaker & Jeewon Kim Serrato, *NY Data Tax Bill Would Create Practical, Policy Hurdles*, 2021 LAW360 (Mar. 31, 2021), https://www.law360.com/articles/1370746/ny-data-tax-bill-would-create-practical-policy-hurdles (last visited Apr. 14, 2022).

302. *Id.* (defining "data collector" as "a for-profit entity that 'collects, maintains, uses, processes, sells or shares consumer data in support of its business activities'").

303. James Nani, *NY Proposal to Tax Data Collection Draws COST Objection*, 2021 LAW360 (Mar. 12, 2021), https://www.law360.com/tax-authority/articles/1364335/ny-proposal-to-tax-data-collection-draws-cost-objection (last visited Apr. 14, 2022).

304. Appleby, *supra* note 298, at 22.

305. *Id.* at 17; Karl A. Frieden & Stephanie T. Do, *State Adoption of European DSTs: Misguided and Unnecessary*, TAX NOTES (May 6, 2021), https://www.taxnotes.com/tax-notes-state/nexus/state-adoption-european-dsts-misguided-and-unnecessary/2021/05/10/59p2l (last visited Apr. 14, 2022).

306. Appleby, *supra* note 298, at 17–18.

307. Nani, *supra* note 303.

308. *Id.*

In the same vein, Omri Marian proposes a theoretical framework for a data tax similar to the proposed New York Data Mining Tax.[309] Marian's data tax is an excise tax with a broader tax base based on the *volume of data*, measured via gigabytes, rather than per resident.[310]

The crux of Marian's idea is as follows: "Data is the value, so it is being taxed as such. Not as a proxy for some other measurement of value."[311] He poses three principles for the data tax: (1) volume (not value) of raw data comprises the tax base; (2) all data uses are included in the tax base; and (3) the taxpayer is the user of the data.[312] In Marian's proposal both uploads and downloads are taxable and measurable.[313]

Marian argues that ascribing monetary value to data is an insurmountable and logically incoherent task, which is why the proposal attempts to avoid this by instead taxing its volume.[314] This is beneficial because "[a] tax on data volume has the benefit of being self-adjusting."[315] Development in the legal system, including the tax system, is considered sluggish compared to the pace of technological development. However, taxing the raw commodity—in this case the data—will allow the tax to adjust to technological advances because the more advanced technology, the more data used, and thus, the higher the tax.[316]

It is also worth noting Marian's justification for an excise tax as a data tax. Generally, excise taxes are criticized for being regressive. However, Marian argues that this data tax is progressive because it is a direct tax on data owners, arguably targeting the "data-rich" that are able to avoid income taxes, but not the "data-poor" who are unable to avoid them.[317] Marian also indicates that a direct data tax as an excise tax is efficient and easily administrable because the tax is collected where the data is collected, making the sourcing issue manageable. Moreover, measuring the volume of data is possible, as shown by cellphone companies.[318]

2. *New Proposal*

Inspired by the two proposals discussed above, this Subpart proposes a direct Data Excise Tax as an alternative unilateral measure to DSTs. The details of the E.U.'s forthcoming digital levy are undetermined. But the Article believes that the proposed Data Tax would offer a good benchmark for the E.U., resolving various policy concerns discussed throughout this

309. Omri Marian, *Taxing Data*, 47 BYU L. Rev. 511 (2022).
310. *Id.* at 562.
311. *Id.* at 569.
312. *Id.* at 562.
313. *Id*. at 563.
314. *Id.* at 562.
315. *Id.*
316. *Id.* at 563.
317. *Id.* at 565.
318. *Id.* at 563–567.

Article. Furthermore, the proposed Data Excise Tax is not only helpful to foreign countries, but also the fifty states considering an improved subnational digital taxation mechanism.

The tax base of the proposed Data Excise Tax is the *volume of collected data*, measured in gigabytes. It does not adopt New York's Data Mining Tax's per capita measurement, which imposes the same amount of tax to commercial data collectors for the data of heavy users and that of light users, because each user counts only once regardless of the amount of data collected from those two users. That is neither efficient nor fair.[319] Also, this proposal is different from Marian's proposal in that it only taxes the volume of *collected* (or downloaded) data, and thus uploads are irrelevant.

To illustrate, consider the hypothetical example of William. William, who lives in the United Kingdom, wants to purchase a new car. William is particularly interested in a mid-size luxury German sedan, and he begins the car-buying process by "googling" key words like "ten best sedans for 2021." Google shows search results, such as sedans by Toyota, Hyundai, Mercedes-Benz E-Class, Audi A7, and BMW 5 Series. The search results include an advertisement of Mercedes-Benz E-Class. William skips Toyota, Hyundai, and only clicks Mercedes-Benz E-Class, Audi A7, and BMW 5 Series.

For Google, the data of "ten best sedans for 2021" collected from William is meaningful, because the algorithm processes that data associated with William's existing information, as well as with big data from other users, and can produce a tailored result. The information that William clicks only Mercedes-Benz E-Class, Audi A7, and BMW 5 Series is also substantial, because now Google has data of William's preference. Thus, Google is required to pay the proposed Data Excise Tax on the collected (or downloaded) data from William—that is, "ten best sedans for 2021" and the user's click of Mercedes-Benz E-Class, Audi A7, and BMW 5 Series.

However, Google is not required to pay the proposed Data Excise Tax on its uploaded search results, including the advertisement of the Mercedes-Benz E-Class. As a platform, Google serves two or more distinct groups of customers or users[320]: in this case, William for online search business, and

319. In that regard, New York's Data Mining Tax may have similar flaws to head count taxes, which are somewhat rare, violate principles of fairness due to their regressive nature, and can be difficult to administer in some countries, including the United States. Steven A. Dean, *Tax Deregulation*, 86 N.Y.U. L. Rev. 387, 396–97 (2011); Neil Brooks, *Flattening the Claims of the Flat Taxers*, 21 Dalhousie L.J. 287, 307 (1998); Donna M. Byrne, *Locke, Property, and Progressive Taxes*, 78 Neb. L. Rev. 700, 733 (1999); Karl Manheim, *The Health Insurance Mandate – A Tax or a Taking*, 42 Hastings Const. L.Q. 323, 354 (2015) ("Head taxes . . . are a discredited notion these days, and [are] often prohibited in state and federal law, although perhaps not unconstitutional.").

320. This refers to network effects. A network effect exists when the value of a product or service provided by a business increases according to the number of others using it. Carl Shapiro & Hal R. Varian, Information Rules: A Strategic Guide to the Network Economy 13 (1999). Such effect exists in the highly digitalized businesses, such as Twitter, Facebook, Google, and Amazon, because the value of their services to users increases as more users join the platform.

Mercedes-Benz for online advertising business. Users on one side of the market (William) are charged little to nothing to participate, while the users on the other side (Mercedes-Benz) are charged all or the majority of the profits. Thus, when displaying the search results to William, Google may have earned income from Mercedes from its online advertisement business, but such income can be taxed under the existing income tax system. Tax reform is necessary to capture the other side of digital business, the exchange between Google and William.

Because there is no cash flow between Google and William, it has been challenging for market countries (the United Kingdom) to collect tax from Google which easily operates in the United Kingdom without physical presence. However, the proposed Data Excise Tax provides tax revenue to market jurisdictions (the United Kingdom) where data providers (user William) are located. Thus, it fulfills the goal of revenue reallocation in favor of market countries. It also overcomes the physical presence requirement in tax nexus, because the tax will be imposed on data collectors regardless of their location, onshore or offshore.

Both the New York Data Mining Tax and Marian's proposal offer use of IP addresses as a way to determine which (market) jurisdiction will tax the data collection. There has been opposition to use of IP addresses due to their susceptibility to manipulation. However, as Marian indicated, if someone does use a VPN, and these taxes are implemented on a wide scale, the data tax will be imposed on the VPN service provider as well.[321] In other words, it generates more revenue, instead of being vulnerable to loopholes.

Furthermore, this Article proposes that the taxpayer be limited to *for-profit commercial data collectors*, similar to the taxpayer identified in the New York Data Tax. Differing from Marian's proposal, not all users of data would be part of the identifiable tax base. Safe harbor thresholds should be created to protect individual users and small businesses. The tax would be directed at businesses using and profiting from the data collected, not at those who offer the data for free.

The proposed Data Excise Tax is not measured in gross revenue or profits, and thus is an improvement compared to DSTs. DSTs have been criticized as a disguised income tax, resulting in double taxation—once by the existing income tax and again by DSTs as disguised income tax.[322] However, the tax base of the Data Excise Tax this Article proposes is the volume of collected data, which clearly distinguishes from income tax. Also, as an excise tax, the Data Excise Tax would be easy to administer, and can be implemented independently or together with the multilateral alternative discussed in Section IV.B, *supra*. It may be very attractive to many governments seeking a practical solution regardless of the global one.

321. Marian, *supra* note 309, at 51.
322. Kim, *supra* note 45, at 166–67.

Joe Bankman, Alan Sykes of Stanford Law School, and Mitchell Kane of NYU imply that a well-designed excise tax would be a better tool to extract the profits of multinationals than a conventional income tax.[323] However, excise taxes are often criticized for being regressive.[324] Although Marian offers an excellent argument for the progressivity of a direct data tax, without empirical data it is not certain how progressive or regressive a data excise tax would be. To mitigate the regressivity issue, this Article recommends a progressive rate structure with graduated thresholds based on the number of gigabytes of data collected in each jurisdiction.

The final point is whether the proposed Data Excise Tax would be discriminatory against American tech giants. The proposal itself has nothing to do with the residence of businesses, and thus is facially neutral. However, given that American tech giants are dominating the market, it is inevitable that majority of taxpayers of the proposed Data Excise Tax would be American multinationals. Then, one might find that this proposal would be no less discriminatory than France's DST discussed in Section III.C. Will the United States again use the card of discrimination no matter how the reform proposal would be improved? The Article hopes not, but if so, that discussion will be reserved for the authors' next project.

Conclusion

Despite the critiques in this Article, the Statement for a global deal represents a remarkable step forward toward implementing an international tax regime fit for the twenty-first century. Pillar One eliminates, for Amount A, the obsolete physical presence requirement as well as the unworkable arm's length standard for transfer pricing, and finally recognizes the crucial role of market jurisdictions in generating income. Pillar Two implements the single tax principle, meaning that corporate profits should be subject to a minimum tax and that if the country with the primary right to tax such income (source or residence) does not impose tax at the minimum level, the other country involved should tax it.

All of these are decisive breaks from the past, which have been suggested for twenty-five years but, until now, have gained little traction. This Article welcomes the momentum for international tax reform. However, like most historical developments, the Inclusive Framework encompasses both revolution and evolution, and each building block has different prospects for success. In particular, Pillar Two has greater potential for success with global

323. Joseph Bankman et al., *Collecting the Rent: The Global Battle to Capture MNE Profits*, 72 Tax L. Rev. 197, 230–32 (2020).

324. Marian, *supra* note 309, at 14; Joseph Pechman, Federal Tax Policy 199–200 (5th ed. 1987) (excise taxes are viewed as regressive because individuals pay the same amount of tax regardless of income); Henry N. Butler & Jason S. Johnston, *Reforming State Consumer Protection Liability: An Economic Approach*, 2010 Colum. Bus. L. Rev. 1 (2010).

support. In contrast, Pillar One has sizeable political and logistical challenges that will be difficult to overcome, in addition to the potential reluctance to repeal DSTs.

In light of these difficulties, this Article recommends separating the two Pillars and pursuing Pillar Two during the global negotiation should Pillar One fail. Pillar One may have alternatives worth examining. This Article focuses on the U.N. proposal and a Data Excise Tax as such alternatives, but there may be others, such as a formulary apportionment in transfer pricing. Furthermore, starting a trade war to protect American tech giants is imprudent, because, in the course of a trade war, U.S. consumers and small- and medium-sized businesses will be the ones suffering. Given that American tech giants are dominating the global digital economy, it is conceivable that they will pay the largest tax bill, as their "fair share of tax," to market countries under any tax reform proposal.