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Designing orthopaedic boots for a clay-footed giant: unconventional fixes for the international corporate tax system

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Abstract

The development of economic activities and the corresponding attribution of income (and wealth) to economic actors for tax purposes have undergone various processes of de-territorialisation and de-materialisation that have accelerated as a result of digitalisation. Recent international (OECD and EU) and, to a lesser extent, domestic initiatives have attempted to adapt the structure of corporate taxation to those changes. However, corporate taxes continue to be built on traditional concepts such as legal personality, residence and income which, due to structural weaknesses, may appear to inadequately determine what types of contributions may be required from corporate actors. Therefore, while we acknowledge the merits of recent international initiatives such as Pillars 1 and 2 of the OECD Base Erosion and Profit Shifting project, it is of value to explore alternatives such as more targeted taxes based on transactions and value as well as a renewed conception of 'contribution' by corporate actors. Three possibilities are analysed: transaction-based taxes, taxes on corporate value, and a re-elaboration of the idea of tax as a contribution (in money or in-kind) inspired by the concept of corporate social responsibility.

Keywords: corporate taxation, digital economy, OECD, Pillar 1, Pillar 2, MNEs, alternative methods

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1. INTRODUCTION

The world is experiencing a strong acceleration in terms of technological innovation that is causing significant changes in social and economic structures.[1] Policy-makers have been striving to find solutions to adapt the current legal framework to the globalisation and digitalisation of the economy. The archetypal illustration of these transformations are the multinational enterprises (MNEs) which operate on a large scale in many different jurisdictions[2] and challenge smaller domestic businesses as well as the states' sovereignty.

MNEs are indeed able to systematically exploit the loopholes and inconsistencies in the tax and legal systems of the jurisdictions in which they perform their activities. Regardless of the lawfulness of those practices, international tax planning of MNEs undermines, in the public opinion, the legitimacy of taxes as such and ultimately of the state itself.[3] There is a widespread perception that the states are only able to effectively impose taxes on smaller domestic businesses and individual taxpayers, while MNEs and high net wealth individuals (HNWIs), ultimately pay much less, at least in proportion, even though they are formally subject to the same taxes.

The corporate income tax (CIT) was introduced as a complement to the personal income tax in order to prevent wealthier individuals from deferring the payment of taxes on business activities by using corporations. In addition, there was the belief that, by structuring the tax levy in two steps, ie, the corporate level and the distribution of dividends, a certain level of progressivity of taxation could be maintained even for shareholders when they reaped the fruits of their investments from companies.

This system has worked quite well; however, digitalisation and globalisation have put CIT systems under pressure. Domestic lawmakers have adopted numerous unilateral measures that have sought to 'plug the holes' in the existing corporate income tax

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[1] For an analysis of the legal consequences of digitalisation, for example, see Terry Hutchinson, 'Legal Research in the Fourth Industrial Revolution' (2017) 43(2) *Monash University Law Review* 567. The author comprehensively analyses and explains how technology's effects on legal procedures and the power of the algorithm to predict outcomes of disputes will change the legal environment we all know and in which we grew up. In this regard, it should be noted from the outset that all the technology terms used in this article, such as 'digital', 'dematerialisation', etc, are not intended to be technical or to refer to legal definitions that may be found in certain jurisdictions. They are used in their common sense and therefore refer to activities carried out in whole or in part by means of information technology (IT) and the internet.

[2] It is not only in recent times that the phenomenon of the exponential growth in the size and importance of multinational companies has caught the attention of scholars. For some studies from past decades, see Raymond Vernon, 'The Multinational Enterprise: Power versus Sovereignty' (1971) 49(4) *Foreign Affairs* 736; Alan M Rugman, 'Multinational Enterprises and Public Policy' (1998) 29(1) *Journal of International Business Studies* 115. Enrico Nuzzo, in the Treccani Legal Encyclopaedia (*Enciclopedia giuridica Treccani* (Istituto della Enciclopedia italiana, 1989)), 'Impresa multinazionale' (dir. trib.), writes that the activities of this type of company have been regulated most often in a shortsighted and fragmentary manner with the problem being reduced to the taxation of branches or subsidiaries of foreign companies.

[3] The connection between territoriality of taxation and fairness is a complex one and is well explained by Wolfgang Schön in 'One Answer to Why and How to Tax the Digitalized Economy' (Max Planck Institute for Tax Law and Public Finance Working Paper 2019-10, 2019) 9-10 (footnotes omitted): 'From a fairness point of view, the rationale for taxation on the basis of territorial activity seems to be that the degree of the presence of the taxpayer in a territory is correlated to the benefits received from the local government, thus justifying fiscal contributions to the public sphere. It is reasonable to assume that the capacity of a state to provide public benefits to taxpayers hardly reaches beyond that state's territory. There exist a certain number of extraterritorial benefits like diplomatic protection, which may be substantially relevant in the context of individuals, but they do not play a major role in the area of international business taxation'.

systems. Some examples are controlled foreign company (CFC) laws[4] representing a spatial extension of the concept of residence, the non-deductibility of certain payments such as interest expenses above a certain threshold[5] which represents a restriction of the taxpayer's right to conduct its business as it wishes, and the mandatory disclosure of tax information[6] which serves to compensate for existing asymmetries between the various parties involved in the tax levy. All these measures are aimed at enabling the tax administration to gain comprehensive knowledge of the taxpayer's foreign activities and to be able to intervene unilaterally and without requiring the cooperation of any other state when the amount of tax due is not as stipulated by domestic law.

At the international level, the Organisation for Economic Co-operation and Development (OECD) and the European Union (EU) have launched initiatives aimed at enhancing international cooperation in the application of domestic corporate income taxes, in particular what is known as the Base Erosion and Profit Shifting (BEPS) project that will be discussed below.

The latest of these initiatives is the agreement reached at the OECD level and already implemented in an EU directive[7] to impose a global minimum tax on corporations of 15 per cent (referred to as Pillar 2). This has been presented to the general public as a very effective tool to resolutely contend with MNEs' international tax avoidance, and even prominent critics of the current system have recognised that it constitutes progress.[8] However, the question looms as to whether this can be regarded as an effective solution for ensuring international tax equity. Large multinational enterprises currently continue to attract and accumulate immense amounts of financial wealth, but their overall tax contribution remains significantly lower than less financially advantaged businesses or individuals.[9]

The BEPS tax policies promoted and implemented in recent years have revolved around three fundamental objectives: (i) limiting multinational enterprises' tax avoidance by shifting resources to low-tax jurisdictions (*base erosion and profit shifting*); (ii) tying

[4] See Organisation for Economic Co-operation and Development (OECD), *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015).
[5] See OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015).
[6] See OECD, *Mandatory Disclosure Rules, Action 12 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015).
[7] European Council, *Directive (EU) 2022/2523 of 14 December 2022 on Ensuring a Global Minimum Level of Taxation for Multinational Enterprise Groups and Large-Scale Domestic Groups in the Union* [2022] OJ L 328/1.
[8] Thomas Piketty, 'The G7 Legalizes the Right to Defraud', *Le Monde* (15 June 2021), https://www.lemonde.fr/blog/piketty/2021/06/15/the-g7-legalizes-the-right-to-defraud/ (accessed 7 May 2024); F Baraggino and G Scacciavillani, '*Tassa minima globale per multinazionali, Piketty: "Scandaloso definirlo 'grande risultato', ci credono imbecilli? Vorrei anch'io il 15% di tasse"*', *Il Fatto Quotidiano* (6 June 2021), https://www.ilfattoquotidiano.it/2021/06/06/tassa-minima-globale-per-multinazionali-piketty-scandaloso-definirlo-grande-risultato-ci-credono-imbecilli-vorrei-anchio-il-15-di-tasse/6221668/ (accessed 7 May 2024).
[9] See, for example, the EU Tax Observatory Report authored by Mona Barake, Theresa Neef, Paul-Emmanuel Chouc and Gabriel Zucman, *Collecting the Tax Deficit of Multinational Companies: Simulations for the European Union*, EU Tax Observatory Report No 1 (2021), available at the website https://www.taxobservatory.eu/.

the value produced by MNEs to a jurisdiction and taxing it there (*value creation*); and (iii) making multinational enterprises contribute more to states' budgets (*fair share*).

Nevertheless, the International Tax Order remains a clay-footed giant, as it progressively strengthens in structure but continues to rest on weak and increasingly inappropriate foundations for achieving the goals for which it was created. In this sense, the giant needs a new pair of boots. They do not necessarily have to be its only footwear, but can complement those it is already using, consisting of an unconventional and radical approach to solving current weaknesses.

Even if current reforms help to slightly increase the amount of corporate taxes paid by MNEs, the authors contend that the three objectives of the BEPS tax policies, while legitimate and fully satisfactory, cannot be pursued all at once simply by reforming the current corporate income taxation framework. The actual fundamental essence lies in the founding concepts of today's corporate income taxation systems, specifically, the corporate taxpayer, corporate residence and corporate income.

The three aforementioned concepts, whose origin dates back to more than a century ago and which remain central today, will be analysed in the following paragraphs. Such concepts can be considered three legal fictions, ie, the distinct legal and tax personality of the corporation (clearly separated from the natural persons controlling it), the concept of income as the difference between revenues and costs allocated firstly to that (fictitious) person, and the proxies used to tie the corporation – and its income – to a jurisdiction (tax residence).

The authors then review the most significant corporate income tax developments that have occurred at the international level to limit the margin of freedom left to taxpayers to freely allocate income to low-tax jurisdictions. They then contend that the basic problem with these initiatives is that, despite their merits, they are bound to have limited effectiveness insofar as they are still based on the legal fictions mentioned above[10] and do not take sufficiently into account phenomena such as globalisation, financialisation and digitalisation.[11] Moreover, their broad scope of application does not make them easily adaptable to the specific situations of MNEs. As Miranda Stewart states:

> While governments have always taxed corporations, tax experts, whether they are lawyers, economists or accountants, have often criticised the corporate tax. … Corporations pose major challenges for tax policy, law and administration and the corporate tax is usually the most complex tax in the armoury of governments. A key reason is the diversity of corporations and their

[10] Since the 1990s, tax scholars have focused on two of the possible approaches to the digital economy. The first is known as the 'revolutionary approach' that aims to elaborate 'new rules for a new reality', thus establishing a dedicated body of rules for cyberspace. The second is known as the 'status quo approach'. This is a conservative approach and is supported by the vast majority of scholars and international institutions. Silvia Cipollina, *I confini giuridici nel tempo presente. Il caso del diritto fiscale* (Giuffrè, 2003) 277.

[11] See the French Collin Report: Pierre Collin and Nicolas Colin, *Task Force on Taxation of the Digital Economy – Report to the Minister for the Economy and Finance, the Minister for Industrial Recovery, the Minister Delegate for the Budget and the Minister Delegate for Small and Medium-Sized Enterprises, Innovation and the Digital Economy* (Report, January 2013), of which the concluding section V elaborates some proposals on how to deal with the disruption caused by the digital economy and is organised, among others, around the following 'traditional' concepts: permanent establishment (5.1.1); transfer prices (5.1.2), and taxation of research and development (R&D) (5.2.2).

> activities. Corporations range from small and closely held proprietary companies that deliver personal services, or trade on a small scale, to large multinational corporate groups operating in countries around the world.[12]

Probably too much has been expected from CIT reforms at the international level, and other more targeted instruments may be needed to find adequate funding of our tax states and our societies.

In this part of the study, the three basic concepts underlying modern corporate taxation identified earlier are systematically compared with (and challenged by) the characteristics of the digital economy, thus highlighting their current inadequacy.

In the last part of the study, three alternative ways of envisaging corporate contributions to states' budgets and to society are subsequently proposed. There is one for each of the goals originally assigned to the BEPS initiatives (avoiding profit shifting to low-tax jurisdictions, tying taxation to the creation of value, and making MNEs contribute their fair share). Rather than provide solutions to fully replace existing corporate income taxes, a proposal is made to complement current income taxation with a tax on cross-border corporate payments, a tax on corporate value, and targeted contributions for specific general interest purposes.

2. THE NEED TO MOVE BEYOND SOME CORPORATE INCOME TAX PARADIGMS

It was about a quarter of a century ago that Professor Michael Graetz wrote one of his most famous articles[13] in which he analyses how the entire international tax order is based on outdated concepts that require radical renewal. It was not until quite a few years later that the BEPS project started, which aimed to revolutionise the international tax order by addressing phenomena and behaviours undermining the functioning of modern states.

As several years have now passed since the BEPS project was launched, the literature on it is extensive. Many scholars have elaborated on it, proposed evaluations and described and taken stock of the situation over the years.

Among the most prominent, Reuven Avi-Yonah argued in 2020 that the innovations introduced by Pillar 1, at the time still in the drafting stage, have the potential to change the international tax regime.[14] This follows the failure of BEPS whose Action 1 failed in his opinion to meet the challenges posed by digitalisation.

In particular, in light of that failure, continuation of this project will lead to the abandonment of the arm's length principle (incorporated in Article 9 of the OECD Double Tax Treaties) and the permanent establishment principle (incorporated in Article 7 of the OECD Double Tax Treaties). The ultimate goal is the creation of a new

[12] Miranda Stewart, *Tax and Government in the 21st Century* (Cambridge University Press, 2022) 179-180.
[13] Michael J Graetz, 'Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies' (2001) 26(4) *Brooklyn Journal of International Law* 1357, 1357 et seq.
[14] Reuven S Avi-Yonah, 'A Positive Dialectic: BEPS and The United States' (2020) 114 *AJIL Unbound* 255 (in Symposium on Ruth Mason, 'The Transformation of International Tax').

'*nexus*' connecting income and territory for the purposes of taxation, through the activation of new mechanisms for allocating them amongst different jurisdictions.[15]

As far as Pillar 2 is concerned, Avi-Yonah merely says in the same article that the United States (US) should support it through a sharp increase in the corporate tax rate, so as to benefit as much as possible from it. He does not propose an in-depth assessment thereof but implies an overall positive assessment of the plan.[16]

Miranda Stewart, too, in some of her articles,[17] stated that one of the most problematic aspects of BEPS, which requires close attention, is the coordination of the tension between some of the dichotomies on which modern tax systems are based: residence and source; production and consumption; capital-import and capital-export countries. The key to resolving these tensions lies in international cooperation, so much so that new conceptions of state sovereignty can be envisaged based on the ability of states to significantly extend their ability to levy taxes abroad by relying on the ever-widening networks of cooperation between tax administrations.

More recently, Professor Michael Devereux[18] welcomed the Pillars stating that even after BEPS the existing international tax system is undermined by the existence of a scattering of very small open economies acting as tax havens. In his view, only a broad consensus on the Pillars, leading to their effective implementation, can create a critical mass to force large multinational enterprises to pay a fair share of taxes in the countries where they operate. According to Devereux, without the achievement of such a critical mass, it will never be possible to defuse the competitive dynamics that nowadays plague relations between states and are at the root of the race to the bottom in tax rates, and thus in revenue.

After stressing the need to reach a critical mass, Devereux, together with John Vella and Heydon Wardell-Burrus[19] in a policy brief, added that overall the Pillar 2 should have a significant impact on tax competition, albeit not as notable as some may have hoped, and certainly not a straightforward impact. Even if all the states were to find common ground for the minimum tax, several avenues for competition would remain open, eg, the offering of government grants, with economic consequences very similar to the current ones. As grants are treated as additional income rather than a reduction in taxes,

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[15] Interestingly, Avi-Yonah suggested to the US policy-makers not to reject the Pillar 1 logic, as Treasury Secretary Steven Mnuchin seemed to do at the time, but rather to tax the web giants, as many of them have their residence in the US.

[16] He even goes so far as to say in his conclusions that the success of these projects could be crucial in providing states with the resources they need to cope with the inequalities caused by globalisation and subsequent shocks, such as Brexit.

[17] See, in particular, Miranda Stewart, 'Abuse and Economic Substance in a Digital BEPS World' (2015) 69(6/7) *Bulletin for International Taxation* 399 and Miranda Stewart, 'Transnational Tax Law: Fiction or Reality, Future or Now?' (Working Paper, Colloquium on Tax Policy and Public Finance, New York University School of Law, 2016). It was discussed in several prestigious universities, such as New York University and the National University of Singapore. In particular, in the first of these two articles, at 408 (footnote omitted), Stewart affirms that '[i]t is also necessary for countries to explore fundamental policy options for the corporate tax in the longer term. A destination-based consumption base has been suggested by some tax experts as the most efficient and viable corporate tax base in a global digital economy; however […] [a]ddressing these challenges requires global coordination'.

[18] Michael P Devereux, 'International Tax Competition and Coordination with a Global Minimum Tax' (2023) 76(1) *National Tax Journal* 145.

[19] Michael P Devereux, John Vella and Heydon Wardell-Burrus, 'Pillar 2: Rule Order, Incentives, and Tax Competition' (Oxford University Centre for Business Taxation Policy Brief, 2022).

their use can allow for much lower 'real' effective tax rates than the 15 per cent set out in the OECD Global Anti-Base Erosion (GloBe) (Pillar 2) proposal.

Even more recently, Wolfgang Schön too emphasised that the BEPS and the subsequent Pillars were, overall, a success story.[20] This success, however, is largely based on cooperation, and in 2023 the world witnessed a series of changes in the global political framework that jeopardised these achievements; in his words:

> This success story is strangely at odds with the visible fragmentation and de-globalisation of world politics where major actors like the United States, the People's Republic of China, Russia or India are increasingly stepping back from multilateral commitments and assume a more confrontational stance.

He draws a valuable parallel between the international political situation and tax competition among states, asking whether it is possible to isolate it and keep it at a low level in such difficult times. His analysis is particularly interesting because it is not based on strictly legal arguments, but questions whether budgetary constraints may be insufficient for encouraging states to continue to cooperate, since a number of them may find it more convenient (or more opportune) to go back to acting in a fully selfish mode.

All the literature cited, as well as much of the tax literature on this topic, seems to agree that the BEPS and the Pillars that followed it are a complex project that is producing some positive outcomes. The present authors agree with this position and there seems to be no doubt that the international tax system is more robust now than in the 'pre-BEPS era'. However, none of the renowned authors mentioned considers that the problems caused by the BEPS have been definitively solved. Above all, rather than stressing the robustness of the legal framework and the more strictly legal aspects, they all seem to be of the opinion that the level of cooperation achieved at the agreement stage might not be transformed into effective and consistent administrative practices or might even fall victim to the changed international political trends.

In our opinion, these fears are justified and, if one wants to make a systematic analysis, they may be attributed to the very nature of corporate taxation. Although decades and even centuries have passed, the structure and basic principles of corporate taxes have in fact remained the same and are today unsuited to coping with a reality such as the one that the world is experiencing. The paradigm within which current studies move is still that of a tax to be paid in money by those who produce value in a certain territory, establishing links by which to measure 'attachment' to the territory and subjecting the action of the lawmaker and the government to legal principles such as that of ability to pay. Within this paradigm, affected by the difficulties posed by current phenomena, the solution proposed always consists of getting states to work closely together, so that they can help each other collect information on the taxpayers and be able to exercise some of their powers across borders.

The authors intend to postulate on a move beyond this paradigm, believing that the time has come to question principles that were developed when the economy was 'fully-material'. For this reason, an unconventional approach to BEPS is proposed, in the sense that it is first put into historical perspective and then some possible alternatives to the status quo are elaborated. In this way, it becomes evident that it is the inadequacy of

[20] Wolfgang Schön, 'International Tax Rules for Unruly Times' (Max Planck Institute for Tax Law and Public Finance Working Paper 2023-08, 2023).

corporate taxation, largely based on old fictions, which underlies the impossibility of effectively combating the contemporary BEPS phenomena.

As stated by Katharina Pistor,[21] capital governs through the law which has the capacity to create wealth also because it is backed by state power. By remaining within solutions that do not change the paradigm and sometimes only minimally change the legal framework, eg, by creating connections between the tax administrations of different jurisdictions or setting thresholds that can easily be circumvented, the BEPS problem will never be truly solved. The authors intend to contribute to the legal scholarly debate by promoting an unconventional approach to BEPS which may be suitable for overcoming and resolving some of the inefficiencies underlying today's corporate taxation model.

3. THE THREE ORIGINAL FLAWS OF CORPORATE INCOME TAX

3.1 The fiction of the corporate entity as an entity subject to an income tax

Corporations have existed since the early modern era, but their importance and presence in the economy has grown exponentially over the last century.[22] Today, large corporations are among the most powerful economic forces, to such an extent that, in some cases, their annual turnover is even greater than the domestic product of certain states.[23]

The importance of corporations in today's world far exceeds their economic role of producing immense quantities of goods and services. They are drivers of technological innovation, cultural influencers, general interest service providers (for example in the telecommunications sector) as well as promoters of massive investment in healthcare, cooperation, and climate-mitigating programs.[24] They may even influence political decisions by lobbying behind the stage, financing parties or individual candidates, and even publicly forcing governments to abide by their conditions.[25] Moreover, they have even taken over some traditional states' prerogatives.

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[21] Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton University Press, 2019) 205.

[22] Grietje Baars and André Spicer, 'Introduction: Why the Corporation?' in Grietje Baars and André Spicer (eds), *The Corporation: A Critical, Multi-Disciplinary Handbook* (Cambridge University Press, 2017) 1.

[23] This is highlighted, among others, by CORPNET researchers, who are involved in a five-year project initiated in September 2015 and located at the Amsterdam Institute for Social Science Research, University of Amsterdam, which is funded by the European Research Council ('ERC' starting grant). They investigate the topic 'Corporate Network Governance: Power, Ownership and Control in Contemporary Global Capitalism' and, in a blog post of 16 July 2018 (Milan Babic, Eelke Heemskerk and Jan Fichtner, 'Who Is More Powerful – States or Corporations?', *The Conversation* (11 July 2018), https://theconversation.com/who-is-more-powerful-states-or-corporations-99616 (accessed 7 May 2024)), they calculate that, of the world's top 100 economic revenue collectors, 29 are states and 71 are corporations.

[24] To understand the scale of the phenomenon, see, for example, Milan Babic, Jan Fichtner and Eelke M Heemskerk, 'States versus Corporations: Rethinking the Power of Business in International Politics' (2017) 52(4) *The International Spectator* 20; Walter Frick, 'The Conundrum of Corporate Power' (2018) 96(3) *Harvard Business Review* 154. More in general and based solely on daily experience, suffice it to think how Facebook has changed social relationships in the last few years or how Netflix, TikTok and YouTube have changed the way we spend our free time.

[25] Aneta Jakubiak Mironczuk, 'Lobbying in a Democratic State of Law – Between Meaning and Judgment' (2015) 72 *Persona y Derecho* 149; OECD, *Financing Democracy: Funding of Political Parties and Election Campaigns and the Risk of Policy Capture* (OECD Publishing, 2016).

In the US, warfare and prison management have now been, at least in part, corporatised. Corporations have even been given the right of free speech.[26] Last but not least, they are responsible for considerable levels of greenhouse gas emissions as well as others forms of damage to the environment (loss of biodiversity, water and soil pollution, etc) and to human health.

From a historical perspective, although some traces of organised enterprises can be found even during ancient times (eg, the *societas* and *societas publicanorum* under Roman law),[27] the development of private, profit-oriented corporations is a fairly recent phenomenon.[28] As the medieval commercial practices that were developed mainly in Italy migrated to northern Europe, by the late 15th and early 16th centuries, the corporate form developed as an organisational model guaranteeing protection and even privileges to economic activities.[29] Nevertheless, charters remained widely an act of dispensation granted through a political rather than administrative process; legally speaking, incorporation was often a royal prerogative that could easily be withdrawn and not an individual's right.[30]

After the period of the large commercial corporations, including, for instance, the well-known names of the West and East India Companies, there came the start of what Philip Stern calls the Liberal Age.[31]

The joint stock companies and regulated companies initiated the development of a number of features that have gradually led towards the contemporary concept of a corporation, specifically the opportunity to produce large capitalisation through the sales of shares to investors; the construction of an individual legal personality that was distinct from its individual members, etc.[32]

During the 19th century, the corporation transitioned from being a public interest organisation created for public purpose by the law and the state to a private enterprise through both legislative and judicial interventions.[33] In the United States at that time, several states, including, for example, New York, New Jersey and Connecticut,

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[26] Daryl G Hatano, 'Should Corporations Exercise Their Freedom of Speech Rights?' (1984) 22(2) *American Business Law Journal* 165; Breanne Gilpatrick, 'Removing Corporate Campaign Finance Restrictions in *Citizens United v. Federal Election Commission*, 130 S. Ct. 876 (2010)' (2011) 34(1) *Harvard Journal of Law and Public Policy* 405.

[27] Geoffrey Poitras and Frederick Willeboordse, 'The *Societas Publicanorum* and Corporate Personality in Roman Private Law' (2021) 63(7) *Business History* 1055; Andrea Di Porto, *Impresa Collettiva e Schiavo 'Manager' in Roma Antica (II Sec. A.C.-II sec. D.C.)* (Giuffrè, 1984).

[28] Philip J Stern, 'The Corporation in History' in Grietje Baars and André Spicer (eds), *The Corporation: A Critical, Multi-Disciplinary Handbook* (Cambridge University Press, 2017) 21, 22.

[29] For a general overview of the evolution of companies in those times, see, among others, Ageo Arcangeli, '*La commenda a Venezia specialmente nel secolo XIV*' (1902) 33(1) *Rivista italiana per le scienze giuridiche* 107; Armando Sapori, '*La responsabilità verso i terzi dei compagni delle compagnie mercantili toscane del dugento e dei primi del trecento*' (1938) 36(1) *Rivista di diritto commerciale* 571.

[30] Stern, above n 28, 26.

[31] Ibid 28.

[32] CE Walker, 'The History of the Joint Stock Company' (1931) 6(2) *The Accounting Review* 97.

[33] See also Ron Harris, 'The Private Origins of the Private Company: Britain 1862-1907' (2013) 33(2) *Oxford Journal of Legal Studies* 339.

introduced concepts of limited liability,[34] while the US Supreme Court contributed to refining the legal framework of the corporation.[35]

In 1896, in the United Kingdom (which ruled the British Empire at the time), the House of Lords delivered the landmark judgment in the case *Salomon v Salomon*[36] that concerned claims of certain unsecured creditors in a liquidation process.[37] They established the foundations of how a modern corporation exists and functions including the principle of separate legal personality.[38] Reversing the Court of Appeal's ruling according to which the corporation is a myth, the Lords held that, when duly incorporated, it is an independent person with its rights and liabilities regardless of the motives of those who took part in its promotion. They can, for instance, sue and be sued in their own name.[39] This legal fiction became a legal reality and went down in history as the 'corporate veil' between the company and its controllers and owners.[40]

The reality of the corporate personality became dominant in the Western world. Countries like Belgium, France, Germany and Italy gradually introduced into their legislation the possibility for individuals to create legal persons to shield their personal wealth from the risks of an economic activity – but not before very heated debates had appeared in the literature concerning its theoretical and even philosophical foundations, although with little effective impact.[41]

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[34] PW Ireland, 'The Rise of the Limited Liability Company' (1984) 12(3) *International Journal of the Sociology of Law* 239.

[35] As reported by Stern, above n 28, 29, in *Trustees of Dartmouth College v Woodward*, 17 US 518 (1819), the Supreme Court 'decided that the state of New Hampshire's attempt to make a private corporation into a public one, in an attempt to reverse the decision of the college trustees in ousting its president, violated the clause of the US Constitution (Article I, sec 10, clause 1) that restricts the state from impinging upon contract rights of private persons'.

[36] *Salomon v A Salomon & Co Ltd* [1897] AC 22.

[37] See, for example, Max Radin, 'The Endless Problem of Corporate Personality' (1932) 32(4) *Columbia Law Review* 643.

[38] Murray A Pickering, 'The Company as a Separate Legal Entity' (1968) 31(5) *The Modern Law Review* 481.

[39] On this topic, see also, among others, Arthur W Machen, Jr, 'Corporate Personality' (1911) 24(4) *Harvard Law Review* 253; Harold J Laski, 'The Personality of Associations' (1916) 29(4) *Harvard Law Review* 404; John Dewey, 'The Historic Background of Corporate Legal Personality' (1926) 35(6) *Yale Law Journal* 655.

[40] Marc T Moore, '"A Temple Built on Faulty Foundations": Piercing the Corporate Veil and the Legacy of Salomon v Salomon' [2006] (2) *Journal of Business Law* 180.

[41] Friedrich Karl von Savigny, *Traité de droit romain* (Firmin Didot frères, 1855); Maurice Vauthier, *Études sur les personnes morales dans le droit romain et dans le droit français* (G Pedone Lauriel, 1887); Otto Friedrich von Gierke, *Die Genossenschaftstheorie und die deutsche Rechtsprechung* (Weidmann, 1887); Gustavo Bonelli, '*Di una nuova teorica della personalità giuridica*' (1890) 9(3) *Rivista Italiana per le scienze giuridiche* 325; Maurice Hauriou, '*De la personnalité comme élément de la réalité sociale*' (1898) 22 *Revue Générale Du Droit, de la Législation et de la Jurisprudence en France et à l'Étranger* 5 and 119; Achille Mestre, '*Les personnes morales et le problème de leur responsabilité pénale*' (thèse de doctorat, Université de Paris, 1899); Marcel Planiol, *Traité élémentaire de droit civil* (Librairie Cotillon, 3rd ed, 1904) vol 1, 977 et seq; Démètre Négulesco, *Le problème juridique de la personnalité morale et son application aux sociétés civiles et commerciales* (A Rousseau, 1900); Georges Trouillot and Fernand Chapsal, *Du contrat d'association – Commentaire de la Loi du 1er juillet 1901* (Lois Nouvelles, 1902); Raymond Saleilles, *De la personnalité juridique, Histoire et théories* (Rousseau, 1910); Alphonse Boistel, *Conception des personnes morales, rapport présenté au IIe Congrès international de philosophie tenu à Genève du 4 au 8 sept. 1904* (Henry Kündig, 1904); Eduard Hölder, *Natürliche und juristische Personen* (Duncker and Humblot, 1905); Julius Binder, *Das Problem der juristischen Persönlichkeit* (A Deichert, 1907); Michele Barillari, *Sul concetto della persona giuridica* (E Loescher, 1910); Frederic William Maitland, 'Moral Personality and Legal Personality' (1905) 6(2) *Journal of the Society of Comparative*

As for the legal studies on corporation, in the 1970s, what is known as the *agency theory*[42] was developed according to which corporations act as agents for their shareholders since the latter entrusted their investments to the directors and management.

Along with the development of corporate governance and a broad process of financialisation, in corporate law the corporation began to be perceived as more than just the sum of its members. The idea that companies are 'real entities' started to materialise together with shareholder primacy according to which firms should be managed with an exclusive view to maximising financial returns to shareholders. In this perspective, shareholders do not own the company but are its 'residual claimers' which means that, not being entitled to directly access its assets while it is a going concern, they do have rights over the surplus that it generates.[43] This view allowed shareholders – and other persons controlling the companies – to benefit from the best of both worlds. On the one hand, the distinct legal personality of the corporation would work advantageously as a shield from any liability claims arising from the economic activities carried out through the corporation. On the other hand, the capital invested in the corporation could be protected. Alternatively, corporate law would give them substantial control over the corporation, including the right to define what to do with the profits generated from the economic activities (investment, *thésaurisation*, accumulation or distribution). As shown by Katharina Pistor, such a legal construction impacts wealth creation and generates inequality.[44]

Corporate income taxes were adopted in the 20th century as an extension of the existing personal income taxes without much discussion about the reasons for such an assimilation.[45] However, even if there may be good reasons for granting legal personality to corporations under corporate law, such as allowing them to conclude contracts or to obtain access to capital through direct investments or loans, making them taxpayers in their own right (moreover subject to CIT) is not a straightforward consequence. The ultimate reason why this path was taken appears to be of a purely practical nature: the '*immediate*' taxation of profits retained in the company. More

Legislation 192; Gabriel La Broüe De Vareilles-Sommières, *Les personnes morales* (Librairie Générale de Droit et de Jurisprudence, 1919); Francesco Ferrara, *Teoria delle persone giuridiche* (E Marghieri, 2nd ed, 1923); Hans Julius Wolff, *Organschaft und Juristische Person – Untersuchungen zur Rechtstheorie und zum öffentlichen Recht, Volume 1* (Carl Heymanns Verlag, 1933); Alexander Nékám, *The Personality Conception of the Legal Entity* (Harvard University Press, 1938); Henri Velge, *Associations et fondations en Belgique, Histoire et théories* (Bruylant, 1942); Jean Dabin, *Le droit subjectif* (Dalloz, 1952) 123 et seq.

[42] Simon Deakin, 'The Corporation in Legal Studies' in Grietje Baars and André Spicer (eds), *The Corporation: A Critical, Multi-Disciplinary Handbook* (Cambridge University Press, 2017) 47.

[43] On the difference between taxing corporations and taxing shareholders, see Wei Cui, 'Residence-Based Formulary Appointment: (In)Feasibility and Implications' (2018) 71(3) *Tax Law Review* 551, 566, where the author notes that: '[a] basic justification for the corporate income tax is that it prevents individuals from deferring tax liability by earning income through distinct legal entities. To achieve this objective, any country should tax corporations owned by its individual taxpayers, regardless of whether the corporation is domestic or foreign'.

[44] On this topic, see again Pistor, above n 21, 48. In chapter 3, the author conducts what she defines as an 'institutional autopsy' of Lehman Brothers for the purpose of showing that corporation law can be and is used not just to optimise the allocation of risks and returns in the production of goods and services. Instead, it can be turned into a capital minting operation by employing the ability to partition assets and shield them behind a chain of corporate veils to access low-cost debt finance and to engage in tax and regulatory arbitrage.

[45] Rebecca S Rudnick, 'Who Should Pay the Corporate Tax in a Flat Tax World?' (1988-89) 39(4) *Case Western Reserve Law Review* 965, 985-986.

specifically, the articulation of a twofold taxation, ie, corporate profits first and dividends second, is in actual fact a way of preventing the wealthiest people from deferring taxation virtually indefinitely.[46]

Indeed, originally corporate taxation was seen as a complement to personal taxation that allowed taxation not to be delayed forever and made it at least partially progressive since dividends were taxed in the hands of the shareholder on the basis of the rate applying to that person.[47]

Similarly, if there may be valid reasons for subjecting corporations to tax, the issue of whether it should be a tax on income (based on residence) is not as straightforward either.[48] Attributing income and capital to a physical person naturally limited in his or her ability to attract, to possess, and to consume wealth is one thing, while doing so for legal persons who do not have the same limitations is another.

3.2 The fiction of corporate income… which makes finding a justification for corporate income taxes necessary

3.2.1 A brief excursus on the historical origin of corporate income tax: understanding the past to better understand the present

When income tax was adopted in the US in 1913, Professor Edwin Seligman[49] traced the primary phases of its history. He stated that direct taxes were the ultimate development that started with voluntary offerings and gradually changed into compulsory payments as well as parallel primitive fees and tolls that evolved into indirect taxes. According to Seligman, one of the main drivers of this development was the clash of divergent interests and the endeavour of each social class to pass the burden of taxation to some other class. This resulted in a slow and laborious elaboration of standards of justice in taxation and rules for implementing them for the community as a whole. In other words, the history of taxation is strictly related to the development of the principle that Seligman refers to as faculty or ability to pay,[50] namely the principle that each individual should be held to help the community in proportion to the ability to help him- or herself.[51]

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[46] Reuven S Avi-Yonah, 'Corporations, Society, and the State: A Defense of the Corporate Tax' (2004) 90(5) *Virginia Law Review* 1193 ('Corporations, Society, and the State').

[47] More in general, see also Edwin RA Seligman, 'The Theory of Progressive Taxation' (1893) 8(1) *Publications of the American Economic Association* 52.

[48] For a general idea, see, for example, Ruud A de Mooij, 'Will Corporate Income Taxation Survive?' (2005) 153(3) *De Economist* 277.

[49] Edwin RA Seligman, *The Income Tax – A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad* (Macmillan, 1914).

[50] On this aspect, see also Roy Blough, 'Basic Tax Issues' (1955) 1st *Annual Tax Conference* (College of William and Mary in Virginia) 17, 22: 'The frequency and importance of the issues concerning the degree of progression have given rise to attempts by scholars and others to develop an objective mathematical measurement of the proper scale of progression, mostly around the idea that taxes should be levied in accordance with "ability to pay." These efforts have not achieved their goal of measuring "ability to pay," but they have popularized the concept'.

[51] James Coffield, *A Popular History of Taxation: From Ancient to Modern Times* (Longman, 1970); Stephen Dowell, *A History of Taxation and Taxes in England* (Longmans, 1884). See also the proceedings of the European Association of Tax Law Professors (EATLP) Congress 2021 held online on 3-4 June 2021, https://www.eatlp.org/congresses/congress-antwerp-2021.

At the outset, when the structure of the economy and the idea and protection of private property were rudimentary, direct taxation often took the form of poll or capitation taxes. This was the case, for example, in the early stages of the Teutonic civilisation and the beginnings of Puritan New England.[52]

As private property developed, so did differentiation between social groups of individuals based on inequality of possessions. Efforts were therefore made to regulate the poll according to various outwards signs with the consequence that, especially in the Middle Ages, direct taxes often proved to be class taxes.[53]

Soon, though, these taxes started being either supplemented or supplanted by property taxes. For many centuries, and more precisely until industry and trade began to develop significantly, property consisted of land and appurtenances to it with the consequence that property taxes in those periods were virtually taxes on real estate. Subsequently, this land-focused system of taxation also gradually underwent a crisis for a number of reasons. First, the fact that, although in the long run the value of land is dependent on its yields, on a yearly basis, there is often a gap between the property and its produce. For example, two farmers may own two pieces of agricultural land of equal value with almost identical characteristics, but one may have bad luck if it floods while the other obtains an excellent harvest.[54]

From the 17th century onwards, it became increasingly common to tax the produce of the land rather than the land itself. This is the system that became known by the name of *taxes réelles* (real taxes) in France and *Ertragssteuern* in Germany as opposed to the previous *taxes personnelles* and *Vermögenssteuern.*[55] Taxes on economic activities evolved from lump-sum taxes (franchise taxes) to profit-based taxes. Income became the best measure to assess taxpayers' economic capability.[56] The exponential growth of

[52] See, among others, Charles A Beard, 'The Teutonic Origins of Representative Government' (1932) 26(1) *American Political Science Review* 28.

[53] See generally Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization* (Madison Books, 1993) 137.

[54] In explaining the rationale underlying land taxation, Achille D Giannini, *Istituzioni di diritto tributario* (Giuffrè, 1951) 285, wrote that this type of tax 'provides a stable and secure basis for the implementation of the levy'. These taxes were considered to be 'inherent in the land'.

[55] For a historical perspective, see Stephen Utz, 'Ability to Pay' (2002) 23(4) *Whittier Law Review* 867. See also Ruud de Mooij, Alexander Klemm and Victoria Perry (eds), *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed* (International Monetary Fund, 2021). In explaining 'why tax corporate income' and elaborating on a 'standard corporate income tax', de Mooij and Klemm in 'Why and How to Tax Corporate Income' 11, 13 and 15, recall that '[t]here are different types of systems to tax capital income … The so-called classical corporate income tax considers corporations as separate entities from their ultimate owners. As wages and interest are generally deductible, the corporate income tax effectively becomes a withholding tax on equity returns at the company level. … Using a definition of profits as the tax base has the implication that, as in accounting, investment is not a deductible expense. As the company merely changes one type of asset (cash) for another (capital), such a transaction is not a cost. The cost to the company is, instead, the loss of value of the capital due to obsolescence or wear and tear, and this depreciation is deductible'.

[56] See also chapter 17, titled 'Taxing Corporate Income', of the final report from the Mirrlees Review, Sir James Mirrlees, Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James Poterba, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011).

the presence of corporations in the economic life of advanced economies led to the development of corporate income taxes in most jurisdictions.[57]

3.2.2 The justification for corporate income tax

There is a general consensus on the idea that income responds better than the previous listed tests to the demands of modern tax systems.[58] However, this does not mean that all other tests have been completely supplanted; property, production and expenditure are still highly relevant as taxable bases.

In the field of taxation, income always refers to net income which is different from mere receipts and gross revenue because expenses related to the economic activity are deducted.[59] Returning to the proposed examples, this means that, if productive assets are purchased relying on debt, interest on such debt must be deducted for tax purposes.[60] Strictly speaking, income is the amount of money or goods that becomes available to an individual or a corporation in excess of all the necessary expenses of acquisition and can be used for its own consumption or distribution. It is intended as a flow of wealth and is calculated over a definite period, ie, the taxable year, during which it is at the disposal of the owner so that, in using it, its capital is not impaired.[61]

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[57] For an overview of some of the most recent trends, see United Nations Conference on Trade and Development (UNCTAD), 'Corporate Income Taxes and Investment Incentives – A Global Review', *UNCTAD Investment Policy Monitor*, Special Issue 8 (July 2022).

[58] Avi-Yonah, 'Corporations, Society, and the State', above n 46, explains how the corporate income tax may be conceived of as a payment in return for the benefits of incorporation such as limited liability. Nevertheless, he also points out that there are several objections to this *defence*. First, some of the benefits conferred by the government also flow to non-incorporated businesses not subject to the tax. Second, there would be no correlation between corporate income and the benefits provided since the same benefits apply (and, in the case of limited liability, apply more forcefully) to corporations that lose money.

[59] For a review of the literature on the theoretical optimal tax, see Spencer Bastani and Daniel Waldenström, 'How Should Capital Be Taxed?' (2020) 34(4) *Journal of Economic Surveys* 812.

[60] In addition to that, it must also be considered that, as explained by David A Weisbach, 'The Irreducible Complexity of Firm-Level Income Taxes: Theory and Doctrine in the Corporate Tax' (2007) 60(4) *Tax Law Review* 215, a high level of complexity arises because firms can hold assets in two ways, ie, directly or through a subsidiary. Dual ownership, as he calls it, creates complexity because it creates the possibility of multiple realisations of the same economic income.

[61] In the Italian tax law tradition, it is commonly accepted that what is taxed by income taxation is 'new wealth' which is a pre-legal concept borrowed by law. Professor Falsitta, among others, has extensively investigated the notion of income for tax purposes since, in the Italian tax system, it is not expressly defined under any statute and is, therefore, considered a 'pre-legal' concept. See Gaspare Falsitta, *Manuale di diritto tributario – Parte speciale* (CEDAM, 7th ed, 2010) 2. See also Giuseppe Melis, *Lezioni di diritto tributario* (Giappichelli, 6th ed, 2018) 544. He explains that income must be taxed where it is related to a productive source, ie, a relationship of derivation shall exist between the increase in assets and an activity or act of management of a productive asset that is capable of producing an economic result. By contrast, according to various theories, what is to be taxed is the mere fact of the existence of an increase in assets irrespective of whether this is linked to a source of production. This issue has also long been present in the legal tradition of common law jurisdictions. In *Commissioner of Income Tax, Bengal v Shaw Wallace & Co* [1932] LR 59 IA 206, the concept of income was held to connote a periodical monetary return '*coming in*' with some sort of regularity or expected regularity from defined sources. In addition to that, Lord Macmillan observed in *Van den Berghs Ltd v Clark* [1935] AC 431, 438 that '[t]he Income Tax Acts nowhere define "income" any more than they define "capital"; they describe sources of income and prescribe methods of computing income, but what constitutes income they discreetly refrain from saying. … Consequently it is to the decided cases that one must go in search of light'. See also Choong Kwai Fatt, *Malaysian Taxation – Principles and Practice* (InfoWorld, 27th ed, 2021) 2-3, in which it is further clarified that, according to the Malaysian tax system, the source is not necessarily one that is expected to be continuously productive, but

Some tax systems include temporal elements in this definition thus also taking into consideration the regularity of the calculated flow. This is why, in certain circumstances, large gifts and inheritances may be considered as additions to capital rather than constituent elements of income.

Different justifications exist in the literature[62] for adopting a corporate (income) tax. However, many of these arguments are justifications as to whether corporations should be subject to tax (the main reason being that most of the money in a market economy tends to pass through a corporation eventually) rather than a solid rationale for the use of income taxes levied on corporations.

In the mid-1990s, Professor Richard Bird reorganised these arguments into three major groups.[63] According to him, companies should be taxed because this is desirable, necessary and convenient.

The first argument is economic in nature and, beyond the technicalities of Pigouvian theory, can be summarised as the idea that it is desirable to tax corporations in order to impose a cost on the negative externalities they produce. Corporate taxes, though not necessarily on income, are therefore a price and an appropriate corrective on activities giving rise to problems (eg, environmental degradation).

Regarding the necessity to tax corporations, this argument is subsequently divided into two main points. The first, which is also one of the strongest, is the copycat element according to which the reason why most countries tax corporate profit is because most other countries do so. In other words, in a world where economies interact and cross-border investment flows are important, tax systems necessarily influence each other and if, for example, the United States taxes profits, Canada should do so too. Second, necessity may arise simply due to the fact that there is no other effective way to tax rents than through some form of corporate tax.

The last argument is that, even if it were not desirable or necessary, taxing corporations is convenient because it is simple. In fact, taxes are paid in money, and most of it that is earned and spent in modern economies passes at some point through the hands of a relatively small number of (small) corporations that generally maintain better records and are easier to locate and track than individuals. To use a colloquial expression, that is 'where the money is'.

Another justification that has been given historically is based on the benefit principle. When the old medieval corporations were abolished in Europe and replaced by the freedom of enterprise, franchise taxes (*droit de patente*, in French) were seen as compensation for removing the barriers to trade and industry that had existed

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it must be one whose object is the production of definite return, excluding anything in the nature of a mere windfall.

[62] See, among others, Steven A Bank, 'Entity Theory as Myth in the Origins of the Corporate Income Tax' (2001) 43(2) *William and Mary Law Review* 447.

[63] Richard Bird, 'Why Tax Corporations?' (Working Paper No 96-2, Technical Committee on Business Taxation, December 1996), available at the official website of the Canadian Government (https://publications.gc.ca/).

previously. They were additionally considered as a counterpart to the legal protection offered to undertakings by public authorities.[64]

Although all these arguments, as well as the one described later considering corporate taxation as a complement to the taxation of individuals, can justify the taxation of companies to some extent, they do not justify the taxation of their income in the way it is currently done.

As explained by J Clifton Fleming, Robert Peroni and Stephen Shay,[65] corporate income tax was originally a product of the progressive era when companies' tax returns were of public domain, and it was then intended as a device to impose a measure of public control on companies' behaviour. When the public disclosure of returns was abolished, corporate income tax was rationalised and remained, also in modern times, as a device for the same purposes. The idea behind this rationalisation process was that, by limiting the accumulation of wealth within corporations and through tax expenditures and denial of deductions, the tax system can help to shape companies' behaviour.[66] Nevertheless, as the authors mention, practical evidence shows that the considerable net worth and cash holdings of large corporations and groups indicate that the corporate income tax has not been a meaningful restraint on accumulations of corporate wealth. Fleming, Peroni and Shay state that 'while the corporate income tax has undeniably affected corporate decisions regarding the location and composition of business activity, its role has been limited outside of the business domain'.[67]

Other justifications rely on the widespread tacit consensus on the idea that corporate income tax is ultimately a tax on shareholders. Companies may exist by themselves in private law but, from a tax perspective, they are nothing more than an empty (cash) box in a sense, ie, a shield placed between the shareholders and the treasury.[68] From a practical standpoint, corporate income tax is still levied because collection is easier at a company level. From a more theoretical standpoint, corporate income tax prevents natural persons with capital from investing in companies' shares, undermining the ability to pay principle, or at least mitigating the consequences of its infringement. Without such a levy in place, they would be able to earn a higher income compared to other natural persons with the same ability to pay who did not incorporate by simply deferring the distribution of dividends or not selling the shares.

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[64] See, for example, in Belgium: Edmond Picard, N d'Hoffschmidt and Jules de le Court, *Pandectes belges*, v° Patente (général) (Larcier, 1903) vol 74, n° 14, 462; Jean Steels, *Les principes fondamentaux du système fiscal belge* (Bruylant, 1943) 57.

[65] J Clifton Fleming, Jr, Robert J Peroni and Stephen E Shay, 'Defending Worldwide Taxation with a Shareholder-Based Definition of Corporate Residence' [2016] (6) *Brigham Young University Law Review* 1681.

[66] See the Joint Committee on Taxation, *Economic Growth and Tax Policy*, JCX-47-15 (20 February 2015).

[67] Fleming et al, above n 65, 1695 (footnotes omitted).

[68] In tracing the historical evolution of income tax, Jane Gravelle, in 'The Corporate Income Tax – A Persistent Policy Challenge' (2011) 11(2) *Florida Tax Review* 73, 80 (footnotes omitted), recalls that an 'issue addressed early on was the interaction between individual and corporate taxes. The individual income tax was initially imposed as a normal tax which was relatively low (one percent) and a surtax. From the beginning of the income tax until 1936, dividends were excluded from the tax base for purposes of the normal tax. Thus, there was early recognition of the double tax imposed under the corporate and individual income taxes. At the same time, there was also concern about the use of corporations to shelter income of wealthy individuals from the higher individual surtaxes'.

3.2.3 Corporate income as an adequate taxable basis for taxing MNEs

Examining the particular situation of MNEs in the current context of globalisation, the question arises as to whether income – as determined by domestic rules – is still a suitable parameter for measuring the taxpaying capacity of those who operate internationally.

According to Professor John Prebble,[69] the concept of income in tax law is not income itself but a legalistic simulacrum of it. Business profits arise independently of the law, and the fundamental problem of any income tax law is that it cannot tax economic transactions directly but taxes the legal forms that are used to represent economic transactions. The point is that income is somehow an artificial concept, more specifically the difference between receipts and expenditures. Furthermore, this difference is very hard to split territorially with the result that it is almost impossible to allocate it to a single jurisdiction in international tax matters. Indeed, the fact that economic activities are global makes it much more difficult for states to ensure that CIT taxable profits reported by multinational groups actually correspond to a fair proportion of the wealth generated by the economic activities carried out by the MNEs in their territory.

On the one hand, revenues generated by MNEs are not always easy to quantify or to attribute to one jurisdiction. They can be the consideration for supplies of services and goods jointly produced by different entities within the group. With regard to financial instruments or capital contributions, it is not even clear at what time they should be considered as an accrual of wealth. A lack of coordination between jurisdictions regarding the characterisation of items of income or the time of realisation are additional sources of indeterminacy.

On the other hand, it is even more difficult to link expenditure to a particular territory, ie, to establish to what extent the expenditure of a multinational enterprise in a certain jurisdiction on the purchase of an asset or service, for example, is actually 'used' in every single jurisdiction around the world.[70] As a result, calculating net income in every jurisdiction and using it as an effective measure to assess corporations' ability to pay creates opportunities for wide errors, arbitrary allocations, and possibilities for manipulation.

Moreover, corporate taxation remains strongly related to statutory accounting. The calculation of income is made based on the balance sheet that is drawn up from a single-jurisdiction perspective. It considers almost exclusively the economic reality of the business in that particular spatial area on the assumption that the deductions, for example, are actually referable to only one jurisdiction.

3.3 The fiction of corporate residence

On the issue of residence, tax legislators also piggy-backed on personal income tax. However, over the years, it has become a concept that is increasingly disconnected from economic substance.

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[69] John Prebble, 'Income Taxation: A Structure Built on Sand' (2002) 24(3) *Sydney Law Review* 301.

[70] For an analysis involving only some specific aspects of this phenomenon, see Ruth Mason, 'Tax Expenditures and Global Labor Mobility' (2009) 84(6) *New York University Law Review* 1540.

Corporate tax residence has two main functions in modern tax systems: (i) providing a domestic connecting factor between a corporation and the tax jurisdiction of a state, and (ii) the allocation of income under tax treaties.

The first arises when the tax jurisdiction goes beyond the political borders of a given state and, in exchange for taking resident corporations into consideration in the determination of economic policy, it envisages the taxation of their worldwide income. Indeed, corporate tax residence forms the basis for worldwide taxation.

In contrast, the second of the listed functions stems from tax treaty law. Corporate tax residence is, in fact, used as a criterion for allocating income to one contracting state or to another. This may be the case, for example, wherever a tax treaty does not grant an exemption in the residence state for passive income and, under clauses drafted following the OECD *Model Tax Convention on Income and on Capital* (Model Tax Convention), allocation is determined by reference to corporate residence.

Events in recent years have demonstrated that legal entities have been a tool for disconnecting created wealth from the income tax base. For tax purposes, in fact, companies have allowed individuals, in a sense, to 'double up' and establish a presence where it is most convenient. This instrument has not always been used merely to limit the liability of investors to conduct business in a jurisdiction other than the one where the investors are physically present, but its nature has often been exploited to 'choose' the most tax-efficient jurisdictions.

Unlike flesh and blood individuals, corporations must necessarily rely on a legal system for their existence. For non-tax law purposes, the concept of corporate residence is useful for answering a number of questions such as where the entities may be sued, where insolvency procedures shall be initiated, where contracts have to be executed, etc.[71] As already explained, tax law borrowed significantly from corporate law in creating its own system of criteria for determining corporate tax residence.[72] Most of the jurisdictions currently rely on a mix of formal and substantive criteria.

The category of formal criteria implies the adoption of tests that result in a high level of legal certainty as well as low administrative and compliance costs. Conversely, they are

[71] For a comprehensive analysis of the complex relationship between residence, citizenship and representation, see Wolfgang Schön, 'Taxation and Democracy' (2019) 72(2) *Tax Law Review* 235, 288 ('If one regards residence-based taxation as a form of quasi-citizenship taxation, the argument for voting rights is strong. But this is not the position taken in this Article. Fiscal residence does not, as has been laid out above, relate to a sufficient level of integration of a taxpayer into the domestic society on polling day').
[72] Another scholar who explores the issue of the artificiality of tax residence is David R Tillinghast, in 'A Matter of Definition: "Foreign" and "Domestic" Taxpayers' (1984) 2(2) *International Tax and Business Lawyer* 239. He begins his analysis by stating (at 239) that '[n]othing is more fundamental under the federal income tax system than determining whether an individual is a domestic or a foreign taxpayer', so as to underline how such a concept is central for the tax system. Subsequently, highlighting how this is the result of political choices, he clarifies (at 239, footnotes omitted) that '[t]here are those who believe that no Constitutional proscription and no rule of international law prohibit the United States from taxing all of the income of any taxpayer that it can reach. Under this view, the federal government could adopt some variation of the unitary tax principle utilized by a dozen American states to reach the income of taxpayers throughout the world. For reasons of history, practicality, comity, and a visceral sense of fairness, the federal government has chosen not to do this. It is this decision, however, which creates the need to differentiate one class of taxpayer from the other'.

exposed to a relatively high level of electivity.[73] While the technical terminology used may vary significantly in different jurisdictions, for the purposes of the present study, they may be gathered under the expression *legal seat of a company* which also includes what is commonly referred to as the place of incorporation.

This category of tests implies that any entity incorporated in a certain jurisdiction remains resident therein for tax purposes regardless of where it is managed or operates. In the United States, one of the most relevant examples of the adoption of this formal criterion dates back to the *Tariff Act of 1909* and to the *War Revenue Act of 1917* when corporations were identified as resident for tax purposes if 'created under the law of the United States, or of any State, Territory or District thereof'.[74] Although the origin of this criterion remains ambiguous in part and currently largely unchanged, there seems to be little doubt that it developed at that time because it was appropriate for a historical period characterised by: (i) somewhat underdeveloped international trade, and (ii) the circumstance that a corporation's legal standing was largely confined to the territory of the state that created it.[75] Moreover, as reported by Professor Omri Marian, there was often a formal requirement jointly with a generalised tacit understanding that corporations were incorporated in the place where they had significant operations, where their officers and directors resided, and where they held their shareholders' and directors' meetings.[76]

Other countries use substantive criteria for residence based on the economic nexus between the corporation and the jurisdiction.[77] The most common criteria within this group are the *place of effective management* (POEM) and *the central management and control* (CMC). The former must be kept conceptually separate from the tie-breaker rule under Article 4(3) of the OECD Model Tax Convention although, in several jurisdictions, their content actually coincides and what is considered relevant is the place where strategic or key decisions are taken. Other jurisdictions instead adopt an overall approach. In the case of groups of companies, the test is generally carried out at the level of each subsidiary unless it has no decision-making power.

In contrast, the CMC assesses where the real business of a company is located. The main element of this test is where the key decisions of the company's policy are taken which is a factual evaluation and shall not be limited to where the board of directors

[73] Daniel Shaviro, 'The Rising Tax-Electivity of US Corporate Residence' (2011) 64(3) *Tax Law Review* 377.
[74] *War Revenue Act of 1917*, ch 63, sec 200 (3 October 1917), 40 Stat 300, 302.
[75] Roland Ismer, 'History and Emergence of the Corporate Residence Concept in Europe: A Comparative Approach' in Edoardo Traversa (ed), *Corporate Tax Residence and Mobility* (IBFD Publications, 2018) 27, 44.
[76] Omri Marian, 'The Function of Corporate Tax-Residence in Territorial Systems' (2014) 18(1) *Chapman Law Review* 157. In that article, a complex evaluation of the corporate tax residence determination in territorial systems is given. Under a positive approach, corporate tax residence is seen positively as pointing to the source of income earned by the corporation. Thus, corporate taxes would serve as a proxy to source taxation. The author acknowledges its historical merit but considers it as obsolete nowadays. Under a negative approach, corporate tax residence would only be relevant to the extent that it prevents income from being sourced to a jurisdiction where income could not possibly have been generated. As such, residence determination would serve as an instrument to prevent income shifting and base erosion.
[77] Among others, Luc de Broe, 'Corporate Tax Residence in Civil Law Jurisdictions' in Guglielmo Maisto (ed), *Residence of Companies under Tax Treaties and EC Law* (IBFD Publications, 2009) 95.

meets.[78] The focus is on the nature of the decisions taken by the board of directors and when the key management decisions are taken by the parent company of a group of companies, the CMC remains with the parent company. Alternatively, because the overall situation has to be taken into consideration, when the key decisions are taken by someone who is not on the board of directors, the CMC remains with that person.

In addition to the above, there are several tax systems that adopt their own model of substantive criteria.[79]

The domestic rules on corporate tax residence also have a significant impact on the allocation of income at the international level as the application of tax treaties relies heavily on them.[80] Under tax treaties, corporate tax residence usually: (i) defines the personal scope of application since only residents are entitled to treaty benefits; (ii) protects against double taxation because almost all allocation rules make some reference to the state of residence; (iii) determines the source of certain types of income such as, for example, dividends, and (iv) is of some relevance with regard to non-discrimination rules and mutual agreement procedures.[81]

Most of the concepts briefly presented in the above paragraph were elaborated in the first half of the 20th century and in the context of an economy strongly based on manufacturing and 'material' (*brick-and-mortar*) activities. One of the most striking and widely cited examples is the leading case of *De Beers*[82] decided by the House of Lords in 1906 for which the substantive criteria of the central management and control were first proposed.

In the judgment, the Lord Chancellor affirmed that, although the corporation has no personal life but only a business life, in applying the conception of residence to it, one should proceed as closely as possible to the analogy with an individual: 'A company cannot eat or sleep, but it can keep house and do business'.[83]

This idea that legal persons are also resident somewhere is reflected and amplified in the network of international treaties against double taxation. These treaties and their functioning, like that of domestic tax systems, are also greatly influenced by the concept of tax residence. Thus, not only do natural persons have the possibility to 'double up' by incorporating but, when deciding where to 'establish' this *alter ego* of theirs, they

[78] Ismer, above n 75, 50. Some of the main judgments in this regard are: *New Zealand Shipping C. Ltd v Thew* (1922) 8 TC 208; *Untelrab Ltd & Ors v McGregor*, SpC55 (1995); *Laerstate BV v HM Revenue and Customs* [2009] UKFTT 209 (TC).

[79] In the Netherlands, for example, an open standard provision is in force under which residence is determined 'according to the circumstances'. Italy relies on two substantive criteria that can determine the residence of a corporation for tax purposes. They are the place of management that adheres to the model described above and the localisation of the main object of business (*oggetto esclusivo o principale dell'ente*). Additionally, in Belgian tax law, two alternative substantive criteria coexist, namely the company's principal establishment and the seat of management or administration.

[80] Ismer, above n 75, 57.

[81] See generally David Elkins, 'The Elusive Definition of Corporate Tax Residence' (2017) 62(1) *Saint Louis University Law Journal* 219.

[82] *De Beers Consolidated Mines, Ltd v Howe* [1906] AC 455 (HL).

[83] Ibid 458. The Court held (at 458) that the tax residence of a company shall be where it 'really keeps house and does business', specifically, as stated by the Court, where its 'chief seat of management and its centre of trading' are. This because, again in the Court's words (at 459), the 'real business is carried on where the central management and control actually abides', not where its business operations are located.

can often also exploit a totally artificial division between residents and non-residents, thus gaining significant advantages.

To a certain extent, the inadequacy of this legal fiction became apparent a long time ago, as indicated by the introduction of CFC rules, the first version of which was introduced in the United States in 1962.[84] These laws apply when domestic shareholders have a 'substantial influence' on a foreign corporation which, as a result of that, begins to be treated as a resident entity.[85] This represents a *de facto* extension of the rules on tax residence and proves that the need to go beyond the traditional categories of tax law emerged long ago. The CFC laws are a good example of what has been argued herein since they are precisely a first attempt to overcome the traditional fictions of residence and existence of legal entities, in order to exercise taxing powers in a way that is more adherent to the economic reality.[86]

4. THE GLOBALISATION AND DIGITALISATION OF THE ECONOMY AS A BREAKING POINT OF THE CORPORATE INCOME TAX MODEL

The OECD opines that the main tax challenges of the digital economy include a lack of nexus (or taxable presence in a jurisdiction), reliance on intangibles, data and user-generated content, income characterisation, spread of new business models in which the buyer and seller are in different jurisdictions, and the expansion of e-commerce.[87]

4.1 Main features of the digitalisation of the economy

Digitalisation is defined as the phenomenon that consists of 'the incorporation of data and the Internet into production processes' and has a profound impact on the structure of the global economy as highlighted by a substantial number of reports and studies.[88] No agreed definition of the digital economy exists. In a narrow context, this expression overlaps with online platforms and activities that owe their existence to them. Conversely, it broadly refers to all activities that use digitised data; thus, almost all of the entire modern economy.[89]

The main driver of digitalisation is currently the internet that is enabling the processing of big data aggregated by online platforms, sensors and smartphones together with a constantly increased storage capacity, computing power and algorithms that are increasingly sophisticated.[90] Moreover, the presence of certain factors with enormous development potential such as artificial intelligence, the fall in price of information and communication technologies (ICT) and the adoption of 5G lead us to think that, in the near future, this phenomenon will only accelerate and will enable the digitalising of even more sectors of the economy.[91] Commonly, the totality of these phenomena is

[84] Reuven S Avi-Yonah, *Advanced Introduction to International Tax Law* (Edward Elgar, 2nd ed, 2019) 38.
[85] Ibid 40.
[86] See, generally, Shaviro, above n 73.
[87] Pascal Saint-Amans, 'Tax Challenges, Disruption and the Digital Economy' *OECD Observer* (10 March 2017) 2.
[88] International Monetary Fund (IMF), 'Measuring the Digital Economy' (Policy Paper, 2018) 6.
[89] See the section 'Definition and Size of the Digital Sector, Products, and Transactions': ibid 7.
[90] See also Martin Mühleisen, 'The Long and Short of The Digital Revolution' (2018) 55(2) *Finance and Development* 4.
[91] See Oliver Cann, '$100 Trillion by 2025: The Digital Dividend for Society and Business' World Economic Forum (News Release, 22 January 2016), available at: https://www.weforum.org/press/2016/01/100-trillion-by-2025-the-digital-dividend-for-society-and-

referred to as the Fourth Industrial Revolution,[92] which is considered to be the most important development in the world economy since the Industrial Revolution. It is strongly characterised by the fusion of the physical, digital and biological worlds[93] as well as, in the case of the sharing economy, by certain boundaries between consumers and producers becoming indistinguishable.[94]

Business operations rely heavily on digitalisation and, from an economic perspective, the faster and more efficient it becomes, the more significant the time and cost savings will be for the product and service development processes. This is boosting the economic performances of these corporations to such an extent that, in certain cases, there is even a tendency towards the monopolisation of their respective markets due to network effects, scale effects, restrictions of use, potential to differentiate, and multi-sided platforms.[95] It is not surprising that, in light of the dimension of these types of businesses, Denmark went so far as to appoint a digital ambassador to deal with large MNEs in the digital sector.[96]

Concerning the characteristics of these business models that are posing the greatest challenges to tax systems, the most relevant factors are that digital goods are highly mobile, and a physical presence of a business in the market country is often not required (often referred to as 'scale without mass').[97] Digital business models generally rely on intangible property such as licences, brands, trademarks and copyrights and place great importance on the use of innovative technologies such as a cloud, analytics, algorithms and smart machines. Some of them are also used in the tax strategies of 'traditional' multinational businesses of which the activities are chiefly focused on manufacturing and tangible items while others are more 'typical' of the digital business sector.[98]

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business/; Naja Bentzen, Mar Negreiro, Vincent Reillon, Nikolina Sajn and Marcin Szczepański, 'Adapting to New Digital Realities: Main Issues and Policy Responses' (European Parliamentary Research Service Briefing, April 2018), available at:
https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2018)614734.

92 Klaus Schwab, *The Fourth Industrial Revolution* (World Economic Forum, 2016) 6.

93 Eli Hadzhieva, *Impact of Digitalisation on International Tax Matters: Challenges and Remedies*, Study Requested by the TAX3 Committee of the European Parliament (2019) 15.

94 For an overview of some of these innovative business models, see, for example, Cristina Trenta, *Rethinking EU VAT for P2P Distribution* (Kluwer Law International, 2015).

95 Hadzhieva, above n 93, 15.

96 Marc Rameaux, '*Les GAFA élevés au rang de puissance diplomatique ou la tyrannie des géants du Web*' *Le Figaro* (2 February 2017), https://www.lefigaro.fr/vox/monde/2017/02/02/31002-20170202ARTFIG00113-les-gafa-eleves-au-rang-de-puissance-diplomatiqueou-la-tyrannie-des-geants-du-web.php.

97 See also Yariv Brauner and Pasquale Pistone, 'Adapting Current International Taxation to New Business Models: Two Proposals for the European Union' (2017) 71(12) *Bulletin for International Taxation* 681.

98 Assaf Harpaz, 'Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy' (2021) 46(1) *Yale Journal of International Law* 57, summarises the main policy challenges posed by digital taxation in two main questions: first, how to establish taxing rights (nexus) in jurisdictions where foreign businesses have significant commercial presence with little or no physical presence and, second, how and where to allocate the taxable profits of MNEs. For a general comment, see also Frans Vanistendael, 'Digital Disruption in International Taxation' (2018) 89 *Tax Notes International* 175 (as to what he refers to as 'the fundamental challenge', he comments (at 177) that '[t]oday taxation of digital economic activity is neither neutral nor efficient, and because of the complications involved in the digital revolution, it is not simple. The digital revolution has completely changed our daily way of life').

4.2 Digitalisation and recognition of value and income for CIT purposes

Digitalisation affects income, value creation and recognition. Its ultimate essence is about *removing most of the mediators* that are present in the market.[99] If one thinks about the book market, for example, the business model of Amazon removes most of the mediators between the publishing house and the final consumer, of which the most familiar is the bookstore. The possibility to download an e-book, more specifically a digital and dematerialised version of the same product, goes even further by also removing the courier who delivers to private homes, ie, one of the last mediators who still 'survives' with the e-commerce business model.[100] Likewise, the business model of eBay also removes a number of mediators and allows goods to circulate among individuals who possess nothing of the business structures that are necessary in a materialised economy.[101]

Similarly, email goes directly from the writer to the reader. All of the intermediary steps, individuals and structures have been removed, eg, purchasing a stamp and envelope, the mail carrier, the post office, etc.

Even Google and Yahoo, in a way, remove a number of mediators. Although they are *per se* not experts in anything, they are currently two of the most relevant sources of information in existence. This is made possible due to their use of algorithms, which are mathematical formulas that are able to direct requests for information according to previously decided indications.

These new business models are radically transforming most production processes, making it problematic to determine where the value is created and which factors contribute to it. In its interim report on tax challenges arising from digitalisation, the OECD[102] identifies three types of value creation processes. The first is the value chain which is a theory of the firm where value is created by converting inputs into outputs through discrete but related sequential activities. The second is the value network which relies on mediating technologies such as, for example, those used by platform operators to link customers interested in engaging in a transaction or relationship (whether for financial consideration or not). Third is the value shop that operates in single-sided markets where interactions take place with one specific type of user or customer such as medical technology used to diagnose and treat a patient's disease. Its main characteristic is the use of an intensive technology applied in order to solve a specific customer demand or problem.

The digital economy also modifies the business models typical of industrial societies because they operate widely with the primary resource of data collected from users. Many social networks, for example, rely significantly on user participation and the

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[99] Alessandro Baricco, *The Game* (Einaudi, 2018) 73.

[100] Montserrat Hermosín Álvarez and José Miguel Martín Rodríguez, '*Los nuevos productos de la economía digital. Características, criterios de identificación y tipos de gravamen aplicables. Especial mención a los libros electrónicos*' in Adriano Di Pietro and Piera Santin (eds), *La fiscalità dell'economia digitale tra Italia e Spagna* (CEDAM, 2021) 76.

[101] See also, Alina Ionela Bădescu, 'Expansion and Contraction of Businesses: The Model of Co-Extension of Business Spaces' (2014) 10(2) *Revista Universitara de Sociologie* 7.

[102] OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Inclusive Framework on BEPS (OECD Publishing, 2018) 34 ('*Interim Report 2018*'). See also Andrew McAfee and Erik Brynjolfsson, 'Investing in the IT That Makes a Competitive Difference' (2017) 86(7/8) *Harvard Business Review* 98.

provision of user-generated content as transactions between the users (as providers of data/content) and the digitalised business with the latter providing financial or non-financial compensation to the former in exchange for such data/content. That non-financial compensation may come in the form of providing data hosting, email services or digital entertainment, for example.[103] Not only have the wealth flows changed their structure and direction but, in fact, they have changed their nature. Even if there is no doubt that the fundamental reason why businesses exist and will continue to do so is to realise profits, replacing major parts of production processes with the exchange and circulation of large amounts of data is often problematic with regard to reliance on the traditional concept of income. The data both add to and have great value in themselves and, since they exist only in the digital borderless world, it is extremely difficult under the current tax law framework, for example, to allocate the net income to a jurisdiction since expenses incurred to realise such data can occur virtually anywhere in the world. Moreover, even the fact that the current notion of income for tax purposes is usually limited to money or physical types of income risks overlooking the enormous data flows which, as mentioned, both have and add significant value to many of the contemporary value production chains.[104] Again, from an international tax law standpoint, it can be noted that data collection has always been considered as an auxiliary activity below the minimum threshold for determining the presence of a permanent establishment able to attract the taxing rights of the state where its activities are performed.[105]

Those transformations have a significant impact on the calculation of the taxable base for income tax purposes that mostly depends on financial accounting. In the last decades, financialisation and digitalisation of the economy have eroded the reliability of financial accounting for assessing the capacity of businesses to generate profits.[106] Contemporary balance sheets are very much focused on physical assets purchased and

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[103] Dirk A Zetzsche and Linn Anker-Sørensen, 'Taxing Data-Driven Business: Towards Data Point Pricing' (2021) 13(2) *World Tax Journal* 217.

[104] See the report of the Schmalenbach-Gesellschaft 'Transfer Pricing' Working Group, 'Data and Information as Taxable Assets' (2020) 60(11) *European Taxation* 489.

[105] Changes to this concept have been discussed for some time. See, for example, Peter Hongler and Pasquale Pistone, 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy' (IBFD Working Paper, January 2015). See also the report of the United Nations Committee of Experts on International Cooperation in Tax Matters, 'Tax Challenges in the Digitalized Economy: Selected Issues for Possible Committee Consideration', E/C.18/2017/CRP.22 (11 October 2017).

[106] In the 2016 book authored by Baruch Lev and Feng Gu, *The End of Accounting and the Path Forward for Investors and Managers* (Wiley, 2016) 35, the authors claimed that, over the last 100 years or so, financial reports have become less useful in capital market decisions and, after having rhetorically asked, 'Are we fair to accounting?', the answer is 'not really. We draw a rather strong conclusion – accounting information has lost much of its relevance to investors – from examining the association of only two financial information items with stock prices. […] We document that the role of reported financial information in investors' decisions eroded systematically and quite rapidly over the past half century, despite the unprecedented expansion of the scope of accounting regulation during this period'. Their entire book is aimed at explaining and investigating the causes of this conclusion, but it is interesting to note that, at the beginning of the analysis, they write: 'A clue to accounting's relevance loss lies in a close inspection of figure 3.4: While the curve declines slightly from the 1950s to the mid-1970s, the drop really began to pick up steam from the late 1970s. Something started in those years to increasingly distance financial information from reality (stock prices). Any astute economic observer can easily guess the impetus: The 1980s saw the emergence and steep rise in the economic role of intangibles (intellectual) assets. Revolutionary changes, shifting economies and business enterprises from the industrial to the information age, started to profoundly affect the business models, operations and values of companies in the 1980s, yet amazingly triggered no change in accounting. Entire industries, which are largely intangible (conceptual industries, as Alan Greenspan called them), including software, biotech, and Internet services, came into being during the 1980s and 1990s'.

sold by means of contracts displaying a price that, in most cases, reflects their market value. Most of the time, these assets can be located in a physical space with a certain degree of precision.

However, digitalised businesses create their value by relying heavily on assets that are external to the perimeter of the companies filing the statutory accounts. Very often, these assets are owned by someone else or are not even the subject of property rights as we know them under private law. Suffice it to take as an example Uber's cars, Facebook's and Google's users, Airbnb's residential properties, etc.

Moreover, the main assets falling directly within the perimeter of digital businesses are, among others, algorithms, peer and supplier networks, artificial intelligence, human capital, etc which are not recorded as capitalised assets on balance sheets as most of them are currently filed. Nevertheless, in order to build these intangible assets, businesses sustain (deductible) expenses that are included in the statutory accounts of the corresponding companies.

Whereas a traditional business must show any purchases, eg, a machine, in the balance sheet as it is expected to have an impact on its performance, the dynamics are very different for digital businesses. A social network that acquires thousands of new users and a platform on which innumerable new videos are uploaded, for instance, will be able to increase its stock market value without showing anything other than tax deductible costs in the statutory accounts.

Even one of the few intangible assets often used by digital businesses that can be included in the capital under current rules, namely the brand, contributes to this trend and constitutes a perfect, illustrative example. In fact, purchased brands are reportable on balance sheets as physical assets and, like physical assets, they thereby generate deductible expenses. However, in contrast to them, brands (ie, intangible assets) do not depreciate with use and are likely to increase in value.[107]

In addition to this, it must also be considered that ultimately in most jurisdictions the tax calculation begins after the directors, on behalf of the shareholders, have already decided how to allocate the profits deriving from the business activity. This derives from company law and is not a strictly fiscal issue, but it causes taxation to represent public interests very late in the process of the business operation and means it is easily influenced by the choices of the taxpayers themselves.

For all the above reasons, relying on income (derived from financial accounting) as the main indicator of ability to pay for corporations has become increasingly difficult for ensuring the equality of tax contributions amongst businesses.

4.3 Digitalisation and 'de-territorialisation' of tax residence

Current tax systems are based on rules such as those determining corporate tax residence that are drafted for the purpose of taxing the profits where the value is created along the production process. By removing a number of mediators, the digitalised, globalised and highly mobile new business models are also eliminating most of the links of production chains and creating completely new business structures. Consequently, this alters the

[107] For a historical overview of the tax issues posed by brands, see David Haigh, 'Make Brands Make Their Mark' (2001) 12(2) *International Tax Review* 40.

flow of wealth characterising materialised economies. Returning once again to the example of the company in the *De Beers Consolidated Mines* case, it is evident that replacing the mine activities in South Africa with an internet activity based on the exploitation of an algorithm becomes problematic when applying the reasoning of the Court and determining where the corporation has its *chief seat of management and its centre of trading*. Indeed, under the current legal framework, it may be difficult to determine where an algorithm is 'preserved' or where it generates its value. Theoretically, it may be in the jurisdiction where the company using it is located, where the final customer lives at that moment or permanently resides, or even in the one or more jurisdictions where the servers supporting the operations or the mathematicians updating the formula are located.

The statement above also derives from the fact that, from an international law standpoint, the notion of value creation is not among the traditional concepts.[108] It did not play a crucial role in the drafting of the OECD Model Tax Convention nor in the drafting of the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* until the BEPS project.[109] On the contrary, when the modern day system of international agreements on the avoidance of double taxation was conceived by the League of Nations in the 1920s, the idea of 'economic allegiance' of a business to a certain jurisdiction served as a guiding principle for the allocation of taxing rights.[110] This is the context that gives rise, for example, to the notion of 'physical' permanent establishment.[111] It derives from a compromise that considers this threshold as a sufficient nexus for the exercising of taxing rights by states other than the residence state.[112] The assumption underlying the adopted solution is that such a regime would have led to an allocation of taxing rights in conformity with the benefit principle. In parallel, it would also have solved most of the 'administrative concerns'. Taxes should be paid where the business would typically avail itself to a significant degree of physical infrastructure and other public goods provided by the state and where it would, at the same time, be visible and accessible to tax authorities.[113]

Digital businesses are often able to significantly reduce their tax burden for two main reasons.[114] In some cases, certain jurisdictions offer low-tax regimes or deliberately

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[108] Johannes Becker and Joachim Englisch, 'Taxing Where Value is Created: What's "User Involvement" Got to Do With It?' (2019) 47(2) *Intertax* 161.

[109] As reported by Becker and Englisch, ibid 162 (footnote omitted): 'It is against this backdrop that the OECD declared its intention to better "align taxation with value creation" and introduced the concept into the BEPS documents. This slogan was put forth as the guiding principle for fixing all the actual or perceived deficiencies of the traditional tax system and make it fit for the 21st century. It allowed the OECD to forge consensus on the overall direction of reform efforts not only among its member States, but to also win the support of (other) G20 member States – altogether a group of 44 nations with quite divergent stages of economic development. The new "value creation" terminology was sufficiently vague and flexible to allow every party to project its own tax policy preferences into it, facilitating international agreement'.

[110] See, for example, Sunita Jogarajan, *Double Taxation and the League of Nations* (Cambridge University Press, 2018) 20, and, regarding the origins of this school of thought, Klaus Vogel, 'Worldwide vs Source Taxation of Income: A Review and Re-evaluation of Arguments' (1988) 16(8/9) *Intertax* 216.

[111] See Becker and Englisch, above n 108, 162.

[112] See generally José Á Gómez Requena, 'Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence' (2017) 45(11) *Intertax* 732.

[113] See for example OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing, 2017) Commentary on Art 7, para 11.

[114] See, among others, Johannes Becker, Joachim Englisch and Deborah Schanz, 'A SURE Way of Taxing the Digital Economy' (2019) 93 *Tax Notes International* 309. See also European Commission, *Time to*

refrain from exercising source taxing rights despite being entitled to do so in order to attract intellectual property or investment. The businesses relying widely on intellectual property and intangible assets often have many opportunities for exploiting that kind of international competition. This is not something that is exclusively exploitable by 'purely' digital businesses, but the fact that a consistent part of the product is dematerialised (eg, a software) or that a significant part of the value added consists of dematerialised components facilitates the artificial allocation of profits in elected jurisdictions. In other cases, certain digital business models allow for a significant presence in the economic life of a country without a corresponding physical presence.

All this is made possible by the exploitation of the three fictions mentioned above that enable substantial wealth to be created but without it forming a substantial income tax base in any high-tax jurisdiction.[115]

As to the innovations that allow business activities to be disconnected from the physical presence in the target market, they undermine the applicability of the rules described above aimed at subjecting income to taxation. While the formal criteria for determining a company's residence have always been elective, this disconnection also renders the substantive criteria elective to a certain extent. Indeed, if the case of *De Beers* is considered and set in the present day, it is evident that the internet would make it much easier than it was at that time to move the place of central management and control of the corporation, thus making the application of rules on corporate tax residence extremely complicated. Furthermore, the mining activities in South Africa can be replaced with either e-commerce or fully digitalised activities that can be conducted from virtually anywhere in the world and imply a limited used of physical support (eg, the servers) that can also be localised almost anywhere in the world. As a result, it is evident that all the substantive criteria for determining corporate tax residence as described, including the centre of trading and the main object of business, are inadequate for capturing the income generated by current digital businesses.

As summarised by Shafik Hebous:

> The decreased importance of maintaining a physical presence of companies for sales (and, more generally, the organizational structure of the global firm) have made guarding the borders between residence and source an extremely fragile undertaking. Distinguishing between different types of income has become more difficult and potentially prone to inconsistency across countries. The consequences are tax competition and profit shifting.[116]

All the above accentuates the need to establish new principles and solutions for modifying legal and tax systems in order to make them appropriate for the digital era. Despite its ambiguity and wide leeway for alternative readings, the logic behind the idea 'tax where value is created' is ultimately a restatement of the more general principle of

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Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy, COM(2018)146 final (21 March 2018) 4; HM Treasury, *Corporate Tax and the Digital Economy: Position Paper Update* (March 2018) 4; French Parliament (Assemblée Nationale), *Rapport d'Information Relative à L'évasion Fiscale Internationale des Entreprises*, No 1236 (12 September 2018) 167.

[115] Michael P Devereux and John Vella, 'Are We Heading Towards a Corporate Tax System Fit for the 21st Century?' (2014) 35(4) *Fiscal Studies* 449.

[116] Shafik Hebous, 'Global Firms, National Corporate Taxes: An Evolution of Incompatibility' (IMF Working Paper 178, 2020) 22.

'fair allocation of business profits'. With reference to multinational companies, it may be translated as 'tax where the market would allocate income if the taxpayers – or a taxpayer's different establishments – were unrelated parties'.[117] The challenge that tax systems are facing is to guarantee this ultimate principle of justice in a context where the difficulties in enforcing tax rules are becoming almost unsurmountable. It is therefore necessary to work in two directions. On the one hand, the current set of standards should be adapted both at a national and international level to the new reality described above. On the other, the current paradigms need to be overturned and forms of taxation developed that disregard the three aforementioned legal fictions. This should all be accomplished in the aim of establishing a framework capable of ensuring a fair distribution of business profits and, consequently, of taxation rights.

5. OECD ACTION UNDER THE BEPS PROJECT: FROM ACTION 1 ON THE DIGITAL ECONOMY TO PILLARS 1 AND 2: NOTHING MORE THAN A FEW ADJUSTMENTS (?)

Various international organisations have been working to find solutions to the problems created by the new economic models.[118] Among these, a leading role has undoubtedly been played by the OECD that has attempted, through various initiatives, to find innovative and appropriate solutions to the problems mentioned above.

5.1 The original OECD BEPS plan

The OECD's BEPS project has been the precipitator for a profound reflection on the adaptation of international taxation to globalisation and digitalisation.[119] In 2013, under the political impetus of the G20, the OECD launched the BEPS project that was divided into 15 Actions. Its general objective is to ensure that profits are taxed where the activities that generated them are located and carried out.[120]

Overall, the 15 Actions are considered fundamental for achieving the project's objectives in practice and are based on some major axioms, ie, making national tax systems coherent; strengthening the substantive requirements underlying existing international standards; pursuing a realignment of taxation to the location of production activities and value creation; increasing transparency and exchange of information; and improving the conditions of legal certainty for businesses and governments. With regard to the phenomena described here, it is no coincidence that the first of these 15 Actions

[117] Becker and Englisch, above n 108, 165.

[118] Not only have international organisations worked on this topic, but tax scholars as well. To give an example of an innovative elaboration, see Reuven Avi-Yonah and Nir Fishbien, 'The Digital Consumption Tax' (2020) 48(5) *Intertax* 538, advocating for the imposition of a digital consumption tax rather than the gross receipts DST. This consumption tax would be applied on the seemingly free interaction between, for example, Facebook (and other companies alike) and its user.

[119] The OECD had already addressed some of the issues relating to the impact of the changing digital economy on tax systems at a 1998 conference in the Canadian city of Ottawa that was followed by the creation of the 'Technical Advisory Group on Business Profits' (TAG Business Profits) and the inclusion of paragraphs 42.01 to 42.10 in the Commentary to the OECD *Model Tax Convention on Income and on Capital* (OECD Publishing, 2003).

[120] On the genesis of the BEPS project, see Edoardo Traversa and Matthieu Possoz, '*L'action de l'OCDE en matière de lutte contre l'évasion fiscale internationale et d'échange de renseignements: développements récents*' [2015] (1) *Revue Générale du Contentieux Fiscal* (R.G.C.F.) 5.

is devoted to the digital economy in a document referred to as *Addressing the Tax Challenges of the Digital Economy.*[121]

According to the OECD, the characteristics of the digital economy required a broad approach to address the very basis of taxation and its allocation across jurisdictions. The final version of the previously mentioned report previously advocated the need – given the significant divergence between where the sale of digital goods and services takes place and where the corresponding income is taxed – to develop forms of taxation that do not require a physical presence. In particular, the recognition of a permanent establishment in the territory of the states where digital multinational businesses are active is recommended. This Action is divided into 10 chapters and is structured around the following points after a review of the basic principles of tax policy in the digital economy as well as the business models and technical aspects of the main innovations leading to a technical revolution. The OECD first identifies the possibilities for base erosion and profit shifting in the digital economy (chapter 5), then develops strategies to address them (chapter 6), and concludes with three chapters on a number of 'options' to address the broader challenges that are raised.

The Action suggests the use of the concepts of *significant economic presence*, commonly also called *virtual permanent establishment* as a main strategy with the aim of identifying a criterion of connection with the law of a state. It recommends using a series of additional parameters, or at least some diverging from the traditional ones, as well as the concept of connection with the territory to verify the requirements deemed qualifying.

The OECD assumes that the evolution of business models and the growth of the digital economy have led to profound changes but not in the fundamental nature of the core activities that firms perform within a business model to generate profits. In fact, the OECD notes that firms still need to source and acquire inputs, create or add value, and sell to customers.[122] With regard to the possibility of creating a taxable presence in a certain jurisdiction where a non-resident business has a significant presence, the OECD states that it should be based on factors that demonstrate a voluntary and sustained interaction with the economy of that jurisdiction through technology or other automatic tools.

These factors should be combined with one based on revenue from remote transactions in the jurisdiction to ensure that only cases of *real* significant economic presence are covered.[123] The OECD argues that revenue generated in a jurisdiction on a sustained basis can be considered one of the clearest potential indicators of significant economic presence, although it also recognises that the payer's jurisdiction and the user's jurisdiction do not always coincide.[124]

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[121] OECD, *Meeting the Tax Challenges of the Digital Economy, Action 1 – Final Report 2015*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, October 2015).
[122] Ibid 100.
[123] Ibid 107.
[124] For analyses on this point, see, among others, Pasquale Pistone, João FP Nogueira and Betty Andrade Rodríguez, 'The 2019 OECD Proposals for Addressing the Tax Challenges of the Digitalization of the Economy: An Assessment' (2019) 2(2) *International Tax Studies*; Isabella Cugusi, 'Prospects for Taxation of the Digital Economy between "Tax Law and New Economy" and "Tax Law of the New Economy"' (2020) 12(4) *World Tax Journal* 763.

As for other factors to be considered in conjunction with revenue, the OECD focuses on those that, as in the traditional economy, make interaction with users and customers possible, ie, a local domain name, a local digital platform and local payment options. Regarding user-based factors, the OECD proposes to take into account monthly active users, the conclusion of online contracts and data collected in a certain jurisdiction.

In contrast to the other Actions, the OECD continued its reflection on the tax impact of digitalisation. It finally published an interim report entitled *Tax Challenges of Digitalisation*[125] that begins by examining some of the main features of the digital economy of which the main concept is that of the massless transnational scale. According to the OECD, as described above, digitalisation has allowed companies in many sectors to locate different stages of their production processes in different countries while having access to a larger number of customers worldwide.

As a result, it also allows highly digitalised companies to become heavily involved in the economic life of a jurisdiction without any or a significant physical presence thus achieving local scale operation without local mass. Following this introductory section, the report assesses the state of implementation of the BEPS project. It indicates that, on the one hand, although it is still relatively early in its implementation, evidence is available that jurisdictions have taken a significant step towards widespread implementation of the various BEPS measures and that this is already having an impact.[126]

On the other hand, it is recognised that the relevance and impact of BEPS measures that have been implemented is far more indistinguishable for the broader direct tax challenges raised by digitalisation (eg, *nexus*) as, for many jurisdictions, these challenges remain largely unresolved. It further explains that this is because the relevant measures in the BEPS package were primarily designed to target double non-taxation rather than address the tax challenges posed by digitalisation more systematically.[127]

Secondly, the report follows the implementation of some national measures that are potentially relevant for digitalisation.[128] These are the following uncoordinated and unilateral measures which, partly along the lines already recommended in BEPS Action 1, can be grouped into four categories: (i) alternative applications of the permanent establishment threshold; (ii) withholding taxes; (iii) turnover taxes, and (iv) specific regimes targeting large multinational enterprises (eg, UK tax on diverted profits).[129]

In the report, the OECD also recognises that the objective of realigning the place where profits are taxed with the place where economic activities take place and value is created appears difficult to pursue in the digital economy. This is because digitalisation tends to geographically disconnect individuals and assets from the value creation process.

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[125] OECD, *Interim Report 2018*, above n 102, 19.
[126] Ibid para 253.
[127] Ibid para 255.
[128] Ibid ch 4.
[129] A rather negative judgement on these unilateral measures was made by a study commissioned by the EU Parliament Tax Committee, authored by Eli Hadzhieva, above n 93, published in February 2019 ('Absence of consensus leads to unilateral measures, making multilateralism lose its appeal. The effectiveness of such interim measures is doubtful. Some scholars recognise the legitimacy of short-term approaches that may put pressure on international organisations to speed up their coordination efforts while others think that they would fall short of fixing the interests of source needs, calling for a serious reform').

The OECD also notes a divide between those states supporting the idea that a state providing the market where a foreign company's goods and services are supplied is a sufficient nexus for creating an exclusive nexus for tax purposes, and those that reject it and prefer to continue to use the traditional criteria for allocating taxing powers.[130]

In conclusion, the report identifies as a basis for future work the belief shared by many jurisdictions that there is a need to review the rules on the nexus and profit allocation and also argues that, pending this review, there is no need to recommend the adoption of specific interim measures.

5.2 The Actions on transfer pricing: a partial attempt to change perspective while keeping the arm's length principle

The BEPS project focused strongly on transfer pricing rules. This is because both governments and scholars have always seen transfer pricing as one of the main means of implementing aggressive tax planning and avoidance schemes.

In past years, the debate has mainly concerned the suitability of the principle to meet the needs to which the transfer pricing rules respond and has gradually shifted to the relationship between transfer pricing and the dematerialised economy.[131]

Among the 15 BEPS Actions, four relate directly or indirectly to transfer pricing. To summarise: the purpose of Action 8 is to develop rules to prevent BEPS through transfers of intangible assets between members of the group; Action 9 develops rules to prevent the transfer of risks or allocation of excessive capital between group companies; Action 10 serves to counter BEPS conduct carried out through involvement in transactions that do not or very rarely occur between third parties, and Action 13 aims, among other things, to revise the rules on transfer pricing documentation to improve transparency in communications with tax authorities.

As a whole, Actions 8 to 10 aim at aligning transfer pricing outcomes with value creation.[132] The OECD, in fact, never expressed the intention to replace the arm's length principle but rather to adapt it to the needs of the present time.[133] On the basis of this approach, it can be stated that the work of the OECD in this area has not been conclusive in the sense that the underlying problems, such as the arbitrary shifting of risks and capital, still remain to a large extent.[134]

With regard to transactions, for example, the project shows that its intention is to focus the transfer pricing analysis on the conduct of the parties and the 'real deal' between them rather than on the formal aspects of economic transactions such as *legal ownership*. The analysis must therefore not be limited to that of contractual clauses but must take into consideration the actual behaviour of the parties, the price applied, the

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[130] OECD, *Interim Report 2018*, above n 102, 172.
[131] See, for example, Helen Rogers and Lynne Oats, 'Emerging Perspectives on the Evolving Arm's Length Principle and Formulary Apportionment' [2019] (2) *British Tax Review* 150; Isabel Verlinden, 'The Value of a Principle … the Arm's Length Principle' (2021) 49(3) *Intertax* 206; Marta Pankiv, *Contemporary Application of the Arm's Length Principle in Transfer Pricing* (IBFD Publications, 2017).
[132] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing, 2013) 19.
[133] Ibid 14-20.
[134] See also, among others, Georg Kofler, 'The BEPS Action Plan and Transfer Pricing: The Arm's Length Standard Under Pressure?' [2013] (5) *British Tax Review* 646.

propensity to take risks, etc. Relationships not formalised in contracts may also be relevant for the purposes of transfer pricing.

On one of the most critical points, ie, intangibles, their valuation and the consequent allocation of the created value, the BEPS project is characterised by two specific aspects. On the one hand, it requires that profits from the transfer or use of intangibles be allocated on the basis of value creation. On the other hand, it encourages the adoption of specific measures with the possibility to deviate from the arm's length principle for the transfer of what is known as *hard-to-value intangibles*. This indeed represents the most reforming aspect of the intangibles project since, firstly, the OECD admits that there are intangibles for which the current transfer pricing discipline based on the arm's length principle is not suitable for a correct valuation; secondly, it emphasises the role of the arm's length principle as a means rather than as an end of transfer pricing analysis.[135]

Ultimately, the OECD focuses on situations in which the very rationale of the arm's length principle fails because there are no comparable transactions in the market, as is often the case with transactions involving intangibles. In this sense, the entire framework of transfer pricing rules remained with the profit split method without introducing any major innovations. To some scholars, this seems to be a solution that actually defeats the project's purposes.[136]

In itself, the profit split presupposes the non-existence of comparable transactions between independent parties and, thus, the application of the arm's length principle in these cases remains *forced* in a certain way. This is because it is not really possible to determine the conduct that independent parties would have assumed in transactions that they never carried out and will never carry out in many cases.

To be consistent with the arm's length principle and the reality of the current business models, the profit split method should theoretically only be used in cases when independent companies would also have used it. However, for integrated companies for which intragroup transactions often involve unique intangibles of value, the profit split method will inevitably be the most widely used method.

The arm's length principle as originally elaborated in Article 9 of the OECD Model Tax Convention worked effectively until globalisation allowed for the emergence of integrated multinational businesses operating in several jurisdictions in which each group entity performs certain functions within the global value chain. With BEPS, in fact, the same need arose as that in the 1930s which led to the elaboration of the arm's length principle as the existing rules did not allow for the fight against elusive phenomena in a widely dematerialised context. In order to achieve this, the new approach being followed is based on the conduct of the parties as well as the facts and circumstances of the transaction rather than the contractual agreements. This therefore suggests that, in addition to being an income allocation tool, the arm's length principle after BEPS also adheres to a more pronounced anti-avoidance purpose. In particular, Actions 8 to 10 arise in pursuit of substance seeking to understand whether the parties to a transaction earn profits by virtue of the functions performed, assets used and risks

[135] J Scott Wilkie, 'Intangibles and Location Benefits (Customer Base)' (2014) 68(6/7) *Bulletin for International Taxation* 352; Yariv Brauner, 'What the BEPS?' (2014) 16(2) *Florida Tax Review* 55.
[136] See also Yariv Brauner, 'Changes? BEPS, Transfer Pricing for Intangibles, and CCAS' (University of Florida Levin College of Law Research Paper No 16-14, 2016).

assumed or whether there is inconsistency between the contractual provisions and the parties' actual conduct.

Nevertheless, the idea of linking value creation to a specific territory with reference to business models that have no physical connection with it is revealing in all of its inherent limitations. Any split of profits can only be arbitrary and is highly likely not to reflect reality. This is all without taking into account the fact that financial administrations have very limited possibilities for reconstructing intangible value chains.

5.3 From international digital business tax reform to international business tax reform in general: Pillars 1 and 2

Further debate within the Inclusive Framework led to the publication of a policy note on 23 January 2019[137] followed by a public consultation of stakeholders and accompanied by a discussion paper published on 13 February 2019.[138] In the discussion paper, the proposals considered by the Inclusive Framework are divided into two sets referred to as *Pillars*. The first relates to changes in the rules for defining the nexus and allocation of profits generated by companies operating globally and the second to unresolved BEPS issues.[139] The OECD persevered in its effort by publishing a blueprint for each Pillar in October 2020 reflecting points of convergence on a significant number of policy features and principles and identifying remaining technical issues and contentious policy choices. This perseverance was successful as it led to an agreement in principle in various forums: first the G7, then the G20, and finally the inclusive OECD framework (130 countries) endorsed the principle of the two Pillars.[140]

5.3.1 The first Pillar (or 'Pillar 1')

Pillar 1 aims to address the fundamental questions of 'how to tax', 'where to tax' and 'what to tax' by reviewing the current tax rules on the allocation of taxing powers between jurisdictions in which multinational enterprises operate, including those on transfer pricing and the arm's length principle. To do so, according to the OECD, it is necessary to prioritise a review of the nexus rules, ie, those that determine the connection of a company with a specific jurisdiction.

At the end of 2019, however, the OECD proposed a '*unified approach*' based on the common features of previous proposals.[141] It consists of revised rules for identifying the profit attribution nexus with the intent to strengthen and broaden the taxing rights of market jurisdictions *vis-à-vis* digital multinational businesses.

This approach is based on the following points: (a) the scope is limited to highly digitised business models, including direct-to-consumer digital businesses; (b) a new

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[137] OECD, *Meeting the Tax Challenges of the Digitalisation of the Economy – Policy Note, as approved by the Inclusive Framework on BEPS on 23 January 2019* (2019).
[138] OECD, *Meeting the Tax Challenges of the Digitalisation of the Economy, Public Consultation Document, 13 February – 6 March 2019* (OECD Publishing, 2019).
[139] For a review of the debate around the main OECD initiatives in this field, see Vikram Chand, Alessandro Turina and Louis Ballivet, 'Profit Allocation within MNEs in Light of the Ongoing Digital Debate on Pillar I – A "2020 Compromise"? From Using a Facts and Circumstances Analysis or Allocation Keys to Predetermined Allocation Approaches' (2020) 12(3) *World Tax Journal* 565.
[140] OECD/G20, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (2021).
[141] OECD, *Secretariat Proposal for a 'Unified Approach' under Pillar One, Public Consultation Document, 9 October 2019 – 12 November 2019* (OECD Publishing, 2019).

nexus concept is proposed that does not depend on the physical presence of the company but is based primarily on sales volume with the establishment of country-specific thresholds calibrated so that even states with smaller economies can benefit from tax revenues; (c) a new profit allocation rule going beyond the arm's length principle is approved that concerns taxpayers falling within the scope of the proposal whether they are physically present (with a permanent establishment or subsidiary) in the marketing or distribution jurisdiction or whether they use 'distributors', and (d) greater tax certainty is sought for taxpayers and tax administrations through the three-tier mechanism. However, this does not affect the right to maintain the current rules when they are more appropriate to meet the needs of a particular case.

Such a mechanism gives market jurisdictions the right to tax in three steps:[142] (1) the calculation of Amount A that corresponds to a share of the presumed residual profit allocated to the market jurisdictions according to a formula, ie, the new right to tax; (2) the calculation of Amount B that consists of a fixed remuneration for the basic marketing and distribution functions that take place in the market jurisdiction, and (3) the calculation of Amount C, ie, a binding and effective dispute avoidance and resolution mechanism relating to the application of the proposal.

As for the development of a new concept of nexus (that would coexist with the traditional concept of permanent establishment), the document[143] states that it should be applicable in all cases when a company has significant and ongoing involvement in the economy of the market jurisdiction. This could occur, for example, through the interaction and involvement of users and consumers there irrespective of the company's physical presence in that jurisdiction.[144]

Based on stakeholder feedback, the Inclusive Framework and the G20 agreed on a new Pillar 1 agenda (the 'Declaration') in January 2020 to replace the one published in May 2019.[145] The Declaration focuses primarily on Amount A that is intended to be the main response to the tax challenges of the digital economy and emphasises that taxing rights granted to market jurisdictions on the basis of specific formulas could be exercised on part of the residual profits of specific categories of business taxpayers. These include: (i) businesses that provide automated digital services to a globally extended customer or user base operating remotely and using little or no local infrastructure; (ii) consumer-oriented businesses which are businesses generating revenue from the sale of goods and services to consumers; (iii) consumer-oriented enterprises which are enterprises generating revenues from the sale of goods and services to consumers (ie, enterprises that provide services to consumers), and (iv) enterprises generating revenues from licensing rights to branded consumer products.

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[142] Ibid 6.
[143] Ibid 8-9.
[144] The easiest way to apply the new nexus concept would be to define a share of the revenues generated by the company in the specific market (the amount of which could be adapted to the size of the market itself) as the main indicator of the company's sustained and significant involvement in that jurisdiction. This would also make it possible to take into account, inter alia, online advertising services to users located in jurisdictions other than those in which the relevant revenues are recorded.
[145] OECD, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy, as Approved by the OECD/G20 Inclusive Framework on BEPS on 29-30 January 2020* (2020).

According to the 2021 agreement, the first Pillar is intended to apply to multinational companies with a global turnover of more than EUR 20 billion and a profitability of more than 10 per cent and to countries where MNEs have generated at least EUR 1 million in revenues (with a lower threshold for small jurisdictions, ie, EUR 250,000). These states could then tax between 20 per cent and 30 per cent of the residual profit (above a 10 per cent threshold). The solution would then be implemented through a multilateral instrument open for signature by all states in 2022 with entry into force from 2023 on.

The original objective of the first Pillar was to ensure that, in an increasingly digital age, the allocation of taxing rights between countries is adapted to the new business models that have emerged as a result of digitalisation. To achieve such a goal, this Pillar aims to extend the taxing rights of market jurisdictions (which are based on the location of users for some business models) where a business is actively and permanently involved in the economy through activities carried out there or from remote locations focused on that jurisdiction. As a result, this new taxing right will, on the contrary, reduce the taxing rights of some jurisdictions (particularly the taxing rights of jurisdictions where multinational entities entitled to residual profits under the existing rules are located).

The compromise reached in July 2021 partly fulfils this objective as it reallocates some taxing power to the market jurisdiction that is limited to a part of the residual profit. However, one of the main problems is that the scope of application of this solution is restricted to a limited number of companies which may consequently exclude some digital multinational enterprises from the new system.

In addition to this and more in general, another problem is that the solution is based entirely on a questionable assumption, namely that value is created in a market jurisdiction. This is one of the misunderstandings arising from the old concept on which modern corporate taxation is based and that we have already examined. On closer inspection, in fact, the only reliable information that can be derived is that consumer payments are made from the market jurisdiction, but otherwise it is difficult to know both whether that is where digital products are actually used and, more importantly, where value is created.

Indeed, in a digital environment, value can even be created in many places at once, and if a market jurisdiction wants to impose a tax, it would probably be more efficient for it to be a tax on cash flow rather than a tax calculated as the difference between costs, which are difficult to identify and localise, and revenues.

5.3.2 The second Pillar (or 'Pillar 2')

Pillar 2 deals with some global proposals against base erosion. In particular, it seeks to address some of the remaining challenges by developing the concept of two interrelated rules:[146] (1) an inclusion rule for [under-taxed overseas] income, and (2) a tax on base eroding payments.

On this basis, the OECD presented the Global Anti-Base Erosion Proposal ('GloBe') in 2019. It consists mainly of two sets of interrelated rules that are reminiscent of and magnify those in the second part of the abovementioned document: (a) an income inclusion rule that provides for the inclusion of the income of the foreign branch in the

[146] Ibid; see particularly p 28 of the document.

tax base of the company to which it belongs (or the parent company) if the tax and effective burden on the former is particularly low, and (b) a tax on tax base eroding payments that consists of denying the deductibility of a related party payment if the related income component is not subject to a minimum effective tax rate in the destination jurisdiction (the under-taxed payment rule) and denying – in the same case – the tax benefits provided in international double taxation treaties (the tax liability rule).

In the OECD's view, the GloBe would help to resolve the remaining problems of base erosion by strengthening the taxing power of each state.[147] Thus, states would continue to have discretion in setting their level of taxation autonomously, but other states would be given subsidiary taxing powers in cases where company profits are not taxed or are taxed below an agreed threshold.[148]

According to the 2021 agreement, the second Pillar encompasses multinational companies with a global turnover of at least EUR 750 million. The minimum effective rate below which other states would be able to apply tax 'countermeasures' has been established at 15 per cent, calculated on a country-by-country basis.[149] Exceptions are made for jurisdictions where there is substantial economic activity.

The objective of Pillar 2 adheres more closely to the original BEPS project and aims to provide a systematic solution to ensure that all internationally operating companies pay a minimum amount of tax. Although the Pillar 2 objective goes beyond the topic of digitalisation of the economy and imposes a minimum tax on all companies, the link to BEPS Action 1 can be found in the observation that the importance of intangible assets as profit drivers often puts highly digitised companies in an ideal position to use profit shifting planning structures.

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[147] For a comprehensive analysis, see the study commissioned by PwC from the Oxford University Centre for Business Taxation: Michael P Devereux with François Bares, Sarah Clifford, Judith Freedman, İrem Güçeri, Martin McCarthy, Martin Simmler and John Vella, *The OECD Global Anti-Base Erosion Proposal* (Oxford University Centre for Business Taxation, 2020). Regarding the project's chances of success, they predict that the claimed benefits in terms of profit shifting and tax competition depend on it being widely, if not universally, adopted. They ask and elaborate on whether this is likely to be the case and whether – even if all or most countries agree to implement it initially – it could be stable in the long run given the option for individual countries not to implement it. An overall positive evaluation and positive expectation of general acceptance is also expressed by Joachim Englisch and Johannes Becker, 'International Effective Minimum Taxation – The GLOBE Proposal' (2019) 11(4) *World Tax Journal* 483. They conclude that: 'Altogether, it could thus have a markedly positive impact on the efficiency and fairness of the international tax system. To what extent this potential can be realized depends not only on the international acceptance of the instrument, but also crucially on its design. In particular, it is necessary to strike a balance between the effectiveness and the administrative feasibility of the minimum tax. This requires a careful calibration and coordination of its several components'.

[148] In November 2019, the OECD published a second public consultation on the second pillar of which the scope is limited to the income inclusion rule asking stakeholders (a) whether and to what extent financial accounts could be used as a tax base to determine the effective tax rate ('ETR') to which a digital multinational enterprise should be subject; b) to what extent the calculation of the effective tax rate should take into account taxes paid on a global or domestic basis; and c) the possibility of providing for exclusions from the scope of the GloBe proposal. See OECD, *Global Anti-Base Erosion Proposal ('GloBE') – Pillar Two, Public Consultation Document, 8 November 2019 – 2 December 2019* (OECD Publishing, 2019), https://search.oecd.org/fr/fiscalite/ocde-sollicite-les-commentaires-du-public-sur-la-proposition-globale-de-lutte-contre-l-erosion-de-la-base-d-imposition-au-titre-du-pilier-2.htm.

[149] See also Angelo Nikolakakis, 'Aligning the Location of Taxation with the Location of Value Creation: Are We There Yet!?!' (2021) 75(11/12) *Bulletin for International Taxation* 549.

However, the development of this second Pillar is also based on conflicting visions. The name of the proposal, ie, the 'Global Anti-Base Erosion Proposal', suggests that the second Pillar should be considered as a mere derivative of the BEPS project that comprehensively addresses residual profit shifting and base erosion. A much broader objective could be inferred from the work program published in 2019. Indeed, it stated that 'global action is needed to stop the harmful race to the bottom' and that Pillar 2 was about 'strengthening the tax sovereignty of all countries to "re-tax" profits where other countries have not sufficiently exercised their primary taxing powers'. These considerations seem to indicate a much broader scope aimed at eliminating tax competition in general.[150] The proposal goes beyond the issue of actual economic activity and focuses exclusively on tax rates. This represents a major change in the way tax competition is perceived for which, previously, it was agreed that low or no taxation was not inherently harmful if it was linked to real presence.

It is questionable whether the introduction of a 15 per cent minimum tax will be a sufficient deterrent for companies (although the complexity of the rules may, in itself, be an adequate reason to avoid applying them as much as possible).[151] On the other hand, it is still uncertain whether this minimum tax will eventually become a maximum tax. In this sense, in fact, the calculation mechanism on which it is based (also known as the QDMTT, or Qualified Domestic Minimum Top-up Tax) seems more likely to push states that currently tax multinational enterprises at a low rate to tax them at 15 per cent, so that they can continue to host them in their territories. The alternative, in fact, is that the 'high tax jurisdictions' apply their much higher rates and in this sense the risk is that once this threshold is set, all states will converge there, both those that currently tax at a low rate and those that tax at a high one.

The outcome will only become clear in the course of time but, beyond the specific content of the measures adopted, one can only welcome the emergence of a genuine global forum for discussion and negotiation on the legal framework for international taxation.

5.4 Assessing the potential outcomes of the implementation of Pillars 1 and 2

All of the OECD's work in this field is certainly commendable, and there is no doubt that it has produced some improvements compared to the pre-BEPS situation.

The authors agree with the scholars in the academic tax law community who have recently stated that, even if it is too early to fully assess the implications of this *uncertain direction of travel*, it would be difficult to envisage effective domestic tax reform

[150] More in general, on why the Pillar 2 undertaxed profits rule would be consistent with US bilateral income tax treaties and the exploration of some of the reasons underlying claims that the undertaxed profits rule ('UTPR') is incompatible with those treaties, see Allison Christians and Stephen E Shay, 'The Consistency of Pillar 2 UTPR With US Bilateral Tax Treaties' (2023) 109 *Tax Notes International* 445.

[151] All of this has a high degree of artificiality, not in the least because, as mentioned by Marcel Olbert and Christoph Spengel, in 'International Taxation in the Digital Economy: Challenge Accepted?' (2017) 9(1) *World Tax Journal* 3, 28 (footnotes omitted): 'Besides anecdotal and descriptive evidence on US digital companies' effective tax rates, there are no specific empirical studies on the interrelation between international taxation and digital businesses models. This lack of evidence might be due to the shortage of readily available data to scrutinize the degree of digitalization, the organizational structures and the financial characteristics of digital business models as well as the topic's newness'.

occurring without reference to theoretical tax principles[152] such as those developed internationally by the OECD. Overall, domestic legal systems are certainly better equipped today to face the challenges of globalisation and the digital economy than they were previously.

However, these developments have taken place within the framework of corporate income tax. The OECD efforts have aimed at better coordinating the existing domestic income taxation systems at the global level. The idea that remains behind all this work is that companies are autonomous entities residing in a particular place, therefore they have to be considered for tax purposes, and consequently they have to report income and pay taxes in that jurisdiction. In the policies outlined by the OECD, there seems to be a firmly rooted belief that through a globalised set of corporate income tax rules a state of residence can be continuously and clearly identified for companies and, consequently, the taxing powers of all the jurisdictions where a particular company operates can be coherently allocated.

It is nevertheless worth noting that recent developments have shown significant departures from traditional categories on three levels.

First, Pillar 1 and, even more clearly, Pillar 2 constitute a shift from individual corporate taxpayer liability to a broader notion of group liability therefore partly disconnecting liability to tax from an individual legal personality.

Secondly, envisaging the situation of the group from a global perspective also constitutes a partial departure from the concept of residence. According to Pillar 2, the income of a company may be taxed in a jurisdiction other than that of residence (and the source jurisdiction that often uses residence – of the payer – as a proxy).

Thirdly, in Pillar 1, proxies other than residence are used to connect the taxable base to a territory, in particular the presence of customers.

The actual tendency seems therefore to preserve the current structure of income tax systems and, consequently, to find solutions that continue to distinguish between residents and non-residents as well as natural persons and legal persons. They must all submit accounting and tax documents in each jurisdiction from which their income is derived and it is hoped that such documents allow the reconstruction of their ability to pay within each specific jurisdiction.[153] When this proves ineffective, the answer is always left, to some extent, to international cooperation and therefore to the hope that other jurisdictions will decide to adopt common rules and share the taxpayers' information they possess.[154] However, this strategy has two major risks.

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[152] Craig Elliffe, 'The Brave (and Uncertain) New World of International Taxation under the 2020s Compromise' (2022) 14(2) *World Tax Journal* 237.

[153] For an empirical analysis of the connection between taxation and accounting, although referred to the situation of a specific jurisdiction, see Nexhmie Berisha Vokshi, 'The Connection between Accounting and Taxation from the Perspective of Preparing the Financial Statements' (2018) 6(4) *International Journal of Economics and Business Administration* 34. For a more general analysis of the topic, see among others Simon James, 'The Relationship Between Accounting and Taxation' (University of Exeter Paper 02/09, 2002).

[154] Although an in-depth analysis of these dynamics is beyond the research scope of this contribution, it is worth noting that the issue is even more complex since there are multiple actors playing a role. This is well explained by Carlo Garbarino in 'Cosmopolitan Rights, Global Tax Justice, and The Morality of Cooperation' (2020) 23(2) *Florida Tax Review* 743, who, in elaborating on what is known as the global tax

First, from a practical standpoint, the globalisation of corporate income taxation implies a very broad political consensus at international level.[155] In fact, just as with all global solutions proposed for global problems, effective global corporate taxation would require a substantial number of jurisdictions to agree and act with strong synergy.[156] As affirmed by Professor Avi-Yonah,[157] once a set of principles is embodied and becomes part of the international tax regime, major problems arise when too many countries need to cooperate for the regime to be effective. He gives the example of two recent OECD projects, ie, the Multilateral Agreement on Mutual Assistance in Tax Matters (MAATM) that was inspired by the US Foreign Account Tax Compliance Act (FATCA) and the BEPS project itself which would certainly be helpful but are bound to have limited effects without a truly global, consistent and coherent effort. Similarly, although on a smaller scale, there is the example even in the European Union of how a project such as the CBR (value added tax (VAT) Cross-Border Rulings), which is not binding and to which only a few countries have adhered, is achieving very limited results.[158]

Secondly, from a more theoretical standpoint, as seen above, it can be said that a significant number of the problems caused by the fact that the categories on which corporate taxation is currently based are outdated remain largely unresolved. This is at the root of a number of inadequacies that existed prior to the digital economy and globalisation and have been amplified by them. It cannot therefore be held for certain that even with a global set of rules adopted and implemented by all jurisdictions worldwide, a reform of corporate income taxes will result in profit shifting, ensure taxation of value creation, and make multinationals contribute a *fair share* to state budgets.

It is therefore necessary to find new forms of taxation that, either as a replacement or as a complement to the current income taxation, make it possible to better avoid the risks

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justice question explains (at 745, footnotes omitted): 'not only governments, but also Global Actors contribute to the current situation of unregulated tax competition compounded with BEPS. This situation is a thoroughly *global* phenomenon (full mobility of capital across the globe) that has idiosyncratic *local* impacts on individuals. There is a complex relationship between these global and local impacts, which can be termed as "impact-glocalization", defined here as the integration of global and local impacts of tax competition and BEPS. This phenomenon combines the word globalization with localization and identifies a new dimension of taxation, which should also be analysed in its anthropological post-modern dimension, a novel perspective'.

[155] Lilian V Faulhaber, 'Taxing Tech: The Future of Digital Taxation' (2019) 39(2) *Virginia Tax Review* 145, 186-187, explains that, despite the potential benefits of an internationally agreed solution on the taxation of digital multinational businesses, there are many hurdles in achieving it. They are of both a political and a legal technical nature: '[t]he first and most fundamental barrier to achieving international consensus is the political difficulty of getting over 130 countries to agree to an effective solution. […] Many legal and technical challenges also limit the likelihood of reaching an international solution, but these are in many ways tied to the political challenges discussed above. For example, one large category of technical challenges is all of the definitional issues that must be addressed'.

[156] On the reassertion of state power as a reaction to difficulties in taxing MNEs, see also Margarita Gelepithis and Martin Hearson, 'The Politics of Taxing Multinational Firms in a Digital Age' (2022) 29(5) *Journal of European Public Policy* 708.

[157] Reuven S Avi-Yonah, 'The International Tax Regime: A Centennial Reconsideration' (2016) 1 *Global Taxation* 27, also available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2622883 (last revised 12 January 2021).

[158] Francesco Cannas, 'The Participation of Italy in the EU VAT Cross-Border Rulings Project: Legal and Procedural Issues' (2020) 31(5) *International VAT Monitor* 272.

inherent in a system based on the following premises, ie, the legal person as taxpayer, the notion of residence as nexus, and the concept of corporate income as taxable base.

5.5 Alternative methods of taxing corporate profits

The current corporate income taxation regime is based on legal concepts that were developed at the time when the economy consisted of small- and medium-sized firms trading tangible goods or services in a single state,[159] and such concepts cannot easily be adapted to fit the realities of a globalised economy.[160] Current reforms of the CIT through the BEPS initiative or at other levels such as the EU and in single states might therefore have a limited impact.

The authors intend to discuss the possibility of approaching BEPS from a perspective that, in the current paradigm of corporate taxation, may be considered as unconventional. The idea is to recognise that the current taxation model is outdated and new concepts need to be elaborated on which to base the contributions that companies are requested to make in order to allow society to work.

The conceptual solutions proposed hereinafter are intended as a starting point for the academic debate and they leverage the analysis of the weaknesses of the current system, aiming to overcome them to guarantee an effective contribution.

It should be underlined that these are unconventional solutions, revolutionary in their own way, and therefore they cannot be implemented in a short time and thus do not allow an immediate move away from one system to another.

Also, on the basis of revenue needs and economic studies, one could hypothesise the partial adoption of new paradigms, for example applied to selected taxpayers based on their type of activity or transnational character. Similarly, it could be hypothesised that for certain taxpayers there could be a transitional regime, or that the new contribution models complement the old ones to a certain extent, without ever completely replacing them.

In practice, the CITs should thus be complemented (if not partially replaced) by alternative specific levies and contributions.[161] Each should be for the purpose of

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[159] It should be noted that various attempts have been made to propose reforms, even radical ones, of tax systems with the aim of making them adequate for the challenges of the present century. Among these, the authors point to a recent one: Michael P Devereux, Alan J Auerbach, Michael Keen, Paul Oosterhuis, Wolfgang Schön and John Vella, *Taxing Profit in a Global Economy: A Report of the Oxford International Tax Group* (Oxford University Press, 2021) ('*Taxing Profit in a Global Economy*').

[160] In recent years, there has been no shortage of proposals for reform, even radical reform, of taxation (among others, to replace the corporate income tax with a tax at ordinary income tax rates on the accrued or mark-to-market income of corporate shareholders; a corporate tax on distributed profits without a reduction in corporate tax revenues; and, for the US, a tax reform plan that uses revenues from a value added tax (VAT) to substantially reduce and reform the nation's tax system). See, as an example, Eric Toder and Alan D Viard, *A Proposal to Reform the Taxation of Corporate Income* (Tax Policy Center, Urban Institute and Brookings Institution, June 2016); Jack Mintz, 'A Proposal for a "Big Bang" Corporate Tax Reform' (University of Calgary School of Public Policy Research Paper 15:7, February 2022); Michael J Graetz, 'The Tax Reform Road Not Taken – Yet' (2014) 67(2) *National Tax Journal* 419; Martin J McMahon, Jr, 'Rethinking Taxation of Privately Held Businesses' (2016) 69(2) *Tax Lawyer* 345.

[161] More in general on this, see also Reuven S Avi-Yonah, 'The Three Goals of Taxation' (2006) 60(1) *Tax Law Review* 1, where the scholar assumes that, when designing tax policies, policy-makers should probably first clearly identify the goals of taxation and assign no more than one to each tax. He explains that the three main goals of taxation are revenue raising, redistribution and regulatory objectives. The challenge for any

achieving one of the three proposed BEPS objectives, specifically: (i) limiting tax avoidance by multinational enterprises by shifting resources to low-tax jurisdictions (*base erosion and profit shifting*); (ii) tying the value produced by MNEs to a jurisdiction and taxing it there (*value creation*), and (iii) making multinational enterprises contribute more to the states' budgets (*fair share*).

The first objective is to focus on payments since profit shifting and base erosion occur mainly through transactions carried out against payment.

The second is to consider the value of the enterprise which has little or nothing to do with its income. Regardless of its income, in fact, the entirety of stocks, bonds and assets have a measurable value.

The third and last, and perhaps the most innovative, would be to request large multinational enterprises for in-kind and money contributions to earmarked funds.

This approach focuses exclusively on taxation and omits other aspects closely linked to it, such as the possibility of intervening on accounting principles or company law. To give an example, we have already seen how the tax calculation begins after the directors have already decided in full autonomy how to allocate the company's profits and how taxation is effectively asked to resolve a large part of the inequities of our societies.

An idea not directly connected to tax law could be to oblige companies to link a part of the dividends distributed or the profits accumulated to activities that have some positive social impact, but this would require intervention that comes into operation before taxation.

5.5.1 Transaction-based taxes

The first conclusion that can be drawn from the analysis carried out is that one should look for alternative proxies other than income to assess corporate ability to pay. As highlighted previously, income is quite appropriate as a proxy for individuals even in a globalised world (of course, subject to transparency requirements for foreign income); however, it is far from optimal for corporations and especially for multinational entities. An alternative should be to focus on transactions rather than income, which can be made in different ways. A number of proposals have been made regarding transaction-based taxes.

One of the first alternatives discussed that comes to mind are, of course, the general turnover taxes, like VAT/goods and services tax (GST). VAT/GST, although labelled as a consumption tax, can also be seen as a proper tax on businesses. Businesses not only act as tax collectors (with correlated compliance costs), but they bear the incidence of the tax. This occurs either indirectly because VAT being incorporated in the final price diminishes profit margins or directly because, at least in the European system, some businesses are denied the right to deduct upstream VAT (for example, the banking and insurance sectors or real estate). However, the limits of VAT to capture corporate profits are evident. First, this is a tax that is ultimately borne by the consumer and,

tax system is to use the right taxes for the right goals, and he suggests dividing the tax system into three major taxes, ie, one for each of these goals.

therefore, business-to-business (B2B) transactions are not supposed to bear any economic burden even though they are legally subject to tax.

Secondly, numerous transactions remain out of scope either because they are not considered as supplies of good or services (for example, capital contributions or dividend distributions) or because they are exempted (most financial transactions). It could also simply be because they are considered as being located outside the jurisdiction that imposes the tax (typically B2B or transactions with foreign clients).

Reforming VAT can play a role in strengthening the system to avoid loopholes. First, subjecting all transactions effectively to VAT (which implies eliminating most of the exemptions) would not only increase corporate contributions to states' budgets but also allow transaction reporting that could be used for other purposes. Considering the fact that the right to deduct can be denied in the case of fraud but also abuse, additional conditions for cross-border transactions with certain jurisdictions could be imposed on the taxpayer to ensure that the intention behind the transaction is genuine.

Another idea that has been developed are destination-based cash flow taxes.[162] This type of taxation should also be coordinated with VAT and is presented as being equivalent in its economic impact to introducing a broad-based, uniform rate VAT in order to be able to make a corresponding reduction in taxes on wages and salaries. Among the positive aspects, Professor Devereux highlights how cash flow taxation is neutral with respect to decisions about the scale of investment and financial decision-making (ie, these taxes do not distort the choice between debt and equity). The most significant element that is not characteristic of the proposal made here would be the 'destination-based' element that introduces border adjustments of the same form as those under the VAT, ie, exports are untaxed while imports are taxed.

Furthermore, taxes on turnover targeting specific economic sectors have been developed.[163] This type of tax, however, makes it difficult to determine the specific sector to which they have to be applied, and there is always the risk of ending up in a potential discrimination. Although turnover is certainly easier to calculate than income and may reduce the risk of manipulation to some extent, eg, with regard to cost deductions and transfer pricing, it is still a form of taxation that relies heavily on the fictions analysed above.

Substantial risks of manipulation persist regarding, for example, tax residency, deferral of payments, and the use of digitisation to make physical assets allocated in space communicate with each other and use them to reduce the tax burden.

Additional specific taxes have also been tested. Digital taxes have been criticised from a theoretical viewpoint but are relatively easy to put into practice.[164] However, they have a limited scope and target only certain types of businesses and, therefore, if badly

[162] One of the most elaborate examples is the destination-based cash flow taxation proposed in Devereux et al, *Taxing Profit in a Global Economy*, above n 159, ch 7.

[163] One example is the Hungarian special turnover tax in the retail store trade sector, which on 3 March 2020 was analysed by the Court of Justice of the European Union (CJEU). It released a decision in the *Tesco* case (*Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, C-323/18, ECLI:EU:C:2020:140, 3 March 2020) ruling that it does not violate the freedom of establishment under the Treaty on the Functioning of the European Union (TFEU).

[164] Claudio Cipollini, 'A Systematic Introduction to Tax and Technology' (2022) 5(3) *International Tax Studies*.

designed, may be challenged under the equality principle. Moreover, there is a risk that they are shifted completely onto the customers. From the source country perspective, they constitute a valid alternative to income tax.[165]

Finally, in order to overcome the use of transactions to erode the tax base and shift profit, one can also think of forms of taxation at source. An instrument inspired by the works of Professor Avi-Yonah, Professor Yariv Brauner and Andres Báez Moreno[166] that can be put in place is a withholding tax on payments made to certain jurisdictions. For example, Belgian companies must report all transactions in tax havens and, although no taxes are imposed if they do so, nothing prevents going one step further.

Other examples can be found in withholding taxes on gross income (which could be characterised as transaction taxes) such as in Malaysia (see further below). It would also be coherent to further develop those taxes as a regulatory tool in order to strengthen anti-money laundering instruments.[167] Such taxes are the most effective instrument to counter profit shifting and to tax stateless (or homeless) income.

As stated by Professor Bret Wells and Cym Lowell, the source country is in the best position to assert taxing jurisdiction over homeless income. If a residence country attempts to tax it, taxpayers will simply 'elect out' of that particular country and instead incorporate their businesses in a more taxpayer-friendly jurisdiction. Since the country of residency is effectively a taxpayer election and because many countries acquiesce to this electivity, there has been an international race to the bottom to attract multinational headquarter companies.[168]

Albeit in a different context and proposing different solutions, some decades ago, Professor Frans Vanistendael[169] wrote an article advocating the use, or more accurately the retention, of withholding taxes concluding that it may be unjust but that it was even 'more unjust still to have no tax of capital income at all'.[170] In his opinion, even if source taxation may not be favourably accepted by economists due to the inefficiencies of double taxation, countries, especially developing countries, should not abandon it.

This type of levy should primarily be imposed on cross-border transactions when the payer and recipient are in different jurisdictions, but one can also envisage a system that

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[165] Moreover, a similar conceptual proposal was already introduced by Wolfgang Schön in 'Ten Questions about Why and How to Tax the Digitalized Economy' (2018) 72(4/5) *Bulletin for International Taxation* 278. He affirms (at 284) that '[i]f one takes the position that the digitalized economy requires measures going beyond the compensatory implementation of the "single tax principle", the first question refers to the option to introduce a new tax on payments for digital services and similar value transfers'.

[166] Andres Báez Moreno and Yariv Brauner, 'Taxing the Digital Economy Post-BEPS…Seriously' (2019) 58(1) *Columbia Journal of Transnational Law* 121; Reuven S Avi-Yonah, 'A Coordinated Withholding Tax on Deductibility Payments' (2008) 119(9) *Tax Notes* 993.

[167] The liberalisation of capital movement in the 1980s certainly brought a significant increase in cross-border trade but also many drawbacks that have never really been addressed. The development of tax avoidance practices with offshore financial centres is a direct consequence of this capital movement liberalisation. There are therefore sound justifications for limiting the tax-free movement of capital to restricted geographical areas, regrouping countries that abide by the same standards regarding money laundering and level of taxation.

[168] Bret Wells and Cym Lowell, 'Tax Base Erosion and Homeless Income: Collection at Source Is the Linchpin' (2012) 65(3) *Tax Law Review* 535.

[169] Frans Vanistendael, 'Reinventing Source Taxation' (1997) 6(3) *EC Tax Review* 152.

[170] Ibid 162.

would be applied in purely domestic situations (whenever the beneficiary would benefit from a preferential regime on the payment received).

This could be seen as a type of withholding exit tax applied on a territorial basis. Refunds or exemptions could be granted in the case of final effective taxation in the hands of the ultimate beneficiary. In addition, personal requirements could also be added for the payer or recipient, for instance, if wanting to restrict the personal scope only to transactions between (related) companies.

Banking and financial institutions could be actively involved in the reporting and taxation of those transactions, at least regarding those from the territory of the state and intended for the purchase of goods and services. The information should always be available to the tax authorities and ultimately, for each reporting period, the system could be structured in such a way that it is either the taxable person or the intermediary who has made the electronic payment possible that remits the payment to the treasury. In any event, the other two parties involved should be held responsible in the event of non-payment so that the treasury may always rely on effective means to collect the sums due.

This solution can be widely applied and is independent of the type of taxpayer, ie, natural or legal person, their residence, their income, or their balance sheets and accounting documents. It would enable all the legal fictions described above to be overcome as well as the practical problems including the need for close international cooperation. Once the scope of application of the withholding tax has been delineated, in fact, no international cooperation would be required, and it would be sufficient to rely on instruments over which the tax administration has effective power to intervene, eg, current accounts with local banks, credit cards issued within the jurisdiction, etc.

Taxation systems which could be used to develop innovative solutions already exist in various parts of the world. One such example is the Malaysian withholding tax on contract payments. Under section 107A of the *Income Tax Act 1967*, all contract payments for services connected or attributable to activities in Malaysia under a contract paid to non-resident contractors are subject to a withholding tax. Part of this levy, however, is not final but a payment in account and is offset against the final tax liability of the non-resident contractor (based on the tax return submitted).[171]

Although an in-depth analysis of these aspects would be beyond the scope of the present conceptual elaboration, such a payment tax could also be made deductible or creditable (with limitations) under income tax rules. In this way, the levy on payments would be a kind of advance on ‘traditional’ income taxes, which would still burden an appropriate manifestation of ability to pay. It would also ensure that the treasury can actually collect a share of the wealth effectively generated within the territory of the state.

5.5.2 Taxing corporate value

As explained above, income (as based on financial accounting) is far from being an ideal proxy for assessing the creation of economic value in the hands of corporations.

[171] In the specific case of Malaysia, 3 per cent of the withheld amount is refundable which is the portion of the contract relating to taxes to be paid by employees. For a complete understanding of this mechanism, see Noor Sharoja Sapiei and Mazni Abdullah, *Veerinder on Malaysian Tax Theory and Practice* (Wolters Kluwer, 5th ed, 2021) 171.

In recent years, there has been a surge in the stock market value of certain multinational companies that was only connected in part with an increase in actual profits. Examples of companies that have been loss-making for years and are nevertheless considered as extremely valuable are well-known even by the general public.

Therefore, developing taxes on an alternative basis should allow a more effective grasp of this increase in value (which necessarily translates into increasing economic power).

An alternative would be to tax corporate wealth for which there are examples of corporate taxes on capital. These taxes also have the advantage of incentivising an effective use of capital. It should not be forgotten that the granting of a legal personality must serve a purpose, which is to develop an economic activity and not to shield profits from taxation in the hands of the company stakeholders.

In its most advanced form, this type of taxation could also take into account the negative externalities created by economic activity, such as environmental pollution, which could be quantified and added to the benefit for society so that the tax levy could also be increased accordingly.[172]

A more radical alternative would be a tax based on the stock exchange value that would apply to tax increases in the value of securities traded on regulated markets. The value of shares traded on the stock exchange, for example, could be seen as a reflection of the real value of a business that is even more reliable than statutory accounts.[173] This tax would be very different from current capital gains or security transaction taxes since the idea is to subject to tax the increases in the value of shares traded on the stock exchange regardless of realisation or distribution. The tax could be imposed on the listed company itself (with the possibility of passing it on to the shareholders) or it could be a tax directly imposed on the shareholders.

The idea of taxing corporate value is not entirely new. In 2007, Professor Calvin Johnson, after having identified the two 'original sins' of corporate taxation (specifically, distortion of investment decisions and favouritism towards debt) proposed adopting a 20-basis-point-per-quarter market capitalisation tax imposed on the issuer on the fair market value stock and debt traded on an established market.[174] His proposal

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[172] On the interaction between the amount of carbon emitted and taxation, albeit from the very different perspective of indirect taxes, see also Francesco Cannas and Matteo Fermeglia, 'Reconciling EU Tax and Environmental Policies: VAT as a Vehicle to Boost Green Consumerism under the EU Green Deal' in Hope Ashiabor, Janet E Milne and Mikael Skou Andersen (eds), *Environmental Taxation in the Pandemic Era: Opportunities and Challenges* (Edward Elgar, 2021) 81; Francesco Cannas and Matteo Fermeglia, 'Environmental Neutrality: Redesigning EU VAT Neutrality to Support the Implementation of the European Green Deal' in Stefen E Weishaar, Janet E Milne, Mikael Skou Andersen and Hope Ashiabor (eds), *Green Deals in the Making: Perspectives from Across the Globe* (Edward Elgar, 2022) 62; Edoardo Traversa and Benoît Timmermans, 'Value-Added Tax (VAT) and Sustainability in the European Union: A Radical Proposal, Design Issues, Legal Aspects, and Policy Alternatives' (2021) 49(11) *Intertax* 871.

[173] More in general, it is also interesting to note that the use of the market value to tax corporations was already identified as a possibility in the late 1800s and was rejected, albeit in a very different context compared with today. Edwin RA Seligman, in *Essays in Taxation* (Macmillan, 1895) 193, writes critically: '*The capital stock at its market value*. This plan is open to several vital objections. The idea is that the market value of the stock will be practically equivalent to the value of the property, or, as it is put by some of our state courts, that the entire property of a corporation is identical with its stock. As has already been observed, heavily bonded corporations would in this way entirely escape taxation; because in such cases – and they are the great majority – the capital stock alone would not represent the value of the property'.

[174] Calvin H Johnson, 'Replace the Corporate Tax With a Market Capitalization Tax' (2007) 117 *Tax Notes* 1082.

provided that the tax would be calculated by the Internal Revenue Service (IRS) on the basis of published information on the fair market value of stock and debt. By adopting this approach, the calculation by tax authorities would ensure that a uniform rule was used across the United States.

Such a tax would affect one of the most evident demonstrations of wealth creation since changes in the value of securities traded on the stock exchange are one of the tests that best and almost in real time measure business performances.

This would also be compatible with the principle of ability to pay since a company that performs advantageously on the stock exchange can certainly distribute a dividend in a short time.

Directly or indirectly affecting shareholders with a tax levy would also discourage keeping large amounts of cash 'parked' in companies since having to pay a tax on the increase in the value of shares would encourage the distribution of dividends. This type of tax could also have positive effects in regulatory terms, discouraging speculative investments and thus limiting the creation of bubbles in the stock market.[175] This is because rapid increases in value of a listed company would translate into a higher tax liability and therefore lesser future returns for the shareholders. However, it would also be necessary to further study potential negative effects of this tax, for example, on investments. The option could be considered of making it at least partially deductible against the taxes on either dividends or capital gains subsequently derived from the sale of shares.

Liquidity could be an issue; however, large corporations with soaring market values are usually very likely to be able to obtain access to credit from financial institutions (if they did not have a sufficient amount of cash to pay the tax). Such a form of taxation would also have a number of practical advantages since it would, for example, be based on data already collected and largely in the public domain as well as being very simple in terms of calculating the tax base.

From an international perspective, the most significant problem with such a taxation system would be establishing a suitable link between the increased value of shares traded on a stock exchange and the state levying the tax. The link would exist for the state of the (beneficial) owner of the shares that could levy the tax (in proportion to the shares owned by its residents). It would also exist for the state where the stock market is located (although, in the case of a shareholder tax, it may raise practical difficulties for collecting the tax directly from foreign shareholders).

However, other market states would be willing to apply these taxes; not all stock exchange listings are indeed made in the main markets where multinational companies operate, and a company listed on a certain regulated market may create its value elsewhere. That would imply the need to develop a set of new economic indicators that went beyond statutory accounts and allowed jurisdictions to allocate the percentage of the increase in stock market value attributable to each jurisdiction.

[175] On this point, see also Joseph E Stiglitz, 'Using Tax Policy to Curb Speculative Short-Term Trading' (1989) 3(2-3) *Journal of Financial Services Research* 101; James Dow and Rohit Rahi, 'Should Speculators Be Taxed?' (2000) 73(1) *The Journal of Business* 89.

A good starting point could be, for example, an OECD report from 1999 entitled *New Measures for the New Economy*[176] that explores possible solutions for resolving the level of uncertainty created by the valuation of intangibles. After explaining why statutory accounts do not reflect the economic reality of those who make massive use of intangibles, the report identifies a number of measures for what is labelled as the 'knowledge economy'. They are the human capital, customers as assets, brands, research and development, and patents. A formula could also be used.

Nonetheless, from a practical viewpoint, the tax could only be collected by the market states in the hands of the multinational group and not its shareholders. The development of this new taxation technique should begin by drawing up a list of regulated markets to be brought within the scope of this tax on the increase in the value of securities. It should include those where the largest globalised and digital businesses are listed. This would make it possible (for the tax administration) to effectively monitor the stock market performance of companies operating in the enforcing jurisdiction and possibly notify them of their status of being a taxable person.

At this point, the tax liability would be incurred by the listed company regardless of its residence or the regulated market on which it is listed. In order to guarantee an effective levy, a system of rebuttable presumptions could be envisaged. For example, a fixed tax rate could be applied on the sum of the increases in value in a given period that could be commensurate with some objective criteria based on publicly available data (eg, total value of the shares on the stock exchange, period in which the listing took place, number of share transfers, etc).

If the company wanted to have a different rate applied, including a zero rate, the burden would be on the company itself to prove that a different percentage of the increases in value on the stock exchange is not attributable to the market of the enforcing jurisdiction. The tool to provide such evidence and rebut the presumptive presence on the enforcing jurisdiction market could be, for example, an 'Effective Capital, Revenue and Income Report' modelled on the 'Intellectual Capital Report' (or 'Intellectual Capital Balance Sheet') to go along with the traditional financial accounts. The purpose of this document would be to illustrate the actual value generation of these businesses, taking into account human capital, customer relationships and organisational competences.

This would, in a sense, also reverse the role of accounting in the tax collection process. Instead of being the basis for taxation, accounting would become the basis for non-taxation in a reverse process in which it would be in the taxpayer's interest to have accounting that reflects the real situation of the business. This is because only if other taxes have already been paid would the taxpayer be allowed not to pay this tax. Instead of the tax administration having to invest time and resources tracing a realistic representation of the business situation from the accounts, the efforts would then be shifted and become the taxpayer's responsibility.

The OECD envisages two approaches, ie, the incremental approach whereby the report on capital is placed alongside and read at the same time as the statutory accounts, and the radical approach whereby reference is made exclusively to the report on capital, and

[176] Charles Leadbeater, *New Measures for the New Economy* (Institute of Chartered Accountants in England and Wales, 2000).

taxation is levied accordingly. With regard to the form of taxation envisaged herein, while both approaches would be theoretically reliable, the considerations proposed above would lead to a preference for a radical approach.

Such a document could also theoretically be the basis for a specific and new form of capital taxation. As explained above, global and digitised firms have a reduced 'traditional capital' compared to the typical business models of the 'old' material economy, and this escapes the current accounting rules. Therefore, a measurement of their 'real capital', which is mainly dematerialised, could enable either its increases or stock to be taxed.

Finally, with regard to the levy, direct involvement of the shareholders themselves could also be envisaged, even if only the majority shareholders, although their possible involvement would depend very much on the level of administrative cooperation achieved. When cooperation is of a high degree, then forms of cooperation concerning tax revenue-sharing can be imagined. This is because multinational groups are often listed on more than one stock exchange and have shareholders in multiple jurisdictions.

5.5.3 In-kind and earmarked corporate contributions to general interest projects

Taxes are not the only instrument capable of making multinational enterprises contribute to public interest policies. They may not even be the most suitable instruments due to some drawbacks. Corporate income taxes are indeed defined in an abstract manner. Such a structure allows equality between taxpayers and legal certainty. However, it produces uncertainty for the states regarding the revenues raised and de facto inequality between taxpayers' effective contributions due to differences in the possibility of using tax planning strategies. Moreover, they are not linked to specific public policies or general interest goals, which may weaken their legitimacy.

Looking at the historical development of the relationship between the state and the market in the production of goods and services could serve as a source of inspiration to redefine the extent and nature of the societal contribution of (large) businesses.

In many countries, especially in western Europe, the decades between the 1930s and the 1990s saw a direct involvement of the government in the economy. Italian Professor Sergio Steve described the emergence of a 'modern' form of public finance, specifically the development of state-owned enterprises such as railways, airlines, postal services, television channels, telegraphs, telephones, etc.[177] In addition to that development, at that time, local authorities also directly owned and controlled large sectors of the economy such as electricity production, gas, water, urban transport, pharmacies, etc. This was the result of instances of both deliberate nationalisation and bailout of companies in difficulty. However, at the time, these 'new' forms of public finance did not have generating revenues for the treasury alongside taxes as a primary objective but the provision of affordable public goods and services (and work) to the general population. Different management criteria, production and price policies than those for private businesses applied because maximisation of profit was not the main driver.

Setting aside the arguments that may be proposed to claim that private or public control of a given sector of the economy is more efficient, the relevant fact is that states have

[177] Sergio Steve, *Lezioni di Scienza delle Finanze* (CEDAM, 6th ed, 1972) 215.

had the power for many years to steer important sectors of the economy specifically towards general interest purposes.

Currently, the government has largely abdicated the direct management of the economy and has carved out a more passive role for itself as controller and supervisor of the markets.[178] After major privatisation programs were initiated in the 1990s, the relationship between public authorities and the private sector was, in fact, reduced to the levy of taxes together with public procurement and subsidy policies. Revenues from taxes that were levied on the private sector have grown in importance over time, progressively overcoming those arising from the direct involvement of the state in the economy.[179] This phenomenon of 'financialisation' of the 'relationship between the government and the large businesses', nevertheless obscures the fact that (large) companies offer goods and services that may be considered as also serving some general public interest in their nature. For example, while the 'space race' during the Cold War was promoted by state space agencies mainly in the US and the Soviet Union, it is now carried out by private companies such as Virgin Galactic and SpaceX.[180] There is no doubt that the latter do so for economic and profit-making purposes, but this does not detract from the fact that their achievements are perceived (also due to the marketing that accompanies them) as collective successes at least to a certain extent.

Even the new wave of public investments for general interest goals aims at stimulating the production of goods and services by private operators. Take, for example, the wide-reaching and mostly debt-based recovery plan called Next Generation EU ('NGEU') with the ambitious goal of reshaping the European economy and society following the Covid-19 pandemic. Although Member States and the Union will have a certain steering role, they will not be directly responsible for the production of public goods and services.[181]

The idea behind this type of relationship is that businesses should be entitled to move in full autonomy while respecting a set of rules for which the scope must be as narrow as possible. Additionally, their greatest duty to the government and the community is to pay their 'fair share of taxes'. All of the OECD's work in recent years, which was discussed previously, is based on the idea that the current situation is pathological because the greatest economic actors who are leading the globalised and digitalised economy do not pay sufficient taxes. The public debate (including many non-governmental actors) has adopted this approach and gives the impression that the only

[178] This radical change went hand in hand with what is referred to as the welfare state crisis for which the fiscal implications are well analysed in Reuven S Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State' (2000) 113(7) *Harvard Law Review* 1573. He explains that the crisis of the welfare state, which began over a century ago with Bismarck's social insurance scheme and has always been financed by a comprehensive income tax, faces the fundamental problem of the aging population. This is the result of the post-World War II baby boom and is part of the general narrowing of the role of the state that underlies the phenomena being described.

[179] Bernardo Bortolotti and Domenico Siniscalco, *The Challenges of Privatization* (Oxford University Press, 2004); Emilio Barucci and Federico Pierobon, *Le privatizzazioni in Italia* (Carocci, 2007).

[180] For a general idea, see, among others, Tim Levin, 'Jeff Bezos Just Launched to the Edge of Space. Here's How Blue Origin's Plans Stack Up to SpaceX and Virgin Galactic' *Yahoo Business Insider* (21 July 2021), https://www.businessinsider.com/elon-musk-jeff-bezos-branson-spacex-blue-origin-virgin-2021-5 (accessed 15 May 2024).

[181] For a legal assessment of the plan, see, among others, Päivi Leino-Sandberg and Matthias Ruffert, 'Next Generation EU and its Constitutional Ramifications: A Critical Assessment' (2022) 59(2) *Common Market Law Review* 433.

way to make businesses contribute is through (corporate income) taxes.[182] While in no way denying that large companies should pay their fair share of taxes, contributions by MNEs could also take other forms.

In this perspective, corporations could be asked to contribute through means other than traditional (corporate income) taxes. They could be requested to either contribute in kind by sharing technology, knowledge and know-how with governments, performing public works, or offering free or discounted services to the general public. This idea was present in the dialogue in 2021 between Elon Musk and the World Food Program Chief, David Beasley, according to whom USD 6 billion would be sufficient to end hunger in the world. Similarly to the proposal, which was never actually implemented, of the multibillionaire to sell Tesla stocks to fund the program,[183] MNEs could also be asked to make contributions to special funds, for example, to fight climate change or mitigate water and soil pollution.

Large corporations could enter into long-term collaboration agreements with governments and perform certain functions that they normally carry out for the government under public procurement rules. In practice, instead of creating a specific digital tax (which might not have the expected yield, due specifically to constitutional or procedural issues), digital companies such as Google could contribute in kind to programs such as the digitalisation of schools and ministries or giving internet access to remote rural areas, Uber could organise the transport of a certain number of elderly people to hospitals for scheduled medical examinations, Glovo and Grab could plan the delivery of meals to socially disadvantaged people, Amazon could lend some of its managers to improve the logistics of strategic state infrastructures, Microsoft could offer online courses to students in difficulty, or Facebook and YouTube could be requested to use their algorithms to promote a minimum quantity of cultural messages. This would consist of asking, at least in part, to do what large state-owned utility companies in

[182] This debate should take into consideration the role of taxes which are an instrument of income policy to redistribute income and wealth for the purpose of reducing inequality and having a regulatory function. As recalled by Hans Gribnau, 'Voluntary Compliance Beyond the Letter of the Law: Reciprocity and Fair Play' in Bruno Peeters, Hans Gribnau and Jo Badisco (eds), *Building Trust in Taxation* (Intersentia, 2017) 17, 22, '[o]ften, the tax system itself is used to promote the common good, eg, to promote economic growth (eg, by attracting foreign investors), to increase employment and for health and environmental policy. In times of financial crisis, for example, businesses benefit from tax incentives, such as accelerated depreciation. In this way, tax incentives are used to affect behaviour. Thus taxation has an enormous impact on all kinds of activities and situations of various members of society, citizens as well as enterprises. Moreover, partly as a consequence of this instrumental use of tax law, the tax burden seems to be ever growing'. The theory of the triple function of taxes is linked back to Reuven S Avi-Yonah who, in 'The Three Goals of Taxation', above n 161, 3 (footnotes omitted), about the regulatory function explains that '[t]axation also has a regulatory component: It can be used to steer private sector activity in the directions desired by governments. This function is also controversial, as shown by the debate around tax expenditures. But it is hard to deny that taxation has been and still is used widely for this purpose, as shown inter alia by the spread of the tax expenditure budget around the world following its introduction in the United States in the 1970s'. More in general, see also Reuven S Avi-Yonah, 'Taxation as Regulation: Carbon Tax, Health Care Tax, Bank Tax and Other Regulatory Taxes' (2011) 1(1) *Accounting, Economics, and Law* article 6.

[183] For a report on the matter, consult the site of the World Economic Forum at https://www.weforum.org/agenda/2021/11/elon-musk-un-world-hunger-famine/.

western Europe did in decades past by assuming their corporate social responsibility in a more direct and transparent way.[184]

This approach could be in conjunction with a broader debate on the role of companies similar to what occurred in the field of company law on the need for a *new theory of companies.*[185] On closer inspection, from whichever perspective the phenomenon of companies is viewed, eg, concession theory, trust and freedom of association theory, fiction theory, contract theory, etc,[186] the common trait is always that companies essentially have the possibility for one or more natural persons to create a purely artificial third party. Each and every one of these theories pays attention to one fundamental element, ie, it is the company's statutes, and thus it is indirectly the state that allows the natural person to *create* this artificial third party that may *act* in the real world. Ultimately, it can be said that companies owe their existence and capacity to act to the intervention of the state.

Therefore, companies should not behave in a way that is detrimental to the state's objectives (for example, by not honouring contracts and debts with other economic actors). However, in democratic societies, companies could also be requested to participate more actively in the pursuit of general interest objectives embedded in democratic constitutions.

Even without going so far as to argue that the government should have a participatory role in managerial choices or the distribution of dividends,[187] it does not seem unbalanced or restrictive of the freedom to do business for the government to impose in-kind or earmarked contributions beyond the payment of general taxes. An existing example is the European Emission Trading System (EU ETS) which serves a similar purpose as a carbon tax without being legally characterised as such. This mechanism, in fact, provides for the setting of public interest objectives and then leaves the private enterprise with the choice between complying with these objectives, bearing the costs itself, or paying a sum of money to the public authorities. This is supposed to compensate for the negative externalities of the economic activity and to be invested by the state in environmental policies.

MNEs could even be given a choice between both forms of contributions (in kind or direct). The dimension of choice and the direct involvement of the corporate persons in public projects with the consequent possibility of establishing a more distinct link between the individual contribution and the general interest goals pursued would increase the legitimacy of the system. Moreover, it would be easier for MNEs to justify

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[184] Although in different terms, the relationship between corporate social responsibility and taxation has already been explored: Arjo van Eijsden, 'The Relationship between Corporate Responsibility and Tax: Unknown and Unloved' (2013) 22(1) *EC Tax Review* 56; Hans Gribnau, 'Corporate Social Responsibility and Tax Planning: Not by Rules Alone' (2015) 24(2) *Social and Legal Studies* 225.

[185] Eva Micheler, *Company Law: A Real Entity Theory* (Oxford University Press, 2021) 195; Nicholas HD Foster, 'Company Law Theory in Comparative Perspective: England and France' (2000) 48(4) *American Journal of Comparative Law* 573. The author (at 575) writes that '[m]any of these organizations are not subject to governmental control, and are therefore not subject to normal constitutional accountability processes, or form such a concentration of power in themselves that they rival governments (or at the least can exert considerable influence on governments), or both'.

[186] David Wishart, 'A Reconfiguration of Company and/or Corporate Law Theory' (2010) 10(1) *Journal of Corporate Law Studies* 151.

[187] Katharina Bluhm, Bernd Martens and Vera Trappmann, 'Business Elites and the Role of Companies in Society: A Comparative Study of Poland, Hungary and Germany' (2011) 63(6) *Europe-Asia Studies* 1011.

that type of contribution to their shareholders, and it could also have a positive impact on how they are perceived by the general public.

From a practical point of view, the government could identify a number of projects in which it could request private parties' cooperation and assess the contribution that certain private enterprises could make to these projects through something like a public call for expressions of interest. Negotiations concerning the exact extent and form of the contributions would then take place involving a large number of stakeholders to avoid giving the impression of collusion.

The concept of payment of taxes in kind is not new in contemporary tax systems. Apart from schemes primarily devised for natural persons such as the payment of personal and inheritance taxes with works of art,[188] an interesting experiment involving undertakings has been established in Peru with the 'Works for Taxes Scheme'. Under this program, private firms are allowed to pay a portion of their income taxes in advance in the form of public works from public buildings to transport infrastructure and beyond. In the Peruvian context, this project was seen as an opportunity to bridge the infrastructure gap in some areas and proved to be an overall success. Between 2009 and 2017, approximately USD 1.25 billion was pledged or invested in 318 Works for Taxes projects with the participation of 82 private enterprises, six ministries, 14 regional governments and 114 local governments.[189] As to the limits of that program, in the case of Peru, they originated from the public officials' lack of sufficient understanding of how the mechanism worked and how it differed from operations affiliated with traditional public works.

Such a mechanism also embodies the idea of corporate social responsibility. In addition to mere compliance with the law, it implies that the business integrates social, environmental and human rights as well as ethical values into its actions. As explained by Frederick,[190] it occurs when business firms consciously and deliberately act to enhance the social wellbeing of those whose lives are affected by the firm's economic operations. Its purpose is to create an organic link between businesses and societies. This reflects the original idea that granting a legal personality is a privilege that must serve a certain general interest purpose. The mere pursuit of profit (sometimes even at the expense of the state grating the legal personality) cannot be seen as sufficient.

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[188] In Italy, for example, it is possible to pay taxes through the transfer of works of art to the state. In particular, it is provided that the taxpayer can settle his or her tax debts (not future debts) relating to income and inheritance taxes through the transfer of goods that are considered to be of artistic interest. The procedure provides that the taxpayer can request to be allowed to pay in this way by making a formal application to the tax authorities. Following this application, a procedure for assessing the documentation is initiated in which the Ministry of Cultural Heritage also participates: Art 28-bis of the DPR 602/1973 on the collection of taxes (*Disposizioni sulla riscossione delle imposte sul reddito*). Antonio Guidara, '*Riscossione fiscale e opere d'arte*' (2019) 90(3) *Diritto e pratica tributaria* 1091; Alberto Traballi, '*L'attività di riscossione e le opere d'arte*' in Simone Facchinetti, Francesco Oliveti, Alberto Traballi and Ennio Vial, *Arte e Fisco: La gestioni legale e fiscal delle opere d'arte* (Maggioli, 2020) 165. A similar mechanism exists in France and in Belgium (for inheritance duties).

[189] Paola Elvira Del Carpio Ponce, 'Peru's Works for Taxes Scheme: An Innovative Solution to Accelerate Private Provision of Infrastructure Investment' (World Bank and International Finance Corporation Emerging Markets Compass 55, 2018).

[190] William C Frederick, 'Corporate Social Responsibility: From Founders to Millennials' in James Weber and David M Wasieleski (eds), *Corporate Social Responsibility* (Emerald Publishing, 2018) 3.

The first idea of corporate social responsibility appeared in the US in the 1920s and manifested itself in the form of corporate philanthropy. From the 1950s onwards, this concept began to evolve, and the idea that companies have obligations to the community began to take hold. Professor William Frederick explains that its primary reason is the 'prevalence of a market-style economy, supported by adherence to free-market ideology and a limited economic role for government'.[191] As this *ideology* has entered a new phase of its existence and the role of governments has significantly changed in recent decades, there are grounds to argue for a further evolution of this *doctrine* by also applying it to quasi-fiscal contributions.

From a legal point of view, this would also require the establishment of a number of guarantees in order to ensure equality before the law or to protect certain rights, such as the right to privacy. It would obviously require a significant amount of trust. This is because, by partially abandoning the standardisation brought about by the current income tax in which everyone submits the same documents, calculates taxes in the same way and pays the same amounts, there would be a greater risk of creating unwanted differences between taxpayers. Comparing the costs and benefits of infrastructure in completely different sectors may not always be easy.

In the case of the European Union, for example, if such a solution were implemented at the EU level, it would require a high level of cooperation because differential treatment between taxpayers has consequences for the functioning of the Single Market. An update of the state aid legislation and corresponding control mechanism might be necessary, for example, as Member States might be tempted to use this form of taxation to favour national enterprises.

A solution such as the one briefly conceived here could appeal simultaneously to the desire of large multinational enterprises to promote their image and the public's desire to justifiably claim a positive return for the community in exchange for everything the multinational enterprises gain from society that does not always need to consist solely of a sum of tax money. Obviously, no one is so naive as to think that large multinational enterprises would adhere to this type of project on the basis of the public good alone. A certain form of constraint would be needed, but to give more discretion in the determination of the nature of the contribution (but not its principle) could yield positive results for both parties.

Such a solution would certainly be innovative and would entail a clear reversal of the traditional paradigms of tax law. The essence of the proposals made here is not to reduce the role of the state but simply to create a legal framework within which it can effectively exercise its authority. This should in no way be perceived as an abdication of its power to levy taxes, but as a complementary instrument to foster corporate contributions in a more collaborative perspective and in the aim of making all the parties involved perceive these contributions as representing a 'fair share'.

[191] Ibid 5.