

The digital economy and its artificial erosion of ‘permanent establishment’ in international tax law

This is a notable entry from one of the runners-up in vLex’s International Law and Technology Writing Competition 2022. Malcolm Superville of The Hugh Wooding Law School, Trinidad and Tobago, won the Present category of the competition for the below article: The Digital Economy And Its Artificial Erosion Of ‘permanent Establishment’ In International Tax Law.

The OECD two-pillar approach is a ‘global’ attempt to remedy the gap teared open in international tax law by the digital technologies behemoth tech companies use to artificially erode ‘permanent establishment’ status so that they can shrink their tax liabilities; Without a global tax authority, however, the pillars give impetus to a clash of national economic interests that threaten to erase the economic sovereignty of small international financial centres (IFCs).

Current international tax rules generally permit countries to tax the business profits of a non-resident foreign enterprise only to the extent that those profits are attributable to a permanent establishment (PE) in that state.¹

Advances in ICT technologies, digital commerce, and neoliberal trade policy, however, permit businesses to centrally manage functions that previously required local presence through the transference of data worldwide in practically real-time, at zero marginal cost.²

In other words, the advent of the digital economy has exposed a cavity in international tax law: the existing thresholds for ‘permanent establishments’ in international taxation require some

¹ Eloise Walker, ‘Taxing the digital economy’

<<https://www.pinsentmasons.com/out-law/guides/taxing-the-digital-economy>>; OECD/G20 Base Erosion and Profit Shifting Project, ‘Preventing the Artificial Avoidance of Permanent Establishment Status’ Action 7, 2015 Final Report, 9.

² Cristian Oliver Lucas-Mas and Raul Felix Junquera-Varela, *Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency* (International Bank for Reconstruction and Development/ The World Bank), 17.

fixed local nexus,³ but since online giants no longer need the same to conduct large-scale business, they can shrink their tax liabilities by artificially avoiding the PE status requirement.

The OECD mandated a two-pillar plan to resolve these mismatches.⁴ Pillar two particularly is a global base erosion (GBE) proposal that seeks to guarantee a minimum 15% homogenised income tax rate on corporate profit worldwide.⁵ It aims to eliminate the risk of profit shifting to entities or jurisdictions with no/low tax rates, no matter where a multinational enterprise (MNE) operates.⁶ But its homogenisation could potentially erase one of the few competitive advantages many small countries hosting tax-havens benefit from – tax competition.⁷

Countries hosting tax-havens ordinarily sell their sovereignty to import capital,⁸ but pillar two reduces their autonomy to do so. Tax-havens offer competitive tax rates which act as a lever to draw in the foreign direct investment (FDI) small Caribbean IFCs use to excite their local development.⁹ However, this conflicts with the overriding objective of the corporate minimum tax to eliminate tax-havens,¹⁰ and there is no global tax authority to afford a balance of competitive advantage, so what results is ‘a friction between the competing economic interests of a home country (to retain tax revenue) versus those of small IFCs (to attract FDI).’¹¹

And whilst provision is made for substance-based carve-outs that shift the pillar’s focus from erasing tax-havens to mitigating profit-shifting,¹² this is not enough. The carve-outs generally aim ‘to ensure that the minimum tax focuses on excess intangible income’ (arising from copyrights, patents, etc) that MNEs can ‘easily shift to no/low-tax jurisdictions for the purposes of avoiding taxes.’¹³ Minimum taxes with carve-outs therefore work to reduce the tax base against which the minimum tax applies.¹⁴

³ OECD, ‘Broader tax challenges raised by the digital economy’ in *Addressing The Tax Challenges of the Digital Economy* (OECD, 2014), 125.

⁴ OECD/G20 Base Erosion and Profit Shifting Project, ‘Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy’ OECD 2021.

⁵ Ibid, 4-11.

⁶ Ibid.

⁷ Doug Connolly, ‘Ireland positions itself as counterpoint to US in debate over global minimum tax’ MNE Tax 2021 <<https://mnetax.com/ireland-positions-itself-as-counterpoint-to-us-in-debate-over-global-minimum-tax-43566>>.

⁸ Prem Sikka, ‘The role of offshore financial centres in globalization’ (2003) Accounting Forum DOI: 10.1046/j.1467-6303.2003.t01-2-00111.x.

⁹ Eilis Ferran, ‘Company Law Reform in the UK’ (2001) European Corporate Governance Institute, 522. See further, Roman Tomasic, ‘The Modernization of Corporations Law: Corporate law reform in Australia and beyond’ (2006) Australian Journal of Corporate Law, 220-232; R. Tomasic, ‘Company Law Modernization and Corporate Governance in the UK – Some Recent Issues and Debates’ (2011) Dictum: Victoria Law School Journal, 43-61; Roman Tomasic, ‘The Rise and Fall of the Capital Maintenance Doctrine in Australian Corporate Law’ (2014) University of South Australia 1, 6.

¹⁰ OECD Two Pillar Solution to Addressing Tax Challenges (n 4), 18-19.

¹¹ Alicia Nicholls and Tammi C. Pilgrim, ‘#BTCColumn – How the global minimum corporate tax will impact’ <<https://barbadostoday.bb/2021/06/13/btccolumn-how-the-global-minimum-corporate-tax-will-impact/>>.

¹² Doug Connolly, ‘EU continues to wrangle over global minimum tax’s carve-outs, rate’ MNE Tax 2021.

¹³ Ibid.

¹⁴ Ibid.

The unintended consequence, however, is that companies will also become incentivised to move real activity to tax havens,¹⁵ which ends up inadvertently exacerbating the very same tax competition the pillars aimed to remove, thereby preserving the investment lever small IFCs rely upon. But this is just a temporary reprieve to an unrelenting problem: the most powerful countries in the international political economy (IPE) use 'global' initiatives like the pillars as an excuse to usurp the economic sovereignty of small IFCs.

High-tax countries blame tax competition for eroding their tax bases,¹⁶ and this inveigles them to target small IFCs. Very little is said though, about the tax loopholes large countries offer corporations to minimise their tax liability.¹⁷ The problem, therefore, has little to do with the idea of legally incentivising tax avoidance but rather the inability of high-tax developed countries to benefit from these incentives when offered by small IFCs.

The truth is that without some global tax authority to force the international community to care for the needs of small IFCs, initiatives like the GBE proposal are predicated on an unequal balance of power, so it operates like a creature conjured by developed states to pedal their 'political interests and economic exigencies',¹⁸ and is ultimately symptomatic of them 'changing the rules and moving goalposts to suit their policy agendas.'¹⁹

Behemoth companies benefit from the increasing subsumption of world economies into one global, borderless economic hemisphere²⁰ because it allows them to amass sufficient power through profit to rival the nation-state for supremacy in international economic relations. Developed countries benefit from their 'global' tax rewrite because it homogenises tax rates to procure more money.²¹ But smaller states (like those in the Caribbean) lag behind because they suffer from asymmetries of dependence,²² and a politico-economically charged need – flowing from their colonial past – to make their economies a cockpit for investment.²³

The OECD's 'global' tax rewrite is not some 'revival of multilateralism'²⁴ – it is the nation-state's latest retaliation against online giants in a longstanding proxy war for hegemony in the

¹⁵ Ibid.

¹⁶ Nicholls and Pilgrim, How the global minimum corporate tax will impact (n 11).

¹⁷ Ibid; for example see: Institute on Taxation and Economic Policy, 'Delaware: An Onshore Tax Haven' (2015) <<https://itep.org/delaware-an-onshore-tax-haven/>>.

¹⁸ Nicholls and Pilgrim, How the global minimum corporate tax will impact (n 11).

¹⁹ Ibid.

²⁰ Joseph Stiglitz, *Globalization and its Discontents* (Penguin, 2002), 9.

²¹ OECD/G20 Two-Pillar Solution to Address the Tax Challenges (n 4).

²² M. Parsi and S. Yetir, 'Unequal Contest: Iranian Nuclear Proliferation Between Economic and Value Symmetry.' (2008) Contemporary Security Policy; M. Tanious, 'The impact of economic interdependence on the probability of conflict between states: The case of 'American-Chinese relationship on Taiwan since 1995' (1995) 4, 1 Review of Economics and Political Sciences.

²³ Elucid A Rose, *Dependency and Socialism in the Modern Caribbean: Superpower Intervention in Guyana, Jamaica, and Grenada, 1970-1985* (Lexington Books, 2002) Norman Girvan, 'Caribbean Dependency Thought Revisited' (2006) XXVII, 3, CJDS/RCED. C.Y.

²⁴ David Goodman, William Horobin and Saleha Mohsin, 'G-7 Strikes Deal to Revamp Tax Rules for Biggest Firms (2)' Bloomberg Tax 2021 <<https://news.bloombergtax.com/daily-tax-report/g-7-strikes-historic-deal-to-revamp-global-tax-on-tech-firms-1>>.

digitalised market economy. The problem is that small Caribbean IFCs suffer the most fiscal casualties due to the collateral damage ensuing from same, and their predicament cannot change without the creation of some international tax body.²⁵

If a global tax agency is administered under the auspices of the United Nations, it could theoretically become a politically neutral international organisation that ensures all countries join as members and participate on a truly equal footing.²⁶ In reality, however, since the UN exists at the mercy of its most powerful member-states' interests, it follows that any international tax organisation created will also likely be little else than an extension of the economic policy goals of rich, developed member-states.

In conclusion, therefore, without a tax authority to galvanise the competing national interests between home countries and small IFCs, the pillars concocted to address the effect of digital technologies on international taxation are just a disguised apparatus developed countries use to dilute the economic sovereignty of those smaller Caribbean territories hosting IFCs. And even if some tax authority was created, it is only if some politically neutralising mechanism that could accommodate the unique needs of developing states is installed that small IFCs will stop being left behind.

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²⁵ Lucas-Mas and Junquera-Varela, *Tax Theory Applied to the Digital Economy* (n 2), 85-90.

²⁶ Ibid.