RITA CALÇADA PIRES
DIOGO FEIO
CARLA VALÉRIO
MARIANA BERALDO
MARTA CARMO

EDITORS

NOVA TAX RESEARCH SERIES

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NOVA TAX RESEARCH LAB

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equipo@bubok.com
Tel: 912904490
Paseo de las Delicias, 23
28045 Madrid

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AUTHORS LIST

Alice Ferraz de Andrade
Master's degree in Corporate and Business Law from the Law School of the Portuguese Catholic University. She also holds a degree in Law from the same university.

Alice has been a qualified lawyer since 2023 and currently works as part of the legal and corporate tax teams of the Nors Group.

Alice has also been a researcher at NOVA Tax Research Lab since 2022, developing her research within the framework of Pillar 1: Tax and Happiness.

Ana Júlia Trindade
Ana Júlia is currently graduating in Law at NOVA School of Law, while also gaining practical experience through a legal internship at InLaw Associates.

Previously, she was the Vice President in charge of Seminars and Conferences at ELSA NOVA Lisbon and the Director for Webinars of ELSA Portugal. She also held the position of communication officer on HeforShe Lisbon. More recently, Ana has developed a strong interest in Tax Law and Public Finances, developing research in the Pillar Tax and Happiness.

Carla Valério
EU Direct Tax Law Associate at the IBFD, in Amsterdam. She was a guest lecturer in International Tax Law at NOVA School of Law. She graduated from the Advanced LLM in International Tax Law from the University of Amsterdam and IBFD and was awarded with the IBFD European Taxation Journal Prize.

She holds a master's in Business Law and a postgraduate degree in Corporate Tax Law from Coimbra University. In Timor-Leste, she was a guest lecturer at the National University and legal advisor for the Government.

She was a member of the NOVA Tax Research Lab coordination team from the creation of the knowledge centre, in 2021, until January 2023.

Catarina Gomes Correia

Lawyer at SRS' Tax Department, with over 10 years of experience. Previously, she worked at the Tax Department of Garrigues Portugal for over 7 years. She is an arbitrator at the Portuguese Centre for Administrative Arbitration.

She holds a Licentiate Law Degree from the University of Lisbon School of Law, a Masters in Tax Law from the same school, a Post Graduate Studies in Tax Management from INDEG-ISCTE and has concluded the 1st semester of the Accountancy Licentiate Degree from ISCAL.

Eduardo Vieira Raposo

Holds a Bachelor's degree in Law from the University of Lisbon (2020) and a Masters in Tax Law from the Catholic University of Lisbon (2022).

He is a Guest Lecturer in the Faculty of Law of the University of Lisbon and a Trainee Lawyer in Tax Controversy & Dispute Resolution Law practice area.

Francisco Dias

Graduated in Solicitor and Administration from Coimbra Business School in 2020 and currently he is attending a Master's degree in Law and Management at NOVA School of Law, in the dissertation stage.

He works as a transfer pricing analyst in Deloitte Portugal.

Disha Bheda

She is a Chartered Accountant from India. Recently, she pursued her Advanced LLM in International Tax Law at University of Amsterdam alongside IBFD.

In the start of her tax journey, she was a Consultant with KPMG India in the Private Equity space. Eventually she worked in in-house roles across various industries and managing tax compliance, litigation, advisory and structuring. Currently she is a Senior Tax Analyst at Amazon, with International Tax Planning being her focus.

Iara Maçarico

She holds a degree in Law from the NOVA School of Law and she is currently attending the Master's in Law and Business at Faculty of Law of the Catholic University of Portugal, in the dissertation stage. Trainee at Legal Services Department of Banco de Portugal.

Inês Vale de Amorim

Graduated in Law at University of Porto, in 2021. She is currently attending the Masters in Law - Specialization in International and European Law at NOVA School of Law. She was recently an intern at the Portuguese Embassy and Permanent Mission to the UN and other International Organizations in Vienna.

José Miguel Anjos
Holds a Bachelor of Laws from the School of Law of the University of Minho. Graduated magna cum laude from the Portuguese Catholic University, with a Masters' dissertation focused on the interest barrier rule foreseen by the Anti-Tax Avoidance Directive I.

He started his professional career as a Corporate Tax Consultant with KPMG. Currently, he is working as an Experienced Senior Consultant of EY's International Tax and Transaction Services practice. In 2016, he was a delegate to the General-Assembly of the Euro-Ibero-American Youth Forum, enrolled on the Committee on Taxation and Customs.

João Comenda António
He holds a degree in Law from the University of Lisbon, a Masters in Corporate Law from University of Lisbon, and a Post-Graduate in Insolvency Law from the Research Centre for Private Law of the University of Lisbon. He started his professional career as a tax consultant in a Big4 firm and currently works as Tax Associate in a top tier law firm in Portugal as a tax expert.

João Gabriel Gonçalves
Graduated in Law from the University of Coimbra in 2021, having obtained a postgraduate degree in Tax Law from the IDEFF - University of Lisbon Faculty of Law in the same year. Master 's student in Tax Law at Universidade Católica Portuguesa - Lisbon School, currently writing his dissertation.

Currently he works as a Trainee Lawyer in the Tax practice at Abreu Advogados.

Lara Silva
Graduated in Law from NOVA School of Law and she is a student of the Master's in Law and Financial Markets at NOVA School of Law and NOVA Information Management School. Currently, she is writing her

master's thesis. Also, is a trainee in the tax and accounting department at ANA Aeroportos de Portugal

Luis Castilho
He has been a Tax Practitioner since 2009, having worked as a Lawyer at PLMJ Law Firm for around 6 years and then as a Senior Consultant and later Manager at Deloitte Portugal (Tax - Financial Services Industry) for close to 4 years.

Between 2019 and 2021, he was an Assistant to the Secretary of State for Tax Affairs in the XXI and XXII Constitutional Governments of Portugal.

In late 2021 he co-founded the law firm Belim Castilho. At the firm, he advises clients on income taxes, property taxes and other direct taxes.

Mariana Passos Beraldo
PhD Candidate at NOVA School of Law, Research fellow at Fundação para a Ciência e a Tecnologia, I.P. - FCT and researcher at CEDIS. She has been part of the NOVA Tax Research Lab coordination team since the second half of 2021, when the knowledge centre was created.

Guest lecturer in Law and Globalization at the University of Araraquara – UNIARA in 2023, and Guest Teaching Assistant in the Public Law Department at NOVA School of Law in 2021/2022. Holds a masters in International and European Law (2021) from Nova School of Law. Specialist in Tax Law (2012) by the Brazilian Institute of Tax Studies – IBET.

Mariana Rodrigues Brito
Advanced Master in International Tax Law at the University of Amsterdam-IBFD (2020-2021) and post-graduated in Public Administration by Getúlio Vargas Foundation (FGV).

An experienced lawyer with the Brazilian tax system, working as a National Treasury Attorney since 2009. During her career, she was engaged in several leading and management positions, coordinating teams and projects. She also has provided legal assistance on public bidding for the Finance Ministry in Brasília-DF.

In 2020, she assisted the Brazilian Delegation to the World Trade Organization (WTO) in Geneva, Switzerland, during the negotiations of the multilateral framework on investment facilitation for development. Currently, she works at a Special Division of the National Treasury

Attorney's office, dealing with the most strategic litigation cases, especially those with the most significant financial impact, including international tax matters

Marta Carmo
PhD candidate at NOVA School of Law, researcher at CEDIS and a tax lawyer at Banco BPI, S.A.. Previously she was an associate lawyer at RPBA – Ricardo da Palma Borges & Associados, Sociedade de Advogados, S.P.,R.L..

She holds a degree in Law and a Master in Law and Management from NOVA School of Law and an LLM in international legal studies from New York University of Law.

She has been part of the NOVA Tax Research Lab coordination team since the second half of 2021, when the knowledge centre was created. She is also a Guest Professor in Corporate Tax at NOVA School of Law since 2022.

Pedro Ferreirinha
PhD candidate at University of Minho School of Law, tax consultant, legal advisor, and researcher at JusGov and IJP.

Previously worked as an international tax consultant, in the Global Compliance and Reporting team, at Ernest and Young Luxembourg.

He holds a degree in Law from Portucalense University, a Master in Legal and Economic Sciences from the University of Porto, and a postgraduate degree in Corporate Tax Law from the University of Coimbra.

Rafaela Cruz
Graduated in Law from the Faculty of Law of the University of Coimbra in 2020. Currently attending the Master's in Law and Management at NOVA School of Law, in the dissertation stage.

She holds a postgraduate degree in Taxation, with a focus on Advanced Taxation of Corporations, from Católica Global School of Law and she is a consultant in the International Tax and Transaction Services team at EY since 2021.

Rita Campos Pereira
She holds a degree in Law and a Master's Degree in Tax Law from the Portuguese Catholic University's Law School in Porto, with theses entitled

"Taxation within a Digital Economy - a path to reshape the corporate income tax".

She is an associate lawyer at CTSU - A Deloitte Legal Practice, providing her activity mainly within Employment and Labor Law and Due Diligences in M&A. Previously, she worked for Campos Pereira, Pedro Alhinho, Leopoldo Carvalhaes, Cândida Mesquita & Associados, Sociedade de Advogados, for a business association (AIMMAP - Associação dos Industriais Metalúrgicos, Metalomecânicos e Afins de Portugal) and, most recently, she worked for a Swiss-based crypto company as an Employment Legal Counsel.

Sara Neto

She is currently attending the Masters's in Litigation and Arbitration at Nova School of Law, in the dissertation stage. Graduated in Law also from NOVA School of Law, in 2021.

Previously, she was a Junior Researcher at NOVA Dispute Resolution Forum, in the department of Insolvency and Civil Procedure.

Sara Vitorino

Graduated in Law at NOVA School of Law, in 2021. She is currently attending the Masters in Financial and Tax Law at Universidade de Lisboa. Trainee Lawyer at Eversheds Sutherland FCB.

Telmo Soares

Graduated in Law from the Faculty of Law of the Catholic University of Portugal (Porto), in 2017. Currently attending the Master's degree in Tax Law at the Catholic University of Portugal (Porto), in the taught stage.
Previously, he was an International Tax Consultant at EY Portugal (Porto Office). At the present time, he is working as a freelance Tax Advisor and as a Legal Expert at Matosinhos City Hall.

Teresa Bouza Serrano

Graduated from her Bachelors at NOVA School of Law in 2021 and is currently a Masters Student in International Laws at Maastricht University in The Netherlands. She previously was President of LisboMUN Association, the first Association in Portugal to organize Model United Nations Conferences, and a Summer Legal Trainee at Morais Leitão in the Public and Administrative Department. More recently she has developed a

keen interest in Tax Law and Tax Policy and will developing research in Pillar Tax & Global Governance.

PREFACE

What characterizes NOVA Tax Research Lab is that its organization and the development of its work are anchored in an integrated and inclusive vision of taxation, with a humanistic and holistic imprint.

We are a research centre that refuses individual work driven by thematic fashions, just as we do not intend to follow a path of individualised research. Instead, we want to contribute to a refocusing of the fiscal system, identifying the big picture, zooming in and zooming out, designing a school of thought that is able to innovate and revitalise the building, reflecting, rethinking, and, above all, the necessary redesign of contemporary fiscal systems.

It is realistic but certain that a macroscopic vision of the whole is necessary to reconfigure the creation, application, monitoring, and evaluation of tax rules, procedures, and impacts.

Our main goal is to create social value with a relevant impact. It is essential to define the fundamental areas for reflection and research.

The NOVA Tax Research Series is a digital publication in English, entirely produced by the NOVA Tax Research Lab team in 2022. Divided into three thematic groups, the NOVA tax Lab researchers sought to explore the state of the art of the selected subjects.

The *first* issue deals with *TAX & HAPPINESS: How the world should and can be* (Chaps. 1-4). Discussing the first issue involves three important vectors with several interconnection points. The first one is on Tax and Citizenship, namely on Tax Education. A global analysis showed that we started by analysing how tax education improves tax morale, tax ethics, and citizenship, by raising awareness of everyone's social responsibility to reach common goals. Additionally, tax education is not only a matter of psychological and sociological impact but also provides knowledge to taxpayers on their duties and obligations. This is the path to improve voluntary compliance and fight tax evasion and fraud. Furthermore, tax education should be a way towards the acknowledgment of taxpayers' rights (Chap. 1). The following paper is dedicated to Tax & Collective Wellbeing. The work links public finances, tax management, tax communication, and sustainability. To this end, the equity and efficiency of

the tax system are highlighted, presenting taxes as a tool for implementing the budgetary principles of stability and sustainability (Chap. 2). Also, the *first* issue addresses the role of taxation in the Social Contract and public governance of tax revenues for a sustainable welfare state. (Chap. 3). The third topic includes Tax & Sustainable Development Goals (SDGs). Thus, it was worked, in this discussion, on the connection between taxation and (i) guarantee of human rights, (ii) reduction of poverty, and (iii) gender equality. Moreover, taxation and the 4 R's: Revenue, Redistribution, Repricing, and Representation will be highlighted. Finally, the importance of paying the fair share for the fulfilment of Economic, Social, and Cultural Rights and the SDGs are explored (Chap. 4).

The *second* issue explores *TAX & GLOBAL GOVERNANCE: How the world is working* (Chaps. 5-10). This issue will be focused on revealing the state of the art of the research in Tax & Global Governance. This was interpreted as having, as a primary focus, the relationship between States notably: (i) the decision-making in tax and international tax policy; (ii) the rationale of the attribution of taxing rights between the states; (iii) inter-state solidarity and tax justice and (iv) the taxpayer as a global subject. With this in mind, the research focuses on principles of international taxation, where we currently stand, and which trends have been identified. The principles indicated therein were considered to be some of the most relevant to be analysed, especially in light of the consequences of globalization and base erosion and profit shifting practices, but the team responsible will give their input as well (Chap. 5). Secondly, it is also considered to be important to understand where we stand in the dynamics of decision-making at the international level, analyse the tax multilateralism trend and if there is representation and participation in the decision fora (Chap. 6). These first two topics are considered to be traditional and important building blocks of the research of this Team. The final subject matter regards Pillar Two since this is the most developed one so far, and it is already possible to make a thorough technical analysis. Given the complexity of the norms, this analysis was limited to some issues defined by the research team (Chap. 7). The *second* issue is still focused on current topics and trends of taxation. In this scope, the impact of taxation on international remote work was studied (Chap. 8). Exit taxes were also analysed, taking into account citizenship taxation (Chap. 9), and closing

the *second* theme, the research addressed the rise of space taxation (Chap. 10).

The *third* issue works with *TAX, TECH & DIGITAL ECONOMY, SOCIETY AND PERSONALITY: How the world is and still is progressively and rapidly becoming* (Chap. 11). This chapter addresses the necessity of taxation on the digital economy to ensure fairness and tax equality. The discussion also explores the key features of the digital economy: from intangible assets to new business models lacking physical presence, and ends by portraying the international approaches to address the tax challenges arising from the digital economy.

NOVA Tax Research Series' first edition includes 11 articles written from an interdisciplinary perspective and produced through collaborative investigation, including in-depth analysis of current issues of domestic tax law and international tax law issues.

We believe this series of Chapters will contribute to a growing body of literature that explores contemporary tax policy challenges and global tax issues. The publication also presents practical contributions, being able to guide the formation of tax policies that seek tax justice and aim at global tax governance.

We wish the riders a pleasant and helpful reading for their interests, whether they are professional, academic, or intellectual.

Rita Calçada Pires, NOVA School of Law Associate Professor and President of the Pedagogical Council/ NOVA Tax Research Lab Director

Diogo Feio, Academia Militar – IUM Assistant Professor/ Guest Professor at NOVA School of Law/ NOVA Tax Research Lab Board Member

PART 1:

TAX & HAPPINESS

How the world should and can be

CHAPTER 1 - TAX & CITIZENSHIP: Tax Education Project

João Comenda António, Marta Carmo and Rafaela Cruz

Introduction

Education is a basic human right, recognized, for instance, in article 26 of the Universal Declaration of Human Rights, article 2 of the First Additional Protocol to the European Convention of Human Rights and article 14 of the Charter of Fundamental Rights of the European Union. However, Tax Education is often an unknown concept and therefore one could question why it is even important.

Therefore, it is of essence to clarify that tax education can be a State policy that has as main goal to promote an active citizen participation, in which taxpayers are aware of their rights and obligations (Lopes, 2011, p. 25). Additionally, another goal is to provide tax knowledge, which "(…) *includes a range of aspects, from the practicalities of how to file a tax return, through to an understanding of the links between tax and public spending. It also includes knowledge of different tax types, how they are collected, taxpayers' rights, and how to navigate any appeal system*" (Mascagni, no date). Finally, it is also worth noting that tax education does not occur only in the educational system context: it can (and should) occur in the daily communication and relations between citizens and tax administrations and also in the context of public and private initiatives in physical and virtual means (OECD, 2021, p. 14).

Consequently, this is the context through which this paper intends to develop the theoretical framework for the Tax Education project that Nova Tax Research Lab is currently developing[1], having in mind the promotion of tax citizenship (and, consequently, tax compliance, can be defined as the "*Degree to which a taxpayer complies (or fails to comply) with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner.*"(OECD, no date)).

For that purpose, our paper starts by analyzing how tax education improves tax morale, tax ethics and citizenship, by raising awareness of everyone's social responsibility to reach common goals, by the improvement of voluntary compliance and tax knowledge. Subsequently, we explore the individual motivations for tax (non-)compliance and how tax education diminishes the weight of psychological compliance costs. Furthermore, we develop the role of States in building confidence in the administrative machine and improvement of cooperative compliance, namely by promoting such tax education in the relationship between the tax administration and taxpayers. Finally, the first chapter elucidates how tax fraud, tax evasion, aggressive tax planning can be minimized through tax education and ethic improvement.

Afterwards, our second chapter explains how tax education should be a way towards the increase of awareness of taxpayers' rights. This balance in tax education is commonly disregarded, but it is extremely important to explain rights and make them part of active citizenship (not only duties and obligations) since a balanced view of the tax relationship improves voluntary compliance. We explain how tax authorities should also have an active role in tax education of the citizen due to the principles of cooperation, transparency, good administration, public service and information, including on taxpayers' rights. Additionally, the Tax Education promoted by NGO, academics, and civil society is also put in this context.

Finally, we explain how Tax Education has a significant contribution to democracy, due to the connection between an active exercise of the right to vote and the fundamental duty to pay taxes, as a result of the social contract. Therefore, it is also shown that tax education is essential to the fulfilment of the principle of no taxation without representation. Lastly, we explore the link between the exercise of the right to vote and tax compliance.

1. Tax Education as a tool for Tax Morale, Tax Ethics and Citizenship: improving Voluntary Compliance understanding Taxes

1.1. What motivates individuals to pay – or to not pay – their legally due tax liabilities?

The motivations that lead a taxpayer to comply or not comply with his/her tax obligations may be difficult to determine. However, the consequences of generalized non-compliance are not so uncertain: less state revenue for countries (namely to develop their policies and economy) leads to a lack of improvement in population welfare.

Thus, the answer to why is necessary a strong tax education for taxpayers becomes easy to foresee: more tax compliance means more resources are available to develop a country. The debate is no longer whether we should pay taxes, but how are our taxes being used. In these terms, with tax education, taxpayers understand where their taxes go and why should they pay, and consequently compliance rates will be higher, as well as the contributions to the overall wellbeing of a community (OECD, 2021).

It is often said that the only things certain in life are death and taxes (Franklin, 1817, p. 266). Notwithstanding, while the first is impossible to escape, individuals tend to create mechanisms to pay the lowest (or none!) possible amount of taxes. But after all, why do individuals have such an attitude? Why are certain individuals' tax compliant while others are more careless and try to not comply with their tax liabilities?

The answer to these questions is not simple, as each individual is different from the others. Still, there are certain indicators and studies that help to understand the motivations for the (non) compliance of their tax liabilities. In fact, compliance or non-compliance may vary with an individual's age, gender, level of tax knowledge, economic status, religion or even culture. Similarly, an individual's motivation to comply may result from their moral standards, such as guilt and shame, as well as from a perception that the tax system is balanced and fair (Louro, 2014, p. 6).

An attitude of tax compliance depends fundamentally on the individuals' predisposition to pay their own taxes, as well as their knowledge regarding their tax obligations and how to comply with them (Lopes, 2013, p. 13826). Thus, non-compliance can be of two types: (i) voluntary non-tax compliance and; (ii) involuntary non-tax compliance. Although the concepts are different from a theoretical standpoint, the consequences are the same from a practical one: reduction of the amount of tax due that is effectively paid.

Even so, the literature is unanimous in stating that individuals increase their tax compliance when they know how their taxes are directly allocated, as well as when they are in favor of the respective public sector

spending programs, in which they voted. In contrast, non-compliance is higher when individuals have no control over the use of their or when it is used for public goods that they not approved or voted (Alm, 1993, pp. 287-288).

On the other hand, the tax administration itself creates mechanisms to increase compliance, namely with programs and reward systems for taxpayers who comply with their tax obligations[2].

Nevertheless, sometimes non-compliance does not arise from individuals' malice, but only from the complexity of tax legislation, which often makes them not even aware of their tax obligations or simply lose interest in understanding the tax system because they believe that it is not within the scope of their understanding (Lopes, 2013, p. 13830). This example is even more evident at the time of submitting tax returns when individuals often do not know how to fill them correctly. But even in these circumstances, their incorrect filling does not necessarily lead individuals to pay less tax, as they are often not aware of the applicable mechanisms that will be more favorable.

From another standpoint, it will be easy to conclude that individuals pay their taxes because are afraid of being caught and fined for their incorrect compliance with their tax liabilities (Alm, 2019, p. 5).

Even so, taking into account that in most legal systems the penalties for convictions for tax infractions are small, as well as the tax audits carried out are few, we could be led to think that most individuals would be reckless at the time of compliance. However, although this could be a "*chronicle of the announced tax evasion*" this will not be the practical reality, since the number of people who comply with their tax obligations is clearly higher than those who do not comply (Posner, 2000, p. 1782).

Thus, there is no way to conclude why individuals comply with their obligations or not. For some, what should be compliance based on a purely on what is correct, for others, non-compliance will be justifiable as a demonstration of disagreement with a particular tax policy. The *Homo economicus* is like a boat without a sail: it never knows which direction the wind will take it.

In this sense, increasing taxpayers' tax literacy is crucial if they are to shape their behavior so that they comply and want to comply with their tax obligations.

Thus, tax education will lead taxpayers, to learn how to comply so that their tax obligations in order to pay their taxes as low as possible, as well as how to avoid submitting late returns and avoid any necessary fines. By knowing more about their tax obligations, they will be encouraged to comply more often and in the most correct way possible. In short, taxpayers who have a good tax education, not only will comply with their obligations but also will participate more actively in the community, and pass their tax knowledge and become an agent for the dissemination of tax knowledge (OECD, 2021).

1.2. The weight of psychological compliance costs

Psychological costs can play in the analysis of the determinants and factors associated with compliance costs and the level of tax compliance. These costs relate to the anxiety, worry and nervousness incurred by taxpayers in the tax compliance process. Much of this psychological effect arises because taxpayers do not know how to properly complete their tax returns or how to pay their taxes, creating a sense of unfairness. In this sense, the taxpayers who incur psychological costs, in particular, the elderly, retired and widowed, whose as they are the ones who usually have a lower tax education (Lopes, 2013, p. 13831-13832).

Taxpayers may have their emotions upset when it comes to complying with their tax obligations. In fact, they may feel anxious, worried or nervous about feeling that they do not know their tax obligations or how to comply with them and that this lack of knowledge leads to paying more than is supposed to. These feelings are most evident at the time of filing tax returns when feelings of frustration due to the complexity of tax procedures lead to concerns about possible tax inspections (Carmo, 2021, p. 289).

Added to this, feelings of injustice and dissatisfaction with the existing tax system may lead to the temptation for taxpayers to commit tax fraud or tax evasion.

Thus, it cannot be ignored that taxpayers have intrinsic motivations that drive them to comply with their tax obligations, and that exists a weight of psychological costs at the time of the decision to comply or to not comply.

As a consequence, tax education can also increase long-term tax compliance by boosting tax morale (and reducing anxiety) because it decreases the time people spend preparing tax returns and makes them less threatening (OECD, 2021). In fact, tax morale can be defined as the

taxpayers "*intrinsic motivation to pay taxes*" (OECD, 2019), *i. e.*, it is a collective attitude towards tax compliance and the respective motivations (Carmo, 2021, p. 291).

One way to combat these psychological costs is through new technologies in tax compliance, because in addition to allowing the taxpayer to comply more quickly and instinctively, it increases the efficiency of the administrative machinery itself (Carmo, 2021, p. 289).

Just bear in mind that the creation of mechanisms and software that allow taxpayers to automate and simulate some effects of the application of the laws, based on the information in their possession and the creation of more practical mechanisms for tax payment (Carmo, 2021, p. 296), helps to reduce taxpayers' stress as it becomes easier to understand how to pay and how much tax they owe.

In these terms, there is a major digital development in the tax field. The pre-filing of tax returns is a digital innovation, which is often accepted without question as a way to significantly reduce transaction costs when paying taxes, but it has the psychological effect of shifting errors from the taxpayer to the tax administration. Tax administrations are also encouraging online submission of tax returns. Pre-filling tax returns are very advantageous because it reduces taxpayers' compliance costs as well as tend to reduce errors and omissions. The most positive outcome from a revenue service point of view is that the taxpayer simply corrects the pre-filled information (Costa, 2018, pp. 16-20).

These are initiatives that, taking advantage of the development of new information technologies and confidence in the fiscal machine, improve compliance with the tax law and improve efficiency by affecting the ratio of costs and tax revenues, reducing the psychological costs for taxpayers.

1.3. The role of States

1.3.1. Confidence in the State and the administrative machine

The best way for States to promote taxpayer compliance is to generate a sense that the tax administration is in "good shape". This perception is only achieved when the taxpayers themselves demonstrate an attitude of trust towards the tax authorities, which is only achieved when States themselves invest in the tax education of their taxpayers. The State, by promoting a fair and transparent system, expects taxpayers to be more inclined to tax compliance, thus fostering tax morale.

To improve tax morale and thereby to increase confidence in their administrative machine, states can take a number of steps, namely engaging with taxpayers. In fact, states can engage with taxpayers through outreach and education programs, as well as through cooperative compliance initiatives that encourage collaboration and mutual trust between tax authorities and taxpayers. In addition, a simple legislative framework should be combined with accessible procedures that guarantee taxpayers better and faster compliance with their tax obligations. For there to be trust in the administrative machine, it is necessary to pursue the public interest, with respect for the legally protected rights and interests of citizens, in compliance with the principles of equality, proportionality, justice, impartiality and good faith[3]. Thus, in the exercise of the administrative activity and in all its forms and phases, the Public Administration and the individuals shall act and relate according to the rules of good faith.

In addition to others, the Tax Administration will also have to respect the general principles of law, including the principle of good faith, by means of which the administrative body or agent is prevented from acting with deceit or any other means in order to mislead the private individual. The duty to act in harmony with the principle of legality is not merely formal subordination to the rules which specifically provide for the action of the administration, but also includes the duty of the administration to take into account the practical consequences of the administrative activity it carries out. Therefore, the tax administration must refrain from implementing legal provisions when, in the light of the particularities of the case, there are no reasons of public interest which justify its action or when a manifestly unfair result is produced, and must, in any case, when restricting individual rights, limit itself to what is strictly necessary to ensure the purposes it pursues, not treating the persons subject to tax in a discriminatory manner or frustrating the expectations that its action has generated in them[4].

In the same way, a good relationship between taxpayers and the administrative machine contributes to greater voluntary tax compliance. It is crucial that the tax administration is close to the taxpayer and that the latter does not feel that the administrative machine is distant and inaccessible.

In this way, the creation of an “oiled machine” in which taxpayers feel that the taxes will be applied in a manner that they themselves approve, as

well as the simplification and clarity of the taxation mechanisms, will make taxpayers more likely to comply with their tax liabilities.

For a cooperative relationship between tax administration and taxpayers, it is essential to promote tax procedures, whose interpretations are clear, allied to simplified inspection mechanisms, which help to balance tax administration interests with the taxpayers' guarantees. The taxpayer should feel close to the administrative machine, verifying that the tax administration easily ensures the availability of necessary and adequate information to comply with their tax obligations, as well as, when in doubt, the taxpayer feels the existence of adequate assistance to comply with their obligations (Pires, 2013, pp. 258-259).

Therefore, it is fundamental that the taxpayer, when faced with a specific case, has the possibility to submit his/her doubts to the tax administration and obtain an answer, which is binding in that specific case. This constitutes a guarantee that the taxpayer has instruments at his/her disposal that allow him/her to prevent conflicts.

On the one hand, an electronic tax administration presents itself as a benefit for the direct relationship with taxpayers. In fact, a fully globalized tax administration, available 24/7, giving the taxpayer, without relevant costs, the possibility to comply with their obligations at any time, at any place, will be a relevant way to promote tax compliance.

In addition, the creation of mechanisms such as instalment plans, or the possibility of settling unavoidable conflicts with the tax administration through extra-judicial means, such as arbitration courts, will incentive taxpayers to comply with tax obligations (Pires, 2013, p. 262).

1.3.2. Cooperative compliance: relationship between the tax administration and taxpayers

Traditionally, the relationship between tax authorities and taxpayers is seen as one of conflict, in which both parties fight and distrust each other. In fact, the relationships between them are crucial for the proper functioning of a tax system in a country. These relationships depend not only on tax legislation and legal procedures but also on cultural, sociological as well as historical elements (Bronżewska, 2016, p. 5). It is in this situation that a relationship and cooperation should exist so that the fulfilment of tax obligations is done quickly, correctly and without distrust.

Thus, cooperative compliance may be described as the creation and development of a relationship between the taxpayer and the tax authority or tax administration based on trust and co-operation from both parties in order to achieve the highest level of voluntary tax compliance and certainty (Iris Tax and Customs, 2023, p. 4). In fact, such concept represents as a voluntarily enhanced based upon mutual increased transparency, cooperation and collaboration.

This principle is a practical development of the principle of collaboration, and therefore of good administration of the tax machine.

Revenue bodies should know that to be in control of tax situations, they should control the consequences of all processes and transactions and not only of tax processes. Therefore, there should be a "Tax Control Framework" (TCF) on the part of taxpayers that allows for internal control of all these variants by the administrative authorities. Thus, taxpayers that are transparent with these plans and comply with the requirements of the TCF can be identified as taxpayers with a lower risk of non-compliance (OECD, 2013, p. 59).

In this regard, tax education helps taxpayers to know and understand his/her tax obligations, and the best way to comply with the law. The best way to promote such education may include, *inter alia*, online resources, and guidance from tax authorities, or simply the guidebooks drawn up by the tax authorities themselves. Access to a clear and accessible information about their tax obligations, tax education can help to promote voluntary compliance and reduce errors or intentional non-compliance. In addition, tax education can also help ensure that taxpayers have the necessary expertise to engage in cooperative compliance activities, such as risk analysis and early engagement. By empowering taxpayers to participate in these activities, tax education can help to encourage a better collaborative relationship between tax authorities and taxpayers.

Thus, faced with an increasingly competitive tax environment at international level, each state is seen as providing a package of services that may or may not be attractive to a particular taxpayer, which leads them to settle in the state that best suits their tax needs. This competition between states has brought new international cooperation standards in tax matters, especially focused on transparency and exchange of information. The rapid development of these parameters has already established the automatic exchange of tax information, including financial transactions to

be reported between jurisdictions. The taxpayer will have to answer for the fight against tax evasion and loss of revenues jointly by several tax authorities (Almeida, 217, pp. 59-62).

The ultimate goals of this cooperation are therefore to raise more revenue for public investment by the administrative machine; and to obtain a greater profit or a lower amount of tax to be paid by taxpayers.

1.4. Tax fraud, tax evasion, aggressive tax planning and ethics

Everyone is free to organize his/her tax situation so that pais his/her taxes as low as possible, always within the legal framework. No one is obliged to pay more, just because that would represent greater revenue for the Public Treasury. For instance, a close look over the tax benefits shows that sometimes the own administrative machine intends to model behaviors, attributing, in principle, a lower tax burden without this being illegal or even immoral.

However, the nature of tax rules and their complexity allows that sometimes taxpayers' behaviour to be outside the scope of the tax rules. Thus, although in most of the cases a particular tax minimization opportunity complies with the law, more aggressive attempts to reduce taxes involving the abuse of the law itself, or the creation of artificial mechanisms to achieve these goals, may (and must be!) challenged by tax authorities[5].

Thus, we are faced with a situation of tax evasion when existing loopholes in tax legislation are exploited with the aim of reducing the burden on the taxpayer to a minimum, although this is not necessarily illegal (Sá, 2013, p. 25). Acting within the perimeter of tax evasion allows taxpayers to reduce the risk of being sanctioned and provides a sense of legal compliance.

On other hand, we faced a situation of tax fraud where we are dealing with behavior that directly results in a violation of the law and results in an illegal reduction of the amount of tax payable. In this behavior, the main concern on the part of the taxable person is that their acts are identified by the tax administration. The detection of this behavior by the competent authorities implies the application of a sanction of an administrative or criminal nature, in addition to the obligation to deliver the tax that should have been paid.

In short, we can say that both practices result in the reduction of the amount of tax paid by taxpayers and the non-compliance with the principle of equality and tax justice. Tax evasion may be perceived as being legal and moral, associated with the intention of reducing the payment of taxes and, thus, understood as an intelligent idea on the part of taxpayers. Tax fraud is understood as being illegal and immoral and is related to the concepts of criminal activity and risk.

Tax education can also play an important role in reducing tax fraud, tax evasion, and aggressive tax planning by increasing taxpayers' awareness and understanding of their tax obligations and the consequences of non-compliance. For instance, tax education can raise awareness about the importance of compliance and the potential consequences of non-compliance, such as penalties and legal action. This can deter taxpayers from engaging in fraudulent or evasive behavior.

On other example, tax education can promote voluntary compliance by helping taxpayers understand their obligations and how to comply with the law. When taxpayers have the knowledge and skills to comply voluntarily, they are less likely to engage in fraudulent or evasive behavior.

Overall, tax education can help to reduce tax fraud, tax evasion, and aggressive tax planning by promoting voluntary compliance, encouraging early engagement, building trust, and supporting cooperative compliance. By providing taxpayers with clear and accessible information about their tax obligations, tax education can help to foster a more compliant and effective tax system.

2. Tax Education in the perspective of taxpayers' rights: raise awareness of citizens' rights and obligations

2.1. Tax Authorities and their role in tax education of the citizen: the principles of cooperation, transparency, good administration, public service and information.

Cooperation in this context can be defined as the collaborative behaviour of public administration in its relationship with the citizen. It is frequently a statutory and constitutional duty of administrative entities in several states.[6] Here we should recall that cooperation is of essence in the context

of taxpayer compliance (v. *supra* 1.1.3.2), improving the relationship between Tax Authority and Taxpayers[7].

A Tax Authority that fulfils its duties of cooperation and good administration should provide public, regular, and systematic information not only on taxpayers' obligations but also on their rights. This implies delivering the necessary assistance to the fulfilment of any obligations and also the duty to inform the taxpayer regarding their rights during such fulfilment. In this way, the degree of effective cooperation makes it possible to foresee the symbiosis between the taxpayers' rights and the respective degree of tax compliance (Carmo, 2021, p. 291). Indeed, taxpayer education also includes practical assistance provided by tax authorities, in their role of supporting taxpayers directly in their compliance obligations[8].

Since tax education should promote awareness of citizens' obligations, a Tax Authority acting in good faith tries to increase such awareness instead of just controlling taxpayer compliance. The behaviour in good faith increases the confidence in the State.

In addition, the average taxpayer does not know neither understands her/his rights and obligations[9], while the main focus of attention of tax legislators, authorities and international organizations has been the fight against aggressive tax planning, tax fraud and tax evasion (increasing the risk of States and international actors of overlooking their duty to protect fundamental rights). In fact, the current tax environment has led to a mutual distrust feeling[10]. Notwithstanding, if the Tax Authorities try to raise awareness also of the citizens' rights, it will also increase the confidence in the State because the citizens will trust that such authority is acting in a transparently and actually providing them with a public service, guided by the legality principle.

Actually, one way for the Tax Administration to act transparently, fully supporting and respecting taxpayers' rights, is to declare them in formal documents, such as administrative taxpayer charters or even in the legislation of the countries. In practice, some of those charters may also reflect a Tax Administration's view of service delivery (e.g. services are comprehensive, accessible, fair and timely) and its view of performance standards in general (Alink and Kommer, 2016, p. 224)[11].

Furthermore, one cannot forget that tax education can be accomplished in different manners, i.e., not only through workshops and formations *stricto sensu*, but also through the publication of schedules, leaflets and

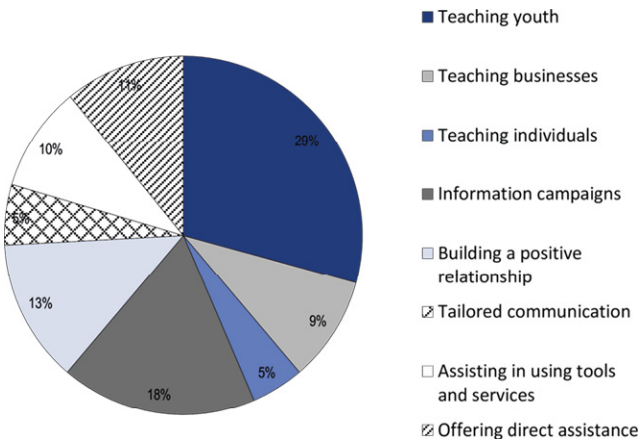
newsletters, manuals, guides, newsletters, models for compliance with ancillary obligations, forms and minutes, or other types of rights and obligations etc.

Finally, by Tax Authorities we should take for these purposes a broad view, including other public initiatives of tax education, such as TAXEDU and other examples. One initiative is "TAXEDU", from the European Parliament, the European Commission and National Tax Authorities, to promote the tax citizen and education available at https://europa.eu/taxedu/home_en (accessed 15 November 2022).

There are also similar national initiatives. An example of a national initiative is the one from the Portuguese Tax Authorities, which has a tab dedicated to tax citizen and education on its website, with materials aimed at children and young people (books, leaflets, videos, games, etc.). They also work with other public entities on tax education projects and in other civil society initiatives to promote tax citizenship. Lastly, it also has materials for adult taxpayers, with a virtual exhibition on tax education and a book with essential notions about taxes (which also includes a chapter on taxpayers' rights and guarantees) (Carmo, 2021, p. 294).

Although many governmental programs are undocumented or had impact evaluation, there are many tax authorities engaged in tax education initiatives, from school initiatives, information in rural areas, radio programmes, songs, social media videos and even tax-themed soap operas, in Argentina, Brazil, Chile, Colombia, Colombia, Estonia, Guatemala, Israel, Italy, Ivory Coast, Jamaica, Japan, Malaysia Mauritius, Mexico, Morocco, Peru, Romania, South Africa, Spain, Turkey, USA and Zambia, among several others[12]. Additionally, it is worth to note that with Covid-19 pandemic, there was in general an increase of online presence, namely online channels and social media campaigns, but also TV and newspapers and other traditional media[13].

It is worth to note the OECD classification of tax education initiatives from tax authorities and the distribution of the same, concluding that the most frequently used types of initiatives per category are teaching youth to share knowledge about taxes and tax systems, information campaigns to communicate on tax, and offering direct assistance to make taxpayers' life easier, as the following figure shows[14]:



2.2. Tax Education promoted by NGO, academics, and civil society.

Tax Education can be promoted not only by the State but also by other entities, such as NGO, academics and civil society in general.

The role of other entities is essential because they may act as a translator, making tax knowledge accessible from the point of view of the language itself but also on the availability of such information, by adapting it to different target audiences. In the same manner, it is a form of training and enabling such tax literacy[15]. Civil society organizations will, in principle, have taxpayer education objectives different from the tax administrations' goals. Even if they aim to improve voluntary compliance, they will probably have as their main goal to allow ordinary citizens to know tax issues well enough to allow them to ask the right questions about the functioning of the tax system in order to hold the State accountable or to properly exercise their rights, as an important part of the social contract. However, this should not only include NGOs and academia, or civil society in general but also companies and business associations themselves, who can play a valuable role in educating taxpayers, especially for small and medium-sized enterprises, who often do not have access to tax information or because they belong to specific niches[16].

An example of an NGO that promotes Tax Education is Tax Foundation, a North-American think tank created in 1937, that develops research on federal, state, and global taxation. On its website, one can found "TaxEDU"[17], a section dedicated to promoting tax literacy across the American society, by providing several educational resources like classroom materials to be used by teachers, a glossary, crash courses (including to lawmakers), videos and podcasts. Even private entities can and should

promote tax education. An interesting example of that is Kidzania (a private chain of indoor family entertainment centers, where children perform tasks of several professions and activities) in some countries, in which children can pretend to work at the national tax authority and learn the importance of taxes for the society (Alink and Kommer, 2016, p. 536)[18].

This is the context in which the Nova Tax Research Lab is developing its Tax Education project[19], in which this knowledge centre established in the Center for Research & Development on Law and Society (CEDIS) of NOVA School of Law tries to fulfil with its obligation to civil society[20]. Targeting young audiences, through an Instagram account, the project tries to clarify the importance of taxes and how they work, in a simple, clear and fun way in the Portuguese context. In this manner, the NOVA Tax Research Lab intends to contribute to a change of culture based on the equitable distribution of the tax effort and on the achievement of tax justice, as well as to mitigate, through education, aggressive planning, and fraudulent tax practices. The aim is also to stimulate the effective participation of young citizens in the public decision-making process in the tax area, contributing to the full exercise of citizenship, fighting back the supposed youth detachment from democracy and its superior values.

2.3. Tax Education as a tool to raise awareness of taxpayers' obligations but also taxpayers' rights[21] – balanced view of the tax relationship

2.3.1. The balance and the improvement voluntary compliance

Fiscal citizenship confers legitimacy to taxation, by the consolidation of taxpayers' rights to control public expenditure as a form of State accountability, as well as the knowledge of the obligations and responsibilities of each citizen (a bidirectional relationship), promoting the satisfaction of the fundamental duty to pay taxes. However, the exercise of such tax citizenship (in a democratic context) requires the creation of political and administrative conditions, so without tax education it will not be possible to improve citizens' tax awareness, allowing them to make more rational decisions (Santos, 2018, pp. 15–16).

Therefore, it is extremely important to note that taxpayers' obligations taxpayers' obligations and means available to Tax Authorities should be taught to the society in general. However, it is frequent that tax education is only focused on taxpayers' obligations while taxpayers' rights are

completely disregarded. Indeed, there is a common effort in several State to improve tax education, but the focus has been on the financial importance of taxes and encouraging voluntary compliance. In most projects, one can find none or few references to taxpayers' rights (or, in some cases, the rights mentioned are the citizens' right to participate in the democratic process – not the taxpayer's rights in the specific tax relationship with the administrative authorities). A notable exception is the already mentioned EU project "TaxEdu", in which there is an emphasis on the need to raise awareness of taxpayers' rights, including improving tax compliance (TaxEdu Editorial Team, 2022)[22].

Furthermore, such balance is of essence to diminish the already mentioned psychological costs (v. *supra* 1.1.2): indeed, for a taxpayer to fulfil her/his duties, she/he has to know them. On the other hand, a taxpayer who is aware of her/his rights[23] will have much lower psychological costs, as she/he will be more confident and safe about adequacy and correction of her/his tax behaviour. Therefore, it also promotes the predictability and legal certainty for taxpayers. In addition, the protection of taxpayers' rights favours tax morality by conferring greater moral legitimacy on tax legislation and administration (Carmo, 2021, p. 292). In short, a context that truly promotes voluntary compliance undeniably must take into account the guarantees perspective, i.e., the safeguards of taxpayers' rights and freedoms, as this is the only way we will have a "friendly tax environment" (Pires, 2013, p. 258).

Educating the taxpayers about their rights and obligations is even more important in the current context, in which tax complexity is constantly increasing. Indeed, taxpayers' responsibilities have increased with more complex tax systems, anti-avoidance rules of greater scope, more disclosure obligations, and a constant change in tax legislation. Unfortunately, "*Those responsible for drafting tax legislation have not often seen a benefit to recognising additional rights of taxpayers. Quite the reverse seems to be true*"[24].

Taxpayer education benefits taxpayers themselves at the scale of society, but also more directly. Tax literacy can help people save money through knowledge of the tax system and the substantive and procedural rights that are provided by such system. They can learn, for instance, through which tax provisions that may legitimately reduce their tax assessments or how to comply correctly and timely. However, this knowledge makes obligations financially, temporally, and psychologically lighter in the long term,

increasing tax morale, because tax literacy reduces costs, time and fear that tax compliance implies[25].

2.3.2. Taxpayers' rights as fundamental rights of citizens in democratic societies

A taxpayer will only have her/his status of citizen completely respected if she/he has awareness of the obligations resulting from such status, but also if her/his fundamental rights as taxpayer are completely respected. Indeed, If citizenship is the free exercise of a citizen's civil, political and social rights and duties, to exercise citizenship it is necessary to be aware of one's rights and obligations (Pereira, 2014, p. 5).

Naturally, the promotion of tax education allows for greater tax awareness, and the connection between tax civility and citizenship must be made, with the inherent consequence of greater compliance. However, as António Carlos dos Santos puts into evidence, "*(…) Tax Law itself does not recognize citizens, but taxpayers or (curious language that evokes a Freudian lapse) taxpayers. He is more interested in being a resident (or non-resident) than being a national or citizen of a certain State. At the supranational level, European law recognizes overlapping partial citizenship, but it does not recognize the European taxpayer. The notion of tax citizenship does not therefore belong to the lexicon of Tax Law or Public Economy*" (Santos, 2013, p. 13)[26]. The author goes on to note that fiscal citizenship is only evoked in the political lexicon to legitimize compliance with the fundamental duty to pay taxes.

A democratic society that follows the rule of law and the principle of human dignity cannot see taxpayers as simple subjects with fundamental duty to pay taxes (along with any other duties and obligations as taxpayer): taxpayers should also be entitled to fundamental rights, and such rights should be fully respected by the State. In fact, the dignity of the human person is an essential principle for guaranteeing the rights of citizens, including their role as taxpayers.

Consequently, in the context of a relationship of typical conflict such as the tax relationship it will be possible to prevent fiscal authoritarianism, in which the supremacy of the public interest and tax power favour a distorted objective of taxation at any cost, concerned exclusively with collecting revenue and tax compliance. The improvement of this relationship in a democratic context, with a focus on the bilateral flows of the same (i.e., not only the fundamental duty to pay taxes but also the taxpayers' fundamental

rights) and the social contract will promote greater respect for transparency and fiscal citizenship, in addition to greater legal certainty (Neto, Gassen and Arabi, 2017)[27]. In fact, the principle of no taxation without representation is one of the main example of how taxpayers' rights are connected with democracy and, notably, the social contract.

A limited tax knowledge and awareness is problematic since it has a strong negative impact on taxpayers' perceptions of the fairness of tax systems, which leads to hesitant citizens, who do not take part in advocacy, fearing the economic, political, or social repercussions of such engagement (Boogaard, no date). In a democratic rule of law, guided by the principles of equality and human dignity, tax laws cannot be addressed only to a privileged group of people, able to understand them: every taxpayer has, or should have, the right to understand what is required of him without the need for an intermediary to decode the hidden meanings in tax laws, as this is the only way he can be a citizen who is fully aware of his tax rights and obligations[28].

On the other hand, an increase in tax education, including on taxpayers' rights, makes tax relationships more transparent and therefore enables active citizens to demand more fairness, equity, good faith, and accountability from the State[29]. Indeed, an appealing, simple, efficient, effective, and equitable tax system from a formal perspective will only be so in a democratic context if the taxpayer and the Tax Authority act within a tax ethics framework, promoted by tax education, as an essential step towards the humanization of taxes.

3. Tax Education and its contribution to Democracy: the interlink between an active exercise of the right to vote and the fundamental duty to pay taxes

Being already established the link between Citizenship and Taxation, it is clear that to think of tax citizenship is to think about the rights and duties that come with it. To be a citizen is to be a person who lives in a societal structure funded by public expenditure. In turn, this public expenditure is funded by taxes.

The right to vote and the duty to pay taxes are both important civic responsibilities in a democratic society. The right to vote is an active exercise of democratic citizenship, allowing individuals to have a voice in

the direction of their government and the policies that affect their lives. On the other hand, paying taxes is a fundamental duty that helps to finance the government and its programs, including those that provide basic services and protections to citizens. Both the right to vote and the duty to pay taxes are essential components of a functioning democracy and are necessary for a healthy and stable society.

It is often said that taxpayers have a fundamental duty to pay taxes[30]. To comply with this duty is often voluntary. Could there be a link between the active right to vote and voluntary compliance with the duty to pay taxes? How can we expect taxpayers to voluntarily comply with tax laws if they don't have a proper understanding of taxation in the first place?

3.1. Taxation without representation

When discussing this matter, the slogan "no taxation without representation" comes to mind. Throughout history it became one of the principles of taxation. At the time that it emerged it was linked with property rights, in the early beginning of what we know today as the United States. Those who had property were stakeholders in Democracy. Why? Because taxation affects, first and foremost the right to property.

As mentioned by Vanistendael (2017, p. 444), taxation has played a significant role in historic democratic events, namely the Magna Carta, the Boston Tea Party and the French revolution. Indeed, the effects of taxation in democracy was an important matter for French revolutionists to the point of including the following tax principles in the Declaration of the Rights of Man and of the Citizen (1789) : *"(1) taxes, including the determination of the rules concerning the rates, base, collection procedures and duration, can only be introduced with the direct consent of the citizens or their representatives; and (2) tax burdens must be distributed equally among citizens in accordance with their ability to pay"*.

Currently, those same principles remain pillars of taxation. However, it has been clear that taxation has no longer been seen as a pillar of Democracy, but instead as a burden on those who cannot evade it. Tax evasion has become a central topic of discussion of taxation in a globalized economy.

Nowadays those with adequate resources and movable sources of income can choose where to invest, create a business, or simply collect passive income, often, taking advantage of a beneficial tax regime.

Notwithstanding current efforts to change this scenario and to ensure the taxation of residents for their worldwide income, states have turned to those who cannot shift their income to other jurisdictions. Local businesses, and workers tend to support the majority of the tax burden through income tax.

Allingham and Sandmo (1972, p. 324) and Srinivasan (1973, p. 345) assumed that the decision to evade taxes results from a rational choice of taxpayers by evaluating the costs and advantages of compliance with the anticipated utility of evasion. This is a choice performed under uncertainty. The act of avoiding taxes is not directly punishable, i.e. there isn´t a direct consequence between not paying the taxes due and being punished. The latter will depend on the direct intervention of tax authorities. Essentially, the decision to comply with the tax obligations by taxpayers could be narrowed down, in most part, to 4 factors: (i) the level of actual income, (ii) tax rates, (iii) audit probabilities and the (iv) magnitude of fines.

Throughout the decades that followed these landmark papers, many have tested and reviewed these factors. Notably, Kircheer, Muehlbacher, Kastlunger and Wahl (2007, p. 20) summarized the various studies published throughout the years and explained the deviations from the initial model.

However, it became clear, that an economical approach would not suffice to understand tax evasion, since there were several empirical contradictions between the studies analyzed. The authors concluded that "*the problem of tax compliance seems too much complex to be explained by a pure economic approach*". We agree.

As such, the purpose of our research is to analyze one of the factors which has been neglected by scholars when discussing motivations for tax compliance on a non-economic approach: the right to vote, and on a broader perspective, the link between political rights and tax education. Could it be sustained that more informed citizens, demonstrate more active participation in democracy, though, namely, the right to vote?

3.2. The link between tax education and tax compliance

Several tax compliance studies have been conducted throughout the years, and although several factors that impact tax compliance have been identified, many questions have not been answered. For example, why do

countries with similar tax systems and reinforcement measures have varying levels of tax compliance?

Alm, McClelland and Schulze (1999, p. 143) introduce the notion of a social norm of tax compliance. Essentially, the decision of an individual whether to comply could rest on a final level, if the individual thinks that compliance (or non-compliance) is the social norm.

This notion of social norm is especially important when discussing policies to increase tax compliance. The idea of the authors is that this social norm is not stagnating and that, in order to increase tax compliance, fiscal policies should focus on ways to change the social norm. In the paper, it is argued that one of the ways to change this social norm is to vote on different aspects of the fiscal system.

Thus, the authors conducted a study, mimicking the main characteristics of tax systems worldwide, and giving the agents the choice to vote on different characteristics of the tax system in a group setting. It was observed that the compliance behavior at the individual level after the vote of the group is different from the tax compliance behavior before the vote.

Furthermore, the authors also observed that the social norm of tax compliance may be affected by communication within the group. It was noted that when the agents entered into "cheap talk" before the voting, it was more likely for them to vote on a higher level of enforcement. Moreover, it was also observed that after the vote, full compliance was reached. This was not the case when the vote on a greater level of enforcement was conducted without prior conversations. In this case, tax compliance was almost null.

At the individual level, it was observed that individuals typically vote in their interest, maximizing their payoffs, independently of the possible social consequences of their decisions.

Wahl, Muehlbacher and Kirchler (2010, p. 8) analyzed the impact of voting on tax payments. On an initial level, their conclusions follow closely the arguments presented above, that higher tax compliance can be obtained when taxpayers have the opportunity to vote, which could explain why higher tax compliance levels are registered in countries with direct and participative democracy.

Furthermore, it was also observed trust in the tax system impacts significantly tax compliance. This trust likely results from the perceived fairness of the tax system. Thus, in order to increase tax compliance, the

states should adopt policies that enhance the procedural fairness of the tax system, namely with policies that increase the participation of taxpayers but also by making the decisions on tax matters more transparent.

Transparency in tax matters refers to making tax decisions and information about those decisions publicly available and easily accessible. This helps to ensure accountability and prevent corruption. There are various measures that can be taken to increase transparency in tax matters, such as publishing tax laws, regulations, and guidelines, providing taxpayers with clear explanations of their rights and obligations, and making tax administrative decisions publicly available. Additionally, ensuring independent and impartial tax tribunals, providing opportunities for public input in tax policymaking, and conducting regular audits and investigations can also contribute to greater transparency in tax matters.

Several of these measures have been implemented by tax jurisdictions and international jurisdictions[31]. For the specific analysis proposed under this section, special attention should be given to the TAXEDU portal, with the aim of providing information on tax education and training activities for tax professionals, policy makers, and the wider public in EU. The portal aims to support the development of tax education and training activities across the EU and provide a platform for sharing best practices, resources, and information on tax-related education initiatives.

As detailed in the portal the objectives of the TAXEDU web-portal are to (i) "contribute to the fiscal education of young European citizens", (ii) "reduce tax evasion and fraud across Europe, through better information and education in this area" and (iii) "provide European citizens with information on the services and facilities that are made possible through tax (education, healthcare, etc.)".

It is our opinion that programs such as the ones described above, focused on tax education, are essential for the active exercise of the tax citizenship of the taxpayer. Through education and training, taxpayers can gain a deeper understanding of their tax obligations and rights, which can help to promote a more informed and positive approach to tax compliance.

Bornman and Ramutumbu (2019, p. 828) develop a conceptual framework of tax knowledge in order to assess tax knowledge as a factor influencing tax compliance. The authors explore the role of tax knowledge in the tax compliance decision, departing from established papers on the matters, and validating concepts such as that "*there is a significant*

relationship between tax knowledge and a positive attitude towards tax (…)" which *"can therefore change people's behavior towards being compliant with tax laws"* [Niemirowski, P., Baldwin, S. and Wearing, A. (2002), as cited by Bornman and Ramutumbu (2019, p. 826)].

Through the empirical analysis conducted, the authors differentiate between general tax knowledge, legal tax knowledge and procedural tax knowledge.

General tax knowledge refers to a broad understanding of the tax system and its underlying principles, as well as an awareness of the types of taxes that exist and the tax obligations of individuals and businesses. This includes an understanding of the tax legislation, regulations, and policies that apply in a given jurisdiction.

Legal tax knowledge refers to a specialized understanding of the tax laws, regulations, and policies that govern the tax system. This includes a deep understanding of the legal principles, tax codes, and case law that apply to various aspects of the tax system.

Procedural tax knowledge refers to the understanding of the processes, procedures, and rules that govern the administration of the tax system. This includes an understanding of how to file tax returns, pay taxes, and resolve tax disputes.

In summary, while general tax knowledge provides a broad understanding of the tax system, legal tax knowledge focuses on the legal principles that govern the tax system, and procedural tax knowledge focuses on the processes and procedures that are involved in tax administration.

It seems that when discussing a more proactive approach towards tax compliance, one should not limit the reach of tax education to a more general perspective of the tax system, but instead, specialized programs should emerge that further develop the procedural and legal tax knowledge elements.

3.3. Drawing a bridge between the exercise of the right to vote and tax compliance

Having established that tax knowledge leads to a more positive and proactive behavior towards tax compliance, it is important to now assess how tax education can directly engage taxpayers. The purpose of our study is to draw a bridge between tax education, the right to vote and tax

compliance. In essence, is a taxpayer who has been educated on tax matters, and who actively participates in democracy, more compliant?

This question is especially important in a country such as Portugal which has high electoral abstention rates [32].

The link between electoral abstention and non-tax compliance is complex and it is not possible to conclusively state that there is a direct correlation between the two issues. However, electoral abstention can be seen as an indicator of citizens' disengagement from politics and institutions, which may be related to tax evasion. In fact, a more disengaged and unbelieving society may be more likely to default on its tax obligations. Furthermore, the lack of trust in institutions can lead to a perception that public money is not well spent, which can reinforce the idea that there is no need to pay taxes. In summary, voter abstention may be a contributing factor to tax evasion, but more studies are needed to fully understand the relationship between the two phenomena.

However, it is important to note that the act of voting is not the only expression of a democratized tax system.

As Figueiras (2017, p. 6) suggests that the active participation of taxpayers in democracy, as a reflection of their role within the tax system, can be understood through other mechanisms rather than voting, namely (i) popular legislative initiative in tax matters, (ii) intensification of the participation in the legislative process in tax matters, and (iii) referendum on tax matters.

The first measure would allow taxpayers to present legislative proposals on tax matters. This popular initiative is already foreseen in Portugal's Constitution, although it was later specified that popular legislative initiative is not accepted when concerning tax or financial matters. The author suggests that this limitation should be removed and that it is not coherent to allow for different limitations on legislative proposals by elected representatives or taxpayers.

Furthermore, the author defends that when elaborating legislative proposals on tax matters, there should be intense participation in public discussion to assure that possible conflicts of interests can be settled before a law is passed. This would allow grant transparency to tax legislative matters, which would then, lead to a higher trust of the taxpayers in the tax system and thus, possible increasing tax compliance. This proposal follows

similarly the conclusions of Wahl, Muehlbacher and Kirchler (2019) mentioned above.

At last, a referendum on tax matters is proposed. It should be noted that according to the Portuguese Constitution, referendums on tax matters are prohibited[33]. This matter has been discussed in the doctrine thoroughly, with contrary arguments, mainly related, on one side, to the possible use of the referendum as a demagogic tool, and on the other side, the possible positive psychological effect of acceptance of the tax system (since the taxpayer contributed directly to its composition). The author presents a convergent opinion that, yes, the referendum should not be on a decision whether or not to tax, but instead, it could be decided on matters of tax compliance (i.e. deadlines to submit tax declarations) or, further down the line, the allocation of public revenues.

Furthermore, not to lose sight of our purpose with this paper, the mechanisms mentioned above will only obtain the desired results if the taxpayers are engaged, i.e., if there is a collective interest in the tax system, which from our analysis, may stem, mostly, from a cohesive tax education effort.

Conclusions

Tax education can be a powerful tool for promoting tax morale, tax ethics, and citizenship in several ways. In fact, with tax education, taxpayers will reduce the likelihood of unintentional non-compliance and increase voluntary compliance, thereby boosting tax morale. On other view tax education can also promote ethical behavior by highlighting the importance of paying taxes as a civic duty. In the same way, it can also help reduce tax evasion by raising awareness of the penalties and consequences of non-compliance. This can prevent taxpayers from engaging in illegal tax activities and it promotes a culture of compliance. Overall, tax education is an essential tool for promoting tax morale, tax, by increasing understanding, promoting ethical behavior, fostering a sense of citizenship, and reducing tax evasion, tax education can contribute to a more fair and effective tax system that benefits everyone.

It remains to be seen, however, whether the state itself and its administrative machinery are willing to encourage this fiscal moral and to be ever closer to the taxpayers, in order to lead to greater tax compliance.

Still, tax education is of essence to raise citizens' awareness of their rights and obligations, from a bilateral perspective. The tax authorities in a context of cooperative relationship and search for good administration of tax issues should provide an active, public, regular ad systematic manner such tax education to taxpayers. It can be achieved not only through workshops and formations *stricto sensu*, but also through a multitude of publications on rights, obligations, and compliance. Such behavior will also increase confidence in the State and consequently improve the desired cooperative compliance. Additionally, tax education can by promoted by NGO, academics, and civil society, often adapting the language and vehicle of information to different target audiences.

Furthermore, tax education must be more than just about tax literacy, realizing the destiny of tax revenue or the importance of tax compliance: it needs also to promote the knowledge of fundamental rights. Without such two-sided perspective, there is no chance to improve voluntary compliance because taxpayers will not feel secure nor rely on tax legal system. Finally, a democratic society, guided by the rule of law, fairness, and human dignity, demands taxpayers to be treated as citizens with fundamental rights.

The "translation" and dissemination of tax values and knowledge, including the balanced view of the tax relationship in a democratic state is the main goal of the Tax Education project that Nova Tax Research Lab is developing. Therefore, it could be interesting to analyze whether the audience of this project (i.e., social media followers) has changed their perspective on taxation or, in a more general way, how Portuguese taxpayers have perceived the tax legal system evolution.

Additionally, the link between exercising one's right to vote actively and the essential obligation to pay taxes in a democratic society is one that may be supported by tax education. People are better equipped to hold their government responsible for its tax policies and actions when they are informed about the role that taxes play in funding public goods and services. A more informed electorate may arise from this understanding, and a more informed electorate may produce policies that are more successful and make better use of available resources.

By making citizens more aware of the significance of paying taxes as a fundamental obligation to further the common good, tax education can also aid in the promotion of a culture of voluntary tax compliance.

Ultimately, tax education can help to strengthen the connection between the exercise of democratic rights and the fulfilment of fundamental duties, promoting a more just and equitable society. Notwithstanding, further empirical research should be conducted on these matters, namely, for example, the importance of tax education for marginalized groups, as a tool for equality.

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1. Information available at https://taxlab.novalaw.unl.pt/?page_id=1872.
2. In Portugal, the program "Fatura da sorte" ("*lucky invoice*") was created to reward the Portuguese taxpayers that request invoices for the purchase of goods or services. The prizes are Treasury Certificates, from the value of EUR 35,000 up to 50,000. This tax lottery was created to encourage taxpayers to request invoices with their tax numbers, as it allows the State to better control the financial flows: to know who pays to whom; how much they pay and; for what product or service. This control seeks to help combat tax evasion and the parallel economy – Cf. Decree-Law no. 26-A/2014, of 17 February and Ordinance no. 44-A/2014, of 20 February.
3. Cf. article 266.º of the Portuguese Constitution.
4. Ruling of the Portuguese Supreme Administrative Court of 26-10-1994, Case no. 17626.
5. By applying the anti-avoidance provisions, tax authorities may exercise their power to qualify legal acts and subsequently correct the tax base. These provisions also represent a way of putting into practice the principle of the prevalence of the economic substance over the form of legal acts or transactions.
6. In the Portuguese case, the so-called principle of collaboration with the citizens is established in article 11 of the Administrative Procedure Code and article 59 of General Tax Law, resulting from the good faith and confidence principles required by article 266(2) of the Portuguese Constitution.

Additionally, one should note that the Right to good administration is even a fundamental right established in article 41 of the Charter of the Fundamental Rights of the European Union, applying in the relation with the institutions and bodies of the Union. It includes, among other, the general principles of duty of care, fairness, legal certainty, legitimate expectations, participatory democracy and transparency. The principles included in such article have been derived by the Court of Justice from 'constitutional traditions common to the Member States', as acknowledged in Article 6 (3) TEU as well as in the Preamble and Article 52 (4) Charter. V. on this regard https://www.europarl.europa.eu/RegData/etudes/IDAN/2015/519224/IPOL_IDA%282015%29519224_EN.pdf (accessed 31 January 2023).
7. In this spirit, in 2016 the European Commission approved the Guidelines for a model of a European Taxpayers' Code (a non-binding instrument compiling a set of essential guiding principles for the balance of rights and obligations of taxpayers and tax administrations), focused on voluntary compliance, the fight against tax evasion, fraud and avoidance, and the consequent increase in tax revenues, and in which cooperative compliance is encouraged. This document is available at https://ec.europa.eu/taxation_customs/sites/taxation/files/guidelines_for_a_model_for_a_european_taxpayers_code_en.pdf (accessed 2 December 2022).

The European Commission continues to launch initiatives to protect and raise awareness of taxpayers' rights, having recently published the EU Taxpayers' Rights in the Single Market (Communication) (available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12626-EU-taxpayers-rights-in-the-single-market-Communication-(accessed 5 December 2022)), seeking, among other objectives, to help taxpayers meet their tax obligations, and also on the Rights of EU taxpayers – simplified procedures to improve compliance with tax obligations (recommendation) (available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12627-EU-taxpayers-rights-simplified-procedures-for-better-tax-compliance-Recommendation- (accessed 12 November 2022)).
8. OECD (2021), Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/18585eb1-en, (accessed 12 December 2022), p. 15.
9. In the same sense, stating that "*Taxpayers are often unaware of their rights and obligations*" - (OECD, 2021).

The International Centre for Tax and Development (ICTD) concluded that "the majority of citizens in Africa do not know what taxes they owe to the government or what tax payments are for" (Mascagni, no date)

10. About the need to change the current and traditional paradigm to a cooperative one, v. ALMEIDA, Carlos Otávio Ferreira de. "Compliance Cooperativo: Uma Nova Realidade Entre Administração Tributária e Contribuintes", in *Revista Direito Tributário Internacional Atual*, 2, 2017, págs. 58–82..

11. An example of administrative taxpayer charter is the Taxpayer Bill of Rights approved by the Canada Revenue Agency, available at https://www.canada.ca/content/dam/cra-arc/formspubs/pub/rc17/rc17-22e.pdf (accessed 10 January 2023).

An example of charter approved by legislation is the US Taxpayers Bill of Rights, stablished in the Internal Revenue Code § 7803(a)(3), available at https://www.law.cornell.edu/uscode/text/26/7803 (accessed 10 January 2023).

An example of a charter for the tax administration service delivery is the one issued by the South African Revenue Service, available at https://www.sars.gov.za/wp-content/uploads/Docs/ServiceCharter/Service-Charter-2022-Updated-23052022.pdf (accessed 10 January 2023).

12. V. e.g. https://www.ictd.ac/blog/taxpayer-education-research/ and OECD (2021), Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/18585eb1-en, pp. 42 and fl..

13. (Mascagni, no date) and OECD (2021), Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/18585eb1-en, pp. 112 and fl.

14. OECD (2021), Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/18585eb1-en, (accessed 12 December 2022), figure 2.3.

15. In this sense, v. e.g. (Boogaard, no date).

16. v. e.g. OECD (2021), Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/18585eb1-en, pp. 108 and fl.

17. Information available at https://taxfoundation.org/taxedu (accessed 05 January 2023).

18. See e.g. https://www.youtube.com/watch?v=FWKg3oHl6pg
https://guadalajara.kidzania.com/en-mx/pages/establecimientos-oficina-de-servicios-de-impuestos
https://www.nippon.com/en/news/yjj2020111100513/ (accessed 05 January 2023).

19. Information available at https://taxlab.novalaw.unl.pt/?page_id=1872.

20. Available at https://taxlab.novalaw.unl.pt/ (accessed 05 January 2023).

21. it should be noted that "taxpayers' rights" is the expression for rights as a taxpayer, i.e., in the juridical tax relationship, and not, more broadly, as a citizen in the relationship with the State. Thus, it is important to distinguish "taxpayers' rights" from "citizens' rights", even though the former are also essential for the democratic legitimacy of the Tax State, under penalty of violating essential principles of the democratic rule of law of which many taxpayers' rights are a corollary.

22. It also mentions the Commission plans' for a recommendation on taxpayers rights in the single market.

23. Such as rights of administrative or judicial appeal against tax assessment or other administrative acts issued by the tax authority, or simply daily rights, such as the right to obtain information regarding her/his rights and obligations, as well as her/his tax situation, that her/his data is protected by tax secrecy or that she/he may be assisted by a legally qualified professional.

24. (Cadesky, Hayes and Russell, 2016, p. 3).

25. OECD (2021), Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education, Second Edition, OECD Publishing, Paris, https://doi.org/10.1787/18585eb1-en, pp. 20 and fl.
26. (free translation from Portuguese).
27. As Clotilde Celorico Palma states, "*Without Education there is no Citizenship, and there is no Citizenship or Education without Morals. These are transversal dimensions that take on a particular meaning in the tax area. Underlying these concepts is, inevitably, a "contractual relationship" established between the State and the taxpayer, based on a social contract, on the construction of a life in society and on the fundamental duty to pay taxes*." (Palma, 2020, p. 2) (free translation from Portuguese)
28. In a similar manner, (Valente, 2017, p. 812).
29. V. e.g. (Boogaard, no date).
30. On this, v. (Casalta Nabais, 2004).
31. v. 1.2.1. and 1.2.2. for further examples of tax education initiatives, at a Portuguese and international level.
32. In the last presidential elections, the abstention rate was 42%. Portugal: Taxa de abstenção nas eleições para a Assembleia da República: total, residentes em Portugal e residentes no estrangeiro | Pordata (acessed on 1 November 2022)
33. Article 115 nº 4 of the Portuguese Constitution: "*the approval of laws relating to fiscal, budgetary, pardon and amnesty matters cannot be the subject of a referendum" (free translation)*

CHAPTER 2 – TAX COLLECTIVE WELLBEING: Linking Public Finances, Tax Management, Tax Communication and Sustainability

Ana Júlia Trindade, Pedro Ferreirinha and Sara Neto

Introduction

The relationship between taxation and collective wellbeing has long been a topic of interest for researchers and policymakers alike. As governments strive to balance their budgets, allocate resources, and promote sustainable development, taxes play a crucial role in achieving these goals, as it requires a complex and subtle interplay between budget execution, tax law, tax transparency and equity. Starting from this premise, this paper will explore the multilayered dimensions of taxation and its impact on social justice and collective wellbeing. Our work is divided in three key points. We begin by examining the impact of budget execution, control, and transparency on democracy perceptions. Firstly, we focus on budget execution, control, transparency and explore the impact of these factors on democracy perceptions. We then delve into the ways in which taxation can be used as a tool for achieving budgetary stability and sustainable development, including the strategies for bridging the gap between tax law and economic policies for an equitable taxation. Lastly, we analyze the implications of new tax technologies, such as universal basic income and robot taxation on tax equity and collective well-being. Finally, we argue that effective tax education is crucial for raising community awareness, promoting citizen conciliation with taxation, and developing a culture of social and intergenerational responsibility for the fulfilment of tax obligations. By examining the relationship between taxation and collective wellbeing, this paper aims to provide key insights and recommendations for policymakers and researchers to effectively design tax policies that promote sustainable development and enhance the wellbeing of citizens.

1. State budget execution, control and transparency, its impact on democracy perceptions

1.1. Beyond the balance sheet: exploring the philosophical relationship between state budget and public trust in democracy

Taxation and democracy stand in a reciprocal relationship. On the one hand, the democratic political process is a precondition for justified taxation[34] and contributes to the legitimacy of taxation (procedural element). On the other hand, taxation itself enhances credentials for democracy and reinforces the conditions for a factual realization of democratic practices within civil society (substantive element)[35]. The bidirectional relationship illustrates the position of taxation within social reality in general. Therefore, the tax system does not only reflect - as a symptom and an effect - the extant social circumstances, but it brings about social consequences, as a cause and transformative force[36].

The dictum *"no taxation without representation"* serves as one of the most distinguished constitutional principles referencing taxation. American colonists made the declaration famous while protesting against taxes imposed on them by the British parliament (whose members the colonists were not entitled to elect and where the colonists had no representation). By the middle of the 18th century, the core content of the principle had already become settled and almost notorious[37]. The bottom line of the demand was voiced with the clear articulation in John Locke's political philosophy: *"The supreme power cannot take from any man any part of his property without his own consent. Government into whatsoever hands it is put… can never have power to take to themselves the whole or any part of the subject´s property, without their own consent… Governments cannot be supported without great charge, and this fits everyone who enjoys his share of protection, should pay out of his state his proportion for the maintenance of it. But still it must be with his own consent of the majority, giving it either by themselves, or their representatives chosen by them. For if any one shall claim a power to lay and levy taxes on the people, by his own authority, and without such consent of people, he thereby invades the fundamental law of property, and subverts the end of government"*[38].

Furthermore, absolute arbitrary power, or governing without settled standing law, can neither of them consist with the ends of a society and government, which men would not quit the freedom of the state of nature

for, and tie themselves up under, were it not to preserve their lives, liberties and fortunes, and by stated rules of right and property to secure their peace and quiet [39]. The doctrine of tax neutrality prescribed that taxation should leave individuals in the same comparative standing in which they resided, in relation to each other, prior to taxation[40]. The same doctrine of equality was witnessed in reference to the fair allocation of tax burden, just as the public provision of goods was conceived to benefit evenly each member of a political community, the tax burden was also proportionally distributed between them[41]. The normative coupling of taxation and representation asserts a procedural condition for legitimacy. Justified extraction of revenues through taxation necessitates that those who are liable to taxes consent to their imposition and consent happens, in effect, through representatives[42].

According to Locke, government duties cannot be performed without spending, and taxes are utilized to cover the expenses, serving the fiscal purpose of financing the government. The confined function of providing for public goods and for most basic administrative tasks remained imperative for the teleological legitimacy of taxation for the subsequent two centuries. During this era, taxation allocated resources in a vertical relationship between state and citizenry but was not intended to reshape the relative economic standings between individuals in a horizontal dimension. The redistributive intention of income taxation bears particular relevance in the context of political citizenship, as the egalitarian allocation of resources is considered one of the cornerstones of political thought[43]. Therefore, taxation serves as an instrument for reinforcing the demand for relative equality in political power because differences in individual economic resources typically breed imbalance in interests as well as in opportunities for political participation, deliberation and influence[44]. Resembling the more overarching turn from formal interpretation of individual liberties towards the conditions of their factual realization, political participation also came to be understood in a more concrete and full-bodied fashion. As a result, taxation was designed to empower citizens whose market citizenship provided scant resources with which to realize their political citizenship through participatory and deliberative facets of democracy.

During the liberal period, taxes were predominantly based on the principle of equality, which focused on ensuring commutative justice in

taxation. However, the advent of the Welfare State marked a significant shift in tax policy, as the State began to adopt a more distributive approach to taxation, aiming to redistribute income within the political community. This marked a departure from the traditional *ad rem* taxes to more personal taxes, which consider individual factors such as the source of income and marital status of taxpayers[45]. The concept of implementing distributive justice through taxes is a relatively recent development in the history of political institutions, and largely stems from the underlying principles of the Welfare State. To support a system of distributive justice through taxation, it is necessary to analyze the requirements that this system must fulfill. First and foremost, the power to support a tax system must be in place, requiring fiscal sovereignty that enables the state to levy, rule out, narrow, or broaden the scope of taxes. Fiscal sovereignty is an essential feature of state sovereignty, and therefore, only states can exercise this power. Secondly, a political community is crucial to support taxation, as taxes represent an inherent expense of the community's existence. The solidarity required to justify individuals willingness to pay for public needs can only exist within a political community. Without this solidarity, the duty to pay taxes would be lacking. The political community is also essential to support distributive justice since the redistribution of resources requires individuals to see themselves as part of a community that owns those assets. Solidarity bonds must be strong enough to convince individuals to share the burden for the benefit of a more just distribution of wealth. Thirdly, the community must correspond to the Welfare State model. It would be impossible to achieve distributive justice through taxes in a jurisdiction where a libertarian political philosophy was prevalent, with roots in the thought of scholars such as Hayek or Nozick, who oppose distributive justice and view personal taxes as a form of theft[46]. Finally, personal taxes must be in place to consider the actual personal circumstances of taxpayers.

1.2. The role of citizen participation in budgetary decision-making and its impact on transparency and accountability

Despite democratic governments best intentions, they often fail to meet the expectations of their citizens, leading to demands for increased transparency. Transparency is widely regarded as a remedy for the shortcomings of democratic governments that fall short of their stated

ideals. In recent times, there has been a global push towards promoting openness in governments, characterized by greater transparency, citizen participation, and accountability[47]. These efforts seek to ensure that a "routine government" processes results in actions, services, and products that are easily accessible to the public and are perceived by citizens as being indicative of the substance, rather than just the appearance, of democracy.

Transparency in fiscal affairs is a crucial indicator of a government's commitment to opening its internal decision-making processes. By providing information about budgets, audits, and related financial policies, fiscal transparency enables citizens to demand government action, apply pressure for performance improvements, and evaluate the effectiveness of administrative actions. Although few citizens may be interested in or knowledgeable about national government budgets, budgets remain critical documents for democratic governance. In democracies, a clear distinction is made between what belongs to the state and what belongs to the sovereign or ruler, a distinction that is commonly understood in most industrial democracies but not in many other countries, with adverse consequences for the fiscal domain. Since public budgets rely on financial contributions from citizens and assets that are publicly owned, citizens have the right to budgetary transparency, participation, and accountability.[48]

Transparency, participation, and accountability are the essential pillars of open and democratic governance that rely on each other's support. However, transparency can be considered the cornerstone of the three, as it serves as a critical foundation for facilitating citizen participation and ensuring accountability. Without transparent access to relevant information on policy domains, it is challenging to proceed with any further actions related to citizen participation and accountability.[49] Therefore, transparency serves as a prerequisite for meaningful democratic engagement, enabling citizens to be informed and engaged in governmental decision-making processes.

In the context of the European Union (EU), the objective of joining the EU and the regulatory requirements of accession have been strong motivators for candidate countries to participate in fiscal and other Reports on the Observance of Standards and Codes (ROSCs). As leading candidates for EU accession have made progress in several aspects of the fiscal transparency code, it is essential that this progress is continued and reinforced. Developing flexible and effective mechanisms for tax

consolidation and adjustment will be a critical requirement for productive EU membership[50].

Portugal, for example, has implemented a range of measures to enhance fiscal transparency and accountability, including the Public Finance Transparency Portal, which facilitates easy access to information on government spending and budgeting. Additionally, the State Budget Law provides detailed information on government revenues and expenditures, and is subject to parliamentary debate and approval, ensuring accountability[51]. To ensure that the government's fiscal policy is aligned with national interests, an independent Fiscal Council has been established, responsible for monitoring and evaluating the government's fiscal policy and providing recommendations to enhance fiscal sustainability. These mechanisms, such as the Public Finance Transparency Portal, the State Budget Law, and the Fiscal Council, foster greater openness and accountability in government budgeting and public financial management.[52] Citizens have access to detailed information on government spending and budgeting, allowing them to hold the government accountable for its fiscal decisions.

1.3. The impact of state budget execution on democracy and social welfare

The primary objective of modern state budget policy is to continually improve the budget system and its crucial elements that directly or indirectly affect the process of ensuring the progressive promotion of social welfare quality and the implementation of social policies. The responsibility of any country to maintain a high level of social welfare for its population is dependent on various factors that influence it. One of the fundamental mechanisms that enable countries to improve the quality of life of their citizens is the financial system of the country, which is based on the budget system consisting of centralized funds of financial resources known as budgets[53]. The budget system plays a crucial role in ensuring the social welfare of the state since the budget is the central element of the country's financial resources. It performs several fundamental functions, including the provision of social welfare. The concept of social welfare was first introduced in the 18th century by Adam Smith, one of the founders of classical economic theory. Smith stated that the level of well-being

depends on labor productivity and is proportional to the needs of the population[54].

Subsequently, the definition of social welfare has evolved over time, reflecting the emergence of new economic schools and approaches. While classical economists like A. Smith[55] believed that the level of well-being is proportional to the needs of the population, neoclassical scholars like A. Marshall[56] and G. Sedgwick viewed social welfare as a means to sustain a person's life and develop their abilities. Utilitarian scholars, including Vilfredo Pareto[57] and Paul Samuelson[58], emphasized that social welfare is the welfare of individual members of society, while social approach scholars like R. Stoltzmann and O. Spann highlighted the non-economic factors fundamental for socio-economic development and progress. Today, social welfare is closely linked to the concept of public goods such as education, health, and economic regulation, which cannot be provided by the market and are paid for by citizens through taxes and other payments.[59] Therefore, the state's budget system plays a crucial role in securing the social welfare of the population.

Article 49.º of the Budget Law of Portugal N.º 151/2015 outlines the various state budget expenditures, which serve as financial investments for the country[60]. These expenditures are typically associated with debt obligations, special allocations, financing of the state business sector, and budget transfers. In Portugal, state budget expenditures can be classified based on functional characteristics and relevant governmental programs. The functional classifier used for the empirical part of this study divides expenditures into categories such as general public services, national defense, public order and safety, education, health, safety and social services, housing and collective services, cultural, recreational, and religious services, agriculture and livestock, forestry, fishing and hunting, industry and energy, transport and communication, trade and tourism, other economic functions, public debt operations, transfers within the general government, and not elsewhere classified[61].

1.4. Final considerations

In conclusion, the relationship between taxation and democracy are both-sided, with both entities reinforcing each other's legitimacy and supporting the conditions for democratic practices. The concept of normative coupling between taxation and representation establishes a procedural

requirement for legitimacy. It posits that the collection of taxes can only be justified if the individuals who are subject to tax liabilities consent to their imposition. Taxation also serves as an instrument for reinforcing the demand for relative equality in political power, as differences in individual economic resources typically breed imbalance in interests as well as in opportunities for political participation, deliberation, and influence. The concept of implementing distributive justice through taxes is a relatively recent development in the history of political institutions, and largely arises from the underlying principles of the Welfare State. To support a system of distributive justice through taxation, it is necessary to analyze the requirements that this system must fulfill, including fiscal sovereignty, a strong political community, and correspondingly strong solidarity bonds. Overall, State Budget Execution, Control and Transparency can have a significant impact on democracy perceptions, as it supports the legitimacy and transparency of taxation and its use in promoting democratic practices and equitable distribution of resources.

2. Taxes as instruments for implementing the fiscal principles of stability and sustainability

2.1. Building a solid foundation: the role of taxes in achieving budgetary stability and sustainable development

In order to achieve a correct conception of taxes as instruments for the implementation of the budgetary principles of stability and sustainability it is necessary to start with the very definition of these principles. Pursuant to Article 10.º, n.º 2 of the Budgetary Framework Law[62,63], the principle of budgetary stability consists of a situation of balance in public accounts, namely between public expenditure and revenue, or even a surplus (in which there is a positive balance of public accounts). The approval and application of all budget rules relating to public administration sectors are subject to this key principle. At the European level, since the Member States of the European Union are united through an intrinsic relationship, with systemic risk, there was a need to impose a set of rules common to all Member States, whose objective is to preserve the stability of the Eurozone. This set of rules is called the "Stability Program" which - as provided for in Article 33.º of the - Budgetary Framework Law, together with the Law on

Major Options in the Matter of Planning and Multiannual Budget Programming, constitutes the State Budget. This Program is based on the European Union's Stability and Coordination Pact, that precisely requires the creation of a Stability Program based on the commitments assumed in the Stability and Coordination Pact, as well as a scenario of variable and invariable policies, on a multi-annual basis (usually 3 years). The rule of budgetary balance contained in the Stability and Coordination Pact was transposed to the Budget Pact, in Articles 3.º to 8.º[64].

As for the principle of budgetary sustainability of Article 11.º of the Budget Framework Law, it can be defined as the ability of the State to finance all the commitments assumed or to be assumed, respecting the budget and public debt balance, so that it does not jeopardize the economy's functioning. The reference to public debt translates into a need to quantitatively limit its value. This is expressly mentioned in Article 20.º, n.º 5 of the Budgetary Framework Law, which states that the budget deficit must not exceed 60% of GDP. This is extremely important, since there will certainly be consequences for both the public and private economy if the limits imposed are exceeded. We can then conclude that the most relevant factors regarding the sustainability of public finances are the debt and the budget deficit. Moreover, the Treaty on the Functioning of the European Union also provides for two articles that establish the principles under analysis – Articles 121.º and 126.º. The *ratio legis* for the first is to prevent imbalances in the public accounts of the Member States, through close control by the European Council, so that a stable financial and budgetary situation is achieved in the medium term. If there is already an imbalance in public accounts, then Article 126.º applies, which stresses the need that "Member States shall avoid excessive budget deficits", in order to maintain the sustainability of public finances. This article provides for a quantitative limit of 60% of GDP for the debt and 3% of GDP for the overall deficit[65].

In conclusion, the two principles analyzed are, therefore, central to the balance of public accounts, and can be denoted, not only by their application at a national level, but also by the imposition of principles at a European level.

2.2. Bridging the gap between tax law and economic policies: tools and strategies for sustainable and equitable taxation

Bearing in mind the definitions above, the basis of public finances is built on the theory of an equilibrium in public accounts. There are three financial functions of the State, that are reflected in the policy options taken in order to achieve this balance: correction of the allocation of resources, redistribution of wealth and income (social vision) and economic stabilization (economic vision)[66]. Therefore, it is possible to conclude that the *ratio* of the tax system is not limited to the objective of collecting revenue from the outset, in Article 104.º of the CRP. It is precisely in this field that extrafiscality originates, to which economic tax law should be applied (and not tax law).

The origin of economic tax law has, above all, to do with the emergence and evolution of the Welfare State and consequently the Welfare Fiscal State. For some authors[67], we are dealing with economic regulations that seek to shape behavior through tax instruments, their objectives being of an economic and social nature. The Tax State is based on the assumption that the main source of state revenue are taxes. This is justified by the fact that there is a certain set of public goods, essential to the pursuit of the aforementioned functions of the State (such as education, national defense, health, among many others) which it is not possible to proceed with the exact imputation of the costs associated with the use of the services provided by each user, but rather it must be borne by all citizens of the same State. Furthermore, it is considered that the State should only exercise its power of authority to obtain revenue through taxes, being completely oblivious to the satisfaction of citizen's needs.

However, a theory of tax sustainability was built and crystallized – this principle has already been analyzed above - and gave rise to the Social Fiscal State, that was consolidated in the 20th century. The evolution from the Fiscal State to the Social Fiscal State was based on the gap felt in relation to the intervention of the State which, although null in the Fiscal State, was considered essential to satisfy the needs of citizens as well as to proceed with a regulation of the market, that was becoming more and more vital. The role of taxes remains crucial, however a social and an economic function is added to them.

In order to understand the notion of economic tax law, we have to understand the relationship between the economy and taxation. In particular, we have to develop some assumptions that are essential for the full implementation of economic tax law, which are, on the one hand, 1) a

fiscal policy of revenue collection to meet public expenditures, 2) a fiscal State that ensures public revenue while preserving the economic freedom of its taxpayers and 3) fiscal instruments, which implement the three main financial functions of the State, as we have seen above (namely, correction of the allocation of resources, redistribution of wealth and income and economic stabilization). On the other hand, it is also important to take into account the "economic consideration of tax facts"[68].

The idea is that economic laws should, at the very least, be able to maintain a balance between State expenditures and revenues (principle of stability), through taxes – whether for a fiscal or extra-fiscal nature - under penalty of becoming unsustainable.

The principle of sustainability therefore has several dimensions. Firstly, a legal-political dimension, already addressed in the previous title, which is considered elementary in the creation of the State Budget, always based on the principle of legality. It also has an economic dimension, essentially related to the regulation of the market economy. There is also a social dimension, since the State must take into account, as mentioned before, the necessities of citizens and their ability to pay (contributory capacity) of taxpayers in the tax relationship. The principle of sustainability also expresses an ethical dimension, in accordance with the principle of intergenerational solidarity, provided in Article 13.º of the Budgetary Framework Law, that is, in the event that the principles under analysis are insufficiently complied with, future generations will be irreversibly penalized, which implies that future generations will inevitably have to condition their own choices. Therefore, it is necessary to emphasize the importance of the intergenerational impact that measures taken imply. The logic of the principle of budgetary stability is essential here, since, in order to guarantee that future generations are not so penalized by the measures taken in the present, it is necessary to balance public accounts and control State expenditure. Finally, the principle of sustainability also expresses an environmental dimension[69], as it will be can concluded in the example below.

Returning to the definition of economic tax law, it is characterized by the use of two tax instruments: extra-fiscal taxes and tax benefits. As for the former, these comprise measures of economic and social intervention through taxation, with the aim of limiting certain behaviors and activities. One example on which extrafiscality[70] is most focused is environmental

taxation. In recent years, environmental protection has gained increasing importance, and public expenditures in this area are also crucial for the State to undertake such initiatives. And, therefore, it is necessary to insist once again on the "golden rule" of public finances – the principle of stability – meaning that sufficient revenue must be collected to cover public expenditure, in order to maintain the balance of public accounts.

In our point of view, an example of an extra-fiscal measure, which constitutes a major change from the point of view of green taxation, is the "contribution" on lightweight plastic bags, provided for in Articles 30.º and following of Law n.º82-D/2014, of December 31st. This consists of a tax on light plastic bags produced, imported or purchased in mainland Portugal for distribution to the final consumer. The purpose of this tax on the consumption of lightweight plastic bags is to reduce the utilization of these bags, thereby reducing the environmental impact. As for tax benefits, under the terms of Article 2.º n.º 1 of the Tax Benefits Statute[71], these are "*measures of an exceptional nature instituted to protect relevant extra-fiscal public interests that are higher than the taxation they prevent*". These are, therefore, measures of a temporary nature, and must be applied for the appropriate period to satisfy the aforementioned public interests to economic activities or social groups that present specific precariousness. Paragraph 2 of the aforementioned article provides that "*tax benefits are exemptions [72], rate reductions, deductions from taxable income and collection, accelerated amortization and reintegration [73]and other tax measures that comply with the characteristics set out in the previous number.*"

2.3. Final considerations

In short, taxation is an essential tool for achieving sustainable development goals, especially in developing countries. However, to maximize the effectiveness of taxation as a tool for a stable and sustainable development, governments need to ensure that tax policies are equitable, efficient, and transparent. On this regard, we note that the principles of sustainability and budgetary equity are taking into account the economic and financial crisis that Portugal is going through. The use of taxes as a means - not only of collecting public revenue, but also of modeling behavior - proves to be essential for the pursuit of effective public policies. Lastly, if, on the one hand, the State has to collect enough revenue, through taxation, to meet public expenses, while at the same time meeting and trying to solve the

needs of taxpayers, on the other hand, we have to keep in mind a concern at the intergenerational level, so not to condition future generations in their choices.

3. Tax, tech and equity: what universal basic income and robot tax mean for tax equity

3.1. Opening remarks

The economy is becoming digital[74]. In recent years, the rapid development and dissemination of technology has led to significant changes in the economy, with robots and artificial intelligence (AI[75]) playing an increasingly prominent role in many industries. These new technologies influence consumer behavior and drive companies to create new business models, new paradigms, new playing fields, and therefore, also new tax challenges[76]. The digital environment, on a global scale, motivates new forms of production, flow of information and a radical change in paradigms that "call into question" the current capacity of tax systems to adapt its means of intervention in the face of the challenges set by the digital economy[77]. While innovation has undoubtedly brought numerous benefits, it has also raised concerns about job displacement and income inequality. In response to these and other issues, some policymakers have proposed the implementation of a universal basic income (henceforth "UBI") to provide a safety net for those who may be negatively impacted by such technological advancements.

At the same time, the rise of automation has also led to discussions about whether robots and other machines should be subject to taxation. Proponents in favor of taxing robots argue that such measures would ensure that corporations pay their fair share[78] in taxes and help fund initiatives such as UBI[79]. However, implementing these measures presents significant challenges for tax law and tax policy[80]. There are numerous questions to consider, such as: How to define and value the use of robots in a way that is fair and accurate? How to balance the benefits of automation with the potential negative consequences? How would robot taxation affect the economy, employment, and innovation? How to implement such taxes?

Despite difficulties, the idea of a universal basic income and robot taxes have recently gained traction as potential solutions to address issues related

with the digital economy and promote tax equity around the globe. Finally, having this principle in mind, we will explore the concept of UBI, robot taxation and their implications for tax law and tax policies. We will examine the relationship between UBI and taxation, as well as the potential impact of UBI on collective wellbeing. Additionally, we will define robot taxation and the implications of robots and AI on tax revenues. Lastly, we will explore strategies for effectively achieve tax equity through UBI and robot taxation, and how these measures can be utilized as tools for implementing the budgetary principles of stability and sustainability, aiming to achieve and promote the collective wellbeing.

3.2. Towards a more equitable society: exploring the definition, relationship, and impact of universal basic income on collective wellbeing and taxation

First, UBI[81] is a policy proposal in which every citizen receives a guaranteed minimum income (a "tax-free subsistence income"[82]) from the government, regardless of their employment status[83]. From this definition, we can clearly acknowledge that a UBI would act in a similar way to most welfare payments. Consequently, it can be said that *"a UBI acts in reverse of the normal understanding of tax; as instead of extracting money, the government is providing funds. Of course, a government would need to be able to fund a UBI; which would likely be from tax revenue"*[84]. The *ratio* behind this policy is assuring collective welfare - establishing the basic standards of living, safeguarding that all citizens have access to vital necessities such as food, shelter, and healthcare[85].

Nonetheless, we can point the biggest questions surrounding UBI[86] as how it will be funded and its economic ramifications[87],[88]. One proposal is to finance UBI through taxation, where taxes are increased to pay for the basic income. This option would require a significant restructuring of the tax system, as current tax rates do not generate enough revenue to fund a UBI program. Other UBI policies criticism[89] are: 1) it may create a disincentive to work, leading to reduced productivity and economic growth; 2) a UBI program may not effectively target those in need, as the same amount of money would be given to all citizens regardless of their income level or other circumstances; 3) it could perpetuate the *status quo* and fail to address systemic issues such as income inequality and poverty; 4) it is not a long-term solution and that it would be more effective to invest

in education and training programs to help individuals secure better-paying jobs, 5) UBI could be viewed as a form of government handouts, which could lead to stigmatization and resentment towards those who receive the benefit[90].

However, some authors[91] argue that UBI could actually simplify the tax system by replacing current welfare programs, which often have complex eligibility requirements, with a single payment that is provided to all citizens[92]. UBI policies could have a significant positive impact on collective wellbeing[93], by providing a basic income to all citizens, UBI could help reduce poverty and inequality, improve mental health[94], improve education rates and provide a safety net for those who lose their jobs (job displacement) or are unable to work[95]. Lastly, UBI policies could also have a positive impact on the overall economy, as it would provide a stable source of income to consumers, increasing demand and potentially stimulating economic growth[96].

3.3. The rise of a new tax payer? Balancing arguments for taxing robots and promoting a collective well-being

The current fourth industrial revolution, like the previous three industrial revolutions, is transforming workplaces with digital improvements. The rise of advanced technology, particularly robotics and artificial intelligence, has brought new challenges to the existing tax systems. One of the emerging ideas in the field of taxation is the concept of robot taxes - which refers to the imposition of taxes on robots, machines and automation technology[97]. Such policy has recently gained traction as an alternative source of revenue for governments, which are facing increased pressure to fund social welfare programs and reduce inequality[98]. In fact, tax equity is an important principle in taxation that emphasizes fairness and equal distribution of tax burden among taxpayers. The development of mechanization has severely disrupted the labor market, resulting in significant job displacement and revenue disparities[99]. Therefore, a robot tax could be seen as a mean to promote tax equity by ensuring that the benefits of modernization are shared among all members of society.

Nonetheless, the relationship between robot taxation and tax equity is a regular debate. Some authors, in favor of robot taxation, argue that: 1) since machines are replacing human workers and generating revenues for their owners, machines should also contribute to the tax system; 2) taxing

robots could finance social welfare programs such as a universal basic income; 3) by taxing robots, governments could encourage companies to invest in human workers, rather than relying solely on automation; and 4) taxing robots could mitigate potential negative effects of automation, such as job displacement and income inequality. On the other hand, against these new taxes, some sustain that: 1) taxing robots could discourage innovation and investment, harming productivity and economic growth; 2) it may be difficult to design how to tax robots fairly, as different types of automation have different levels of impact on the economy; 3) taxing robots could lead to higher costs for companies, which could in turn lead to higher prices for consumers; 4) taxing robots may not be necessary if other forms of taxation, such as corporate or income taxes, are already "capturing" profits from automation[100],[101].

In conclusion, the concept of robot taxation is a complex issue that requires careful consideration of its potential impact on tax equity and collective wellbeing. Policymakers should carefully consider the potential benefits and drawbacks of robot taxation before implementing such policies.

3.4. Revolutionizing tax law and policies: implications of universal basic income and robot taxation

The introduction of a UBI and robot taxes could bring significant changes, disrupting tax law, tax administrations and the overall tax system.

Firstly, UBI has the potential to change the way in which taxes are administered and communicated to the public. The implementation of this measure would force a major reform to the current tax system, such as the introduction of new tax brackets, adjustment of current tax rates or a restructuring of tax credits. This would likely require legislative changes, new administrative proceedings, changes in tax reporting and compliance[102] - to ensure that the tax system is in line with its angular principles: legality, equality, certainty, efficiency, etc. Moreover, a UBI policy would have implications for taxation beyond its administration. For instance, if implemented at a high level, it could lead to the elimination of existing social welfare programs, such as pension and unemployment payments, agricultural and railroad subsidiaries, food stamps, social security, social and health insurance, housing assistance programs, childbirth policies, and others[103].

Secondly, as for the repercussions of robot taxation on tax law, we point a first major problem, as we have seen, the justification for the introduction of the tax itself. So far, there is no conclusive empirical evidence on the future of the labor market and its correlation with robots. The truth is that the nature of work is rapidly changing. The first image that usually comes to people's mind when they think of a robot is a sort of machine with humanoid shape, like those from popular movies such as *"I, Robot"* or the *"Terminator*". However, to be subject to tax, a robot must be clearly determinable from a legal point of view, and not by its physicality. The concept is still not sufficiently delimited today to be adequately defined legally. Moreover, it is challenging to design the automation tax system itself. Should it be a tax directly on robots? A tax for the use of robots? Should we increase of the corporate tax rate?[104] Lastly, imposing a tax on robots would be a difficult task, as taxpayers need to be certain about who pays the tax and how it should be calculated. The tax must be understandable and reasonable so that taxpayers can voluntarily pay it, as modern tax systems are self-reporting. Tax administrations also need to comprehend how the tax would operate and implement effective

mechanisms to combat tax evasion and avoidance. Public records or the obligation to report robot purchases could be implemented to help enforce this tax, but would require a multilateral organization to address them. Therefore, there is a risk that implementing these proposals would involve complexity and arbitrariness, increasing the compliance and administrative burden on taxpayers and tax authorities.

3.5. Final considerations

Robots and AI are transforming our lives and replacing humans at work. There is a fear of unemployment and increasing income inequality due to this rapid development. Consequently, a tax on robots has emerged as a possible solution to slow down automatization in the workplace and obtain resources that could be used in initiatives such as universal basic income. The design of these tax policy is complex and must consider questions such as what a robot is, economic aspects, and difficulties related to taxpayers compliance and audit by tax administrations. Ideally, a machine tax should be calculated in relation to those workers who were substituted or would have been employed if robots had not been used. Moreover, a tax on companies that use robots would be logical because they are the ones who benefit from them. There is field for debate on whether to focus on a specific robot tax or narrow the differences in how capital income and labor income are taxed. Ultimately, effective strategies for achieving tax equity through UBI and robot taxation can promote the principles of stability and sustainability, aiming to achieve and promote collective wellbeing.

Conclusion

We started our work by highlighting the interconnectedness of public finances, tax management, tax communication and sustainability in promoting collective wellbeing. Our analysis provided a comprehensive breakdown of the various aspects of taxation, including budget execution, control, transparency, taxpayer participation and their impact on democracy perceptions. Moreover, we discussed the crucial role of taxes as a tool for achieving budgetary stability and sustainable development, emphasizing the need to "bridge the gap" between tax law and economic policies and offering tools and strategies for achieving a sustainable and equitable taxation. By doing so, we concluded that: 1) the principle of

budgetary stability requires a balance between public expenditure and revenue; 2) this balance forces an accurate conception of taxes as instruments for implementing budgetary principles; thus, 3) economic tax law seeks to shape behavior through tax instruments, with objectives of economic and social nature, 4) using extrafiscal taxes and tax benefits, in a direct link with the legal-political, economic, social, ethical dimensions of the sustainability principle. On a more futuristic approach, we explored the implications of universal basic income and robot taxation on tax equity and collective wellbeing. We defined UBI as a policy proposal that guarantees a minimum income to every citizen. The biggest issues surrounding UBI relate to its funding and economic ramifications - including concerns about the potential disincentive to work, the effectiveness of targeting those in need, and the potential perpetuation of systemic issues such as income inequality and poverty. While UBI policies could have a positive impact on collective well-being, improving mental health, education rates, providing a safety net for job displacement, and other programs as seen in sub-chapter 2.3.1., it would demand a significant restructuring of the tax system and a careful consideration of its long-term effectiveness. On the other hand, robot taxation also presents several challenges, including defining what constitutes a robot from a legal perspective, designing the automation tax itself, and ensuring taxpayers understand who pays the tax and how it should be calculated. A machine tax should ideally be calculated in relation to workers who were substituted or would have been employed if robots had not been used, and a tax on companies that use robots would be logical since they are the ones who benefit from them. Both policies could significantly disrupt tax law, tax administration, and the overall tax system - including legislative changes, new administrative procedures, changes in tax reporting and many more. Effective strategies for achieving tax equity through UBI and robot taxation must, therefore, consider the economic aspects of these policies, as well as questions related to taxpayer compliance and audits by tax administrations. On this regard, we suggested that emerging technologies have the potential to revolutionize tax law. However, policymakers should carefully consider the implications of these reforms on the overall welfare of society - arguments should be balanced, there is still much room for debate and studies. Hence, further researches on the topic of tax, collective well-being, and sustainability should address questions such as: 1) the role

of tax incentives in promoting sustainable development and potential drawbacks of relying on tax incentives as a policy tools; 2) the impact of tax policies on income inequality - focusing on developing countries and unequal societies; 3) the use of blockchain technology in tax collection, compliance, management and the implications for privacy and data protection; 4) the role of tax policy in promoting gender equality; and lastly, 5) the relationship between tax policies and political stability, focusing in fragile states and countries with high levels of corruption.

In sum, this paper has explored the crucial link between taxation and collective wellbeing, with a focus on the key areas of public finances, tax management, tax communication, and sustainability. Through an in-depth analysis of the role of taxation in achieving budgetary stability and sustainable development, as well as the potential impact of new technologies and concepts such as universal basic income and robot taxation, we have highlighted the importance equitable tax policies for promoting a more fair and prosperous society. However, to truly achieve a citizen conciliation with taxation, we must also address the issue of tax education. As we have seen, developing a culture of social and intergenerational responsibility, where citizens understand and accept the reasons for taxation and acquire the skills to fulfil their tax obligations, is crucial for promoting an integrated, egalitarian community based on a sense of justice. Through effective tax communication, taxpayer participation in budget execution, and increased tax transparency, we can foster a more informed and engaged citizenry that is better equipped to contribute to the decision-making process on matters of public interest.

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45.The tax system should discharge three basic functions, namely the procurement of revenue in order to finance basic public goods, the redistribution of income within the political community and the management and steering of the economy.
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60. Cfr. Constitution of the Portuguese Republic.
61. WORLD BANK, *Portugal: Public Expenditure and Financial Accountability Review*.
62. Law n.º 151/2015, of September 11.
63. For specific critics on Budgetary Framework, see NABAIS, José Casalta, *Reflexões sobre a constituição económica, financeira e fiscal portuguesa*, In *Por um Estado Fiscal Suportável*, Vol. IV, 2015, p. 163 e ss.; NABAIS, José Casalta, *Estabilidade Financeira e o Tratado Orçamental*, In *Por um Estado Fiscal Suportável*, Vol. V, 2018, p. 111 e ss.
64. Cfr. Resolution of the Assembly of the Republic N.º 84/2012, of 3 July.
65.A distinct figure from the structural deficit, provided for in Article 20.º of the Tax Framework Law, which has a limit of 0.5%.
66. MUSGRAVE, Richard A., *The Theory of Public Finance*, McGraw Hill, New York, 1959.
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68. About the evolution, characterization, dimensons and legal framework of the economic tax law, see NABAIS, José Casalta, Problemas Nucleares de Direito Fiscal, Almedina, 2020, pp. 193-226.
69. See SOARES, Cláudia, Imposto Ecológico versus Subsídio Ambiental? O enquadramento Comunitário dos Auxílios de Estado a Favor do Ambientes, Almedina, 2003. p. 53.
70. Extra-fiscal taxes are also know as "*erdrosselungssteuern*" or "suffocating taxes" in the german terminology, or "destructive taxes" on the anglo-saxon *lexis*, their main goal is to avoid or inhibit the verification of the assumption of fact or triggering event, so that, as taxes, they are assumed to be true "suicide taxes". Cfr. NABAIS, José Casalta, *Problemas Nucleares de Direito Fiscal*, Almedina, 2020, p. 213.; ANTONINI, Luca, *Dovere Tributario, Interesse Fiscale e Diritti Costituzionali*, Milano, 1996, p. 316.
71. Decree-Law No. 215/89, of July 1
72. It is worth noting that exemptions are different from tax exclusions. In a situation of tax exclusion and, therefore, of non-subjection, the application of tax rules is excluded and, therefore, the subject to taxation is completely excluded. In an exemption situation, the taxable persons (who are obliged to pay the tax) of the tax legal relationship do not cease to be part of this same relationship and must fulfill other auxiliary obligations, even if they are not taxed (or are taxed to a lesser extent). quantity), subject to the application of tax rules.
73. If they are not accelerated, they are just "structural measures aimed at determining taxpayers' real profit" and not tax benefits.
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75. Cfr. BARBOSA, Mafalda Miranda, *Inteligência Artificial: entre a utopia e a distopia, alguns problemas jurídicos*, Gestlegal, 2021.
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79. Cfr. CERDA, Francisco Ossandón, *Taxation on robots? Challenges for tax policy in the era of automation,* Revista Chilena De Derecho y Tecnología, Vol. 9, N.°2, 2020.
80. Discussing advantages and disadvantages of implementing a robot tax, see AHMED, Sami, *Cryptocurrency & Robots: How to Tax and Pay Tax on Them*, South Carolina Law Review, Vol. 69, N.°3, 2018. Proposing tax and non-tax policy measures to improve the future labor market with a focus on balancing capital and labor income, see MAZUR, Orly, *Taxing the Robots*, Pepperdine Law Reveiew, N.° 277, (2019).
81. This concept first appeared as a satirical critique of 16th century crime deterrent in Thomas Moore's book *Utopia*. It was further developed in the work of Johannes Vives. In the 20th century, UBI policies stated to be refined and debated. Currently, UBI and other welfare concepts are again appearing in political and economic discussions as a response to deepening income inequality across the globe and changes to the labor force arising from technological advancements. Cfr. MORE, Thomas, *Utopia*, Penguin Classics, 1963. pp. 43-44.;VIVES, Johannes Luis, *De Subventione Pauperum, Sive de humanis necessitatibus*, University of Toronto Press, 1998. p. 62.; HARDOON, Deborah, NIEVA, Ricardo, AYELE, Sophia, *An Economy for the 1%: How privilege and power in the economy drive extreme inequality and how this can be stopped*, Oxfam, 2016.
82. VEEN, Robert Van Der, *Real Freedom versus Reciprocity: Competing Views on the Justice of Unconditional Basic Income,* Political Studies, 1998. p. 141.
83. Conceptually, a UBI represents a straightforward application of the principles of horizontal equity (treating equal "citizens" equally) and public equity (the public as an equity partner of economic activity). The principle of horizontal equity should be understood as complementary rather than antagonistic to the alternate principle of vertical equity (treating unequals unequally, for example, on the basis of unmet basic needs). RANKIN, Keith. *"Prospects for a Universal Basic Income in New Zealand." Journal of Sociology & Social Welfare*, vol. 43, no. 3, 2016, pp. 51-72.
84. Cfr. BAYLISS, Myles, *Universal Basic Income: The Potential Impact on the Australian Tax System*, Journal of Australian Taxation, Vol 21, N.°1, 2019.
85. UBI policies can vary greatly in structure and substance, making it is impossible to totally analyse the specific impacts of a specific system without knowledge of its structure. As an example, see the contrast between Milton Friedman's Negative Income-Tax proposal for households with incomes falling below a certain level with Charles Murray's proposal of an annual $10,000 cheque to all citizens over the age of 21.
86. For futher developments on potential methods of funding, criticisms and issues regarding funding a UBI see SAMPFORD, Charles, *Paying for Basic Income*, Palgrave Macmillan, 2016. pp. 133-156.
87. For example, Minsky argued that even when a guaranteed income program balances the policy will still have an inflationary effect on the economy. MINSKY, Hyman, *The Macroeconomics of a Negative Income Tax*, 1969, pp. 4-5.
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89. A basic income experiment in the Canadian province of Manitoba (colloquially known as the "Mincome") in the 1970's generated a 11,3% percentage point reduction in labor market participation amongst program participant. This is somewhat explainable due to social interaction effects such as pregnant women, or mothers with young children taking the opportunity to take a break from the workforce or individuals nearing retirement age taking a early retirement, but is still a significant consideration for any future policy. Cfr. CALNITSKY, David, LATNER, Jonathan, *Basic Income in a Small Town: Understanding the Elusive Effects on Work*, Social Problems, 2017;

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90. For further developments see: CANTILLON, Bea, *UBI will not effectively address poverty and inequality. - Basic income and social justice: A symposium",* Basic Income Studies, Vol. 12, N.º 1, 2017, pp. 1-14.

91. Universal basic income policies and their potential for addressing health inequities Transformative approaches to a healthy, prosperous life for all HAAGH, Louise, ROHREGGER, Barbara, *Universal basic income policies and their potential for addressing health inequities: Transformative approaches to a healthy, prosperous life for all*, World Health Organization, 2019, p. 18

92. At present, only trial UBI programs for research or testing purposes have been implemented. Most of these trial programs have involved automatic monthly or weekly payments to the recipients who were then left to spend the money as they wished. The only established and on-going cash transfer program in the UBI mould is the Alaskan Permanent Fund in the American State of Alaska. The Fund is a constitutionally established permanent fund administered by a state-owned board providing an annual payment to Alaskan residents that qualify under the Fund's eligibility criteria. Cfr. BAYLISS, Myles, *Universal Basic Income: The Potential Impact on the Australian Tax System*, Journal of Australian Taxation, Vol 21, N.º1, 2019. p. 70.

93. As an example, the "Bolsa Familia" program of Brazil is also suggested to be a UBI type program, however this program is more similar to already existing traditional welfare programs assisting poor families with children. *"The effects of the Bolsa Familia do emphasise the highly positive impacts a cash transfer program can have on economically disadvantaged families".* For more details see: SOUZA, Thiago, *The Bolsa Familia Case: A Road to the Unconditional Basic Income*, Master Dissertation in Political Science, Faculdade de Ciências Sociais e Humanas Universidade Nova de Lisboa, 2021, pp. 63-65.

94. A trial in Kenya found citizens receiving automatic payments had lower stress, improved psychological health, and lowered spending on 'temptation goods' such as alcohol and tobacco. HAUSHOFER, Johannes, SHAPIRO Jeremy, *Household Response to Income Changes: Evidence from an Unconditional Cash Transfer Program in Kenya*, Princeton Working, N.º 36, 2013.

95. For example, several trial UBI programs in India showed positive impacts on health and labor participation with the most significant impacts occurring within traditionally disadvantaged classes such as women and the disabled. STANDING, Guy, *India's experiment inbasic income grants,* International Sociological Society Global Dialogue, Vol. 3, N.º 5, 2013.

96. In Iran, a subsidy program beginning in 2010 has resulted in a sharp decline in the percentage of individuals living below the poverty line as well as wealth inequality. These trials also showed increases in spending on education and business ventures. SALEHI-ISFAHANI, Djavad, MOSTAFAVI-DEHZOOEI, Mohammad, *Cash Transfers and Labour Supply: Evidence From a Large-Scale Program in Iran*, Journal of Development Economics, Vol. 135, 2018. SOLEIMANINEJADIAN, Pouneh, YANG, Chengyu, *Effects of Subsidy Reform on Consumption and Income Inequalities in Iran*. International Journal of Economics and Management Engineering, Vol. 10, N.º 12, 2016.

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98. In a report of February 2017, the European Parliament has considered granting a legal personality to robots. In essence, granting a legal personality to robots could lead to the emergence of an electronic ability to pay, which should be recognized for tax purposes. European Parliament,

Committee on Legal Affairs, *Report with Recommendations to the Commission on Civil Law Rules on Robotics*. (A8-0005/2017). 2017

99. Cfr. SCHULZE, Kathryn, NOZEMACK, Karie, *Humans vs. Robots: Rethinking Tax Policy For a More Sustainable*, Maryland Law Review, Vol. 79, N.º 4, 2020

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101. Describing robot tax proposals as "illogical", see HEMEL, Daniel, *Does the Tax Code Favor Robots?,* Public Law and Legal Theory Working Paper Series, N.º 738, 2019.

102. This measure would reduce the administrative burden and associated compliance costs.

103. BAYLISS, Myles, *Universal Basic Income: The Potential Impact on the Australian Tax System*, Journal of Australian Taxation, Vol 21, N.º1, 2019. p 80.

104. CERDA, Francisco Ossandón, *Taxation on robots? Challenges for tax policy in the era of automation,* Revista Chilena De Derecho y Tecnología, Vol. 9, N.º2, 2020.

CHAPTER 3 – THE IMPORTANCE OF PAYING THE FAIR SHARE FOR THE FULFILMENT OF ECONOMIC, SOCIAL, AND CULTURAL RIGHTS AND TO ACHIEVE THE SUSTAINABLE DEVELOPMENT GOALS

Lara Silva, Mariana Passos Beraldo and Sara Vitorino

Introduction

The anti-poverty and development organizations, such as Tax Justice Network, Action Aid, and Christian Aid[105][106] have highlighted taxation as a key point for development and the fight against global inequality. This reasoning makes up the growing movement that calls for tax justice (REISCH, 2019, p. 34). In addition, several international documents highlight the need for better tax collection (REISCH, 2019, p. 39; DE SCHUTTER, 2019, 66).

The 2015 Lima Declaration on Tax Justice and Human Rights[107] and the subsequent 2017 Bogotá Declaration on Tax and Women's Rights[108] are examples that taxation is increasingly in vogue to guarantee human rights. These documents reflect diverse civil society actors' growing commitment to treating tax policy as a human rights policy and challenging the inadequacy and inequality of tax policies nationally and internationally (REISCH, 2019, p. 34).

In addition, at the Third International Conference on Financing for Development in July 2015, the Heads of State and Government and High Representatives "recognise that significant additional domestic public resources, complemented by international assistance as appropriate, will be instrumental in realizing sustainable development and achieving sustainable development goals" in the adopted Addis Ababa Action Agenda - AAAA. The signatories further committed to "improve revenue

administration through modernized and progressive tax systems, improved tax policies and more efficient tax collection"[109].

According to Meyer-Nandi (2021, p. 63) the AAAA "puts taxation distinctively into the spotlight of the Sustainable Development Goals (SDGs)" and Lennard (2019, p. 211), also highlighting AAAA, explains that taxation "represents an avenue to more modern sustainable development-focused economies, responsive to modern challenges".

Soon after, the 2017 Inter-Agency Task Force Report on Financing for Development: Progress and Prospects[110] clarify the relevance of taxation for development by mentioning the expression "tax" 267 times in the Report (LENNARD, 2019. 211).

Reisch (2019, p. 34) complements the leading anti-poverty and development organizations have worked to make taxation "a key issue in the post-2015 Sustainable Development Goals". Furthermore, the author mentions that civil society groups and governments from 'The Global South'[111] strongly pressure to address taxation in the Sustainable Development Goals - SDGs. Following this reasoning, Long and Miller (2017) call attention to the 'rethink' in the development financing required by the 2030 Agenda.

This paper highlights how taxation is necessary for fulfilling Economic, Social, and Cultural rights - ESC Rights and the SDGs. In light of this, the importance of paying the fair share is explored to increase collection and make systems fairer.

The paper adopts the literature review as a research method, includes four sections that intertwine and complement each other within a logical sequence, and has been structured as follows. The first two sections present the literature review on ESC Rights and SDGs and taxation's role in fulfilling those rights and goals. The third section explores the conception and importance of fair share compliance for tax systems. Afterward, the final section includes the conclusion.

2. Economic, Social, and Cultural rights

2.1. What are the Economic, Social, and Cultural rights?

Economic, social, and cultural - ESC rights cover a range of entitlements that have been growing and developing more and more, such as the right to work and to fair and adequate working conditions; the right to form and join trade unions; the right to social security; the protection of the family, women, and children; the right to an appropriate quality of living (which includes having enough and adequate food, clothing, and shelter); the right to the highest standard reasonably achievable in terms of mental health; the right to education, and the right to participate in cultural life and enjoy the advantages of scientific progress. All of these are safeguarded under the International Covenant on Economic, Social, and Cultural Rights - ICESCR and distinguished in the Universal Declaration of Human Rights - UDHR as well as in the United Nations - UN Charter (BANTEKAS; OETTE, 2020, p. 412-413).

Article 2(1) of the ICESCR, which reads as follows, predicts the type of obligations addressed to states in their implementation of ESC rights:

> «Each state party to the present Covenant undertakes to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures».

Every right protected by the ICESCR is subject to conduct and result obligations. These can be subdivided into three categories of accountability: to respect, protect, and fulfil. States are precluded from interfering with the exercise of a right either directly or indirectly under their commitment to respect by, for example, refusing or restricting access or imposing discriminatory practices. States must take action to stop outsiders from interfering with the right to meet their obligation to protect. Finally, the obligation to fulfil demands the implementation of appropriate legislative, administrative, budgetary, judicial, promotional, and other measures (BANTEKAS; OETTE, 2020, p. 425).

2.2. The role of taxation for ESC rights

The realization of ESC rights relies on taxation policies. These enable States to mobilize resources for vital investments in infrastructures, including transportation, energy and water supply, housing, social protection, and healthcare, all of which are crucial (DE SCHUTTER, 2019, p. 59). Additionally, they allow States to reallocate revenue from the wealthiest sections of the population to the poorest. The Committee on ESC Rights has identified three main correlations between taxation and the realization of ESC Rights. First, taxes enable States to produce sufficient revenue that must be allocated and applied to guarantee that their ESC Rights commitments are met. Second, the implementation of taxation must also have a redistributive impact on resource mobilization. Third, it is through human rights compliant taxation that the principles of good governance are upheld. (AMBROS, 2018, p. 23). Let us see.

How States mobilize resources and select their spending priorities has become a human rights concern, making tax justice one of them (DE SCHUTTER, 2019, p. 59). Firstly, the progressive fulfilment of ESC Rights depends on the amount to which resources that are made available are directed towards the completion of ESC Rights. Secondly, tax laws can correct ingrained social, economic, and gender disparities through redistributive effects. Thirdly, a civic pact based on the fulfilment of citizens' rights and strengthened by applying a good governance concept through participation, transparency, and accountability gives the State the legitimacy to collect taxes. (AMBROS, 2018, p. 6).

Taxation plays a fundamental place in representing, creating the social contract, and supporting government accountability. However, its role in achieving citizens' expectations for justice, fairness, and substantive equality is frequently underestimated. Taxes are essential in ensuring that States can carry out their responsibilities, including financing public services and reducing economic and social disparities. It also enables a robust process of representation within society so that political inequalities can be overcome. For example, to ensure that wealthy elites are subject to effective, progressive taxation (NELSON, 2021, p. 10). The position that taxes occupy is unique: more than any other source of public revenue, it embodies the civic contract between the people and the government, and since the community pays, it constitutes a strong incentive for greater accountability (DE SCHUTTER, 2019, p. 60).

Consequently, such decisions cannot be left only to the arbitrary and capricious choices of States. Instead, they must be subject to a detailed investigation by Courts and other institutions responsible for enforcing the Covenant on Economic, Social, and Cultural Rights (DE SCHUTTER, 2019, p. 59).

Examining resource production, capital allocation, and the actual spendings are essential components in determining whether a State is monetarily complying with its Human Rights commitments. Regarding the economic, social, and cultural rights and the State's ability to provide health care, the educational system, and offer access to food and decent housing to mitigate socioeconomic discrepancies, the subject of financial resources is especially interesting (AMBROS, 2018, p. 5).

Taxation is the most reliable and predictable source of public financing for ESC Rights realization. Taxes are the main source of State's revenue in most countries. However, there are differences in the composition of the tax revenue between states: developed economies generate twice as much revenue from taxes than developing nations do, and the most significant portion comes from direct taxes, like the income tax. In developing nations, indirect taxes like those on trade and consumption generate most of the tax income (AMBROS, 2018, p. 5).

2.3. The 4 R's of Tax Justice

As previously stated, tax has a significant impact on both the well-being of individuals and societies broadly through support for human development, also acting as a key tool for income and wealth redistribution to help mitigate the severest effects of inequality and realizing human rights (NELSON, 2021, p. 10). The "4 Rs of Tax Justice" can be employed to summarize the main advantages of taxation:

a. Revenue, to fund public services, infrastructure and administration;
b. Redistribution, to curb inequalities between individuals and between groups;
c. Repricing, to limit public "bads" such as tobacco consumption and carbon emissions;
d. Representation, to build healthier democratic processes, recognizing that higher reliance of government spending on tax revenues is

strongly linked to a higher quality of governance and political representation (TAX JUSTICE NETWORK, 2020,p. 26).

a. Revenue

Tax revenue collection is essential to funding public services (AMBROS, 2018, p. 27). One of the most crucial ways that a government fulfils its human rights responsibilities is to raise enough revenue by increasing domestic resources gradually and working with other countries while also being aware of and evaluating the effects of policy design on individuals. A failure to raise revenue through progressive taxes makes Governments negligent and complicit in human rights malfunctions (NELSON, 2021, p. 12).

b. Redistribution

The second of the four Rs of taxes, redistribution, is essential in the combat against rising inequality and for the realization of human rights as it has the capacity to minimize and undo the harm caused by inequalities.

Through making public health and education services accessible, as well as by addressing both individual and societal poverty as well as other aspects of mental and physical distress, the redistribution of wealth and income promotes social mobility (NELSON, 2021, p. 14).

The disparity in wealth distribution can culminate in discriminatory effects in terms of having access to certain services such as education, health, or old age security, which are reserved exclusively for a select few due to financial barriers in the form of high fees (AMBROS, 2018, p. 49).

c. Repricing

The tax system acts as a means for compensating the social costs and collateral 'bads' of private interests. A well-functioning progressive tax system may play a significant role in sustainable development, and it may accomplish this by modifying behaviours, such as high carbon use, as previously stated. Another example is the fossil fuel industry, which must be revalued to limit the effects of carbon emissions and provide revenue for a fair transition that generates green jobs, redesigns infrastructure, and protects people and the planet (NELSON, 2021, p. 20). Taxation is used to restrict and try to control the 'bad'[112] while, on the other hand, encouraging public goods.

d. Representation

As previously said, the fulfilment of human rights requires an elevated level of integrity and accountability. As governments levy taxes on citizens, a more outstanding obligation develops to fulfil citizens' wants and needs and consequently to spend effectively and for the common good. The larger the share of taxable income as a percentage of overall tax receipts, the stronger the citizen-state relationship. This relationship, in turn, improves the efficiency of spending.

Tax money rather than revenues obtained from extractive, natural, or other resources, promotes a positive link between tax reliance and democracy. At the same time, there is a statistically significant negative relationship between total non-tax revenue and democracy." Citizen taxpayers reinforce trust in the government and support the possibility of fulfilling the entire range of human rights responsibilities by contributing their "earned income."

Taxation must guarantee that governments develop channels and organizations in charge of achieving rights, wants, and ambitions. These include academic institutions, healthcare systems, and legal and regulatory entities. (NELSON, 2021, p. 21).

2.4. The importance of progressive taxation

According to Ambros (2018, p. 45), progressive tax systems are the most appropriate for ESC Rights realization. De Schutter (2019, p. 62) adds that a progressive tax system plays a crucial role in the fulfilment of social rights because it is intrinsically related to each person's capacity to pay and, thus, to justice. It helps reduce inequalities because it is a levy tailored to the individual and not indifferently applied to all citizens. The tax system should be progressive and equitable, based on the premise of capacity (AMBROS, 2018, p. 31).

However, progressive taxation can only reduce inequality if the revenue generated by taxes is redistributed through social initiatives that help the poor instead of being used on projects that merely allow the wealthy to get wealthier. The combination of income mobilization and investment decisions counts for the effective fulfilment of economic, social, and cultural rights, and none of these factors alone will determine if the State's efforts are sufficient (DE SCHUTTER, 2019, p. 63).

There are solid arguments for adopting progressive taxation systems as a prerequisite for fulfilling economic, social, and cultural rights and thus as an obligation of ICESCR' State parties. However, progressive taxation with substantial inequality-reducing effects may be impossible for many governments to implement since indirect taxes (such as VAT) are easier to collect. Thus, despite their regressive effects (because poor households spend a higher proportion of their income on purchasing consumer goods), they may be the preferred method of revenue collection for governments with limited administrative capacity (DE SCHUTTER, 2019, p. 64). However, the expanding use of the VAT, if not carefully constructed, risks dragging low-income people further into poverty and has delayed structural development (ALSTON; REISCH, 2019, p. 432).

In another way, unlike direct taxes, consumption taxes often have a regressive impact because people with low or no incomes may nevertheless be subject to the same rates as individuals with higher incomes. As a result, consumption taxes have discriminatory effects based on gender and/or poverty status that are widely acknowledged but tolerated in most nations and are factually challenging to measure and define (ALSTON; REISCH, 2019, p. 433).

In 2014, Magdalena Sepulveda, then the UN Special Rapporteur on Extreme Poverty, argued that progressive tax regimes should be a key weapon for reducing poverty and the accompanying human rights violations of individuals living in extreme poverty experience (NELSON, 2021).

3. The Sustainable Development Goals - SDGs

3.1. The 2030 Agenda and the 17 SDGs

Sustainable development has been endorsed and is highlighted in State Agendas and International Forums and Community. States must adopt development strategies "constantly and generally" and implement international development programs aimed at sustainable development.

As repeatedly highlighted by the World Trade Organization - WTO arbitral awards[113], sustainable development emphasizes the integration of economic and social development and environmental protection.

The need for comprehensiveness in the design and implementation of development policies has become the centrepiece of the Sustainable Development Goals - SDGs adopted under the 2030 Agenda for Sustainable Development (BANTEKAS; OETTE, 2020, p. 649).

The 2030 Agenda for Sustainable Development, which sets global targets for the period to 2030, "break with the predecessor framework of the Millennium Development Goals – MDGs" (COBHAM, 2019, p. 148). In the late 1990s, the widening gap between the poor and the very poor was observed, and the concern that even the slightest fluctuation in global food prices could produce waves of famine around the world was highlighted. It was also evident that human development would not be solved, in an isolated way, by nations (BANTEKAS; OETTE, 2020, p. 644).

As a result, in the Millennium Declaration adopted at the UN General Assembly (UNGA) in 2000, eight MDGs were agreed: (1) eradication of extreme poverty and hunger; (2) realization of universal primary education; (3) promoting gender equality and empowering women; (4) reduction in infant mortality; (5) improved maternal health; (6) combating HIV/AIDS, malaria and other diseases; (7) ensure environmental sustainability; and (8) establishment of a global partnership for development[114].

Taxation was invisible under the MDGs (COBHAM, 2019, p. 148). Furthermore, inequalities, which include fiscal inequality, were largely peripheral in the MDGs (COBHAM, 2019, p. 148). However, with the economic recession of 2008 and the lack of external resources, it was necessary to mobilize internal resources, mainly through taxes, to finance the MDGs (REISCH, 2019, p. 39).

Despite all global efforts to implement the MDGs, according to the Human Development Report, more than 15 per cent of the world's population remains vulnerable to multidimensional poverty. At the same time, nearly 80 per cent of the global population lacks comprehensive social protection, and finally, about 12 per cent (842 million) suffer from chronic hunger (UNDP, 2014).

So, after the Millennium Declaration, the 2030 Agenda or Sustainable Development Agenda -SDA was agreed upon by the world's governments in New York in 2015. This initiative "set out an ambitious agenda for ending extreme poverty and hunger, ensuring equal rights for women and marginalized communities" (BYANYIMA, 2019, p. x), by covering an action plan designed through objectives and goals[115], taking into account

economic, social and environmental issues as components of sustainable development and emphasizing broad and central themes such as prosperity, planet, peace, security, and justice. So, "with an interdisciplinary understanding of sustainable development and in order to achieve the above objectives, the SDA included 17 objectives and 169 goals" (RODRÍGUEZ, 2021, p. 102) to respond the development challenges, including those related to human development, poverty, inequality, climate, environmental degradation, prosperity, and peace (UN, 2015, p. 5-7), for both developing and developed states.

Among the global targets of the 2030 Agenda are: no poverty - SDG1; zero hunger - SDG2; good health and well-being - SDG3; quality education - SDG4; gender equality - SDG5; clean water and sanitation - SDG6; affordable and clean energy - SDG7; decent work and economic growth - SDG8; industry innovation and infrastructure - SDG9; reduced inequalities - SDG10; sustainable cities and communities - SDG11; responsible consumption and production - SDG12; climate action - SDG13; life below water - SDG14; life on land - SDG15; peace, justice, and strong institutions - SDG16 and partnerships for the goals - SDG17.

"During the negotiation of the successor agreement to the MDGs, the Sustainable Development Goals (SDGs), the issue of financing was front and center" (REISCH, 2019, p. 39). So, in the SDGs taxation occupies a prominent place as the first means of implementing the goals. A specific target has been foreseen for reducing illicit financial flows (target 17.1), including cross-border tax abuses by individuals and multinationals (16.4). Finally, inequalities are central to the SDGs (COBHAM, 2019, p. 148).

Consequently, the final version of the SDGs contains commitments to "significantly reduce" illicit financial flows by 2030, fiscal stem losses, and "[s]trengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection."[116]

The SDGs are not simple or easy goals to be achieved by countries. On the contrary, they represent ambitious goals that, despite being defined and agreed upon at the UN, must be achieved by individual countries (WALKER, 2019, p. 316). Byanyima (2019, p. x), reinforcing the alert made by World Bank and International Monetary Fund - IMF in 2015, emphasizes that delivering "on these goals will cost trillions of dollars". Thus, it is up to countries, in the midst of a multitude of controllable and

uncontrollable factors, to adopt the necessary measures to try to achieve the SDGs.

Kohonen et al. (2019, p. 385-386) emphasize that taking into account a broader Sustainable Development perspective, the states' tax systems should serve different purposes, that includes (i) revenue collection; (ii) redistribution; (iii) representation, and (iv) repricing, purposes already highlighted in the previous section. Cobham (2019, p. 148) adds that the primary character of the tax collector and the redistributive purpose of taxes is key to achieving the SDGs. Cobham (2019, p. 148) also highlights "the underlying importance of taxes to strengthening political representation and governance over time". Therefore, even if not highlighted by the SDGs, taxation is a central factor to be considered by countries. (WALKER, 2019, p. 316).

3.2. Taxation and SDGs

Unlike the process of adopting the MDGs, during the negotiation of the Sustainable Development Goals (SDGs), the issue of financing was at the centre of attention (REISCH, 2019). Many of the 17 SDGs directly address tax issues, being implicit in the SDGs the requirement of state financing via taxation to fill the investment gap (WALKER, 2019, p. 310). According to the Platform for Collaboration on Tax – PCT[117118] (2018, p. 9), taxation "is a significant factor in 10 of the 17 SDGs". Thus, to achieve their SDGs, countries must adopt a comprehensive approach to tax, favouring the promotion and complementation of other areas of development (WALKER, 2019, p. 303).

Walker (2019, p. 310) argues that taxation, like private investment, is a large piece of the SDG puzzle.

Within the SDGs that directly mention tax issues, SDG 3 - Ensure healthy lives and promote well-being for all ages - notes that 'weaknesses in tax systems' are a "major obstacle to improving health outcomes. Hence, increases in tax collection could potentially improve outcomes." (WALKER, 2019, p. 304). Ensuring healthy lives and promoting well-being requires allocating a large part of the budgets of developed countries. Walker (2019, p. 304) suggests that a basic universal health system could encourage better tax compliance, as taxpayers could directly benefit from health services financed by taxes.

Another goal closely linked with tax aspects is Goal 8: Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all.

High economic growth, when sustainable, increases jobs and wages that trigger poverty reduction. Likewise, income increases lead to increased productivity and growth (TABASSUM; MAJEED, 2008, p. 727).

Nowadays, scholars and policymakers are giving up the expression of 'economic growth, replacing it with 'inclusive growth' (AJIDE et al., 2021, p. 689). The term "inclusive growth" means growth that increases shared prosperity and accelerates the reduction of poverty and inequality (AJIDE et al., 2021, p. 693).

Taxation directly affects economic growth, as taxes significantly impact several economic growth elements (WALKER, 2019, p. 304). The tax system, as well as international tax policy, must also be carefully considered by countries (WALKER, 2019, p. 305). Countries should seek the best combination of the tax burden imposed on the main categories of taxes, considering the country's peculiarities (WALKER, 2019, p. 304-305).

Long and Miller (2017, p. 11-12) warn that a well-designed system can stimulate and help stabilize growth, while a poorly designed system can delay and increase growth volatility. Thus, encouraging economic growth would be a critical element in the design and administration of the tax system. For the PCT (2018, p. 26), tax systems must favour domestic and foreign direct investments in productive sectors. Moreover, tax systems that contemplate broad bases with low rates to meet collection needs are more efficient (PCT, 2018, p. 27).

Although the classic understanding that taxes negatively affect economic growth prevails, the performance of taxes to encourage or discourage certain behaviours - a regulatory function of taxes, has gained strength in this scenario of sustainable economic growth (WALKER, 2019, p. 304). In addition, Long and Miller (2017, p. 11) state that "taxation can be divisive rather than inclusive", and accordingly to PCT (2018, p. 27), the tax system's design affects how people behave economically. Furthermore, it is worth remembering that many Scandinavian countries have high Gross Domestic Product (GDP) growth rates while maintaining high tax/GDP ratios (WALKER, 2019, p. 304).

Moving on to the next goal, SDG 10 - Reduce inequality within and among Countries - includes the Goal targets and tax issues: 10.4 Adopt

policies, especially fiscal, wage, and social protection policies, and progressively achieve greater equality.

Although market integration has reduced inequality between countries (CHANCEL; PIKETTY, 2021; AJIDE et al., 2021, p. 690), this effect has not occurred within countries (WALKER, 2019, p. 306). Despite economic growth, the income distribution in many countries became more unequal between the early 1980s and the mid-2010s[119].

Both the distribution of wealth within countries, but especially inequality between nations, are challenging to control, especially given the absence of a central authority and states' common lack of planning. However, how tax systems are presented is controllable, and governments can favour adopting policies to reduce inequality (WALKER, 2019, p. 306).

Not only subgoal 10.4 but also subgoal 10.1[120] call for a progressive tax system, where the ability to pay principle is effectively applied.

Specifically, regarding gender equality, SDG 10 is linked with SDG 5 - Gender Equality. The SDG 5 aims, among others, to recognize and value unpaid care and domestic work through the provision of public services, infrastructure, and social protection policies and the promotion of shared responsibility within the household and the family as nationally appropriate (subgoal 5.4); to ensure women's full and effective participation and equal opportunities for leadership at all levels of decision-making in political, economic and public life (subgoal 5.5); and the adoption and strengthen sound policies and enforceable legislation for the promotion of gender equality and the empowerment of all women and girls at all levels (5.9).

Nowadays, national tax systems are not gender neutral: they can either promote or undermine it and thus can mitigate or reinforce asymmetrical gender relations (TALLADA, 2017, p. 12). Due to the diverse and unequal positions that women and men occupy in the workforce, as consumers, as producers, as owners of goods, and as responsible for the activities included in the 'care economy', women and men experience the impact of fiscal policies in different ways (SEPULVEDA, 2018, p. 2; CARMO, 2020, p. 56-57). Therefore, assessing issues related to the effects of taxation on personal income and indirect taxation (including the 'tax on tampons') and the impact of evasive practices on gender equality is essential to redesign tax policies aimed at achieving SDG goals 5 and 10 (CARMO, 2020, p. 62-64).

Limberg (2019), in a study focused on fiscal fairness and progressive income taxation, concludes that tax justice claims still play a role in formulating tax policies. The author suggests that although policymakers are more sensitive to the policy preferences of wealthy citizens, his study shows that the general demands for tax justice to compensate for unequal treatment can still prompt the need for progressive income taxation (LIMBERG, 2019, p. 14).

Finally, Walker (2019, p. 316) among other scholars have pointed out that SDGs 8 and 10 could be mutually exclusive. The incompatibility lies in that a business-friendly tax approach that does not contemplate progressivity can increase economic growth (SDG 8), while raising inequality, unlike SDG 10. On the other hand, despite not being a unified view, the OECD and IMF both argue that inequality negatively affects economic growth (CINGANO, 2014, p. 28). Therefore, economic growth should be accompanied by a decrease in inequalities returning to the idea of 'inclusive growth' (AJIDE et al., 2021, p. 691, 693), already mentioned previously.

Other SDGs that easily connect with aspects of taxation are SDG 12 - Responsible Consumption and Production, SDG 13 - Climate Action, and SDG 16 - Peace, Justice, and Strong Institutions.

In the first two, the regulatory function of taxes, already highlighted in this topic, can be a 'weapon' to implement these SDGs. Taxation discourages undesirable conduct (i.e., actions harmful to the environment or consumption of luxury goods). At the same time, it encourages desirable practices (i.e., consumption of sustainable goods and a green economy).

And finally, concerning SDG 16, a simple reading of the subgoals shows that governments should, also in the field of taxation, take actions to: 10.12 Promote and enforce non-discriminatory laws and policies for sustainable development; 10.5 Substantially reduce corruption and bribery in all their forms; 10.6 Develop effective, accountable and transparent institutions at all levels and 10.4 Reduce, significantly, illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime.

3.3. Structuring tax systems and tax policies to finance SDGs

The historical record suggests that good things come to those who tax more. That's because the evidence base suggests that rising levels of

taxation are associated with more social spending and more effective and accountable states in the long run, which are likely to contribute to meeting SDG targets (LONG; MILLER, 2017, p. 11-12).

Expanding access to key public services such as healthcare and education represents the key enablers of sustainable development (HANNI; MARTNER, 2019, p. 531). So, the viability of the SDGs depends on investments in education, health, and infrastructure, especially in many developing countries (WALKER, 2019, p. 303; HANNI; MARTNER, 2019, p. 531). Until today, the lack of taxation resources is a key constraint for further spending on health, education, and social protection and achieving the SDGs (LONG; MILLER, 2017, p. 2).

Therefore, the existence of adequate revenues to enable the financing of the Sustainable Development of the 2030 Agenda will most likely vary depending on the tax policies to be adopted by countries (KOHONEN et al., 2019, p. 385; WALKER, 2019, p. 316).

Firstly, the tax system reform, especially in developing countries, is urgent to alleviate the adverse effects of taxation and finance such investments (WALKER, 2019, p. 303;). In addition, international cooperation and the 'support network'[121] are often seen as necessary to enable developing countries to face obstacles to achieving the SDGs.

In the second place, governments may have no choice but to prioritize certain SDGs over others is an issue repeatedly raised (WALKER, 2019; p. 316).

For instance, reducing corporate taxes to attract investment, a business tax approach used to increase economic growth (SDG 8), is generally supported by concentrating taxation on labour. However, this same SDG 8 prioritizes full employment. As a result, countries will need to review fiscal policies that may affect the enjoyment of full employment. Likewise, this business-friendly approach tends to increase economic growth while increasing inequality, thus contradicting SDG 10. Moreover, SDG 8 can increase environmental degradation, negating SDGs 12 and 13.

The third point is raised by Hanni and Martner (2019, p. 516, 529) regarding the 'fiscal' pacts that exist, explicit or implicit, in all countries to define the rights and obligations of governments and citizens. With the adoption of the 2030 Agenda, an opportunity would arise for governments and their citizens to rebuild their' fiscal pacts' to value the delivery of high-quality public services and benefits foreseen in the 2030 Agenda through a

holistic approach focused on public tax revenue and spending priorities. The authors also state that "bringing more citizens, especially those of the middle class, into the personal income tax system – as well as addressing the low taxation of passive income and property – would not only strengthen the system's redistributive power but provide substantial resources to support the realization of rights" (HANNI; MARTNER, 2019, p.536).

Furthermore, the PCT[122] (2018, p. 9) highlighted the connection between taxes and SDGs follows four broad pathways: (i) taxes generate the funds that government activities in support of the SDGs; (ii) taxation affects equity and economic growth; (iii) taxes influence people's behavior and choices, with implications for health outcomes, gender equity, and the environment; and, (iv) fair and equitable taxation promotes taxpayer trust in government and strengthens social contracts that underpin development. In conclusion, the authors argue that making progress on taxation is vital for achieving the SGDs.

The PCT (2018, p. 17- 42) also summarizes 15 key messages that aim to provide general guidance to governments, institutions, and other SDG stakeholders:

- Key Message 1. Developing and emerging-market countries must have strong domestic revenues to support achievement of the SDGs.
- Key Message 2. Domestic resource mobilization is also central to how developed countries can support achievement of SDGs.
- Key Message 3. Effective tax administration is essential.
- Key Message 4. Voluntary compliance is the foundation of a modern tax-administration system.
- Key Message 5. Effective taxation of extractive industries is key for resource-rich countries. But it should be accompanied by a robust tax regime that covers the rest of the economy.
- Key Message 6. Encouraging economic growth is a critical element in tax system design and administration.
- Key Message 7. An equitable tax system is a vital element in tax structure design and tax administration.
- Key Message 8. A medium-term revenue strategy should be the framework used for structuring a tax system and developing a country's revenue strategy.

- Key Message 9. Environmental taxes, including carbon taxation, are necessary components of economically viable solutions to pressing environmental problems.
- Key Message 10. Excise taxation continues to have a role in public-health issues.
- Key Message 11. Gender bias in taxation can be explicit but is most often implicit; both should be eliminated.
- Key Message 12. Public trust in government, including in the tax system, is essential to achieving the SDGs.
- Key Message 13. Transparency is an important attribute of national institutions and a key contributor to successful taxation and achievement of the SDGs.
- Key Message 14. International tax problems are stubborn, even while there has been progress in addressing issues related to cross-border flows.
- Key Message 15. The Platform for Collaboration on Tax has a vital role to play in improving global taxation.
- Key Message 16. All stakeholders must have a seat at the table.

In this new perspective of Sustainable Development, looking at tax policy through the lens of human rights obligations can lead to a shift in the relationship between individuals and sovereign governments, in the debate over the scope of justice, and in how to balance justice with efficiency and other tax policy goals (CHRISTIANS, 2009, p. 230).

4. Fair Share

4.1. Seeds of the concept

In the previous sections, taxation's role in realizing ESC rights and SGDs has been analysed. However, in the current social context, supranational and international entities have drawn attention to ensure the payment of fair share by all taxpayers.

The scandals about tax avoidance and tax evasion by individuals and companies with high levels of wealth and mobility[123]; the exponential growth of the digital economy and the difficulties of adequate taxation in this new space; damages inflicted on the vast majority of the population by the increasingly common financial, economic and social crises, specifically

through degradation of public goods and services and unsustainable increase of sovereign debts; and inequality growing or stagnating all over the world; are the ingredients with which the *status quo* of deep dissatisfaction and disbelief in democratic institutions, namely in the ability of States to fulfil their functions, and of dangerous distrust and tension between individuals has been cooked up (GRIBNAU; VAN STEENBERGEN 2020, p. 2; PIRLOT, 2020, p. 409; HONGLER, 2019, p. 14-20; OGUTTU; IYER, 2019, p. 193; VORDING; 2020, p. 24; MARTÍNEZ; 2021, p. 151-152; DEVEREUX et al., 2021, p.1-7).

Thus, the concept of fair share emerges as a response from civil society to defend its legitimate and sometimes not legitimate interests, but without the essential rigor and coherence that would allow it to bring about fundamental transformations (BRASSEY; ORDOWER 2020, p. 100-101, 106-107).

4.2. Many shades of fair

Fair share is usually defined as the fair distribution of the tax burden among taxpayers, in other words, the fair amount of taxes owed by each taxpayer. (HONGLER, 2019, p. 9; DAGAN, 2020, p. 5-6; VORDING, 2020, p. 1-3; BROEKHUIJSEN; VORDING, 2020, p. 2-3; DUSARDUIJN; GRIBNAU, 2020, p. 6-7; VAN BREDERODE, 2020, p. 10) Nevertheless, to grasp this definition, it is necessary to understand the notion of fairness. Namely, if the imposition of taxes is fair, and if the quality and quantity of the tax burden and public expenditure are fair (STEWART; 2019, p. 251; BROEKHUIJSEN; VORDING, 2020, p. 3; CHRISTIANS, 2018, p. 11 e 12; VAN HULTEN; 2019, 61-63). The positions that answer these questions are decisive in identifying the fair distribution of the tax burden among taxpayers (HONGLER; 2019, p. 9-12). Nevertheless, the article does not intend, even because it would be unreasonable in such a short space, to analyse the various answers proposed by economists, philosophers, jurists, and political scientists.

After this preliminary remark, it is possible to follow with the most relevant conceptions of fair share. It is reasonable to argue that there are formal conceptions and material conceptions. The former has in common the understanding that it is up to the legislator to create the tax rules that delimit the tax obligations of each taxpayer and that mere compliance constitutes the payment of the fair share by the taxpayer (VAN

BREDERODE, 2020, p. 10-13). From the formal conceptions, it is possible to distinguish between those who defend that mere compliance with the letter of the law is the farthest we can go in terms of a fair distribution of the tax burden (DEVEREUX et al., 2021, p. 35) and those who defend that the payment of the fair share is performed only when the letter and the spirit of the law are followed (VAN BREDERODE, 2020, p. 14-15; OSTAS 2022, p. 5-7, 20-21).

Nevertheless, mere taxpayer compliance with democratically established tax rules would be insufficient. It is essential to find a justification for the established tax rules that go beyond their democratic formation process and serve as a decision criterion for the legislature and a guiding compass for taxpayers and law enforcers (GRIBNAU; DUSARDUIJN, 2020, p. 170-172). The two guiding criteria or principles often pointed out are the ability-to-pay principle and the benefit principle (CHRISTIANS, 2018, p. 12; DAGAN, 2017, p. 17-18).

The ability-to-pay principle is currently dominant in several national legal systems (DAGAN, 2017, p. 18; PUCKETT, 2018, p. 427; CHRISTIANS, 2018, p. 15; DUSARDUIJN; GRIBNAU, 2020, p. 7). This principle is a corollary of the principle of equality by stating that taxpayers must contribute according to their means to develop and maintain the society to which they belong. Therefore, taxpayers are required to make an equal sacrifice for the common good of their communities (CHRISTIANS, 2018, p. 15-16; VAN BREDERODE, 2020, p. 6).

However, fundamental questions arise for which there are several answers, specifically, how to measure the capacity of each taxpayer and the fair amount of sacrifice to be demanded, meaning, what should be considered relevant, what should be taxed, and how much should be taxed to maximize or not to undermine the ability to pay (DAGAN, 2017, p.19; PUCKETT, 2018, p. 427-429; HONGLER, 2019, p. 388-389). The widely advocated solution has been progressive taxation, based on the concept of diminishing marginal utility. Still, serious problems persist since it is not possible to measure with reasonable accuracy the decrease in satisfaction per monetary unit of the individual with rising income[124]. (VAN BREDERODE, 2020, p. 6-7)

Even if consensual answers to the above questions are found, new problems emerge with globalization. More and more taxpayers relate to several societies and, as such, different tax systems. These taxpayers are

taxed differently from taxpayers who relate to only one jurisdiction and have the same ability to pay due to the variations in the tax systems (HONGLER, 2019, p. 401-402). Solutions have been presented and implemented, though highly criticized on normative and effectiveness grounds.

Regarding the benefit principle, it states that taxes owed by each taxpayer are a payment made to the State for the goods and services it provides or, in a broader perspective, are the price of the benefits received by each taxpayer from the development and maintenance of the society with which they relate. In other words, the amount of taxes someone pays equals the benefit that person gets from the State. This principle establishes that taxpayers give something up, so they must receive something back (DAGAN, 2017, p. 17-18; CHRISTIANS, 2018, p. 12; PUCKETT, 2018, p. 426; HONGLER, 2019, p. 447; VAN BREDERODE, 2020, p. 6).

This principle was overcome due to its growing inadequacy to the State's progressive growth and was widely abandoned with the establishment of the Welfare State paradigm. It became impossible to assess the benefits offered by the State in a context of deep intervention in the lives of citizens (DAGAN, 2017, p. 18), particularly in the lives of the most disadvantaged, who could not be forced to pay more taxes for the increase in benefits they received. It would be giving with one hand to immediately take back with the other, perpetuating their needs and exclusion. Another pertinent criticism is the manifest difficulty or impossibility of assessing the benefit to each taxpayer of specific goods and services provided by the State, namely public goods and services, precisely those that the State traditionally provides (CHRISTIANS, 2018, p. 12-14; HONGLER, 2019, p. 448).

As such, the benefit principle was reconceptualized to consider the overall well-being of the taxpayer for relating to a given community. In other words, the benefit principle changed from 'I pay this amount of taxes because this is the price of the goods and services that the State makes available to me' to 'The amount of taxes I pay corresponds to the price of the well-being that I have for relating to a given community.' (CHRISTIANS, 2018, p. 14-15; VAN BREDERODE, 2020, p. 6).

The reformulation has successfully overcome the weaknesses pointed out but fails to offer a precise method to measure the well-being of each taxpayer. The quantity and quality of resources owned could be defended as

measurement criteria. Still, the consequence would be, in practice, the approximation of the principle to the ability-to-pay principle. (CHRISTIANS, 2018, p. 15).

Despite the prevalence of the ability-to-pay principle, with globalization and tax competition, the increasing mobility of taxpayers has revived the idea of the state-citizen relationship as an exchange/consumption relationship, so perceived in the light of the benefit principle. The growing detachment of taxpayers from the ties of affection and their lack of sense of belongingness to communities have been the catalysts for the increase of taxpayers seeking the jurisdictions that best satisfy their interests according to a judgement based on the mere price-quality ratio. Nowadays, prevails the selection of the highest possible quantity and quality of benefits for the lowest possible amount of taxes owed (DAGAN, 2017, p. 38-42).

Then, what is the right way to go? Dagan delineates in a sublime way the choice that we as societies have at hand. In the following words, the author asks:

> "Are "we" in any meaningful sense a cohesive group with a shared sense of solidarity, commitment, and belongingness? Or are "we" simply a group of people with a shared interest in increasing our collective net-worth?" (DAGAN, 2017, p. 39)

The *status quo* of contemporary societies and human relations, including the relations between taxpayers and between the State and taxpayers, unequivocally answers which way the scales are tipping.

Taxpayers perceive taxation as a mutual exchange of benefits. Each taxpayer replicates what other taxpayers in their position do, expecting all to pay according to the benefits provided. Also, each taxpayer demands all to be treated equally by law and law enforcers. Therefore, the individual's perceptions of States' options and actions and of other taxpayers influence the individual's decision to comply or not to comply, how much to contribute, and how to cooperate. (LARSEN, 2018, p. 26-28, 34-36; FARRAR et al, 2018, p. 495-498; VAN BREDERODE, 2020, p. 10)

How did we get here? How human beings relate to themselves and others has undergone a vast transformation. Contemporary human relations are fragile because they have become conditional, mere connections that only exist if they are profitable and as long as there are no better options on the market. Sacrificing, conserving, repairing, maintaining, holding on,

waiting, and being content with what you have become irrational actions and laughing stocks. The new gods are immediacy, novelty, convenience, speed, and quantity. Hence, the individual looks at others as potential objects of pleasure that can be easily substituted without ever being satisfied. Simultaneously, he survives tormented by the constant threat of being discarded and exchanged for something or someone apparently more beneficial. Soon the struggle to maximize pleasure at no cost or at the lowest cost has become the source of human despair and the destruction of our humanity. The ideal of the uniqueness of each human being was replaced by the banalization of the commodification of the self (BAUMAN, 2003, p. xi-xiii, 66-76).

4.3. The Importance of fair share to the implementation of ESCRs and SDGs

If the conception of fair share is a source of many problems and disagreements, why is it still discussed?

Fairness validates and legitimizes Law, despite the apparent existence of many different understandings of its factual content (HONGLER 2019, 5-6; DUSARDUIJN; GRIBNAU, 2020, p. 4). Without it, the "law" is nothing more than commands contrary to law with no capacity to bind the conscience. Essentially, "law" would be nothing more than dead letter (D'ENTRÈVES; NEDERMAN, 1994, p. 42-43, 115).

Additionally, the perception of fairness inspires trust. As such, people feel more willing to comply with the law, a *conditio sine qua non* for the integrity of the system and prosperous life in society (BENNER, 2017, p. 65; FARRAR et al., 2018, p. 487; GRIBNAU; VAN STEENBERGEN, 2020, p. 6-10; VAN BREDERODE, 2020, p. 9 e 17).

Moreover, tax compliance according to fair share would allow for a substantial increase in tax revenue, essential for human rights protection, by financing more and better public goods and services, effectively redistributing wealth, and, consequently, reducing the high levels of inequality. (PUCKETT, 2018, p. 412; GUNNARSSON, 2021, p. 481-486)

4.4. Now what?

The result of the above exploration is the perception of the concept of fair share as a destination of long and winding roads. For that reason, it was abandoned by many who claim its impossibility. However, to give in to the

theoretical and practical difficulties is opting for the facile, often disguised as pragmatism.

Some crucial steps are going to move us in the right direction. The first and foremost is the severe and profound debate on how to effectively create a global society in which a dignified life for all humans, living and not yet living, is inherent. Dignity acknowledged as the pure, unconditional, and willingly recognition by oneself and others of the supreme, irreplaceable and unique value of oneself and of the other's selves. Thus, humans are treated with dignity by others and by themselves when they cheerily and altruistically give themselves and others a real opportunity to build, preserve and express their selves. (BAUMAN, 2003, p. 77-81)

Bauman (2003) brilliantly explains why human dignity must be the beginning:

> "It is not only that the dignified life and respect due to the humanity of each human being combine into a supreme value that cannot be outweighed or compensated for by any volume or any amount of other values, but all other values are values only in as far as they serve human dignity and promote its cause. All things valuable in human life are but so many different tokens to purchase that single value that makes life worth living. The one who seeks survival by murdering humanity in other human beings survives the death of his own humanity." (BAUMAN, 2003, p. 82)

Therefore, it is initially necessary to understand what it takes to achieve human dignity for all, trying to identify whether the quantity, quality and distribution of existing resources allow its reach. Since it is reasonable to assume that the current quality and quantity are adequate or adaptable and their distribution, resulting from the market, harms human dignity, (Dagan 2017, p. 221) there follows the discussion about the *quantum* that each human should contribute to all humans. In addition, it must be evaluated under what terms this contribution should occur. In essence, the recognition of the most adequate entities and instruments for a redistribution of resources that materializes human dignity.

After fully addressing the subjects raised above, it is appropriate to move on to the conception of fair share, to the quantification of the sacrifice demanded from each taxpayer by the human community through States, and subsequent reflection on how to ascertain its effectiveness.

For that purpose, it must be highlighted the relevant role of civil society and international organizations. Compliance with fair share is allied to the international movement of fiscal moralization, putting into question the reputation of taxpayers who do not meet their effective ability to pay (PIRES, 2018, p. 384).

Although, a lot remains to be done. A call for a continuous and fruitful inter- and intra-disciplinary dialogue is evident from the above. The answer to the definition of fair share or the correct way to get there must be addressed by economists, philosophers, political scientists, jurists, sociologists, anthropologists, psychologists and neuroscientists. All should try to go hand in hand because understanding the tax phenomenon is also understanding human nature, human relations, and their vicissitudes. (ALSTON, REISCH, 2019, p. 1-2; DAGAN, 2017, 20-23)

5. Final considerations

The ESC rights cover a range of entitlements that have been growing and developing more and more. Note that ESC rights are subject to conduct and result obligations. Thus, States must respect, protect and fulfil them. Regarding the obligation to fulfil, this demands the implementation of appropriate legislative, administrative, budgetary and other measures. Precisely within the scope of fulfilling these social rights, attention is drawn to the role of taxation policies for the realization of ESC rights.

In the same sense, taxation appears as a measure for financing SDGs. Unlike what happened with the MDGs, where fiscal policies, including fiscal inequality, were invisible, already during the negotiation of Agenda 30, the issue of financing was a central issue. Thus, the primary character of the tax collector and the redistributive purpose of taxes came to be considered fundamental aspects to achieve the SDGs.

It is noteworthy that several of the 17 SDGs directly address tax issues and argue that taxation would be a significant factor in 10 of the 17 SDGs. As highlighted in the article, to ensure a healthy life and promote well-being (SDG 3) it would be necessary to differently allocate a large part of the budgets of developed countries. Likewise, fiscal policies substantially interfere in achieving the reduction of inequalities within and between countries (SDG 10) and gender equality (SDG 5). Not to mention the

impact that taxation has on promoting sustainable and inclusive economic growth (SDG 8).

However, it has already been argued that some tax policies, by directing the fulfilment of one SDG, may negatively impact the achievement of another. Thus, it will be up to States, policymakers and scholars to better unravel this issue to seek a reasonable balance to this 'apparent conflict'.

When talking about compliance with ESC rights or achieving the SDGs, there is a bridge of convergence, both demand restructuring tax systems, either through tax reform, or through the strengthening of progressive taxation, and raise awareness in changing the mindset of policymakers and civil society.

It is precisely in this context that the discussion of fair share in taxation is so relevant. Assuming States have honestly decided to embrace ESC rights and SGDs, products of human dignity, fair share is the compass for treading what has been and continues to be a journey filled with uncertainty and obstacles. There is no human dignity without justice, no justice without tax justice and no tax justice without fair share. Furthermore, 'Welfare States' face a continuous growth of the burdens inherent to the maintenance and promotion of human dignity. Human rights multiply and grow, but they do not fall from trees. Nor do they result from or are they protected by the natural functioning of the market. Thus, the significant and continued increase in public expenditure and, the subsequent and proportional, increase in public revenue makes tax compliance according to fair share more than just a political preference.

Therefore, without a stabilized conception of fair share, the countless proposals for transforming the tax systems are worth little or nothing, are mere contingent constructions to respond to contingent claims. So, if it is truly intended to build a world rooted on human dignity, it must be accepted that there will be storms, tempting shortcuts, and the absolute need to work side by side recognizing and celebrating the fact that humanity is a plural unit and, for that reason, capable to succeed.

Finally, as Lennard (2019, p. 211) wisely pointed out "Tax represents an avenue to more modern sustainable development-focused economies, responsive to modern challenges"

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111. For example, the statement on Behalf of the Group of 77 and China by the H.E. Ambassador Kingsley J.N. Mamabolo, Permanent Representative of the Republic of South Africa, Chair of the Group of 77, at the Roundtable on Ensuring Policy Coherence and an Enabling Environment at all levels for Sustainable Development and the Third International Conference on Financing for Development, 14 July 2015, available online at http://www.g77.org/statement/getstatement.php?id=150714b

112. As a example, the authors mention tobacco control efforts focused on increasing cigarette taxes (KOHONEN et al.,2019, p. 386)

113. Shrimp-Turtle case (1999) (WTODSB) para. 129.

114. UNGA resolution 55/2 (18 September 2000).

115. The SDGs were first agreed upon at the UN Sustainable Development Summit on September 25-27, 2015, in New York. After, the SDGs were adopted as part of the UN's 2030 Agenda for Sustainable Development.

116. Transforming our world: the 2030 Agenda for Sustainable Development, Resolution Adopted by the General Assembly on 25 Sept. 2015, UN Doc. A/RES/70/1, 21 Oct. 2015, at para. 16.4 and 17.1.

117. The Platform for Collaboration on Tax (PCT) — a joint initiative of the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the United Nations (UN), and the World Bank Group (WBG). About PCT, Walker (2019, p. 309) explains "The platform was created by the OECD, World Bank, IMF, and the UN. the Platform seeks to bolster collaboration between the sponsor institutions, support capacity-building in the area of tax for developing countries, and facilitate the participation of the latter in multilateral dialogues regarding international tax policy (REISCH, 2019, p. 41).

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120. 10.1 By 2030, empower and promote the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status
121. formed by the OECD, UN, IMF, and World Bank. To know more, access: http://www.oecd.org/ctp/platform-for-collaboration-on-tax.htm or access the a joint report by the IMF, OECD, United Nations, and World Bank in 2011, "Supporting the Development of More Effective Tax Systems," available at: https://www.oecd.org/ctp/48993634.pdf
122. To know more, access the Taxation & SDGs - First Global Conference of the Platform for Collaboration on Tax Conference Report, available at: https://www.oecd.org/tax/tax-global/first-global-conference-of-the-platform-for-collaboration-on-tax-february-2018.pdf
123. For example, the reports "Offshore Leaks", "Swissleaks", "Luxleaks" and "Panama Leaks" produced by the International Consortium of Investigative Journalists – ICIJ (2013; 2014; 2015; 2016) exposed tax activities that were little known until then. To know more, access: https://www.icij.org/
124. Van Brederode (2020, p. 6-7) explains it with the following examples: "Both a Chevy and a Ferrari bring you from A to B, but the additional satisfaction found in the thrill of driving a Ferrari cannot be quantified. How would we measure the satisfaction of Bill Gates, the founder of Microsoft, in giving billions of dollars away to charitable causes? Is the satisfaction derived from driving a Ferrari larger or smaller than the satisfaction derived from buying your son a new baseball bat for his birthday?"

CHAPTER 4 – THE ROLE OF TAXATION FOR THE SOCIAL CONTRACT & PUBLIC GOVERNANCE OF TAX REVENUE AND THE SEARCH FOR A SUSTAINABLE SOCIAL STATE[125]

Alice Ferraz de Andrade, Iara Maçarico and Catarina Gomes Correia

1. The social contract

A. The political foundations of the social contract

The debate about the genesis of civil society, as we know it today, began with the development of the contractual theories attributed mainly to the political philosophers Hobbes, Locke and Rousseau[126]. According to this line of thought, civil society wouldn't exist without the celebration of a social contract between human beings. It is the conclusion of this contract that underlies the political organisation of modern western civilisations (Catarino (2020), p. 38).

In the path of contractualist thought, in a pre-societal context, everything begins with the state of nature. In its purest state, without any laws or moral concepts, human individuals are left to their fate among others, striving for self-preservation. This state of nature ends, precisely, with the conclusion of the social contract.

This new concept marks the transition of humanity from the state of nature to the state of civilisation. This requires them to give up a certain part of their individual freedoms and rights and to transfer them to that collective entity which, once endowed with authority, will bind them, as a collectivity, to the law. People will do this, precisely, in order to obtain from this sovereign body, i.e. the State, a whole series of rights, freedoms and guarantees that they never knew in their state of nature. We can, therefore, conclude that the social contract represents a genuine exchange

of the natural and individual freedom of man for the guarantees offered by civil society.

With this paradigm shift, the citizen will now be at the centre of the power system (Catarino (2020), p. 37). Therefore, and based on this premise, the State (as an organised power structure) will now assume responsibility for guaranteeing social rights, promoting equality among citizens, developing economic regulation and wealth redistribution policies, and guaranteeing legal order and security.

Now, in the context of a State of Law, it must use the public power granted by its citizens in order to fulfil its duties. However, such public power cannot be exercised in a discretionary or arbitrary manner. The State is, therefore, always bound by the rules of law, which means that whenever it acts, it must comply with the principles of legality, which can be enforced through a system of checks and balances between the different and independent sovereign branches (legislative, executive and judicial).

However, the social contract does not only impose duties and obligations on the State. They also extend to the sphere of the citizen. Indeed, the general concept of citizenship itself implies the existence of a set of rights and duties inherent in the legal sphere of each citizen, which contribute to a fairer and more cohesive society.

The same considerations apply to taxation. In fact, the concept of citizenship includes what is known as fiscal citizenship, which mainly concerns the civic duty to pay the taxes that every citizen is obliged to pay.

In fact, it is through the taxes paid by citizens that the State raises public revenue and thus ensures the fulfilment of the duties assigned to it in the social contract and which benefit the general interest of society. Taxes are, in a sense, the price of living in society (Nabais (2016), p. 132). This is why we can now speak of a fiscal social contract. And this is precisely what we will be discussing in the next section.

B. Domestic Fiscal Social Contract: assumptions and dimensions

Since, according to the social contract, the pursuit of public interests is the State's responsibility, there is an obvious need to transfer wealth from the private sector (i.e. citizens and companies) to the public sector. And taxation is the main economic instrument used for this purpose.

However, as mentioned in the previous exposition, the State's actions, especially when it comes to collecting taxes from citizens, cannot be

discretionary. For this reason, and for the purposes of this article, the first assumption that legitimises the collection of taxes - and perhaps the most important of all - is precisely the examination of the legality's principle, which is closely linked to the principle of democracy.

Accordingly, in a democratic State, such as the Portuguese one, the citizens' representatives are elected by universal, equal, direct and secret suffrage. Consequently, from a formal point of view, taxes can only be introduced by the Parliament, institution that directly represents the sovereign people (Nabais (2016), p. 138). The underlying idea of such a reservation on the creation of taxes then expresses, as we shall see in the following chapter (with regard to the factor of representation, which, as we shall see, integrates the set of the four R's of taxation), the principle of "*no taxation without representation*" (Guimarãea (2020), p. 87)[127]. Thus, taxes and their essential elements (incidence, rate, tax benefits and guarantees for the taxpayer) are necessarily created by law or by an authorised government decree, provided that the latter is preceded by an enabling law[128].

Moreover, the creation and collection of taxes also depend on the respect of other highly important legal and constitutional principles, such as legal certainty, equality and ability to pay (Nabais (2016), p. 151). Indeed, in the case of direct taxation of citizens' income - which in itself constitutes a restriction on the fundamental right of citizens to private property (Guimarães (2020), p. 94), which they agree to renounce in part under the fiscal social contract - the State may not levy taxes that are manifestly confiscatory in nature, resulting in the fiscal strangulation of taxpayers[129].

Now that we have briefly described the foundations that justify the State's tax collection activity within the framework of the fiscal social contract, we'll move on to analyse the dimensions of this contract today. In this respect, the social contract has a vertical and a horizontal dimension.

The fiscal social contract, in its vertical dimension, can be characterised mainly by the terms we have discussed so far. It involves, as we have said, the establishment of a genuine *quid pro quo* in the relationship between the State and the taxpayer. However, taxpayers' satisfaction with the public services provided by the State is inevitably linked to a greater or lesser degree of compliance when it comes to paying taxes (Tengs, 2020, p. 6). Thus, while it is true that the State can ultimately collect taxes by coercion, it is also true that the way in which the collected tax revenue is

managed can also be scrutinised by the recipients of the public services provided. This means that the State remains accountable to taxpayers' perceptions of public spending. However, given the coercive powers of the state in tax collection, experience has shown that this vertical dimension of the fiscal social contract tends to be more effective than its horizontal dimension.

The latter differs from the vertical dimension in that it is based on the relationship between citizens and their cooperative capacity to act collectively for the common good. The horizontal dimension of the fiscal social contract is essentially based on the relationship between citizens (Tengs, 2020, p. 8), which is different from the relationship between citizens as taxpayers and the State (perceived here as a higher hierarchical authority, which is why we can consider that the State-taxpayer relationship incorporates the vertical dimension of the fiscal social contract).

While the effectiveness of the social contract in its vertical dimension will be consensual across States, the success of the horizontal social contract will tend to depend on the type of society in which it operates. The effectiveness of the horizontal social contract typically requires the convergence of, at least, three fundamental sociological variables, namely: (i) trust, (ii) solidarity, and (iii) unity of values and cultural identity among the actors of the same society. However, this horizontal dimension is not, and could not be, any less relevant for the characterisation of the fiscal social contract, since it implies an idea of willingness and solidarity on the part of each taxpayer when it comes to paying taxes for the public good (Tengs, 2020, p. 16-17).

To better understand this idea, it is enough to think of the example of the Portuguese case of direct taxation, where personal income is taxed through a progressive system of tax brackets[130]. In theory, a progressive income tax system is based on the concept of each taxpayer's ability to pay, so that, for a fairer society, each taxpayer is taxed at a different rate (higher or lower, and therefore heavier or lighter on the taxpayer's total income) according to the amount of his/her income. In practice, the higher the income of each citizen, the higher the tax rate applied to them. It is precisely from this perspective that the horizontal dimension of the fiscal social contract - which, as mentioned above, is essentially based on the relationship between the citizens of a given society - may face more challenges in terms

of its effectiveness. This is because, in the case of direct taxation, not all taxpayers are expected to pay exactly the same amount of tax to the State. And, on the other hand, for those citizens who do pay taxes, the question remains to what extent they are prepared (under the assumptions mentioned above and in the light of the principle of solidarity among fellow citizens itself) to give up a large part (in comparison with other citizens who earn a lower income and therefore pay less tax, if any) of their own personal income in order to finance the general welfare needs of society.

Notwithstanding the above and the relevance of the fiscal social contract dimensions, it is certain that today, as we will see below, there are several countries, including Portugal, that have increasingly high levels of tax arrears, which obviously has a negative effect on tax collection.

2. The importance of Representation and Redistribution to the State's accountability and sustainability and to the social contract

The fiscal social contract, as we know it today, may indeed not provide the protection and answers for the sustainability of public finances. And this is due to the emergence of a variety of factors that we will elaborate in the course of this paper, such as tax default, lack of legal certainty, clarity and quality of the legislative technique, tax bureaucracy, digitalisation, globalisation, harmful tax competition, and so on. This shows that the fiscal social contract is currently in a state of crisis. And this crisis, which affects both the vertical and horizontal dimensions of the fiscal social contract, inevitably affects the efficient collection of tax revenue and, consequently, public finance policy.

And more recently, this has become even more apparent, particularly due to the Covid-19 global pandemic and the Russia-Ukraine war, which together have increased underlying inflation. This situation, which is likely to worsen, inevitably leads to a reduction in the purchasing power of households as their real income is eroded (Oner, 2017, p. 30). More specifically, in the Portuguese case, the rise in inflation led the government to adopt new measures to protect families, such as the granting of cash subsidies and a reduction in the VAT rate on electricity.[131] In addition to the above, and now particularly in relation to the consequences of the

pandemic, it is also worth highlighting some other examples of problems that have significantly worsened, such as excessive social inequality and the deterioration of the national health and social security system (Passos Beraldo, Passos and Abrantkoski Rister, 2020, p. 83).

It is precisely in this context that society is increasingly demanding changes to fully meet the needs of taxpayers. And these changes must necessarily be addressed by governments, both national and international, taking into account the "four Rs of tax", i.e. the four benefits of taxation (Cobham, 2022, p. 31), which we will now reflect upon.

First, *revenue*, which is essential to finance public services and goods, such as education or national health systems. Second, *redistribution*, which is a key factor in tackling inequality and poverty, for example by reducing disparities between citizens. Then there is *repricing*, which aims to encourage changes in taxpayers' behaviour, for example by introducing taxes on fuel products, tobacco or foods with added sugar. And finally, *representation*, which is crucial to making governments effectively accountable to their citizens and to reclaiming political space.

However, we will now focus on the analysis of the representation and redistribution factors.

First, the aforementioned principle of "no taxation without representation", originally enshrined in the English Magna Carta of 1215 and later adopted by the American colonies, illustrates the importance of the representation element. Indeed, the American Revolution was in part due to the creation of the Sugar Act, the Stamp Act and the New Townshend Duties in the 1760s to pay for the war effort associated with the Seven Years' War (Ross, 2004, p. 6). The main purpose of the Stamp Act was to require all printed documents used or produced in the colonies to bear an embossed tax stamp. Following the publication of this act, the colonial assemblies declared that such a tax was illegal, precisely because they had no representation in Parliament. The colonists argued that they should have voted for or against the Act. And this sense of injustice led to the rise of an opposition movement that saw the Act as a step towards despotism and a symbol of "taxation without representation". The criticism that arose from this situation demonstrates the value of strengthening the relationship between society and the State, not only then but also today.

This component of taxation can determine the legitimacy of a government. Holding governments accountable promotes the efficient

management of tax revenues and, more broadly, good public financial management, which is essential in today's fragile environments (The World Group, 2009, p. 12). On the other hand, redistribution is linked to the horizontal and vertical social contract mentioned above. Civil society knows that the contributions it makes to the State are essential, not only to keep the system running, but also to support the programmes and services that improve the quality of life, especially for the most vulnerable (Cobham, 2022, p. 31). By improving the quality of life and public services, by increasing confidence in a welfare State, taxpayers will be more willing to meet their tax obligations. We must never forget that one of the objectives of governments is to create a fairer society, where the gap between rich and poor is blurred, where poverty and discrimination do not exist, and always remembering the importance of sustainability as a whole (environmental, economic and social).

However, this is only possible if all taxpayers pay their fair share of taxes. As mentioned above, in the horizontal dimension of the fiscal social contract, the ability-to-pay principle establishes that the tax burden should be distributed according to each person's economic capacity, which in practice means that each taxpayer should pay taxes in proportion to their income. (Campos, 2007, p. 104). Therefore, as part of the idea of ensuring redistribution, every citizen now expects his fellow citizens to pay the taxes they owe to the State. The problem is that many taxpayers - individuals and companies - often fail to meet their tax obligations. And this particular aspect is quite evident and discussed extensively in the report 'The State of Tax Justice 2021' by the Global Alliance for Tax Justice, Public Services International and the Tax Justice Network, which found that in 2021, global tax losses due to global tax abuse will rise to $483 billion. Multinational corporations will be responsible for US$312 billion of the total due to cross-border tax abuse, and wealthy individuals for US$171 billion due to offshore tax evasion. The report also analyses the impact of tax losses in higher and lower income countries. The former has higher tax losses, but the impact is smaller, i.e. it represents a smaller proportion of the money they have to spend. For the latter, the opposite was found: tax losses are lower, but the impact is greater.

Therefore, taking into account all that has been said so far, we can only conclude that the lack of tax compliance weakens the sustainability of a welfare State. According to the World Commission on Environment and

Development (1987, p. 41), "*(…) a sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs (…)*". This concept has three pillars: social, economic and environmental.

Over the years, the importance of each pillar has changed. Colantonio (2009, pp. 3-4) argues that the environmental pillar was the most important in the 1980s and mid-1990s due to environmental trends. However, this perspective started to change in the late 1990s when the economic pillar started to gain some importance. Today, and especially due to the impact of the 1992 UN Conference on Environment and Development, where the Rio Declaration on Environment and Development was signed, there has been a paradigm shift: the environmental, economic and social pillars are of equal importance.

It is important to explore the dynamics of each pillar by linking them to tax.

From an economic point of view, it is not simply a question of mobilising resources and collecting the necessary revenue, but above all of the way in which taxes are collected in order to promote and ensure that economic prosperity can be maintained over time by promoting the sustainability of public finances and, for example, the pension system.

At an environmental level, the main goal is to keep nature healthy over time. Taxation can be used to encourage investment in the production of renewable energy or to reduce the use and purchase of fossil fuels.

Finally, the social component of sustainability can be achieved by never compromising the needs of present and future generations and by creating a more equal society. For example, promoting gender equality can be achieved by applying lower taxes to sectors of the economy where women are most prominent, or by applying higher taxes to sectors where the vast majority of actors are men. As mentioned earlier, tax can help to change the way taxpayers think and act.

Taking all this into account, we can conclude that the extremely negative impact of tax evasion on the sustainability of the welfare state is undeniable. This is because, as a result of the tax evasion phenomenon, the resources needed to achieve the objectives of sustainable development will inevitably be less than what is expected and, in the worst case, less than what is needed. It is therefore up to governments and international organisations to take action and design better tax systems.

However, we must not forget the need to build a relationship between the State and taxpayers. Therefore, people must also be empowered to stand up for themselves and hold their governments accountable when tax administrations are not effective and efficient.

Perhaps with the desideratum of responding to citizens' demands by fulfilling the horizontal social contract and seeking the social sustainability of the State by strengthening it, on 10th October the Portuguese government presented the proposal for the 2023 State Budget, in which it is proposed to introduce a 28% tax on capital gains arising from the sale of cryptocurrencies and crypto-assets. Until now, Portugal has been considered almost a "tax haven" for crypto.

In addition, and although it is not included in the State Budget as it will not be applicable until 2023, Portugal will apply a 33% tax on the windfall profits of energy companies, according to Council Regulation (EU) 2022/1854 of 6th October 2022. The law has yet to be approved but is expected to be applied as early as 2022.

These are measures that are also being discussed at international and European level (OECD and EU) and are being implemented in many countries, as developed below.

3. Recent challenges to the fiscal social contract and the State's tax sustainability

A. Necessity to re-think the fiscal social contract model: the crisis of the current fiscal social contract and the globalization phenomenon

There is a current and globally widespread idea that the current model of the fiscal social contract seems compromised or outdated. Today, several challenges have arisen, in particular due to the evolution of modern societies and the culture of globalisation itself. As a result, this reality calls for action on the part of States and the need to renegotiate the fiscal social contract with social actors.

We believe that, today, one of the main reasons that could explain the fiscal social contract crisis, in its vertical dimension, is related to the growing legitimacy deficit of governments and the lack of credibility of politicians in general. The permeability of governments when it comes to decision-making, the interests of entrenched elites and the primacy of

lobbying over the needs of the collective interest are a reality. Thus, there is an increasing lack of fairness in the design and implementation of tax laws in favour of certain elites (whether through the drafting of "tailor-made" laws or the use of tax loopholes by these elites), which in itself is one of the main reasons for the decline in citizens' political trust in governments.

The vertical dimension of the fiscal social contract is also challenged by the lack of legal certainty in tax matters. Today, taxpayers find it increasingly difficult to predict the tax consequences of their actions. This is because the tax system, especially the Portuguese one, is constantly changing[132]. Every year, the State Budget Law aggravates or creates new taxes, or at least makes several changes to the known tax legislation, with the added complication that the tax measures implemented often promote inequality for certain economic agents.

In addition, the lack of legal clarity and the imprecise quality of the legislative technique used in drafting tax rules (or even their excessive complexity) seem to make it difficult to understand the law and therefore to comply with it. This also contributes to the already significant lack of tax literacy and education among citizens, which the State should always ensure, in particular by creating services specifically designed to help taxpayers increase their tax literacy and awareness of tax citizenship and the need to pay taxes. Therefore, one possible solution that could be considered to combat tax evasion, especially for the reasons mentioned above, could be the development of simpler and clearer tax rules (PWC and World Bank Group, 2020, p. 28). Moreover, the clearer the tax rules, the lower the compliance costs and the more people will comply with their legal obligations.

Also, with regard to the lack of legal clarity, it is important to bear in mind that tax design itself can strengthen and improve the fiscal social contract in its vertical dimension. In order to redesign tax systems to meet the needs of citizens, both nationally and internationally, the involvement of civil society is paramount. As noted in The State of Tax Justice 2021, "*such strong civil society alliances are crucial because the scale of change needed to tackle tax injustice will never be given, but can only be won through people power*". This also means that civil society should be empowered to advocate for fairer tax systems and be able to hold governments to account for their actions and decisions.

Furthermore, as regards the issue of citizens' tax literacy - which, as we have already noted, is quite low - we believe that one way of overcoming this challenge is to promote tax education. According to the OECD (2021, p. 18), to finance the Sustainable Development Goals, countries need to develop more effective and efficient tax administrations and continue to fight tax evasion. However, this is not enough< to meet the current challenges. Tax administrations need to strengthen and increase taxpayer compliance, in particular by raising awareness of the importance of their contributions. Indeed, in a first edition of this report, the OECD also suggested that countries, as well as public and private organisations, should promote tax education initiatives for a wide range of age groups, to communicate taxes in different formats and to support tax compliance[133].

Nevertheless, as mentioned in the first chapter, it is not only the vertical dimension of the fiscal social contract that is in crisis. In fact, the horizontal dimension of the social contract is also facing several challenges, but perhaps in a sociological sense. From the point of view of relations between citizens, particularly in terms of tax compliance, the effectiveness of the horizontal fiscal social contract, as we have seen, tends to be measured on the basis of the voluntarism shown by each taxpayer when it comes to paying taxes for the common good. And it is precisely in this context that it is relevant to try to understand whether relations between citizens are indeed sufficiently consolidated to the extent that each citizen voluntarily agrees to contribute with a larger share of his own income to the needs of his fellow citizens, including those who may not pay taxes to the State due to insufficient income.

Experience has shown, however, that it is not enough to evoke notions of solidarity and morality per se to ensure closer relations between people to the extent that they are willing to take the risk of financing the public project from their own resources for the benefit of others. The mistrust of some citizens towards others can also lead to a certain reluctance to voluntarily comply with the obligation to pay taxes. As we have seen, we are often confronted with the news that not all citizens and economic agents may be paying the taxes they should (and may be involved in tax fraud).

A change is also needed to reverse the balance of power in the tax relationship. As a result of globalisation and the development of new technologies, the relationship between taxpayers and the tax

administration has changed. On the one hand, tax administrations are sometimes perceived as 'intransigent', for example, when they use their powers to enforce their tax credits (even if they are sometimes still being debated in the courts) and are able to do so very quickly and almost automatically due to technology. On the other hand, tax administrations sometimes perceive taxpayers as abusive taxpayers who engage in tax planning. For these reasons, tax administrations should review the common rules of taxation in order to regain their place in the relationship with the taxpayer (Pires, 2017, p. 41), or at least to improve this relationship.

In addition to all of the above, at the international level, globalisation and the phenomenon of harmful tax competition between States also pose challenges to the fiscal social contract. Harmful tax competition often encourages tax avoidance and the transfer of capital by large taxpayers and companies to countries with more favourable tax regimes and to tax havens. And despite the best efforts of the OECD to combat this harmful trend in tax competition, the truth is that each state's policy choices and approaches to taxation are its own exclusive sovereignty[134]. The hypothesis of a global social contract between nations has therefore been proposed (Christians (2009), p. 139). In this context, States would be required to give up some of their sovereignty over tax policy by not introducing certain tax advantages into their own legal systems, in order to prevent the distorting effects of harmful tax competition and to ensure the international neutrality of tax policy[135]. However, particularly in a context where States are faced with the need to increase tax revenues and attract foreign investment, the phenomenon of harmful tax competition is unlikely to abate, even if it means harming other States. Nevertheless, this situation inevitably jeopardises the internal social contract of each State, as States find themselves deprived of the tax revenue that would be generated by the fair share owed by the entities that take advantage of and benefit from this competition by choosing to relocate their capital.

B. Recent challenges: windfall taxes and taxation of crypto assets

As mentioned above, perhaps with the aim of promoting social sustainability - inevitably also following the recommendations and demands of the European Union - the Government had analysed the possibility of introducing the so-called "windfall taxes" on energy and the taxation of crypto actives. In October 2022, the Government presented the

draft State Budget Law for 2023, in which it introduced the taxation of crypto-actives. In addition, the government announced that it would legislate on windfall taxes in 2022.

i) Taxation of crypto assets

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Portugal had lately been seen as a 'tax haven' for cryptocurrencies[136], but this appears to be about to change.

In the proposed state budget law for 2023, the taxation of income derived from cryptocurrencies and crypto-actives is explicitly introduced.

There have been many attempts by Portuguese parties to pass legislation to tax this reality, but they haven't found a consensus. The government wanted to study very thoroughly the better way to address the taxation of this reality and ended up proposing its taxation in a very simple way in the State Budget. The proposal foresees the approval of a new model declaration specifically designed for the voluntary declaration of income derived from crypto. This declaration will have to be submitted by companies that provide custody and administration services or manage negotiation platforms (intermediary companies).

These intermediaries will also be taxed through stamp duty on the commissions charged for the transactions, according to the 2023 State Budget Bill.

The taxation of crypto has received more attention from the States due to the completely unregulated market that has arisen from it, where tons of profits have been made completely untaxed, but the truth is that, as with many other digital and e-commerce transactions, the challenge is to be aware of the existence of such transactions, to track them and link them to the people involved, and ultimately to identify the beneficiaries of the income and where the income is derived and where it takes place.

There is no question that equal effort and contribution (fair share) should be demanded from those who derive income from these realities, just as from other types of income that are more easily traceable.

The question remains whether States will have to rely on the good will of the few companies that do comply, or whether they will eventually have to find ways and mechanisms to better track these transactions. However, the reporting requirements that currently rely on intermediaries may help to overcome this difficulty (Jacob, 2022, p. 51). DAC 8[137] could also play a role here. It is expected that e-money institutions and crypto-asset custodians may be required to identify the tax residence of their customers and report them annually to their respective tax authorities.

On the other hand, and at the risk of facing many criticisms related to the principle of equality, there are states (Portugal may be included) that are considering creating a special tax framework for crypto to attract crypto investments. If so, the question may arise as to how to reconcile such objectives of attracting investment for economic growth with the horizontal social contract. Will other taxpayers understand the need to create tax incentives for such realities? Is the economic growth argument strong enough? Will such economic growth lead to economic sustainability? If so, will it translate into improvements in public goods and services to individuals?

At the same time, as mentioned above, the creation of tax advantages can encourage tax competition between different jurisdictions, which can lead to a crisis in the global social contract.

ii) Windfall taxes

Environmental taxes are not new and have long been used to discourage practices that may be harmful to the environment and contribute to increased pollution. Such environmental taxes have been seen as a way of promoting the sustainability of both the environment and the community.

Recently, however, there has been some discussion about whether energy producing companies should pay a higher fee on their extraordinary profits.

With the war between Russia and Ukraine, energy prices have soared since late February 2022 and many energy producing companies have seen a significant increase in their profits.

Against this background, the European Commission, in its RePowerEU plan (COM(2022) 108 final), has addressed the possibility for Member

States to introduce a temporary "windfall' tax[138] on the energy sector - until 8 March 2022. According to Annex 2 of this Communication, fiscal measures need to be carefully designed to avoid market distortions while encouraging investment in renewable energy.

But even before the European Commission's proposal, many countries, such as Spain and Italy, had already started to introduce windfall taxes on the energy sector.

In Portugal, the Minister of Economy initially allowed this possibility for very specific situations, but only as a last resort. As of September 2022, the government put that possibility aside and instead focused on creating measures to protect households from energy price increases, as mentioned above.

In addition to corporate income tax, energy companies in Portugal already pay a special contribution ("Contribuição Extraordinária sobre o Setor Energético"). The purpose of the special contribution is supposedly to reduce the tariff debt. However, this special contribution is not a tax on income, but on the company's assets. The report on the State Budget for 2014, by which this contribution was created, states that the contribution is considered to promote the systemic sustainability of the sector and to help distribute the budgetary effort among the companies with the greatest ability to contribute.

The Extraordinary Contribution on the Energy Sector has been challenged by taxpayers, including before the Portuguese Constitutional Court, namely on the grounds that it violates the principles of proportionality and equivalence, but without much success so far.

One question that arises with the possibility of introducing yet another tax on the energy sector through these windfall taxes is whether these companies will internalise these additional costs or whether they will pass them on to individual consumers.

If the latter is the case, an additional question arises: would it be fair and just for consumers to suffer not only from the increase in energy prices, but also from the additional tax?

And even if these companies were to internalise these additional costs, the legitimacy of the state imposing these windfall taxes needs to be reconsidered in terms of the social contract and sustainability.

The social contract implies, among other things, that the state has the legitimacy to impose a higher tax burden on the richest, with the aim of

channelling this revenue into the provision of public goods and services and thus redistributing wealth within the community.

People expect the principle of ability to contribute to be applied, thereby serving and promoting the idea of the social contract and the sustainability of the welfare State. So, the general idea in society can be that these companies should contribute, even temporarily, in line with the extraordinary profits they are making and thus pay their fair share.

From another perspective, it is crucial to channel all revenue derived from such windfall taxes to the cause that justified its creation (State's accountability plays a role here).

On 6th October, 2022, the European Council adopted Regulation 6th October, 2022 which, among other measures, created a temporary solidarity contribution on the excess profits of companies operating in the crude oil, natural gas, coal and refining sectors. This contribution is compulsory for all Member States. The Member States must adopt this solidarity contribution by 31st December, 2022.

According to this Regulation, the revenue generated by the collection of this contribution shall be used for one of the following purposes (b) financial support measures that contribute to reducing energy consumption, such as demand reduction auctions or tendering systems, reducing energy purchase costs for final energy customers for certain volumes of consumption, promoting investments by final energy customers in renewable energy sources, structural investments in energy efficiency or other decarbonisation technologies; (c) financial support measures that support enterprises in energy-intensive industries, provided that they are conditional on investments in renewable energy sources, energy efficiency or other decarbonisation technologies; (d) financial support measures to develop energy self-sufficiency, in particular investments in line with the REPowerEU objectives set out in the REPowerEU Plan and the REPowerEU Joint European Action, such as projects with a cross-border dimension; (e) in a spirit of solidarity between Member States, Member States may allocate part of the proceeds of the temporary solidarity contribution to the joint financing of measures to mitigate the adverse effects of the energy crisis, including support to protect employment and to retrain and up-skill the workforce, or to promote investments in energy efficiency and renewable energy, including cross-border projects, and the Union's renewable energy financing mechanism provided for in Article 33

of Regulation (EU) 2018/1999 of the European Parliament and of the Council.

The legitimacy of this contribution is based on the energy crisis and is levied with the aim of minimising its impact.

In view of the above, accountability is key. The Member States will have to account for the way in which they use the revenue from this contribution, which is predetermined by the European Union itself.

The first of the above applications - financial support measures for final energy customers, in particular vulnerable households, to mitigate the effects of high energy prices in a targeted way - seems to be the most immediate and necessary application. And the easiest to monitor and control. End-consumers are the ones most affected by energy price rises, so it's logical that they should be the priority targets for channelling such revenues (through direct financial support or other means).

From the point of view of the companies that will pay the contribution, the notion of a horizontal social contract needs to be strongly anchored in the community to facilitate its acceptance.

In the case of Portugal, the conjugation of the solidarity contribution with the extraordinary contribution for the energy sector ("CESE") could raise several questions of equivalence and proportionality - even if each of these contributions seems to serve different purposes - as there are many different types of companies operating in the market (small and medium-sized), not all of which are large energy companies.

Conclusions

Although the concept of the social contract was first introduced in the 18th century, it remains relevant today and is now linked to various other issues.

In recent decades, the importance of promoting sustainable development has increased. However, true sustainability is not limited to environmental concerns, but also encompasses social and economic issues, which are the focus of this paper.

As discussed earlier, the existence of a contractual relationship between the State and its citizens implies a symbiotic relationship of rights and duties that exist in both spheres. To ensure the sustainability of the State

and its public finances, both the vertical and horizontal dimensions of the social contract must be maintained and strengthened.

On the vertical dimension, the 4 R's of taxation are essential for maintaining the fiscal social contract. Through adequate representation, taxpayers can hold the state accountable for inefficient management of tax revenues. On the other hand, redistribution ensures that the benefits and burdens of taxation are shared fairly, and tax education can increase tax compliance. However, many are the challenges posed to the sustainability of tax revenues that can undermine the welfare state.

In this context, windfall taxes and the taxation of crypto assets have been proposed as potential ways to improve tax collection. However, the implementation of these measures needs to be carefully considered to avoid unintended consequences. For example, windfall taxes may aggravate pending litigation, while the taxation of crypto assets may pose technical and enforcement challenges.

Moreover, the erosion of the horizontal dimension of the social contract, which depends on citizens' trust and compliance, poses additional challenges to the sustainability of the tax system. Tax evasion and avoidance can reduce tax revenues and undermine the legitimacy of the tax system. In this context, measures to increase compliance, such as simplification of the tax legislation and its stability or predictability, can be effective in promoting voluntary compliance.

Overall, the fiscal social contract is essential for maintaining the legitimacy of the tax system and ensuring sustainable development. Maintaining and strengthening the vertical and horizontal dimensions of the social contract through adequate representation, redistribution, tax education and compliance measures can improve the relationship between the state and its citizens and promote the common good. However, it requires a continuous effort on both sides to fulfil their obligations and maintain the benefits inherent in the social contract.

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https://www.loc.gov/exhibits/magna-carta-muse-and-mentor/no-taxation-without representation.html

https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf

125. DISCLAIMER: this paper was developed until October 2022 with reference to the national tax law in force at that time. However, due to the approval of the 2023 State Budget Law, some of the tax provisions addressed herein have been amended.

In addition, and regarding the Extraordinary Contribution on the Energy Sector (typically applied to companies operating in the energy sector, including companies dealing with electricity, gas and fuels), which is addressed throughout this work, it is also necessary to take into account the publication of the recent Ruling no. 101/2023 of the Portuguese Constitutional Court. In an unprecedented decision, the Court ruled that the provision in paragraph d) of article 2 of the law that establishes the aforementioned Contribution is unconstitutional, as it violates article 13 of the Portuguese State Constitution. Essentially, the Court held that this provision violated the principle of equality, since concessionaires of transport, distribution and underground storage activities in the natural gas sector should not be subject to the payment of such Contribution as from fiscal year of 2018 onwards, since they do not cause nor benefit from the public provisions this Contribution aims to finance according to the budgetary change of revenue allocation.

126.Although the three authors share a common basis of thought, their theories regarding the details of the social contract are different.

Thomas Hobbes (1588-1679), the English political philosopher who wrote Leviathan, believed that the state of nature was a state of war and that only a vigorous and centralized government could guarantee social order and peace.

According to John Locke (1632-1704), the English political philosopher who wrote "Two Treatises of Government", the state of nature was a state of liberty and equality, so the role of the government was primarily to protect the individual's natural rights, while political power should be exercised with their consent.

In turn, Jean-Jacques Rousseau (1712-1778), the French political philosopher who wrote "The Social Contract", claimed that the state of nature was a state of harmony and that civil society was corrupting human nature, mainly in the name of private property. According to Rousseau, sovereignty should be vested in the people, rather than in the government or the elite.

127. However, tax policy nowadays is highly vulnerable to the ideology of the governments that are formed. Therefore, the tax policy tends to oscillate according to the parliamentary majorities existent. This reality causes some difficulties within the system and, ultimately, may jeopardize the fiscal social contract, to the extent that it may open the door for the government to create taxes whenever it wants. This happens because, systematically, when parliamentary majorities exist, in theory and regardless of the political party (politically positioned closer to the Right or further to the Left, which is irrelevant to the current paper) that is governing, the majority of the Parliament may become a sort of Government chamber, since the latter will propose the laws at its discretion, and the Parliament will tend to vote in the Prime Minister's direction. Such a reality may subvert the genetic principle of the fiscal social contract. On the other hand, one might also defend that parliamentary majorities are formed precisely by the will of the people (that elected a given party with the sufficient votes to form such majority). It is up to the majority party to reflect such will and legislate according to the political program that granted them all the votes and thus respecting the Representation factor.

128. *Vide*., article 103, §2, article 165, §1 and article 165, §2, §3, and §4, of the Portuguese Republic Constitution, and also article 8 of the General Tax Law.

129. *Vide*., articles 1, 2, 25 and 32 of the Portuguese Republic Constitution and also article 7, §3, of the General Tax Law. Moreover, in Portugal's case, because the citizen stands at the core of the power system, when it comes to direct taxation, particularly in the context of personal income tax,

the State can't tax the amount of income needed to ensure a minimum existence with dignity. In fact, this rule is drawn from the fundamental principle of human dignity itself.

130. In Portugal's case, mainly provided for in article 68 of the Portuguese Personal Income Tax Code (IRS Code), which establishes the table of progressive tax rates applicable to the taxpayer's taxable income (obtained from the sum of each category's net income).

131. Decree-Law no. 57-C/2022, 6th September.

132. See below section B for a better illustration of this idea.

133. From an academic perspective, there are already several initiatives of this kind, such as the Commitment to Reducing Inequality Index or TaxEdu. The former is a comprehensive Index developed by Oxfam, which ranks 158 countries according to their performance on issues such as progressive taxation. The latter is a pilot European project, originally set up and managed by the European Parliament and the European Commission, with the purpose of reaching out to children, teenagers and young adults to help them understand the significance of taxation.

134. Emphasizing the importance of the fiscal social contract, the OECD has developed proposals for a fairer and more sustainable international tax system, in contrast to the State's sovereignty in tax matters. Good examples of this are Pillars One and Two proposals, which resulted from the BEPS Action Plan launched by the OECD in collaboration with the G20 in 2013 to address aggressive tax practices by multinational companies.

Pillar One: Addressing the Tax Challenges of the Digitalization of the Economy proposes a new approach to profit allocation for multinationals that considers a company's digital presence in each market. The aim is to update international tax rules to reflect the increasing digitalization of the global economy and to ensure that companies are taxed where they generate economic value, even if they have no physical presence in each jurisdiction. On the other hand, Pillar Two: GloBE (Global Anti-Base Erosion) addresses base erosion and profit shifting by proposing a global minimum tax rate for multinational companies to prevent them from artificially shifting profits to low tax jurisdictions, thereby reducing their overall tax burden.

135. In this context, we can ask ourselves to what extent, for example, the Portuguese regime for the taxation of personal income of non-habitual residents doesn't jeopardise the global social contract, assuming it exists. This regime is attractive to non-residents, especially those with higher incomes. In general terms, the non-habitual resident regime offers non-residents, namely those who end their working life and change their tax domicile to Portugal, a tax advantage that exempts them from paying direct tax (in this case, IRS) for a maximum period of 10 years (in some cases, while in others it significantly reduces the tax to be paid). The existence of this tax regime has led to the Portuguese State being perceived as a genuine tax haven, aimed at attracting non-residents, in particular pensioners. For this reason, Sweden requested Portugal to draw up a protocol to amend the existing tax treaty in order to return to Sweden the competence to tax Swedish pensioners residing in Portugal as from 1 January 2023. As Portugal maintained the status quo within the framework of its sovereignty over tax policy, Sweden withdrew from the tax treaty with Portugal on the elimination of double taxation, which had been signed in 2002 and entered into force in December 2003.

136. In the Binding Information Process no. 5717/2015, dated 27.12.2016, the Portuguese Tax Authorities stated that cryptocurrency is not taxable under the Portuguese tax system, unless it constitutes a habitual professional activity, in which case it might be taxed as professional activity income – however lacking some enforcement. This Information can be consulted here: https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/informacoes_vinculativas/rendimento/cirs/Documents/PIV_09541.pdf

137. The DAC-8 Directive is the eighth amendment to the Directive on Administrative Cooperation.

138. Windfall tax is an expression used to characterise taxes on sudden and unexpected profits that weren't planned by the people/companies earning it.

PART 2:

TAX & GLOBAL GOVERNANCE

How the world is working

CHAPTER 5 – INTERNATIONAL TAX LAW PRINCIPLES: past, present and future

Luís Castilho, Inês Vale de Amorim and Telmo Soares

1. Declaration of intent

A paradigm shift has silently but unquestionably occurred in international taxation around the turn of the century.

In the early to mid-twentieth century, the focus of international taxation was almost exclusively on the prevention of double taxation, acting out of the fear that the threat of double taxation would inhibit the development of international trade. As such, at the time, the international tax regime – documented in the 1923 report drafted by a committee of four leading economists to the League of Nations (Bruins, Gijsbert et al., 1923) – revolved around three primary principles: (i) a country should be entitled to tax all income derived from sources within its territory; (ii) a country should be entitled to tax the worldwide income of its residents; and lastly, (iii) that it should be the responsibility of the home country to alleviate or mitigate double taxation.

It was only by the second half of the century that scholars started trying to justify the international tax regime in terms of equity and neutrality and ability to pay in order to give international taxation some much needed theoretical justification (Elkins, David, 2006, p. 43-90).

By the turn of the twenty-first century, as markets opened, competition for investment – especially from multinational enterprises (MNEs) – totally shifted the focus of international taxation from preventing double taxation to preventing what the Organisation for Economic Co-operation and Development (OECD) refers to as "double non-taxation," the phenomenon of multi-national corporations not paying tax in any jurisdiction (or paying a low overall tax burden)[139], which culminated in the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS).

This phenomenon is the inevitable aftermath of the advent of the globalized economy and most recently the global digital economy, which

has heightened opportunities for aggressive tax planning by MNE and has allowed the opportunity for tax competition between jurisdictions that are increasingly faced with the trade-off between protection of their tax revenue bases and the encouragement of international investment.

Responding to these challenges, during the last decade, the European Union (EU) and the OECD have been proposing and implementing an ever-increasing number of arguably fragmented measures aimed at curling harmful tax planning and consequently decreasing the opportunity for unbridled tax competition.

The danger of this approach is that disjointed measures tend to be narrow-sighted and hence be at risk of introducing serious disruptions to the previously accepted international tax architecture, if there ever was one. As such, in the dawn of one of the biggest fragmented intervention to the established international tax order, with the new nexus and profit allocation rules and the global minimum tax proposed by the OECD/G20 Inclusive Framework on BEPS (beginning in the fact that it only applies to MNE companies that meet a certain threshold and does not include any harmonization of tax bases), it is a good time as any other to go over what scholars have been writing on international tax principles, particularly in the last decade, and see if the essence of those principles still has the chance to endure.

2. The allocation principles

2.1. Benefit principle

From a traditional perspective, the benefit principle forms the classical justification offered by the governing powers for the imposition of taxes over their domain, namely by touting the idea that taxpayers ought to be obliged to pay taxes in proportion to the benefits obtained from their government.[140]

Even so, due to practical difficulties in determining the individual share of public benefits for each taxpayer, on the national front we have reached (mostly) a common understanding that, in matters of domestic taxation, the benefit principle should yield to the ability to pay principle. Hence, the amount paid by taxpayers must, above all, be in accordance with their

resources, even if the benefit-contribution ratio is not always met (Hongler, 2019, p. 448).

However, in the international tax world, the usefulness of the benefit principle has not only been revived but actually magnified. Indeed, when faced with the challenge to find a rationale to allocate tax jurisdiction, nations quickly turned to the benefit principle, as it allowed for the awarding of taxing rights to the State that contributed the most to the generation of the income.

In fact, following the benefit rationale, authors have traditionally qualified the tax allocation based on a theoretical distinction: (i) active (business) income should be taxed primarily by the country of source, while (ii) passive (investment) income should be taxed primarily by the country of residence (Avi-Yonah, 1997, p. 50).

Such rationale, which was slowly woven over the years into the framework of more than 3,000 tax treaties worldwide, often operates by reducing taxation at source on passive income streams, while allowing source countries to tax active income, as long as a minimum presence threshold is achieved (e.g., permanent establishment, number of days, etc.).[141]

In this context, striving to attain an up-to-date pulse on the benefit principle, we shall focus on the modern challenges raised, setting our focus on (i) the inquiries into the consistency of its application in treaty allocation rules overall (customary practice test), (ii) the debate regarding its overall fairness as an allocation criterion (distributive justice test) and (iii) the hurdles set forth by the digital economy (obsoleteness test).

Benefit principle as a favoured allocation rule (customary practice test)

Although undoubtably influential over cross-border policies worldwide, the hypothesis of the benefit principle as one of the guiding material principles of the international tax order, for allocation purposes, remains as much of an unclosed chapter today as it did in the end of last century.

As a matter of fact, whilst a fair number of scholars still believe this principle will continue to inform international tax policies in the years to come (López, 2019, p. 31; Shay *et al.*, 2001, p. 90), several authors have raised doubts if such standard can be regarded as a universally accepted tool to allocate income between contracting states, especially given its growing

inconsistent application in international tax treaty practice (Mason, 2020, p. 46; Shön, 2010, p. 75).

For instance, even though most common allocation rules for royalty income will lead to exclusive taxation in the state of residence[142], in an increasingly globalised market it is no longer possible to solely trace the payments generated by a licenced patent back to one single country. In a global economy, product development latches on to multi-country benefits, be it in the country where the owner contributed the necessary capital, the country where the underlying R&D was performed, the country where the patented products were manufactured, or even the country where the final products were sold (Shön, 2021, p. 10). Nevertheless, in each stage of the economic lifespan of a certain patent, public benefits may have been provided by different countries around the world, in different forms. These contributions may amount to public subsidized education of researchers, conduction of safety inspections, creation of regulatory oversight bodies or even enforcement of patent law, but still, tax jurisdiction is only granted to the residence state.

On the other hand, the rise in popularity of cross-border retirement in recent years, coupled with the free movement rights present in certain areas of the globe (e.g. EU), has also brought forward concerns regarding the taxation of private pension income, since commonly the allocation rules assign exclusive taxation to the resident state[143], thus effectively disregarding any tax claim by the country of origin, even in cases where tax exemptions were granted during the contribution phase of the portfolio, with the expectation of collecting tax revenue down the road.

As a result, recently the international community has been witnessing real tax jurisdiction standoffs between States, with parties going so far as to withdraw all together from double tax treaties, to protest the allocation over pensions.[144] Such disputes present so much harmful potential, mainly due to the double taxation that follows, that they seem to have resonated into academic research, with some scholars now invoking the need for an overall individual tax reform that would rethink the application of the benefit rational to pension income (Beretta, 2019, p. 88-101). In fact, several proposals are being brought to the table, like the imposition of extended origin-based taxation, the creation of specific subject-to-tax rules, the use of exclusive or cumulative source-based taxation, the adoption of a

global minimum tax for individuals or even the levy of a compensation tax to counteract the loss of revenue by the state of origin.[145]

Furthermore, seeing that pandemic times only sparked the desire for more workplace mobility, the pressure on States to rethink individual taxation has also increased regarding other sources of income, like employment, as formerly insignificant labour models, such as remote work agreements, become increasingly more relevant for revenue-hungry host states, with several hastily creating or improving special taxation regimes in a bid to attract foreign skilled workers.

For example, in the end of 2020, Greece[146] enacted new rules that not only aim to simplify visa procedures for remote workers, but also grant them a seven year long 50% tax exemption on employment and business income, earned by individual taxpayers, that transferred their tax residence to the country, granted they were not tax resident therein in the 5 previous tax years. Even so, the Hellenic Republic is hardly the only party concerned with attracting remote workers, countries like Italy[147], Luxembourg[148], Cyprus[149], amongst many others, have also improved or else simplified the access to pre-existing special immigration and / or taxation schemes to better attract remote workers.

Among the many trends created in this new remote working reality, the most serious threat to the benefit principle may be found in digital nomadism, since this philosophy calls for taxpayers to have the ability to work from anywhere, holding no habitual abode and remaining in constant motion across the globe (Beretta, 2022, p. 5-11).

This modern reality severely clashes with current tax treaty rules, that still shy away from granting taxing rights to source states for short stays, reserving exclusive taxation for the residence state. This view relies on an outdated belief that labour is mostly stationary and that consequently residence states should tax since (i) they must be the ones granting the bulk of the benefits provided to individuals and (ii) they are the ones in better conditions to apply the ability to pay rational on a case-by-case basis.

However, it is curious to see that this nomadic factor may well be enough to completely shatter these States' ability to tax these individuals. After all, savvy digital nomads can easily manipulate internal tax residence criteria and obtain a worldwide non-resident status. Even so, States currently seem more preoccupied with studying ways to compete in attracting digital nomads and less worried about upholding the benefit principle standard.

In these circumstances, since no theoretical justification for these divergences from the benefits rationale can be readily found, one must question if the principle has been significantly eroded by the everchanging reality of a globalized world and, if so, what future role shall it have in tomorrow's tax treaties, especially in the context of the struggle by developing countries to attract a bigger slice of international tax rights to source States.

Benefit principle as a fair allocation criterion (distributive justice test)

A different thorn on the benefit principle's side, can be found in the rising wave of authors who defend that such tenet, as an allocation standard, does not necessarily lead to a just outcome, with some going as far as to claim that contemporary tax treaties, heavily infused with the benefit-based rationale, are in fact "poisoned chalices"[150]. Such instruments, under the guise of cooperation, end up shifting taxable income towards developed countries at a bargain price and, as such, developing nations would be wise to avoid such agreements all together (Brooks & Krever, 2015, p. 159).[151]

The Allocation Problem, as it was dubbed by some (Ozai, 2020, p. 324-328), is currently at the centre of the discussion whenever an international organization drafts a new tax measure, as more and more authors question the negative outcomes of current distributive rules in the international tax order (Christians, 2005, p. 661-662), with some arguing that to decide the allocation of taxable income according to the benefit principle would necessarily lead to detrimental effects for developing nations (Brooks & Krever, 2015, p. 160). Such negative effects are depicted as unavoidable, since the use of public benefits, as an objective standard, entails that their value needs to be determined under market rules, meaning that those provided in rich countries shall normally have a higher value, due to higher productivity rates, thus tipping the scale from the start in favour of the most well-off nations.

Actually, the disparity in the value of benefits is the crucial argument to understand why allocating taxable income based on a strict application of the benefit principle leads to unfair outcomes. A good proof of concept of such theoretical position can be found in the Professional Boxer example, as formulated by Peter Hongler. In this hypothetical case, the author imagines a professional boxing athlete that resides, trains and prepares for most of the year in Haiti to represent his country in the Olympic Games, in

London, thus receiving a salary from the national boxing federation, the equivalent to Euro 10.000, only to compete overseas for a couple of weeks at most (Hongler, 2019, p. 449-452).

However, when the time comes for the two countries to split the taxable income, if they were to use a pure form of the benefit rationale, some could argue that an equal distribution of the base is in order, since the proportional costs of infrastructure, security and personnel to organize such a massive event could match or even outweigh the benefits provided in the country of residence during a full year, no matter how short the event may be. In this context, the sportsman would now be faced with a 30% tax rate in England, but only 10% in Haiti, which means that the first country shall expect to collect, at least, Euro 1.500, while the latter would be left collecting only Euro 500, this excluding eventual obligations to provide double taxation relief at residence, which can further reduce the tax revenue. This outcome, while taken to the extreme, is pointed out as an example of how unfair allocations under the benefit principle may be, since it would not only guarantee a higher tax revenue to the best-off country, but also introduce a degree of uncertainty by imposing the quantification of the provided benefits, an exercise that would not take into account the level of sacrifice made by the developing country to provide such benefits, for example by considering their proportion to overall available public funds.[152]

As such, irrespective of the type of income at hand, if real-world applications of even the purest form of the benefit principle, as an allocation key, may lead to unfair results, due to something as fundamental as market valuation differences between developed and developing nations, one may doubt if the benefit principle should be allowed to further influence future international distributions at all.

In this setting, it is not surprising to see some scholars now suggesting that the role of the benefit principle in international tax law has shrunken over time, as it should now be seen as little more than a justification-to-tax principle, a simple command directed at States to refrain from taxing certain income streams created by using public benefits obtained abroad (Pistone & Hongler, 2015, p. 33).

Therefore, as the debate about the need for distributive justice reaches new heights, with rising claims for nations to embrace a more cosmopolitan view of global justice[153], one might be forced to rethink the scope and

content of the backbones that support the international tax system all together, since it, much like us, cannot evolve without ponderation and self-critique.

Benefit principle as a solution to the digital economy challenges (obsoleteness test)

Not all the writing on the wall spells disaster for the benefit principle, as some authors seem to consider that such paradigm, while needing an update patch from its conventional form, may very well be the theoretical foundation to address the challenges posed by the digital economy.

An innovative stream of thought, etched by Eva Escribano López, has suggested that a presumptive version of the benefit principle might provide a consistent theoretical foundation for future value-based measures (López, 2020, p. 2), by essentially establishing that taxpayers ought to be subject to tax wherever they perform their economic activities, provided that such performance makes them potential users of the public benefits offered by the host State.

According to this approach, tax rules should exclusively rely on presumption clauses to establish access to public benefits in a certain State, rather than going through a nearly impossible case-by-case analysis of effective use. Such a route would counteract practical constraints to establish both the actual enjoyment of public benefits and their respective valuation, according to fair market values (López, 2019, p. 36).

Beyond these considerations, the presumptive benefit principle could also be used to provide a justification for taxation over digital profits in states where customers or users are located, instead of using traditional approaches, since in a way the existence of a certain market of well-off consumers can be attributed, albeit partially, to governmental public policies and to a properly functioning State.

Although creative, this recent position is not unanimous, since for some scholars it fails to take into account the original sins of the benefit theory, like the fact that developed nations unequivocally have the capacity to provide more benefits than developing nations, or that such benefits, even if identical in shape, might differ in value between locations, thus luring developing nations, under the guise of avoiding unfair double taxation results, to surrender their tax rights (Antón, 2020, pp. 266).

Even if such inequity could be overlooked (which it cannot), this formula does not seem to address the difficulty for MNE groups to determine, with certainty, which particular business units are to be considered as beneficiaries of the advantages provided by a certain State, a hindrance only made worse whenever a proportional allocation is in order.

In sum, even though this position has its merits, such as greater flexibility when compared to current solutions, adopting tax rules based on assumptions that public benefits are being received by a taxpayer would ignore intricate pre-existing inequity problems connected to this traditional principle and, as such, one cannot conclude outright that a presumptive formulation of an old idea would be enough to solve all the tax hurdles of the digital economy.

2.2. Value creation principle

Propelled by outrage flames, set ablaze by scandals of enormous MNE paying negligible amounts of tax worldwide, the idea that income should be taxed where value is created, distilled into the value creation principle, seems to have gathered a wide range of support in the international community in the past few years, bringing developed and developing nations together on the premise that an all-out international tax reform is in the making.

In fact, the value creation principle has been directly cited, by both the G20 and the OECD, as a guiding principle for the pivotal BEPS project and more recently for the Inclusive Framework on BEPS initiative, being referred to as the basic paradigm for the taxation of cross-border profits, in both action 1 (digital economy) and actions 8-10 (transfer pricing).[154] Even so, critics do point out that policymakers have not only failed to provide a clear concept of value creation as an allocation factor, but also continue to struggle to explain why this should be the principle commanding the allocation of taxing rights (Hay, 2018, p. 203-208).

Although we are witnessing heightened enthusiasm to discuss specific projects, that supposedly represent embodiments of the tax over value approach, one must not dismiss the need for an overall discussion on the unexpected distributive impacts of the value creation theory.

Therefore, in line with our goal to report on the recent developments of the principle in modern literature, we will now focus on two relevant conceptual challenges that the principle might face going forward, namely

(i) the faulty assumptions around value, prompted by international players, whenever discussing such concept as an allocation key and (ii) the seemingly ignored impacts of hidden environmental and social distortions in current global value chains.

Value creation principle as a source for faulty assumptions (clearness test)

The growing enthusiasm around the value creation theory, as a tax allocation mantra, appears to stem from the intuitive correlation between its main proposition, to tax where value is created, and a certain understanding of fairness, rooted in the easily digestible idea that "*everyone who enjoys his share of protection should pay his proportion of the cost*" (Locke, 1690, sec. 140). An historical mantra, still relevant nowadays, that invokes our need for community bonds, whilst reminding us of the inherent need to share the costs across the board, an easily relatable dynamic.

The international tax system, that we have inherited from the exploits of the last century, has never really been concerned with ascertaining where value is created. To a large extent, the aim was always to create a set of rules, by which competing taxing authorities would agree to yield their sovereignly justified power to tax, in exchange for guarantees to prevent double taxation and thus create a more favourable environment for foreign investors.

For this reason, not only does this shift disavow the political compromises of the past, it creates a new paradigm where one must assign the primary right to tax to the economically "correct" jurisdiction, implying that the allocation of taxing rights, among countries with valid standing, is an empirical matter sheltered from the political struggles of the international panorama.

Within this frame of reference, as brilliantly explained by Allison Christians[155], the discourse about value becomes riddled with faulty assumptions that threaten the preservation of the otherwise peaceful international consensus (Christians, 2018, p. 1379-1383). As a brief overview, we showcase two of them: first, the assumption that multinational income can be fragmented using neutral methods; second, the assumption that, due to the empirical nature of such methods, countries must not deviate from the given fragmentation of income, as long as it follows a value-based rationale.

Regarding the first mentioned assumption, several authors continuously remind us that it is incontrovertibly wrong to think that technicians (of any background) will be able to fragment multinational sourced income, that was derived from business decisions that took advantage of the symbiotic global economic order, and correctly assign it to a certain country, based on criteria that uphold scientific or economic standards.[156]

The tracing of the creation of value in global value chains, to a degree where the end result can be seen as a millimetric representation of reality, amounts to a scientifically impossible task. Indeed, this is true both due to the enmeshed nature of international trade and due to the fact that relevant gains largely correspond to the surplus produced by the cooperation of all those involved in the chain. To borrow a picturesque expression, it would be like trying to unscramble eggs (Christians, 2018, p. 1381).[157]

As for the second assumption, failure in proving the scientific merits behind the fragmentation of value, means that the allocation according to value can only be born out of negotiations between nations. Thus, there is no basis to uphold that countries cannot establish a multitude of different criteria to measure value, all of which would be equally valid.

Considering the above, one might question why would countries be so vocal in their support of such an impractical principle. While some parties may have just been waiting to see what would happen in the implementation phase others, harbouring hope for change, might have been misled by the neutrality smokescreen put forward by well-off states, who wanted to gather agreement at all costs, even if it meant pretending that the newly endorsed principle would not favour them over all others.

Regarding the distributive facet of such theory, tax scholars were quick to anticipate negative consequences by merely exploring the logic behind value generation in multinational supply chains. Shouldered on the conclusions of economic research that namely showed us that value is normally concentrated at the beginning and at the end of the chain, in the pre- and post-production phases, giving rise to a smile curve composed of tasks like conceptualization, R&D, branding, marketing and sales, the claim that taxation by value will mainly empower the position of developed countries becomes particularly persuasive (Rungi & Prete, 2017, p. 3-7).[158]

Nonetheless, the curtain might have already started to fall now that the implementation of the "Unified Approach" is underway. Indeed, the roll-out of Pillar One's Amount A, which is based on a mere percentage of the residual profit derived by an MNE in market countries (defined as profit in excess of 10% of revenue), has already sparked comments that value creation has been side-lined. For some, this new accessory allocation leaves behind most of the revolution brought by the value rationale, to focus solely on taming the fiscal interest of market countries, that are keen to get their hands on a small piece of the profits made by foreign firms that are able to conduct their business at source, without really setting shop in the territory therein (Shön, 2021, p. 3 *et seq*).

In light of the above, given that the lack of clearness of the entire discussion has taken a serious toll on the value creation principle, with countries only finding agreement in halfway solutions, the future of the principle and its ability to influence the international tax regime is now more uncertain than ever.

Value creation and the underlining problems of global value chains (awareness test)

Henceforth, considering that the value creation theory still has a role to play in the future of cross-border taxation, a deeper analysis of the hidden problems of global value chains must be imported into the discussion. This becomes vital when coming across the effects of certain market distortions that, when coupled with a valued-based allocation mechanism, might aid to perpetuate or even exacerbate the creation of unjust distributive results.

For the international tax system, the main difficulty with value-based taxation lies in the non-contentious fact that market prices do not always correspond to fair market prices. These distortions are caused by purposely hidden valuation gaps, like the cost savings derived from the exploitation of labour in certain developing markets, in which workers might be systematically compelled to trade their labour for less than a living wage or the evident value created by cherry-picking countries with low environmental protection standards.

This parallel economic reality, if not corrected taxwise by safeguard measures, can camouflage the actual value created in production countries by undercutting prices, prompting a double jeopardy situation in terms of allocation for such countries – the burden of the war on labour exploitation

and the loss of tax revenue needed to see it through (Apeldoorn, 2018, p. 19 *et seq.*).

As for potential solutions, one must salute the analysis carried out by Allison Christians and Laurens van Apeldoorn, who propose an interesting remedy based on an evolution of the current transfer pricing rules. Their approach, in accord with the values of the arm's length principle, introduces the claim for a labour-based exploitation adjustment, as a means to achieve a fairer market price, between related parties (Christians and Apeldoorn, 2018, p. 19 *et seq.*).

Almost immediately, the translation into practice of such a claim might seem unconquerable, after all the transfer pricing rationale achieves an arm's length price by comparing related and unrelated operations. If faced with a hidden phenomenon like the exploitation of labour how can countries adjust what they cannot see? On this particular point, one should applaud the wholeness of the analysis, not only did the authors correctly identify a linchpin factor that brings inequity into value-based tax allocations, they went out of their way to suggest a mechanism to implement the needed adjustment.

Oversimplifying the explanation, the proposed mechanism would build on top of known economic methods, namely the Anker or the Asia Wage Floor methods[159], to produce a forecast of the living wage that would be owed to the workforce in a hypothetical transaction absent the factor of exploitation. Subsequently, local tax authorities would have to adjust the agreed intra-group prices to account for the estimated living wage, fictitiously reallocating more taxable profits to production countries, thus better capacitating their institutions in the struggle against labour exploitation.

Regarding the overall merit of this proposal, although some parties may voice concerns about the reliance on estimations to calculate the standard living wage, an approximation to a fair outcome might be an improvement over our dismissive transfer pricing system. Whenever a price comparative method, remains this detached from such realities, it can end up erroneously deeming a price formed on the basis of exploitation a fair market price, this is possible because the closest comparable operations may come from non-related enterprises that engage in the same exact practice, a common problem when facing systemic exploitation of labour.

Additionally, scholars have also identified that the adoption of a value-based tax allocation, supported by conventional notions of value, will undoubtedly fail to address the significant value for multinational activities derived from externalizing environmental costs (Christians, 2021, p. 23-25). In order to arrive at this conclusion, one must first accept the idea that cost reduction is as much of a quantifiable source of value as any other.

Morally, leeching off uncompensated environmental impacts may be a badly viewed practice in international trade. Still, there is no denying that operating in jurisdictions with lenient regulations on polluting practices, coupled with deficient administrative and legal systems, topped by systemic diversion of public funds due to corruption, will increase the bottom line of multinational businesses, who would otherwise have to internalize the costs of eco-friendly preventive measures.

In a similar way to labour exploitation, the current solutions on the table demand a new role for transfer pricing evaluations, now with the possibility for tax authorities to convert the environmental cost savings into a price (discount) factor, either on case-by-case basis adapted to particular industries or areas (itemized method) or by computing a single intangible asset that would aggregate the cost saved in a particular jurisdiction (location savings method).

In conclusion, recent research efforts have previewed a few of the potential shortcomings of taxation according to value creation, with some arguing that the adoption of such a principle is impractical and others recommending greater convergence with other principles. One thing is certain, any attempt to implement value-based distributive measures must be met with lucid awareness by tax policymakers on the harsh realities of international trade.

3. The efficiency principles

3.1. Single tax principle

Even though the single tax principle exists since the beginning of the 20th century, it became particularly important in the late 1990s (Schön, 2021, pp. 10-11) with the emergence of a new academic theory that defended the concept of an "international tax regime" (De Lillo, 2018; Parada, 2021). This regime would include the network of bilateral tax treaties as well as

the domestic tax legislation of the most significant trading states (Parada, 2021, p.5). The single tax principle at the foundation of this international system can be stated in the following way: "Income from cross-border transactions should be subject to tax once (that is, neither more nor less than once" (De Lillo, 2018, p.15).

Generally speaking, it is understood that imposing a single layer of taxation would, in consequence, be the idyllic and proper tax policy to apply to cross-border income (De Lillo, 2018), because, theoretically, single taxation would prevent income from being "overtaxed", "undertaxed", or "not taxed at all" (Parada, 2021, p.7), assuming that "all countries would maintain both a personal and a corporate income tax" (Parada, 2021, p.7). Regardless of its initial controversy, this thesis increasingly became consensual (De Lillo, 2018), and it is even officially recognized in international tax instruments such as the Base Erosion and Profit Shifting (BEPS[160]) Action Plan. It is also in the origins of the credit and the exemption methods, the two double tax relief mechanisms provided for in the OECD Model Tax Convention on Income and Capital (OECD, 2017) and in the UN Model Double Taxation Convention between Developed and Developing Countries (UN, 2017). Nonetheless, all these years after the proposal of the international tax regime, we stand at a point in which the foundations of the Single Tax Principle and its status as a settled and binding international tax principle are being more and more questioned among experts. The main difficulties and proposals related to single taxation will be briefly described and clarified in the subsections that follow.

Rethinking the importance of the avoidance of double taxation and of double non-taxation

If we decompose the single tax principle, we are left with two elements: the avoidance of double taxation and the avoidance of double non-taxation. From the early focus on avoiding double taxation to the later shift to avoiding double non-taxation, these two components were not questioned and were seen as essential in establishing the international tax regime for decades (Schön, 2021, pp. 16-19). In general, tax treaties have settled on two standard ways of achieving single taxation: the credit method and the exemption method. For a long time, there appeared to be no more pressing issue in the international tax community than the endless discussion over which of these mechanisms was superior (Schön, 2021, pp. 16-19). Furthermore, with BEPS, the goal to reach single taxation has been reaffirmed by the international tax community, a fact that demonstrates widespread consensus regarding this issue among governments (Schön, 2021, pp. 16-19). However, nowadays, the necessity to eliminate both double taxation and double non-taxation is being questioned. In other words, the adequacy of the premise that, in any cross-border transaction, income should be taxed exactly once is being rethought, and the reasons for its establishment have even been considered "conceptual problems" (Parada, 2021, pp. 13-18).

When it comes to double taxation, and according to Leopoldo Parada, the question that prompts is "why should we care about how many times a tax is imposed when the concern should simply be "how much" tax is ultimately paid?" (Parada, 2021, p.13). The author states that "most of us would rather be taxed twice at a 15% rate than once at a 40% rate" (Parada, 2021, pp. 13-14). The focus should, therefore, lie on the tax burden instead of the number of times the same income is taxed. Parada also contradicts the necessity of fighting double non-taxation, stating that it is not necessarily a synonym for tax evasion, as the element of abuse and/or fraud is lacking (Parada, 2021, p.16), and that countries deciding not to exercise their taxing rights is also a form of sovereignty (Parada, 2021, p.46). Besides, Parada claims that, in some situations, avoiding double non-taxation can lead to the creation of new situations of double taxation, and that in most of the cases involving a double non-tax outcome what actually happens is a one-year deferral. There seems to be a paradox, he says, because "*protecting single taxation cannot be done without violating*

single taxation" (Parada, 2021, p.12). Summing up his view, this author states that "*the conceptual frustration behind the notions of double taxation and double non-taxation is the engine that has driven commentators to insist upon defending an idea—single taxation—that might work well in a perfectly closed and principled international tax system but that is far from being consistently applied in practice*" (Parada, 2021, p.18). In other words, Parada sees the failures in fighting double taxation and double non-taxation as a consequence of the inadequacy of the Single Taxation principle to the system as it is in reality.

Single taxation and BEPS

Politicians realized the problem of tax avoidance with the 2008 financial crisis and subsequent austerity and concluded that they needed a strategy to fight it (Avi-Yonah & Xu, 2017, p.1). Although governments were aware of these tax avoidance strategies prior to BEPS, their unilateral measures were ineffective in combating them. Because of this, a response from the OECD and the G20 was necessary and consisted in starting the BEPS project in 2013, which resulted in the issuance of a set of tax planning actions by the OECD and G20 countries in October 2015 (Avi-Yonah & Xu, 2017, p.1). This is important because, as mentioned, the notion of single taxation was officially endorsed in BEPS, even though the main goal shifted from avoiding double taxation to avoiding double non-taxation (Mason, 2020; Parada, 2021).

The opinions on the BEPS Project vary a lot. Some authors, such as Ruth Mason, argue that this is a project with a significant positive impact (Mason, 2020), since it brought a big expansion of the agenda of international tax policymaking, as well as of the participant actors. They also argue that with BEPS comes the introduction of new forms of soft law and institutional arrangements that are ideally adapted to safeguarding tax sovereignty while also combating state defection. Lastly, it is claimed that BEPS Project reignited ancient concerns over how tax revenue from international trade should be distributed among countries (Mason, 2020, p.4). On the other hand, there are also a lot of critics of this project. BEPS is based on consensus (Christians, 2016), but it is questioned whether true consensus could be achieved given the limited timeframe of the project and lack of space for discussion. It is also argued that BEPS will only serve to reinforce the monopoly of a group of few wealthy countries, and that the

fact that its focus lies in the avoidance of double non-taxation "suggests a focus on the symptoms of the regime and not the structure of the regime itself" (Devereux & Vella, 2014, p.12). Despite the criticism, the global acceptance of the BEPS Package and its coordinated implementation through domestic laws and tax treaty clauses is found to be remarkable (Fung, 2017, p. 1).

Following the criticism that was raised after the first BEPS initiatives (BEPS 1.0), as well as the imposing of unilateral tax measures by many countries, a spinoff or extension BEPS project, notably from BEPS Action 1 emerged – BEPS 2.0 (Mason, 2020, pp. 36-49) This is a two-pillar approach and its purpose is to bring various types of unilateral efforts together into a consensus stance so that mismatched unilateral efforts and double non-taxation can be avoided. By proposing a global minimum corporation tax rate that nations might utilize to safeguard their tax bases, the BEPS 2.0 project also intends to ensure that MNEs pay a fair share of tax wherever they operate. Finally, BEPS 2.0 aims to address the issues posed by the digital economy's taxation (KPMG, 2022). While BEPS 1.0 partially endorsed the Single Tax Principle, BEPS 2.0. explicitly and fully implements it (Avi-Yonah, 2021, p.8). 130 countries approved a statement proposing a foundation for this worldwide tax reform on July 1, 2021 (Timpany & Lu, 2021).

Full taxation

According to Ruth Mason (2020), there is a new international tax norm: full taxation. It dictates that "all of a company's income should be taxed in places where it has real business activities" (Mason, 2020, p. 22). Full taxation does not only include the goal of avoiding double non-taxation, which is generally acknowledged in international tax, but also any other objectives that may assimilate to that one, such as profit shifting prevention, closing loopholes, and avoiding aggressive tax planning (Parada, 2021, p. 30). This concept can be seen as a confirmation of the prevention of double non-taxation since it aims to tax the totality of a company's income. It is, however, impartial when it comes to the methods to achieve this goal, requiring only that taxing rights are transferred to jurisdictions where MNE have actual factors of production and real operations, bringing the notion closer to abuse prevention (Parada, 2021, p. 20). In comparison with the avoidance of double non-taxation, full

taxation is more compatible with BEPS, by not making double non-taxation, per se, a problem. One should only worry in circumstances where taxpayers would achieve it artificially (Parada, 2021, p. 20).

Leopoldo Parada has, once again, a less optimistic view. Even though he recognizes that full taxation is an attractive concept, he sees it as "vague and inconsistent" and with the "purpose of taxation just for the sake of taxation" (Parada, 2021, p. 24). This would be reflected in the principle's incapacity to provide solutions as to where taxes should ultimately take place (Parada, 2021, pp. 21-29), but also in its over-inclusiveness (Parada, 2021, pp. 29-36). Because of this, he understands that full taxation cannot be considered a new international tax norm.

Single Tax Principle and the taxation of business

Another challenge faced by the single tax principle is the agreement on the quantitative amount of taxation to be applied. Following both the letter and the spirit of the single tax principle, it is important to know what nominal or effective tax rate should be applied to a particular object of income (Schön, 2021, p.19). . Avi-Yonah had advocated for a substantial tax burden of 30–60 percent on commercial earnings (Avi-Yonah, 2007), which was a quite similar idea to the results of the famous Ruding Committee, which proposed a minimum tax rate of 30% for business taxation in Europe in the 1990s (Schön, 2021, pp. 16-19). Nowadays, it is very rare to find such high business taxation rates. In many nations, the statutory corporate tax rate has fallen from 30% to less than 20%, and an increasing number of countries impose nominal tax rates of less than 10% on typical business income (Schön, 2021, pp. 16-19).

Pillar 2 of the OECD Inclusive Framework on BEPS' (global minimum taxation) plays an important role in finding significant political agreement regarding corporate taxation. If governments are unable to agree on that, low-tax jurisdictions can simply undercut the single tax concept by claiming their taxing rights over particular types of income while imposing a tax rate so low that the tax burden is minimal, as has been done so far. With Pillar 2, the strategy is intended to precisely accomplish that: a global approach to the problem of imposing a significant tax burden on all forms of international transactions. This should be achieved by allowing other nations to extend their tax jurisdiction to ensure a minimum level of taxation of MNE profits (Schön, 2021, pp. 16-19). In October 2021, 137

jurisdictions of the Inclusive Framework on BEPS agreed to support a global minimum corporate tax rate of 15%.(Schön, 2021, pp. 16-19) This topic is analyzed in detail in section X.

Where we stand

Has the single tax principle gained the status of a guiding and binding principle of international tax law? While BEPS, and specially BEPS 2.0, reflect the agreement of a significant number of countries in achieving single taxation, a lot of authors have raised relevant concerns that challenge the foundations and the necessity of the principle itself. Thus, it is probably wise to state that the answer to the presented question is "yes", for now; however, it is possible that it changes in the future.

3.2. Neutrality

Pareto efficiency in the allocation of capital resources

The concept of neutrality is an economic concept that is related to the decision-making of economic actors (Auerbach, Alan J., 1985, p. 61; Auerbach, Alan J., 1989, p. 1-36). The idea underlying neutrality in the tax realm is the same whether we are thinking of the domestic space or the international scene: the market's own supply and demand rules are ordinarily an efficient means of allocating capital resources and no regulatory intervention – not even taxes – should disrupt its functioning. Under Pareto's classic economic theory, economic agents will continue to exchange goods and services until there is no possible exchange that makes anyone better without making someone else worse-off, at which point the allocation of resources will satisfy the requirements of Pareto efficiency (Hutchison, Terence Wilmot, 1953).

Taxation can disrupt this process by imposing deadweight losses (Free, Rhona C., 2010; O'Reilly, Terrance, 2007) to resource allocation, in the sense that someone willing to work at, for example, € 80 an hour that finds an employer willing to pay € 90 an hour will find himself at a welfare loss if he is charged a labour tax higher than 11%.

There is, however, one important caveat: the principle of neutrality does not apply to Pigouvian taxation (A.C. Pigou, M.A., 1932), meaning taxes imposed by governments to overcome negative externalities (i.e. scenarios whereby the pursuit of self-interest by economic agents will impose costs on third parties higher than the benefits the parties obtain for themselves,

hence it triggers a net reduction in total societal welfare). A Pigouvian tax forces market actors to internalize the externalities of their behaviour, so that the costs their behaviour imposes on third parties becomes a marginal cost (tax) of the activity itself (ideally the underlying tax revenue would be transferred to the victims of the negative externality as subsidies or public services). Since the aim of a Pigouvian tax is to induce behaviour modification, a neutral Pigouvian tax would be a contradiction in terms as it would defeat its purpose (McCaffery, Edward J., 1993, p. 983-1048).

In a macroeconomy perspective, neutrality also demands that the tax system raises revenue while minimising discrimination in favour of, or against, any particular economic choice. This implies that the same principles of taxation should apply to all forms of business.

The many faces of the neutrality principle

In its most widely cited form, the concept of neutrality in the context of international taxation is understood to mean that taxes should not be a factor in investment decisions or, in other words, capital should be subject to the same tax burden whether it is invested at home or abroad[161].

Although neutrality is commonly cited as single principle, it is actually a multi-concept principle, since it requires that capital be subject to the same tax burden wherever it is invested, be it inbound or outbound, or be it pertaining to a capital investment or divestment. As such, concepts of neutrality discussed in the literature[162] include most commonly Peggy Musgrave's capital export neutrality (CEN) and capital import neutrality (CIN)[163], as well as the more recent capital ownership neutrality (CON) subprinciples[164].

The underlying idea, however, is the same regarding all mentioned subprinciples and that is that in order to maximize aggregate global welfare, capital needs to flow to where it is able to produce the highest pre-tax return (Elkins, David, 2019), i.e. the overall objective is to promote free movement of capital. As such, if a given investment offers the highest pre-tax returns of all alternative investments, it should necessarily also offer the highest after-tax return. If it doesn't, the capital investment in question has suffered a misallocation in directly contradiction to the neutrality principle, under which allocative efficiency can only be achieved when alternative investments bear similar tax burdens (Graetz, Michael J., 2001, p. 261, 285; Keinan, Yoram, 2006; Rosenzweig, Adam H., 2010).

Tax neutrality is at the core of the EU's fundamental free movement of capital within the internal market, which according to article 26 of the Treaty on the Functioning of the European Union (TFEU), "*comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured*" (Schön, Wolfgang, 2000, p. 97; Kemmeren, Eric C.C.M., 2012, p. 158). According to article 120 second sentence of the TFEU, "*the Member States shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources*", which ensures that decisions affecting the allocation of goods, persons, services and capital are not distorted by domestic law-making, including national tax legislation.

How is neutrality achieved

There are many ways of achieving the aforementioned allocative efficiency and consequently tax neutrality on cross border investments. However, the most common one is for countries to simply tax the worldwide income of their resident taxpayers at the same rates, regardless of where the source of said income is located (what is popularly known as the worldwide income tax base system)[165]. It is intuitively understood that when a taxpayer is faced with the same tax burden wherever it chooses to invest, then those investments that offer the highest pre-tax return will also offer the highest after-tax return. More importantly, the worldwide income tax base system, in theory, allows for a level playing field (i.e., neutralization) between international and domestic investments, thus achieving the much desired CEN neutrality.

The principle of neutrality thus leads to the conclusion that it is only when the various investment alternatives are subject to the same rate of tax that the tax will not affect investor behaviour and will not misdirect capital (Bittker, Boris I., 1979, p. 735, 739-740).

However, as it has been widely noted, even when countries have in place a worldwide income tax base system, resident taxpayers can easily escape it – or at least defer its effects– by holding foreign income through a foreign corporation or subsidiary.[166]

To discourage such evasions from the neutralization achieved in the worldwide income tax base systems, countries usually put in place anti-abusive regimes that aim to tax foreign income not only held at the level of their residents, but also at the level of foreign corporations that are owned

or controlled by said residents. Such is the case of the Controlled Foreign Corporation (CFC) tax regimes, whose strengthening has been increased tenfold in the last five years as per recommendation of the OECD Action Plan on BEPS[167].

CEN favours worldwide taxation while CIN encourages a territorial tax system. Effectively, the global adoption of a territorial tax system satisfies CIN, since in a world where every country has a territorial tax system, investors pay tax only in the source country, thus, competition among investors for the highest after-tax rate of return will push after-tax rates of return across jurisdictions into equality (Knoll, Michael S., 2011, p. 99).

Authors like Klaus Vogel (Vogel, Klaus, 2002, p. 4) envisaged a world united under the exemption method where each country would simply tax income generated on their soil, securing capital import neutrality and leaving unaffected tax policy choices made by other countries for residents and activities present on their respective territories.

Accordingly, ownership neutrality can be satisfied using either territorial or worldwide taxation (without harmonizing tax rates) as long as all jurisdictions use the same type of tax system (Knoll, Michael S., 2011, p. 99).

These tensions permeate on some of the fundamental differences found on two most popular double tax treaty models: OECD Model versus United Nations (UN) Model. The drafters of the OECD Model (Wattel, Peter J. and Marres, Otto, 2003, p. 69) assumed that the countries have more or less the same tax bases and the same tax systems. The UN Model is meant for treaties between countries with unequal economic status. As such, while the OECD Model presents the views of developed countries and advocates CEN and residence taxation, UN Model endorses the view of developing countries as net capital importers and generally favours CIN neutrality and more source taxation (going as far as rejecting CFC rules).

However, there is another method for achieving neutrality in the international tax arena that has been very much the pipedream of the international taxation literature in the last decade, which is simply to harmonize the tax regimes (either at the level of the tax base or at the level of the rate) of the various countries, at least for international investments, as a way to diminishing harmful tax competition[168]. The central idea here is that international taxation cannot simultaneously satisfy both CEN and

CIN, unless tax rates on capital are harmonized across countries (Graetz, Michael J., 2001).

Scholars go as far as noting that unless there is a completely harmonised global tax system, full neutrality under both CEN and CIN is impossible to achieve, since the measures required for CEN conflict with those required for CIN, and vice versa (Knoll, Michael S., 2011, p. 203-205).

To compete or not compete?

Even though it is very much widely accepted that investment decisions should not be influenced by tax considerations (hence should be tax neutral), preventing the misallocation of resources and a diminution of aggregate global welfare, it is not so widely agreed that it is appropriate or desirable for countries to cooperate in order to create a neutral international tax regime.

Despite the fact that the academic community has largely supported international efforts to combat tax competition[169], there are an ever increasing number of scholars arguing that countries should pursue their own national interests even when it conflicts with worldwide aggregate welfare (Shaviro, Daniel N., 2014, p. 108-109) or, more pragmatically, since it is impossible in practice to guarantee full cooperation by all countries (with even a small number of non-conformers creating enough distortion to misalign capital allocation), countries are justified in pursuing their own self-interest (Kane, Mitchell, 2004, p. 89).

Professor Dagan (Dagan, Tsilly, 2018, p. 58-59) argues that the world is better with competition because coordination represents assertion of powers of developed countries over developing countries per the developed countries' interests. In this way, according to Dagan, worldwide efficiency will increase and developing countries will not be discriminated against.

It is a well-researched result of international public finance that both full harmonization and full tax competition can have both a positive and negative effect on overall efficiency (Keen, Michael and Konrad, Kai A., 2013, p. 317).

Most surprisingly is one scholar's (Elkins, David, 2019) attempt to go as far as establishing that allocative efficiency in the international arena actually requires that capital flows to the jurisdiction that offers the highest after-tax return (and not the highest pre-tax return), since attempts to neutralize the effects of taxation and to direct capital to those jurisdictions

that offer the highest pre-tax return would, in most instances, produce allocative inefficiency to the detriment of aggregate global welfare. In a nutshell, the idea is that the amount of tax a jurisdiction chooses to impose on international investment should be determined by the supply of and demand for that international investment and, consequently, should be increased or lowered according to each jurisdiction's needs in order to avoid both over and underinvestment.

As David c. Elkins (Elkins, David, 2016) argues, not only is international tax competition inevitable, but free and fair tax competition, far from misallocating resources, may very well be necessary in order to allocate resources efficiently and to maximize global welfare. Thus, by limiting tax competition we may be exacerbating problems of global poverty and leading to a more unequal distribution of wealth.

4. Are we at a cross-road?

Having reviewed and tested the endurance of the principles of international taxation, one cannot but question if we are not reaching a cross-road – a point of tension – in the previously accepted international tax architecture.

Reuven Avi-Yonah (Avi-Yonah, Reuven S., 2004, p. 483-501; Avi-Yonah, Reuven S., 2007, p.2) was one of the first scholars strongly advocating the recognition of an "international tax system", meaning a well-established ruleset transcending the unilateral perspective of nation states. In his view, international tax practices had led to a stable overarching regime built on two interdependent principles: the "single tax principle" and the "benefits principle" (Avi-Yonah, Reuven S., 1997, p. 517).

On the other side of fence, David Rosenbloom (Rosenbloom, H. David, 2007, p.115 – 118), Michael Graetz (Graetz, Michael J., 2001, p. 277) and Daniel Shaviro (Shaviro, D.N., 2014, p.107; Shaviro, D.N., 2016, p.1293) have been arguing that the diverging interests of countries (in particular the clear focus of the U.S. tax system to serve its own specific fiscal and economic policies) call into doubt the existence of an 'international tax system, or even a genuine political interest of individual states in supporting the creation of such system.

However, since these discussions started, we have had major unprecedented breakthroughs in coordinated actions of international taxation.

In 2013, OECD – commissioned by the G20 - published its BEPS Action Plan. When the BEPS Action Plan entered its implementation phase by the end of 2015, countries around the world were able to choose from an extended range of tools to ensure coordinated action, most impressively, more than 90 countries moved on from conventional bilaterally agreed tax treaties and signed up to a "multilateral instrument", an ingenuous international convention meant to simultaneously change several hundred tax treaties through a single treaty. Last but not least, in 2016, going well beyond the confines of OECD, a new global institution – the "Inclusive Framework on BEPS" – was created, under which representatives from nearly 140 countries from all over the world regularly meet in the context of the Inclusive Framework. More recently, 137 jurisdictions have signed up for a second round of BEPS, promising a shake to the core of international taxation.

Does this mean that we are at dawn of an institutionalized "international tax system" or just a one-off international tax coordination effort?

Wolfgang Schoen (Shön, Wolfgang, 2021) studied both possibilities and concluded that that we have reached an intermediate stage, whereby, on the one hand, the traditional institutional framework of international taxation has morphed into a dense network of multilateral cooperation involving unprecedent levels of organization, but, on the other hand, there is a growing uncertainty and much explicit disagreement about the substantive fundamentals driving international tax policy and an increasingly bitter clash of revenue claims raised by governments around the world.

Only the future will tell.

Until then, a serious and comprehensive study should be made as to how the principles of international taxation should be rewritten in the post-BEPS world to better match the new increasingly globalized (and hopefully harmonized) international tax architecture.

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139. See, e.g., Avi-Yonah, Reuven S., 2000; Azam, Rifat, 2017 and Bank, Steven A., 2013.
140. For an in-depth analysis of the benefit principle and its historical evolution, see Dodge, J.M., 2004, p. 1–29.
141. See Shay, M., 2019, p. 24.
142. See article 12 (1) of the OECD Model Tax Convention on Income and on Capital (2017).
143. See article 18 of the OECD Model Tax Convention on Income and on Capital (2017). For a statistical analysis on how common is the application of this formulation of the article in tax treaty practice, see Wijnen, W., and de Goede, J., 2014, p. 137-139.
144. Following the creation of a special tax regime by Portugal, that provided for a 10-year exemption on foreign-source pension income, Finland and Sweden decided to terminate their double tax treaties with Portugal, from 2019 and 2022 respectively, in a bid to regain full taxing rights over non-resident pensioners. In the past, Denmark also terminated its tax treaties with France and Spain, effective 1st January 2009, but has since then signed a new agreement with France in exchange for cumulative source-based taxation of pension income.
145. See Beretta, G., 2019, p. 88-101. See also article 17 (2) of the Ireland-Netherlands Income and Capital Tax Treaty (2019) and of the Germany-Netherlands Income Tax Treaty (2016), which provide for source taxation on private pension income that exceeds, respectively, a Euro 25.000 and Euro 15.000 per annum threshold.
146. See Law n. º 4758/2020, published on the 4th of December 2020, that enacts changes to Law n. º 4172/2013 (Income Tax Code), published on the 23rd of July.
147. See Law n. º 178/2020 (Budget Law for financial year 2021), published on the 30th of December 2020.
148. See Law n. º 7666/2020 (Budget Law for financial year 2021), published on the 15th of December 2020.
149. See Law n. º 179 (I)/2020, published on the 15th December 2020, that enacts changes to the Income Tax Law.
150. The analogy between tax treaties and a 'poisoned chalice' for developing states was borrowed from Martin Hearson of the London School of Economics, first used in his presentation, in 2013, to the Strathmore Business School, Nairobi - see http://www.slideshare.net/martinhearson/doubletax-treaties-a-poisoned-chalice.
151. For a different opinion see Zolt, E., 2018, p. 111-149, claiming that developing countries might find reasons to enter into treaties, but only if they are able to guarantee robust withholding rates and safeguards against treaty abuse, suggesting that escaping taxable income streams are in fact being granted to foreign investors in the form of tax incentives.
152. For a deviating opinion on the feasibility of an allocation based on the overall benefits, see Valta, M., 2014, p. 48.
153. See Stark, J., 2021, p. 138. See also Brock, G., 2013, ed., p. 1-331.
154. See OECD (2015), *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, p. 3.
155. See Christians, A., 2018, p. 1379-1383.
156. See also Devereux, M., 2021, p. 110 et seq., stating that "it is extremely difficult to establish how much value is created in each country"; See Morse, S., 2018, p. 198, also indicating that "it may be impossible to link income with the location of a value-creating or productive activity".
157. See Christians, A., 2018, op. cit., p. 1381.
158. See Rungi, A. and Prete, D., 2017, p. 3-7.
159. For more information, see Anker, R. and Anker, M., 2013, p. 2-4; See Merk, J. (2009), p. 39-42.

160. The OECD defines BEPS as "tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax". *See* OECD. (2019). *About - OECD BEPS*. Oecd.org. https://www.oecd.org/tax/beps/about/.
161. See, e.g., Hanna, Christopher H., 2018, p. 231; Mason, Ruth; Knoll, Michael S., 2012, p. 1014, 1043; McMahon, Stephanie Hunter, 2018.
162. See, e.g., Gravelle, Jane G., 2017, p.5-10; Pugh, Richard; Peroni, Robert; Gustafson, Charles, 2011, p. 20-22; Shaheen, Fadi, 2006, p. 203-205.
163. See Musgrave, Peggy B., 1963, and Musgrave, Peggy B., 1970.
164. See Desai, Mihir A. and Hines, James Rodger, 2003, p. 487-495; Desai, Mihir A. and Hines, James Rodger, 2004, p. 937–960.
165. See, e.g., Devereux, Michael P., 2008, p. 698, 707; Troup, Edward and Hale, Paul, 1998, p. 1081, 1082.
166. See, e.g., Marian. Omri, 2013, p. 1613, 1654-1655; Marples, Donald J. and Gravelle, Jane G., 2021,; Rosenzweig, Adam H., 2015, p. 471, 497.
167. See Org. for Econ. Co-operation & Dev. [OECD], Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report (2015).
168. See, e.g., Avi-Yonah, Reuven S., 2009, p. 783-795; Brauner, Yariv, 2003, p. 259, 263, 291, 294-297; Dean, Steven, 2009, p. 125, 151.
169. See Avi-Yonah, Reuven S., 2000; Benshalom, Ilan, 2014, p. 317-358 and Owens, Jeffery, 2012, p. 173.

CHAPTER 6 – TO THE BASICS (OR NOT THAT MUCH): Why an International Tax Regime, what are the BEPS Actions and the Future Ahead. A critical analysis

Disha Shah, Mariana Rodrigues Brito and Teresa Bouza Serrano

Introduction

The article aims to bring an overview and critical context to the public in general about the reasons for the existence of an international tax regime, the efforts of establishing international standards and goals for governments, companies and individuals in respect of tax matters, especially the base erosion and profit shifting issue.

A better understanding regarding the tax implications of a government public policy, as well as a company's structure and its impact in a certain country, could bring a more critical view to society in relation to their choices as citizens, voters, consumers, etc.

Despite the existence of different international and regional organizations dealing with public policy on taxation (e.g., United Nations, World Bank, International Monetary Fund, EU Commission, etc.), the Organisation for the Economic Co-operation and Development (OECD) currently represents the most influential actor on the international community[170].

Thus, the OECD 2013 Base Erosion and Profit Shifting Project (BEPS) was a direct response to growing concerns on the abusive schemes used by multinational enterprises (MNE). These aggressive tax-planning strategies often resulted in profit evasion to low tax – or even no tax – jurisdictions. In summary, there was a general claim from society for a more realistic "fair share" of tax to be paid by companies and wealthy individuals[171]. On the other hand, the advance of technology with the creation of different forms of consumption and services brought new challenges to tax administrations and taxpayers.

The reflection on these issues represents the contemporary focus of the international tax community. Additionally, governments tend to consider a number of political and economic interests in order to assess whether adopting a multilateral approach rather than a bilateral one would be advantageous to their jurisdiction. Therefore, a consensus that would be naturally challenging by itself is even more complex in relation to tax matters.

It is also essential to analyse the effective participation of developing countries on the creation and improvement of global standards for the international regime. Their contribution could result in a more balanced legal framework since it would consider a broader range of realities and, hence, interests. Lastly, it is crucial to consider the current international scenario to visualize the upcoming repercussions on the international tax regime.

The paper's aim is to bring a general, but critical, overview on the past, present and future of the international tax regime to the society in general. The preliminary stage of bringing context and basic understanding is crucial for further development of deeper discussions within the Nova Tax Lab project.

2. Why an International Tax Regime and How Did It Emerge?

The use itself of the term "international tax law" could be reasonable argued against since there is no single specific international binding legislation that obliges States and taxpayers to behave in a certain way. It would be more accurate to refer to the international aspects of the income tax laws of a particular jurisdiction, since "tax laws" are usually a creation of sovereign states in their domestic rules[172]. Therefore, there is no overriding international law of taxation.

The "international tax system" of a jurisdiction comprises a number of bilateral tax treaties, mainly with the country's trading partners. The increase in global trading between countries has led to the exponential growth of tax treaties in the past twenty-five years. Currently, there are more than 3.000 tax treaties in force and those agreements usually represent a limitation of the taxing powers of contracting states[173]. Hence, the tax treaties are relieving in nature, since they encompass protective

mechanisms against double taxation to taxpayers, providing more certainty to tax administrations and investors.

The existing international guidance and principles on international taxation was born in 1923, as a result of a report ordered by the League of Nations – also known as the "predecessor of the United Nations"[174]. The study's goal was to address the double taxation issue and the task was entrusted to four international renowned economists. As highlighted by Professor Avi-Yonah[175], the nationality of those specialists was not chosen randomly, two of them were from of a capital importing country (Italy and Netherlands), one of them of a capital export country (United Kingdom) and the last one from a rising economy at the moment, i.e., United States. The goal was to balance the discussions and conclusions with opposite points of view and interests.

The study represents the foundational stone of the international tax regime and its principles were widely accepted and thus incorporated into present double tax agreements worldwide[176]. As stated by Arnold, B. J.[177], the design of the international tax policy of a country should consider the four major goals of income tax, i.e., revenue considerations, fairness, competitiveness considerations, capital-export and capital-import neutrality.

Nonetheless, a number of situations and parties have questioned the aforementioned international framework. For instance, the lack of effective participation of developing countries in the formulation of such rules, as well as the advance of technology, tend to challenge basic concepts of the current international tax system. The ultimate focus is to safeguard taxing rights to countries, especially to market jurisdictions.

3. The Role of International Organizations and the OECD BEPS Project.

3.0. Achievements and Shortcomings

Regardless of the domestic provisions having the major impact in a country's taxing rights, several international organizations play an important role in respect to the international tax system such as OECD, the International Monetary Fund (IMF), the United Nations (UN) and

the World Bank Group. They are considered the most important in terms of international taxation[178].

Those international organizations establish a series of guidance material, advisory services and capacity building in relation to tax policy. They also aim to provide mutual assistance to developing countries in strengthening their tax systems through the "Platform for Collaboration in Tax"[179].

The OECD undoubtedly is considered the most influential in tax matters[180]. In summary, the OECD comprises thirty-six member States and its work is conducted on a consensual basis. Non-member countries also participate in the organization with an "observer status", mainly through the "Centre for Tax Policy and Administration" and the "Global Forum on Transparency and Exchange of Information for Tax Purposes".

The existence of basic principles and bilateral treaties led to more certainty in investments worldwide, however, a more globalized and integrated scenario resulted in opportunities for Multi National Enterprises (MNEs) to significantly minimise their tax burden[181]. Therefore, the manipulation of different tax systems often led to abusive situations, e.g., double non-taxation[182]. For instance, some MNEs incorporated aggressive tax planning with the only purpose of avoiding taxation. In some cases, the tax system of a country became the main reason for setting up a company, even without economic substance, since the main goal was to take advantage of the "gaps" of different tax systems.

The 2008 financial crisis and the recession that followed contributed for the general feeling of inequality between wealthy individuals and regular taxpayers, as well as between developed and developing countries[183]. Hence, the overall society have become more aware and interested into tax fairness issues[184]. The increasing pressure for a higher contribution of the MNE group with their "fair share" in taxes was a reality among civil society, especially on those economies where the companies were undoubtedly active, but did not have a corresponding tax burden[185].

In this context, it was necessary to promote fundamental changes in the international tax policy in order to effectively prevent double non-taxation and the cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it[186]. Therefore, as a response for those abusive situations, the G-20 countries and OECD launched the Base Erosion and Profit Shifting (BEPS) Project in 2013,

which was allocated into a 15-action plan, also known as "inclusive framework"[187].

The main idea of the action plan was to restore confidence in the system by combating abusive situations and ensuring that substance of business would be the triggering aspect for the taxation of profits. Thus, the BEPS inclusive framework represents a new international standard designed to ensure the coherence of corporate income taxation at the international level[188].

The design of such new international standards required a thorough analysis of the different business models and a better understanding of the generation of value in diverse economic sectors[189]. The 15 BEPS-action plan addresses three key topics: i) the need for coherence on domestic rules that relate with cross-border activities (actions 02, 03, 04, 05); ii) the strengthening of the concept of economic substance as a requirement for transactions/activities (actions 06, 07, 08, 09, 10); and, iii) the improvement of transparency and certainty[190] (actions 11, 12, 13, 14). The specific concerns on the digital economy (action 01) and an innovative way of implementation of the measures (action 15) were tackled separately.

As a brief overview, the article will highlight the main policy concerns, proposed changes and challenges of each one of the 15 BEPS-Actions.

3.1. BEPS 01 – Tax Challenges Arising from Digitalization

The Action 1 addresses the tax challenges of the digital economy. It calls out on the key features brought by the evolution of the digital economy, such as mobility, reliance on data, network effects, the spread of multi-business models and the tendency towards monopoly/oligopoly and volatility[191], all of which have posed great challenges to the foundations of the global tax system.

New technology truly is at the centre of this revolution. Firstly, because it allowed for business models to disregard (or at least consider dispensable) the need for physical proximity to target markets, and secondly, because it allowed for MNEs to easily shift profits to low or no tax jurisdictions. Since under current international tax rules an enterprise generally is not taxed in a country in which it does not have a physical presence, the effectiveness of existing profit allocation and nexus rules applicable to cross-border activities has been greatly eroded.

In terms of what has been done by OECD, in 2015 a report was published addressing the challenges posed by the digital economy, analysing the evolution of the information and communication technology and its impact on the economy, and evaluating the broader direct and indirect tax challenges raised.

In October 2021, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) agreed on a two-pillar solution to reform international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate[192]. Pillar One deals with the re-allocation of taxing rights, more specifically, it aims to ensure a fairer distribution of profits by re-allocating some taxing rights over certain MNEs from home countries to the countries where they have their business activities, regardless of physical presence. Pillar Two deals with the global anti-base erosion mechanism, that seeks to introduce a global minimum corporate tax rate, with the ultimate aim of levelling the score for competition over corporate income tax.

The implementation[193] of Pillar One would be through the adoption of a Multilateral Convention (MLC) and necessary changes to domestic law, with a view to allowing it to come into effect in 2024. This MLC would apply in scope to MNEs with global turnover above 20 billion euros and profitability above 10%, and create a new special purpose nexus permitting allocation of Amount A to a market jurisdiction when the MNE derives at least 1 million euros in revenue from that jurisdiction (where goods or services are used or consumed).

The Pillar Two seeks to establish a global minimum corporate income tax rate of 15%, leveling competition and increasing stabilization of the international tax system and thus the certainty for taxpayers and tax administrations. Its implementation will be according to the Global Anti-Base Erosion Model Rules published at the end of December 2021.

Currently, the OECD's Committee on Fiscal Affairs is currently holding public consultations, requesting input from stakeholders on the implementation of aspects of Pillar One and Pillar Two, and we are taking the first steps in what will surely be a long revolutionary process.

3.2. BEPS 02 – Neutralising the Effects of Hybrid Mismatches Arrangements

The Action 2 focuses on establishing international coherence of corporate income taxation, more specifically on neutralising the effects of hybrid mismatch arrangements. These hybrid mismatch arrangements are differences between States in the treatment of entities or financial instruments that are used by taxpayers to achieve double non-taxation, double deductions, long-term deferral or undue treaty benefits[194].

They were one of the key drivers of the whole BEPS project, since reports as early as 2012 already concluded that they have a negative impact on competition, efficiency, transparency and fairness, and one of the greatest challenges they pose is the fact that oftentimes it is difficult to determine unequivocally which individual country has lost tax revenue under the agreement, since according to the agreement in force, no country technically has.[195]

In order to address this issue, the OECD report on Action 2 recommends common approaches for changes in domestic laws and the OECD Model Tax Convention. A number of countries have already adopted rules to attempt to tackle a range of hybrid and branch mismatches, such as the United Kingdom, Australia and New Zealand, that enacted legislation consistent with the common approach in Action 2. The US Treasury issued regulations in 2019 for the application of the hybrid mismatch rules introduced under the Tax Cuts and Jobs Act and the EU adopted Council Directive 2017/952 which requires hybrid and branch mismatch rules to be effective in Member States[196].

3.3. BEPS 03 – Controlled Foreign Company

The Action 3 focusses on the acts of taxpayers that might result in stripping their tax base in their country of residence, by shifting such income into a 'Controlled Foreign Company' ('CFC'), being motivated either wholly or partly by tax reasons, rather than commercial reasons. This therefore constitutes the form of an abuse. The absence of CFC rules provides opportunities for profit shifting and long-term deferral of taxation[197]. Though many countries already have CFC legislation in place, they seem to have failed to keep up with the development in today's agile business environment and therefore framing and recommending effective CFC rules was an important aspect of the BEPS initiative, which aimed to harmonise the treatment of CFCs and importantly effectively prevent taxpayers from shifting their income[198].

The recommendations, which are not minimum standards, are in the form of 6 building blocks, (a) definition of CFC, (b) exemption & threshold requirements, (c) definition of CFC income, (d) computation of income, (e) attribution of income and (f) prevention of double taxation. These blocks act as guiding factors for all the countries who do not have CFC legislation and are seeking to implement one or for those countries who have CFC legislation that needs upgrade.

Each building block provides a wide liberty to the country to design a CFC legislation that suits its tax policy. Simultaneously, it provides for a coherent and efficient approach to address only the critical cases of potential abuse, without causing a burden on the tax administration or creating tension on tax certainty, thereby not affecting the functioning of businesses.

Though detailed recommendations for best practices have been provided by the OECD under the BEPS initiative for countries willing to adopt CFC legislation, this Action does not in fact recommend countries to adopt CFC legislation[199]. Also, the stark irony of Action 3 is that though it discusses various best practices, it has failed to harmonise the most important aspect i.e. 'CFC income' as it provides for a very open-ended and non-exhaustive approaches in Block 3. Therefore, not only does Action 3 fail to recommend countries to adopt CFC legislation, but also it failed to provide solid guidance to countries who wished to do so[200]. Despite this, the EU introduced the Anti-Tax Avoidance Directive (2016/1164) (ATAD) in July 2016 and CFC rules are an important part of the it's system of rules.

There has been a large discussion on the compatibility of the ATAD provisions citing 'non-genuine arrangements test' with that of the existing EU soft law developed around 'wholly artificial arrangements' pursuant to the landmark judgement in case of CFCs[201]. The overlap of the CFC legislation with that of the transfer pricing rules can potentially lead to situations of double taxation, specifically in situations where a transfer pricing adjustment has been made between two jurisdictions and the CFC charge arises in a third jurisdiction, therefore, the CFC provisions could sometimes be viewed as a backstop to the transfer pricing provisions[202].

However, with specific recommendations in Action 3 requiring the parent jurisdiction to relieve the double tax, this concern can be addressed. Another important consideration is the possible overlap of the current CFC legislation with the Pillar Two proposal, both of which are trying

provide solutions for the concern of base erosion and profit shifting. Certain authors defend that, considering the complexities involved with Pillar Two proposals, it would be better to revamp the unclear so-called best practices under Action 3 and to prescribe minimum standards for CFC legislations.

Also, since the compatibility of CFC legislations with tax treaties has already been established, it provides a principled approach to address the concern of base erosion[203]. However, the OECD despite recognizing the similarities of the objects of Pillar Two and CFC legislation simply stated that both can co-exist as they pursue different policy objective[204]. Therefore, the ambiguity persists.

3.4. BEPS 04 – Limitations on Interest Deductions

While Action 3 focussed on the BEPS concerns arising from taxpayers shifting their income to a 'Controlled Foreign Company', Action 4 focusses on the BEPS concerns arising from funding structures adopted by MNEs, which may arise from the following scenarios[205]:

- groups placing high amounts of third-party debt in high-tax countries;
- groups using intra-group loans to generate interest deductions in excess of the group's actual third-party interest expense;
- groups using third-party or intra-group financing to fund the generation of tax-exempt income.

Since the MNEs have been able to artificially separate taxable income from the underlying activities that drive value creation, the best counter approach sets out to link the amount of interest deduction in an entity to the level of its taxable economic activity. Broadly, the best practice approach also suggests an optional de Minimis threshold, fixed ratio and group ratio rules, optional carry forward / carry back of unused interest and some targeted as well as specific rules for special circumstances. In order to bring harmonisation, Action 4 also recommends that limitations should apply to interest on all forms of debts, payments economically equivalent to interest and any expense incurred in connection with raising finance.

As Action 4 is not a minimum standard, it only recommends best practices for countering the base erosion concerns arising from interest deductions. These can either be implemented through unilateral actions by individual countries (which, in itself, could lead to a distortion of the

results produced by each country), or through a multilateral instrument (which may require extensive negotiations). Therefore, such a measure can give rise to situations of over-taxation of the MNEs, in the absence of harmonisation[206]. Further, the EU approach to implement such provisions via ATAD is rather perceived as the implementation of the BEPS Project, leading to excessive and unjustified taxation of MNEs and overriding the sovereignty of Member States[207].

Despite the risk of overlapping rules with transfer pricing, the proposals of Action 4 partially recommend global formulary apportionment approach, which allocates the profit with some predetermined criteria, rather than in accordance with the FAR analysis or value creation as contemplated by the arm's length principle[208].

However, although interest limitation rules can lead to economic double taxation, they are general rules which lead to such taxation as opposed to transfer pricing rules which are specific to associated enterprises. Therefore, Action 4 proposals cannot be tested against transfer pricing rules, specifically when they allow carry-forward or carry-back[209].

3.5. BEPS 05 – Harmful Tax Practices

The so-called 'substance test' was already developed by OECD pursuant to the 1998 report on harmful preferential regimes[210]. Action 5 however aimed to revamp the work on harmful tax practices including improving transparency, compulsory spontaneous exchange on rulings related to preferential regimes and guidance on substantial activity for any preferential regimes[211].

Furthermore, this action is a minimum standard, which is subject to peer review in order to ensure timely and accurate implementation and thus safeguard a level playing field. Since a preferential tax regime of one jurisdiction could be perceived as harmful for the tax base of other jurisdictions, the Forum on Harmful Tax Practices (FHTP), in Action 5, focused its work on establishing a compulsory and spontaneous exchange of information on rulings within the IF. Thereby it stimulates Transparency Framework and the adoption of a 'modified nexus approach' for determining the substantial activity requirement.

This new approach uses expenditure as a proxy for activity and builds on the principle that, because preferential regimes are designed to encourage activities and to foster growth and employment, a substantial activity

requirement should ensure that taxpayers benefiting from these regimes did in fact engage in such activities and did incur actual expenditures on such activities.

The EU Code of Conduct Group on Business Taxation in 2014, in coordination with developments achieved by the OECD, accepted that the 'modified nexus approach' for IP regimes is appropriate to ensure that taxpayers covered under such regime have sufficient substance[212]. Since then, the member states started making legislative amendments to their IP / other regimes to incorporate the modified nexus approach. Currently, most member states for determining the substance of the taxpayers covered under such preferential regimes use the modified nexus approach.

The Mutual Assistance Directive on administrative cooperation in the field of taxation (2011/16) has been amended, requiring EU member states to automatically exchange a basic set of information on cross border tax rulings and APAs with all member states[213]. 'Substance' has always been a buzzword in international tax planning, but now it will become more than ever a reality to be dealt with, as Action 5 provides much required guidance on this and raises the bar high[214].

3.6. BEPS 06 – Prevention of Tax Treaty Abuse

Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted, thereby depriving countries of tax revenues[215]. Action 6 therefore intended to address the following broad objectives in relation to treaty abuse[216]:

Development of treaty provisions and recommendations on designing domestic rules to deny granting of treaty benefits in inappropriate circumstances (Section A);

Clarification by way of reformulation of the title and the preamble of the OECD Model Tax Convention that the Tax treaties are not designed to be an instrument to create double non-taxation (Section B);

Identification of policy considerations for states before conclusion of tax treaty (Section C).

The Action 6, therefore, recommends inclusion of various anti-abuse provisions in the tax treaties and proposed minimum standards for combatting treaty shopping. However, instead of prescribing one single

measure, Action 6 grants flexibility to the States by enabling them to choose the manner they find most suitable for combatting abuse, which are:

a simplified Limitation on Benefits (LOB) clause combined with Principal Purpose Test (PPT), or

a standalone PPT clause, or

a LOB clause combined with anti-conduit legislation.

It is noteworthy that although Action 6's primary target is abusive treaty shopping, no precise definition of the same has been provided, which has attracted criticism[217], as it was found to be vague, broad and incomplete, thereby resulting in unbalanced outcome in implementation. However, it seems that on account of varying views of the treaty shopping in various countries, formulating a precise and exhaustive definition may in effect defeat the purpose. Therefore, avoiding an exhaustive definition seems intentional so as to retain flexibility and discretion in designing anti-abuse provisions for treaty shopping[218].

This is also evident from the PPT clause (perceived as a treaty GAAR), which aims to target all treaty shopping situations and denies the availability of treaty benefits where one of the principal purposes of a transaction or arrangement is to obtain such benefits. The exception is provided for granting the benefits in accordance with the object and purpose of the relevant treaty provision.

A main concern is that the PPT would introduce significant tax uncertainty and may have significant consequences on the investment. In particular, the ambiguous nature of the rule and the interpretive examples could allow tax authorities to seek to deny treaty benefits in almost any situation (as a tax benefit arises in virtually every situation in which a tax treaty applies).

Therefore, the PPT might be the easiest way of complying with Action 6 and also the most preferred manner as it would give larger discretion to the tax authorities compared to the other proposals[219]. In practice, therefore most signatories to MLI introduced PPT in their tax treaties. However, a vague and open-ended anti-abuse provision accepted by the majority and providing significant discretion to the tax authorities may likely have a more detrimental impact on the tax certainty, thereby defeating the larger purpose of a tax treaty.

Action 6 further proposed a modification to the preamble of all the tax treaties, by way of a minimum standard, which adds more interpretative

value to the treaties and re-emphasises that such treaties are not intended to be used to generate double non-taxation[220]. This amendment to the preamble signifies the high interpretational value of it, which is in line with Article 31(1) of Vienna Convention on Law of Treaties 1969.

Although the ultimate purpose of tax treaties is to enhance international commerce between contracting states and the first operational purpose that facilitates being able to achieve this ultimate purpose is to eliminate double taxation, the new preamble explicitly adds a second operational purpose, which is to prevent tax avoidance[221]. Furthermore, the second operational purpose is achieved by way of a PPT clause. Therefore, even though the PPT clause seems open-ended, vague and giving large discretion to the tax authorities, such clause has to be read with the new preamble which provides the object and purpose.

This essentially would entail that where a treaty is applied to eliminate double taxation with the effect of only one single taxation remaining, the granting of such benefit can never be challenged by the PPT clause[222]. Therefore, even though the PPT clause seems open-ended, when read with the preamble, it becomes clearer that it targets only abusive treaty shopping situations which lead to double non-taxation or reduced taxation.

3.7. BEPS 07 – Permanent Establishment Status

Action 7 attempts to restore the full effects and benefits of international trade, by developing changes to the definition of permanent establishment to prevent the artificial avoidance of the permanent establishment status, taking into consideration its crucial role in determining whether or not a non-resident enterprise is liable to corporate income tax in another jurisdiction[223].

These changes aim to ensure that where the activities that an intermediary exercises in a jurisdiction are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that jurisdiction unless the intermediary is performing these activities in the course of an independent business.

As such, Action 7 proposes specific changes to restrict the application of exceptions to the definition of permanent establishment to guarantee that it is not possible to take advantage of them by the fragmentation of an enterprise into several smaller business operations.

Such changes focus specifically on addressing situations of foreign enterprises using intermediaries to perform activities in certain jurisdictions that are intended to result in the regular conclusion of contracts and on addressing situations of circumvention of existing exceptions for construction sites through the splitting-up of contracts between closely related enterprises.

The changes made to the permanent establishment definitions were integrated in the amendments introduced in 2017 to the OECD Model Tax Convention in Articles 12 to 15. Furthermore, half of the Multilateral Instrument (See Action 15) signatories have adopted the MLI articles that implement the permanent establishment changes.

3.8. BEPS 08, 09, 10 and 13. Transfer Pricing Issues

The Actions 08, 09, 10 and 13 of the BEPS Project deal with transfer pricing issues in relation to multinationals intragroup transactions. However, before analysing those specific actions, it is important to explain the extent of the term "transfer pricing".

In an objective and precise definition, Arnold, B. J[224] states that 'a transfer price is the price established in a transaction between related persons'. Therefore, transfer price is the concrete outcome on prices deriving from transactions between related companies that belong to the same multinational coordination.

This common business practice has tax implications, since the parent company could simply manipulate the prices to shift profits to a more favourable jurisdiction[225]. In practice, a modern multinational structure makes it possible for the taxable income to be divided among the subsidiaries controlled by the parent company[226].

The transfer pricing rules were borne to tackle the profit shifting which erodes a country's tax base. The core centre of any transfer pricing analysis is the so-called 'arm's length principle'. According to it, the member of a corporate group has to be seen as a separate taxpayer in relation to the allocation of income[227].

The international guidance on the subject is of major importance for both tax authorities and taxpayers. In contrast to the base erosion issue, the absence of coordination could also lead to double taxation in detriment to the MNE group[228].

In a solely domestic context of transfer pricing rules, tax authorities could be able to adjust the prices when they differ from market prices and it result in residual taxation of the same income if there is no correspond adjustment from the other jurisdiction involved[229]. Hence, double taxation is a serious issue when several countries apply their domestic transfer pricing rules to the same transactions.

Originally developed by the United States as a technique for limiting transfer pricing abuses[230], the arm's length standard is widely accepted and it was incorporated in the OECD and UN Model conventions as an attempt to bring some uniformity interpretation to the subject. The provision of article 9(1) provides that transfer pricing should reflect the prices that would be settle by unrelated parties acting independently.

Consequentially, in order to avoid the base erosion of a certain country and prioritize an alignment with value creation, the transactions between related companies should be treated the same way as independent companies. The "arm's length" is also the fundamental basis of the transfer pricing methodology adopted by the OECD's Transfer Pricing guidelines.

The exponential growth of intragroup transactions[231] and the use of 'shell companies' – with limited or no economic activity – highlighted the need for a revision on the guidance regarding transfer pricing, since it became a toll of allocation of profits to companies in low taxes jurisdictions or preferential tax regimes.

Therefore, the BEPS Actions 08-10 and 13 focused on the revision of the OECD TP Guidelines in order to align TP outcomes with value creation[232]. The conduct of the parties will prevail over the contractual arrangements[233]. The overall goal is to prioritize a company's economic reality in relation to the 'paper reality'.

In order to improve the TP rules, four key-areas were prioritize: i) intangibles (Action 08); ii) risk and capital (action 09); iii) high-risk transactions (Action 10); and, iv) documentation (Action 13).

Action 8. Intangibles

In summary, Action 08 deals with transfer pricing issues related to transactions involving intangibles[234]. The concerns on intangibles is justified due to its mobile characteristic, usually being hard to be economically valued, for both tax authorities and taxpayers.

The additional challenge on evaluating intangibles often results in misallocation of profits by companies, especially those with royalties, copyrights and license payments. These information asymmetries also give rise to specific guidance on hard-to-value intangibles and cost contribution arrangements[235].

The new guidance on intangibles clarifies that legal ownership by itself does not result in an automatic right to a return from its exploitation. The prevailing factor will be an accurate analysis of the actual performance of the group companies, delineating their functions, risks carried out and assets invested in the transaction. The entitlement and amount of the return will depend on those factors[236].

Action 9. Risk and capital

The Action 09, on the other hand, analyses the coherence between the contractual allocation of risks and the consequent distribution of profits in connection to those risks. It also addresses the level of return to funding provided by a capital-rich MNE group member[237].

Action 10. High-risk transactions

Regarding high-risk transactions, Action 10 tackles some specific situations[238], such as the profit allocation resulting from controlled transactions, which are not commercially rational. It also targets the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group. Moreover, Action 10 aims to neutralise the use of certain types of payments between members of the MNE group, which are often utilised as a way mechanism to erode the tax base in the absence of alignment with value creation (e.g., management fees and head office expenses).

Action 13. Documentation

Lastly, the Action 13 relates to transfer pricing documentation and it encompasses a minimum standard of the Inclusive Framework. In brief terms, the final report contains new reporting standards and a template for Country-by-Country Reporting of income, taxes paid and certain measures of economic activity[239].

According to the 2013 Action Plan on Base Erosion and Profit Shifting, the Action 13 require the development of 'r*ules regarding transfer pricing documentation to enhance transparency for tax administration, taking into*

consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template'.

The potential asymmetry of information between taxpayers and tax administration undermines the administration of TP rules[240]. Consequently, it makes difficult the control of the arm's length price, since tax authorities would not have an overview of the taxpayer's value chain. Besides enhancing opportunities for BEPS, the lack of uniformity and diverge approaches on TP documentation result in significant administrative costs for business.

As a result, the revised guidance encompasses a three-tiered standardised approach to transfer pricing documentation: i) master file; ii) local file; and, iii) country-by-country report[241]. In summary, the "master file" is available to all relevant tax administrations and contains a high-level information of a MNE' global business and transfer pricing policies. The "local file" is specific to each country and it brings a more detailed picture of the related party transactions, the amounts involved and a company's TP analysis of those transactions.

Lastly, the Country-by-Country Report is mandatory to all MNE with an annual consolidated group revenue equal to or exceeding EUR 750 million and it should be filed, on an annual basis, in the jurisdiction of tax residence of the ultimate parent entity and shared between jurisdictions through automatic exchange of information[242].

It provides for each tax jurisdiction the amount of revenue, profit before income tax and income tax paid and accrued. The MNEs also need to report their number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction. The CbC requires the identification of each entity doing business in a certain country and an indication of the business activities each company engages in[243].

In relation to BEPS Action 13, the European Union adopted it through via DAC 4[244].

Despite the new guidance on transfer pricing set up by the BEPS Project, some issues arise in relation to digitalized economy, extent of value creation, implications on the CBC reporting and effective valuation of intangibles.

One of the main challenges faced by the OECD BEPS Project is the new realities on business models due to the global digital economy[245]. Therefore, the alternative tax framework must be stable enough, since the starting point for taxation on BEPS is the arms' length principle, widely accepted by a number of countries[246].

In order to tackle that issue, the OECD and the G-20 articulated a tax policy that addresses the digitalization of the economy[247]. There was a proposal based on BEPS Action 01 and the two pillars of the Interim Report[248] regarding the tax challenges arising from digitalization.

In summary, the Pillar One deals with taxing rights allocation and the Pillar Two deals with the other BEPS issues. In respect to transfer pricing, the Pillar One requires a deviation from the arm's-length principle: *"The Inclusive Framework recognises that the implications of these proposals may reach into fundamental aspects of the current international tax architecture. Some of the proposals would require reconsidering the current transfer pricing rules as they relate to non-routine returns, and other proposals would entail modifications potentially going beyond non-routine returns. In all cases, these proposals would lead to solutions that go beyond the arm's-length principle"*[249].

The fact that the BEPS Project did not define the value creation principle raises additional challenge for its application. However, the BEPS report considers that the value added principle deals with the income or the profit created through the activities of the MNE groups[250].

According to Allison Christians[251], the final report on BEPS supports that value creation principle has an influence against the current residence and source principle, since it stated its objective to '*revise the rules to align them to developments in the world economy, and ensure that profits are taxed where economic activities are carried out and value is created*'[252].

The use of a formulary approach is also seen as an alternative for taxation of companies. It moves away from the traditional method of a separate entity accounting and encourage profit allocation through the real economic activities of the MNE's[253].

According to Sonali Sachdeva, '*the formulary apportionment would evaluate a MNE's income through factors such as assets, jobs and capital which not affected by the countries' varying tax policies including tax rates, standards for determining corporate residency, and approaches to transfer pricing enforcement*'[254]. One of the main criticism to the method is its difficulty in the application in the global context[255], being hard to achieve an

international agreement on such matter, considering the differences on the predominant economic activities of countries[256].

In relation to intangibles, the BEPS Report to Actions 08-10[257] points out that the legal ownership does not generate, by itself, a right to all return in relation to intangibles. In line with the 'value creation' standard, the final report states: '*The group companies performing important functions, controlling economically significant risks and contributing assets, as determined through the accurate delineation of the actual transaction, will be entitled to an appropriate return reflecting the value of their contributions*'.

For that purpose, the residual profit split method could be used as a criterion, since it suits the situations where there is a unique and valuable contribution of the companies involved and/or there is a high level of integration. It also applies when there is a shared assumption of economically significant risks. In practical terms, the profit split method is based on the segregation of the 'routine profit' derived from tangible assets and 'residual profit' attributable to intangibles[258].

Despite the new reporting provisions of BEPS Action 13 promote the enhancement of transparency and contribute to the tax administration goal of understanding, controlling, and tackling BEPS behaviours[259], it could bring unreasonable burdens to taxpayers, depending on how the domestic provision regulates it. The additional administrative and compliance cost of the measure could be an unreasonable extra burden to taxpayer. Moreover, this level of uncertainty could lead to misapplication of data by tax administration and detrimental litigation between jurisdictions and companies[260].

In order to stress the purpose of Action 13 and the CbC, the OECD BEPS Report highlights that '*the specific content of the various documents reflects an effort to balance tax administration information needs, concerns about inappropriate use of the information, and the compliance costs and burdens imposed on business*'[261].

3.9. BEPS 11 – BEPS Data Analysis

The 2013 BEPS Action Plan suggested that there was vast substantial evidence to suggest BEPS as a widespread behavior, as it was "evident from a number of indicators that BEPS was indeed taking place, posing a threat in terms of tax sovereignty and of tax revenue"[262].

The Action 11 attempts to tackle the issue of lack of data, by establishing methodologies of data collection and analysis both on the economic and fiscal effects of tax avoidance and on the impact of measures proposed in the BEPS project[263].

The *Corporate Tax Statistics* database was first launched in January 2019 to assemble and analyze relevant data of BEPS, include information for more than 100 jurisdictions. The second and third eeditions incorporate Action 13 CbCR statistics, now covering 38 jurisdictions and 95% of all CbCRs filed, thus being a reliable, varied and helpful source for analyzing BEPS implementation.

3.10. BEPS 12 – Mandatory Disclosure Rules

The BEPS Action 12 mainly addresses the tax administrations worldwide and provides some guidance on tax policy regarding the design of mandatory disclosure of rules of taxpayers. The final report points out that the absence of timely, comprehensive and relevant information on the aggressive tax planning (ATP) strategies is one of the challenges tax authorities face worldwide[264].

The ultimate goal of BEPS Action 12 is to tackle aggressive tax planning arrangements, which, consequently, lead to base erosion. The OECD concern on providing general guidance is to guarantee an effective control by tax administrations, without setting unreasonable compliance burden to taxpayers[265]. The provision of such information by companies will enable governments to adjust their legal tax systems, as well as provide accurate data to assist the risk assessment to future audits[266].

In its content, the Action 12 of the BEPS Action Plan does not represent any mandatory minimum standard and jurisdictions are free to choose to adhere or not to such rules. According to Avi-Yonah [267]: "*As the recommendations are not universally mandatory, it is easy for the MNEs to avoid the mandatory requirements in certain jurisdictions by incorporation in another jurisdiction without such requirements. It is also possible for the jurisdictions to join the race to the bottom by refusing to adopt mandatory disclosure regime*".

On the other hand, it suggests the formulation of a number of good practices, based on the comparative analysis of different models of unilateral mandatory mechanisms for the disclosure of tax schemes (MDR) in the tax systems that had already implemented such mechanisms (United States, Canada, South Africa, Portugal, United Kingdom and Ireland)[268].

One of the major outcomes of the BEPS Action 12 was the adoption of Council Directive (EU) 2018/822 by EU Member States (DAC 06). It requires a mandatory report of cross-border aggressive tax planning, offshore structures and Common Reporting Standard avoidance schemes to EU tax authorities. The directive incorporates the model rules set out in the 2018 OECD report *Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures*.

The adoption of the Council Directive (EU) 2018/822 did not support on any of the objectives of the Treaty on the Functioning of the European Union, but only on the Action 12 of the BEPS Plan[269]. Some concerns

arise in its application, such as taxpayers' rights, uncertainty, possible increase of litigation, extra administrative and compliance costs.

Despite the focus on the concept of aggressive tax planning, there is no specific definition of what exactly would be unlawful ATP schemes. According to BEPS Action 12, it is "*designed to detect TP Schemes that exploit vulnerabilities in the tax system*"[270]. This lack of definition could lead to differences on the treatment by jurisdictions and uncertainty to taxpayers, besides the additional administrative costs in order to comply with several rules.

3.11. BEPS 14 – Mutual Agreement Procedure

The Action 14[271] of the BEPS project aims to strengthen the effectiveness and efficiency of MAP process[272] (currently included in article 25 of the OECD Model Tax Convention). This aim is sought to be achieved by not only ensuring consistent and proper implementation of MAPs in tax treaties, but also effective and timely resolution of disputes regarding their interpretation or application through MAP. Thus, various mechanisms prescribed within Action 14 reveal that main objective i.e. ensuring tax certainty. The core proposals are

- Adoption of ***Minimum Standards*** by all countries of the Inclusive Framework ('IF'); like ensuring that the treaty obligations related to Article 25 are fully implemented in good faith and MAP cases are resolved in timely manner; ensuring that the administrative process promotes prevention of treaty related disputes, and in case of any disputes, its timely resolution; ensuring that the taxpayers meeting the requirement have access to the MAP.
- ***Best Practices*** which complement the minimum standards, like Inclusion of Art 9(2) to enable corresponding adjustments; Implementation of bilateral APA programmes; Suspension of collection procedures during pendency of a MAP case.
- Adoption of ***Mandatory Binding Arbitration*** procedure.

Though the BEPS project endeavoured to strengthen the MAP via Action 14 by ensuring easy access to the taxpayers, it has failed on ensure that the MAP applications are resolved in a timely manner. Further, with only limited countries adopting the mandatory binding arbitration and no time-limit set on closure of the MAP applications, it seems that there will

be more and more MAP cases pending for resolution. Therefore, in effect, it seems that the primary objective of ensuring tax certainty is still unmet.

3.12. BEPS 15 – Multilateral Instrument

The Action 15 covers the Multilateral instrument that would allow jurisdictions to swiftly implement agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. A Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) was adopted on 24 November 2016, that already covers 99 jurisdictions from all continents and all levels of development. The MLI entered into force on 1 July 2018[273].

It can be defined as a multilateral instrument with characteristics of bilateralism, since it does not aim to eliminate the entire network of bilateral tax agreements, but rather to interact on an equal footing with them, being defined by Hidalgo as a step towards 'bilateral multilateralism'[274]. In fact, this MI is compatible with bilateral treaties, since it modifies rather than terminates the existing bilateral treaties, all based on Article 30(3) VCLT that codifies the basic principle of *lex posterior derogat legi prior*.

It effectively means that certain provisions of the bilateral treaties would be modified and superseded by the MI, meaning that provisions not covered by the MI (which would be an important part of the Treaties) remain in force and unchanged. The OECD further recommends, for States that do not have bilateral treaties, the adoption of a Compatibility Clauses in the adoption of new bilateral treaties to prevent issues arising from this[275].

The MLI is an instrument that provides flexibility in the level of commitment, since different levels of commitment can be made between some parties compared with other parties. Furthermore, it can ensure transparency and clarity for all stakeholders.

As such, we can say that the success of this MLI is definitive, because it represents basis of consensus and unprecedented dialogue in the international community and the collaboration between countries. Some authors, like Hidalgo, even consider it a "landmark because of the set of wills it encompasses and the ability to generate a meeting point in which

Member States negotiate common measures in the fight against the base erosion at the international level"[276].

4. Multilateralism

Attempts to create a multilateral international tax order have existed from as early as the League of Nations[277], with the issue gaining special prominence in the second decade of the 21st century in the aftermath of the 2008 financial crisis, that brought attention to the need to achieve worldwide transparency and tax coordination[278].

Multilateralism does bring some advantages to the table. Firstly, it makes it easier for countries to expand their networks (especially developing countries, that often times have insufficient resources to conduct multiple bilateral negotiations). Secondly, it facilitates the work of tax administrations, since as more countries are involved in tax treaties, the exchange of information between said countries can be done in a more coordinated manner.

Thirdly, it greatly lessens treaty shopping opportunities and more easily resolves triangular cases, as there is more convergence of treaty provisions[279]. Finally, a single text instead of thousands of similar but slightly varying texts would lead to consistent interpretation and provide certainty for businesses[280].

Nevertheless, bilateral treaties are still preferred, and there currently exist well over 3,000 bilateral tax treaties based on the OECD model. There is two main reasons for this: firstly, we must recognize that each country has its own particular domestic tax system and countries are quite different in terms of their levels of development, furthermore, each country also has its particular domestic tax law system. With such different circumstances it is no surprise that, when two countries meet to negotiate a tax treaty, the outcome of concessions and compromises of the negotiating parties, will lead to a unique tax treaty and accordingly no two treaties are identical[281].

Multilateral treaties have a very different way of coming into existence. They are mostly discussed through international organizations in diplomatic conferences – in these conventions, oftentimes an initial draft prepared by the secretariat of an international organization is first presented to small negotiating groups, reviewed in a plenary meeting for review, signed, and submitted to the parties' domestic procedures for ratification.

Generally, multilateral treaties also provide for some minimum number of ratifications to enter into force. Multilateral treaties thus need more formalities and negotiations are often more complex and difficult as there are more interests to accommodate[282].

Jung-hong Kim argues that "*it has been a conventional wisdom among the international tax community that a multilateral tax treaty is not practicable and bilateral treaties are a more appropriate way to eliminate double taxation at the international level*". Therefore, the author recognizes that the most effective multilateral tax treaties are among countries in close proximity geographically and economically, which can mean they have similarities in levels of development and goals with negotiation, and probably a close pre-exiting relation that eases the whole process[283].

4.1. Will the MLI open the pave to a Multilateral order?

As previously established, the current tax system as a complex network of bilateral treaties, mostly based on model conventions. Some argue the MLI will mean a shift into a multilateral order.

Oftentimes due to the complexity of this question parallels are drawn with other legal regimes international trade and investment regimes. This parallel is a logical one since much like tax treaties, bilateral investment treaties are essential economic treaties governments conclude, and tend to have a number of common similar provisions with some variations reflecting each country's particular need.

When we consider the world of investment, we see that there has been no shift into a multilateral order. In the 1990s when the World Trade Organization (WTO) replaced the General Agreement on Tariffs and Trade (GATT) a shift to multilateralism could have been expected, but in reality, it actually ironically led to the proliferation of regional trade agreements clearly deviating from the multilateral track.

Nevertheless, Jung-hong Kim wonders whether the international tax regime could smoothly move from bilateralism towards multilateralism when one considers that tax is even more politically sensitive than trade or investment, as it is at the core of a nation's sovereignty[284]. Indeed, one has to take into account that there are some relevant differences between the field of investment and trade and the field of taxation that may build a more positive case for multilateralism in the latter, since arguably the need and circumstances in which multilateralism arises for taxation are unique. In fact, that need is the genesis of the BEPS project: the clear rupture from the source-residence duality criteria has become obsolete due to the digital economy, and the globalisation phenomenon accompanied of the reduction of collection of public revenues by tax administration has revealed disagreement between taxpayers and tax administrations in the pursuit of undeclared incomes.

As such, base erosion and profit shifting increased tax rates since States are unable to cover their revenue projections[285], which has a great impact on tax pressure and thus national politics. One can argue that Governments might have more political interest in creating a functioning international tax system based on cooperation, even allowing perhaps some transfer of sovereignty in tax matters, purely out of necessity

Another argument against the move to a Multilateral order is brought Ana Paula Dourado, that notes the existing risk in the openness to reservations of the multilateral convention. She argues that the OECD work on taxation in the digital economy might actually end up resulting in more legitimacy for the overlapping of residence, sources and market state taxation, thus actually increasing and legitimizing unilateralism and discrimination against taxpayers with cross-border activity and income, instead of promoting multilateralism[286].

This argument, focused on the substance not only of the MLI but of the BEPS project as a whole, we argue that it is exactly that openness to reservations and flexibility that makes this instrument so appealing[287]. Here, it becomes important to differentiate between relative multilateralism, where we have a majority of supporting States, and absolute multilateralism, where we find unanimity in all signatory States. There are very little fields in which we will find absolute multilateralism, but taxation at the present moment certainly would not be able to be one of them, since, as explained above, each country has its particular domestic tax law system. The relative multilateralism that the MLI allows for might be the smooth transition needed from a unilateral and bilateral tax order to a multilateral one.

5. Developing Countries effective participation

The revolution to the manner of doing business brought about by digital economy has necessitated new international tax rules to ensure that the tax system provides a fair share of tax revenues to countries having a rightful claim. The fairness or the equity principle requires that there must be an equal level playing field between all jurisdictions; developed or developing[288].

However, the current law is rather perceived as favouring the capital exporting jurisdiction (residence based developed countries) rather than capital importing jurisdictions (source based developing countries)[289]. From that perspective, even though OECD in its endeavours to tax the digital economy tried to establish fair balance, developing countries are rather sceptical about the fairness and equity of the proposals.

For instance, the Pillar One for taxing digital economy proposes a unified approach based on three nexus approaches viz., user participation, marketing intangibles and significant economic presence. There are multiple concerns raised by various developing countries on this new nexus approach, like it benefiting larger economies more than smaller economies, significant challenges for developing countries to procure data in order to formulate the apportionment, challenges on distinction between routine and residual profits etc. Therefore, in order to protect their tax bases, various developing countries have implemented unilateral measures for taxing such digital economies.

Similarly, the proposal under Pillar Two, which aim to prevent harmful tax competition, are hoped to be in favour of the developing countries as they address the concerns of excessive interest, royalties, fees for services pay-outs to low taxed jurisdictions. Furthermore, the developed countries for a long time has seen the tax incentives provided by developing countries as a 'race to the bottom' and has classified such incentives as inefficient tool for stimulating development in such countries.

In fact, OECD emphasizes that by virtue of these measures, it shields the developing countries from the pressure of providing inefficient incentives, which shall have an overall detrimental effect[290]. However, the G20 Development Working Group affirms that well-structured tax incentives have the potential to contribute to a country's economic development[291]. Further, a broad review of the proposals suggests that, the entire exercise is

being drawn from the perspective of the developed countries. This is because it gives the holding company a right to levy the top-up tax in situations where the effective taxes levied on the income are lower.

However, its clear that since most of the MNEs will be headquartered in developed countries, it passes on the taxing right to such developed countries. Indirectly, it pressurizes the developing countries who may have a policy of providing certain incentives (even though they are well structured), to change their policies, if they want to ensure that the incentives provided by them are not washed out by a top-up tax in the holding company jurisdiction.

This situation may have a curbing effect on the tax sovereignty of such developing countries. In practice, countries like UAE are now making changes to their domestic tax regimes to restrict the washing out effect of their tax incentives, by introducing new taxes. Therefore, though the aim is to encourage the participation of the developing countries and to frame international tax laws that are equitable, they rather seem biased.

6. Final Remarks. The Future Ahead

After an overall look at the origins and development of the international tax regime, it is clear that the OECD BEPS Project represents a very important landmark on the international community. Therefore, after the launch of the Inclusive Framework, the base erosion and profit shifting issue have a global approach and its standards are pursued by 141 signatory countries. However, the implementation of the actions face many challenges by the jurisdictions involved.

The continuous change on society's demands requires an adjustment of the prioritized public policy by governments and organizations. On that regard, the current international scenario faces additional challenges due to the digitalized economy, environmental issues, alternative dispute resolution mechanisms, COVID-19 pandemic aftermath and, more recently, war implications.

Before the COVID-19 pandemic, the main area of concern of the international community relied on the impact of the digitalized economic in taxation. The Action 01 of BEPS Action already dealt with such issue and, as a result, there was an extensive discussion, which resulted in an Interim Report and its two Pillars proposals[292].

Currently, 137 countries signed the Two-Pillar Solution in order to promote the reform of the international tax regime and guarantee that MNE pay their fair share of tax in the jurisdictions they operate[293].

As previously mentioned, the Pillar One will promote a re-allocation of taxing rights and the Pillar Two introduces a global minimum corporate tax rate, which aims to tackle the harmful tax competition between jurisdictions[294]. Recently, the OECD launched the Pillar Two Model Rules, also known as "Global Anti-Base Erosion Model Rules" (GloBE)[295]. In summary, those rules were designed to ensure that economic relevant multinational enterprises (MNEs) had to pay a minimum level of tax on the income arising in each jurisdiction where they operate. The document also provides a template that jurisdictions could incorporate in their domestic law as from 2022.

Other issues represents an additional challenge to tax administration and policymakers in the digital economy, such as crypto-assets. Firstly, the crypto-assets are a growing market and it affects jurisdictions, which must adapt to the tax implications of such new concept[296]. Some of the features of crypto-assets, including cryptocurrencies, results in new compliance challenges for taxpayer and additional efforts for tax administrations[297].

Therefore, tax policymakers are still at an early stage in considering their implications. In face of that circumstance, the G20 Leaders and Finance Ministers requested international organisations to assess the crypto-assets risks in a tax perspective[298]. As a result, it was delivered the "Taxing Virtual Currencies Report", which represents the first OECD document related to virtual assets and it encompasses an comprehensive analysis of the policy gaps in relation to the main tax types (income, consumption and property taxes) for such a large group of countries[299].

Taking into consideration a market capitalisation of USD 346 billion – as of September 2020 – it makes the government's concerns even more relevant[300]. Therefore, the need for a comprehensive tax policy framework is essential to guarantee a uniform and consistent treatment in order to prevent tax avoidance. Moreover, the virtual assets also represents a potential additional tax base to jurisdictions, which could generate additional amounts to their revenues.

Additionally, a specific tax policy to virtual assets could contribute for improving transparency and certainty to taxpayers and tax authorities[301]. A clear framework would encourage taxpayers to comply and report activities,

facilitating the access of information and control of transactions by tax administrations[302].

Currently, there is an ongoing public consultation released by OECD that aims to develop a new global tax transparency framework[303]. The goal is to promote a crypto-assets reporting and exchange of information obligation, also known as "Crypto-Asset Reporting Framework" (the "CARF") and amendments to the Common Reporting Standard (CRS) for the automatic exchange of financial account information between countries[304].

The global concerns on climate change and the protection of environment has a significant impact in tax matters. The international tax community addresses those issues, for instance, by the use of carbon pricing.

In order to decrease the risks of dangerous climate change, jurisdictions have an increasing concern about the need for a net zero greenhouse gas (GHG) emissions by around the middle of the century[305]. Many countries have responded with ambitious emission reduction targets. In order to bring uniformity to such matter, the OECD launched some reports aiming to translate those long-term ambitions into concrete policy packages. Hence, carbon pricing is a relevant mechanism that might help jurisdictions to achieve climate objectives and support a green recovery[306].

The COVID-19 pandemic also brought some repercussions on tax matters. This global health crisis resulted in a profound decline in the countries' economic, resulting in a serious detriment of countries' public finances. A current challenge is on how jurisdictions could rethink their approach to public finances and develop fiscal policies that could result in inclusive and sustainable economic growth. For that purpose, the OECD prepared a report for G20 Finance Ministers and Central Bank Governors that make some considerations to policymakers in order to design an optimal tax reform as a response to the pandemic[307].

Moreover, besides the challenges regarding the tax policies, some other issues arose as a direct aftermath of COVD, such as, travelling restrictions, remote work, comparability issues on transfer pricing, digital audits for tax administrations, etc.[308].

Finally, it seems to be a global tendency to reduce litigation towards the use of alternative mechanisms of dispute resolution, not only through mutual agreement procedure or through Arbitration, but also mediation, tax rulings, advanced price agreements (APA), etc. Those measures aim to

bring more certainty, reducing administrative costs and compliance to taxpayers and ensuring a optimal use of the limited sources of tax administrations.

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CHAPTER 7 – GLOBE RULES: Current status and issues[309]

Carla Valério, Eduardo Raposo and Rita Campos Pereira

Part 1: Analysis of the GloBE rules: the search for an international framework

1. Background

The growth of globalisation experienced in the last half century has allowed a considerable increase in cross-border relations across the globe.

There are several reasons for this phenomenon. The fact that since the Second World War we have lived in relatively peaceful times - something that may, unfortunately, be reversed - enabled many States to conclude trade agreements, integration treaties as well as tax treaties, typically concluded to develop their economic relationships, and therefore intensifying relations between them. Furthermore, the emergence of digitalisation and new technologies, namely in communication, information and transport has allowed a greater openness and connection between people, cultures, and economies, and as a consequence we can state that today we live in a true global village (T. Gibson et al., 2012, 312-313).

However, as a result of this same globalisation and digitalisation, we find ourselves in a crisis of national state sovereignty, and in particular a crisis of the fiscal state (Dourado, 2018, p. 27).

The existing international tax system is threatened by tax competition, tax planning and there is a true race to the bottom of the corporate income taxes (van Dam et al., 2021, p. 164). Ending it would be a game changer (Devereux et al., 2021, p. 1) since it is calling into question the functions of taxes in different states and unbalance the international tax order (Dourado, 2018, p. 30).

Taking into account all these challenges, the OECD released in 2013 the Action Plan on Base Erosion and Profit Shifting in which it put forward 15

major actions "covering elements used in corporate tax-avoidance practices and aggressive tax-planning schemes" (Remeur, 2019, p. 1).

Following this plan, the OECD/G20 Inclusive Framework ("IF") on Base Erosion and Profit Shifting continued its work, this time attempting to address the tax problems arising from the digital economy as a priority (van Dam et al., 2021, p. 164) since the rules as they currently stand, do not effectively address the tax gap (Brokelind, 2021, p. 212), due to being "inadequate to deal with tax base erosion occasioned by state aid practices and advantageous tax rulings" (Das et al., 2022, p. 44).

To answer this problem, the question was divided into two policy goals, creating on one hand Pillar 1 and on the other Pillar 2. The former proposes a partial re-allocation of taxing rights towards market jurisdictions, while the latter aims to introduce minimum effective taxation for large multinational groups.

With regard to Pillar 2, which is the object of this article, and in order to cease or attenuate this problem, the OECD has devised a set of rules to ensure that Multinational Enterprises ("MNE") pay a fair amount of tax wherever they operate, in an ongoing attempt to put a stop to tax practices that allow them to move profits to jurisdictions where they are subject to no or low taxation. This action is significant, but it is also raises questions.

Through the establishment of a global minimum level of taxes, this important reform intends to set a floor on competition over corporate income tax rates. In theory, the global minimum tax reform will level the playing field for businesses worldwide by removing a significant portion of the benefits of transferring profits to countries with no or low taxation, and will allow jurisdictions to better safeguard their tax bases.

On 8 October 2021, 136 jurisdictions (currently counting 137) reached an agreement under the Statement on a Two-Pillar Solution to Address The Tax Challenges Arising from the Digitalisation of the Economy (hereinafter "Global Agreement"), which has then been translated into the Global Anti-Base Erosion Model Rules (hereinafter "GloBE Model Rules") approved on 14 December 2021 by the OECD/G20 Inclusive Framework on BEPS.

2. General Issues

2.1. Object

As previously stated, the GloBE rules intend to impose a minimum taxation on MNE groups on the income arising in each jurisdiction where they operate, which was agreed to be at 15% effective tax rate[310].

To get a clear understanding of this reform, it is essential to grasp and define a few concepts put forward in the GloBE Rules.

The first one is the concept of a "Group", which, for the purposes of the GLoBE Rules, means a collection of Entitiesthat are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of those Entities: i) are included in the Consolidated Financial Statements of the Ultimate Parent Entity[311] ("UPE"), or ii) are excluded based on size or materiality grounds or on the grounds that the Entity is held for sale[312].

The concept of a Group also includes any Entity located in a jurisdiction which has one or more Permanent Establishments ("PE") located in other jurisdictions as long as they do not meet the above criteria to be considered a group[313].

In turn, a MNE group means any group that includes, at least, one entity or PE which is not located in the jurisdiction of the Ultimate Parent Entity ("UPE")[314].

Finally, it must be mentioned that the UPE stands at the heart of the system, since it is considered to be the entity in the best position to guarantee that the group's jurisdictional taxation level meets the agreed minimum rate.[315]

According to the GloBE rules, an UPE encompasses an Entity that:

a. owns directly or indirectly a Controlling Interest in any other Entity, and it is not owned, with a Controlling Interest, directly or indirectly by another Entity,[316] or
b. the Main Entity of a Groupis located in one jurisdiction and has one or more Permanent Establishments located in other jurisdictions provided that the Entity is not a part of another Group.[317]

Pillar two and its effectiveness depends on the proper application of three main rules:

1. The Income Inclusion Rule ("IIR")
2. The Undertaxed Payments Rule ("UTPR")
3. Subject to Tax Rule ("STTR")

Under the IIR, a parent entity (primarily the UPE) of an MNE group is charged a top-up tax "on a parent entity in respect of the low taxed income of a constituent entity"[318].

The UTPR acts as a backstop to the IIR, denying deductions or requiring an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR.[319]

Together these two two interlocking domestic rules are known as the GloBE rules[320], with the former becoming effective in 2023, and the latter having effect from 2024 onwards.

Regarding the STTR, it consists in a treaty-based rule that "allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate"[321] and is not subject to analysis in this article.

2.2. Scope

The GloBE rules apply to Constituent Entities that are members of MNE groups with an annual revenue (as determined under applicable Consolidated Financial Statements of the UPE) of at least 750 million EUR, in no less than two of the four consecutive preceding fiscal years[322]. If the fiscal year does not correspond to a period of 12 months, a pro rata will be applied[323].

Smaller groups than the value agreed upon and purely domestic groups (unlike under the proposed EU framework discussed under part 2) are not subject to these rules.[324]

Furthermore, certain entities due to their intrinsic nature and object pursued are excluded from the scope of application of the GloBE rules, namely governmental entities, international or non-profit organizations, pension funds, investment entities or real estate investment vehicles that are ultimate parent entities[325].

Moreover, entities that present the following criteria are also excluded from the scope:

a. where at least 95% of the value is owned by Excluded Entities[326];
b. where an entity acts solely (or virtually solely) for the advantage of Excluded Entities by holding assets or investing funds[327];
c. where an entity only performs activities that are ancillary to those performed by an Excluded Entities[328];

d. where at least 85% of the value of the Entity is owned by an Excluded Entity provided that substantially all of the Entity's income is Excluded Dividends or Excluded Equity Gain or Loss that is excluded from the computation of GloBE Income or Loss.[329]

Excluded Entities are not considered for the purposes of the computations under GloBE rules, except for the application of the revenue threshold[330].

3. Income Inclusion Rule

3.1. Application of Income Inclusion Rule

The main rule[331] for the application of the IIR in the UPE jurisdiction establishes that the UPE of an MNE group that owns (directly or indirectly) an Ownership Interest in a Low-Taxed Constituent Entity at any time during the Fiscal Year shall pay a tax in an amount equal to its Allocable Share of the Top-Up Tax of that Low-Taxed Constituent Entity (LTCE) for the Fiscal Year[332].

That being said, the UPE is the entity that, as a general rule, is required to apply the IIR. Indeed, if the UPE *"is in a jurisdiction where a Qualified IIR is in effect for the Fiscal Year and none of the LTCEs of the MNE Group are held by a POPE [partially owned parent entity] required to apply a Qualified IIR, then the IIR will only be applied by the UPE in the UPE Jurisdiction"*.[333]

On the contrary, *"if the UPE is located in a jurisdiction where it is not required to apply a Qualified IIR for the Fiscal Year, then under the top-down approach the next Intermediate Parent Entity down the ownership chain is required to apply the IIR to its Allocable Share of the Top-up Tax for an LTCE in which it holds a direct or indirect Ownership Interest"*.[334]

In the scenario that low taxed constituent entities are more than 20% owned by a minority interest holder outside the MNE Group regardless of where the UPE is located, the top-down approach will not be followed, and instead partially owned parent entities (POPE) are bound to apply the IIR, proportionally, to their allocable share of top-up tax.[335]

3.2. Allocation of the IIR top-up tax

The amount of tax due by the Parent Entity on a Low-Taxed Constituent Entity depends on its allocable share of top-up tax[336].

The allocable share is *the amount of Top-up tax owed in respect of an LTCE, determined by reference to the Parent Entity's Ownership Interest in the income of the LTCE*[337]. It can be reached *by multiplying the Top-up Tax of the LTCE by the Parent Entity's Inclusion Ratio*[338].The Parent Entity's Inclusion Ratio, in turn, represents *the ratio of the Parent Entity's share of an LTCE's GloBE Income to its total GloBE Income for the Fiscal Year*[339].

The Parent Entity's Inclusion Ratio for a Low-Tax Constituent Entity for a Fiscal Year translates into the following formula:

Parent Entity's Inclusion Ratio for a Low-Taxed Constituent Entity for a Fiscal Year =
(GloBE Income – GloBE Income allocable to Ownership Interests held by the other owners) / Total GloBE Income of the Entity[340].

3.3. Offset mechanism

The offset mechanism applies where any parent entity owns an ownership interest in a Low-Taxed Constituent Entity indirectly through an Intermediate Parent Entity or a Partially-Owned Parent Entity[341].

In this case, if the intermediate parent entity or the partially owned parent entity, are subject to a qualified IIR, the top-up tax due by parent entity is reduced by an amount equal to the portion of their allocable share in the top-up tax that is due by the referred entities, under the qualified IIR[342].

3.4. The IIR in scholarly literature

The IIR has been analysed by scholars from different perspectives since it has been conceptualized under the Pillar Two Blueprint. Primary focus has been given to analysis under international law principles, comparison and relationship with CFC rules, design issues, and interaction with tax treaties. Some examples will follow.

One of the points raised is how the application of a rule such as the IIR affects sovereignty. Schmidt (2020, p. 996) considers that the IIR can be seen as an "infringement of other states' fiscal self-determination" since the source States's decisions on their own tax system become conditioned by the IIR. The author considers, therefore, that the income inclusion rule can be in conflict "with some of the most fundamental principles of international taxation as the proposed rule may in fact lead to taxation in the jurisdiction of a parent company of income that has exclusively been generated through genuine economic activities in another state (conflict with the source principle) by solely obtaining benefits in that other state (conflict with the benefits principle)."

In parallel Silva (2020, p. 123), advocates that the Pillar Two rules may express a "significant encroachment on the sovereignty of jurisdictions". Tax systems are designed to suit on the particularities and needs of each country and as long as they are linked to a substantive-based business

wherever the income is generated, tax competition emerges as a valid option.

The IIR and subsequently the Pillar Two rules are not restricted to counter abuse practices. On the contrary, they target every MNE's whose constituent entities in a given jurisdiction that are taxed below the 15 % ETR. However, the IIR has been described by scholars as a "super-CFC" (Hey, 2020). And curiously, even before the first steps were taken towards the implementation of Pillar Two, Avi-Yonah (Avi-Yonah, 2016, p. 155), already described the CFC rules "as a de facto worldwide system with a minimum tax".

This relationship is also noted when Silva (2020, p. 141) argues to favour the adoption of CFC regulations instead of the implementation of Pillar Two by alternative jurisdictions, since there is already a wide familiarity with those rules, therefore avoiding uncertainty and duplication of additional legislation.

On what the design options are concerned, Arnold (2022, pp. 5–6) pointed out the unclarity around the allocation of the initial right to impose the top-up tax, to resident countries instead to source countries. The author considers this option is "largely a formality that does not really determine whether residence or source country tax has priority".

Regarding the IIR and its relationship with the OECD Model, Schoueri (2021, p. 7) states that a Pandora Box may be open given the fact that this "could lead to a taxation according to the unitary approach". In other words, extending the application of the IIR to profits derived from value creation in the other state, not only distorters the logic of the economic allegiance, but also contradicts article 7 (1) of the OECD Model. An eventual application of the article 3 (1) of the OECD Model may seem the solution, however a contradiction to the idea of value creation would still prevail.

4. Undertaxed Payments Rule

As stated above the UTPR acts as a backstop of the IIR. This mechanism was put in place to guarantee that the minimum tax is paid even if no top-up tax is collected under a qualified IIR, or not all of the top-up tax is allocable to the UPE is collected under the IIR (Dietrich & Golden, 2022).

Therefore, the UTPR allows for an adjustment in respect of the Top-up Tax calculated for a low-taxed constituent entity, *to the extent that such Top-up Tax is not brought within the charge of Qualified IIR*[343].

The UTPR may take one of two forms:

a. The denial of deduction, according to which the Constituent Entities of an MNE Group will not be allowed to deduct otherwise deductible expenses *"in an amount sufficient to result in the Constituent Entities located in the UTPR Jurisdiction having an additional cash tax expense equal to the UTPR Top-up Tax Amount allocated to that jurisdiction"*.[344] The amount of tax payable as a result of the denial of a deduction is "*equal to the taxpayer's rate of tax multiplied by the amount of the payment for which the deduction was denied*".[345]
b. An adjustment that is equivalent to the denial of a deduction, but for which the Model Rules do not prescribe any specific mechanism: the design and implementation of adjustment mechanisms is left to the domestic law of the UTPR jurisdictions.

In any case, the UTPR results in an additional cash tax expense, increasing the amount of tax that the Constituent Entities would otherwise have paid under the domestic law, and therefore is applied after any domestic law provisions affecting the deductibility of expenses.[346] Even though the additional cash tax expense is determined in respect of the fiscal year, if certain adjustment is insufficient to result in enough additional cash tax expense to equal the UTPR Top-up Tax Amount allocated to the jurisdiction for the fiscal year (because, for example, there is a limited amount of deductible expenses), the difference is carried forward to the following years.[347]

The determination of the ETR and the amount of top-up tax follows the same computation rules as the IIR, notably the GloBE income or loss, the covered taxes, and the application of the substance-based exclusion[348].

The *Total* UTPR top-up tax amount in a certain fiscal year is the sum of the top-up tax calculated for each of the low taxed constituent entities, i.e., those located in a jurisdiction where the MNE's jurisdictional effective tax rate is below the Minimum Rate. [349] Consistently, the jurisdictional UTPR top-up tax is determined by multiplying the total UTPR top-up tax amount by the jurisdiction's UTPR percentage.

The jurisdiction's UTPR percentage, on its turn, is computed taking into account the following quantitative factors[350]:

- Dividing the number of Employees in the jurisdiction by the number of employees in all UTPR jurisdictions and then sum up 50% of the value reached
- Dividing the total value of tangible assets in the jurisdiction by the total value of tangible assets in all UTPR jurisdictions and then sum up 50% of the value reached.
- Summing up both values.

After determined the UTPR top up-tax and the jurisdictions' UTPR percentage, both values are multiplied to reach the UTPR top-up tax levied by a jurisdiction.

5. Computation and Allocation of Qualifying Income or Loss

5.1. Computation of GloBE Income or Loss

The starting point for the computation of GloBE income or loss is the Financial Accounting Net Income or Loss of each of the Constituent Entities[351], meaning that the first step towards determining the GloBE income or loss is calculating the *net income or loss of the Group Entity before making any consolidation adjustments that would eliminate income or expense attributable to intra-group transactions*[352].

In principle, the consolidated financial statements are the financial statements prepared by a UPE in accordance with an acceptable financial accounting standard[353]. In the case that the UPE does not have financial statements prepared consonantly one of the acceptable financial accounting standards an adjustment would be necessary to prevent material competitive distortion using an Authorised Financial Accounting Standard[354].

However if it is not reasonably practicable for the Constituent Entity to use the UPE's financial accounting standard to compute the Constituent Entity's Financial Accounting Net, it may use an alternative accounting standard, depending on the fulfilment of three criteria:

- the financial accounts of the Constituent Entity are maintained based on that accounting standard[355]

- the information contained in the financial accounts is reliable; and[356]
- permanent differences in excess of EUR 1 million that arise from the application of a particular principle or standard to items of income or expense or transactions that differs from the financial standard used in the preparation of the Consolidated Financial Statements of the Ultimate Parent Entity are conformed to the treatment required under the accounting standard used in the Consolidated Financial Statements of the Ultimate Parent Entity[357].

5.2. Adjustments to determine GloBE Income or Loss

There are differences between each Inclusive Framework jurisdiction's financial accounting net income or loss since each of them has its own combination of additions to and exclusions to reach the taxable income under its domestic tax law[358].

Considering that the financial accounting net income is the jumping-off point to determine the GloBE Income or Loss for all Constituent Entities wherever located, discrepancies may arise as a result.

To avoid these discrepancies, a set of adjustments to the financial accounting net income was put in place by the following amounts[359]: net tax expense; excluded dividends; excluded equity gain or loss; included revaluation method gain or loss; gain or loss from disposition of assets and liabilities excluded; asymmetric foreign currency gains or losses; policy disallowed expenses; prior period errors and charges in accounting principles; and accrued pension expense.

Furthermore, given the specific characteristics of certain sectors, activities and features, the GloBE rules provides some exceptions for the computation of the qualifying income or loss, namely: special rules for intragroup financing arrangements[360]; exclusion of certain insurance company income[361]; additional tier one capital[362]; exclusion of international shipping income[363]; special rules for the allocation of income or loss between a main entity and a permanent establishment[364]; special rules for the allocation of income or loss from a flow-through entity[365].

6. Computation of Adjusted Covered Taxes

In order to effectively calculate if a constituent entity is a low-taxed entity and to know if the application of this regime is needed, firstly we have to

set *the amount of taxes that are to be associated with that GloBE Income or Loss for purposes of calculating the ETR*.[366]

For the purposes of the GloBE Rules, covered taxes comprise *taxes imposed on a Constituent Entity's income or profits as well as Taxes that are functionally equivalent to such income taxes and Taxes on retained earnings and corporate equity*[367], including for that matter, taxes on income, profits or its share of the income or profits[368]; taxes on profit distributions or deemed distributions[369], taxes imposed in lieu of a generally applicable corporate income tax[370], taxes levied by reference to retained earnings and corporate equity[371].

On the other hand, the GloBE Rules exclude from its covered taxes any Top-up tax or UTPR applied[372], disqualified refundable imputation taxes[373] and taxes paid by an insurance company in respect of returns to policyholders[374].

After all tax expenses relating to covered taxes are summed up, a number of adjustments are made, to *arrive at adjusted covered taxes*[375].

7. Computation of the Effective Tax Rate and the Top-Up Tax

7.1. Determination of the jurisdictional effective tax rate

The Effective Tax Rate ("ETR") is a key piece of the GloBE Rules, considering that it's applied to determine *whether in a Fiscal Year, the MNE Group is subject to a minimum level of tax on its income arising in a particular jurisdiction and, if the jurisdiction's ETR is below the minimum rate*[376], which stands at 15%.

As a general rule, the ETR is computed on a jurisdictional basis, which protects the applicability of the regime from "shifting income and taxes between Constituent Entities located in the same jurisdiction and avoids potential distortions caused by particular features of the domestic tax system"[377]. There are only three exceptions to this rule: Investment Entities and Insurances Investment Entities[378]; Constituent Entities in which the UPE holds 30% or less of the Ownership Interests but nonetheless, it has a Controlling Interest in the Entities[379]; stateless Constituent Entities[380].

The calculation of the ETR of an MNE Group translates into the following formula[381]:

ETR = The sum of the Adjusted Covered Taxes of Each Constituent Entity located in the jurisdiction for the Fiscal Year / Net GloBE Income of the jurisdiction.

The Adjusted Covered Taxes of Each Constituent Entity shall be calculated as stated in the previous section. On the other hand, the Net GloBE Income of the jurisdiction is the difference between the Income and the Loss of all Constituent Entities of a Jurisdiction calculated as explained in section 5.

7.2. Computation of the top-up tax payable in a jurisdiction

To correctly quantify the Top-up Tax due in a particular jurisdiction and its allocation to the Low-Taxed Constituent Entity Constituent Entities located in that jurisdiction, the following steps are to be followed:

The first step is to calculate the Top-up Tax Percentage, as the rate needed to bring the tax rate on the Excess Profit of the low-taxed jurisdiction up to the Minimum Rate. A jurisdiction *is considered Low-Taxed Jurisdiction in respect of the MNE Group and the Constituent Entities located in the jurisdiction are considered LTCEs when the ETR is below the Minimum Rate*[382]. The Top-up Tax Percentage can be reached by the following formula:

Top-up tax percentage = Minimum Rate (15%) – Effective Tax Rate[383].

Subsequently, it is necessary to calculate the amount of Excess Profit that is subject to the Top-up Tax Percentage. It shall be determined through the following formula:

Excess profit = Net GloBE Income – Substance based Income Exclusion[384].

Two notes must be pointed out about the excess profit. The first one is that the taxpayer may choose not to apply the Substance-base Income Exclusion. In that case, the amount of Excess profit is the same as to the Net GloBE Income for the jurisdiction[385]. The second one is that if the Substance-based Income Inclusion is equal or above the Net GloBE Income, there will be no *Top-up Tax computed for that year unless there is Additional Current Top-up tax for that Fiscal Year*[386].

As for the Jurisdictional Top-up tax, its formula is composed by four elements: Jurisdictional Top-up tax[387] = (Top Up tax Percentage x Excess Profit) + Additional Current Top-up Tax – Domestic Top up Tax. The element of the formula that has not been explained so far, the Additional

Current Top-up Tax, refers to the *amount of Top-up Tax added to the current year that is attributable to certain re-calculations of the Top-up Tax in previous years*[388]. On what concerns the Domestic Top up tax there is no obligation by a jurisdiction to adopt it under the common approach. However, if adopted, the Top-up tax may be brought down to nil.[389]

Finally, and after the jurisdictional top-up tax is determined, the Top-up tax should be allocated to the Constituent Entities located in the respective jurisdiction in accordance with the following formula[390]:

Top up Tax of a Constituent Entity = Jurisdictional Top up Tax x (Globe Income of the CE/ Aggregate GloBE Income of all CEs).

7.3. Substance-based Income Exclusion

The policy rationale based on this exclusion, a substance-based cave-out, is built on the premise that the use of payroll and tangible assets *as indicators of substantive activities is justified because these factors are generally expected to be less mobile and less likely to lead to tax-induced distortions*[391]. Its application in the calculation of Excess Profit was explained in the previous section.

This topic is one of the most discussed in scholarly literature and It might be because of the unclarity and possible incompatibility between the objectives of the rules and the proposed mechanisms for implementation.

Agianni et. Al.(2020, p. 18) have also noted the ambiguous position of the OECD on the topic. quantitative substance-based carve out chosen, "can be seen as a reflection of the reticence about carve-outs", since no carve out was foreseen under the Second Public Consultation Document because it could bias the goal of the proposal. According to Das and Rizzo (n.d., p. 50) the substance based exclusion, applicable to active business, hinders the objective of preventing tax competition.

According to Schoueri, the substance exclusion is key to ascertain the lengths of the parallel between the IIR and CFC rules. Also in the author's view (2021, pp. 5–7) the substance-based carve out is the "touchstone" to ensure that "value created in a jurisdiction is not be subject to taxation in the ultimate parent´s jurisdiction". Yet the scope of the substance-based carve out, as it stands, is quite restricted, and consequently may be subject to the IIR in profitable activities related to a jurisdiction, which puts in question both the principles of sovereignty and value-creation.

The limited character of the substance-based exclusion is also ambiguous regarding the objectives and it raises efficiency concerns. Pistone and

Turina (2020, p. 6) expressed reservations on the carve-out in a proposal aiming to implement a global minimum tax since its effects in tax neutrality and increase complexity of tax systems may outturn its benefits. Indeed, Chand and Lembo (2020, p. 42) had already pointed that in order to achieve "a simpler system in which compliance costs would be lower for both MNE's and tax administrations" an approach with no carve-outs should be pursued.

On a positive note, Schmidt, argues that the substance-based carve out mitigated the sovereignty infringement that is an inherent part of the income inclusion rule, as discussed in section. 3.4. However, we are uncertain if such mitigation is relevant, considering the low threshold proposed.

7.4. De minimis exclusion

In cases where the Constituent Entities are located in a jurisdiction where the Average GloBE revenue of such jurisdiction is less than EUR 10 million and the average GloBE income or Loss of such jurisdiction is a loss or is less than EUR 1 million, the Top-up Tax respecting those Constituent Entities shall be deemed to be zero.[392]

7.5. Minority – Owned Constituent Entities

Respecting the Minority-Owned Constituent Entities there are two possible regimes applied.

The first one concerns to the Minority-Owned Constituent Entities that are members of a Minority-Owned Subgroup, and *states that the computation of the ETR and Top-up Tax for a jurisdiction (…) shall apply if they were separate MNE Group*[393]. As a result, an *MNE Group could have two or more computations with respect to Constituent entities located in a jurisdiction*[394].

The second one relates to the Minority-Owned Constituent Entity is not a member of a Minority-Owned Subgroup. Regarding this group, the ETR and Top-up Tax of the Entity is computed on an entity basis[395].

8. Conclusion

The world is undergoing profound changes. The economy, heavily influenced by digital innovations, has shifted the paradigmand so international tax rules must keep up with the changes.

As a result of those changes, the international tax scene may see a new order as the Pillar Two and the GloBE rules are increasingly emerging as a feasible reality and no longer as a distant ideal.

Notwithstanding, many doubts have been raised and some questions marks arise from the implementation of this reform. To name a few: 1) The effectiveness of Pillar Two to reduce tax competition and to change the race to the bottom mindset "given that it targets tax arrangements that are seen as allowing multinational corporations to move profits to countries with no or low taxes" (Screpante, 2021, p. 8), having quite a limited scope; 2) The circumstance that the race to the bottom mindset may be overcome to a race to the average (Chand et al., 2020, p. 37); 3) The possibility that we may find ourselves legitimizing profit shifting (da Silva, 2020, p. 121) as long as the EFT stays above 15%; 4) The increase in complexity and the loss of sovereignty; 5) The interconnection with the CFC rules; 6) The concerns regarding the substance-based carve out triggering the system; 7) Leveraging asymmetries between developing and developed countries.

Despite all the doubts, one thing is certain. This proposal will not end tax planning or tax competition overnight, however a reduction of profit shifting, and an increase of tax revenue are expected.

IMF researchers estimate that the implementation of global minimum tax of 15% may raise corporate tax revenues by 5.7% through the top-up tax and potentially by 8.1%, through reduced tax competition (IMFBlog, 2022). Accordingly, the effect of a worldwide implementation of Pillar 2 could lead to almost 14% more in corporate income taxes annually.

Thus, Pillar Two rules emerge as one of the most ambitious tax projects of the last decades, which will increase the States' tax revenues, combat tax planning and implement a global taxation standard.

Part 2: Implementation of the GloBE in the European Union: the search for compatibility

1. Introduction

This section highlights the issues raised under EU law by the implementation of Pillar 2 GloBe Rules in the European Union, as well as the main differences between Globe Model Rules, adopted by the OECD/G20 Inclusive Framework as a follow-up to the Global Agreement,

and the Proposal for a directive on corporate minimum taxation,[396] and provides insights on the reasoning behind such differences. This section has scholarly literature and relevant international organizations' publications as a basis for the review.

2. GloBe Rules and EU law

At the time of the writing of this article, most scholars that have addressed the issue of compatibility between GloBE rules and EU law based their analysis on the Blueprint (OECD, 2020), hence before the publication of the Model Rules, the Commentary, and the adoption of the Proposal for a Directive. And, although the IIR was kept quite stable, the UTPR has a different configuration under the Model Rules than what was initially planned (Johnston, 2022, p. 2). On what concerns the Directive, some features of the rules have been polished with the objective of aligning it with EU law.

3. The choice of instrument: A Directive

The adoption of a Directive at EU level requires unanimity under Article 115 TFEU and, at the moment of writing of this article, is still under negotiation in the Council. A month away before the end of the French Presidency of the Council, it is still uncertain whether Poland will embark on the adoption of Pillar Two without a legal link to pillar One (Valerio, 2022)

The adoption of a Directive has several political, economic, and technical advantages.[397] The assessment by the ECJ of the compatibility of measures with EU law depends on the means of implementation, and it has been noted that Directives enjoy a presumption of compatibility with primary EU law, when comparing to domestic measures (Szudoczky, 2020). That being considered, the implementation of the GloBe Rules through a Directive would enjoy a more lenient analysis by the ECJ, notably taking into account the unanimity that was reached (Broe & Massant, 2021, pp. 95–98; Nogueira, 2020, pp. 494–495).

On what concerns the duplication of instruments, notably at international and EU level, European Tax Advisers Federation (ETAF) pointed that the still ongoing work at the OECD level may lead to divergences between OECD rules and the Directive, as well as lack of clarity and uncertainty, if the OECD work is not duly taken into account by the Council and the Commission (ETAF, 2022, p. 4).

Also with this in mind, the European Parliament recommended the inclusion in the Directive of powers to the Commission to adopt delegated

acts to keep the Directive up to date with the foreseeable upcoming "refinements" of GloBE Model rules.[398]

When analysing this topic, some questions may pop to mind: Is this directive a minimum standard? Will Member States be able to go beyond? In which provisions? Is "going beyond" the directive and the Model Rules desirable? And will there be a three-layer regime? What are the effects of such multiplication for legal certainty? The Directive states on recital 4 that "it is crucial that the global minimum tax reform is implemented in a sufficiently coherent and coordinated fashion", but is coherence and coordination enough for the implementation of the GloBE Rules, or do we need a harmonized, single text?

4. Compatibility with EU law: Which Freedom?

When analysing the compatibility of a certain framework with primary EU law, it is firstly necessary to identify the relevant freedom. The major point of relevance lies in the scope of the applicable freedom: where the free movement of capital applies, the prohibition of discriminatory treatment is extended in relation to third states investors, on worldwide scope, and unilaterally. Any other freedom, such as the freedom of establishment, is applicable only to intra-EU relations.

Under *FII 2*[399] case law, legislation designed to apply to portfolio investment and generic legislation (unless it regulates market access) can be tested under the free movement of capital. Contrarily, legislation governing situations of definite influence, especially group measures, are outside the scope of the free movement of capital (Wattel et al., 2018, p. 114). Hence, Article 63 TFEU may be used to render inapplicable generic tax measures not targeting intra-group relations nor regulating market access, if they limit the free movement of capital rights. If that is not the case, then freedom of establishment provided under Article 49 TFEU applies.

According to scholars who have expressly addressed this topic, the freedom of establishment is applicable hereto, since the rule applies only to situations of definite influence (Schmidt, 2020, p. 987).

Admittedly, this topic would have a higher importance if the Model Rules were not implemented through a Directive, which is yet to be confirmed. This is because the domestic rules, enacted unilaterally by a

Member States legislature, would be analysed under a stricter approach then the implementing measures of an EU Directive (see section 1.2). Indeed, the implementing measures of a Directive would be analysed in light of secondary law, while the rules under the Directive itself would enjoy a presumption of legality.

Secondly, the relevance of this discussion also depends on the existence of a restriction or discrimination, which would require justification. In such sense, the fact that the Directive drove its way out of the path of discrimination through the extension of scope to purely domestic situations, could mitigate the concerns on the compatibility of the GloBE rules, as implemented through the Directive, with primary EU law.

However, and in any case, an analysis in light of the actual rules proposed under the Directive is still lacking in scholarly literature, and this gap should be addressed.

5. Compatibility with EU law: specific issues

5.1. Can IIR + substance-based carveout = CFC's out-of-jail card?

This section is aimed at grasping the possible compatibility issues of the IIR with EU law, while also considering the existence of a substance-based carveout and, to a certain extent, the precedent of the CFC rules.

Pietro (2021, p. 221) analysed the relationship between the IIR and EU tax law, referring to the case law of the ECJ on abuse of law. In the author's view, the IIR conflicts with EU fundamental freedoms because the substance-based carve-out does not target exclusively instances of abuse. The author reads in the IIR the core elements of CFC legislation "application of a top-up tax at the level of the parent entity (...) in proportion to its participation in a Constituent Entity located in a low-tax jurisdiction in order to assure a minimum level of taxation in that jurisdiction", and therefore analyses its compatibility based on the Cadbury Schweppes[400] leading judgement dealing with CFC rules. Since the restriction to the freedom of establishment was justified only when domestic anti-abuse provisions specifically targeted wholly artificial arrangements that do not reflect economic reality, and the existing carve-outs applicable to the IIR do not exclude genuine arrangements, the author proposes to solve the conflict based on the introduction of a facts and

circumstances carve-out, which would allow to target only wholly artificial arrangements.

Similarly, Englisch (2021b, p. 210) argues that the threshold for the justifications based on the need to counter tax avoidance is so high under Cadbury Schweppes (situations where the foreign subsidiary has no economic substance), that the "modest and formulary carve-out" would not be able to meet it. On the other hand, the reverse situation would also entail a negative consequence: a substance based carve-out which is able to meet the wholly artificial arrangement standard would undermine the policy intent of the GloBE rules, that is not only to tackle profit shifting but also to mitigate excessive tax competition for genuine business activities (Schmidt, 2020, p. 995).

Arrived at this point, we wonder: is that why we are stuck in the middle, with a timid substance based carve-out? Is the European legislator trying to achieve a balance, where a mid-way position brings mostly unclarity?

It should be noted that CFC regimes are considered to be against the freedom of establishment because they treat differently domestic and cross-border payments. However, a parallel reasoning might not apply to the IIR under the Directive, since the UPE has to charge top-up tax also in a domestic setting.

It seems that, for this argument to proceed, the IIR needs to be justified with the prevention of tax avoidance. The IIR would have to hold its *ratio legis* (and any purposive interpretation) in the prevention of abusive practices, but that is not even remotely clear and needs to be confirmed through further research. Indeed, according to Pillar Two Blueprint, "*Pillar Two addresses remaining BEPS challenges and is designed to ensure that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions they operate in*" (OECD, 2020, p. 15). In October 2021, the Global Agreement did not mention the objective of Pillar Two. Later the same year, in December, the Model Rules left the BEPS concerns behind, stating that the GloBE rules intend "to ensure large multinational enterprise (MNE) groups pay a minimum level of tax on the income arising in each of the jurisdictions where they operate" (OECD, 2022b, p. 7). The Proposal for a Directive, published the same week, refers to fairness and to efforts "to put an end to tax practices of MNEs which allow them to shift profits to jurisdictions where they are subject to no or very low taxation" in the recitals (see recitals 1 and 2).

The meaning of these not only technically ambiguous but also inconsistent mentions might result in difficulties arguing the possibility of purposive interpretation.

This unclarity was also addressed by Dourado in her preliminary comments on the Proposal for a Directive (2022, p. 201). According to the author, the substance-based income exclusion rule, based on payroll costs and tangible assets, "introduced an inadequate element of abuse in the purpose of minimum taxation", since it "suggests a relationship with genuine activities which would not be the object of aggressive tax planning (and abuse)". The author proposes its exclusion from Pillar Two rules, as it may create difficulties in the interpretation of the Directive by the ECJ: "In other words: Is the regime about minimum taxation or antiabuse rules? In the latter case, irrebuttable presumptions cannot be used, and, for example, automatic application of the income inclusion rule (IIR) to the covered entities could be challenged." (Dourado, 2022, p. 201). As a final note, it is submitted that CFC regimes are considered to be against the freedom of establishment because they treat differently domestic and cross-border payments. However, a parallel reasoning might not apply to the IIR under the Directive since, under the proposed rules, the UPE also has to charge top-up tax in a domestic setting.

All this considered, it should be questioned: is there a relationship between minimum taxation and anti-abuse frameworks? If so, is it a direct link? Specifically on what concerns GloBE rules, what is the purpose and the effects of the anti-abuse characteristics? This topic demands further research, notably the possible relationship between GloBE rules and anti-abuse frameworks.

Another possibility would be to ground a possible restriction to the Fundamental freedoms on the need to preserve a balanced allocation of taxing rights between the Member States. However, according to Englisch, this justification could not be invoked successfully (2021b, p. 210).

5.2. Interaction between Model Rules and EU law

On what regards the interpretation, the model rules and the commentary may be used as an interpretative element by the ECJ, but the Directive will not have such role for the interpretation of the Model Rules (Dourado, 2022, p. 205). Moreover, Dourado sees a risk of future incompatibility between the Directive and the Model rules since, as mentioned, model rules are easily updated while the Directive is not.

The duplication of provisions and concepts is neither necessary nor advisable (Dourado, 2022, p. 205). According to ETAF (2022, p. 4), the Commentary to Model Rules as well as the Implementation Framework should be incorporated in the Directive, and should not be left to the choice of the Member States.

To avoid the implementation of minimum exclusively in the European Union, probably putting away investors in a moment where the EU critically needs it, the inclusion of a sunset clause has also been suggested by ETAF. With such a sunset clause, if a significant number of international (third state) jurisdictions does not comply with the global agreement, the Directive would cease to apply (ETAF, 2022, p. 5). This has not been considered by the European Union legislators, either out of trust that the rest of the UPE jurisdictions will embark on Pillar Two as well, or out of fear of sending the wrong signal to the international community. In either case, the implementation of Pillar Two only in the European block could have damaging effects in the economy, which would need to be studied in future research.

6. Implementation – Proposal for a Directive

6.1. Introductory remarks

On 22 December 2021, the European Commission adopted a proposal for a Directive on ensuring a global minimum level of taxation for multinational groups in the Union. This Proposal is aimed at implementing the GloBE rules one Pillar Two of the OECD Inclusive Framework Global Agreement (hereinafter the Global Agreement) as described in section 1, in the European Union.

The Model Rules were published two days before the adoption of the Directive, suggesting that the European Union was intensely involved in

the decision-making and drafting process of the Model Rules.

A general analysis of the framework in the Proposal for a Directive can be found in Valério (2022). In this section, we will focus on the main differences between the Proposal and the Model Rules, the impact of such differences, and other selected issues.

6.2. Main differences

The main differences between the Model Rules and the Proposal for a Directive aim to ensure compliance with EU law. They include:

- The application of the Directive not only to MNE groups, but also to large-scale domestic groups (Art. 2, para. 1 and art. 3, para. 5 Directive, Art. 49.), aiming to avoid discrimination between domestic and cross border situations (Dourado, 2022, p. 203; Nogueira, 2020, sec. 4.6; Valério, 2022, p. 157). This point of divergence has been considered by the European Tax Adviser Federation as the only admissible departure from OECD Model Rules (ETAF, 2022, p. 3).
- The application of the IIR where a low taxed constituent entity is located in the same jurisdiction as the parent entity – under the Directive, the IIR applies to all entities in the parent entity's jurisdiction (to the parent entity itself and other constituent entities located in the low-taxed Member State) (arts. 5(2), 6(2), 7(2)) (Valério, 2022, p. 157).

  However, according to Dietrich & Golden (2022, p. 188), the Directive does not clarify what amount of top-up tax is allocated to the parent entity in that scenario. Specifically, in the case where an intermediate parent entity is the one required to collect the top-up tax in respect of itself, "it is not clear whether this relates to 100% of the top-up tax computed or whether it should be limited to the UPE's allocable share of the top-up tax for that entity". According to the same authors, the rule allowing for parent entities to collect top-up tax in the jurisdiction where it is located, in theory, reduces "the number of instances in which the UTPR can apply to cases in which the UPE is located outside the European Union and a) the UPE, together with its subsidiaries located in that same jurisdiction, are low-taxed (i.e. no top-up tax collection under the IIR); or b) the UPE's jurisdiction of residence has not implemented a qualified IIR and not all of the top-up

tax that is allocable to the UPE is collected under the IIR, as the UPE holds more interest in the low-taxed Constituent Entity than any other IPEs that are subject to a qualified IIR." (Dietrich & Golden, 2022, p. 188). Dourado (2022, p. 204) sums it up: "There is no need for a UTPR within the EU because the IIR is binding and, therefore, the UTPR is to be applicable only by a Member State in relation to third countries."

- The option to offset income and losses arising from the disposal of tangible assets located in the Constituent Entity's jurisdiction to third parties is exclusive to immovable assets (Art. 3.2.6 Model Rules and art. 15, para. 7 Directive).

  The Directive does not include a safe harbour election (Art. 8.2 Model Rules).

  The Directive provides penalties in case of failure to provide the top-up information return (art. 44), while there is no parallel provision in the Model Rules.

The first two points of departure aim at limiting the distinction between domestic and cross border situations. Indeed, the ECJ finds that a measure is discriminatory if it treats cross-border situations in a less favourable manner than purely domestic situations. However, the additional layer of administrative burden (Schmidt, 2020, p. 996) resulting from the extension of the GloBE rules to purely domestic situations, without concrete benefits is not peripheral.

Apart from the noted differences, the Commission has included in the Proposal the possibility for the Member States to implement in the qualified domestic minimum top up tax (QDMTT) (Arts. 3, para. 23 and 10 Directive). This provision subjects constituent entities in the implementing jurisdiction to a GloBE compliant ETR – if the ETR is not complied with it is the jurisdiction where the entity is located that applied the top-up tax. Accordingly, Member State may collect top-up taxes in respect of excess profits of low-taxed Constituent Entities located in its jurisdiction in priority to the IIR top-up tax collection mechanism, which means that it may prevent the triggering of the GloBE rules in other jurisdictions (and the respective tax collection).

There are still to be noted different wordings between the Model Rules and the Directive, which may create ambiguity and complexity (Dourado, 2022, p. 204).

6.3. Are the differences innocuous?

Dietrich & Golden have identified, through case studies examples, practical differences and outcomes that arise from the application of the Model Rules and the Directive, notably:

- Regarding the application of the IIR at UPE level under the Directive where the UPE is in a EU low-taxed jurisdiction, and unlike what is provided under the Model Rules, the UTPR will not apply (Dietrich & Golden, 2022, p. 191). Only where the UPE is located in a low taxed third country, the UTPR top-up tax will apply.
- Where the top up tax is collected by an EU based IPE (as the UPE is located in a third country that does not apply the IIR) and low taxed constituent entities are not wholly held by a parent entity, full relief may be unavailable under article 13 of the Directive. As the IPE applies the IIR and UTPR relied is only available where the low-taxed Constituent Entities are wholly held by a UPE that applies the IIR or via an IPE that applies the IIR, and partial relief is only available where the top-up tax has been collected in a third country that applies a qualified IIR, the top-up tax may be collected twice, both under the IIR and the UTPR, possibly leading to double taxation (Dietrich & Golden, 2022, pp. 193–194).

The authors conclude that the broadening of the scope of the UTPR results in inconsistencies on how both rules interact, possibly giving rise to risks of double taxation and double non-taxation (Dietrich & Golden, 2022, p. 195)

In our view, there is scope to further the research about the necessity and the impact of the broadening of the scope of the IIR. The divergent outcomes resulting from the application of the GloBE rules and the Directive, where confirmed, may be explored from different perspectives:

- the common approach of the GloBE rules does not impose its implementation by the jurisdictions that have adopted the Global Agreement. But, if that is the case, it should be in accordance to what has been agreed by the OECD/IF. It must be questioned if such differences are still compatible with the Global Agreement and what would be such threshold in respect with EU law.

- possible restrictions to the fundamental freedoms and, therefore, incompatibilities with EU law, including vis a vis third countries,
- if the taxing powers of developing countries would be negatively affected by the prevalence of IIR rules over the UTPR rules, under the Directive. (see EP resolution)

6.4. Alternative proposals

Some scholars have been debating alternative ways to implement Pillar Two in the European Union.

Even though Englisch considers that the extension of the proposed GloBE regime to domestic situations would be a viable option to avoid restrictions to the freedom of establishment (since it would not be discriminatory, *de iure* or *de facto*), the author proposes an alternative: the creation of a new taxpayer only for GloBE purposes, i.e., the group itself (Englisch, 2021b, pp. 217–218). This would convert GloBE in a form of "unitary (minimum) taxation" and, according to the author, would ensure a minimum level of effective taxation in each jurisdiction in which large groups have such a physical presence. The main features of this proposal are:

- liability of qualifying groups to pay top-up tax for each jurisdiction that has an ETR below the minimum rate (which could arise in respect of domestic and MNE groups),
- the territorial link would be residence by a group or a presence under the form of a PE,
- one of the entities would be designated as the one declaring and paying the top-up tax.
- The top-up tax would be calculated under GloBE rules.

Besides the advantage of avoiding the restriction to the freedom of establishment, the author points out others, from which we highlight the possibility of collecting top-up tax without a resident UPE or lower-tier resident parent company and a mitigated risk of double taxation (Englisch, 2021b, p. 218).

Englisch offers an additional alternative proposal, which he calls "the avoider pays" principle (Englisch, 2021a, pp. 139–141), including in a paper co-authored with the economist Becker (Becker & Englisch, 2021, pp. 54–56). According to this proposal, the entity with undertaxed profits

would be the "minimum tax taxpayer", instead of parent companies within the MNE. In this case, the IIR and the UTPR would serve exclusively to determine the allocation of taxing rights (where it is collected, but not who collects the top-up tax). The undertaxed entity would pay taxes in the parent company's jurisdiction, but the parent entity would not incur in additional tax liability. There is a 'piercing the territorial veil' for the collection of top-up tax which would, according to the author, altogether follow the logic of a switch-over clause, as it has been accepted by the CJEU in Columbus Container (Becker & Englisch, 2021, p. 56; Englisch, 2021a, p. 140).

Another proposal aimed at ensuring compatibility with EU law while foregoing of the substance based carveout and the extension of scope to purely domestic situations, would be to "explain the policy rationale of the income inclusion rule in a manner that makes it possible to argue that the income inclusion rule could be justified on new grounds, e.g. the need for establishing a fair and balanced situation for domestic and foreign activities" (Schmidt, 2020, p. 996). The author is looking here at the introduction of a new justification that would allow the realization of the policy objectives of the GloBE, notably the curbing of international tax competition.

7. Forward look

Scholars have referred to the opportunity that the implementation of GloBE rules in the European Union, under an EU legislative instrument, represents. Notably, the coordination of tax bases in corporate income tax among Member States (Dourado, 2022, p. 200), brings back to life the dream of a common consolidated tax base for corporations.

Indeed, it might be the case that the BEFIT proposal, a proposal for a new framework for income taxation for businesses in Europe, planned for 2023 - and which will include "key features of a common tax base" (European Commission, 2021, p. 11) -, will not only incorporate the options followed under the Minimum Taxation Directive but also take advantage of the momentum and the work laid out at international level.

Part 3: Implementation of the GloBE rules in developed and developing countries: the search for asymmetries

1. Developed and developing countries - main differences

Collected data on taxation policies show that developed countries are able to assemble higher shares from income taxation than developing countries, whilst developing countries' tax revenues tend to come more from trade taxes and taxes on consumption (Ortiz-Ospina & Roser, 2016).

Developed countries are perceived as "*advanced economies*", demonstrating a high level of industrialization, a well-established export base, integration within the global financial system and "capability for a government to implement its policies effectively and efficiently" (Corporate Finance Institute, 2021, p. 5). Such factors constitute interesting characteristics for companies to establish on.

On the other hand, developing countries are often deemed as emerging markets or frontier markets, with much lower capital market liquidity and low to middle income per capita percentages (Investopedia, 2022, p. 4).

Whilst developed countries, as a rule, offer stable policies and economies, developing countries may be struggling with political instability and, in consequence, economic and financial volatility.

Such investment risks within developing countries affect their ability to attract foreign direct investment and naturally lead businesses to establish themselves in developed countries. Developed countries' state budgets rely mostly on tax revenues and indeed, many of the world's largest multinational companies are established in developed countries.[401]

Developing countries remain in different circumstances, since they still do not pose as that attractive for companies to establish on - in such a way, a considerable amount of their tax revenues does not arise from income-related taxes[402].

As we will see further below, developing countries are fighting to stop being perceived as non-attractive jurisdictions by implementing tax incentives, granting preferential tax treatments offered to a group of taxpayers to "*promote a particular economic goal*" (Chen et al., 2018).

And even so, developing countries are also victims of tax avoidance practices, exacerbated by globalization and digitalization, losing "*substantial revenues*" (Lammers, 2020, p. 1).

Furthermore, collecting the "*billions of dollars in MNE tax avoidance*" that would have entered developing countries' tax safes to finance their

modernization and development policies and activities for the upcoming years (Mccarthy, 2022, p. 27).

As Pillar Two targets profit shifting, with its main losers being European non-havens and developing countries (Englisch & Becker, 2019), it will impact income-related taxes. So how will Pillar Two affect the developing countries tax systems?

2. Sharing (but not dividing) the minimum tax pie: GloBE rules for developed and developing countries

The IIR and the UTPR, the two interlocking GloBE rules, were explained in Part 1 of this Article. The first imposes a top-up tax on the ultimate parent entity of a low-taxed entity of a multinational group and the latter seeks to deny deductions or require an equivalent adjustment where the low taxed entities are not subject to tax under an IIR (OECD, 2021, p. 12).

From the abstract description of how the rules operate, we can take a step further and consider what will be the outcome from the perspectives of the states, particularly where the differences between the states, might have a direct impact in the minimum tax revenues.

2.1. Income Inclusion Rule (IIR): which countries will be entitled to implement the top-up tax?

The IIR top-up tax is to be applied in headquarters jurisdictions, where the ultimate parent entity is located. It is the primary GloBE rule, holding priority over the UTPR, and is based on a residence criterion (residence of the UPE).

The countries where the IIR will apply are mainly the G7 countries "and to a lesser extent the G20 countries" (de Wilde, 2022, p. 3). Englisch goes further, arguing that "developing countries will hardly ever be able to generate revenue from the prioritized IIR", which favors "*developed industrialised countries and classic holding locations*", and Fedan states that developing countries are "unlikely to receive IIR tax and could end up with no GloBE tax allocation at all" (2021, p. 399).

Since developed countries still headquarter most multinational companies, extra revenue from the global minimum tax rate would be "*unequally distributed across the globe*", as developed countries will gain more than developing countries (Barake et al., 2021, p. 18).

2.2. Undertaxed Payments Rule: a way for developing countries to obtain tax revenues?

Whilst the IIR ends up benefiting residence countries (Sundaravelu, 2021), the UTPR should be typically of the interest of source countries, and it is applied by "the other countries, the operational jurisdictions, the smaller countries with smaller economies" (de Wilde, 2022, p. 3).

However, the UTPR will only kick in if the parent jurisdiction does not apply the IIR. The IIR has a priority over the UTPR, and therefore favours the taxing rights of the jurisdictions where the UPE are established.

The existence of a priority of the IIR over the UTPR, in this order, unbalances the GloBE tip towards developing countries interests.

It would have been possible to design a framework taking the interests of developing countries seriously, but it seems that the Global Agreement designers did not do so in the distribution of the potential additional GloBE revenues, not in the treatment of tax incentives (which are, as we'll see below, a very important tool for developing countries) nor on their administrative capacity, which may "*entail negative consequences from a developing country perspective*" (Riccardi, 2021, p. 29).

Moreover, when looking at the Model Rules Commentaries, one can see a difference also when it comes to the "side rules" of the IIR and the UTPR. In particular, whilst the countries entitled to apply the IIR appear to be given the chance to broaden the scope of the measures, the same does not seem to apply to the UTPR.

In fact, the Commentary states that if a jurisdiction would set a lower revenue threshold for the application of the UTPR, "this would cause the UTPR to operate as the primary rule for those MNE Groups that were above this domestic threshold but below the agreed GloBE threshold", which would result not only in inconsistent outcomes but "undermining the expected outcomes for MNEs headquartered in jurisdictions that have adopted a Qualified IIR" (OECD, 2022a, p. 11).

However, as noted by de Wilde (2022, p. 2), it seems that (any) jurisdiction is allowed to apply their own IIR below the GloBE's threshold, and that "would not be contrary to the design of the GloBE Rules or undermine the rule order that had been agreed as part of the common approach" (OECD, 2022a, p. 11).

It has been noted that the complexity of the GloBE proposal and the Model Rules will impose a heavy administrative burden, not only for the in-scope MNEs but also for the tax administrations (Chowdary, 2021, p.3). Taking the perspective of a developing country, there may even be technical difficulties and one can foresee the necessity of technical assistance to implement these rules.

Hence, even with the UTPR favouring developing countries, these countries may have difficulty in administering this measure, for it requires "*more coordination with countries and more risks of double taxation*". Indeed, developing countries' tax authorities might not have the means and the resources to handle all necessary information (Sundaravelu, 2021) leading "*to increased administrative burden on tax authorities in these countries*" (Wamuyu, 2021), of rules that are complex.

Furthermore, the question poses: is it beneficial for developing countries to let go of their leeway to adopt other measures to implement the Undertaxed Payments rule? Since developing countries are highly keen on tax incentives, would they benefit from disregarding these incentives and activate the Undertaxed Payments rule?

3. Developing countries and tax incentives

3.1. An overview of the tax incentives adopted by developing countries to attract foreign investment

Multinational companies determine the countries in which they invest taking into account several circumstances, such as labour legislations, availability of workforce, infrastructure opportunities, political stability and, of course, tax policies.

As tax policies pose as one determining factor in choosing the place for investment, developing countries often adopt corporate tax incentives to attract and retain foreign direct investment, asserting their right to low tax or to not tax certain types of income (Navarro, 2020, p. 5). The FDI is the holy grail and an investment tool (Marsit, 2020, p. 17) of developing countries, which is seen as a boost to the development of the economy, generating more employment, industrialisation and, more recently, digitalisation.

Examples of tax incentives on domestic terms and within the exercise of the countries' tax sovereignty, include exempting investors from taxes or offering large periods of tax holidays within investment contracts (Bernasconi-Osterwalder et al., 2021, p. 2).[403]

To ensure the effectiveness of such tax incentives, developing countries often adopt tax sparing clauses – which grant a notional credit at the country of residence, "*namely a discount on the taxes due, even if no or lower taxes were paid at source*" (Navarro, 2020, p. 1). This ensures that the MNE is not taxed in the residence state on the measure that has benefited from the incentive on the source state – otherwise, the tax incentive would represent absolutely no benefit for the taxpayer and would undermine the objective of attracting the investment to the country offering the incentive.

Although it is unclear for some that the loss of tax revenues pays off for the adoption of these incentives, others have found that agreements including tax sparing clauses "*are associated with up to 97% higher*" foreign direct investment (Navarro, 2020, p. 5). Thus, one could see the importance of these measures for the developing countries' economies, which rely heavily on tax incentives, as they seek to attract and retain foreign direct investment and to compete with the developed world.

3.2. Can GloBE Rules affect existing tax incentives?

Although the Cover Statement by the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two states that jurisdictions are free to determine their own tax systems, and whether they will even have a corporate income tax, one can only foresee that Pillar Two will imply thorough revisions of existing domestic tax rules, which were built in a pre-BEPS world (Bernasconi-Osterwalder et. al, 2021, p. 2). As Schoueri puts it, "This idea (…) is immediately contradicted by the statement that other jurisdictions would have the right to apply the remedies envisaged in Pillar Two where income is taxed below the agreed minimum rate" (Schoueri, 2021, p. 2)

By establishing a global minimum effective tax rate and entitling other jurisdictions to "*tax back*" income arising from foreign entities when its correspondent country of source does not tax it at the minimum level, within the scope of the Income Inclusion rule, Pillar Two can compromise developing countries' decisions on setting their own tax incentives policies

and end up limiting their tax sovereignty, since these "*jurisdictions may be taken away the right to not to tax or grant tax incentives on income generated domestically*" (Riccardi, 2021, p. 23)

On the other hand, the global minimum effective tax rate, as currently defined, is actually "far lower" than the ones established at the moment within several developed countries' jurisdictions (McCarthy, 2022, p. 20)

Hence, it may be difficult for developing countries to maintain their tax holidays[404] and other incentives if another country can be entitled to tax what the tax benefits have purposedly left untaxed, ie. when the IIR interacts with "*developing countries' treaty policies*" (Marsit, 2020, p. 17).

This is one of the points where the so called "infringement of tax sovereignty" may be more damaging for developing countries (Schmidt, 2020, p. 996).

If countries implement the GloBE rules as they stand, several scenarios may unfold. There might be a tax treaty between the countries, with or without tax sparing clauses, or there might not be a tax treaty. These scenarios require further study, as it should be understood if tax treaties can limit the application of the GloBe rules and, specifically, if tax sparing clauses can resist to such far reaching rules.

One must note that countries relying on tax incentives are already giving up tax revenues to attract FDI and, the loss of that possibility to might create a wider gap between the North and the South.

Furthermore, as Dourado states, developing countries do not hold the same financial possibilities and the same means as the developed countries to concede to MNEs tax benefits through other mechanisms, such as allowances or incentives on social security contributions, for example, which can be implemented as key to attract the MNEs investment (2022, p. 4). So far, this approach seems to be insufficient.

3.3. Will the Subject to Tax rule respond to the developing countries' current concerns?

The Subject to Tax rule (STTR) is part of Pillar Two but is not included in the GloBE rules. It consists of a standalone treaty-based rule under which a jurisdiction can impose limited source taxation when certain payments between related parties are taxed below the agreed rate of 9% (OECD, 2021, p. 3). If a gross payment would be taxed at a lower rate than 9%

according to the applicate CIT tax rates, the STTR imposes taxation until it reaches 9%: the taxing right is the difference between those two rates.

It seems that the Subject to Tax rule will only be effective in case of profit-shifting for payments from developing countries to tax havens, "*as other states can simply increase the tax on the payment up to*" the 9% rate (Fedan, 2021, p. 6).

As this rule will come first in the order of the GloBE rules, and does not depend on the IIR's effective application, it seems that developing countries might be able to collect revenues by imposing a withholding tax on a particular set of intragroup payments that would end-up under tax havens jurisdictions (BEPS Monitoring Group, 2022, p. 3).

But, in practical terms, if there is already an existing tax treaty in place where the withholding tax rates are above the proposed STTR range, this rule per se would not give rise to additional taxing rights, unless the existing rates are amended or cancelled (BEPS Monitoring Group, 2021, p. 9).

So, one can wonder what will be the effectiveness of such rule if it is necessary a tax treaty between the developing country and the tax haven, if only adhering Inclusive Framework jurisdictions will be implementing this rule, and "when requested to do so".

As the Subject to Tax Rule specifically targets profit shifting to tax haven jurisdictions, which affect the tax revenues of several developing countries, one can admit that if developing countries have the capacity to administer this rule, there can be margin for a "*moderate benefit*" for these countries resulting from the Subject to Tax rule (Fedan, 2021, p. 21).

4. Are there any other options?

Tax organisations working on behalf of developing countries' interests suggest a change in the Pillar Two's order of rules, so that countries on both sides can reach a compromise and not give priority to the Income Inclusion rule alone, allowing the countries of source to effectively allocate to their jurisdictions additional tax rights (Sundaravelu, 2021, p. 2).

Future research should be focusing on options to balance the developed and developing countries positions, both in the context of Pillar Two rules, and outside of that context (v,.g., in the coordination between Pillar One and Pillar Two, or through domestic and treaty based solutions).

5. Final remarks

It is not clear that Pillar Two will result in additional tax revenues for developing countries. Strong criticism has been voiced on this matter, with the view that developing countries "*are likely to gain close to nothing*" by adopting those rules, whilst being at the same time precluded on their tax sovereignty (Jacobs, 2022).

Again, we could be reviving the discussions of the legitimacy of the OECD rule making, even under an "Inclusive Framework". According to scholars, it seems that developing countries concerns have failed to be prioritised by the Inclusive Framework's table of work (Riccardi, 2021, p. 29). In fact, developing countries might be disregarding their own needs if they implement the Global Agreement.

One could also verify that the non-participation of developing countries in the "Inclusive Framework" negotiation process made it rather difficult to address or even identify the impact of Pillar Two within the upcoming revenues for developing countries (2022, p. 20).

Furthermore, Pillar Two model rules are extremely complex and, specially for developing countries, simplification is key for implementation. Developing countries continuously urge for simplification measures within the international tax framework (OECD, 2021, p. 24), and frequently report that cooperation measures and the obligation to introduce domestic legislation in correlation is a "*significant burden*" (OECD, 2021, p. 26)

But one must note that since the IIR (and even the UTPR, despite being triggered in a residual manner) extends the power to tax income that is taxable by other jurisdictions, under international tax law rules, there might be a point where developing countries do not have to implement Pillar Two. As the UPE jurisdictions will tax, it does not matter what these countries, on other end of the line, will do. They will be *subject to other countries' tax*.

One could state that this relationship should also be a focus of future interdisciplinary research, as so many issues are still uncertain. How many States will have to *implement* Pillar Two for it to be a truly global minimum tax? Would UPEs be willing to relocate to developing countries outside the IF to avoid the minimum tax? (In that case, at least EU countries would be able to tax in their jurisdictions up until the ETR, a qualified domestic minimum top up tax is being implemented). Does agreeing to a Global

Agreement mean that developing countries are bound to implement (except what is common approach)? Does it mean that they have to let other countries implement it as agreed and cannot affect their effects? How were developing countries convinced to agree to it? And how can jurisdictions opt-out of the global agreement? Will the reforms on the "Inclusive Framework" deal add further transparency and participation from the developing countries perspective? Can these issues be solved by a United Nations Tax Convention?

In fact, one can conclude that developing countries could only be entitled MNE constituent entities that meet the agreed threshold if the IIR has not been implemented by the UPE jurisdiction, by adopting the Undertaxed Payments rule (de Wilde, 2021, p. 3).

On the other hand, the Subject to Tax rule only seems to be effective on certain intragroup payments from developing countries to tax havens. In fact, it seems that it is not solving the need for developing countries to still be competing with developed countries to attract foreign investment and obliging the first to thoroughly review their tax policy preferences, even with a much inferior administrative capacity to do so.

As the system enters on a new era of further developments for the adoption of a global minimum effective tax rate, with, for example, the European Union adopting a directive on this subject, it will be interesting to see if one can count on existing tax-treaty new negotiations and new tax-treaties being entered into between developed and developing countries to address the latter's' concerns on their tax revenues and sovereignty[405].

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335. Commentaries on Article 2, Paragraph 7
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400. *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue* (Case C-196/04), 12 Sep. 2006.
401. For instance, in the United States of America (companies like Walmart, Amazon and Apple), Japan (home to companies like Panasonic, Son and Toshiba) and European Countries (in 2020, 116.497 multinational companies had their headquarters in an European Union Member State). For this last data, see (Pârjoleanu, 2020, pp. 109–126)
402. Some exceptions can be found within developing countries that present as fast-growing economies, such as China, which is currently home to several multinational companies' headquarters such as Huawei Technologies and Alibaba Group.
403. As did the Guinea Republic in a contract with a large mining project, conceding the investor "*a 10-year tax holiday, for 25 years*". Please refer to Bernasconi-Osterwalder et. al., 2021, p. 2, and to the Convention de base entre La République de Guinée et Winning Consortium Simandou SAU-SAU pour l'Exploitation du Mineral de Fer des Blocs I et II de Simandou, dated January 9th, 2020.
404. Several developing countries have implemented tax holidays for certain industries, such as Bangladesh, Cambodia, Indonesia, Malaysia, Thailand and many more. Furthermore, studies have concluded that more than 40 tax incentive regimes across the Asia Pacific region will most likely be impacted by Pillar Two measures. For this data, please refer to "*The impact of BEPS on tax incentives in Asia Pacific*", KPMG, September 2021.
405. Since, as it seems, they could be deprived of maintaining their tax incentives' effect and, on the other hand, there won't be much additional taxing rights allocated to their jurisdictions.

CHAPTER 8 – THE SPREAD OF INTERNATIONAL REMOTE WORK: Impacts on taxation

Rita Campos Pereira

Introduction – is it still "another day at the office"?

Although remote work was not a revolutionary concept introduced only by the covid-19 pandemic, the constraints imposed by the coronavirus did revolutionize the way many people envision their work life.

In fact, the successive lockdowns that forced companies to implement work from home policies have awaken a particular taste to further implement this regime and other nuances of it in a post-pandemic context, with a survey conducted in the United Kingdom finding that 33% of employees expected to work from home at least three days a week and 81% expecting to work from home at least one day a week in a post-lockdown scenario[406] (ICM, 2020).

Employers have also recognized this need to readjust the way work is performed, with 44% acknowledging that they "*were going to take additional measures or increase investment to enable greater homeworking in the future*"[407] (CIPD, 2020).

After the work from home model, some companies have readjusted even further, implementing work from anywhere initiatives, such as Amazon and American Express (Boyarsky, 2021)[408], which meant an even greater change as to how and where employers hire and maintain their employees – and then arose the concept of "*digital nomadism*" (BERETTA, 2022, p. 5)[409].

Whilst traditionally employers would only hire employees locally, implying that the employee would be resident himself within the same jurisdiction, a new work from anywhere model comes to potentially switch this dynamic, as it implies that the "*employees are able to choose where to reside, regardless of employer location*"[410] (DE LA FERIA and MAFFINI, 2021, p. 4).

This spread of the workforce does not come without triggering issues – or, at least, questions – at a personal income tax level for the employees and at a corporate income tax level for the employers, as we will analyse further below.

2. Corporate Income Tax for the Employers

2.1. Deemed existence of a permanent establishment

On the employer's side, one can firstly note that a problem that may occur is the potentially deemed existence of a permanent establishment of the company where an employee decides to reside, considering that their choice of residence is in a different jurisdiction than the one where the employer is based, and that the employer does not have a legal entity in the employee's chosen country of residence (CARVALHO, 2022)[411].

Since 2011, the OECD has been pouring over the possibility of work from home giving rise to the possible deemed existence of a permanent establishment, having concluded that such institute may exist when the employee is carrying out his activities from home "*on a regular basis*" or if the work performed constitutes "*core functions*" of the employer's business activity (OECD, 2017, p. 96 and 112)[412].

For BERETTA (2022, p. 19), it's arguable that a home office set in another jurisdiction could generate a permanent establishment for a foreign company if an employee performs his work from home on a continuous basis and if the "*employer requires the individual to use his home in lieu of the office*", drawing special attention to this in cases where the employer provides office equipment for the employee to perform his duties from home, and adding that the activities of such employee must be related to the "*employer's core business*".

This can also be strengthened by the fact that the concept of physical presence "*has faded in legal significance over the years*", being even considered irrelevant, for some jurisdictions, to determine the legitimacy of a state imposing "*corporate income tax on firms doing business in the state*" (AGRAWAL, STARK, 2022, p. 61)[413]

If an employee working remotely from a jurisdiction other than the employer's country of residence may inadvertently create a permanent establishment, the employer will have the profit generated by that

employee be taxed in said jurisdiction, being hence "*subject to different filling obligations and tax liabilities*" (EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, 2022).

Several risky situations as to unintentional permanent establishment creations arose during the covid-19 pandemic, when many remote workers were forced to remain at their locations at the time the virus broke down, even though they could not even intend to reside there. In April 2020, the OECD released an analysis on how to handle the tax treatment of cross-border teleworkers and of their employers.

The OECD referred to the test of "*habitual abode*", according to which a person is deemed resident where they live "*habitually, in the sense of being customarily or usually present*" and refers to "*the frequency, duration and regularity of stays that are part of the settled routine*" of a person's life. The OECD concluded that advising the tax administrations to consider "*a more normal period of time*" to determine a person's country of residence was thus the most reasonable way to go.

In that sense, if the employee was not deemed resident in the country in which they were found "trapped" during the pandemic, then their current domicile cannot be classified as a permanent establishment of the company for which they work (BANACLOCHE PALAO, 2022, p. 23).

One could only help but wonder if this means a potential future flexibilization of the criteria to determine a person's country of residence and hence the criteria for deeming the existence of a company's permanent establishment.

2.2. Additional registration requirements

Along with the risks of having a part of their profit allocated to a jurisdiction in which they did not choose to settle in, employers with cross-border teleworkers also frequently face the hassle of "*register the business with the agency of the state in which the employee lives*" to work as the usual withholding agents for the employees' country of residence tax and social security systems (MITCHELL and MCADAMS, 2021)[414].

MITCHELL and MCADAMS (2021) enlighten that this additional registration requirement verifies even when the employee's move is temporary, exemplifying that employees are subject to tax withholding and payment if they work in the state of Illinois for more than 30 days and in the state of New York for more than 14 days.

Providing another example, in January 2019, France issued a withholding income tax regime ("Prélèvement à la source"[415]), which implemented the obligation for all companies (regardless of being a French or foreign company) employing French residents to collect tax at the source, as well as social security contributions. This implied that foreign companies with employees living in France had to register in such jurisdiction to repay social security contributions and withholding income taxes and to appoint a tax representative.

On the corporate income tax side for the tax administrations, the above stated will come with more significant change to the correspondent tax base across countries, as DE LA FERIA and MAFFINI illustrate (2021, p. 12).

But has labour market mobility had an impact on the personal income tax base?

3. Personal Income Tax for the Employees

3.1. Double taxation issues

The European Economic and Social Committee (2022) has recently acknowledged that a "*cross-border teleworking employee could be faced with double taxation on their income*"[416].

Authors such as AGRAWAL and STARK (2022, p. 9) have wondered if a remote worker's personal income should be taxed according to a residence sourcing rule, admitting that this dilemma becomes more complex when international remote work is involved in a case where bilateral tax treaties do not exist between the country of work and the country of residence.

In fact, as the European Commission (2021, p. 3) explained, cross-border workers may find themselves subject to tax on personal income in two countries: i) the country in which they perform their work as non-residents and ii) their country of residence[417].

Referring to the OECD's Model Convention to Prevent Double Taxation, article 15, no. 2, the state of residence has taxation rights on an work-related income obtained in another state when (i) a person is present in the state of resident for more than 183 days in a 12 month period, (ii) the remuneration is paid by an employer which is not resident in the other

state and (iii) the remuneration is not supported by a permanent establishment or fixed entity that the employer may hold in the other state.

Whilst typically remote workers who live in one state but work in another "*receive a tax credit to eliminate double taxation*" of their income, or may have certain income exempted from taxation (PEREIRA DA COSTA, ARRIAGA E CUNHA, 2022)[418], some states (in the United States, for example) apply personal income taxes to remote workers where the employer is based "*even if they do not actually work in the state (…), exposing them to double taxation*" (WALCZAK, 2020)[419].

Indeed, unless there are double taxation avoidance tax treaties, international remote workers who privilege mobility may face taxes where the company is based and where they are deemed resident.

3.2. Tax competition between states and redistribution of the personal income tax base

DE LA FERIA and MAFFINI (2021, p. 11) point that labour market mobility has led several countries to implement incentives on personal income tax regimes to attract mobile and high-skilled employees (such as the Portuguese Non-Habitual Residents regime, which provides workers that have not been resident for the past five years in Portugal with a fixed tax rate of 20% on some of their personal income for the first ten years of their residence in Portugal).

Most recently, Indonesia has announced the launch of an Indonesian digital nomad visa to allow remote workers to live in the country "tax-free" for a period of (at least) five years, with anyone who i) is a digital nomad who works for a company outside of Indonesia and gets paid to a foreign bank account, or ii) owns a company abroad and only does business outside of Indonesia, or iii) registers an LLC to own a business in Indonesia being able to apply to this new digital nomad visa[420].

Incentives such as this allied to the possibility of employees working from anywhere they want may trigger a shift in the personal income tax tax base, potentially creating significant revenue losses to countries which cannot offer attractive characteristics to remote workers (DE LA FERIA and MAFFINI, 2021, p. 12 and 13), and hence challenge the progressive distribution of taxation of income (AGRAWAL and STARK, 2022, p. 69).

4. Final remarks

Remote work and digital nomadism's continuous increase in the labour market general picture pose significant questions and issues to the tax systems spread throughout the world, not only at a corporate income tax level, but also at a personal income tax level.

Furthermore, workers mobility has also the power to affect the employees themselves, the employers and the tax administration systems that have some sort of connection with the first two.

Is labour mobility requiring a shift (or, at least, an update) on the criteria for tax residency and permanent establishment? How (or where) will a permanently mobile worker, ie. a person that does not spend more than 180 days in one country be taxed (AGRAWAL, STARK, 2022, p. 68)? Are we

facing an increase in tax disputes due to double taxation of mobile workers' income? And, when applicable, are existent tax treaties sufficient to solve these queries?

Will we have a personal income tax distribution problem, as we have experiencing for corporate income tax distribution across countries? Will we have a BEPS 2.0 with a two-pillar approach applicable to a personal income tax "fair distribution"?

As digitalisation keeps growing on us and heavily affecting key points of society, such as the labour market, one can only foresee that tax legislation will have to rapidly adapt to this continuous growth.

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CHAPTER 9 – CITIZENSHIP TAXATION AND EXIT TAXES: Fairness or Tyranny?

Luís Castilho

1. Declaration of intent

The Swedish government announced on May 25th, 2022 that it is looking into reviewing the existing capital gains tax regime for individuals in order to possibly introduce an exit tax on unrealized gains derived by individuals who are moving away from Sweden[421]. This means that Sweden may soon end up joining other EU countries, like the Netherlands, Finland, Germany, Spain and Switzerland, that have some form of exit tax on unrealized gains derived by individuals departing their residence countries on a permanent basis.

However, in post-COVID world, high net-worth individuals (HNWI), entrepreneurs and key employees are getting ever more internationally mobile, and location choices are becoming ultra-sensitive to a country's level of tax exposure[422]. That is why many European countries offer favourable tax schemes to skilled immigrants[423]. Any form of exit tax might be enough to deter someone from immigration to such a country or will potentially accelerate plans to emigrate. More worrisome is how exit taxes may become paywalls that get in the way of the desirable free migration and establishment, not only in the EU but in the world in general.

There are also some countries[424] that although they do not have a formal exit tax in place use varying criteria of domicile (deemed or otherwise) for tax purposes that go beyond the place of residence of the taxpayer, which may attract taxation (at least on a territorial basis) beyond what would be possible with a normal tax residence criteria.

On the most radical end of spectrum, we also have a few countries (very few actually) that – in full contrast to conventional international tax law – tax their citizens, in a world wide income basis, regardless of either residence or domicile (the so called citizenship taxation).

Of course one cannot ignore that both exit taxes and citizenship taxes exist for a legitimate (even if possibly outdated) reason: to raise and/or withhold tax revenue to finance public expenses that the taxpayer has benefited from (or could have benefited from) or may come to benefit in the future due to his citizenship.

At a time where physical and cultural borders of countries are starting to blur – specially due to the insurgence of digital nomadism and increased popularity of remote work – it is a good time as any to go over what scholars have been writing in favour and against exit taxes and citizenship taxes, particularly in the last decade, and see if the essence of these (abnormal) forms of taxation hold the test of time.

2. Citizenship taxation

2.1. How it works?

Types of citizenship taxation

The United States of America ("U.S.") is one of the few countries in the world[425] to use a person's citizenship status, in addition to residence status, as a jurisdictional basis upon which to impose a world-wide income taxation, in the sense that, subject to some significant exceptions, a U.S. citizen is subject to U.S. income tax even if he or she resides outside the U.S., and even if all of his or her income arises outside the United States[426].

In addition, a US citizen are also subject to U.S. transfer tax on all lifetime gifts, as well as their entire estate, regardless of where in the world the assets are located[427]. Also, a form of exit taxation applies in the case of a U.S. citizen who renounces or otherwise loses his U.S. citizenship if, at the time of the renunciation, his net worth or average income tax liability exceeds specified thresholds[428].

Purpose of citizenship taxation

U.S. citizenship taxation system is rooted in a very deep history[429], seeing as it was first established at a time of Civil War, when citizens living in the U.S. were expected not only to finance the war effort through the payment of taxes but also to serve in the military, which triggered the perception that citizens living overseas were hiding away to avoid contributing their fair share of taxes necessary to finance the war effort[430].

Although the historical justification that was at the genesis of the U.S. citizenship taxation system can hardly be argued to still hold in the 21st century[431], the fact is that U.S. citizenship taxation has continued to exist, more or less unquestionably[432], since its conception[433].

2.2. Arguments in favour

According to scholars and academics, the main arguments in favour exit taxes can be summarized as follows:

a. The consent argument holds that taxation of U.S. non-resident citizens is justified by the **implicit consent** that can be deducted from their failure to renounce their citizenship[434], which shows consent to be governed.
b. The **benefits argument** holds that U.S. citizenship by itself confers benefits that justify taxation, namely personal protection, property protection, right to vote, right to enter, and past benefits[435] which needs to be paid for[436].
c. The **ability to pay** argument holds that U.S. citizens are part of a community and should contribute their fair share to the pool of income that is redistributed across the community, as a way to support the government with the least sacrifice (because of the declining marginal utility of money) and as a way of achieving redistribution[437]. In other words, to the extent that citizenship reflects membership in U.S. society, a citizen living abroad should be expected to support, in some way or other, that society, regardless of there being an immediate direct benefit or not[438].
d. The **administrability argument** holds that citizenship is an administrable proxy for domicile which is a better nexus for taxation of personal income than residence, since both citizenship and domicile focus upon permanent political allegiance, rather than immediate physical presence[439]. In this sense, citizenship taxation can even be supported on the basis of neutrality concerns, in the sense that it minimizes the role of taxes in a citizen's decision on where to live and eliminates the incentive for U.S. citizens to reside abroad in order to escape U.S. taxation[440].

2.3. Arguments against

According to scholars and academics, the main arguments against citizenship taxation can be summarized as follows:

a. Americans who are citizens only of the U.S. **lack a genuine alternative** to retaining their U.S. citizenship and stop being taxed for their citizenship[441].
b. The U.S. is **not unique in providing non-resident citizens both voting and protection benefits**, but is unique in taxing them based on their citizenship. Additionally, the benefits theory cannot ignore that resident U.S. citizens receive far more benefits than non-resident ones. The U.S. are not accounting for how much they save because they are relieved from the obligation to provide full government benefits to non-resident citizens[442].
c. **Citizenship is not a good proxy for membership to the U.S. national community**[443], since increased mobility and plural nationality has impacted how we should define a national community. There are citizens of the U.S. that have citizenship by virtue of being born in the United States, but who may never have resided in the United States.
d. A person's ability to pay should be calculated by reference to the place where one lives, rather than the place where one holds her citizenship. Also, since **foreign taxes** (including not only income taxes, but also consumption taxes) **are not fully credited** under U.S. citizenship taxation (despite the foreign income exclusion regime in place), non-residents' ability to pay will differ from residents' ability to pay[444].
e. Citizenship taxation **discourages immigrants from moving to the United States** and naturalizing as citizens, which puts the United States at a competitive disadvantage compared to other migrant-receiving states in attracting skilled foreign workers[445]. Also, if people are mobile, countries should set tax rates to reflect the taste of their residents and let the people decide where they want to be taxed[446].
f. Citizenship taxation imposes an **unreasonably high compliance costs**[447] to U.S. citizenship living abroad, with disproportionately high penalties for non-compliance[448].

3. Exit taxation

3.1. How does it work?

Types of exit taxes

According to scholars and academics, there are three types[449] of exit taxes:

a. **Immediate exit taxes**, which are levied on the (yet unrealized) market appreciation of the taxpayer's assets (real estate properties usually, but in some cases some movable properties such as shares and other financial holdings) as evaluated at the date of emigration. Immediate exit taxes may vary widely in terms of how broad the scope of covered assets is, as well as the applicable exemption thresholds.
b. **Re-entry charges**, which are levied not on unrealized gains of departing migrants, but rather on capital gains realized by returning taxpayers that previously resided in the taxing country during the interim years when the individual was not resident there.
c. **Extended tax liabilities**, which are levied on realized gains from the disposal of assets by former resident taxpayers after emigration, thus working as a deemed residency that extends the tax residency in the departing country for a certain number of years after emigration. Extended tax liabilities may, again, vary widely in terms of how broad the tax base of said deemed residency is (it may for example tax worldwide income, or just tax income sourced in the departing country at aggravated rates), as well as on the number of years it remains in force.

Purpose of exit taxes

The self-declared purpose of exit taxes is to discourage tax motivated transfers of tax residency and consequently prevent the loss of potential tax revenues that would otherwise derive from the fact that, under tax treaties based on the OECD Model Tax Convention, gains from alienation of shares and other movable assets are taxable only in the residence State of the alienator[450].

The fact is that under international tax law, at least when following OECD Model Tax Convention, capital gains on movable property tend to be taxed exclusively in the State of residence of the alienator. As such, in the absence of exit taxes, the State of residence is likely to lose the right to tax gains accrued prior to the emigration but obtained after that event, which could foment tax avoidance[451].

3.2. Arguments in favour

According to scholars and academics, the main arguments in favour exit taxes can be summarized as follows:

a. Exit taxes can be perceived as a way to ensure horizontal **tax fairness** between long-lasting resident taxpayers and departing taxpayers, in the sense that it ensures that, ultimately, both taxpayers will pay capital gains tax equally over the value appreciation occurred during their residency (the only difference being timing: while long-lasting resident taxpayers pay taxes out of realized capital gains, departing taxpayers pay taxes out of the market appreciation of their assets, measured at the time of departure)[452].
b. Exit taxes also ensure actual implementation of the **territorial principle of taxation**, in the sense that it both counters tax-driven migrations facilitated by treaty benefits granted by OECD Model tax treaties[453] and also allows for the state of departure to exert its (arguably) legitimate right to tax capital gains accrued in its territory, even when, partially or fully, realized at a time when the taxpayer is no longer resident there[454].
c. Lastly, it could also be argued that exit taxes are justified on the grounds of **legitimate budgetary concerns**, in the sense that countries of departing taxpayers have incurred in general government budget expenditures to provide the positive environment which contributed to developing and increasing of departing assets market value and, justifiably, expect to be compensated through tax revenue.

3.3. Arguments against

According to scholars and academics, the main arguments against exit taxes can be summarized as follows:

a. If the home State taxes the gain accrued up to the moment of emigration through exit taxes and the State of residence does not provide for a step up according to the deemed disposal value (or there is, simply, a mismatch in valuation methods), then the pre-emigration gain would be taxed twice with no possibility of such **double taxation** being eliminated under OECD Model tax treaties[455].
b. Exit tax do not usually allow for full and immediate **loss offset** (meaning that negative tax will not be paid to the individual at exit or be deductible against present, past or future taxes due in the departing country)[456].

c. Since not all tax jurisdictions levy exit taxes, the absence of exit taxes creates a comparative advantage and, as such, can be perceived as yet another instruments that states have at their disposal to **promote aggressive international tax competition**, which, in itself, goes against the (even if unrealistic) ideal of international tax harmonization of tax bases and territoriality principles[457].
d. The most logical argument against exit taxes is the fact that it imposes an (arguably) excessive burden on migration and consequently can be perceived as an **economic obstacle to the freedom of movement and establishment**, which is particularly important in the context of the European Union, since it is a fundamental right guaranteed pursuant to Article 49 of the Treaty on the Functioning of the European Union (TFEU)[458].
e. There is also grounds to argue for **discrimination**, in the sense that those taxpayers who decide not to transfer their residency or assets to other jurisdiction are not obliged to be taxed immediately on the unrealized market appreciation of their assets and, as such, have a more advantageous tax treatment than departing taxpayers[459], which is specially burdensome since exit taxes raise **cash flow constraints** by taxing yet unrealized (and consequently non-cashed out) gains assets.

4. Final balance and future debate

4.1. Citizenship taxation: friend or foe?

When thinking about citizenship taxation, it is helpful to re-examine the premise of taxation beginning from its fundamentals: taxation is primarily about raising revenue to finance public services (either services already provided in the past – i.e. pay public debt – or services to be provided in the future).

Once a country decides how much it needs to raise in revenue to finance public services, that country will then need to determine the tax base (both the subjective base – who to tax – as well as the objective base – what to tax), for which issues such as jurisdiction, enforceability, and administrability must be considered.

It is at this point that citizenship taxation becomes anomalous. With the exception of citizenship-based taxation, all taxes – including exit taxes –

are levied on some form or combination of situs, residence and source.

In fact, under conventional international tax principles, income of resident taxpayers is usually taxed on a worldwide basis and income of non-resident taxpayers is only taxed when derived from a local source. In other words, a community will not lay a claim to the entirety of a person's income unless the person is domiciled in that community[460].

Because citizenship-based taxation is outside the sphere of commonly accepted international tax principles, it is not surprising that many scholars and academics view it as somewhat of an aberration, to be shunned as a crazy U.S. eccentricity. However, most surprisingly, there is still a general lack of conversation about it.

In fact, U.S. government has not formally commented on the rationale for citizenship-based taxation since Cook v. Tait was decided in 1924, nor is that debate in the political sphere. What is interesting is that although other countries have tried (particularly developing countries, which have more to lose when HNWI emigrate), no other country – besides the U.S. - has successfully employed citizenship-based taxation, probably due to problems of enforceability and administration (and not so much for concerns about fairness).

There are even scholars that have created an impressive body of work to try to devise technically sound reasons to justify the existence of citizenship taxation. Such is the case of Edward Zelinsky[461] that argues that citizenship is just a better nexus for personal income taxation than residency criteria, because whereas residence requires consideration of factors such as the number of days present in the taxing country, citizenship is easier to determine and account for.

Edward Zelinsky goes as far as saying that citizenship taxation ends up reaching largely the same people as residence taxation, at least for countries that define tax residence to include concepts like domicile or "ordinary residence", since citizenship is a concept that looks beyond mere physical presence to establish tax residence[462].

Although Edward Zelinsky is correct in his assumption that citizenship is an easier nexus to enforce than residence, it is greatly underestimating how much higher the administrative costs of actually enforcing citizenship taxation are when compared to residence-based taxation, at least in what concerns to non-resident taxpayers.

However, the cited concerns about enforceability and administration may soon be completely surpassed.

The fact is that since FATCA was put in place in 2010, the U.S. capacity to assess and collect citizenship-based taxation has greatly increased, which now makes it harder to truly reopen the debate of the fairness of its existence, because it is now a very viable tax revenue source for the U.S. treasury[463] and consequently a topic that is not easy to include in the public agenda.

In this sense, Professor Michael S. Kirsch[464] goes as far as arguing that recent economic, technological, and other developments do not justify the abandonment of citizenship-based taxation, but instead might even strengthen the case for using citizenship as a basis for taxing individuals who live outside of the country.

However, concerns about fairness of citizenship taxes still hold. Although it is undeniable that, in the context of an income tax, there is no necessary correlation between the benefits and the taxes paid, there should be a minimum nexus between the taxpayer and the taxing state to justify income taxation, especially on a worldwide basis.

Which poses the question: is citizenship a fair nexus for worldwide income taxation? Surely, on the one hand, one must wonder if by allowing non-residents citizens to vote in their country of citizenship without paying taxes, we are not creating a type of moral hazard, in the sense that those voters do not bear the economic consequences of their political participation[465]. But, on the other hand, shouldn't there be other, less aggressive ways, to pay for citizenship, for example, by charging yearly fees on passport issuance to non-resident citizens?

4.2. Exit taxation: paywall or fair trade?

Unlike citizenship taxation, exit taxes are quite common, even within the European Union, and have a very sound technical foundation to justify its existence (regardless of one's own personal view on it), since they can easily be understood to be a fair extension of the territorial principle of taxation in the sense that they are a legitimate way for a country to avoid losing the right to tax gains accrued during the taxpayers residency due to limitations imposed under tax treaties based on the OECD Model Tax Convention.

That may be why - much like citizenship taxation, but for totally different reasons - exit taxes have also not been discussed enough in the political sphere (nor in the judicial sphere, for that matter). The fact is that there seems to be a general understanding that exit taxes are within each jurisdictions legitimate taxing rights and questioning those rights may only raise unwanted fears of diplomatic incidents.

However, there are sufficient (and legitimate) concerns raised by exit taxes that justify, at the very least, putting it at a closer scrutiny. The most pressing concern is how it creates a paywall to emigration, which may - even if unintendedly - deter a taxpayer's freedom of movement and establishment (at least those who can't afford it, which raises additional issues of discrimination), a restriction that is especially worrisome in the European Union.

The fact is that while some forms of exit taxes imply paying taxes as if one was selling one's movable assets, but without really having monetized that operation, others create a surcharge over realized capital gains for either returning or recently departed taxpayers that raises their tax burden to levels that exceed those applied to other resident taxpayers (on either the country of emigration or the country immigration), which creates a double taxation burden not easily mitigated by OECD Model Tax Conventions[466].

In short, exit taxes – regardless of the form they take – forces the taxpayer to either pay taxes on a financial gain that may not have been earned or may very well never be generated or pay taxes at an excessive level (when compared to the one applied to other resident taxpayers), which creates a significant financial strain to migration.

Which poses the question: are exit taxes fair trade or just a paywall? Is the aim of exit taxes truly a legitimate mechanism to preserve a country's tax base or is it a desperate measure to keep taxpayers locked in (or locked out)? If it's the latter, shouldn't we focus more on incentivising taxpayers to come into the country, than disincentivising taxpayers to leave?.

4.3. Citizenship taxation vs Exit taxes: pick your poison

Despite having many technical and conceptual differences, citizenship taxation and exit taxes both aim to solve a common concern: how to preserve a country's tax base in an increasingly globalized world, specially in face of the insurgence of digital nomadism and increased popularity of

remote work, which has made previously low populated countries suddenly become a hot destination for NHWI emigration.

Scholars seem to, more or less, agree that some form of protectionism is justifiable, with a clear preference going more towards exit taxes than to citizenship taxation. However, scholars are also very quick to point out that these forms of protectionism, although justifiable in some degree, do create undesirable effects, as it would be expected from any form of economic obstacle to the freedom of movement and establishment does. Some of these undesirable effects may even surpass mere tax collection concerns and go into a more political realm of creating an environment that promotes the stigmatization of emigrants as dissenting and defectors.

It seems that there is still much to debate before a common and widespread understanding is reached as to how far these forms of tax base protectionism can go, knowing that, in the meantime, the current one-sided and disharmonized solutions may very well be creating more friction than truly solving the, albeit legitimate, concerns the protecting countries are facing.

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421. Assuming it will follow Swedish Tax Agency 2017 proposal, the exit tax will cover most asset classes including stocks, receivables and partnerships in Swedish enterprises. For listed assets, the tax base is expected to be equivalent to the market value at the exit date and for unlisted assets, the tax base evaluation is still unclear. To comply with EU's freedom of movement and establishment individuals moving to a country within the European Economic Area (EEA) will be able to defer the tax payment until the time that the asset is disposed, but with the tax liability being determined at exit. However, if the individual re-enters Sweden after a period within the EEA, holding the same asset portfolio as at the time of exit, the tax payment due will be set to zero. For individuals moving outside the EEA, a deferral of the payment is restricted to cases where Sweden has a bilateral tax treaty with the country in question, with a maximum time of deferral of five years.
422. Ufuk Akcigit, Salomé Baslandze, and Stefanie Stantcheva, Taxation and the International Mobility of Inventors, 21024, National Bureau of Economic Research Working Paper Series (2015).
423. Belgium, Denmark, Finland, the Netherlands, Romania and Portugal, just to name some examples.
424. United Kingdom and Ireland to name some examples.
425. Eritrea and North Korea are usually cited as also having citizenship-based taxes.
426. Although, in practice, many non-resident US citizens may end up not owing any U.S. citizenship tax on income arising abroad, since the foreign earned income exclusion regime currently in place permits qualifying individuals to exclude a part of foreign earned income (up to a maximum cap established yearly).
427. To learn more about U.S. estate and gift tax and its applicability to non-resident citizens, we recommend visiting the Internal Revenue Services' ("IRS") on the matter at www.irs.gov/individuals/international-taxpayers/some-nonresidents-with-us-assets-must-file-estate-tax-returns and https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-gift-taxes.
428. To read more about expatriation tax, we recommend visiting the IRS own FAQ on the matter at www.irs.gov/individuals/international-taxpayers/expatriation-tax.
429. The first citizenship taxation in the U.S. was imposed in 1864, as amendment to the Civil War income tax to apply to the income of "*every person residing in the United States, or of any citizen of the United States residing abroad*", regardless of whether the income arose "*in the United States or elsewhere*.". This first version of the U.S. citizenship taxation continued until the Civil War income tax expired in 1872, which was revived in 1894, and later incorporated into the "modern" income tax of 1913.
430. As stated by a senator who served as a manager in the conference committee that adopted the 1861 tax law (taxing non-resident citizens at a higher rate): «*We do not desire that our citizens who have incomes in this country…should go out of the country, reside in Paris or elsewhere, avoiding the risk of being drafted or contributing anything personally to the requirements of the country at this time, and get off with as low a tax as everybody else… If a man draws his income from our public debt, or from property here, and resides in Paris, skulking away from contributing his personal support to the Government in this day of its extremity, he ought to pay a higher income tax*». Later, Senator George Hoar stated in 1894 to argue in favour of taxing non-resident citizens on their worldwide income: «*There are a great many people, I am sorry to say, who go abroad for that very purpose [of avoiding tax], and some of them went abroad during the late [Civil W]ar. They lived in luxury, at the same time at less cost, in a foreign capital; they had none of the voluntary obligations which rest upon citizens, of charity, or contributions, or supporting churches, or anything of that sort, and they escaped taxation*». See Michael Kirsch, Taxing Citizens in a Global Economy, 82 NYU L. Rev. 443 (2007).

431. Avi-Yonah, Reuven S., The Case Against Taxing Citizens (March 25, 2010). U of Michigan Law & Econ, Empirical Legal Studies Center Paper No. 10-009, U of Michigan Public Law Working Paper No. 190.
432. In 1922 a US citizen living in Mexico, George Cook challenged the constitutionality of the US citizenship taxation, but the Supreme Court upheld the taxation of non-resident citizens in Cook v. Tait 265 US 47 (1924), with the following argument: ""*[T]he government, by its very nature, benefits the citizen and his property wherever found, and therefore has the power to make the benefit complete. Or to express it another way, the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, and was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen.*".
433. The only major overhaul of US citizenship taxation was done in 1918, when the US government implemented a foreign tax credit system to eliminate the issue of double taxation that paved the way to the foreign earned income exclusion that aims to appease the concerns of US corporations operating overseas that found US workers to be in competitive disadvantage to non-US ones. Also, it is worth mention 2010, when the U.S. government enacted the Foreign Account Tax Compliance Act ("FATCA") for the purposes of enforcing tax compliance by U.S. taxpayers, both resident and non-resident, who use foreign bank accounts, in order to stop tax evasion by U.S. residents.
434. See Alice G. Abreu, Taxing Exits, 29 U.C. DAVIS L. REV. 1087, 1122 (1996) and Michael S. Kirsch, Taxing Citizens in a Global Economy, 82 N.Y.U. L. REV. 443, 445 & n.5 (2007).
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436. Non-resident U.S. citizens retain the rights to vote in federal elections, travel on a U.S. passport, pass on U.S. citizenship to their children born abroad, re-enter the U.S. at will, work in the U.S., receive personal and property protection from the U.S. while abroad, apply for diplomatic and consular services, and they can request evacuation in emergencies. However, the most significant benefit of U.S. citizenship is arguably the ability to enter the United States at any time, which, Professor Michael S. Kirsch argues that based on the high demand by noncitizens to enter the United States, undoubtedly has some significant objective value.
437. See Michael S. Kirsch, Taxing Citizens in a Global Economy, 82 N.Y.U. L. REV. 443, 445 & n.5 (2007).
438. See Kirsch, Michael S., Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice (October 28, 2013). 16 Florida Tax Review 117 (2014), Notre Dame Legal Studies Paper No. 1457.
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446. See Reuven Avi-Yonah, The Case Against Taxing Citizens, 58 TAX NOTES INT'L 389, 394 (May 3, 2010).
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453. The Commentary on Article 1 of the OECD Model recognizes the fact that the extension of tax treaties increases the risk of treaty abuse by facilitating the use of artificial structures. Naturally, towards this end, the Commentary on Article 1 of the OECD Model states that the benefits of tax treaties should not be given in abusive situations, which are determined through a fact finding process, i.e. by applying domestic general anti-avoidance rules (GAARs), such as a statutory general anti-avoidance rule or judicial anti-avoidance rules (substance over form, economic substance, etc.)
454. B. Carramaschi, Exit taxes and the OECD Model Convention: Compatibility and Double Taxation Issues, 49 Tax Notes Intl., pp. 283-293 (2008) and L. De Broe, General Report, The Tax Treatment of Transfer of Residence by Individuals, IFA Cahiers de Droit Fiscal International, vol. 87b, sec. 2.3.1. (Kluwer L. Intl. 2002), Online Books IBFD.
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458. The Court of Justice of the European Union (former European Court of Justice, ECJ) has issued a handful of landmark decisions regarding exit taxes on both individuals and companies, for example in National Grid Indus's case (C-371/10) its main conclusion was that national exit tax rules are justifiable but not proportionate to goals they aim towards. More recently, regarding the German exit tax, the ECJ (C-164/12) decided that "*national legislation of a Member State which provides for the immediate taxation of unrealised capital gains generated in its territory does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between*

Member States, provided that, where the taxable person elects for deferred payment, the requirement to provide a bank guarantee is imposed on the basis of the actual risk of non-recovery of the tax".

459. Wattel, P. (2012). Exit Taxation in the EU/EEA Before and After National Grid Indus. International Tax Notes, pp. 371-372.

460. See Ruth Mason, Citizenship Taxation, 89 S. CAL. L. REV. (2016).

461. See Edward A. Zelinsky, Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile, 96 IOWA L. REV. 1289 (2011).

462. See Edward A. Zelinsky, Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile, 96 IOWA L. REV. 1289 (2011).

463. Before FATCA, unless U.S.-citizen taxpayers either worked for a U.S. corporate subsidiary or had previously complied with their foreign reporting and filing obligations, the IRS has no real way of knowing who was truly complying with US citizenship taxation obligations..

464. See Michael S. Kirsch, Taxing Citizens in a Global Economy, 82 N.Y.U. L. REV. 443, 449–56 (2007).

465. See Ruth Mason, Citizenship Taxation, 89 S. CAL. L. REV. (2016).

466. Chand, Vikram (2013), "Exit Charges for Migrating Individuals and Companies: Comparative and Tax Treaty Analysis", in *Bulletin for International Taxation, 2013 (Volume 67), No. 4/5 (Next issue)*, published on April 5th 2013.

CHAPTER 10 – THE RISE OF SPACE TAXATION: A Tale of Foresight

Telmo Soares

1. Declaration of intent

The growing interest surrounding outer space activities is undeniable, the new frontier displays an ever-increasing appeal as a worthy investment not only for institutional investors but also for well-funded entrepreneurs, from various backgrounds, hoping to achieve significant long-term returns from their early-bird strategy.[467]

According to recent estimates, the space market has a monumental potential for growth. Indeed, forecasting powerhouse names like Goldman Sachs[468] believe that the space economy will be worth at least more than USD 1 trillion in the 2040s, while Morgan Stanley[469] projected a USD 1.1 trillion growth up until the 2040s and a third study by Bank of America / Merrill Lynch[470], claiming the most optimistic prediction, sees the market swelling to circa USD 2.7 trillion, within the same timeframe. Contrastingly, the current revenues from long-established global commercial airlines seem to pale in comparison, representing only a USD 782 billion market in 2022.[471]

While future growth prospects help to paint a gleeful picture of exponential profits for investors, gloomier, but perhaps more realistic, voices remind us of the increased risks for the general public of space exploitation by private entities. As examples range from safety hazards, to uncontrolled re-entries of space objects or to the insufficiently known environmental costs, it is clear that outer space economical activities demand strong monitoring and regulation.

Inevitably, considering the foreseen expenditure of public resources by states to ensure the necessary supervision of this sector, communities might naturally start to demand that space companies pay their fair share to society, both as a means to justify their enjoyment of the provided benefits

(e.g., skilled labour) and also as a form of compensation for all the negative externalities produce therein (e.g., emission of pollutants).[472]

In this article, we shall first strive to define the state of the art in what concerns the international space tax regime, starting with an initial focus on the importance of certain baseline rules established by international law. Our initial approach, shall then be followed by a condensed review on the application of modern international tax rules to commercial activities presently being pursued in outer space, as well as a prospective analysis on the potential implications for innovative business models that might go live in the near future.

Undoubtedly, the possibility of contributing to the next best thing in this game-changing industry has stimulated private space entrepreneurs and investors alike to make plans into the future. In fact, just recently, we witnessed announcements by several companies that four new all private space stations are already being constructed and will allow for added research, manufacturing and touristic capabilities.[473]

As such, in the course of our analysis, we shall focus our sights upon the advantages, disadvantages and limitations of the solutions currently being presented in regards to international space taxation, attempting whenever possible to draw conclusions based on the interpretations of the international law framework.

At last, our ultimate goal shall be to dissect, assess and predict the challenges posed by novel space activities to international tax law. As such, whenever faced with legal vacuums our objective shall be to propose coherent solutions that may allow states to act with reinforced certainty when taxing in this new frontier.

2. A brief introduction to International Space Law

As a field of study, although international space law is normally considered to be a working part of general international law, stemming from the same sources of law, its object is specific enough to set it apart from other international law regimes (Jakhu & Freeland, 2017, pp. 607). Indeed, international space law is usually viewed as a special branch of the *corpus iuris internationalis*, represented on its own by a small constellation of international treaties, customary rules and general principles (Jakhu & Vasilogeorgi, 2013, pp. 29-30).

Therefore, more than a triathlon through all of the framework rules, to understand the fundamentals of international space law, in what impacts a state's public power to levy tax, one first needs to embark on a guided reading of the treaties belonging to this special branch of international law, pausing on their core principles and observing the lessons they have to impart.

In this context, we must start by referring the "Outer Space Treaty" (1967)[474], as the oldest, broadest and most important source of international space law, still in force today. Still, one cannot discard the four subsequent treaties as irrelevant since in covering ancillary matters to the main topic they made important contributions to its expansion, they are known as (i) the "Rescue Agreement" (1968)[475], (ii) the "Liability Convention" (1972)[476], (iii) the "Registration Convention" (1976)[477] and (iv) the "Moon Agreement" (1984)[478].

Naturally, we shall not feign a desire to be exhaustive in our incursion, as the study of the principles of international space law deserves a more pondered reflection. In fact, our main aim remains to solely draw up a proper context for tax purposes and, therefore, we have made a selection of principles that would appeal mainly to private space commercial operators, namely the "Common Interest Principle", the "Freedom Principle" and the "Non-Appropriation Principle".

The "Common Interest Principle", set forward by Article I (1) of the Outer Space Treaty, declares that any exploration and use of outer space "(…) *shall be carried out for the benefit and in the interests of all countries, irrespective of their degree of economic or scientific development, and shall be the province of all mankind*". Such formulation is undoubtedly broad, fluid and undetermined, having prompted different perspectives on the legal status of outer space areas over the years.

Even so, in what now concerns us, it may be enough to say that for those that walk a narrower path of interpretation (Jakhu & Vasilogeorgi, 2013, pp. 21), such provision solely translates the idea that activities performed in outer space are not within the exclusive sphere of the domestic jurisdiction of certain individual states, an ideal that seems to gather ample support. As such, one should retain as a minimum standard that mankind, currently understood as the international community, holds its own jurisdiction over all matters related to the exploration and use of outer space, irrespective of its members being spacefaring nations or not.

From a more practical perspective, this majority ideal means that whenever an issue falls within the jurisdictional scope of the collective domain, rather than the individual one, no claims of non-intervention in the internal affairs of a State may be accepted and any collective deliberation on these matters cannot be faltered by them. Thus, for the abovementioned authors (Jakhu & Vasilogeorgi, 2013, pp. 22), the common interest ideal is solely intended to recognise the inclusive interests of all countries in the new frontier and, therefore, any duty of abstention from "*(…) [intervening], directly or indirectly, for any reason whatever, in matters of internal or external affairs of any other State*"[479] cannot be applied to outer space due to its status as *res communis omnium* (or "*thing of the entire community*").[480]

Differently, some commentators (Cocca, 1998, pp. 53; CHENG, 1997, pp. 425-436) appear to value the use of the expression "*province of all mankind*" in a special light, arguing that outer space should actually be understood as the "*common heritage of mankind*", a concept more closely connected to the idea of equitably sharing the natural resources present in space.[481] This shift in perspective seems subtle, but it could ultimately mean that all of humanity would not only be entitled to a fair share in the economic benefits of the new frontier, but that a common management system of such resources should be established.[482]

However, other authors (Gawronski, 2018, pp. 187-188; Jakhu & Vasilogeorgi, 2013, pp. 21-22) tend to underline that a conceptual distinction between the term "*province*" and the expression "*heritage*" must be made, because while the former is broader in that it refers mainly to the nonexclusive right to use and explore space (i.e., to activities), the latter pertains exclusively to the realm of outer space resource allocation, being even included in this sense in the Moon Agreement.[483] In sum, the preponderant doctrine, so far, shies away from the application of the "*common heritage*" standard to space resources under the Outer Space Treaty.

Under Article I (2) of the Outer Space Treaty, one may find the rendition of the "Freedom Principle" through the affirmation that "*[o]uter space, including the moon and other celestial bodies, shall be free for exploration and use by all States (…)*". Judging by this passage alone, the concept of "*freedom*" in outer space appears to be exceptionally wide, in fact one would immediately assume it was designed to allow for all sorts of activities,

ranging from military to civilian uses, as well as scientific and commercial objectives alike, whether undertaken by states, by international organizations or even by private entities.[484]

Nonetheless, although this fundamental legal principle aims to acknowledge the free exploration and use of outer space as a protected right such freedom is not absolute, as it can only be exercised within the limitations prescribed by international law. As such, in the densification of the general rules in the Outer Space Treaty, policy-makers made sure to specify that this freedom of action must be exercised "*without discrimination of any kind*", "*on a basis of equality*" and "*in accordance with international law*".

On the expression "*without discrimination of any kind*", our views tend to align with other authors (Jakhu, 2006, pp. 40) who defend that the delayed use of outer space by non-spacefaring states cannot constitute a valid reason for their freedom *in potentia* to be jeopardized by the first comers.[485] Therefore, not only are freedoms in outer space restricted, the only way for them to be exercised should be in accordance with the "common interest" principle, by measuring the validity of one's actions against their negative effect on the future enjoyment of outer space by others.[486]

As for the phrase "*on the basis of equality*", it alludes to a *de jure* equality or sovereign equality, much in the same sense that is also recognized in Article 2 (1) of the Charter of the United Nations, thus meaning that international space actors must be equal in the eyes of the Law and must enjoy equal rights and duties in the exploration and use of outer space, irrespective of their territorial size, military might or economic prowess.[487]

As for the excerpt "*in accordance with international law*", it can be interpreted to imply an extended application to outer space matters of the general principles and rules of international law, as long as they are consistent with the provisions of the Outer Space Treaty. As stated before, space law is viewed as a special branch of general international law, meaning that in areas of direct conflict one may expect international space law to prevail over general international law provisions, in compliance with the general legal principle of "*lex specialis derogat lex generali*" (Lachs, 1972, pp.15).

Without excluding any of the foregoing principles, in regards to matters of international taxation, perhaps the most important ideal can be found in the "Non-appropriation Principle", also known in his negative form as the prohibition of national appropriation. Its presence in Article II of the

Outer Space Treaty needs little interpretation to be uncovered since the formulation is quite direct, declaring that "*[o]uter space, including the moon and other celestial bodies, is not subject to national appropriation by claim of sovereignty, by means of use or occupation, or by any other means*".

From such provision, one can draw the conclusion that any sovereign claims, in whichever shape or form, made by states over territories in outer space are irrelevant, void and inapplicable, according to Article II of the Outer Space Treaty. Irrespective of the foregoing, the appropriation of space by private operators seems to be a more contentious matter, with a more flexible position (Gorove, 1969, pp. 351) claiming that the elected wording of the rule only disallows "*national appropriation*" by states and, therefore, private appropriations of outer space should be seen as lawful, under the Outer Space Treaty.

For a significant number of commentators (Christol, 1984, pp. 236; Masson-Zwaan & Hofman, 2019, pp. 231; Pop, 2000, pp. 276-277), such interpretation cannot prevail in the wider context of the rest of the treaty, with arguments being made that it would be an inconsistency to accept any form of private exclusive appropriation (e.g., property rights), when that very same agreement imposes an all-encompassing objective responsibility on States for activities carried on by their nationals in outer space, whether by governmental agencies or private entities.

Moreover, according to some authors (Goedhuis, 1970, pp. 36; Jakhu, 2006, pp. 43-45), the recorded evidence from the treaty's negotiating context, seen under international law as a valid supplementary resource for its interpretation[488], allows for the conclusion that the intention of the drafters was to fully prohibit exclusive appropriation in any shape or form, irrespective of the private or public status of entity pursuing such activities.

Thus, the appropriation of outer space, understood for states as the creation of sovereignty links in extra-terrestrial locations, is strictly forbidden by current treaty rules. Notwithstanding, under the terms of Article VIII of the Outer Space Treaty, two important exceptions to this rule may arise, as follows: (i) States will retain jurisdiction and control over registered objects and personnel sent to outer space and (ii) ownership rights over any objects (and their components) launched into outer space or on a celestial body, will not be affected by their presence in outer space or by their return to Earth.

Finally, considering the significance of a well-defined territorial scope for tax purposes, our brief overview on international space law would not be complete without a reference to the lower boundary of outer space and the need for a demarcation between space law and air law. So far, this topic has stubbornly remained an unresolved item on the agenda of the Legal Subcommittee of COPUOS[489], with many countries, in meetings over the years, insisting on the establishment of the limits of outer space in clear terms.

At the same time, several other prominent countries in the international order, namely the United States and their allies, have posed in the past strong objections against an international agreement on the vertical boundaries of space, claiming that the absence of such demarcation between "air space" and "outer space" has not caused major problems up until now.[490]

In spite of these objections, many commentators (Li, 2021, pp. 714; Jakhu, 2016, pp. 32) have remained resolute in their requests for a clear boundary line, pointing out that the need for such demarcation is made obvious by the disparity between the legal regimes that regulate these domains, as they undeniably bring about different obligations for all parties involved.

Although there is still an ongoing discussion, we have seen over the years some airtight scientific proposals on how to logically establish such limit. For example, the "aerodynamic-lift theory" sets the frontier at 83 km above the surface of the Earth (or generally in between 80 and 90 km), because after such point aircraft functions are no longer feasible due to the density of the atmosphere not being sufficient to support vehicles that have not achieved circular velocity, a capability that can only be expected from propulsion-based spacecrafts.[491]

Even so, the United Nations and other international organizations have proved unable to bring states to agree on an objective conventional limit between "air space" and "outer space". In this international legal vacuum, it is no surprise that most national legislators avoid compromising their position by regulating the topic in a broad and abstract manner, usually giving no straight answer, while seemingly leaving the door slightly open to an extension of their sovereignty. In all fairness, in the past, these theoretical topics were of little importance in practice, as space technology was still in the development stage and most space activities were either in

governmental hands or commercially inefficient from a cost-benefit perspective.

However, with the fast-paced development of new space technologies being now led by private parties[492], such hurdles are starting to fade at an astonishing speed and soon formerly unremarkable literature will leap from textbook pages into reality, hopefully prompting states to finally adopt a more decisive course of action.

3. Outer space activities: from international law to international tax law

Considering the above, the inevitable conclusion is that international space law has remained over time in an embryonic state at best, displaying perceivable foundations but lacking concrete solutions to pressing challenges. In this context, we shall now focus our analysis on understanding exactly how can states exert their tax powers in this peculiar domain, especially considering the inherent limits set forth by international statutes.

In keeping with our systematic approach to the topics at hand, we opted to commence this chapter by addressing the limitations thrust upon taxation by international space law (*"how far can we tax?"*). Because, only then are we able to properly access the current international panorama on the taxation of space activities (*"how far have we gone?"*). Likewise, we shall build on the lessons learnt to date in order to test the adequacy of the current international tax framework versus future space endeavours, currently being planned (*"how far will we go?"*).

3.1. General considerations – "How far can we tax?"

As the previous chapter made clear, the boundaries of space law are deeply shaped by our current understanding of a state's territorial sovereignty, as well as by the international compromises in favour or against its extension into outer space areas. Regarding the establishment of tax sovereignty in space, one might argue that it should closely follow the conceptual foundations of such compromises, since tax sovereignty is generally viewed an inherent or essential component of the sovereign status.[493]

Therefore, considering more traditional ideas on tax sovereignty, one would be tempted to regard it as the supreme, exclusive and

uncompromised exercise of a state's power to tax within their own territorial borders and over their own people.[494] Howbeit, in the advent of globalization, with the decrease of trade barriers and the increase of transnational connectivity, such close-minded conceptualizations of sovereignty as an unchallenged power to tax within a delimited territory have become largely outdated.[495]

In reality, common practice shows that States tend to accept, or at least not try to prevent, other sovereign States from exercising their right to tax in cross-border situations, even if this action might constitute an extension of their reach into foreign sovereign territories.[496]

For the most part, such extension is seen as a natural consequence of international economic integration, insofar as foreign countries can claim a sufficient connection to the item, income or person being taxed. Accordingly, states normally tend to exert their tax powers beyond borders by screening for criteria such as residence, source or citizenship, in reality these links became so common that they are viewed by some as "customary norms" (Kaufman, 1997, pp. 148-149).[497]

On the other hand, considering the framework provided by international law, one must not forget that outer space cannot be subject to national appropriation of any kind, which includes claims of sovereignty over any of its locations, be it either in the void of space or inside the atmosphere of a celestial body, making this particular domain effectively sovereignless or, as explained before, *res communis omnium*.

In this context, although the application of a strict non-appropriation principle to space is not questioned, some commentators (Hertzfeld & Dunk, 2005, pp. 88; White, 1998, 4-5; Cepelka, 1970, pp. 6-7) point out that States are not powerless in outer space, as carefully placed exceptions allow for the limited exercise of functional jurisdiction, including the exercise of tax powers. For example, the State of registry shall be able to retain "*jurisdiction and control*" over objects or personnel sent to outer space (Article VIII of the Outer Space Treaty).[498]

As such, while the non-appropriation principle precludes states from enforcing rules of general applicability in the vastness of outer space, States may still exercise their tax jurisdiction over their own nationals (personal jurisdiction) or over the domains within registered space objects, namely registered spacecraft, satellites or space stations, thus extending their

jurisdiction to all foreign or domestic persons and things on board (quasi-territorial jurisdiction).[499]

On this subject, we must emphasize that the enactment of taxation over quasi-territorial realities is not exactly a new predicament. As a practical example, ships and aircrafts operating in the high seas or over them are considered to be quasi-territorial domains, normally under the jurisdiction of the "state of the flag"[500] and employment income received for work performed aboard these vessels is widely known and has already been addressed multiple times, even prompting the creation of specific international tax rules.[501]

From this point onwards, having established a sufficient bridge between the current understanding of tax sovereignty and a certain temporary sovereign domains in outer space, created under international law, it is useful to determine exactly what categories of space traffic scenarios can occur in this new frontier, before descending into greater detail with our analysis.

In this regard, we have elected to categorize space related voyages into **territorial**, **quasi-territorial** and **non-territorial**, depending on whether their intended primary destination is located in the sovereign territory of another state, in a quasi-territorial location belonging to another state (e.g., a space object, an aircraft or a ship) or in an extra-territorial location that cannot be appropriated by any state (e.g., outer space, high seas, etc.).

From our perspective, unlike the nautical or aeronautical sectors where territorial voyages are the most prevalent objectives, in outer space the exercise of tax jurisdiction by States will vary according to the above referenced traffic scenarios, as their application will have a meaningful impact on the eventual application of the Model Tax Convention and on the qualification of the source of the space related income.

Indeed, its well known that the application of the Model Tax Convention between two Contracting States depends on certain abstract requirements being fulfilled, namely (i) the existence of a cross-border operation connected with two distinct contracting states or their territories[502], (ii) the tax being levied over such operation by either contracting states being in accordance with the material scope of the treaty and (iii) the beneficiary of the income must be tax resident in at least one of the contracting states and, therefore, fully liable to tax in that state.

Henceforth, taking into consideration the categories of space voyages defined before, as well as the application of the requirements underlined above, it is possible to envision how the current international framework might react to commercial operations in this new frontier.

On the one hand, territorial and quasi-territorial space voyages may benefit from the application of the provisions of Double Tax Treaties ("DTT"), so long as the entities managing the space operation comply with the pre-flight registration obligations imposed by Article II of the Registration Convention, since only then can states lawfully extend their tax jurisdiction into outer space areas.[503]

Whereas, in what refers to non-territorial space voyages, no DTT application shall be possible as these trips cannot be viewed as external in nature, but rather as voyages into a sovereignless void with a return point set for the territorial domain of the same state of departure. Moreover, if no state can appropriate such areas under international law, it is untenable to even consider applying a tax treaty whose scope requires cross-border operations, linked to two distinct contracting states or their territories, to trips essentially destined at the void of space.

In addition, by applying the referred quasi-territorial classification, one is more readily prepared to visualize solutions for more complex cases, for example the eventual activation of DTT provisions in cases pertaining to space objects being launched from maritime platforms in the high seas[504] or from mid-air systems, through the use of auxiliary airplanes flying in the airspace above such areas[505], intricate situations by themselves that tend to get even more convoluted whenever the vessels at play hold registries from separate countries.

Considering the above, in general the mandatory requirements in order to apply the provisions of the DTTs to some space traffic activities seem to be met in abstract terms, at least in the cases where territorial or quasi-territorial links to distinct states can be found. Therefore, since the specificity of this universe warrants a more detailed analysis of the income streams that might be generated, we shall continue our probe by looking into specific space activities and their associated challenges.

3.2. Current space endeavours – "How far have we gone?"

Operating satellites in the international context: from old queries to new challenges

As a brief overview, one may start by clarifying that the launch, maintenance and general exploration of outer space satellites shall, more often than not, correspond to a profitable endeavour by a certain corporate legal entity.[506]

As such, like most corporate profits, it is expected that from an internal viewpoint, taxation shall follow the worldwide income principle, meaning that it is likely that the common spacefaring corporation headquartered in or otherwise effectively managed from a certain country shall be typically taxed based on their worldwide obtained income.[507]

Despite space taxation being in an embryonic stage of its development, the exploration of extra-terrestrial satellites constitutes the most discussed space operation from an international tax perspective at the moment, as it already gave rise to some interesting court decisions and even opinions by the OECD Committee on Fiscal Affairs (hereinafter "OECD Committee").

Until now, the main international tax challenges have been centered around (i) whether satellites might constitute permanent establishments (hereinafter "PE") for the entities acting as their operators (Article 5 of the Model Tax Convention) and (ii) if the payments received from the leasing of the transponder capabilities of satellites can be considered royalties (Article 12 of the Model Tax Convention).

Regarding the first topic, according to the OECD Committee a PE can only be situated in a certain state when a relevant place of business exists in the territory of that state.[508] As such, when dealing with a satellite, typically located in geostationary orbit[509], the focal point of the analysis relates to how far can the territory line of the state below extend into outer space. Under such constraints, the best answer the committee experts could provide was that "[*n*]*o member country could agree that the location of these satellites can be part of the territory of a Contracting State under the applicable rules of international law*"[510], which appears to lead to the conclusion that a PE link cannot be formed in such domains.

As previously mentioned, regardless of how many scientific theories are created or how politically neutral they appear to be, the demarcation between the concepts of "air space" and "outer space" remains an impossible consensus for the international community. Although we recognize that international negotiations are usually complex events, permeated by political agendas, we must underline that from a tax

perspective the stalemate will inevitably have negative impacts going forward.

While the lack of certainty might indeed stagger foreign investment and prompt states to act unilaterally, the adoption of an uncoordinated approach could be even worse, leading to the rise of cherry-picking practices of space legislation. Such practices, similarly to what we have witness before, rely on the careful identification of countries that may opt to establish the lower possible "vertical borders" in their territory, with the idea being that since States do not hold tax or legal jurisdiction in the outer space area, the lower the limits of "air space" are established the easier it shall be for private operators to untangle themselves from regulation and taxation, when operating above such limits.

In the past, due to their concern over such topics, seven equatorial countries attempted to claim an extension of their territorial sovereignty over the geostationary orbit above their territory, this was done by adopting a multilateral instrument, known today as the "Bogota Declaration" (1976).[511] Their main objective was to combine their geopolitical influence within the international community, in hopes that other states would recognize their claim and accept their view that the non-appropriation principle, as stated in the Outer Space Treaty, was never meant to extend to geostationary orbits, since they can be viewed as a natural phenomenon caused solely by the gravitational forces of the planet and, therefore, not entirely a part of outer space.[512]

Faced with such novel claim, the international community responded with fierce and resounding disagreement, with several developed and developing nations bounding together in an effort to protect their current and/or future launching rights. In the midst of the discussion, backed by the results of scientific enquiries into the matter, a greater number of states held that geostationary orbit does form an inseparable part of outer space and, consequently, this area is subject to the provisions of the Outer Space Treaty, most notably to the non-appropriation principle and to the freedom of exploration and use by all States.[513]

In this context, the first brush of tax courts with these subjects dates back to almost forty years ago, through the decision by the California Courts of Appeal, known as the *Communications Satellite Corporation v. Franchise Tax Board*[514], in which a company headquartered in another state owned a satellite, located in geostationary orbit above international waters, that was

transmitting communication signals to an earth station, located in the state of California, for further out-of-state distribution by third party companies. In sum, the conflict revolved around the application of a special allocation formula that resulted in the apportionment of the company's total income to California, based on the fact that the satellite was being mainly used in that state.

Curiously, the referred court of law upheld the breakdown of the income amongst the states, considering the satellite to be mainly functioning in the state of California as an active part of a business activity, but only due to the presence of the earth station, owned by the same company and devoted to receiving its signals in the territorial grasp of the state of California. However, this solution could have unforeseen consequences nowadays, since modern technology has severely altered the playing field by allowing signals to be received virtually anywhere in the world, either by the customer's own earth station, by a satellite dish or even by a satellite phone.[515]

More recently, we have also witnessed interesting discussions around these topics sprouting from the Indian courts. Such decisions, although partially centered in the interpretation of national tax provisions, are useful tools when forecasting the challenges ahead by providing us with examples of fully formed tax rationales adopted in the face of situations that intertwine space, international law and taxation.

A noteworthy decision can be found in the *Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax* ruling[516], known in short form as the "AsiaSat case", decided by the Delhi High Court. In summary, the dispute focused on the validity of the tax authorities taxing a non-resident company ("AsiaSat") on income received from payments made by various non-resident television networks, in return for their use of the transponder capacity of two satellites, used to transmit their programmes to non-resident telecast and cable operators, that will then convey them to final costumers located in India.

Immediately, one must note that these satellites were not hovering over Indian airspace and neither were they within Indian orbital slots, as allocated by the International Telecommunications Union[517]. Thus, their principal connection with that country's territory was their transmission footprint that, besides also encompassing other countries in the world, was only being used by third-party non-resident entities to amplify and transmit

their signals into Indian territory, in what can be described as a triangular ricochet operation.[518]

Within this framework, the referred court of law ruled that it was categorically impossible to state that "AsiaSat" had a sufficient business activity or connection in India due to the satellites transmission footprint, since from a material perspective the process of amplifying and relaying the programmes was being performed in the satellites themselves, which were not physically located in Indian airspace[519] and, as such, no PE would form in these situations, due to the lack of a place of business in the receiving state, preventing taxation in the receiving state thereof.[520]

Furthermore, the court of law also looked into the qualification of the payments received by "AsiaSat" as royalties, these transfers derive from the so-called "transponder lease agreements", signed with the referred telecast and cable operators for access to satellite's capabilities. According to the Delhi High Court, such payments for the provision of transmission services could qualify as royalties, since unlike what was claimed by the Indian tax authorities "AsiaSat" did not provide the use of a "process" to its clients.[521]

Insightfully, the court of law reached this decision by carefully analysing the role played by "AsiaSat" in the entirety of the transmission operations, stating that the central question when faced with such agreements is whether the payments made by the clients entitle them to use, operate and fully control the satellites belonging to "AsiaSat". After reviewing their findings, the court officials ended up concluding that it did not, as the clients never had real control or possession over the equipment.[522]

In reality, such position is neither novel nor unexpected, as the OECD Committee on Fiscal Affairs had already defended that these operations, normally referred to as "transponder leasing agreements", were out of the scope of the concept of royalties, as defined in Article 12 (2) of the Model Tax Convention.[523] For such experts, despite the deceitful use of the expression "lease" in some agreements, whenever a customer does not acquire the physical possession of the transponder, but only its transmission capacity, the payments made by the customers are in consideration of services to be rendered and, as such, must be viewed as business profits which will be only taxable by the residence state (Article 7 of the Model Tax Convention).[524]

Notwithstanding, it is worth pointing out that the abovementioned decision was not agreeable to all parties, since in the wake of this

judgement, legislative changes to the Indian Income Tax Act were swiftly enacted[525] to extend the scope of the concept of "royalty" for tax purposes. According to these new interventions, the term "process" in respect to royalty income sourced in India, will henceforth include and shall be deemed to have always included the transmission by a satellite, irrespective of the fact that possession, control or direct use of such equipment remains with the owner and regardless of the fact that the satellite is not located in the Indian territory.

Afterwards, pertaining to the practical reach of these legal alterations, it is equally interesting to see that the Delhi High Court – through the case *Director of Income Tax vs New Skies Satellite BV*[526] – clarified that these unilateral amendments, enacted to the Indian Income Tax Act, cannot supersede the position expressed in the OECD Commentary to the Model Tax Convention, as defended in the "AsiaSat" case law, without an alteration to the provisions of India's current tax treaties. For the court of law, in case of direct conflict between internal statutes and international tax law the latter must subsist, particularly holding to the fact that under Article 39 of the Vienna Convention[527], a treaty may only be amended by mutual agreement.

Considering the above, and how tenuous the links between the satellites and the source country are in these "transponder leasing agreements" (i.e., transmission footprint), the dispute might seem nonsensical and solely caused by the desire to increase tax revenues. However, the motivation for the dispute can be better comprehended in the light of the ongoing struggles by developing nations to convince the international community to adopt a tax allocation mantra that is more aligned with the creation of value at source.[528]

Truthfully, although the value creation debate is normally viewed as a challenge of the digital economy, the fact is that the space economy, especially in what concerns the satellite subsector, may constitute an even more adequate breeding ground for the value creation principle to flourish. In fact, some commentators (Cano, 2019, pp. 1-3) are already pointing out that many of the challenges therein seem to be a magnification of current international tax issues presented by the digital economy and new tax demands by source countries are expected in the near future.

As an intermediate set of conclusions in what regards to the taxation of activities involving the international management of satellites, one should

note that (i) it seems unlikely for a satellite-based PE to form, either due to geostationary orbit being considered by many States a sovereignless domain or because its transmission footprint is insufficient to justify a business activity within the other contracting state; (ii) payments made against the use of the satellite's transponder capacity cannot be considered royalties whenever the buyer lacks relevant control of the equipment, unless a special provision is added to the tax treaties and (iii) as the space economy exponentially grows, developing countries might be tempted to push for tax solutions based on a value rationale, much like their claims for the digital economy.

Space Tourism: from trips to a jurisdictional void to other accessory hurdles

Before anything else, we must note that the term "space tourism" is often used to describe a myriad of different activities directly or indirectly related to space, not all of them necessarily developed in the outer space domain.

In this context, one could look at different iterations of space tourism, from vertical rocket launches that reach immense altitudes to suborbital space flights or even longer space trips to the void of space, options for space tourism activities are enlarging by the minute. In itself, the business model of the space promoters is not so different from other touristic activities, as they tend to charge a premium fee for the rendering of a full package service, which involves transportation, pre-flight training, meals and accommodation, among other.

For the purpose of this article, in the interest of avoiding confusion, we shall assume a definition of space tourism that exclusively encompasses activities that involve "*flights of humans intended to enter outer space (a) at their own expense or that of another private person or entity, (b) conducted by private entities, or (c) both*" (Dunk, 2011, pp. 146).

From an internal tax perspective, at the present moment, these activities are being treated as normal corporate profits, linked to a certain national legal entity and thus, much like the commercial exploration of satellites, taxed based according to the worldwide income principle.

As for the international perspective, under Article 7 of the OECD Model Tax Convention, most business profits shall be taxable only in the state of residence of the company earning them, unless the enterprise carries its

business in the source state through a PE situated therein, in which case the profits that are attributable to the PE may be tax in that other state.

Even so, important exceptions to the PE principle have long been established for certain specific business sectors, for example the wording of Article 8 of the Model Tax Convention indirectly excludes the application of this general rule to business profits derived from the international transportation of goods or passengers, by creating a special regime in which the "[*p*]*rofits of an enterprise of a Contracting State* [*derived*] *from the operation of ships or aircraft in international traffic shall be taxable only in that State*".

The most common doubt, when viewing space activities through this particular lens, often arises with the possibility of integrating spacefaring vehicles in the concept of "aircraft", a problem deeply connected with the absence of an established line between space law and air law, a matter that as we explained gathers no international agreement among States.

According to Gaetan Zeyen[529], with who we tend to agree, since the term "aircraft" is not defined in the OECD Model Convention, it shall have the meaning that it holds, at a given time, under the law of the state applying the treaty and for the purposes of the taxes to which the convention applies, under Article 3 of the Model Tax Convention.

Indeed, as the aforementioned authors mention, the national legal definitions for the term "aircraft" are commonly not designed in a broad enough manner to allow their application to "spacecraft", as the intended purpose, mechanics and general characteristics of a vehicle meant to operate in each domain differ immensely at core.

For example, while outright copying the Chicago Convention[530], the Portuguese legal regime for the licensing of radioelectric equipment's aboard aircraft[531] defines the term "aircraft" as any machine that can derive support in earth's atmosphere from the reactions of the air, other than the reactions of the air against the earth's surface.

On the other hand, the recent Portuguese Space Activities Regime[532], defines "space object" as (i) an object launched or that is intended to be launched into space, namely earth's orbit or beyond or (ii) any vehicle that is destined to launch an object described in previous point or that is destined to return such object, even if operated without it, also designated as a launcher.

Nonetheless, according the explanations of the "Committee on the Peaceful Uses of Outer Space" (hereinafter "COPOUS"), the term

"spacecraft" should be understood to represent an object or vehicle "(…) *capable of moving in outer space (either orbital or suborbital) without any support from the air and should have a power source not dependent upon external oxygen*".[533]

Considering the above, one could argue that in the Portuguese case national lawmakers seem to have gone beyond the scope of the traditional definition of "spacecraft", expanding this concept to include certain elements that normally belong to the "air law" domain, for example by deeming support aircrafts integrated into air-to-space launching systems as "space objects", even if such aircraft are not capable of travelling without the support of air and make use of oxygen dependent power sources.

Unfortunately, such deviating examples might only help to further showcase that national lawmakers sometimes lack the proper conceptual rationale to aid them in establishing a distinction between "air law" and "space law". In this regard, in alignment with the previously mentioned author, we consider that the aforementioned "aerodynamic-lift theory" represents an objective proposal, one that by calculating the estimated altitude point above which an aircraft can no longer sustain its flight due to loss of density in the atmosphere should be universally acceptable, reverting us once again for the pressing need of an international consensus on the lower border of outer space.

As for the second most common doubt, according to the definition of "*international traffic*" (Article 3 of the Model Tax Convention), for a certain voyage to gain international status the undertaken journey must not be exclusively carried out within one state (Schwarz, 2020, pp. 291). More importantly, under the OECD Commentary to the Model Tax Convention[534], a ship or an aircraft shall be considered as being operated solely within a given state whenever the place of departure and the place of arrival are both located within that state.

In truth, this special rule seeks to guarantee that profits, derived by the operation of ships or aircrafts, in international traffic, are exclusively taxed in a single state. According to some commentators (Falcão, 2020, pp. 1065), the motives behind this special treatment originally stemmed from an antiquated notion, on the part of legislatures worldwide, that the extremely mobile nature of these activities would make allocating their income amongst several states a burdensome task, as their economic

allegiances would be naturally fragmented between a larger number of states when compared to usual businesses.

Without delay, one may detect a fundamental difference between your run-off-the-mill international traffic business model and space tourism, as the former tends to entail physical contact with a higher number of states by design. Thus, when considering the potential application of Article 8 of the Model Tax Convention to space touristic activities, one could argue that the teleological rationale that justifies the existence of this special tax rule is not currently met by most space voyages, as their main objective is to connect earth to space and not several territories belonging to multiple states.

Guided by this framework, but without relinquishing the support provided by the conclusions drawn in chapter two regarding the extension of tax jurisdiction into space, we shall comment on the expected international tax consequences for the most common touristic scenarios carried out in space.

In this setting, we shall approach such scenarios according to our previous breakdown of space voyages according to their primary destination (i.e., non-territorial, quasi-territorial, and territorial space tourism). For the sake of simplicity, in the present subsection we will focus mainly on the first two categories, since currently territorial space tourism holds little to no expression in the grand scheme of the industry, as most voyages either connect to the sovereignless void of space or to quasi-territorial realities present therein (e.g., International Space Station).

Currently, common industry procedures show us that non-territorial touristic voyages tend to launch from the territory of a certain state destined for their primary objective – reaching a high altitude in the void of space above said state – only to then return to the same state, to the point of departure or close by. Therefore, given that these constitute round trips that connect on a jurisdictional level to only one state, we must reaffirm our view that no DTT needs to apply to such scenarios since no real risk of international double taxation occurring exists and, as such, taxation shall essentially be ruled by decisions made at a national level.

Even so, in order to reach such conclusion, we actively recognize that our opinion is predicated on our views regarding the interpretation of outer space as the "*province of all mankind*". In this point, we tend to agree with those that defend that the true intention of the parties behind the Outer

Space Treaty was to create a legal framework that would allow for the nonexclusive exercise of activities in outer space, without any clear indication of the desire to establish a pluri-sovereign domain, requiring a common management system to be established among the states of the international community (Mallick & Rejagopalan, 2019, pp. 16 et seq).

For authors that may favour other approaches, namely by imagining outer space under the "*common heritage of mankind*" concept, it is possible that space tourism may be seen not so much as the development of an activity in a sovereignless void, but as the creation of a simultaneous connection to all earthly tax jurisdictions at once. Although we disagree with such ideas, the possibility of their resurgence at a unilateral level in a time of geopolitical tension should prompt states to reignite the discussion, in hopes of establishing a more robust legal and tax international framework for outer space.

In short, most space tourism voyages will be taxed at a national level, with such taxation being dependent on whatever objective or subjective requirements states elect to enforce (e.g., residence, place of effective management, etc.).[535] This, however, does not mean that space tourism constitutes an exclusively domestic activity, since trips by tourists alongside essential personnel to quasi-territorial realities (e.g., International Space Station) have already been successfully executed and more are being planned for the near future.[536]

As such, when faced with touristic activities that involve the transport of passengers to and from orbiting space stations, one could rightfully wonder if the concept of "*international traffic*" would be met in cases where the space object, regarded as the destination, and the place of departure belong to the jurisdiction of different states.

In our view, granted that such nations are bound to the wording of Article VII of the Outer Space Treaty, the registry state of the space object (i.e., space station) shall be treated as an extension of the State of source, since the activity is partially or fully carried out aboard. Meanwhile, the process of determining the State of residence of the entity shall remain dependent upon the application of national criteria, in accordance with Article 4 (1) of the Model Tax Convention.

Moreover, one can claim the same outcome to be true for the inverse situation: whenever a spacecraft is launched from an aircraft mid-flight (air-to-space launch system), with the purpose of achieving an outer space

station registered to an entirely different country from the residence state of the company or from the launching state. As an example, imagine that a space tourism company, tax resident in State A, owns a spacecraft and an air-to-space launching craft, both registered in State A, resorting to such equipment the company routinely launches paying customers to a space station, registered in State C, with such launches occurring mid-flight over the territorial waters of State D.

Under the current legal landscape, it may be possible to qualify these operations as "international traffic", at least in the specific cases where national rules define "aircraft" in a broad enough manner. Thus, we would be forced to allocate the right to tax solely to the state of residence of the company (State A), in order to comply with Article 8 of the Model Tax Convention.[537]

Given the above, it is clear to see that current space technologies have the capacity to create very complex situations from an international tax perspective. For the states left with curtailed taxing rights, such outcomes might indeed be a throwback to the questions raised by the digital economy, primarily due to the natural imbalance of the international tax system towards the allocation of tax revenue to residency states.

In fact, no one can deny similitudes between the topics, as in both cases source countries will be (i) facing large multinational companies, (ii) which are deriving essential degrees of value from their society to be able to conduct their business models and (iii) that by the use of modern technologies end up paying taxes exclusively to the residency state, all under the rules of the Model Tax Convention.

As an intermediary conclusion, we would like to point out that the application of international tax law to space touristic activities, namely in what concerns to the special regime of the Article 8 of the Model Tax Convention, appears to be possible under certain conditions. Notwithstanding, not only is the execution of the current regime dependant on national legislators bridging the gap between the concepts of "aircraft" and "spacecraft", it also seems likely that as the industry evolves source countries will once again voice complains about the hegemony of the tax powers bestowed upon residency states.

Furthermore, in agreement with the concerns raised by Galya Savir[538], it is already clear that the discomfort for launching states will be particularly noticeable. Since, from an international tax perspective, they will have to

stand down and allow the transfer of their taxing rights to the residency states, but under international law such launching states, now under the status of registry states, will continue to be liable for any damages caused by those space objects on the earth's surface or on other aircraft. A precarious position and a dubious trade-off for launching states, that are also expected to deal with the environmental consequences of the launches such as ozone depletion, climate change, ecosystem toxicity, among others.[539]

Looking back to the abovementioned example, one cannot fathom why a residency-based exclusive allocation would be agreeable for the state of source (State C) and for the state of launch (State D), particularly when you factor in both the growing concerns about the negative externalities caused by spacecraft launches[540] and the fact that the impacted States could not have foreseen the economic importance of this sector upon the original negotiation of the tax treaties.

As the future unfolds, the international community should also be vigilant of new tax engineering risks that might arise during the development of this new frontier, constant labour to prevent such outcome is as essential in this field as in other sectors. In this setting, the abovementioned author is particularly insightful in reminding legislators that space transportation is a good opportunity to start from a blank page, creating early on measures that tackle ancient problems posed by the naval and air commercial transportation landscape.[541]

In fact, among many others, we would like to echo the concern for the potential increase of a practice known as "flag of convenience", a strategy that involves the careful selection of the state of registration based on favourable legal and tax regimes. This practice mainly depends on the inherent interdependency between the state of registry of the vessel and the issuing attraction of its legal jurisdiction, a trait plainly identifiable in international space law and that will no doubt fuel the risk for cherry-picking practices by space commercial operators, a vector that may give rise to base erosion and profit shifting.

Space Employment: from lessons learnt to new questions to be uncovered

In view of the above, it is only logical that the expansion of the space industry will heavily depend on a select, highly skilled and well-trained workforce, such workers will not only be responsible for research teams

achieving their primary objectives of the missions, but shall also have guarantee the safety and well-being of the accompanying space tourists.

Just recently, the National Aeronautics and Space Administration (hereinafter "NASA") released a notice indicating that upcoming private astronaut missions must always include a former flown NASA (U.S.) government astronaut, as the mission commander, to provide experienced guidance and training, from pre-flight preparation to mission execution.[542]

Considering the expected functions attributed to these private astronauts, the employment income generated by their pledge to work will be fairly similar to the one earned in other jobs performed at ground level, particularly assuming that the rendering of the work shall be supported on employment agreements.

From an international tax perspective, pursuant to Article 15 (1) of the Model Tax Convention, employment income shall be taxable only in the state of residence, unless the employment activities are rendered in the other contracting state, thus creating a sufficient link to merit the allocation to the source state of concurring tax rights. However, any remuneration derived from employment as a member of the regular complement of a ship or aircraft, engaged in international traffic, shall be taxable only in the state of residence of the employee, unless such ship or aircraft is operated solely within the other contracting state, according to Article 15 (3) of the Model Tax Convention.

Consequently, when dealing with cross-border operations such as quasi-territorial trips to space stations, it is generally expected that employment income earned by any crew member, for the entirety of the voyage, shall be taxable in the state of residence of the employee, an understandable rule as it simplifies the allocation of taxing rights among the states concerned.

Nevertheless, some commentators have underlined that international taxation of space employment income might not always have an unambiguous solution (Zeyen, 2022, pp. 22-23). In this regard, one must single out the conclusions reached by the United States tax courts in the decision known as *LeTourneau*[543], in which a flight attendant, resident in France, claimed a foreign earned income tax exclusion, based on the time spent working inside an airplane travelling over international waters.

Noteworthy, from the court's analysis, is the fact that although the decision actively recognizes that international airspace, like international waters, is not under the sovereignty of any government the petitioner's

claim was still denied, based on the fact that the exclusion can only apply to wages earned due to work rendered in (or over) "foreign countries", a concept understood to represent territories that are subject to the sovereignty of a government other than that of the United States.[544]

Within this frame of reference, now applied to outer space employment income, the abovementioned authors have posed interesting questions on whether such income, earned for example by astronauts working for months at a time in space stations[545], can be considered "stateless" for tax purposes and, if so, are we always limited to an allocation of taxing rights to the state of residence as the sole solution.

Regarding the first point, taking into account the conclusions achieved during the course of this paper, the claim that the majority of the income derived by space employees might be "stateless" cannot be upheld under the current legal landscape. From our perspective, this conclusion is a direct consequence of the systematic application of the Outer Space Treaty in conjunction with the provisions of the applicable tax treaties, as the former constitutes an important piece of context to the latter.

Thus, given that states are able to retain "*jurisdiction and control*" over registered objects sent to outer space, under Article VIII of the Outer Space Treaty, governments must be able to ascertain quasi-territorial tax jurisdiction over such realities, as this rule is a known exception to the non-appropriation principle. Although permanent, unbound and immovable sovereignty links cannot be established in outer space, to interpret such rule in a way that supports a scenario in which states would not be able to exert their legitimate public powers over mobile realities (e.g., spacecraft, space stations, etc.), while simultaneously making such states fully liable to the damages caused thereof by such objects, would be going too far beyond the scope of international law.

In our perspective, sovereignty bonds in outer space are not connected to any patch of earth, molecule of water or volume of air, but they may be connected to a space object itself, thus creating a temporary, mobile and limited jurisdictional capsule, inside which States retain their sovereignty, their rule of law and their control, even for tax purposes.

Therefore, in our view, the primary jurisdictional boundaries in outer space shall be located in the airlocks and other systems that grant astronauts access to the space void outside the craft. Thus, although some apportionment of income to outer space might be possible in regards to

spacewalks and related operations, its global irrelevance to the total time spent in outer space should stifle concerns regarding "stateless" space income.

Nonetheless, given the absence of space related rules in current tax treaties and favouring the promotion of increased legal certainty within the international community, it's our opinion that States would do well to integrate provisions in modern tax treaties that recognize such quasi-territorial space exceptions, as it would go long way to ensuring that future non-taxation scenarios or allocation conflicts do not come to pass.

Truthfully, by essentially granting tax jurisdiction over the spacecraft to the registry state, the important matter will be to decide if the remuneration of such activities falls under the category of income earned by aircrews (Article 15 (3) of the Model Tax Convention) or if the taxation of such income is exclusively under the reach of national rules.

As we made abundantly clear in the previous section, the performance of activities related to "international traffic" shall be key that enables the application of the first mentioned rule, but its identification shall depend on a careful case-by-case analysis of the facts, namely by looking at the place of departure and at the primary destination of the mission.

Therefore, in cases where the space voyage is territorial or quasi-territorial in nature (e.g., foreign space stations), we expect Article 15 (3) of the Model Tax Convention to take the lead due to the fact there is a viable link that justifies the existence of "international traffic" between two different states. Moreover, in cases where the space voyage is non-territorial (e.g., round trips to orbit) the issue is non-international for lack of a substantial connection between more than one contracting state, although taxation according to residency (worldwide income principle) will depend on the provisions of national tax law, which are known to favour such link for tax purposes.[546]

In this specific context, negative comments can be raised against the fact that this framework allows for an astronaut to depart from the territory of a certain state, to work aboard a space station registered in the same state, only to return to the same location months (or soon maybe years) later, without ever triggering the "international traffic" clause.

Although, to some degree, one might question the merits of the solution as a tax policy altogether (e.g., since it may create difficulties in apportioning income to individual states in federalist regimes with different

tax rates), the systemic coherence of international law showcases that the international community wanted states to preserve their jurisdictional status quo over launched "space objects", under the Outer Space Treaty, regardless of the consequences.

In realistic terms, we may conclude that the likelihood that space employment income will become "stateless" in the near future are fairly limited, particularly when we consider that space is quite a hostile environment and that our current ability to survive in such domain, without the assistance from a nearby spacecraft, is microscopic at best.

Finally, addressing the robustness of the international tax framework for space employment, it is worth underlining that, at the moment, there seems to be an overreliance on the exclusive allocation of taxing rights to the state of residence of the employee. As some have already pointed out[547], we are now at a point where it is realistic for individuals to cease to be resident in any state when they go to work in outer space, thus enabling the avoidance of personal income tax over their earnings all together.

Bearing this in mind, we would argue that *de lege ferenda* the conclusions drawn during our analysis offer sufficient foundational support to allow for the creation of a source taxation system directed at private astronauts, based on the development of their activities in quasi-territorial realities. In any case, source taxation will always depend on states enacting, on common accord, the necessary alterations to the current treaty model rules, no doubt a pressing concern to be pondered during the negotiation or renegotiation of tax treaties.

3.3. Future space endeavours – "How far will we tax?"

Private Space Stations: from multilateral cooperation to the concept of "modular" jurisdiction

For over two decades, the International Space Station was not only the main symbol of cooperation among the most relevant spacefaring nations in the world, but also a clear reminder that the launch and management of outer space stations was firmly in the grasp of state agencies and governments.

But, as reports begin to appear sentencing the station to retirement within the next decade, the public dominance over space station endeavours seems to be shifting into the hands of the private sector, with

several companies already preparing to launch four different space stations in the upcoming years.[548]

In this context, despite the fact that details on the expected managerial agreements of these new realities are not yet known, we shall attempt to analyse the probable international tax consequences by using two prospective models of private space stations: (i) single country stations, where only companies of one state are responsible for developing and exploring the space station and (ii) collaborative stations, meaning projects that entail multilateral cooperation between companies from different states.

As such, in regards to the exploration of single country stations, the expected jurisdictional framework will inevitably be quasi-territorial in nature, with activities being developed from the space station amounting to activities comparable to the ones located in the territory of the state of registration. Therefore, as we explained before, the state of registration of the space station shall be perceived as the source of such the income, in similar fashion to the situations addressed before.

Obviously, under this specific framework, new possibilities in the field of international space taxation may arise. Indeed, as enterprises start to develop their business activities aboard new predicament like the triggering of permanent establishments ("Space Station PE") might appear, particularly whenever economic activities are permanently being developed from the confines of a station registered with another contracting state.

Furthermore, standing as a great example of the interconnectivity between different systems of international law, collaborative space stations may also pose interesting tax challenges in the near future, from both the perspective of international space law and international tax law. At present moment, with the first fully private stations still under construction earth-side, we are forced to take lessons from the exercise of other public powers in known similar models, the prime example of them all being the International Space Station Intergovernmental Agreement[549] (hereinafter "IGA").

In this perspective, considering the similarities between tax law and criminal law, namely as branches of public law, we find it useful to integrate into our analysis the conclusions undertaken by criminal space law studies conducted into these matters. Surely, an attempt to establish common

denominators between criminal law and taxation in this new dimension is not farfetched, as both fields seek to regulate the exercise by the state of coercive powers to some degree in the pursuit of the common good, as per the social contract.[550]

As we discussed before, the default rule regarding space objects is that jurisdiction and control powers over them remain with the state of registry (Article VIII Outer Space Treaty). However, given the unique and unprecedented nature of the International Space Station project, States decided by conventional agreement that criminal jurisdiction in the station shall be primarily exercised by the state of nationality, pursuant to Article 22 of the IGA.

According to specific literature on the topic (Chatzipanagiotis, 2014, pp. 6-7), one of the most important reasons for the deviation from the norm pertains to the collaborative nature of the International Space Station, coupled with the fact that registry States still desired to maintain some form of jurisdiction over the different modules that form the final overall structure. Therefore, adopting a (quasi) territoriality principle would result in a jurisdictional chaos if a criminal offense was committed on board, since it would be nearly impossible to determine the applicable national law.[551]

From this framework, the international tax community may take several lessons, among the most important ones we can point to is the importance of establishing allocation clauses in all international treaties concerning collaborative space stations, public or private, since current DTTs were not built as multilateral instruments. Inevitably, since bilateral tax treaties are unable to bind more than two states, the application of the DTTs themselves will depend on a casuistic analysis to determine in which module the relevant activity took place, leading to unfathomable uncertainty.

In addition, giving the current international space law context, states should be aware that a prolonged omissive attitude on their part has the potential to fraction the application of the DTTs according to economic relations being established between the different constituent modules of the space object. Thus, without the creation of specific provisions, current international rules might give rise to chaotic new realities that, for the lack of a better term, may be seen as a type of “modular tax jurisdiction” free-

for-all, that will become inevitable in the next few years once the newly announced private space stations become operational.

Henceforth, as an intermediary conclusion, giving that the expected evolution of the space sector is likely to increase the complexity of space operations, it is highly unlikely that the current international tax framework will be able to provide the adequate level of support to states wishing to levy taxation over such realities. In fact, the only way for States to ensure they properly reap their share of the economic benefits created by space exploration is to act sooner rather than later and create specific, robust and broadly negotiated international tax legislation.

4. Conclusion

In general terms, as demonstrated throughout our analysis, it is clear that the application of international tax rules, including the allocation of the right to tax, should be heavily influenced by the established principles of international space law. Undoubtedly, due to the specific nature of international space law, the transformations imposed by it onto international tax law create an entirely new playing field, with rules of its own.

Among them, brought forth by the workings of the Non-Appropriation Principle, the quasi-territorial jurisdictional effect imposed by international space law stands out, since from its intersection with other more established principles of international tax law, such as the Residence and Source Principle, one may envision new dimensions to old problems.

In reality, such merger between international space and tax principles might actually aid countries in establishing commonly agreeable new divides in space, enlarging the horizon for what might constitute an income's source in this new frontier, in what we call the quasi-territorial source theory.

Such idea constitutes an extension of the Source Principle, in the sense that a Registry State's tax jurisdiction should be recognized as attached to the confines of any space object, to the point that it ("the object") may be considered as the source platform or "situs" for the income derived within.

In the course of our study, we have found that this alternative perspective has the potential to be incredibly crucial to both current and future space endeavours, particularly in regards to space tourism trips, space

employment and the prospective exploration of private space stations, expected to start in the near future.

Overall, as a potential solution to the allocation of international taxing rights in space, the quasi-territorial source theory presents the undeniable advantage of building over a pre-existing structured international system of rules, hailing from previously signed treaties and, thus, constituting a more immediate, stable and believable compromise to garner approval amongst the nations of the international community.

In this context, reverting back to our initial objectives, one can say that modern international tax rules seem to be ill-prepared to face all of the current challenges posed by the outer space economy, as their application presents little more than a frail mending of an in-world operating system, needing for an update.

On the other hand, regarding our prospective analysis into the international tax regime of the innovative business models, one must admit that the modern international tax regime appears oblivious to the dangers in the horizon, at best. In truth, it is more than likely that old grievances will fester in this domain, particularly in what concerns complaints by the source states, be them the hosts of the launching points or the managers of quasi-territorial realities in outer space, since in all cases they might end up bearing the bulk of the environmental, infrastructural and social costs connected with the expansion of the space economy.

Truthfully, although such unrest between the interests of residence and source states is not new in the international tax order, it is our opinion that the outer space domain needs to be treated as a special case due its particular characteristics. Namely, the fact that the further development of the space economy shall be dependent on anchor-type quasi-territorial realities, that present little interjurisdictional mobility and, thus, may be used to attain a more agreeable middle ground allocation of tax resources, that is even in line with value creation ideals.

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480. See Svec, M. (2022), "Outer Space, an Area Recognised as Res Communis Omnium: Limits of National Space Mining Law", Space Policy n. ° 60, pp. 2-3. For the translation from latin, see Fellmeth, A. (2009), "Guide to Latin in International Law", Oxford University Press.
481. See Noyes, J. (2011), "The Common Heritage of Mankind: Past, Present, and Future", Denver Journal of International Law & Policy, Vol. 40, n. ° 1, pp. 449, particularly when stating that "[s]*tates and commentators have promoted the CH Principle as applying particularly to areas beyond the limits of national jurisdiction and to the natural resources found there*" (e.g., sea-bed, ocean floor and the subsoil thereof).
482. See Cheng, B. (1997), "The Legal Regime of Airspace and Outer Space: The Boundary Problem, Functionalism Versus Spatialism: The Major Premises", in Studies in International Space Law, pp. 425-436 describing the heritage-of-mankind concept as "*(…) the idea that the management, exploitation and distribution of the natural resources of [a particular outer space] area (…) are matters to be*

decided by the international community (…) and are not to be left to the initiative and discretion of individual States or their nationals".

483. See Article 11 of the Moon Agreement, namely when affirming that "[*t*]*he moon and its natural resources are the common heritage of mankind, which finds its expression in the provisions of this Agreement (…)*" and "States Parties to this Agreement hereby undertake to establish an international regime, including appropriate procedures, to govern the exploitation of the natural resources of the moon (…)".

484. See Article VI of the Outer Space Treaty, particularly the prohibition of the use of space for military purposes. See also M. Lachs, 2010, "The Law of Outer Space: An Experience in Contemporary Law-Making", Reissued on the Occasion of the 50th Anniversary of the International Institute of Space law), pp. 122.

485. Such conclusion, seems to be in accordance with the Preamble of the Outer Space Treaty, namely when it "*[reaffirms] the importance of international cooperation in the field of activities in the peaceful exploration and use of outer space (…) and the importance of developing the rule of law in this new area of human endeavour*".

486. On the interesting discussion of whether the "*general presumption in favour of freedom of action*" by states in the international order may be applied to Outer Space, following the PCIJ case "*The SS 'Lotus' case"*, France v. Turkey, Ser. A No. 10 (1927), see Jakhu, R. (2006), "Legal Issues Relating to the Global Public Interest in Outer Space", Journal of Space Law, Vol. 32, pp. 41 and Brownlie, I. (2003) "Principles of Public International Law", Oxford Univ. Press, pp. 301.

487. See Ansong, A. (2016), "The concept of sovereign equality of states in international law", pp 25. See also Nincic, D. (1970), "The Problem of Sovereignty in the Charter and in the Practice of the United Nations", Martinus Nijhoff Publishers, pp. 37.

488. See Article 32.º of the Vienna Convention on the Law of Treaties, adopted on 22nd of May 1969.

489. See Report of the Legal Subcommittee of COPOUS, from its fifty-eighth session, held in Vienna in April 2019, pp. 16 and 17.

490. See Jakhu, R. (2006), "Legal Issues Relating to the Global Public Interest in Outer Space", Journal of Space Law, Vol. 32, pp. 93.

491. See Gaëtan, Z. (2022), "Taxation of outer space income resulting from air transport or employment activities", CIDEFF – Centre for Research in European, Economic, Fiscal and Tax Law, pp. 18-20. For more information on a different proposal, known as the Karman Line, usually set at 100 km of altitude, see McDowell, J. C. (2018), "The edge of space: Revisiting the Karman Line", Acta Astronautica, Vol. 151, pp. 668-677.

492. See Webb, R. (2016), "Is It Worth It? The Economics of Reusable Space Transportation", CORE | NASA Technical Reports Server Publication, pp. 19.

493. See Knoeller, H. (1938), "The Power to Tax", Marquette Law Review, Vol. 22, Issue 3, pp. 134.

494. See Scholte, J. (2000), "Globalization: A critical introduction", Second Edition, pp. 188 et seq.

495. See Trachtman, J. (2006), "Welcome to Cosmopolis, World of Boundless Opportunity", Cornell International Law Journal, Vol. 39, Issue 3, pp. 479.

496. See Christians, A. (2009), "Sovereignty, Taxation and Social Contract", Minnesota Journal of International Law n. º 245, pp. 107-108.

497. See Kaufman, N. (1997), "Fairness and the Taxation of International Income", Law and Policy in International Business n. º 29, pp. 148-149.

498. The State of registry of a space object, in compliance with the wording of Article II of the (1976) Registration Convention, shall correspond to the State responsible for the launching of such object into earth's orbit or beyond, with the treaty imposing not only that such State maintain a

record of the launch but that it also must inform the Secretary-General of the United Nations on the contents of such registry.

499. See Svec, M. (2020), "Outer Space, as Area Recognised as *Res Communis Omnium*: Limits of National Space Mining Law", Space Policy n. º 60, pp. 2.

500. See Marchisio, S. (2010), "National jurisdiction for regulating space activities of governmental and non-governmental entities", in UN / Thailand Workshop on Space Law - "Activities of states in outer space in light of new developments: meeting international responsibilities and establishing national legal and policy frameworks", pp. 2-3.

501. See OECD (2017), "Commentary on Article 15", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, pp. 321, especially the part stating that "*Paragraph 3 applies to the remuneration of crews of ships and aircraft operated in international traffic and provides that such remuneration shall be taxable only in the State of residence of the employee*".

502. Often, clauses fully describing the extension of the territory of each contracting state are added, during the course of the negotiations, into the definitions article of double tax treaties, see Schwartz, J. (2021), "Schwarz on Tax Treaties", Sixth Edition, Wolters Kluwer, pp. 159-161.

503. See Riordan, D. (2004), "The Challenge of Taxing Business in Outer Space", Challenge Journal, Vol. 47, n. º 6, pp. 112.

504. See Song, Z., Xie, Z., Qiu, L., Xiang, D. and LI, J. (2020), "Prospects of sea launches for Chinese cryogenic liquid-fuelled medium-lift launch vehicles", Chinese Journal of Aeronautics n. º 34 (1), pp. 424-425.

505. See Clarke, J., Cerven, K., March, J., Olszewski, M., Wheaton, B., Williams, M., Yu, J., Selig, M., Loth, E. and Burton, R. (2015), "Conceptual Design of a Supersonic Air-launch System", AIAA/ASME/SAE/ASEE Joint Propulsion Conference Papers, pp. 2-3.

506. See Wood, Therese (2020), "Visualizing All of Earth's Satellites: Who Owns Our Orbit?", Visual Capitalist, October, pp. 2-3.

507. For more on the US perspective, see Andrews III, William Lee (2000), "Targeted Tax Relief for Space Commerce", Journal of International Taxation, pp. 12-13.

508. See OECD (2010), "Commentary on Article 5", in Model Tax Convention on Income and on Capital: Condensed Version 2010, OECD Publishing, pp. 95.

509. Usually defined as "*the band of space in which satellites circle the earth at a speed equal to its rotation, and appear to hang motionless above a fixed point on the earth's surface*", see Brital, F. (1979), "Geostationary Orbit", in Proceedings of the twenty-first colloquium on the law of outer space, pp. 10. See also Britannica, The Editors of Encyclopaedia. "*geostationary orbit*", in Encyclopaedia Britannica, "*a circular orbit 35,785 km (22,236 miles) above Earth's Equator in which a satellite's orbital period is equal to Earth's rotation period of 23 hours and 56 minutes*".

510. See OECD (2017), "Commentary on Article 5", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, pp. 122.

511. See the "Declaration of The First Meeting of Equatorial Countries", also known as the "Bogota Declaration", signed on the 3rd December 1976, by the head of the delegations of Brazil, Colombia, Congo, Ecuador, Indonesia, Kenya, Uganda and Zaire.

512. See Sheraga, J. (1987), "Establishing Property Rights in Outer Space", Cato Journal, Vol. 6, n. º 3, pp. 897.

513. See Agama, F. (2017), "Effects of the Bogota Declaration on the legal status of geostationary orbit in international space law", Nnamdi Azikiwe University Journal of International Law and Jurisprudence, Vol. 8, n. º 1, pp. 28-29. See also Arnopoulos, P. (1982), "The International Politics of the Orbit-Spectrum Issue", Annals of Air and Space Law, Vol. 7, pp. 219-220.

514. See *Communications Satellite Corporation v. Franchise Tax Board*, (n. º A016317), Court of Appeals of California, rendered on the 31st of May 1984.

515. See Schwartz, J. (2019), "Taxation of Space: the final frontier", Kluwer International Tax Blog, pp. 2.
516. See *Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax*, (ITA n. º 131 and 134 of 2003), Delhi High Court, rendered on the 31st January 2011.
517. See Codding Jr., G. (1995), "The International Telecommunications Union: 130 years of telecommunications regulation", Denver Journal of International Law & Policy, Vol. 23, n. º 3, pp. 504 et seq.
518. See *Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax*, (ITA n. º 131 and 134 of 2003), Delhi High Court, rendered on the 31st January 2011, para. 59.
519. See *Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax*, (ITA n. º 131 and 134 of 2003), Delhi High Court, rendered on the 31st January 2011, para. 33, particularly when the court state that "*[e]ven the Tracking, Telemetering and Control (TTC) operations are also perform outside India (…) [n]o man, material or machinery or any combination thereof is used by the appellant in the Indian territory*".
520. See Schwartz, J. (2021), "Schwarz on Tax Treaties", Sixth Edition, Wolters Kluwer, pp. 220-221, particularly when stating that for a PE to arise "*(…) there must be a place of business, normally premises, at the disposal of the enterprise, although it can, in certain circumstances be machinery or equipment*".
521. In this regard, please note that the court's judgement was cast based on a provision of the Indian Income Tax Act (section 9 (1) (vi) explanation 2) that, at the time, partially defined the term "royalty" in a similar manner to Article 12 (2) of the OECD Model Tax Convention (2017), namely as a consideration for "(…) *the use of any patent, invention, model, design, secret formula or process or trade mark or similar property*".
522. See Vogel, K. (2022), "Klaus Vogel on Double Taxation Conventions", Wolters Kluwer, pp. 1654, particularly when stating that "(…) *in most cases, only transmission capacity is rented out, while the satellite as a whole stays in the control of its owner.* (…) *The owner of the satellite just uses it to perform a service to the payer (i.e., the provision of transmission capacity)*".
523. See OECD (2017), "Commentary on Article 12", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, pp. 276.
524. For a similar decision, see *PT Cyberindo Aditama v. Direktur Jenderal Pajak* (Case PUT-27005/PP/M.X/13/2010), Indonesian Tax Court, 8 November 2011, stating that the leasing of the internet bandwidth of a satellite does not give rise to royalties, but only to business profits taxable at source, since no PE could be established. For more information, see Schwartz, J. (2021), "Schwarz on Tax Treaties", Sixth Edition, Wolters Kluwer, pp. 331-332.
525. See section 9 (1), subsection (vi), explanation 2, 4, 5 and 6 of the Indian Income Tax Act, first introduced into law by the Finance Act of 2012.
526. See *Director of Income Tax vs New Skies Satellite BV*, (ITA 473/2012, 474/2012, 500/2012 and 244/2014), Delhi High Court, rendered on the 8th February 2016.
527. See the Vienna Convention on the Law of Treaties, entered into force on the 27th of January 1980, United Nations, Treaty Series, vol. 1155, p. 331 et seq.
528. See Hay, J. (2018), "Taxation where value is created and the OECD/G20 Base Erosion and Profit Shifting initiative", Bulletin for International Taxation, April/May, pp. 203-208.
529. See Zeyen, G. (2022), "Taxation of outer space income resulting from air transport or employment activities", The Lisbon International & European Tax Law Seminars, n. º 1 /2022, pp. 18-21.
530. See Convention on International Civil Aviation (Annex 7), signed on the 7th December 1944, by 52 states and waiting on pending ratification by 26 others.
531. See Article 3 (1), subsection a), Decree n. º 50/2014, published on the 31st of March.

532. See Decree n. º 16/2019, enacted on the 22nd of January, which establishes the legal regime of access and exploration of space activities.
533. See Report of the Legal Subcommittee of COPOUS, from its fifty-seven session, held in Vienna in April 2018, pp. 17 et seq.
534. See OECD (2017), "Commentary on Article 3", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, pp. 95-96.
535. See Schwartz, J. (2019), "Taxation of Space: the final frontier", Kluwer International Tax Blog, pp. 3 et seq.
536. See Dunn, M. (2022), "Rich trio back on Earth after charter trip to space station", ABC News, available at www.abcnews.go.com, pp. 2 et seq.
537. See OECD (2017), "Commentary on Article 8", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, pp. 219. However, it is noted that, until a new survey was performed during the 2017 reform, most states favoured the allocation of tax rights according to the place of effective management and some may still prefer to maintain such formulation in their tax treaties.
538. See Savir, G. (2016), "Tax Infinity & Beyond", SSRN Electronic Journal, pp. 78-79.
539. See Dallas, J. et al. (2020), "The environmental impact of emissions from space launches: A comprehensive review", Journal of Cleaner Production, 255, pp. 1-12.
540. See Ross, M. and Toohey, D. (2019), "The Coming Surge of Rocket Emissions", Eos, Issue 100, pp. 3 et seq. See Maloney, C. et al. (2022), "The climate and ozone impacts of black carbon emissions from global rocket launches", Journal of Geophysical Research: Atmospheres, Issue 127, pp. 1-17. See Ross, M. and Jones, K. (2022), "Implications of a growing space flight industry: Climate Change", Journal of Space Safety Engineering, pp. 1-9.
541. See Savir, G. (2016), "Tax Infinity & Beyond", SSRN Electronic Journal, pp. 82-83.
542. See NASA notice ID n. º 80JSC022PAMINFORMATION, issued on the 1st of August 2022.
543. See Letourneau v. Commissioner of Internal Revenue, case n. º 13457-09, US District Court for the Middle District of Florida, 21st February 2012.
544. See Rogers v. Commissioner of Internal Revenue, case n. º 13261-11, US Tax Court, 13th March 2013.
545. See Finch, J. et al. (2022), "Record-Setting NASA Astronaut, Crewmates Return from Space Station", NASA Press Release, 30th March 2022, available at www.nasa.gov, pp. 1-3.
546. See Elkins, D (2021), "A scalar conception of tax residence for individuals", Virginia Tax Review, Vol. 41, pp. 6 et seq.
547. See Schwartz, J. (2019), "Taxation of Space: the final frontier", Kluwer International Tax Blog, pp. 3.
548. See Kluger, J. (2022), "The age of the private space station is upon us", Time Magazine, available at www.time.com , pp. 3.
549. See the International Space Station Intergovernmental Agreement, signed on 29 January 1998, by fifteen governments involved in the space station project.
550. See Jordan, B. (2003), "Criminal justice, social exclusion and the social contract", Probation Journal, Vol. 50, Issue 3, pp. 198-199.
551. See Sinha, H (2004), "Criminal jurisdiction on the International Space Station", Journal of Space Law, n. º 30, pp. 90 et seq.

PART 3:

TAX, TECH & DIGITAL ECONOMY, SOCIETY AND PERSONALITY

How the world is and still is progressively and rapidly becoming

CHAPTER 11 – ZOOMING OUT - WHY DO WE NEED TO TAX THE DIGITAL ECONOMY

José Miguel Anjos, João Gabriel Gonçalves and Francisco Dias

1. Introduction

The fast increase of technological progress from the late 80s up today led to significant changes in the global economy, especially in what concerns to the trade of goods and services. Unlike the "traditional" economy, in which goods and services transacted mostly relied on physical elements (*e.g.*, tangible assets, effective provision of services based on human-factor rather than technology and physical means of payment), the current economy, driven by the technological progress, is mostly focused on intangible features, networks and volatility.

As duly pointed out by OECD, "*Ubiquitous digital devices, connectivity and "smart" technology are bringing significant changes that are profoundly affecting relationships and markets. ICT has become part of the foundational infrastructure for business and society, evidenced in a heavy reliance on efficient and widely accessible online communication networks and services, data, software, and hardware*" (OECD 2018, paragraph 5).

In this respect, the World Bank estimates that the digital economy contributes to more than 15% of the global GDP and, since the past decade, it has been growing at two and a half times faster than the "physical economy" GDP[552] - for instance, the World Bank estimates that the digital transformation may lead to an increase of 46% on the GDP produced by Middle East and North African countries.[553] In addition, the organization foresees that by the end of 2022, 60% of the global GDP rely on communication technologies.

Considering the above, the digital economy is quickly becoming the economy itself, triggering new kinds of commerce and business models, opportunities and, consequently, challenges.

As further detailed, in general, modern tax systems rely on the "residence *vs source*" dichotomy to grant power of taxation to a specific jurisdiction. In

a nutshell, "*Sovereign states have, in principle, imposed taxes on the basis of the following two factors: (1) the connection of profit with a state's territory, i.e. the direct connecting factor or source; and/or (2) the connection of the beneficiary of the profit with the state's territory, i.e. the indirect connecting factor or residence*" (Valente 2018, page 2).

Linking the above idea solely to the specific features of the traditional (and physical) economy, no further challenges would emerge considering that (i) income categories foreseen in DTTs are pretty clear, even though OECD comments to the Model Tax Convention help to clarify some points with respect to income characterization and (ii) the OECD Model Tax Convention generally grants to the residence jurisdiction the exclusive right to tax in the vast majority of the cases, without prejudice to the limited power to tax granted to the source jurisdiction in specific categories of income (e.g., royalties, interest, dividends and capital gains derived and/or related with immovable properties).

With the advent of the digital economy, this *status-quo* has been challenged, mostly due to MNEs whose business is primarily tech-based and which income is mostly derived by operating in overseas markets, notably through e-commerce platforms or other networks. In this particular, even though such MNEs are headquartered on a specific jurisdiction, their income mostly derives from their "online presence" in markets across the globe, whose jurisdictions, under the aforementioned current international tax principles, may not be granted with a right to tax such income.

In this respect, article 7 of the OECD Model Tax Convention grants to the residence jurisdiction the exclusive right to tax business profits, with exception of those cases where a non-resident company has a PE in the source jurisdiction, but insofar that such business profits are allocated to that PE. As known, the tax PE concept mostly rely on the physical presence of a company in other jurisdiction, even though such presence may be physical or legal.[554]

From a theoretical perspective, the abovementioned framework leads to severe and negative impacts on tax fairness and equality. The presence in other jurisdiction of MNEs whose business mostly rely on physical elements (such as industry) may generally trigger a tax PE, unlike the digital and tech-MNEs – as described, the current PE concept, relying on physical elements, is inadequate to address the presence of tech and digital companies in other jurisdictions.

Besides the significant impact that the loss of revenue has for national GDPs, the social pressure is increasing. In addition to the tax inequality pointed out, national governments will be required to enhance their public expenditure in the upcoming years to increase social security systems in the post-pandemic and current Eastern-Europe conflict scenarios, to be obviously supported through tax revenue. If the abovementioned favorable (and unequal) tax treatment granted to digital companies is not addressed in the upcoming years, revenue collection by means of personal income taxes and consumption-based taxes, mostly affecting individuals and companies tax-resident in a specific jurisdiction, will have to raise. Such situation may indeed trigger a general sense of outrage within the population, undermining Government's legitimacy and accelerating undesirable political instability.

With this in mind, back in 2013, the G20 Leaders fully endorsed the BEPS Action Plan, whose action 1 aims to address the tax challenges arising from the digital economy. As a consequence of the works developed under BEPS action 1, OECD and G20 members agreed on a two-pillar solution to address the tax challenges arising from the digital economy, triggering a BEPS 2.0 project.

However, in the absence of unanimity and general consensus, a vast number of countries across the globe started to enhance domestic rules to tackle such challenges. Having in mind the specific global nature of the digital economy, these domestic measures, always uncoordinated, often led to loopholes and mismatches that jeopardize their main goals.

Throughout this essay, all of these topics will be addressed.

2. The issue at hand and underlying reasons - between fairness, equality and social pressure

The quick development of digital businesses is justified with the rapid technology progress, which has dropped the prices of digital and similar products (smartphones, tablets, laptops, etc…).[555]

As duly pointed out by the OECD[556], information and communication technology rely on personal computing devices, telecommunication networks, software, content, use of data and cloud-based processes.

From a practical perspective, our day-to-day life, both from professional and personal standpoints, has been eased with several online platforms that

allow us to manage our tasks in a quick and safe manner, such as online banking apps, online payment apps (*PayPal* for instance), governmental apps, etc…

Only to see the severe increase that digitalized economy is having, in 2015, the OECD considered virtual currencies as an "emerging and future development".[557] By the end of 2022, it is foreseen that revenue from cryptocurrencies will rise to 37.72bn USD, and is expected to represent 74.30bn USD by 2027.[558]

From a tax perspective, the increase of the digitalized economy poses concrete and real risks of base erosion and profit shifting, which indeed led to the existence of a specific Action (1) of BEPS project to address these risks. Briefly, whenever a company operating in digital market is headquartered in a low-tax jurisdiction, a zero-tax result at the source country / market jurisdiction (considering that, as mentioned, under contemporary DTTs, business profits are exclusively taxed in the residence jurisdiction) may be added to a low tax or zero-tax result at the level of the company.

Linked to that result, from political and diplomatic standpoints, discussions arise as the source countries, which are not legally entitled to tax those profits, want to collect their fair share of tax, overriding the unjustified difference between their taxpayers and non-resident ones solely based on the business activity of the latest. Having in mind the abovementioned financial figures, such difference has a material impact on the GDP of these source-countries, usually emergent/undeveloped countries or countries with high expenditures considering their welfare state.

Lastly, both tax and political perspectives generally lead to social pressure. Taxes are generally on the top of the agenda of far-right and far-left movements recently created, who call for the insurgency of the society that, in their words, is taxed or "stolen" on the monthly wages comparing with the high profits of the tech companies that pay zero-tax on the countries where operate. Such speech, as known, is having a remarkable effect in European democracies, allowing for the appointment of such movements into national parliaments and even governments. In the absence of effective coordinated tax regulation able to tackle the positive outcome for the tech companies, the pressure is indeed higher, resulting in

the increase of abstention and/or voting in populist movements and, as a result, in the struggle to establish moderated governments.

3.Key features of the digital economy: from intangible assets to new business models lacking physical presence

As discussed, bearing in mind the increase of the size of the digital economy in the economy itself, as recognized by the OECD, " (…) *it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes."*[559]

In this particular, the digital economy led to the emergence of contemporary business models, such as web-hosting, security and customer care solutions, content management services and web-based commerce enablers.[560] In addition, payment services[561], such as cash payment solutions (for instance, virtual credit cards created for specific transaction), e-wallets or cyber-wallets and mobile payment solutions (*Paypal*, the Portuguese "*MBWay*" and the Brazilian "*Pix*"[562]), have emerged throughout the recent years, allowing for the protection against fraud, faster transactions and possibility of setting payment in several currencies.

On the other hand, online app stores[563] have benefited from the "democratization" of information and communication technology, notably with the mass production of smartphones, tablets and other "gadgets" that are currently available to every single individual. Under the latest information, in 2021, combined revenue from Android and IOS apps reached 133bn USD.[564]

According to the latest stats, by 2022 year-end, global e-commerce reach 5.7trillion USD, to be increased in 20.8% in 2023 and 23% by 2025.[565]

Having briefly described the numbers at hand, it is of upmost importance to introduce the key features of the digital economy and how those impose a severe challenge to the current international tax system.

According to OECD's works, developed since 2015, the following key characteristics were identified on the abovementioned business models:

3.1. Mobility

Mobility[566] is a key characteristic of digitalized businesses, being present on intangibles, users and functions. In this respect, to the lower need for local

personnel to perform activities[567] we may link the lower need of having other fixed items in specific jurisdictions, such as servers for web-hosting.

This characteristic enhances the disruption of businesses and, as a consequence, the break of the nexus between businesses and specific jurisdictions, whereby reducing the chances of being liable to tax under business profits.

3.2. Reliance on data

Another key feature of the digital economy is its reliance on data, meaning the chance of collecting data about their customers, users, suppliers and operations.[568]

Besides the recent regulatory scandals based on the wrong use of big data, such as Cambridge Analytica, the global big data market is forecasted to group up to 103bn USD by 2027.[569]

3.3. Network effects

Network effects[570] arise whenever compatibility with other users is important – for instance, an operating system utilization directly depends on the software and hardware with which is compatible, the same being also applied to smartphones, tablets, smartwatches, hardware and software, etc.

3.4. Multi-sided business models

Multi-sided business models[571] rely on markets where distinct groups of individuals interact through a centralized platform, for instance, e-commerce platforms, payment card systems, operating systems, etc.

In this respect, e-commerce platforms will be more valuable if the number of seller and buyers, providers and users, are higher. On the other hand, payment card systems will also be more valuable if the number of stores and other merchants covered by it is higher than other systems.[572] Finally, operating systems will also be more valuable to developers depending on the number of consumers that use such system.

3.5. Tendency toward monopoly or oligopoly

Monopoly or oligopoly features present in the digital economy[573] mean that, whenever a company is the first player to assume a leading position on

a market, the aforementioned network effects combined with low incremental costs may enable the player to achieve a dominant position in a very short time.

3.6. Volatility

Quickness of the digital transformation and technological progress serve as an ingredient to foster innovation and new business models. Volatility, for these purposes, means that the digital market is constantly changing and its characterized by rotation on the key players and products.[574]

3.7. Cross-jurisdictional scale without mass

Digitalisation has allowed companies to allocate various stages of the production process to different jurisdictions and to be involved in the economic life of a jurisdiction without any, or significant, physical presence therein, thus achieving operational local scale without local mass.

3.8. Reliance on intangible assets, including IP

One of the most important characteristics of digital companies is the increasing investment in intangibles, especially intellectual property, such as software, algorithms and others, which may be held by third-parties and leased to the companies. The jurisdiction in which those intangibles are controlled is relevant to conclude where the respective business' profits are subject to tax.

3.9. Data, user participation and their synergies with IP

In specific businesses as social networks, the importance of the user participation is increased. For instance, the current business model of social networks mostly relies on advertising and the sale and use of user's data in order to adjust algorithms to their preferences. With this in mind, the said business model would no longer exist if a mix of user participation, user data, network effect and user-generated content was not achieved.

3.10. Relationship between digitalised business models and value creation

In a nutshell, the above features are important insofar they contribute, as a whole, to the value creation on a specific jurisdiction.

Topics surrounding the concept of "value creation" are yet to be effectively clarified and doubts emerged from such concept are still under discussion, notably regarding (i) the specific concept of value creation for purposes of settling proposals drafter under BEPS 2.0 and (ii) which key features, and to extent, do effectively contribute to the value creation. For that reason, problematics developed concerning value creation will be addressed on this essay on a later stage.

4. The foundations of the modern tax systems at a dangerous crossroads: the classic "nexus" and "profit allocation" rules as inadequate tools to ensure contemporary tax fairness

As already mentioned, one of the most remarkable challenges imposed by the required taxation of the digital economy arises from the fact that modern tax systems rely on physical presence of operators and tangibility of the economy itself, rather than the intangible or "untouchable" reality created by the advent of the digitalization.

As a matter of fact, such challenges were identified several years before the very first material discussions on the future (now current) taxation of the digital economy. Indeed, the 1998 Ottawa Ministerial Conference on Electronic Commerce welcomed the 1998 CFA Report "*Electronic Commerce: Taxation Framework Conditions*",[575] setting out the key principles of taxing electronic commerce. Especially worthy for the matter under discussion, it was CFA's understanding that tax systems should be (i) neutral, thus equitable between forms of electronic commerce and between conventional and electronic forms of commerce, disallowing a more favourable treatment to the digital economy comparing with other "regular" economy activities and (ii) flexible, meaning that they should also be sufficiently flexible to allow for their adjustment to technological development.

Without prejudice to the above, worldwide tax systems remained quite conventional and conservative to the digital progress, only registering a small evolution mostly due to the causes already pointed out.

In this sense, it is recognized that a jurisdiction ability to tax under the modern tax systems' core principles derives from two aspects directly related to the State's sovereignty: the power over a territory ("enforcement jurisdiction") and the power over a particular set of subjects ("political

allegiance"). This means that, from a tax standpoint, legitimacy to tax arises from the connection of legal and/or physical persons, and objects and/or income to a specific jurisdiction.[576]

4.1. Taxation of cross-border income

Even if States have a general will to tax income with significant relation to their territory, it is worth mentioning that throughout the last decades, both domestic regulations[577], EU Directives[578], DTTs and several other legal instruments[579] were put in place to tackle double taxation phenomena. Effectively and generally speaking, these instruments limit the ability to tax of, at least, one of the involved States, generally the source jurisdiction, either foreseeing full exemptions or reduced rates, being the double taxation at residence prevented through tax credit.[580]

In this particular, DTTs address double taxation issues by allocating taxing rights to each of the involved Contracting States. In general, we may distinguish three categories of allocation of taxing rights: (i) exclusive to the residence jurisdiction, notably business profits[581], income from international shipping and air transport, pensions and other income; (ii) limited in the source-jurisdiction, for example, dividends, interest and royalties[582]; and (iii) full source and residence taxing rights (income from immovable property).[583]

In this respect, the aforementioned framework of DTTs relies on the concept of economic allegiance, which measures the existence and extension of a "nexus" of an income of a person, either legal or physical, with a given jurisdiction. Based on OECD's opinion, economic allegiance criteria underlies on the (i) origin of wealth or income, (ii) *situs* of wealth or income, (iii) enforcement of the rights to wealth or income, and (iv) place of residence or domicile of the person entitled to dispose of the wealth or income.[584]

Based on the above factors, it was concluded that the greatest weight to define tax allocation rights should be granted to the origin of the wealth (source) and the residence or domicile of the owner who consumes the wealth (residence)[585].

In light of the above, the basis of the current international tax system can be summarized in the following triptych: (1) state sovereignty; (2) taxation; and (3) territory.[586]

In addition, besides these "nexus" rules ensuring the allocation of taxing rights, profit allocation rules should also be considered. We note that, with respect to business income, taxation at source is limited to the existence of a tax PE and to the attribution to that PE of a certain business income[587]. On the other hand, limitations imposed on the right to tax at the level of the source jurisdiction regarding interest and royalties only apply to amounts which are arm's length.

All in all, under the current tax systems,

> "*the taxation of a non-resident enterprise depends on rules that are strongly rooted in physical presence requirements to determine nexus and allocate profits. The principal focus of the existing tax framework has been to align the distribution of taxing rights with the location of the economic activities undertaken by the enterprise, including the people and property that it employs in that activity. This conceptual approach was recently reinforced by the BEPS Project, which sought to realign the location where profits are taxed with the location where economic activities take place and value is created. However, the effectiveness of these rules may be challenged by the ongoing digitalization of the economy to the extent that value creation is becoming less dependent on the physical presence of people or property*"[588]

4.2. Tax challenges arising from the digitalization of the economy

Moving forward, the current digitalization of the economy, characterized by intangibility and lack of physical presence of operators, poses severe challenges to the described core principles of worldwide tax systems, driven by tangible, "touchable" and palpable features.

In fact, advances in digital technology have not changed the core activities that businesses carry out. In turn, they have definitely changed the manner how those activities are handled, enhancing remote tasks, speeding up processes and, as a consequence, swiftly increasing markets and customers to be reached.[589]

The abovementioned status led to the reduction of tasks conducted by local personnel and the need of having a strong local infrastructure in markets where MNEs operate, fading and dissolving the elements of connection to a specific jurisdiction.[590]

This is particularly crucial with respect to the concept of PE and a "nexus" rule to allow for the taxation of business profits also at source and,

therefore, to the ability (or not) of source states to tax business profits related to a non-physical presence. The advent of digitalization turned possible for a company to be significantly involved in economic life of a country with a full absence of local infrastructure.[591]

In light of the above, special attention was given by OECD and several Nations in the review of the key concepts of the international tax system (i) "nexus" and (ii) profit allocation rules. The outcomes are addressed hereafter.

5. Approaches to address the tax challenges arising from the digital economy

Over the last few years, several discussions were held at an international level in order to discuss the key impacts derived from the digitalization of economy and, for the specific matter at hand, how worldwide tax systems should evolve in a way that would allow to adapt them to tax both tangible and intangible economy.One of the most important findings of such discussions, was introduced by OECD BEPS action1 1, aimingto address, analyse and provide solutions for the tax challenges arising from the digitalization of economy. Indeed the BEPS 1.0 project establishes a cross-sectional approach with other BEPS actions that address solutions and approaches also applicable to the tax challenges arising from the digital economy, notably Actions 6 and 7[592]. In this regard, the most tangible solution arising from Action 6 was the introduction of the PPT clause in OECD's MLI[593]. In turn, Action 7 introduced a change on the PE concept foreseen in DTTs, foreseeing that where essential business activities of a company are carried on at a given jurisdiction, the company cannot benefit from the list of exceptions usually found in the definition of the tax PE.[594] This update was also introduced through the MLI.

Looking specially into the works performed under OECD BEPS Action 1, the key feature that came up is a new nexus rule based on the significant economic presence rather than significant physical presence[595], grounded on three core factors: revenue-based, digital-based and user-based.

A significant economic presence may create a taxable presence in a country insofar factors which evidence a purposeful and sustained interaction with the local economy through technology and other automated tools are met. These factors, working as criteria, may be

combined with revenue-based factors that would work as a threshold, ensuring that only cases of significant economic presence would be covered by this new tax framework.

Regarding this revenue-based factor, income generated in a specific jurisdiction is clearly an adequate and suitable tool to measure the economic presence of a specific company with that market-jurisdiction. Provided that customers and payments arise from the same jurisdiction, an economical nexus would clearly exist between that jurisdiction and a non-resident company.

Whenever is concluded that a non-resident company has a significant economic presence in a market-jurisdiction, granting to the latest a right to tax under the proposed approach, it is of upmost importance to establish the threshold of the tax to be collected, i.e., the limit of the said right to tax[596]. As extensively described, the existing rules mostly rely on physical presence, so an adjustment should be done allowing to overcome that current paradigm. In this respect, the OECD proposes either (i) a fractional apportionment of the profits of the whole company to the digital presence, which would require the definition of the tax base to be divided, the determination of the allocation keys to divide that tax base, and the weighting of these allocation keys, or (ii) the inclusion of a deemed profit system, based on equalling the economic presence to a physical presence and determine the deemed net income, by applying a ratio of presumed expenses to the non-resident companies' revenue derived from transactions concluded with in-country customers.

The OECD also proposes the introduction of a standalone gross-basis final WHT on digital transactions. You may find elow the main critics pointed out to WHT based-taxation, which are indeed the reasons why such alternative has not been considered on a consistent basis by the OECD, even though some countries have enacted domestic WHT measures.Nowithstanding the above, in the absence of an effective solution agreed on an international level, the already described social pressure and the significant sense of inequality derived from the differences on the tax treatment between the "physical" and "digital" economy led national governments to enact domestic measures aiming to tackle and mitigate the "natural" advantages of the tax framework applied to the digital economy.

Among these measures, both tax base rules and anti-tax avoidance provisions were enacted, aiming to prevent profits to be diverted from

market jurisdictions to residence jurisdiction – often low-tax jurisdictions – and anti-trust investigations against companies that focused their activity in the digital market.[597]

From a pure legal standpoint, countries enacted legislation that may be grouped in the following categories: (i) alternative application of PE threshold, (ii) withholding taxes, (iii) turnover taxes; and (iv) specific regimes targeting large MNEs[598]. For ease of exposure and based on their effective application, our article will only focus the first three categories.

5.1. Alternative application of PE threshold

For this specific category, we should highlight the newly-introduced concept of "digital PE". This new concept, that in substance means a contemporary evolution of the "traditional" PE concept arising from international double tax treaties, triggers the existence of a taxable presence in the market jurisdiction based on revenue, digital and/ or user-based factors that demonstrate sustained interaction with a jurisdiction.[599]

Certainly, this new solution imposes several challenges as identified by OECD, notably the need of having a provisional P&L statement for the business conducted in the market jurisdiction, allowing for the allocation of profits and expenses for income tax purposes.

In addition, even though this challenge is not identified in OECD reports, we understand that, from a practical perspective, the tax to be assessed in the market-jurisdiction may be finally "paid" by the residence jurisdiction, through tax credit methods, which, from a sole political standpoint, may lead to tensions in the ongoing negotiating process.

5.2. Withholding taxes

Under the current OCED Model Tax Convention, profits of a non-resident taxpayer are generally taxed at source insofar a tax PE is triggered therein, with exception of passive income as dividends, interest and royalties, with respect to which source jurisdictions are entitled to WHT at rates usually varying from 5% to 15%, and capital gains derived and/or related with immovable properties.

As identified by the OECD, we may observe a contemporary increase in the use of such exceptions in domestic law and double tax treaties for specific categories of digital products and services, notably by the broadening of the "royalties" concept.[600]

Notwithstanding, the use of withholding taxes to address the contemporary tax challenges imposed by the digitalized economy may also be subject to criticism.

Firstly, the process of digitalization may hamper the characterization of a certain type of income within one of the categories existing in DTTs, notably as "business profits" or "other income", taxed only at the level of the residence jurisdiction, or as "royalties", over which a withholding tax may impose at source.

On the other hand, provided that changes in bilateral DTTs are enacted treaty-by-treaty (a mechanism similar to the OECD MLI does not exist for these topics yet), there is the risk that taxpayers resident in a specific jurisdiction may have to deal with DTTs that impose significantly different treatments to the same types of income. Such differences may indeed work as in incentive for taxpayers to target their business to a more favourable jurisdiction, whereby indirectly creating Treaty-shopping realities.

Moreover, is yet to be determined how changes in the concepts of royalties for Treaty purposes will be managed with EU Directives, notably the Interest & Royalties Directive. While the concepts themselves may be different, also the aforementioned Directive provides for a full withholding tax exemption whenever the underlying requirements are met, comparing with DTTs, that only allow for the reduction of WHT rate at source. Therefore, a cross-sectional solution must be achieved at both OECD and EU level.

Finally, for B2C transactions, it is arguably that withholding tax obligations are legally attributed to consumers with low or none tax experience, which may indeed jeopardize the tax collection at source level. To overcome this challenge, several countries are using intermediaries for these functions, notably LATAM ones.[601]

5.3. Turnover taxes

Another category of alternatives recently implemented on a worldwide basis is the introduction of taxes to suppliers of products and services on the digital market. Among the common features of these solutions is the application to both resident and non-resident taxpayers, irrespectively of the eventual physical presence of the latest in those market jurisdictions.[602]

While the OECD points out that these turnover taxes share a common policy objective, which is to neutralize the difference within resident and

non-resident taxpayers that act on the digital market[603], from an economical perspective, several challenges arise from that circumstance. As a matter of fact, provided that the resident taxpayers are already taxed under a general corporate income tax scheme, if these turnover taxes, working therefore as an additional tax on income, are not deductible for corporate income tax purposes, a double taxation would arise for resident taxpayer that would not exist to non-resident ones, leading therefore not only to a significant tax leakage at the level of the first ones, but also to a significant sense of inequality and unfairness.

Lastly, commonly with withholding taxes, these turnover taxes impose several administrative and compliance issues, namely in what respect to the tasks of collection themselves, as they should be conducted by the consumer/acquirer or by a tax representative to be pointed out by the non-resident supplier to the market jurisdiction, hence the low level of tax collection of these taxes may be definitely justified by these challenges.

6. BEPS 2.0 – the "state of the art"

On 21 October 2021, the United States of America, together with the United Kingdom, Austria, Italy, France and Spain made a joint announcement [604] in which they set out, following their accession on 8 October 2021 to the Inclusive Framework"[605] (IF) proposed by the OECD, in which they undertake to remove from their legal systems the unilateral measures generically referred to by the jargon "Digital Services Taxes" (hereinafter "DST's"), in addition to refraining from implementing any similar measures. In its place, these States have committed to adopt the multilateral measures presented under "Pillar One" of the OECD proposal.

This moment is a highly relevant turning point in the development of tax law and tax policies of States to cope with the digitalization of the economy. The "two pillar solution" proposed by the OECD has appeared as (arguably) the largest and most recent joint effort in the fight against the BEPS phenomenon since the BEPS Action Plans, which already date back to 2014, and which may generate profound transformations in the functioning of international taxation[606].

However, back in 2018, the European Commission tried introduce a new criterion to establish a nexus for the taxation of companies based on their economic presence in a specific EU member-state rather than physical, in

light of the works performed under OECD BEPS project[607]. This attempt was unsuccessful due to the lack of internal political consensus within the EU, but resulted in the unilateral introduction of DSTs among member states [608][609]. Furthermore, on account of loans for the recovery of the European economy in the COVID-19 pandemic crisis, in January 2021 the Commission announced that it plans to introduce a "digital tax" for the European Budget for 2021-2027[610], despite the failure of the previous initiative.

Notwithstanding the above, while the European countries undertook to repeal the taxes in question when the Pillar One measures were implemented, the United States did so with immediate effect from the time it joined the IF, i.e. on the 8 October of that year. In the cases of Austria, United Kingdom, Italy, France and Spain, there will also be a transitional regime in which taxpayers will be entitled to credit the excessive tax paid under the current rules comparing with tax that would have been due in the first year of application of the Pillar One[611].

In light of the above, uncertainties regarding the permanence of this type of taxes in legal systems still exist. Nevertheless, one aspect is unavoidable in this issue: the taxation of digital industries requires adaptations of the taxable bases and the determination of the profit of taxpayers, being the traditional factors of consideration insufficient and, sometimes, erroneous to effect the taxation of this phenomenon, as extensively exposed.

For this reason, there is a marked variability in the factors of assessment chosen by each jurisdiction to effect this taxation, and there is no uniformity in the tax bases of these taxes. It is therefore important to list and critically analyse the main criteria that have been used in this area, in order to assess their suitability to the challenge of taxing in a proportional, fair and efficient way the digitalisation of the economy.

Having the object of the present study duly determined, it is also important to identify its method. Firstly, we propose to analyse the different factors that have been used as a basis for DSTs around the world. This corresponds to the most relevant design option for the present analysis.

Then, the most common models will be evaluated based on three factors: (i) impact on taxpayers' behaviour, (ii) administrative simplicity and (iii) equity. These are the factors that serve as a parameter to assess the impact of this tax on taxpayers' behaviour and on the financial-budgetary system of each jurisdiction.

Finally, concluding remarks will be made on the future of digital taxation with regard to DSTs, in order to give a modest contribution to its understanding as a tax phenomenon.

Most European countries have followed the directive proposal brought by the Commission in 2018[612], which idealizes an indirect tax [613] which would tax 3 types of activities (objective incidence): online advertising, online intermediation services and sale of user data. Although the Commission's proposal presented a taxation at 3%, in the domestic orders of the member states that opted for the adoption of these DSTs the rates vary between 2% (United Kingdom) and 7.5% (Hungary).

Furthermore, the subjective scope of the tax proposed by the commission is determined by the presence of two cumulative requirements: an overall turnover in excess of EUR 750 million and a tax base attributable to the territory of the European Union of EUR 50 million or more. To create the taxable person, the proposal for a directive relies on the 'user' criterion, i.e. a citizen in European territory who is exposed to one of the activities covered by the objective assessment, serving as a 'link' between the taxable person and the territory competent to levy the tax.

6.1. Tax Design: Brief Introduction

As mentioned above, in order to assess the profit allocation criteria used in the various DSTs around the world, a brief introduction to the methodology of "Tax Design" is due.

This methodology is set forth by Adam et al., which brings a number of characteristics that are considered desirable in any tax (good) tax system, namely:

- Minimization of negative effects on economic efficiency and welfare – namely, substitution effect – through neutrality;
- Lesser administrative costs for the tax authorities and compliance burden on the taxpayer – simplicity; and,
- Transparency at the level of the determination of the taxable base – stability.

Naturally, not all of these parameters can be equally met at the same time. However, each of these factors can be an indicator as to how "good" or "bad" a certain tax is in a certain State's tax system. Consequently, when

designing a tax, these are the "rules of thumb" that have to be taken into account[614].

Regarding neutrality, it is determined by treating similar activities in similar ways, thus avoiding a certain outcome despite the form chosen to do so. This goal is achieved through designing a tax system that minimizes distortions over people's choices and behaviours[615], which, in taxation, happens when the form of an activity pursued is deemed irrelevant considering the substance of it.

When it comes to DSTs, neutrality must be analysed from the perspective of the businesses and consumers alike. This is due to the fact that, as it happens generally with indirect taxes, the burden borne by taxable subjects can be shifted towards the final consumers of products[616]. As such, an ideal DST would be one that exerts minimum influence towards consumers and businesses in how they conduce their daily operations. It "must not be distortive and stifle the economy"[617], unless the policy option is to discourage growth and limit innovation.

In the matter of transparency, it is imperative that a tax system is a simple one in order to not invite avoidance[618]. An increased administrative burden is a driving factor for avoidance, consisting in a deadweight loss[619] for the public revenue and increased compliance costs for the companies.

This aspect of design has to be particularly considered in the case of DSTs. Since one of the common arguments for proponents of this genre of taxes is that MNEs should pay their "fair share of tax"[620] and, considering that these companies have the means to set up extremely complicated structures to minimize tax exposure[621] and enhance BEPS strategies, simplicity is likely to be determinant on the effectiveness of these taxes.

Hence, if one desires an efficient tax system, it must also be simple. If not, the very characteristics that define the digital economy, which DSTs seek to tackle and address, would be their undoing.

Finally, transparency in the context of DSTs would mean a clear determination of the taxable base over which these taxes impose. In other words, there must be a clear distinction between a DST and a corporate tax or consumption tax, thus avoiding the phenomenon of "stealth taxation"[622].

Regardless of what the object of such taxes is, as we discuss below, it is imperative that businesses can foresee and prepare in advance the increased burden that such taxes will bring. The criteria chosen must be clear, with

precise definitions of key concepts (most commonly "online targeted advertising" or "number of users"), a necessary condition to ease and streamline compliance tasks but also to reduce litigation exposure.

In summary, the methodology of Tax Design applied to DSTs determines that these taxes shall be structured in a way that it is not detrimental to the development of digital services, that allows companies to meet compliance standards without excessive administrative cost and also guarantee maximum transparency standards towards all relevant stakeholders.

6.2. Digital Services Taxes

Having the above parameters in mind, it is imperative to first determine what constitutes a DST. Bunn et al. (2020) assert that "*digital services taxes are gross revenue taxes with a tax base that includes revenues derived from a specific set of digital goods or services or based on the number of digital users within a country*"[623].

From this definition it is possible to identify two types of DSTs based on how they determine their taxable base: (i) those which are levied on goods or services, namely digital, such as direct advertising and data transfer and (ii) those which are levied on users within a certain jurisdiction. As we will see further, these two types entail difference in the respective design and, as a consequence, material differences on how they affect taxable subjects and their behaviour.

Without prejudice of the existence of these two types, both seek the same goal: to bring taxation close to where and how value is created in the new digital economy business models, even though this is not an easy task: not only the digital market is defined by very different business models as above stated, but there is (usually) no consideration directly linked to the value created by an user individually, which turns difficult to determine the amount of income over which tax should be levied.

In this particular, in the digital economy, user distribution does not match value creation between jurisdictions[624]. In fact, the latter seems to be highly concentrated in a small number of jurisdictions, as seen below:

TABLE 1.

The Geographic Mismatch Between Users and Digital Value Creation, 2015

Regions	Millions of Internet Users	Share	Information Industries (Trade in Value Added in Millions of U.S. Dollars)	Share
North America	343	11%	1,179,632	37%
Europe	508	16%	818,529	26%
East and Southeast Asia	1,080	34%	625,194	20%
South and Central America	206	7%	99,675	3%
Other Regions	997	32%	432,448	14%
World	3,133	100%	3,155,478	100%

Note: Information industries includes publishing, audiovisual, broadcasting activities, telecommunications, IT, and other information services (industry codes: D58T60, D61, D62T63).
North America includes Canada, Mexico, and the United States; Europe includes Iceland, Norway, Switzerland, Russia, the United Kingdom, and the 27 member countries of the European Union; East and Southeast Asia includes Japan, Korea, Brunei, China, Hong Kong, Indonesia, Cambodia, Malaysia, Philippines, Singapore, Thailand, Chinese Taipei, and Vietnam; Other Regions include Australia, Israel, New Zealand, Turkey, India, Morocco, Saudi Arabia, South Africa, and Tunisia; World includes the remainder from the rest of the world.
Source: "Number of Internet Users by Country," Our World in Data, accessed May 22, 2020, https://ourworldindata.org/grapher/number-of-internet-users-by-country; and OECD, "Trade in Value Added (TiVA): Principal Indicators," accessed May 22, 2020, https://stats.oecd.org/Index.aspx?DataSetCode=TIVA_2018_C1.

Source: BUNN, DANIEL, ELKSE ASEN, AND CRISTINA ENACHE, 2020, *Digital Taxation around the World*. Available online at: https://files.taxfoundation. org/20200527192056/Digital-Taxation-Around-the-World.pdf

According to the above, Europe and North America, despite only bridging 27% of the internet user share, still account for 63% of all value created in the digital industry. As a consequence, DSTs face yet another design challenge: to design a criteria fit for to bridge the gap between user presence and value creation. However, those practical challenges have not stopped countries from enacting unilateral measures to tax such income as mentioned in the previous chapter.[625].

A) Economic Efficiency

As stated above, an efficient DST will be one that is as neutral as possible. Although neutrality may sometimes not be the primary goal of a tax system, it is certainly desirable[626]. In the case of DSTs, a non-neutral design may hamper innovation, lead to the exit of MNEs from markets and increase the cost of services provided by the digital industry[627].

To avoid these unwanted consequences, the scope of a DST is a feature that cannot be overlooked. As literature indicates, these taxes are closer in nature to an excise tax than a corporate income tax and, as such, its burden will most likely be borne by consumers in the form of an increase in prices[628]. This risk is widened when most DSTs proposed until now, including the European Union proposal, are levied on revenue rather than profit, without allowing for deductions.

From a design perspective, this means that businesses with lower profit margins are disproportionally affected, as their taxable income is derived only from revenue. This can be specially harmful in the case of certain "platform economy" companies, startups and also enterprises with a high volume of sales but high operating costs, which, despite the high turnover,

still operate with low or even negative margins, near the "break-even"[629]. In this case, if they are to be subject to a DST that taxes revenue on a gross basis, there is a potential breach of fairness and efficiency which might lead to the unwanted consequences mentioned above, which are, in turn, detrimental to neutrality and economic efficiency as a whole. Among those consequences, a gross-basis taxation is a direct challenge to tax systems relying its income taxation on the "ability-to-pay" principle, increasing risks of tax avoidance and litigation.

Additionally, the existence of thresholds based on the global revenue of the companies targeted by these DSTs, such as in the case of the EU proposal[630], create competitive advantages for the companies out-of scope, thus distorting the market by creating different treatment of companies in similar economic positions[631], discouraging investments in the long term, which can be specially detrimental for developing economies[632], as they further the gap of digital inclusion amongst a country's population.

B) Administration

Naturally, the introduction of a new tax also brings forth the issue of how to effectively collect and enforce it. Additionally, policymakers have to consider, as abovementioned, that the deadweight loss incurred by companies to meet compliance standards when paying such taxes has to be minimized.

In this realm, the existence of thresholds significantly increases the simplicity of enforcement, as there are fewer taxpayers to control, in line with the general policy option to target MNEs through DSTs and ensure they pay their fair share of tax. However, the different thresholds between countries, specially within the EU, where fundamental freedoms apply, can make it difficult for the taxable subjects to meet the compliance standards in each country where they are deemed to have a digital presence.

Such issue is magnified when the said tax uses "number of users" as the relevant criteria to impose tax. As BECKER AND ENGLICH[633] point out, allocating revenues based on users can prove to be "a nightmare of complexity and a mess of legal uncert-ainty", as it will require not only that companies make this data available to every single jurisdiction that they operate in, but also that some tool for enforcement and verification of this data is put in place, which will be burdensome for both companies and tax administrations.

On the other hand, taxing on the basis of goods and services provided also presents new challenges to be solved by policymakers. Transactions and targeted advertisement are not easily trackable, which entails that businesses will step up to a higher compliance standard than usual, and, as some literature points out governments "need to consider specifying what level of enforcement would be sufficient for companies to make good faith efforts to source their revenues to local users"[634], in order to make sure these new taxes can be properly administered, enforced and collected.

C) Transparency in the determination of taxable bases

The design of a DST has to meet certain transparency standards in its design, namely in the precision of concepts and its place in the general tax system. Namely, and as mentioned, it cannot be treated as a mere proxy or disguise other taxes, namely consumption taxes.

In order to accomplish this goal, the choice for taxing gross revenue is dangerous, as it result in much more elevated effective tax rates than those apparent at first glance, as the Commission rightly identified[635], making it very burdensome for companies and, most importantly, does not allow for a clear assessment of the legal nature of such tax, which might entail constitutional and legal disputes in various jurisdictions[636]. Effectively, one might argue that this lack of transparency might create a "stealth tax" on companies.

Accordingly, coordination between countries is especially relevant in the case of the taxation of foreign companies with no PE in a certain jurisdiction. As discussed, in the absence of a P&L statement regarding a specific taxpayer activity in a market jurisdiction, it would be critical to obtain information regarding transactions involving multiple countries, that could certainly present challenges in determining the taxable base in a clear manner, leading to eventual situations of double taxation and certainly to wrong assessments of tax to be collected. Such framework would be critical to taxpayers, who may be unable to file tax declarations properly and even challenge administrative decisions in courts, and for administrations, which will not be provided with the correct tools to assess the tax due by companies within the scope of a DST.

Finally, concepts commonly used, such as "targeted online advertising", "user base" and "sale of data for advertising purposes" have to be thoroughly defined so that companies can plan ahead and assess whether they fall on

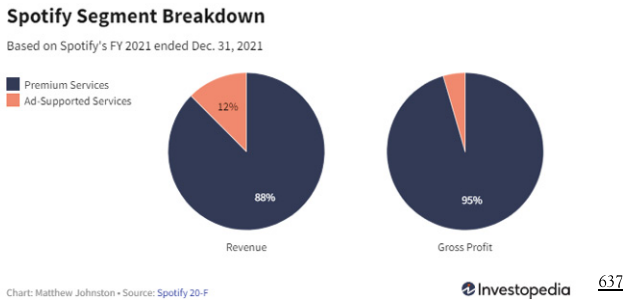
the scope of the new tax or not. In the EU proposal, for example, under article 3°, "taxable revenue", paragraph 1, the proposed tax shall include the following activity in its scope:

> *"(a) the placing on* ***a digital interface of advertising targeted*** *at users of that interface;*
> *(b) the making available to users of* ***a multi-sided digital interface*** *which allows users to find other users and* ***to interact with them****, and which may also facilitate the provision of underlying supplies of goods or services directly between users;"*

However, under paragraph 4 of the same provision excludes "the making available of a digital interface where **the sole or main purpose of making the interface available** is for the entity making it available to **supply digital content** to users or to supply communication services to users or to supply payment services to users" from its scope.

Immediately, the lack of clear definitions creates significant questions on what is excluded or not from the scope of this tax. For example, Spotify follows a "freemium" business model and offers two different services to its users: Spotify Premium, in which the user is allowed to add and listen to songs without advertising, and Spotify Free, in which users must listen to advertising between songs. The first kind of income seems to be excluded from the scope of the tax, as it falls under the provision of paragraph 4, while the second service seems to be included.

If one is to look at the income distribution between free services and premium services, however, it is clear that, if the interpretation stated above holds true, the DST will not tackle the actual value created by the company.



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This situation, while anecdotal, demonstrates a flaw in the design of the tax, mainly due to the lack of clearness in the terms used, such as "supply

digital content" and "multi-sided digital interface", which result in an evidently unfair. By consequence, this design flaw undermines the very objective of the DSTs as a whole: make sure companies operating in the digital market pay their fair share of tax.

Conclusions

All in all, the analysis of the general structure of DSTs reveals major design flaws under the lens of the Tax Design methodology, at various levels.

Most notably, the levying of tax on gross revenue, not allowing deduction of costs incurred to obtain income that is indeed subject to taxis a very dangerous and flawed designed choice, as it creates distortions and goes against general principles of neutrality and ability-to-pay that are generally sought by any "good" tax system.

Additionally, the administration of such taxes can prove to be a hurdle for tax administrations and companies alike to enact effective taxation of MNEs, creating a deadweight loss that might hamper and disincentive innovation in the digital environment and even the exit of companies from markets.

Finally, special importance has to be given to the definition of terms, specially within the scope of such taxes, in order to allow transparency for companies to plan ahead and prepare themselves for the additional tax burden they will have to incur and to meet compliance standards under this new reality of DSTs.

Despite all of this hurdles, in the context of financial recovery of European countries after the COVID-19 pandemic, the search for revenue by Member States might mean that this type of taxes is "on hold" to be introduced, depending on the outcome of the IF negotiations regarding Pillar I and II initiatives. Regardless, we endorse the conclusion stating that "The emergence of DSTs reintroduces the negative economic consequences of turnover taxes—a step back in terms of sound tax policy"[638] and thus should be avoided.

7. Pillar I

This two-pillar solution is composed by Pillar One and Pillar Two, each pillar seeks to implement different changes. Pillar Two was the first one to

be discussed and in a sense advanced. Furthermore, Pillar Two intends to level the field by reducing the race to the bottom and therefore decrease tax competition by implementing a 15% minimum tax rate[639] that jurisdictions should carry out for multinationals enterprises (hereinafter MNEs) who are in the scope to comply with this new regime.

Furthermore, on 15th of December of 2022, the European Union Council approved a directive which imposes a minimum tax rate of 15% for multinational enterprises. It was agreed by IF to effectively implement such directive in 2023. The EU members agreed to apply rules for the tax period beginning in or after December 31st, 2023, giving taxpayers an additional year to prepare for such changes. With the adoption of Pillar II by Member States, it is fundamental for multinationals to monetarize the transposition of the rules by the member states of the EU and the preparation of the GloBE rules.

Pillar One, being the principal character for this article, strive for adaption of the international tax regime to new business models through changes to the profit allocation, nexus rules applicable to business profits, mitigate double taxation of profits, and avoid a harmful and trade war. It expands the taxing rights of the market jurisdictions where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at that jurisdiction.

Pillar One is not looking for the relevant physical presence that a certain business has in a specific market jurisdiction but rather to the economic relevance that a business has in a specific market. This economic aspect introduced by Pillar One is in line with how new business models operate, generate profit and distribute itself.

7.1. Value creation worldwide

Nowadays, MNEs have their value chain spread all over the globe (global value chain), from its manufacturing to its distribution. Through owning or controlling subsidiaries in other jurisdictions where they engage in foreign direct investment or carry out activities to produce goods or services in more than one country.

In the 21st century, MNEs have been dominating and exploiting the digital era. They managed to maximize production by using technology to ease the market access, and by shifting their business models from country-

specific to global models with integrated value chains and functions that are centralized at a regional or a global level.[640]

For digital companies, the value of the business is placed where upstream activities like, research and development (R&D), software, intellectual property (IP) such as patents, trademarks, copyrights, brand names and know-how) or where production of core components occur, as well as in the downstream activities where marketing or branding occurs.[641]

In this sense, digital companies rely on data and user participation. The use of a product or a service by a user may provide data about the user which will bring added value to the business both in improving existing products and services or in providing products or services to another group of customers.[642] The reliance on personal data is mostly used in social networking-focused business models, the collaboration between the users and the platform is the key value driver of the business.

The decisions made by some users have an impact in other users, the so called "network effects". The welfare of the existing users is increased even though there is no explicit agreement compensation. For example, Tiktok, a media sharing platform, which all content is generated and created by the users, therefore the experience of users is improved as additional users join and share their content.[643] These business models are successful due to the contribution of their users, because if we were just to consider the software on its own, the value of the business would be reduced.

Although, the key features of the digital business models have reached a global consensus, there is no consensus on their importance to the location of value creation and the identity of the value creator.[644] Some countries acknowledged that the user participation is a central part of the digital business models, playing an important and unique role as drivers of the value creation. Other countries view the user participation has a nonmonetary agreement, meaning an exchange of users' data for the allowance of entering a digital platform. With digital companies, it stopped being clear where the value is created.

Given the present context, the international tax regime is not hand in hand with the current economy. Therefore, there have been made a lot of attempts to try to redeem the status quo of the international tax regime.

From countries unilateral approaches such as Digital Tax Services, this measure aims at taxing these giant tech companies and reallocate their fair amount of taxes that a given enterprise collected in their country

(although in a more consumption perspective), jurisdictions such as Austria, France, Hungary Italy, Poland, Portugal, Spain, Turkey, and the United Kingdom[645] have implement. To the OECD BEPS Project (including the Two Pillar Solution) the most promising development up to 2023.

Nowadays, MNEs have their value chain spread all over the globe, from its manufacturing to its consumption. Most of the corporation who have their value chain disaggregated have an economic ratio behind it (for the distribution of its activities), nevertheless others use these schemes to escape tax compliance and as a consequence reduce its tax burden.

Activities whose physical presence is not relevant (intangibles) are the more movable ones. When we look into digital enterprises, their biggest assets are the software, research and development (R&D) and other intangible assets going in line with their business models.

Because these enterprises rely so much on their intangibles and given the current situation of the international tax regime, a nexus must be met for the market jurisdiction to collect the tax gains that specific enterprises made in the country. This nexus is a physical presence in a market jurisdiction. Although, there have been already a lot of discussion in this field, for example, France has implemented an unilateral measure - ***"digital tax"*** that aims at taxing these tech giants and reallocate the fair amount of taxes that a given enterprise collected in their country, but because the international tax regime is not updated, they do not collect these taxes. Furthermore, (DSTs were also a hot topic that some jurisdictions implemented, such as Austria, France, Hungary, Italy, Poland, Portugal, Spain, Turkey and the United Kingdom.[646]

For the strict purposes of this article, we will explain how Pillar One (Amount A) is allocating tax rights in the market jurisdictions, what are the main concerns and what is expected in the near future.

7.2. Pillar One: Technical Approach

The key elements of this Pillar are the following:

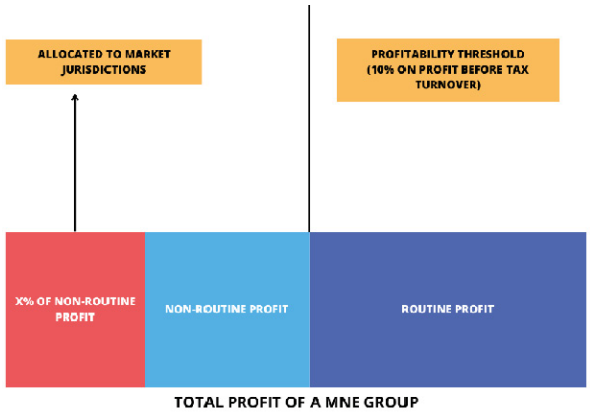
a. **Amount A (new taxing right)** applies a portion of the residual profit[647] from MNEs who are in the scope of this Pillar.[648]
b. **Amount B** for marketing and distribution functions based on arms' length principle, applicable to all businesses.[649]

c. **Tax Certainty**, increase certainty for enterprises on Amount A.[650]

Here are the technical details from Pillar One (Amount A):

- **Scope:** All MNE Groups whose revenues are greater than EUR 20 billion and have the Pre-Tax Profit Margin of the Group greater than 10 percent (profitability test)[651].
- **Exclusions:** Extractives and regulated financial services are not subject to Pillar One**.**
- **Revenue sourcing rules**: Revenues arising from the final customer of the finished goods are incorporated into that jurisdiction. For example, revenues resulting from the provision of services, such as Location-Specific Services, Advertising Services, online intermediary Services, Transport Services, Customer Reward Programs, and other Services, revenues based on licensing, sale or other alienation of Intangible Property or User Data, are totally or partially sourced to the market jurisdiction. By applying these sourcing rules, an MNE must use a Reliable Method based on the Covered Group's specific facts and circumstances.[652]
- **Nexus**: For the allocation of the Amount A, the market revenue threshold must be equal to or greater than EUR 1 million for jurisdictions with a Gross Domestic Product (hereinafter *GDP*) equal or greater than EUR 40 billion; or EUR 250.000, for jurisdictions with a GDP less than EUR 40 billion.[653]
- **Tax base determination:** Some adjustments (book-to-tax adjustments) to the profit before tax of the Group (rather than on a separate-entity basis), i.e. Tax Expense, dividends, equity gain or loss[654].
- **Profit allocation:**It will be used of a formula [655] to proportionality allocate the fair profits to the market jurisdiction. 25% of the residual profits defined as profit in excess of 10% of the revenue will be allocated to the market jurisdiction.
- **Elimination of double taxation and double counting:** Pillar One suggests that the issue arising from double taxation would be addressed by dispute prevention and resolution mechanisms.

For a better understating, take this image as an illustration of the Amount A:



Source: Illustration produced from the research results findings

The blue bar represents the total profit of a MNE Group before tax. The blue bar is divided into two: a) routine profit and b) non-routine profit. The profit within the profitability threshold of 10% are routine profits, whereas those who are above the profitability threshold are considered non-residual profits. 25% of non-routine profits are treated as Amount A and distributed amongst market jurisdictions, therefore there is a profit split.

Considering what as described above, the international tax regime is going after where the value is created. Although sometimes it is difficult to locate and calculate the creation of the value. But by shifting its taxing right from a physical presence approach in the market jurisdiction to an economic relevance approach, will change the way how business look and operate at the international tax arena. This approach will give states a more accurate tax revenue about their digital economy.

General Conclusion

Over the last few years, the economic and political challenges imposed by the advent of the digital economy led to the urgency of enacting legal regulations able to grant to Countries worldwide a right-to-tax profits derived from this new "intangible economy".

Such need has been addressed by different initiatives, both domestic and international, mostly at the level of OECD and EU. As a matter of fact, a challenge which has a remarkable cross-border nature also impose cross-border solutions. However, in the absence of effective and crystal-clear solutions until now, several countries imposed domestic-derived regulations, creating loopholes and mismatches on the tax treatment

among jurisdictions, resulting in possible alternatives for e-commerce platforms and similar businesses to focus their attention on more "friendly" tax markets.

Given the nature and causes of this conundrum, we strongly believe that the "way forward" in taxing the digital economy lies in collaborative international initiatives rather than unilateral ones, for two main reasons.

Firstly, digital MNEs are mostly linked with cross-border transactions, whereby asymmetries and loopholes on the applicable tax systems may lead double taxation and double non-taxation. In addition to this, unilateral and disintegrated domestic measures may indeed increase the tax burden and create an incentive for fiscal competition, triggering an international "race to the bottom", as other countries, especially those which are recognized by assuming protectionist positions in the geopolitical scenario, such as China, UAE and the U.S, will be invited to tune down their tax systems, providing MNEs with favourable tax regimes a haven for the digital companies.

Secondly, now and more than ever, there seems to be a strong political drive within international organizations to produce new legislation and protocols in the tax field[656], as evidenced by the recent initiatives in the EU (DEBRA, BEFIT, SAFE, DAC-8, the European Crypto Tax, Unshell Directive, among others). Additionally, we believe that the EU, as a major stakeholder in this matter, can be the forefront runner in order to promote cooperative solutions for the taxation of the digital economy, rather than relying on the OECD, which still operates on a voluntary basis.

In conclusion, multilateral solutions, despite all the political hurdles that might encompass, still provide the most efficient measures for granting tax fairness between the tangible and non-tangible (digital) economy Thus, we should steer away from treating the digital economy as a pure domestic and national but rathera global and multilateral topic, which should be taxed as such.

List of abbreviations

B2C – business to consumer
BEFIT - Business in Europe: Framework for Income Taxation
BEPS – Base Erosion and Profit Shifting
BN – Billions

CFA – Committee on Fiscal Affairs
DAC – Directive on Administrative Cooperation
DEBRA - Debt-Equity Bias Reduction Allowance
DTT – Double-Tax Treaty
EEA – European Economic Area
EU – European Union
Interest & Royalties Directive – Council Directive 2003/49/EC
IP – Intellectual property
LATAM – Latin-American
MNE – Multi-National Entity
GDP – Gross Domestic Product
MLI – Multilateral Instrument
NGN – Nigerian Naira
OECD – Organization for Economic Co-operation and Development (OECD)
OECD MTC – OECD's Model Double Tax Convention
Parent-Subsidiary Directive - Council Directive 2011/96/EU
PE – Permanent establishment
P&L – Profits and Losses
PPT – Principal Purpose Test
SAFE - Securing the Activity Framework of Enablers
UN MTC– United Nations's Model Double Tax Convention
US – United States
USD – United States Dollar
WHT – Withholding Tax

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552. https://www.weforum.org/agenda/2022/08/digital-trust-how-to-unleash-the-trillion-dollar-opportunity-for-our-global-economy/

553. Cusolito et al,; page 22.

554. In summary, DTTs foresee that a non-resident company may be deemed to a have a PE in other jurisdiction under the (i) fixed place of business rule, (ii) dependent agent rule and (iii) building site or construction rule. The OECD's MLI introduced the following changes to the PE concept:

- Any ships (and not only drilling ships) used for the prospecting or exploitation of natural resources should be included in the concept of a PE;
- Decrease from 6 months to 90 days the creation of a PE for activities exercised through facilities, platforms or ships used in the prospecting or exploitation of natural resources;
- Introduction of a Service PE clause if the activities exceed 183 days in a 12-month period;
- Expansion of the agency PE definition to include the following elements:
  - An agent usually plays a decisive role for the conclusion of contracts on a routine basis and without substantial changes; or
  - An agent maintains a deposit of goods for their delivery on behalf of the company, even though it does not usually conclude contracts in relation to those goods nor has any intervention in the conclusion of such contracts.
- Removal from the list of preparatory and auxiliary " the use of facilities for the purpose of delivering goods or merchandise of the enterprise";
- Introduction of an anti-fragmentation rule.

555. OECD (2015), paragraph 64.

556. OECD (2015), paragraphs 66 to 82.

557. OECD (2015)., paragraphs 87 and 88.

558. STATISTA: https://www.statista.com/outlook/dmo/fintech/digital-assets/cryptocurrencies/worldwide

559. OECD (2015), page 11.

560. OECD (2015), paragraph 118.

561. OECD (2015), paragraphs 126 to 129.

562. According to the Brazilian Central Bank, by October 2022, the volume transacted under PIX was 1,034bn - Estatísticas do Pix (bcb.gov.br)
https://www.bcb.gov.br/estabilidadefinanceira/estatisticaspix

563. OECD (2015), paragraphs 130 to 135.

564. App Revenue Data (2022) - Business of Apps
https://www.businessofapps.com/data/app-revenues/

565. Shopify.com
https://www.shopify.com/enterprise/global-ecommerce-statistics

566. OECD (2015), paragraphs 152 to 163.

567. It is worth mentioning the current effort that MNEs have to incorporate worldwide shared services centers that develop administrative, IT support and other supporting activities to the core business, which have been established in jurisdictions with lower labor costs. In these cases, MNEs may no longer have physical presence on a jurisdiction, even though such supporting services benefit

revenue sourced in those jurisdictions. With a thinner nexus with those jurisdictions, also the liability to be being taxed therein will be lower.
568. OECD (2015), paragraphs 164 to 167.
569. Statista
https://www.statista.com/statistics/254266/global-big-data-market-forecast/
570. OECD (2015), paragraphs 169 to 172.
571. OECD (2015), paragraphs 173 to 177.
572. For instance, Visa is clearly the most valuable payment network as it is the most used one, comparing with other competitors as MasterCard and American Express.
Insider Intelligence
https://www.insiderintelligence.com/insights/credit-card-networks-payment-list/
573. OECD (2015), paragraph 178.
574. OECD (2015), paragraph 179.
575. OECD (2015), paragraphs 6 to 9.
576. OECD (2015), paragraph 20.
577. Several jurisdictions foresee domestic exemptions / reduced rates to income perceived by non-resident entities, notably concerning capital gains derived from the disposal of shares and income with financial nature, e.g., distributed or originated in financial investment vehicles.
578. We would like to point out the Interest & Royalties Directive, which provides for a full exemption at source for interest and royalties paid to their effective beneficial owner whenever the latest is tax resident within EU. Similarly, the Parent-Subsidiary Directive provides for a full exemption at source for dividends distributed from subsidiaries to participants whenever both are tax-resident in EU, though there are countries, as Portugal, that extend such exemption to taxpayers resident in Countries with whom a DTT was concluded or are included within the EEA.
579. For instance, the agreement concluded between the EU and Switzerland in order to extend the Interest & Royalties Directive also to Swiss tax-resident companies.
580. Under article 23-B of the OECD MTC, in its version of 2017, tax credit is allowed as a deduction of the tax paid abroad, but it should not exceed the tax that would be paid in the residence jurisdiction. In addition, if it is true that the said OECD MTC also provides for an exemption method rather than a tax credit method, DTTs concluded worldwide mostly follow the tax credit method.
581. Business profits are generally subject to tax in the residence state unless (i) a tax PE exists in the source jurisdiction and (ii) such business profits are allocated to that PE. As duly pointed out by OECD, this is the "nexus" rule for business profits as it identifies the profits that are taxable by a country by reference to their relationship to a PE, which should only exist, under the current framework, if a physical / tangible presence of the head-office in the source jurisdiction is identified – please refer to OECD (2018), paragraph 378.
582. Usually, whenever the recipient of such income is the respective beneficial owner, income taxed at source – through withholding tax – should not exceed rates ranging between 5% to 15%.
583. Indeed the double tax rights attributed to residence and source countries with respect to income from immovable property (either rents – article 6 or capital gains – article 13) are the modern expression of the Latin-criteria drafted under the Roman Law "Lex Rei Sitae", i.e., the applicable regulations to immovable property are the ones enacted in the territory in which such real estate assets are located.
584. OECD (2015) , paragraphs 28 to 32.
585. Or, in other words, "Sovereign states impose taxes based on the connection of profit with a state's territory, i.e. the direct connecting factor or source; and/or the connection of the beneficiary

of the profit with the state's territory, i.e. the indirect connecting factor or residence." - P. Valente, Digital Revolution,(…) page 2.
586. P. Valente (2018), o page 2.
587. The application of the arm's length principle is the key feature of the said profit allocation. To the specific case of PEs, arm's length requires the analysis of the functions performed, assets used and risks assumed by each associated enterprises/PE - please refer to OECD (2018), op cit., paragraph 378.
588. OECD 2018, paragraph 379.
589. OECD (2015), paragraphs 253 and 254.
590. Among several examples that may be at hand, we may look for net banking apps, which allow for individuals and companies to manage all their savings, movements, payments, credit cards etc. with no need to physically go to a desk.
591. OECD (2015), paragraph 256.
592. "Prevention of tax treaty abuse" and "Permanent establishment status", respectively.
593. The PPT determines that DTT benefits shall not be granted if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the DTT.
594. OECD (2015), paragraph 217.
595. OECD (2015), paragraphs 277 to 283.
596. OECD (2015), paragraphs 284 to 291.
597. For instance, US authorities have conducted anti-trust investigations to Google as its taxable income reported for US tax purposes was significantly lower comparing with its overall profits. The same applied to technology players like Amazon, Facebook, Apple, etc., to conclude whether these "big players", by being entitled to low-tax in its residence jurisdictions, are indeed conducting anti-competitive behavior Jalan, Nupur and Misquith, Elvira , pages 1-2.
598. OECD (2018), , pages 133 and further.
599. Looking for the already known models, in Israel, a "significant digital presence" is deemed to exist based on criteria such as the number of contracts with Israeli customers, high use of services by Israeli customers, website adaptations to Israeli customers (language, currency), high volume of web traffic from Israel, etc. In Indonesia, foreign sellers and operators of e-commerce platforms are required to appoint a local representative in the country to pay and report taxes, as a "de facto PE".

For instance, Nigeria adopted a PE threshold mechanism for non-resident companies with a gross turnover of above NGN 25 millions - Jalan, Nupur and Misquith, Elvira, page 6.
600. These measures are indeed supported by key changes implemented on a bilateral basis in existing DTTs, such as (i) broadening the domestic concept of royalties, allowing for the characterization of income previously regarded as "business profits" into "royalties" and thus being subject to withholding tax, (ii) introduction of WHT of fees for technical services, even though this was only implemented in the UN MTC and (iii) enacting new withholding taxes on specific categories of items – OECD (2018), pages 139-140.
601. Jalan, Nupur and Misquith, Elvir, page 5.
602. Among several countries which implemented the turnover taxes scheme, Zimbabwe enacted internal legislation foreseeing that any non-resident company providing broadcasting services that receives revenue higher than 500,000 USD from sales in Zimbabwe will be subject to tax. Argentina is other Country that followed the turnover tax scheme - Jalan, Nupur and Misquith, Elvir, pages 6 and 7.
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607. Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence 21 March 2018, available in: https://ec.europa.eu/taxation_customs/fair-taxation-digital-economy_pt
608. M. Alvarado, Digital Services Taxes across Europe in the Midst and Aftermath of the COVID-19 Pandemic: A Plausible Option to Raise Tax Revenue?, 61 Eur. Taxn. 9 (2021), Journal Articles & Opinion Pieces IBFD
609. Currently, Austria, France, Hungary, Italy, Poland, Portugal, Spain, Turkey and the United Kingdom have enacted DSTs, while Belgium, Czech Republic and Slovakia have published draft DST proposal,. Latvia, Norway and Slovenia have officially amounted the implementation of DSTs in a near future.
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628. Sean Lowry, Digital Services Taxes (DSTs): Policy and Economic Analysis, Congressional Research Service, Feb. 25, 2019, available at https://fas.org/sgp/crs/misc/ R45532.pdf.
629. Uber, for example, allegedly operates on a loss on a consistent basis: https://www.macrotrends.net/stocks/charts/UBER/uber-technologies/pre-tax-profit-margin
630. Businesses are in scope if their annual global revenues exceed EUR 750 million and EU revenues exceed EUR 50 million.
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636. For example, if a DST is to be considered to be, in fact, a Corporate Income Tax, it could raise issues with Double Taxation Agreements and the attribution of credits.
637. Data and graph available at: https://www.investopedia.com/articles/investing/120314/spotify-makes-internet-music-make-money.asp
638. Bunn, Daniel, Elkse Asen, and Cristina Enache, 2020, Digital Taxation around the World, p. 21. Available online: https://files.taxfoundation. org/20200527192056/Digital-Taxation-Around-the-World.pdf
639. Tax challenges Arising from the Digitalization of the Economy Global Anti-Base Erosion Model Rules (Pillar Two).
640. "The parallel rise of multinational enterprises and the historical development of international tax rules – Introspection for the new rules to tax the digital economy." By Annet Wanyanna Oguttu
641. Ibid.
642. OECD 2015 "Tax Challenges Arising from Digitalisation"
643. James Aim, "Tax Evasion, technology, and inequality"
644. OECD 2018 "Tax Challenges Arising from Digitalization – Interim Report 2018", page 25
645. https://taxfoundation.org/digital-tax-europe-2020/ ,consulted on 25/03/2023
646. https://taxfoundation.org/digital-tax-europe-2020/ ,consulted on 08/01/2022

647. The residual profit can be calculated between the total profit minus the routine profit.
648. Progress Report on Amount A of Pillar One (Two-Pillar Solution to the Tax Challenges of the Digitalisation of the economy).
649. Ibid.
650. Ibid
651. Ibid
652. Ibid
653. Ibid
654. Ibid.
655. Q = (P-R *10%) * 25% *L/R

Q = profit amount of the Covered Group to be allocated to a specific market jurisdiction.

P = Adjusted Profit Before Tax of the Covered Group

R = Revenues of the Covered Group

10% = Profitability Threshold

25% = Reallocation percentage of the profit

L = amount of Revenues of the Covered Group that arise in that specific market jurisdiction

Progress Report on Amount A of Pillar One (Two Pillar Solution to the Tax Challenges of the Digitalisation of the Economy)

656. https://eco.sapo.pt/opiniao/os-quatro-novos-acronimos-da-fiscalidade-internacional-e-o-acronimo-em-falta/