MULTINATIONAL

Pillar 1 Talks to Resume, But Digital Tax Debate Persists

by Stephanie Soong

Negotiations on finalizing pillar 1 profit allocation reforms that would abolish digital services taxes will continue once pillar 2 global minimum tax issues are settled, but the DST debate isn't likely to disappear anytime soon.

Delegates in the OECD inclusive framework on base erosion and profit shifting are concentrating on resolving new issues under pillar 2 of the OECD's two-pillar global tax reform plan, according to Eric Robert, project manager for pillar 1 workstreams at the OECD Centre for Tax Policy and Administration.

Once those issues are settled, the inclusive framework will return to talks on pillar 1, Robert said, pointing to recent statements from the inclusive framework and the G7 signaling the need to resume those discussions. He spoke September 26 at a conference organized by the Amsterdam Centre for Tax Law at the University of Amsterdam.

There's been a lot of discussion about the problems DSTs pose, and those concerns aren't just going to go away, according to Robert. "It's a question of timing, and obviously, right now, there are very important issues being discussed that are taking a lot of time and focus," he said. Negotiations will likely resume when resource-limited country delegates have the bandwidth to do so, he added.

Pillar 1 calls for amount A, a formulaic, partial reallocation of excess profits that the largest, most profitable multinational enterprises earn in the jurisdictions where they have consumers but lack traditional permanent establishment. Amount A would be implemented through a multilateral convention, which inclusive framework members have been trying to finalize. Parties to the multilateral convention would agree to withdraw their DSTs and other similar measures and refrain from introducing such measures in the future.

Many countries have adopted revenue-based DSTs as temporary measures pending the implementation of pillar 1. However, the United States opposes DSTs, arguing that they discriminate against American companies and threatening to impose retaliatory tariffs against countries that enforce them.

Pillar 1 is likely to fail, but there appears to be a global convergence on the idea that market-based allocation of taxing rights is the correct course of action to address the tax challenges of the digital economy, according to Georg Kofler of the University of Vienna.

"Even if everything fails technically, the mental shift has taken place," Kofler said. The United States can push back on the idea, but it's unclear whether it would be able to make the idea go away, he added.

Is That Even Legal?

The persistence of DSTs raises many legal questions, including under international tax law and EU law, according to some conference speakers.

The international community likely sees DSTs as being outside the scope of tax treaties, Kofler said. Some Silicon Valley companies have argued that EU policymakers intentionally designed DSTs like that, violating the good faith underpinning the allocation of taxing rights, he added.

However, "you can also spin the argument to say, well, if a country succeeds in inventing a tax that brings about policy change, taxing more in the market jurisdiction outside the treaty network is also a good thing, because you have made a policy change without violating your international obligations," Kofler said.

Revenue-based taxes are likely compatible with the EU fundamental freedoms, but DSTs have characteristics — like high revenue thresholds — that could leave them vulnerable to potential legal challenges, according to Balázs Károlyi of the Hungarian Ministry for National Economy. DST harmonization at the EU level could address those vulnerabilities, he said.

Attempts at an EU-wide DST have failed, leading to fragmentation as many EU member states adopt their own DSTs, Katerina Pantazatou of the University of Luxembourg said. It's likely that pillar 1 won't become a reality, so the EU has two options: either maintain the status quo and allow member states to retain or introduce their

own DSTs, or make another attempt at harmonizing DSTs, she added.

The EU will never have a DST because the EU relies on U.S. defense in the war in Ukraine and the United States would pressure the EU to drop the tax, according to Itai Grinberg of Georgetown University. "It means that there will be no DST expansion, and there will probably be some DST pullback, at least until the Ukraine war is over," he said.

The DST debate should also rely on expertise from various stakeholders so that technical options are available when political conditions are right, Raffaele Russo of the University of Amsterdam and Chiomenti said. He pushed back on Grinberg's prediction, saying he disagreed with the idea of building tanks first before imposing DSTs. "It's not the world I want to live in," Russo said. ■

NETHERLANDS

Dutch Retail Chain Prevails In Dispute About Arm's-Length Loan

by Alexander F. Peter

The non-arm's-length character of a loan cannot be proven by merely demonstrating a disparity between the loan amount and the acquisition value of the target, a Dutch court has ruled.

In a decision (AWB – 23 _ 4895) dated August 28 and published September 15, the Dutch North Holland District Court found that tax reasons do not invalidate a loan structure and ensuing interest expenses if the debt has a valid business purpose. Further, a loan amount that is higher than the acquisition value is not harmful in the absence of tax avoidance measures such as subsequent dividend distributions, the court said.

"We're seeing this 'holistic' approach of the tax authorities more frequently in the Netherlands, where the loan is challenged as a whole as not arm's length rather than the focus being solely on the interest rate," Omar Moerer of Deloitte in the Netherlands told *Tax Notes* on September 30. "Unlike the OECD transfer pricing guidelines, Dutch case law prohibits the loan's split into an arm's-length and non-arm's-length part. So a win of the tax authorities on the loan amount would have resulted in the disallowance of most of the interest on the loan — Dutch case law would still permit a deduction of interest, albeit at a risk-free rate or rate equivalent under a deemed guarantee — and not only on the part that would be, even in the opinion of the tax authorities, an arm's-length amount."

Moerer was pleased that the court emphasized the burden of proof. "The court also points out that business purpose — essentially antiavoidance — arguments under various legal doctrines cannot remain mere accusations volleyed at the taxpayer in a one-size-fits-all approach," he said. "Such claims must be supported by concrete evidence and substantiation. In recent cases, the tax authorities have been successful with that strategy. So it's good to see that the court makes sure arguments hold water, considering that a yea-or-nay outcome is at stake."