TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY: THE DEVELOPMENT OF THE OECD PROJECT AND POSSIBLE IMPLEMENTATION IN RUSSIA

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The digitalisation of the economy has created a number of complex problems in the area of taxation. A majority of these problems relate to the issue of the distribution of taxing rights between states in the context of taxing income received as a result of cross-border activities. This article discusses the initiatives of the Organisation for Economic Cooperation and Development (OECD) regarding the taxation of international groups of companies in the era of the digital economy. It considers methodological approaches to taxation of the digital economy and highlights the features of the digitalisation of the economy that play an important role in tax policy. The study undertaken is based on a comparative legal method that allows for the examination of similar legal problems found in legislation and international treaties, as well as the identification of optimal ways to solve them. The following main problem with taxation of the digital economy is highlighted: tax systems laid down in the 1920s traditionally take into account the principles of the source of income and residency. In the new world of globalization and the digital economy, these principles have become significant obstacles to international trade. It is on this ground that the issues of the new nexus as well as the new model of allocation of taxing rights should be established. The article provides an analysis of the OECD's two-pillar approach to these issues. Pillar 1 deals with the reallocation of profits of multinational enterprises to market jurisdictions. Pillar 2 deals with the issue of a global minimum tax. Additionally, the article discusses the various ways in which the new OECD concept could potentially be implemented in Russia.

Keywords: tax law; taxation of the digital economy; OECD; BEPS Action Plan; European Union; digital services tax; tax administration; corporate taxation; permanent establishment.

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Introduction

An important issue on the agenda of the international community is the development of the digital economy, which has significantly altered tax regulations around the world. The digitalisation of the economy has created a number of complex problems in the area of taxation, the majority of which relate to the issue of the distribution of taxing rights between states in the context of taxing income received as a result of cross-border activities. In this context, we are speaking not only about countering tax base erosion and profit shifting but, more importantly, about the new distribution of taxing rights.

The main characteristic of the digital economy is the diminished importance of the necessity for businesses to maintain a physical presence in market jurisdictions. Value is created through user engagement and is concentrated in intangible assets

that can be easily transferred to tax havens in order to minimize taxable profits. At the same time, corporate taxation systems continue to be based on the economic reality of the 1920s, when the rules of taxation were laid down according to territorial and resident principles. The conclusion of this brief discussion is that a tax in the origin country is unlikely to satisfy the criteria for a good tax on business profit.[1] In the absence of a consensus, many states have begun to formulate unilateral rules for the taxation of the digital economy. Inconsistencies in these rules will increase the tax burden of multinational enterprises (MNEs), given the fact that each state seeks to protect its own interests.

On 16 March 2018, the Organisation for Economic Cooperation and Development (OECD) presented an interim report on tax challenges arising from digitalisation (hereinafter the "OECD Interim Report").[2] On 21 March 2018, the European Commission published draft directives on taxation of the digital economy.[3]

As of October 2021, 137 countries have joined a new two-pillar approach to reform international tax rules and ensure that multinational enterprises pay their fair share of tax wherever they operate.[4]

The OECD's work on tax issues arising in connection with the digitalisation of the economy is divided into two distinct categories: Pillar 1 and Pillar 2. Pillar 1 deals with the reallocation of profit made by MNEs to market jurisdictions. Pillar 2 deals with the issue of a global minimum tax.

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1 Michael P. Devereux, *How Should Business Profit Be Taxed? Some Thoughts on Conceptual Developments During the Lifetime of the IFS*, 40(4) Fisc. Stud. 591, 608 (2019).

2 OECD, Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (March 2018) (Aug. 10, 2022), available at https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm.

3 European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM (2018) 147 final, 21 March 2018 (Aug. 10, 2022), available at https://taxation-customs.ec.europa.eu/system/files/2018-03/proposal_significant_digital_presence_21032018_en.pdf; European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final, 21 March 2018 (Aug. 10, 2022), available at https://taxation-customs.ec.europa.eu/system/files/2018-03/proposal_common_system_digital_services_tax_21032018_en.pdf; European Commission, Communication from the Commission to the European Parliament and the Council – Time to establish a modern, fair and efficient taxation standard for the digital economy, COM (2018) 146 final, 21 March 2018 (Aug. 10, 2022), available at https://eur-lex.europa.eu/resource.html?uri=cellar:2bafa0d9-2dde-11e8-b5fe-01aa75ed71a1.0017.02/DOC_1&format=PDF.

4 OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Base Erosion and Profit Shifting Project, 8 October 2021 (Aug. 10, 2022), available at https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

1. The Main Concepts of Taxation in the Era of the Digital Economy

1.1. The Challenges of Taxation of the Digital Economy

It is important to point out that the rules that were initially developed for digital companies are now established for MNEs in different industries. Starting with the fact that it is impossible to ring-fence the digital economy, it is far from easy to develop a framework within the context of corporate income tax that can capture profits derived by cross-border digital transactions in an orderly way.[5] Many MNEs have already restructured their production chains in order to separate basic manufacturing, which can be allocated a "routine" profit, from functions such as research and development (R&D) and design, which may be considered high-value-adding and can be located in areas where they will be lightly taxed at a lower rate.[6] Moreover, the sale of traditional products and the sale of digital ones are so closely connected that it is often effectively impossible to separate the integral parts that make up the complete service.[7]

The solutions proposed so far include tax measures that specify the jurisdiction of the source or the destination. Additionally, until a globally agreed solution is reached, the taxation options for digital companies discussed at the OECD, United Nations (U.N.) and European Union (EU) levels include short-term solutions aimed at adapting the existing international tax system to digital reality.

Historically, the methodology of international taxation was formed in the co-society of the states that are members of the OECD, as well as under the auspices of the U.N. The aim of the measures proposed by the OECD and the U.N. to solve the tax problems of the digital economy is to determine the "nexus" (this term will be defined below). These measures include a revision of the concept of a permanent establishment (PE), as well as an assessment of whether or not the collection and monetization of data leads to value creation for the purposes of transfer pricing. At the same time, digital enterprises should not be isolated from traditional ones, since the ultimate goal of forming new rules of taxation of digital companies is to create a global tax mechanism and an effective tax system.

Let us now focus our attention on the problems related to the taxation of a permanent establishment. This is a complex category of tax law, the purpose of which is to establish a fair taxation procedure for the activities of a foreign

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5 Wolfgang Schön, *Ten Questions About Why and How to Tax the Digitalized Economy*, Max Planck Institute for Tax Law and Public Finance Working Paper 2017-11 (December 2017) (Feb. 2, 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3091496.

6 The BEPS Monitoring Group, Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project (2018), at 9 (Feb. 2, 2022), available at https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf.

7 Karina Ponomareva, *Comparison of Proposals to Adjust the Permanent Establishment Concept to the Digital Economy*, 73 Bull. Int'l Taxn. 581 (2019).

organisation on the territory of the source state. It is one of the conditions under which a foreign organisation becomes obliged to pay tax.

The issue of the legal nature of a PE is closely related to categories that are basic in international and European doctrine and practice but have no analogues in the Russian language or Russian tax legislation. These are the nexus and the threshold.

The term "nexus" refers to a situation in which an enterprise is subject to taxation in the territory of a state because of its connection with that state. It is traditionally noted that the list of tax bindings that provide the necessary nexus of a subject with the state includes: citizenship (nationality); domicile or residence; presence or doing business in the country; finding property in the country or carrying out transactions in the country or transactions resulting in income in the country.[8]

1.2. Timeline of the Projects of International Organisations Devoted to Taxation of the Digital Economy

The OECD acknowledged in its Interim Report that the changing global economy calls into question the adequacy of the two main concepts underlying the taxation system. These are the profit allocation problem and the nexus problem. In its Action 1 Final Report, the OECD focuses on the fact that:

> New ways of doing business may result in a relocation of core business functions and, consequently, a different distribution of taxing rights which may lead to low taxation is not per se an indicator of defects in the existing system. It is important to examine closely how enterprises of the digital economy add value and make their profits in order to determine whether and to what extent it may be necessary to adapt the current rules in order to take into account the specific features of that industry and to prevent base erosion and profit shifting (BEPS).[9]

It was clear that the emphasis of the BEPS (base erosion profit shifting) Action 1 Plan was placed on constantly improving tax minimization tools within multinational corporations, with profit shifting to low-tax jurisdictions being only one of the elements. Gaps (differences) in the legislative bases of various countries, especially in the field of e-commerce and intangible assets, were particularly noted.[10]

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[8] *See* Charles H. Gustafson et al., *Taxation of International Transactions: Materials, Texts and Problems* 15 (2006).

[9] OECD, Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project (2015) (Feb. 2, 2022), available at https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1667812117&id=id&accname=guest&checksum=801BD101E030BA4C5E2608249B75B76A.

[10] *Котляров М.А., Рыкова И.Н.* Противодействие переносу налоговой базы в низконалоговые юрисдикции: опыт ОЭСР и приоритеты для России // Финансовый журнал. 2014. № 4. С. 51 [Maxim A. Kotliarov & Inna A. Rykova, *Prevention of Tax Base Shifting to Low-Tax Jurisdictions: OECD Experience and Priorities for Russia*, 4 Financial Journal 47, 51 (2014)].

The OECD has considered the following taxation options for the digital economy: (a) a new nexus rule in the form of a "significant economic presence" test, (b) a withholding tax which could be applied to certain types of digital transactions and (c) an equalisation levy, intended to address a disparity in tax treatment between foreign and domestic businesses in situations where the foreign business has a sufficient economic presence in the jurisdiction.[11]

The criterion of significant economic presence takes into account the following factors:

- Income-based factors;
- Digital factors;
- User factors.[12]

Thus, indicators for establishing a significant economic presence may include the following: the presence of a user base; the amount of digital content received from the jurisdiction; invoicing in local currency or using a local form of payment; maintaining a website in the local language; responsibility for the final delivery of goods to users (customers) or the provision of ancillary services, such as after-sales service or repair and maintenance; and sustained sales activity.

In 2018, the European Commission submitted a Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence (hereinafter the "Proposal") in which it considers the taxation of the digital economy within the framework of the Single Digital Market initiative and intends to regulate this area unilaterally at the EU level unilaterally.[13]

The Proposal presents both long-term and short-term measures. The most important long-term goals are to determine the assignment of the added value created and to adjust the international taxation rules of the permanent establishment.

In addition, the Commission proposes short-term solutions similar to those adopted by the OECD, such as an equalization payment from the turnover of digital companies, an income tax on digital transactions and a tax on income received from the provision of digital services or advertising activities.

A "significant digital presence" shall be considered to exist in a Member State in a tax period if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface and one or more of the following conditions is met with respect to the supply of those services by the entity carrying on that business, taken together with the supply of any such services through a digital interface by each of that entity's associated enterprises in aggregate:

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11 OECD, *supra* note 2, para. 20.

12 OECD, *supra* note 9, sec. 7.6.1.

13 European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, *supra* note 3.

(a) the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7,000,000;

(b) the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100,000;

(c) the number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that Member State exceeds 3,000.[14]

The profit will be distributed to such a PE on the basis of economically significant functions, namely its activities that it carries out through a digital interface that is connected with data and users. This activity is considered economically significant and includes the collection, processing and sale of user data; the collection, processing and display of user content; the sale of advertising space on the Internet; and the provision of content created by third parties for sale on the Internet market (Arts. 5(3) and 5(5) of the Proposal).

According to European scholars, the decision to focus the offer on users and the data they provide as factors in determining costs for most highly differentiated business models is a positive step, but this should be followed by a thorough study of the value creation process within these business models as well as an analysis of the location of significant economic activity.[15] However, enterprises are increasingly using multiple business models within the same legal entity. For example, there is no single universal model for the taxation of online platforms. Because these platforms are frequently built on the "principal-agent" model, the platform itself is not engaged in the provision of goods or services; rather, they serve only as an intermediary between the seller and the buyer. As a result, the platform is unable to establish a taxable presence in the state. Even if such a presence does exist, many traditional cost factors (for example, intellectual property) may exist outside of this jurisdiction. As a result, the total amount of income tax for such a company in countries where the firm has a large user base could end up being significantly small.

This approach is appealing for addressing the peculiarities of taxation of foreign digital companies in Russian tax legislation, for example, by using the structural elements of a PE agency.

The introduction of the concept of a digital permanent establishment is, in our opinion, the preferred method of taxation of digital companies engaged in conducting cross-border activities for the sale of goods or the provision of services via the Internet to users located in various jurisdictions. The main problem associated

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[14] European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, *supra* note 3, Art. 4.

[15] *See* Johannes Becker & Joachim Englisch, *Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?*, 47(2) Intertax 161 (2019); Lisa Spinosa, *A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*, 46(6/7) Intertax 476 (2018); Julia Sinnig, *The Reflection of Data-Driven Value Creation in the 2018 OECD and EU Proposals*, 27(6) EC Tax Rev. 325 (2018).

with the implementation of this concept is that it requires changes to double tax treaties (DTT). However, this is beyond the scope of this study.

Another problem is that, taking into account the differences in the positions of the countries reflected in the OECD Interim Report, the EU is attempting to impose a solution on the countries that are members of the OECD and the BEPS Inclusive Framework. At the same time, the tax systems of the EU Member States will continue to be vulnerable to BEPS from payments for services and royalties made to non-resident states. An alternative to the revision of all existing DTTs could be the adoption at the EU level of a multilateral document similar to the OECDs Multilateral Instrument (MLI),[16] according to which the existing DTTs between Member States would be modified to implement the digital PE definition.

In 2020, the course of reforms was affected by the crisis caused by the COVID-19 pandemic. As tax revenues from traditional industries decline due to the economic downturn, additional taxation of the digital sector can potentially compensate for this loss of fiscal revenue. However, considering the current growth in the volume of world-wide digital transactions, no country has yet been able to efficiently tax the local share of income that foreign digital businesses obtain from their markets. This problem can be solved either unilaterally or multilaterally.[17]

The current situation, in which people are increasingly using digital services for remote work and leisure, underlines the relevance of the OECD/G20 digital taxation project. Governments are mobilizing their tax systems to combat the economic crisis by putting pressure on national budgets. This may lead to a dilemma for governments as they negotiate the taxation of digital companies. States will not have the ability to arbitrarily raise national taxes (which will almost certainly be the result of any G20/OECD agreement), either during or after the economic crisis.

In the post-crisis period, therefore, it would be impractical to take a one-sided approach and enact new taxes, such as a tax on digital services. Therefore, we believe that the best approach for states would be to try to reach an agreement on a multilateral basis.

2. The OECD/G20 Two-Pillar Approach

On 8 October 2021, 137 countries and jurisdictions joined a new two-pillar approach[18] to reform international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate.

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[16] Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) (Aug. 10, 2022), available at https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

[17] Nikolai S. Milogolov & Azamat B. Berberov, *Russia in Global Digital Tax Reform: Together or Apart?*, 14(11) J. Sib. Fed. Univ. Humanit. Soc. Sci. 1731, 1733 (2021).

[18] OECD, *supra* note 4.

Here are the agreed components of each Pillar of the OECD's statement on a two-pillar solution.

2.1. Pillar One: The Key Points of the Concept of New Profit Allocation Rules

Pillar 1 provides for new profit allocation and nexus rules for MNEs that are in scope. These rules are embodied in "Amount A." According to the OECD Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy "in-scope companies are the multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10% (i.e. profit before tax/revenue) calculated using an averaging mechanism with the turnover threshold to be reduced to 10 billion euros, contingent on successful implementation including of tax certainty on Amount A, with the relevant review beginning 7 years after the agreement comes into force, and the review being completed in no more than one year. Extractives and Regulated Financial Services are excluded."[19]

Amount A requires the development of sourcing rules and a revenue-based allocation key. Details of these rules are not contained in the statement although the statement confirms that jurisdictions from which revenue of €1m or more is earned by an in-scope MNE will receive an allocation. This allocation is reduced to €250,000 for jurisdictions with a GDP of less than €40 billion.

Where the residual profits of an in-scope group are already taxed in a market jurisdiction, a marketing and distribution profits safe harbor will cap the residual profits allocated to the market jurisdiction through Amount A.

Furthermore, the statement confirms that all jurisdictions will be subject to mandatory binding arbitration with only a limited number of less developed countries being permitted to use an elective mechanism.

It also makes the commitment that no new Digital Services Taxes or other relevant similar measures will be enacted and imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the Multilateral Convention (MLC), whichever comes first. The MLC will require all parties to remove all existing Digital Services Taxes and any other relevant similar measures with respect to all companies, and to commit not introduce such measures in the future.

Extractive industries and regulated financial services remain outside of Amount A.

Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method.

The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit.

In-scope MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double taxation for Amount A, including all issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and

[19] OECD, *supra* note 4.

binding manner. Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism. An elective binding dispute resolution mechanism will be available only for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of MAP disputes. The eligibility of a jurisdiction for this elective mechanism will be reviewed regularly; jurisdictions found ineligible by a review will remain ineligible in all subsequent years.

The application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low-capacity countries (*Amount B*). This work will be completed by the end of 2022.

2.2. Pillar Two: The Global Anti-Base Erosion Rules (GloBE) Rules

According to the OECD Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy,

> Pillar Two consists of two interlocking domestic rules (together the Global anti-Base Erosion Rules (GloBE) rules):
>
> • Income Inclusion Rule (IIR), which imposes a top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and
>
> • Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR; as well as
>
> • Subject to Tax Rule (STTR) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GloBE rules. The taxing right will be limited to the difference between the minimum rate and the tax rate on the payment. The minimum rate for the STTR will be 9%.[20]

The GloBE rules will operate to impose a top-up tax using an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined by reference to financial accounting income (with agreed adjustments consistent with the tax policy objectives of Pillar Two and mechanisms to address timing differences).

The minimum tax rate used for purposes of the IIR and UTPR will be 15%.[21]

The GloBE rules will apply to MNEs that meet the 750 million euro threshold as determined under BEPS Action 13 (country by country reporting). Countries are free

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[20] OECD, *supra* note 4.

[21] *Id*.

to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold.

Government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities of an MNE Group or any holding vehicles used by such entities, organisations or funds are not subject to the GloBE rules.

2.3. Implementation and Timelines

The detailed implementation plan sets out key milestones that need to be reached for the finalization of the detailed rules, as well as the target timelines for legislation or treaties to be implemented or ratified and for the rules to be in effect.

• The GloBE model rules and commentary and the STTR model treaty provision and commentary will be developed by the end of November 2021.

• The multilateral convention (MLC) containing the Amount A rules and its explanatory statement, as well as model domestic legislation and commentary, are to be concluded by early 2022.

• The MLC signing ceremony is scheduled for mid-2022.

• The STTR multilateral instrument (MLI) is to be developed by mid-2022.

• The GloBE rules implementation framework will be completed at the latest by the end of 2022 (possibly including a multilateral convention for GloBE).

• The Amount B deliverables are scheduled to be released by the end of 2022. While the implementation plan refers to the need for consultation with stakeholders, it is not clear whether there will also be public release of the above documents at the times indicated.[22]

There are also a large number of open issues in the two-pillar approach that include the definition of MNE group, foreign de minimis revenue exclusion, Amount B rules (including status as mandatory or voluntary), design of mandatory and binding dispute resolution mechanism, safe harbour design, scope of the STTR and circumstances in which treaty upgrades are needed, technical design features such as losses, deferred tax, UTPR allocation mechanism and joint venture rules.[23]

3. Recommendations and Practical Proposals for Improving the Mechanisms of Taxation in the Era of the Digital Economy in Russia

3.1. Examples of International Tax Cooperation

Currently, work is actively underway on the implementation of reforms to international profit taxation (Pillar 1 and Pillar 2). Are there risks for Russia in this situation, or should we expect positive dynamics?

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[22] KPMG Update on October 2021 BEPS agreement on Pillar 1 and Pillar 2 (Aug. 10, 2022), available at https://assets.kpmg/content/dam/kpmg/ru/pdf/2021/10/ru-en-update-on-beps-agreement.pdf.

[23] *Id.*

The purpose of the current study is also to highlight issues of the OECD Action 1 Final Report which are relevant to Russian tax legislation. Some of the other BEPS actions have already been studied by scholars.[24]

International cooperation in tax administration is a new reality, at least with regard to the taxation of profit of the largest digital MNEs, provided that an international consensus is more or less reached within Pillar 1. It should be noted that international cooperation in the area of taxation is not a qualitatively new phenomenon and has been actively developing in recent years in many countries, including Russia. The following are three examples of such cooperative efforts:

1) the mechanism of VAT payment in the EU when importing digital services into the Single Market;

2) the mechanism for the provision and exchange of country reports of the CRS (country-by-country report) within the framework of Action 13 of the BEPS Project;

3) the International Compliance Assurance Program (ICAP) of the OECD. ICAP[25] is a voluntary program that allows multinational corporations to eliminate uncertainty and ensure predictability regarding the taxation of transactions and business activities in the participating states of the program.[26]

It should be noted that Russia participates in two of the three cooperation programs mentioned above, which indicates that the very idea of international cooperation in the field of administration is not new for Russia.

3.2. Possible Risks of Implementation of the New Rules

Despite the relatively high degree of detail of the dispute prevention and resolution mechanisms proposed by the OECD Pillar 1, there are still unresolved issues about how such an international cooperation mechanism will work in practice. A key source of tax risks for taxpayers and potential tax disputes between countries is associated with the inability to isolate Amount A from other CRS tax obligations (related to the application of transfer pricing rules, the determination of Amount B, etc.). It will require an unprecedented level of international cooperation as well as quick decision-making from the tax authorities of different countries in order for the mechanism for the distribution of global profits of the MNE to work in practice.

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[24] *See Берберов А.Б., Милоголов Н.С.* Оценка масштабов проблемы размывания налоговой базы в России // Финансовый журнал. 2018. № 6. С. 47–58 [Azamat B. Berberov & Nikolai S. Milogolov, *Assessment of the Scope of Tax Base Erosion in Russia*, 6 Financial Journal 47 (2018)]

[25] OECD, International Compliance Assurance Programme – Handbook for tax administrations and MNE groups (2021) (Aug. 10, 2022), available at https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/international-compliance-assurance-programme-handbook-for-tax-administrations-and-mne-groups.pdf.

[26] *Милоголов Н.С., Пономарева К.А.* Международная кооперация налоговых администраций при налогообложении цифровых бизнес-моделей: миф или реальность? // Налоги. 2021. № 3. С. 29–33 [Nikolai S. Milogolov & Karina A. Ponomareva, *International Cooperation of Tax Administrations in Taxing Digital Business Models: Myth or Reality?*, 3 Taxes 29 (2021)].

The proposed Pillar 1 mechanism for dispute resolution through international arbitration does not correspond to the position that Russia holds. Thus, none of the tax agreements in Russia contain provisions on mandatory dispute resolution. In addition, Russia did not accept the relevant provisions of the BEPS MLI when joining it. This position of Russia is connected with the fact that in the current political conditions and in the current conditions of intense international competition, the authorities of the Russian Federation do not consider it possible to transfer part of the national tax sovereignty to the supranational level. It is this factor (rejection of the mandatory dispute resolution mechanism) that may cause Russia to refuse to adopt the Pillar 1 approach discussed in the framework of the BEPS Project.

The mechanism of international cooperation of tax administrations in the taxation of digital business models as proposed by the OECD under Pillar 1 includes the following mechanisms:

1) a mechanism for self-declaration at the level of the ultimate parent entity of the group;

2) a mechanism for preventing disputes regarding Amount A and the instruments for involving the company in this mechanism;

3) a mechanism or legally-binding resolution of disputes that are affected by Pillar 1's rules;

4) the simplification and unification of the rules for attributing profits to basic marketing operations and resale operations (Amount B).

The key idea of the proposed rules is to provide the possibility of a "single window" through which the MNE can access all relevant tax administrations at once. We consider it expedient to implement this idea regardless of the success of the Pillar 1 initiative.

As for the proposed mechanism for mandatory dispute resolution, it has the following features. Firstly, a new multilateral mechanism for binding dispute resolution is proposed, which will be used if the existing mechanisms fail to resolve the dispute; and secondly, a wider range of issues than the determination of Amount A are expected to be covered by this mechanism (including Amount B, transfer pricing and the availability of PP). The main elements of the mechanism are the international panel discussions and a decision-making process based on the analysis of the proposals of the parties. The OECD justifies its proposals by the fact that the company located in the perimeter of Sum A bears a higher level of compliance burden and, as a result, should be entitled to better conditions in dispute resolution (the quid pro quo principle is a service for a service).[27]

[27] Milogolov & Ponomareva 2021.

3.3. Advantages of Possible Implementation of the New Rules

In addition to the obstacle outlined above (the mechanism of mandatory dispute resolution) to Russia's accepting the proposed Pillar 1 administration mechanism, some advantages of this mechanism should also be noted, including for Russia.

International cooperation in the field of tax administration in general is not an inconceivable phenomenon for Russia. Moreover, the Federal Tax Service of Russia is a world leader in the field of digitalisation of tax administration. The Russian tax monitoring system is recognized as the "best practice" of cooperation and collaboration of tax authorities with taxpayers in the OECD 2020 report, which summarizes trends in the digitalisation of tax administration.[28] Starting in 2018, the largest taxpayers have the right to apply to the Federal Tax Service of Russia with an application for the conclusion of a pricing agreement with the participation of a foreign competent authority. In addition, it should be noted that the payment of customs duties on the import of goods into the territory of the EAEU is carried out between the budgets of the EAEU Member States, based on their formula distribution and in accordance with established principles. Thus, the very idea of in-depth cooperation with the authorities of foreign countries on a variety of fiscal issues has already been reflected in the existing tax administration practices applied in Russia.

In this regard, our key recommendation for the development of tax administration in Russia is to expand and adapt the approaches proposed by the OECD under Pillar 1 to international cooperation in the field of digital business tax administration, while at the same time, taking into account national specifics and fiscal interests.

In addition, we agree with esteemed authors Milogolov and Berberov, who propose amending the corporate tax residence criteria in Russia with the aim of safeguarding its taxation rights as a state of residence in the context of virtual businesses. Scholars propose two ideas for such a reform. First, an assessment of the economic functions performed by a company in each state, as well as an analysis of the places of permanent residence (or places of vital interests) of key executives, would serve as useful extensions to the existing criteria for corporate residence under Russian domestic law. Second, the formalisation of corporate tax residence standards could also ensure tax certainty. The analysis of the geographical distribution of a company's assets and employees could serve as valuable evidence to support the conclusion that the company has an economic nexus with Russia as its state of residence.[29]

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[28] OECD, OECD Secretary-General Tax Report to G20 Leaders (November 2020) (Aug. 10, 2022), available at https://www.oecd.org/tax/oecd-secretary-general-tax-report-g20-leaders-november-2020.pdf.

[29] Milogolov & Berberov 2021.

3.4. Specifics of the Russian Tax Framework in Terms of Taxation of Digital Services

We believe that the necessity to respond to the challenges of the digital economy in the current conditions at the level of Russian legislation is beyond doubt. In addition, the effectiveness of the new rules can be ensured only if the measures implemented in the legislation of as many states as possible are harmonized. Otherwise, it will be impossible to ensure uniform regulation of cross-border tax relations.

Russia is unique in that it serves as both a market for consumers of digital services as well as a market for providers of these services. Russia is home to globally competitive information technology (IT) companies such as Yandex, VKontakte and others. However, Russian tax legislation has a number of features that allow foreign Internet companies to receive tax advantages in relation to Russian Internet companies.

Foreign companies, on the other hand, do not function as tax agents for personal income tax. Additionally, they do not pay insurance premiums when paying remuneration to individuals, and they apply income tax rates that are set by the countries in which they were incorporated. As a result, Russian technology companies bear a heavy tax burden and are unable to provide a competitive financial offer to content producers and service providers who find it more cost-effective to work with foreign platforms.

In this regard, we believe it may be appropriate to consider assigning foreign digital companies (in particular, Facebook, Twitter and Apple) the functions of tax agents when paying income to individuals for services rendered by them.

Currently, Russian legislation establishes the specifics of calculating and paying taxes when foreign organisations provide services in electronic form (Art. 174.2 of the Tax Code of the Russian Federation). However, there are still difficulties with how the Russian tax authorities are able to control the delivery of cross-border services, even with the implementation of this legislation.

In terms of personal income tax administration, our recommendation is to consider a mechanism for registering foreign technology companies for taxes. When foreign organisations provide services electronically (pt. 4.6 of Art. 83 and Art. 174.2 of the Tax Code of the Russian Federation), this mechanism is used to collect VAT payments in addition to the self-declaration and payment of personal income tax by those companies.

Furthermore, foreign companies do not pay corporate income tax in the territory of the Russian Federation on profits earned at the expense of users located in Russia. Due to the fact that this profit is generated by Russian users, it has an economic connection with the Russian market. Additionally, foreign companies customize their services for the Russian market by providing Russian-language translations of their services and user agreements adapted for users from the Russian Federation.

Thus, the current regulation does not allow taxes to be fully levied on the income that digital MNEs make from services relating to Russian users. At the same time,

Russian organisations engaged in similar business bear the tax burden by paying income tax, VAT, as well as other taxes and fees mandated by the Tax Code of the Russian Federation.

This increases the profitability of foreign companies providing digital services relating to Russian users compared with the profitability of Russian companies providing the same services. In this regard, we can talk about the violation of the conditions of fair competition between Russian and foreign digital companies.

In this regard, we believe that it is necessary to establish special rules for calculating and paying income tax on foreign digital companies while simultaneously expanding tax incentives for Russian companies. The increase in the share of the digital economy in relation to the volume of the traditional economy raises questions about the need to revise approaches to taxation of a permanent establishment both in the doctrine of tax law and in tax legislation.

As noted in the main directions of the budget, tax and customs tariff policy for 2020 and for the planning periods of 2021 and 2022, it is necessary to carefully work out the provisions of tax legislation that would allow declaring profits for tax purposes in those jurisdictions where users (customers) of digital companies are located, where profits are generated as a result of attracting, interacting and user contributions, as well as to develop new rules for the distribution of profits in countries using intangible marketing assets.[30]

3.5. Key Challenges of Regulating the Taxation of Digital Companies in the Russian Federation

We believe that the following are key challenges in regulating the taxation of digital companies in the Russian Federation:

- Protection of competition;
- Ensuring equal conditions for all market participants, regardless of the source of capital and the underlying jurisdiction;
- The presence of clear criteria for determining the range of regulated entities;
- The availability of effective enforcement mechanisms;
- The establishment of a tax regime that promotes the development of the Russian market and national digital companies.

We are talking about the implementation of state sovereignty in the form of new legal frameworks that encourage foreign companies providing services on the territory of the Russian Federation to comply with the requirements of national legislation not only in selectively (for example, in terms of taxation), but also in a broader sense.

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[30] Основные направления бюджетной, налоговой и таможенно-тарифной политики на 2020 год и на плановый период 2021 и 2022 годов // Министерство финансов Российской Федерации [Main Directions of the budget, tax and customs tariff policy for 2020 and for the planning period of 2021 and 2022, Ministry of Finance of the Russian Federation] (Feb. 2, 2022), available at https://www.minfin.ru/common/upload/library/2019/10/main/ONBNiTTP_2020-2022.pdf.

We propose using the experience already implemented in some EU countries of legalizing the activities of foreign companies and enshrining in legislation the obligation to conduct business through a specially created representative office in the jurisdiction of the actual provision of services or a national partner. In order to accomplish this, it is also necessary to introduce requirements for registering with tax authorities or for making payments through payment agents located within the jurisdiction of the Russian Federation, as well as to provide for the implementation of a representative office based on the personal account model in the information system.

Furthermore, we believe it is necessary to define the general criteria of the permanent establishment, which is a significant economic presence in the Russian Federation. These criteria can be summed up as follows:

1) implementation of activities related to digital services;

2) reaching the threshold number of users from the Russian Federation for the site, application, or resource;

3) registration of an electronic resource and systematic distribution of advertising in Russian;

4) achieving the minimum threshold of revenue from sales of digital services to consumers in the Russian Federation.

The existing rules of taxation of a permanent establishment require changes in the following areas:

1) recognize user participation as a key driver of value creation for digital enterprises;

2) identify the companies within the group with which users should be associated and those that should be taxed on profits related to the value created by the user;

3) allow jurisdictions in which users are located the right to tax these companies, even if they are non-resident companies that do not have a permanent establishment in accordance with traditional definitions;

4) select a method for the allocation of profit received by these companies as a result of user activity.

In addition, the internationalization of tax law inevitably entails the expansion of the conceptual apparatus of the doctrine of tax law. A comparative legal analysis of international and European practice has revealed that a permanent establishment is the minimum degree of presence that a non-resident should have in the country as a requirement for tax collection.

In this regard, it is proposed to introduce into scientific circulation the concept of nexus, which characterizes the relationship between the state and the subject (object) of taxation, on the basis of which the taxpayer is subject to taxation in this state. The proposed definition determines the validity of taxation either according to the presidential (if the relationship is based on the subject of taxation), or the territorial principle (if the relationship is based on the source of income on the territory of the state).

We propose the introduction into tax legislation (in Art. 306 of the Tax Code of the Russian Federation) of the expanded definition of a permanent establishment containing rules aimed at countering abuses developed within the framework of BEPS Action 7 and reflected in the position of the Russian Federation upon accession to the MLI. These norms comply with the provisions of Part IV (Avoidance of Permanent Establishment Status) of the BEPS Multilateral Convention (Art. 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies, Art. 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions, Art. 14 – Splitting-up of Contracts, Art. 15 – Definition of a Person Closely Related to an Enterprise).

These provisions have a broader scope than the taxation of digital international trade in goods and services, digital services and intangible assets. However, they are also related to e-commerce business models. For example, when applying the expanded definition of a permanent establishment, profits from the activities of non-residents when selling goods to local buyers from warehouses rented in the country and carried out through an Internet site whose work is fully supported from abroad will fall into the taxation perimeter.

Conclusion

It is clear that Russia has much to gain by adopting the measures proposed by the OECD. In particular, it will be able to rely on a part of the profits of digital multinational enterprises as one of the sales markets in which they operate. At the same time, Russia will be able to set its own thresholds for the revenue of digital giants in order to recognize those companies that are obliged to pay additional taxes in Russia because Russia is not an OECD Member State.

It is worth noting that digitalisation is the area of work in the OECD in which Russia excels the most. One example of this can be seen in the achievements of the Federal Tax Service in the field of digitalisation of control. For example, in the framework of tax monitoring, the use of online cash registers, among others.

The Ministry of Finance of the Russian Federation closely monitors trends in the taxation of multinational corporations, despite the fact that Russia is not a member of the Organisation for Economic Cooperation and Development and therefore should not introduce new rules based on its own decisions. Additionally, Russia plans to develop new rules for the distribution of profits in countries where intangible marketing assets are used.

As for the issue of taxation in the context of digitalisation, we recall that since 2013 it has been designated as one of the priorities of the BEPS Action Plan. In particular, within the framework of Action 1 of the BEPS Plan, it was possible to approach the resolution of a number of issues related to taxation in the context of digitalisation, including payment of VAT in digital commerce at the location of

the consumer (the so-called "Google tax"), digital PE and so on. These are some of the decisions that were defined and agreed upon at the international level in 2015. However, they did not fully contribute to the solution of the global problem, which is that digital companies do not have permanent establishments in the countries in which they sell their services to consumers, and as a result, they do not actually pay taxes in those countries.

Solutions that were outlined in the BEPS Action Plan can no longer save the situation. Rapid changes have begun to occur in this regard. For example, numerous European countries have begun to impose unilateral taxes on digital services (such as France, Italy etc.). Countries began to impose DSTs ranging from 2%–3% on income received from online mediation services and online advertising in the country. In fact, a new barrier in international trade has begun to form.

As mentioned above, the two-pillar approach will require countries to remove all digital services taxes and other relevant similar measures, as well as to commit to not introduce such measures in the future. No newly enacted digital services taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and the earlier of 31 December 2023 or the coming into force of the MLC. Thus, the OECD has come to the conclusion that taxes placed on digital services disrupt the global tax landscape.

International digital companies have to comply with reporting requirements that differ according to jurisdiction. This did not contribute to improving the fairness of the global tax system. In this regard, serious disputes and conflicts have begun to arise between countries, for example, between France and the United States over the implemented tax regimes in the field of digital services.[31] Of course, this is not the outcome the international community wanted: new barriers to trade and increased difficulties with tax administration. The world community has come to the realization that the further introduction of such taxes will lead to new trade conflicts and even trade wars between countries as they compete for the revenues of digital companies. On the other hand, the absence of a consensus-based solution could lead to a proliferation of unilateral digital services taxes and an increase in damaging tax and trade disputes, which would undermine tax certainty and investment, according to the OECD. In the worst-case scenario, which involves a global trade war triggered by unilateral digital services taxes worldwide, the failure to reach an agreement could reduce global GDP by more than 1% annually.[32]

As a result of these unilateral decisions, the goal was outlined – to choose a unified approach to solve the problem.

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[31] *See* Macron and Trump Declare Truce in Digital Tax Dispute, Reuters, 20 January 2020 (Feb. 2 2022), available at https://www.reuters.com/article/us-france-usa-tax-idUSKBN1ZJ24D.

[32] International community renews commitment to address tax challenges from digitalisation of the economy, OECD, 12 October 2020 (Feb. 2, 2022), available at https://www.oecd.org/tax/international-community-renews-commitment-to-address-tax-challenges-from-digitalisation-of-the-economy.htm.

The initiative of unilateral decisions limits the tax sovereignty of countries. The digital economy lacks clear boundaries, making it impossible to tax it within one jurisdiction. Taking into account today's realities, an internationally agreed definition of the solution to the problem is required. This is a new approach that is being developed on the international platform of the OECD. The digitalisation of business significantly affects the income of states from corporate taxes. These are the decisions that the competing market jurisdictions must fight for. The OECD has set itself the task of developing some approaches for the fair taxation of profits of digital companies (Google, Facebook, etc.), taking into account their presence in the market. Because it is obvious, for example, that Facebook's principal source of revenue comes is earned primarily on the potential of advertising, which is directed at users in various countries, including Russia.

In summarizing the topic of the new two-pillar solution the following observations can be mentioned.

Pillar 1 of the OECD is focused on the establishment of new rules of profit allocation. These rules are not limited solely to the physical presence of the company. The countries were attempting to figure out how they could change the existing provisions in order to introduce a new tax law for market jurisdictions, which previously did not exist in international tax law. Taking into account the fact that a significant number of users of the company are located in the jurisdiction and generate revenue for it, the new law should enable market jurisdictions, including Russia, to tax the profits of companies. This is an example of the new kind of notion that is reflected in Pillar 1.

Pillar 2 of the OECD is designated as a kind of direction that involves solving the remaining problems in the field of taxation. These were the issues that were not fully resolved during the implementation of the BEPS Plan. Thus, this could be regarded as a kind of 'spin-off' of the BEPS Action Plan in the context of further digitalisation of the economy.

The essence of Pillar 2 is the establishment of a minimum corporate tax rate for international companies, regardless of their location. Thus, if a company is located in a "tax haven," other countries will be able to collect tax from it at the minimum established rate, which will reduce the incentive for businesses to transfer profits to jurisdictions with lower tax rates. In the second direction, it is proposed to equalize the tax burden for multinational companies to the lowest possible level by the implementation of cross-border taxation. As a result, countries that have a reasonable tax rate and which are also locations in which multinational corporations operate will be able to claim an additional portion of the income tax, if that tax is kept to a minimal level in any other country. In addition to that, it provides for a review of the tax rates that are applied to paid income received in the form of interest and royalties.

In 2019–2021, countries held discussions on proposals pertaining to Pillar 1, within the framework of which it was proposed to determine three different categories of

taxable profit. The greatest interest is undoubtedly caused by Amount A, which describes the share of residual profit distributed between market jurisdictions. The majority of the questions that arose were regarding the definition of the coverage of companies to which the new rules were to apply. According to the OECD, the rules should be applied to multinational enterprises that can actively and sustainably participate in the economic life of a market jurisdiction without necessarily having a proportionate level of taxable presence in this market. Additionally, it was proposed that the rules should be applied to two categories of companies: firstly, to companies that provide digital automated services (online advertising services; online search engines; social networks; digital content services, etc.); and secondly, to consumer-oriented businesses. When it came to the first category, everything was more or less clear. However, it was more difficult to justify the boundaries of coverage of a consumer-oriented business for the application of the new rules. The OECD also proposed that the rules only apply to sufficiently large MNEs whose revenues exceed 750 million euros (by analogy with the coverage of cross-country reporting requirements under the CbC MCAA).

In 2021, the approach to the coverage of MNEs has been significantly changed compared to the previous year. The OECD's statement on the two-pillar solution no longer addresses the categories of digital automated services and consumer-oriented businesses. The new rules will apply to MNEs with a global turnover of more than 20 billion euros and profitability above 10%. The extractive sector and financial services will be excluded from coverage. As a result, the OECD identified two new goals: a multilateral instrument that will be used to implement Amount A (to be developed and opened for signatures in 2022) and that Amount A should enter into force in 2023.

Pillar 2, which consists of the Global Rules for Combating Base Erosion (GloBE) as well as the Rules on Taxation (STTR), allows the parent company to impose an additional tax on low taxable income. Additionally, these rules allow source jurisdictions to impose a limited source tax on certain payments of related parties that are taxed below the minimum rate. Pillar 2 aims to limit competition in terms of income tax by introducing a global minimum corporate tax rate that countries can use to protect their tax base. According to the statement, this rate should be at least 15%. This raises the question of the future prospects of the existence of preferential tax regimes in countries with respect to income tax. The Ministry of Finance of the Russian Federation has already expressed concern about the risks arising from the Pillar 2 proposal for Russian preferential tax regimes (for example, in the IT industry). Everything needs to be weighed and worked out.

It is already evident that the planned changes will have a large-scale impact on the activities of the MNEs. Given how quickly the reforms will go into effect, it is important that groups potentially affected by the reforms can make adequate preparations for the prospective changes to their legal frameworks.

Changes in the international tax and legal fields will require changes in national regulation and the ratification of multilateral documents by the relevant states. It will be crucial for companies to make use of the appropriate tools to assess the impact of regimes on their activities, assess interdependence and prevent double taxation or other unintended impacts. In the future, countries will be required to implement each component of the global tax reform, which will create additional difficulties.

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