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Digital Business and Tax Law: New and Global Tax Rules for Tech- Giants Using Artificial Intelligence in their Business Models

1 Introduction

Digital business and tax law is an evolving field in many aspects.¹ The growth of the digital market has made the traditional grounds for the allocation of taxing rights less effective. The objective with this article is to present and discuss new legislation on the taxation of multinational enterprises (“MNEs”) agreed upon by more than 130 nation states on 8 October 2021. The legislation is so far not decided by national parliaments, and it is still uncertain whether it for example will be passed by the US Senate. The target of the new legislation is in particular large US tech-companies conducting digital business, such as Google, Apple, Facebook and Amazon. Artificial intelligence (AI) is a core element of the business models of these tech giants. In addition, MNEs in other fields of business are also covered by the new tax rules.

The agreement generally deals with the allocation of taxing rights between states. Many states fear the loss of revenue due to the old tax law concepts not being sufficient to impose an effective taxation of business income, in particular income from digital businesses activities. A large

¹ Many thanks to Assistant Professor Katja de Vries and Associate Professor Martin Berglund for valuable comments on a previous version of this article. Of course, I am solely responsible for the views expressed and any remaining mistakes.

number of states have recently decided to apply a new model for taxing digital businesses.

How does this connect to artificial intelligence? One connection is that several of the MNEs that will be taxed according to the new set of rules are using artificial intelligence in their business models.

The proposal from the OECD, which has now been agreed upon, and is discussed in this article, is called “Pillar One”. “Pillar Two” of the OECD project concerns new anti-avoidance measures supporting the traditional tax concepts, that will continue to work in parallel with the concepts of Pillar One.

The concept of artificial intelligence is only briefly addressed in this article. However, it is obvious that it has had a large impact on business which the OECD labels “automated digital services”. This is at the core of the tax agreement on Pillar One as elaborated by the OECD in the 2020 Blueprint report.

Other perspectives on tax law and artificial intelligence are possible. An obvious one concerns the collection of information from and about taxpayers, and which now have also reached the activities of tax advisors.² The EU is active in this area of law, and a number of directives have been introduced. The exchange of information between tax agencies has for long been an area of interest to the EU. Already in 1977, the European Community adopted a directive on the exchange of information. In recent years, this has developed much further. The fundamental legal act is, today, the Directive on Administrative Cooperation (DAC), which is the basic directive.³ This directive has in turn been supplemented with revised versions of the directive on several occasions. The so-called DAC 6 contains an obligation for tax advisors to file information to the tax agency on planned, but not necessarily executed, tax planning schemes.⁴

² The use of AI from a tax agency perspective is discussed in Zackrisson, Marcus; Bakker Anuschka and Hagelin, Johan, AI and tax administrations: A good match, Bulletin for international taxation (IBFD), 2020, pp. 619–625, and Antón, Fernando Serrano, Artificial intelligence and tax administrations: Strategy, applications and implications, with special reference to the tax inspection procedure, World Tax Journal (IBFD), Volume 13, No. 4 (published online 27 September 2021).

³ Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

⁴ Council Directive (EU) 2018/82 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.

This is a fundamentally new approach by the European Union, and it raises some questions in relation to fundamental rights.

Another less discussed issue is international tax planning using digital tools. In the 1990s and early 2000s such tax planning tools were much marketed towards tax practitioners. It is my impression that such marketing is less frequent today.

What is artificial intelligence? In my view it seems rather to be a concept that can be described but hardly defined. It is a computerized process, at least to a significant degree, in which creative, innovative results are acquired. The process requires the collection of information, and the application on that information of some kind of a mathematical algorithm that identifies human connections, patterns, interests and preferences, some of which may be earlier known, while others may be previously unknown. I must admit that I am a bit sceptic to the term “artificial intelligence”, perhaps because it almost seems to be an oxymoron (contradiction in terms), just like “minor crisis”, “only choice”, or – half-jokingly – “military music”. In my mind “intelligence” in its cognitive meaning is something that includes both “sense and sensibility”, to use the words of the novelist Jane Austen.⁵ Or is it precisely that distinction which the attribute “artificial” in “artificial intelligence” refers to: Sense (“intelligence”) without sensibility (“artificial”)?⁶

The algorithms that constitute a basis for artificial intelligence may, of course, express prejudices, and even spreading and strengthening them. They may ignore minorities, for example due to unrepresentative training data, as well as the – sometimes – arbitrary and unpredictable behavior of mankind.

Still, it is true that the digitalization of the world economy has largely influenced the lives of many. A simple example can illustrate the idea. A multinational enterprise (“MNE”) which provides a search engine on

⁵ Austen, Jane, *Sense and sensibility*, Penguin Classics, London, 2004 (1811).

⁶ There is a legal definition in the proposed EU Artificial Intelligence Act. The definition is contained in Article 3 and reads: “‘artificial intelligence’ (AI system) means software that is developed with one or more of the techniques and approaches listed in Annex I and can, for a given set of human-defined objectives, generate outputs such as content, predictions, recommendations, or decisions influencing the environments they interact with”. See European Commission, Proposal for a Regulation of the European Parliament and of the Council laying down harmonised rules on artificial intelligence (artificial intelligence act) and amending certain union legislative acts, COM(2021) 206 final, Brussels, 21.4.2021.

the internet identifies that someone is searching for an apartment to buy. In response, the search engine directs advertisements on new furniture and bathrooms to the apartment seeker. This is likely to be for the benefit of all parties involved. The growth of multinational tech companies in recent years bears evidence of this development. It is likely that the covid-19 pandemic has enforced the digital evolution. In addition, the major government subsidies given to businesses during the pandemic, also enforces the need for states to secure tax revenue. Already before the pandemic, many states had responded unilaterally with different levies on income from digital business activities. The United States, where many of these tech companies are resident, have responded with sharp criticism of the measures. For example, in relation to France, the US made some threats of minor retaliatory measures, such as tariffs on champagne and other French luxury products.⁷ In recent years, the OECD and G20 have been working on proposals to tax digital businesses and to establish a global minimum taxation of corporations.

Today, in November 2021, there are several European states that have implemented different kinds of taxes on digital services. Other states are planning or have proposed the introduction of such taxes.⁸ The idea is that a global tax system according to Pillar One will replace such national measures, which has been strongly advocated by the United States.

As previously mentioned, an agreement has now been made between more than 130 nation states and jurisdiction on the Pillar One and Pillar Two proposals. These states and jurisdictions cover more than 90 per cent of the world's GDP.⁹ However, the agreement between the involved states and jurisdictions must also be enacted with national law and tax treaty law. This might be an even larger problem than reaching the October 2021 agreement.

For several years there has been an ongoing discussion in the EU on whether to adopt common legislation on the taxation of digital services

⁷ Cf. *The Economist*, July 11, 2019, France's digital tax riles the White House.

⁸ Among the states which unilaterally have introduced taxation on digital services are Austria, France, Hungary, Italy, Poland and the United Kingdom. See Alvarado, Mary, Digital services taxes across Europe in the midst and aftermath of the Covid-19 pandemic: A plausible option to raise tax revenue, *European Taxation (IBFD)*, 2021, pp. 403–410, at p. 407 (with a list of current digital services taxes in Europe either proposed or decided).

⁹ OECD/G20 Inclusive Framework on BEPS, Progress report July 2020–September 2021, Paris, 2021, p. 2.

and other digital business activities. In 2018 it came so far that the European Commission proposed two directives on the issue. One directive concerned a digital services tax and the other corporate taxation of a significant digital presence.¹⁰ These directives have been subject to considerable discussion, and today the Commission has withdrawn both of them. Instead, in May 2021 the Commission presented plans for a more comprehensive approach to corporate taxation, including the taxation of digital business.¹¹ The Commission plans to propose a “digital levy”¹². The Commission has also stated that it intends to propose a directive that would implement Pillar One with EU Law.¹³ An agreement on Pillar Two would also require changes with EU law affecting the Member states.¹⁴ A recent statement by the European Commissioner for economy, Paolo Gentiloni, suggests that it is only Pillar Two that requires legislation through EU directives, and that Pillar One may not require an EU Directive.¹⁵ The probable reason why a directive may not be required for Pillar One is that it will be based on a multilateral treaty between the states and jurisdictions involved.

In the EU there is a requirement for unanimity to decide on tax matters, such as implementing Pillar One and Pillar Two through directives.¹⁶ For some time, it was uncertain whether Ireland, Estonia and

¹⁰ Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018) 148 final, Brussels, 21.3.2018, and proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM(2018) 147 final, Brussels, 21.3.2018.

¹¹ Communication from the Commission to the European Parliament and the Council, Business taxation for the 21st Century, COM(2021) 251 final, Brussels, 18.5.2021.

¹² *Ibid.*, p. 5.

¹³ *Ibid.*, p. 8.

¹⁴ Pillar Two would have an impact on for example the Anti-Tax Avoidance Directive, Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance that directly affect the functioning of the internal market. Amended by Council Directive (EU) 2017 of 29 May 2017), and the Interest and Royalties Directive, Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

¹⁵ Press release by EU Commissioner Gentiloni dated 13 October 2021, and a news bulletin from Popa, Oana, European Union, IBFD, 14 October 2021 (“Commissioner Gentiloni welcomes G20’s endorsement of agreed global tax reform and highlights EU plans to implement OECD pillars).

¹⁶ Article 115 of the Treaty on the Functioning of the European Union.

Hungary would sign the agreement. In the final rounds of discussion, however, they all decided to enter into the agreement.¹⁷ Accordingly, at present there seems to be no member state of the EU that is likely to veto any measures subsequently adopted by the EU.

As far as I can deduce from the list of countries which have entered the OECD/G20 Inclusive Framework agreement, it is only Kenya, Nigeria and Sri Lanka that have not entered into the agreement.¹⁸ The likely reason is that they consider the agreement to be unfavourable to developing countries, not least when they have a large population constituting a considerable market for MNEs.

Following the decision by the OECD/G20 Inclusive Framework on Pillars One and Two on the 8 October 2021, a number of European states, including also the United Kingdom, have stated that they will allow a gradual termination of their unilateral taxes on digital services.¹⁹ This is because the agreement on Pillar One and Pillar Two requires the removal of all digital services taxes.

The agreement and the underlying proposals are new, and the academic literature is still not that large. In this article I focus the discussion on the primary source, the 2020 OECD/G20 Pillar One Blueprint, and on what was included in the agreement on 8 October 2021.²⁰ I refer to the 8 October 2021 agreement as the “agreement”, which is based on the 2020 OECD/G20 proposal contained in the report “Tax challenges arising from digitalisation – Report on Pillar One Blueprint”, which I refer to as the “Pillar One Blueprint” or the “proposal”. The October 2021 “agreement” is only a few pages with a general description of the rules and fundamental thresholds, whereas the “Pillar One Blueprint” covers

¹⁷ *Financial Times*, 8 October 2021, OECD close to final deal on corporate tax.

¹⁸ Cf. *Financial Times*, 1 July 2021, World’s leading economies agree upon global minimum corporate tax rate.

¹⁹ States abolishing digital services taxes include Austria, France Italy, Spain and the United Kingdom. In response the United States will terminate trade actions on France, which were put in force because of France’s unilateral digital services tax. See De Lillo, Francesco, Report (IBFD), 25 October 2021, France joins agreement on transition from digital services tax to new international tax framework.

²⁰ OECD, Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy, Statement issued 8 October 2021 (available on www.oecd.org).

224 pages.²¹ It should be emphasized that it is not clear what the details of the October 2021 agreement includes, and to what extent the details of the Pillar One Blueprint, will also be included in the forthcoming proposals for new legislation.

The work on the proposals for Pillar One and Pillar Two has been administered and largely conducted by the OECD. Staff at the OECD has worked together with experts from the governments of the member states of the OECD and of the large number of states and jurisdiction. These states are part of the “OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting”, which is often referred to as the “OECD/G20 Inclusive Framework” or just the “Inclusive Framework”. Today there are 38 member states of the OECD, among them Sweden, which has been a member since the organization was established in 1961. Following the world financial crisis in 2008, the OECD and G20 started an ambitious work against the erosion of the corporate tax base, called work against “Base Erosion and Profit Shifting” or “BEPS”. To the surprise of many, this project has been successful, and has led to much new legislation both at the national level and at tax treaty level. The Inclusive Framework continues the work of the BEPS project and includes almost 140 states and jurisdictions. A major task for the Inclusive Framework is to assess the implementation of the legislation developed from the BEPS project, and to work on the continuation of the project with Pillar One and Pillar Two.

At present, it is still unclear to what extent the 2020 Blueprint for Pillars One and Two ultimately will be followed. As regards Pillar One, it remains to be seen to what extent the distinction between “automated digital services” and “consumer facing business” will be upheld. Irrespective of the final outcome in that regard, some kind of digital tracing of consumers will be required in order to identify the residence state of the consumer.

²¹ The leaders of the G20 met in Rome on 30 and 31 October 2021. At the meeting, the G20 endorsed the 8 October 2021 agreement by the states and jurisdictions forming the OECD/G20 Inclusive Framework. See Agianni, Vasiliki, Report (IBFD), 1 November 2021, G20 leaders welcome historic OECD/G20 Inclusive Framework global tax deal.

2 Traditional concepts for taxing businesses income

The basic structure for business taxation in an international environment was developed in the 1920s. After the First World War many states found it necessary to severely raise tax revenue. There was a need to rebuild society after the world war and raising tax revenue was considered necessary. An effect was that companies doing business in different jurisdictions faced the problem of paying considerable taxes, if the income was taxed both in the home state of the company, and in the state where its goods or services were sold. This is the problem of international (juridical) double taxation.²²

The League of Nations was established after the First World War, and it had its seat in Geneva, Switzerland. The League of Nations identified the problem with international (juridical) double taxation and developed a model for an international instrument – the double taxation convention for the elimination of double taxation. This model contained several basic concepts for allocating income between states. It should be noted that it dealt not only with companies, but also with income earned by private individuals. The work of the League of Nations was later adopted by the OECD which has worked with international tax law issues since the organization was established in the early 1960s. The OECD has further developed the model tax treaty developed by the League of Nations, but the OECD model still contains the same basic framework as the first League of Nations model from 1928.²³

In general, one can say that a tax treaty allocates the income earned by a company between the residence country and the other country, which

²² In principle, double taxation has two forms: international juridical double taxation and economic double taxation. Tax treaties primarily deal with international juridical double taxation. It can be described as the situation when one taxpayer is taxed on behalf of the same income in at least two states for the same time period. Economic double taxation is the taxation of income, for example business profits, first at the corporate level and then in the form of dividend income (or capital gains) at the shareholder level. Other forms of income may also be subject to economic double taxation, such as interest and royalties.

²³ The 1928 Model tax treaty developed by the League of Nations was partly based on a report from 1923 by four academic tax experts, G.W.J. Bruins et al., League of Nations Econ. & Fin. Comm., Report on double taxation: Submitted to the Financial Committee, League of Nations Doc. E.FS.73.F.19 (1923).

usually is the source country of the income. This expresses the residence principle and the source country tax principle. For companies, residence is mostly identified either according to the registration principle or the seat principle. Sweden applies the residence principle, Chapter 6, Section 3 of the Income Tax Act (ITA). Companies are subject to an unlimited tax liability on its global income, if they are registered in Sweden. Non-resident companies are subject to tax in Sweden if they have income that is connected to a permanent establishment in Sweden. A withholding tax (30 per cent) applies on outbound dividend payments. In general, both the residence principle and the source country tax principle rely on some form of physical presence in order to apply. However, the registration principle concerning companies does in fact not rely that heavily on a physical presence, whereas the real seat theory does. It is not possible to deal with that in further detail in this article.

Another fundamental concept for traditional corporate taxation is the arm's length principle. It concerns how to determine the correct price on goods and services sold between related companies in different states. In brief, one can say the arm's length price should be the market price, namely the price that would have been used if the same or similar goods or services were sold between independent parties. Without the arm's length principle, it would be possible for multinational groups of companies to create extra costs in high-tax jurisdiction, and extra profit in low-tax jurisdictions.

The basic concepts developed by the League of Nations were implemented in tax treaty law, and thereby also had an influence on purely domestic law. The effect of the tax concepts, was more of a loose-legal binding effect, however, with considerable impact. The agreement now being reached within the OECD/G20 Inclusive Framework project has more of a hard-law approach, and it will take effect both in tax treaty law and in purely domestic law.

Following the financial crisis, which began in 2007–2008, many states became in urgent need of strengthened public finances, and an effective tax system to support this. From a European perspective, states like Greece, Italy and Spain had weak finances, but the problems were identified also on a broader scale. The OECD initiated a project regarding the preservation of the corporate tax base, called BEPS, which stands for: Base Erosion Profit Shifting. It concerns the threat of the corporate tax base being diverted to low-tax jurisdictions around the globe. The first

reports in the BEPS project were published in 2012 and 2013.²⁴ They were followed up by additional reports on 15 different areas of tax law, which were submitted in 2015. One area was the taxation of the digital economy. After 2015, the OECD continued its work on new tax rules, not the least concerning the field of digital business. Numerous states unilaterally introduced measures taxing digital businesses. In focus for those laws, at least partly, were large US multinational companies. The acronym GAFA became well-known in the French tax debate and identifies tax legislation aimed at profits earned by Google, Apple, Facebook and Amazon. These new tax laws irritated the US government under President Trump, and lead to some counter measures issued by the US on goods sold by French companies in the US.

In general, the OECD reports on the taxation of digital business identified a risk that the profits earned by the giant tech companies turned out to be un-taxed or at least taxed at very low rates according to the traditional tax principles.²⁵ When targeting a specific market, these companies did it through companies established in low-tax jurisdictions such as the Republic of Ireland. The products are sold digitally in other states, but due to use of digital services there is no need for any physical presence in the market state. According to traditional tax principles, there is accordingly no possibility for the market state (source state) to tax the income generated in that state.

As already mentioned, several states have unilaterally introduced tax legislation for taxing the profits of such digital businesses. Previously, the European Commission has also issued proposals for the taxation of digital business. However, in the recent year a fundamental proposal for the taxation of digital businesses has been put forward by the OECD and endorsed by the G20, most of the EU member states, and also a large number of other states such as the Peoples' Republic of China, India, Russia, Brazil and South Africa. Moreover, the United States under the new Biden administration and with the finance minister Jane Yellen, strongly endorsed the proposal. Sweden is also behind the proposal, even if it seems to be with some hesitation: Sweden is dependent on digital

²⁴ OECD, *Addressing base erosion and profit shifting*, Paris, 2013, and OECD, *Action plan on base erosion and profit shifting*, Paris, 2013.

²⁵ On the problems with digitalization of business and the erosion of corporate taxation, see OECD, *Addressing the tax challenges of the digital economy*, Action 1: 2014 Deliverable, 2014, Chapters 5 and 6.

businesses, and there is a risk that some of the corporate profits will be taxed in the market states, which for many Swedish companies will be in other states than in Sweden. With a population of only 10 million inhabitants, Sweden is a small market, and the allocation of corporate profits to Sweden according to the new legislation will probably be small. The European Commission has already made it clear that it is behind the OECD/G20 Inclusive Framework proposals and agreement, and that it intends to propose to the EU to adopt them, when necessary, through directives or changes to existing directives.

3 The OECD/G20 Inclusive Framework agreement and proposal according to Pillar One and Pillar Two

The OECD/G20 Inclusive Framework proposal and agreement on Pillar One and Pillar Two includes fundamental changes to the system for corporate taxation. Pillar One, which is discussed in this article, concerns a new model for taxing corporate income stemming from digital business. Pillar Two deals with additional rules to supplement the traditional principles for taxing corporate income. The idea is to make the traditional principles more protected in a global economy, and that they should be used in addition to the new principles concerning digital businesses. An important aspect of Pillar Two is that, in effect, it enforces a minimum corporate tax rate of 15 per cent.

The Pillar One proposal issued by the OECD a year ago, in October 2020, is complex, full of details, and there are still many issues that needs to be resolved by the participating states.²⁶ It is not possible to go into all the details of the proposal in this article. Instead, I will focus on some aspect of the definitions of the digital business that are suggested will be covered by the new tax regime.

What are the driving forces behind the proposal by the OECD and the Inclusive Framework (“IF”) states? One important force is the risk that major tech companies, active on a global basis, will earn income that will largely remain untaxed. The traditional set of corporate tax rules, with

²⁶ In academic literature proposals have been made to simplify Pillar One, see for example Graetz, Michael J., A major simplification of the OECD’s Pillar 1 proposal, Tax Notes Federal, January 11, 2021, pp. 213–225.

their emphasis on physical presence, is easy to circumvent, or, rather, they do not adapt to the form of business that the tech companies undertake. Another driving force is the tax interest of the market state, that is the state where the consumer is resident. Many of the business models conducted by tech companies include the involvement of consumers: User postings on Facebook and Youtube are only two obvious examples.²⁷

The proposed corporate tax rules for large tech companies will work in parallel with the traditional corporate tax systems, which probably is one of the major hurdles with the proposal.

As previously mentioned, on October 8, 2021 an agreement was made by most of the states and jurisdictions participating in the OECD/G20 Inclusive Framework on both Pillar One and Pillar Two. Regarding Pillar One, which is discussed in this article, agreement was made on the following – important – details.²⁸ The in-scope companies are multinational enterprises (MNEs) that have a global turnover of more than 20 billion euros. They should also have a profitability that exceeds 10 per cent. The profitability is calculated as profit before tax divided with revenue. After 7 years, the turnover threshold is reduced from 20 billion euros to 10 billion euros. The October 2021 agreement explicitly excludes “extractives” (which presumably includes mining activities as well as oil and gas extraction) and regulated financial services from the scope of the proposed tax system.

A further condition (called “nexus”) requires that an in-scope MNE has at least a profit of 1 million euros from a market jurisdiction in order for that jurisdiction to be allocated a taxing right according to Amount A, which is the income from digital business discussed in this article. For a

²⁷ A general description of the digital economy is outlined by the OECD in the report, *Addressing the tax challenges of the digital economy, Action 1: 2015, Final report*, Paris, 2015 (esp. pp. 51–74). A critical study of the digital economy and the tech-giants is made by Harvard professor (of business administration with an academic background in social psychology) Shoshana Zuboff in her bestselling book, *The age of surveillance capitalism. The fight for a human future at the new frontier of power*, Profile Books, London, 2019. It is an interesting book, even if I think that she to some degree overemphasises problems with the digital economy and overlooks the possibilities and benefits it has brought to both producers and consumers.

²⁸ OECD, *Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy*, Statement issued 8 October 2021 (available on www.oecd.org).

jurisdiction (“market state”) with a GDP lower than 40 billion euros, the nexus will be met at a revenue of 250,000 euros from that jurisdiction.²⁹

The income that will be sourced to the market state and taxed there, is called “quantum”. It will constitute 25 per cent of the residual profit which exceeds 10 per cent of the revenue earned by the MNE at issue. A revenue allocation key will be used to divide the taxable income between different market states. The basic approach is that the income will be allocated to that market state where the final consumers are resident.

Sourcing rules are important to calculate Amount A.³⁰ It is through sourcing rules that the consumers are identified and thereby the “market state”, which will be allocated a taxing rights according to Pillar One. It is not possible to discuss the details of the proposal in this article. However, a few remarks should be made. When it comes to digital services, which primarily are covered by the term “automated digital services” complex mechanisms are required for identifying the consumer. For example, when it comes to online advertising services, it is the real-time location of the viewer that constitutes the “sourcing rule”, which will identify the market state.³¹ In order to practically apply this sourcing rule, a number of different indicators are used. They include the geolocation of the device, the jurisdiction of the IP address, and other available information.³² Another example is the sale or alienation of user data. The sourcing rule is the jurisdiction of the real-time location of the user that is the subject of the data being transmitted, at the time when the data was collected.³³ Among the relevant indicators are the jurisdiction of the geolocation of the device of the user at the time of collection, and likewise, the jurisdic-

²⁹ The five countries with the highest GDP in 2020 were 1) The United States (20,936 billion USD), 2) China (14,722 billion USD), 3) Japan (5,064 billion USD), 4) Germany (3,806 billion USD), and 5) The United Kingdom (2,707 billion USD). Sweden ranked 22 with a GDP of 537 billion USD in 2020. Examples of countries close to the threshold of a GDP of 40 billion euros were Cameroon, Tunisia, Bahrain, Uganda, Bolivia and Paraguay. A large number of countries have a annual GDP well below 40 billion euros. The statistics are obtained from the World Bank (www.worldbank.org). The World Bank statistics use USD as currency, and the Pillar One thresholds are set in euros. At the time of writing (2 November 2021) 1 euro equals 1.16 USD (currency information from Svenska Handelsbanken, www.handelsbanken.se).

³⁰ OECD, Pillar One Blueprint, 2020, Chapter 4.

³¹ OECD, Pillar One Blueprint, 2020, para. 238.

³² OECD, Pillar One Blueprint, 2020, para. 239.

³³ OECD, Pillar One Blueprint, 2020, para. 243.

tion of the IP address.³⁴ User profile information and billing address are also used as indicators. It is the MNE that has to provide the information needed to apply the sourcing rules. However, it should not be done at the level of the individual consumer. It is suggested that this can be obtained from “systemic data” kept by the MNE, under the assumption that it has a “robust internal control framework on which the tax authorities can rely”.³⁵ It remains to be seen whether this can be achieved.

The taxable income will be calculated using financial accounting.³⁶ From a Swedish perspective, this is another breach with traditional concepts, because special tax rules normally apply, although they may be influenced by financial accounting.

Double taxation will probably be a major problem with the new rules. The reason is that they will apply in parallel with the traditional tax rules.³⁷

It is highly likely that the new tax rules will be difficult to interpret and apply. The EU is planning to issue two directives, one for each of the two pillars agreed upon by the OECD/G20 and the Members of the Inclusive Framework.³⁸ According to the proposal for Pillar One, there will be new mechanisms for dispute prevention and resolution mechanisms.³⁹ As a means of last resort, the regular administrative system of each participating state may be used to interpret the new rules and resolve tax disputes.

How is the shift of tax revenue to the market state justified? The tax debate on this issue identifies several reasons. One reason is that the digital economy with little need for physical presence in the market state has made the traditional tax principles obsolete. They were to a high degree focused on corporate residence and physical presence through, for example, offices, factories, and personnel. In the digital economy services and goods are provided online, and it is possible to reach a high degree of integration in the economy of the market state without any physical presence. Another reason is that consumers to a high-degree integrate with

³⁴ OECD, Pillar One Blueprint, 2020, para. 244.

³⁵ OECD, Pillar One Blueprint, 2020, para. 388–391 (quote from para. 390).

³⁶ OECD, Pillar One Blueprint, 2020, para. 407–410.

³⁷ OECD, Pillar One Blueprint, 2020, chapter 7.

³⁸ European Commission, Communication from the Commission to the European Parliament and the Council. Business taxation for the 21st century, COM(2021) 251 final, Brussels, 18.5.2021.

³⁹ OECD, Pillar One Blueprint, 2020, chapter 9. The issue of dispute prevention and resolution are addressed under the title “Tax Certainty”.

other consumers and the supplier of digital services, and thereby participate in creating corporate value.⁴⁰ Therefore it is justified for the market state to tax the earning from those services. The market state has for example provided the infrastructure for the digital market penetration. That infrastructure can include obvious parts like the availability of telecommunication facilities and fiber optic cables. From a larger perspective one could add educational level and computer knowledge supplied by the educational system of the market state.⁴¹

4 Digital business activities to be covered by the proposed tax legislation

4.1 Introduction

There are two major digital business activities that are suggested that they should be covered by the new tax. This income will be taxed according to what is labelled as “Amount A”. There is also an “Amount B” that will cover “baseline marketing and distribution activities”, that is a category of income that many tech companies have, and which can give rise to considerable problems with current rules. It should however be noted that regarding “Amount B” there is only a revision of details of the current rules, the principal approach – including the arm’s length principle – is maintained.

Regarding “Amount A” there is, a fundamentally different approach for allocating the taxable income between states. This approach is not new in itself, though it has not been used to any wider extent on an international level. The tax theoretical label is the formulary apportion

⁴⁰ There has been much academic criticism on “value creation” as a theoretical ground for allocating taxing jurisdiction to the market state. In brief, the concept is considered too vague. See for example, Hey, Johanna, “Taxation where value is created” and the OECD/G20 Base Erosion and Profit Shifting initiative, Bulletin (IBFD), 2018, pp. 203–208, and Schön, Wolfgang, Is there finally an international tax system?, World Tax Journal (IBFD), 2021, pp. 357–384.

⁴¹ Cf. on this topic Li, Xiaorong, A potential legal rationale for taxing rights of market jurisdictions, World Tax Journal (IBFD), 2021, pp. 25–61.

method, and it has for decades been rejected by the OECD.⁴² However, times are changing.

There are two general fields of activity that are covered by the “Amount A”. They are “Automated digital services” (“ADS”) and “Consumer facing business” (“CFB”). The proposed tax rules will tax net profits generated by such digital business activities. The income identified as “Amount A”, will be allocated between different states on behalf of the nexus to the different states. A considerable part of that income will be allocated as taxable income to the state in which the digital business has its market.

4.2 “Automated digital services” or “ADS”

In general, “automated digital services” refers to MNE activities that have provided digital services all over the world with little or no infrastructure in their market states. In addition, their business models include interaction with customers, who also provide content to the digital services and increase the economic value of the services provided.⁴³ The fact that consumers provide value to the services, for example postings on Facebook or videos on Youtube, is a key rationale for arguing that the market state should have a taxing right on the income generated by the MNE’s digital business.

What constitutes an ADS is identified in three steps. First, according to a positive list of activities that are considered to be ADS. Second, with a negative list of activities that are not considered to be ADS. Third, with a general definition which apply on activities that are not covered by either the positive or negative list. The practical application is to begin with the positive list, and then continue with the negative list, and ultimately, if no answer is provided in the first two steps, apply the general definition.

In order to get a general understanding of ADS, it is suitable to begin with the general definition. It stipulates that an ADS is:

⁴² OECD, *Transfer Pricing Guidelines*, Paris, 2017, para. 1.16–1.32. In these guidelines, the OECD explicitly rejects global formulary apportionment, which actually is what the taxation of Amount A is. Much has happened since the recent version of the guidelines was published in 2017.

⁴³ OECD, *Pillar One Blueprint*, 2020, para. 24.

- automated, which means that when the system is established the provision of the service to a particular user requires minimal human involvement on the part of the service provider, and
- digital, which means that it is provided over the Internet or an electronic network.⁴⁴

The meaning of “automated” is at the centre of the definition. It implies that it is possible for the consumer to use the service through different kinds of equipment, such as computers and digital communication, without interaction with personnel employed by the provider. It is also possible for the providing company to scale up its business to meet a higher demand, with “minimal human involvement”.⁴⁵

The “positive list” on ADS gives a good picture on the activities that are covered. The positive list includes:

- Online advertising services,
- Sale or alienation of user data,
- Online search engines,
- Social media platforms,
- Online intermediation platforms,
- Digital content services,
- Online gaming,
- Standardised online teaching services, and
- Cloud computing services.⁴⁶

It is recognized that these categories are not mutually exclusive, and that there may be an overlap between them.⁴⁷

The negative list contains five categories of activities, namely:

- Customised professional services,
- Customised online teaching services,
- Online sale of goods and services other than ADS,
- Revenue from the sale of goods of a physical nature, irrespective of “network connectivity”, which includes “the Internet of things”, and

⁴⁴ OECD, Pillar One Blueprint, 2020, Box 2.1, p. 23.

⁴⁵ OECD, Pillar One Blueprint, 2020, Box 2.1, p. 24.

⁴⁶ OECD, Pillar One Blueprint, 2020, para. 44.

⁴⁷ OECD, Pillar One Blueprint, 2020, para. 45.

- Services providing access to the Internet or other form of electronic network.⁴⁸

There is a major difference between the activities on the positive list and those on the negative list. The positive list contains activities that are “automated”, and the negative list contains activities that are designed for a particular customer and that includes some form of direct human involvement.

There is an interesting example from the perspective of the legal profession on “customised professional services”. It is recognized in the report that law firms rely heavily on AI when it comes to due diligence activities. A due diligence may for example be performed when one company plans to buy another company (“target company”). In order to investigate the activities of the target company a law firm is hired to make an inquiry, which for example includes contracts and tax matters. The law firm may use AI in order to identify issues of interest. This is considered to be a “customised professional service” that falls out of scope of ADS. The reason is that human involvement is necessary to develop the AI and to evaluate the results it provides. However, the payments that the law firm makes to the provider of the AI developer may be covered by ADS, according to the OECD report. The reason is that the activities of the AI developer can constitute cloud computing or digital content service, see the previous discussion on the “positive list”.⁴⁹

It is of course possible that the large MNEs that are at issue, can have, or even frequently, will have parts that deal with ADS, and parts that will not. This is a classic issue in tax law: Should one tax according to the different parts or consider the activities of the corporate group as a whole?

If the ADS parts are clearly identifiable the “revenue streams” from those activities should be taxed separately. However, if the ADS parts are highly integrated in the parts of other non-ADS business activities, they should be considered as a whole. Only if the ADS part forms the substantial part, should the business activity as a whole be considered as ADS. If the ADS is a smaller part of the integrated business activity, it should not as a whole be considered as ADS. It goes without saying that the distinctions will be difficult to generally lay out in tax law, and legal practice concerning specific business activities will be necessary. However, this is

⁴⁸ OECD, Pillar One Blueprint, 2020, para. 46.

⁴⁹ OECD, Pillar One Blueprint, 2020, Box 2.22, para. 32–33.

something with which tax law is familiar, and it will be possible to do it in case law. Of course, for the benefit of tax payers and tax agencies, attempts to draw the borders in tax law provisions are welcome.

4.3 Consumer facing business (“CFB”)

The other major category of income covered by Pillar One is “consumer facing business” (“CFB”). It includes a large area of business activities. The general description is that CFB is business that generate income from the sale of goods and services, which commonly are sold to consumers.⁵⁰ Accordingly, goods and services commonly provided to other businesses are not covered. There is of course a wide range of such activities, and I would assume that equipment and maintenance of, for example, industrial facilities, ports, airports and windmills would not be covered. As always in tax law, there will likely be a number of border line situations which have to dealt with in case law.

Even if the scope of CFB is large, some activities within the scope are explicitly discussed in the OECD report. One example is pharmaceuticals, which are covered if they are sold to consumers. Not least from the current pandemic, a number of global pharmaceutical companies have provided the world with vaccines. The pandemic is not addressed in the OECD report, but from my understanding it seems a bit unclear whether vaccine producing companies, or that part of the multinational pharmaceutical enterprises, would be covered. From my understanding, it has not been the case that consumers themselves have purchased the vaccines, but governments have done so and distributed them through the health care system in their respective countries. The national health care system may contain private health care providers, but that would not make any difference. The vaccines are not commonly sold to consumers, which is the general prerequisite for pharmaceuticals to be covered by CFB.⁵¹ Therefore, it seems unlikely, at least according to the current version of the proposal for defining CFB, that vaccine producing companies would be covered on behalf of that activity.

It is recognised that some goods and services may be of dual use, that is, of use for both consumers and other businesses. Cars, computers and some medical products (such as blood pressure monitors) are examples

⁵⁰ OECD, Pillar One Blueprint, 2020, para. 52.

⁵¹ OECD, Pillar One Blueprint, 2020, para. 57.

of products fall within this category, according to the OECD.⁵² The approach taken is that if the goods or service is commonly sold to consumers, then all sales of that goods or service will be covered by the definition of CFB. This is, evidently, an either-or-approach. Only if there is a marginal sale to consumers, will the sale be excluded from the scope of CFB.⁵³

There are several exclusions and “carve-outs” from the scope of CFB. In my view, some of them follow from the general definition of CFB, but are still explicitly discussed in the report. The sale of natural resources is excluded. The meaning of “natural resources” is, of course, wide, and the OECD discusses for example agriculture, forestry, and the mining industries. To me it seems unlikely that the raw materials extracted from mining would meet the general definition of CFB, because it needs to be processed before reaching the consumer in some form. However, products from agriculture and fishing may not require that, and can more easily be provided directly to the consumer. The extraction and production of fossile energy and the production of renewable energy is also discussed, but the conclusions are vague. The issues are sensitive, and it seems that they will have to be further discussed.⁵⁴

5 Concluding remarks

The agreement on Pillar One and Pillar Two by most of the more than 130 states participating in the OECD/G20 and Inclusive Framework project means a fundamental shift in the global system for taxation of corporate profits. The different thresholds for the new rules to apply, makes this specific tax system applicable only for very large MNEs. The European Commission plans to propose a directive, or amendments in current directives, for the implementation of at least Pillar Two.⁵⁵ Basically, there are two fundamental shifts if the two pillars ultimately come

⁵² OECD, Pillar One Blueprint, 2020, para. 93.

⁵³ OECD, Pillar One Blueprint, 2020, para. 93. Practical aspects of drawing a line between sales to consumers or businesses seems to be the general reason for the approach (ib., para. 95–97).

⁵⁴ OECD, Pillar One Blueprint, 2020, para. 116–121.

⁵⁵ In this article I have focused on Pillar One. Regarding Pillar Two, there are problems with the compatibility with fundamental freedoms of EU law cf. Brokelind, Cécile, An overview of legal issues arising from the implementation in the European Union of the OECD’s Pillar One and Pillar Two Blueprint, Bulletin (IBFD), 2021, pp. 212–219.

into effect. First, there will now be a global set of rules for the taxation of corporate profits. It is possible that these rules will apply in more than 130 states and jurisdictions all over the world. Second, the new rules include a new approach for dividing the tax base between companies, namely a formulary apportionment method that allocates parts of the income to the market state.

Even if it is only large MNEs that will be covered, I consider it likely that the approach will permeate into the system for taxing other (including small and medium-sized) companies conducting international business activities. The directives on corporate taxation which the EU has introduced on certain cross-border situations, have had such spill-over effects on strictly internal situations in the Member states. For example, the implementation of the EU Merger directive had such effects in Sweden on internal re-organizations of corporations and corporate groups.

Will Pillar One and Pillar Two ultimately take effect? So far, it is only the governments of most of the participating states and jurisdictions within the project that have reached an agreement. For the agreement to take effect, it will have to be implemented with national law and tax treaty law. It remains to be seen how national parliaments will react on the agreement. That is a problem. The proposals on Pillar One and Pillar Two have, so far, been a project discussed by governments and the large MNEs through different lobby organizations. There is also an academic debate, however, in a rather limited group. In my view, there has so far not been any public debate.

Individual rights and the protection of personal integrity is likely to be an issue when the details of Pillar One will be put forward as proposals for new national tax legislation. The earlier discussion of Amount A makes it clear that the location and consumption patterns of billions of individuals will form the basis for allocating taxing power to the market state. The issues of individual rights and personal integrity are hardly discussed in the OECD Pillar One Blueprint. It still remains to be seen what the new legislation, for example, an EU Directive on Pillar One will contain in this regard. When individual rights and personal integrity is discussed in relation to the digitalisation of society, references are often made to the oppressive state portrayed by George Orwell in his novel "1984". There is, however, a precursor to this novel, which also portrays a state that keeps its citizens under close surveillance, namely Evgeny Zamiatin's novel "We" (*Mbl*). In the novel, we follow an engineer (with the impersonal name "D-503") who on the commission of the state and

its leader, the Great Benefactor, is developing a new technological tool that will keep the citizens under an even stricter control. The technological tool is called “Integral”. In a famous passage, the engineer formulates how this totalitarian state considers the rights of the individual, a way of reasoning which also provides the title of the novel:

“There are ideas made of clay, and there are ideas sculpted for the ages out of gold or out of our precious glass. And to determine what material an idea is made of, all you have to do is let a drop of powerful acid fall on it. Even the ancients knew one such acid: *reductio ad finem*. That’s what they seem to have called it. But they were afraid of this poison. They preferred to see at least some kind of heaven – however clay, however toylike – to this blue nothing. But we are grown-ups, thanks be to the Benefactor, and don’t need toys.

Look here – suppose you let a drop fall on the idea of ‘rights’. Even among the ancients the more grown-up knew that the source of right is power, that right is a function of power. So, take some scales and put on one side a gram, and on the other side a ton; on one side ‘I’ and on the other ‘We’, OneState. It’s clear, isn’t it? – to assert that ‘I’ has certain ‘rights’ with respect to the State is exactly the same as asserting that a gram weighs the same as a ton. That explains the way things are divided up: To the ton goes the rights, to the gram the duties. And the natural path from nullity to greatness is this: Forget that you’re a gram and feel yourself a millionth part of a ton.”⁵⁶

It is important to follow the forthcoming legislation on Pillar One (and, of course, Pillar Two) and identify eventual infringements on individual rights. It is a pity that this issue has hardly been addressed in the materials so far published. Considering that there has not been any public debate, and that multilateral treaties and domestic legislation are intended to be decided in 2022, to take effect in 2023, there is not much time. There is a potential problem with consumer integrity in the huge amounts of information that will be required in order to identify the market state.

⁵⁶ Zamyatin, Yevgeny, *We*, Penguin, London, 1993 (1924), p. 128 (translation to English by Clarence Brown). On the fascinating life of Zamyatin, see the biography of the Oxford professor of Russian literature, Julie Curtis, *The Englishman from Lebedian’ – A life of Evgeny Zamiatin (1884–1937)*, *Ars Rossica* (ed. David Bethea), Academic Studies Press, Brighthton (MA, USA), 2013. There is also a Swedish translation of the novel, *Zamjatin, Jevgenij, Vi*, Modernista 2015 (1959), translation by Sven Vallmark, including a foreword by Nils Håkanson.