TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY: A LEGAL AND ECONOMIC ANALYSIS OF OECD'S ONGOING EFFORTS AND MAIN CHALLENGES

by

Grazielle Gonçalves Pereira

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AUTHORSHIP DECLARATION

I hereby declare and confirm that this thesis is entirely the result of my own work except where otherwise indicated. I acknowledge the supervision and guidance I have received from Professor Basanta Kumar Pradhan. This thesis is not used as part of any other examination and has not yet been published.

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ABSTRACT

The G20/OECD BEPS Project was created to tackle the tax base erosion and profit shifting done by Multinational Enterprises, divided in fifteen actions. This paper analyses the BEPS Project, focusing on Action 1 (Tax Challenges Arising from the Digitalisation of the Economy) and the Two-Pillar Solution proposed in 2021, and identifies the main legal and economic challenges for its implementation by the countries. The main challenges identified were the difficulty of applying a uniform solution for countries with considerably different social and economic positions, the domestic aspects faced by the countries to modify their tax law, the difference in relevance that each country gives to the proposed measures, and the fact that the positive effects of the Proposed Solutions will only be noticeable after a wide implementation.

JEL Classification: K34, F23, E61

Keywords: International Tax Law, International Business, Multinational Enterprises, OECD, Base Erosion and Profit Shifting

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1. INTRODUCTION

1.1. Background and Context

Taxation is one of the ways a country exercises its sovereignty (OECD, 2013a, p. 15). Nevertheless, when business activities involve more than one country there will be some inconsistencies and gaps as to which tax law is applicable (OECD, 2013a, p. 9). To address this issue while respecting the countries' sovereignty, the international corporate tax system started to be developed in 1923 in the context of the Report on Double Taxation prepared by the League of Nations (IMF, 2019, p. 49).

Since then, globalisation has increased the complexity of commerce and, consequently, taxation. New business models, corporate structures, and tax treaties were created to accommodate such changes.

Nevertheless, with the digitalisation of the economy and the increase in the number of Multinational Enterprises ("MNEs"), these challenges become harder to address using the existing international tax framework. Basic concepts and assumptions, such as physical presence, used for calculating taxes and assessing transfer pricing strategies, no longer apply to some of the largest companies today.

This led to the increase of tax avoidance by MNEs through tax-planning strategies that consist of exploring legal loopholes for shifting their profits to low or no-tax jurisdiction, causing an erosion of the countries' tax base, resulting in

uncertainty and unpredictability for businesses and governments[1]. As stated by the Organisation for Economic Co-operation and Development ("OECD") (2013a),

> Governments are harmed. [...] Overall resource allocation, affected by tax-motivated behaviour, is not optimal. [...] Individual taxpayers are harmed. [...] Other taxpayers in that jurisdiction bear a greater share of the burden. Businesses are harmed. [...] Fair competition is harmed by the distortions induced by BEPS ["Base Erosion and Profit Shifting"]. (p. 8)

In an attempt to solve this issue, in 2012 the G20 Finance Ministers engaged the OECD to study the situation and propose guidelines for the countries' tax systems, trying to create a more seamless and integrated international tax framework.

The OECD delivered the reports on the BEPS Project in 2015, and a fifteen-action framework was created to address the issue (the "Inclusive Framework"), allowing the interested countries and jurisdictions, including developing countries, non-OECD, and non-G20 members, to take part in the creation of norms and implementation of the designed measures (United Nations, 2017, p. xiii).

This paper is focused on Action 1 - Tax Challenges Arising from the Digitalisation of the Economy. For Action 1, a Two-Pillar Solution was created in 2021. The Two-Pillar Solution was developed to modify international taxation rules

[1] Corporate taxes are levied as a percentage of the company's income or profit. If such income or profit is shifted to another jurisdiction the amount of income or profit that will be considered for levying the taxes is reduced, which is called "base erosion". As a result, the amount of taxes paid by the company and collected by the country where the income was generated will be reduced as well.

and ensure that MNEs pay a fair share of tax wherever they operate. So far, over 135 countries and jurisdictions, members, and non-members of OECD, have committed to the Inclusive Framework (OECD, n.d.b*).*

However, modifying tax laws is not an easy task. It requires that every country engaged in this initiative change its domestic laws to reflect the solutions proposed by OECD, resulting in legal, economic, and political challenges not only in the international aspect but also inside these countries.

1.2. Research Question and Objectives

This paper aims to analyse the Two-Pillar Solution proposed by OECD under a legal and economic aspect to answer the question **"What are the main legal and economic challenges to implementing the OECD Two-Pillar Solution on BEPS?"**

Considering the relevance of the project, as it involves many countries and proposes bold developments to international taxation, it is important to understand what can delay its implementation and prevent its success as a way to ensure its effectiveness, otherwise all the efforts and investments in developing such project would have been wasted.

Thus, the objective of this paper is to analyse what has been developed so far regarding the BEPS project and identify the factors that may hinder or delay the implementation of the Two-Pillar Solution by the willing countries, suggesting some strategies to increase the efficiency of these policies.

1.3. Scope and Methodology

This paper focuses on the analysis of Action 1 of the OECD/G20 Inclusive Framework, about the Tax Challenges Arising from the Digitalisation of the Economy, giving special attention to the Two-Pillar Solutions developed by the OECD and their implementation by the countries. The other 14 actions of the Inclusive Framework are not analysed in this paper, although some of them are mentioned when strictly related to Action 1.

A qualitative research and literature review of the papers published by the OECD regarding the tax challenges arising from the digitalisation of the economy and BEPS was performed, complemented by a review of papers published by other international institutions and legal and economic researchers about the matter.

Considering the contemporaneity of the BEPS Project and this paper, many OECD efforts were still ongoing when this paper was written and therefore were not reflected here.

This methodology was chosen due to its ability to provide insights into the patterns and goals of the international community regarding this topic, as well as insightful information on the timeline of the latest developments from a legal and economic perspective.

2. TAXATION IN THE DIGITAL ECONOMY

2.1. Traditional Corporate Taxation Models and Their Applicability

According to the Traditional Corporate Taxation Models, the taxation is done primarily in the country where the business activities took place and residually in the company's country of residence. To avoid double taxation, several Double-Taxation Agreements ("DTA") were made between countries to allocate the tax base among them according to some principles and rules (IMF, 2019, p. 49), such as the "*nexus*" and "*profit allocation*" rules (OECD, n.d.b*)*. Currently, there are more than three thousand DTAs in force (IMF, 2019, p. 49).

The "*nexus*" rule relies on the existence of a permanent establishment of the business in the source country, which is often understood as a physical presence (IMF, 2019, p. 49), like an office, a branch, a factory, a store, etc. The existence of a "*nexus*" between the company and the country is a requirement for the government to be entitled to tax a company.

When there is a "*nexus*", the next step is to determine the "*profit allocation*" among the jurisdictions the company operates to allocate the profits to the jurisdiction where the profitable activities were performed (OECD, n.d.b*)*.

However, a customary practice among MNEs is to have transactions between the companies that are part of its corporate group, the so-called "*related entities*". These intra-group transactions are called transfer pricing transactions and can involve several things, from the transfer of services and goods to financial loans.

> Transfer prices are the prices set for goods or services traded between different divisions or entities within the same firm. In effect, transfer pricing determines how profits are allocated within an MNE Group and how much tax is paid on those profits in different jurisdictions. (Laudage et al., 2024, p. 1)

To ensure the due allocation of profits arising from MNEs' transactions with their related entities, transfer pricing rules were created. These rules are based on the Arm's Length Principle ("ALP"), through which the companies should value the transactions within their corporate groups at market prices for tax purposes, that is, the taxes would be levied considering prices to which third parties in the same conditions would agree (IMF, 2019, p. 49).

> To limit harmful profit shifting and tax avoidance, governments worldwide have introduced anti-tax avoidance rules into their domestic tax codes. Transfer pricing (TP) legislation aims to limit profit shifting and harmful tax avoidance by regulating the setting of transfer prices by MNEs. The core of TP legislation is the arm's length principle, which states that transactions between related parties should be set as between two unrelated parties, i.e. at arm's length. (Laudage et al., 2024, p. 1).

2.2. Challenges in Taxing Digital Businesses Using Traditional Taxation Models

The Traditional Corporate Taxation model is not perfect, but it has been used (and useful) for a long time. However, with the digitalisation of the economy, the

assumptions and criteria of this model are no longer enough. The "*nexus*" rule is based on permanent establishment, which is not identifiable when businesses are selling products or rendering services online from another jurisdiction, even if an economic and online presence can be noticed (OECD, 2013b, p. 20).

Furthermore, there is an increase in the use and reliance on intangible assets and multi-sided business models that rely on value created by free products (ex: social media), making it hard to identify where the creation of value occurred, where the source of income is, what can be considered income, and where is the company's country of residence, hindering the use of the "*profit allocation*" principle (OECD, 2013b, p. 20).

> A key reason why tax systems are under pressure is the extent to which capital and profits have become internationally mobile, which in turn is driven by changes in the fundamentals that affect the production and organization of global firms: the role of intellectual property, new business models (including an increasingly important role for digital services) and technological change. All this leads to a fall in the cost of doing business globally and facilitates international tax avoidance and income shifting of multinational corporations (MNCs). (Merlo & Wamser, 2023)

These challenges can be summarised in three terms: (i) scale without mass, (ii) reliance on intangible assets, and (iii) centrality of data (the "Challenges") (OECD, 2013a, p. 10).

2.2.1. Scale without mass

This challenge refers to the possibility of digital businesses having a significant economic market presence and generating significant revenue in a country without having a permanent establishment there.

Companies are now able to export their products without having an office or a warehouse in another country or, in the case of services and intangible assets, to sell their services and products digitally, having customers in other jurisdictions without the need for a physical presence.

All the infrastructure and workforce can be located in one country while rendering services and selling products to other countries, allowing the companies to escalate their business internationally without having a permanent establishment abroad.

Without the permanent establishment, there would be no "*nexus*" and, therefore, no right for the countries to duly tax the income generated by these businesses, resulting in an erosion of the country's tax base and diminished tax revenue collection, since their customers would be spending their money overseas and the companies would not be paying taxes there.

2.2.2. Reliance on intangible assets

This challenge refers to the reliance of digital businesses on intangible assets such as intellectual property, digital products, algorithms, know-how, copyrights,

etc., instead of tangible assets, like physical goods, workforce, machinery, sales income, and real estate.

Intangible assets are harder to value and easier to transfer among jurisdictions, making it nearly impossible to accurately allocate the revenue generated through their use among different jurisdictions using traditional transfer pricing methods.

Furthermore, it is harder to have a reference price to assess intangible assets on ALP since often there is no comparison between that asset and other company's assets. This difficulty explains why the main tax avoiders are companies that rely on digital businesses, such as Google, Apple, and Microsoft (Zucman, 2015, p. 104).

2.2.3. Centrality of data

The third challenge refers to the reliance of digital businesses on data, especially personal and market data. The data is collected for many reasons, like developing their product, creating targeted advertising, providing personalised services, etc. The challenge is that the place where the data is collected, processed, and used is often not the same, making it hard to apply the "*nexus*" and "*profit allocation*" rules.

Furthermore, it is hard to assess how much the data that was collected impacted or generated revenue for the company. Again, there are no grounds for valuation or for making a comparative analysis with competitors, as often the data

collection, the value of data, and how the data is used are unique for each digital business.

2.3. Tax avoidance through the shifting of profits by MNEs to low or no-tax jurisdictions

Profit shifting by MNEs to low or no-tax jurisdictions is no news. Companies are always looking for ways to increase their profits and generate more return on investment for their shareholders. Since taxes are a big part of the financial burden a company faces, it is nothing but expected that companies will look for places where the tax rates are lower and, therefore, their profitability can be higher (OECD, 2013b, p. 28).

> To minimize the overall tax burden, an affiliate in a high-tax country pays an inflated (i.e. above the market price) transfer price for an input or service provided by an affiliate in a low-tax country. This behaviour shifts profits from the high-tax affiliate to the low-tax affiliate, where profits are subject to zero or low taxes. (Laudage et al., 2024, p. 1)

> A key determinant of shareholder value under current corporate reporting standards is Earnings per Share ("EPS"). An important element of EPS is tax, which means that the net effect of having an ETR of 30% is that any earnings are reduced by 30%. [...] Although excluded from EBITDA ["Earnings before interest, tax depreciation and amortisation"], the ETR also has an impact on other financial indicators used by corporate analysts, such

> as the ROE [“Return on Equity”] or the WACC [“Weighted Average Cost of Capital”], and therefore the stock valuation. (OECD, 2013b, p. 30)

Profit shifting is often done following the law, by exploring loopholes instead of taking illegal paths. As stated by the OECD, “MNEs engaged in BEPS comply with the legal requirements of the countries involved.” (OECD, 2013b). Merlo & Wamser (2023) reviewed the work done by Tørsløv et al. (2022), which was based on 2015 macroeconomic data and concluded that multinationals shift around 36% of their profits to tax havens.

Nevertheless, due to the Challenges, it is harder to apply the transfer pricing and ALP rules to digital businesses to ensure the correct allocation of taxing rights and the control of these loopholes. It is easier for digital companies to choose the most favourable jurisdiction for each step of the process, allowing them to develop the intangible assets in one country while being headquartered in another, registering them in a third country and using and profiting from them globally.

This tax avoidance leads to two consequences: (i) MNEs are paying fewer taxes than what they should be paying and (ii) governments are collecting fewer taxes due to the erosion of the tax base, i.e. the profits and income linked to that country through the *“nexus*” and *“profit allocation*” rules.

2.4. Base erosion and profit shifting (BEPS)

When assessing the income and profit of traditional business models, factors such as the revenue obtained through sales, tangible assets, workforce, payroll,

imports and exports of goods and services, and financial transactions are good indicators (OECD, 2013b).

However, when assessing digital business, these aspects are less relevant since their income is often unrelated to them. The lack of definition about which aspects should then be assessed for establishing the tax base can negatively impact the ability of governments to identify corporate tax revenues and effectively collect the applicable taxes (Clausing, 2015). The OECD (2013a) states that:

> Inaction in this area would likely result in some governments losing corporate tax revenue, the emergence of competing sets of international standards, and the replacement of the current consensus-based framework by unilateral measures, which could lead to global tax chaos marked by the massive re-emergence of double taxation. [...] some countries may be persuaded to take unilateral action to protect their tax base, resulting in avoidable uncertainty and unrelieved double taxation. (OECD, 2013a, p. 10-11)

3. OECD PROPOSED SOLUTIONS

To deal with the Challenges mentioned above, the G20 requested the OECD to conduct some studies and create frameworks to adequate the international tax system to the new economic models, which resulted in the BEPS Project. The work on this project started in 2013 and is still ongoing.

This paper focuses on Action 1 of the BEPS Project, “Tax Challenges Arising from the Digitalisation of the Economy'', for which a Two-Pillar Solution was proposed (“Proposed Solutions”). The main goals of the Proposed Solutions are to establish model rules to make it harder to have tax planning strategies exploring legal loopholes to reduce tax rates (LexLatin, 2023) and to ensure MNEs pay a fair share of tax wherever they operate (OECD, n.d.b), avoiding a tax fight between States (the “Model Rules”).

> The tax challenges arising from the resulting increase in the share of cross-border equity ownership and the share of foreign-to-total corporate profits, can only be addressed through international policy coordination. (Merlo & Wamser, 2023, p. 2)

The countries and jurisdictions that took part in the development of the Inclusive Framework agreed on some characteristics of the new Model Rules, as described in the OECD Report on the Pillar One Blueprint:

> [...] any new rules should be based on net basis taxation, should avoid double taxation and should be as simple as possible. They stressed the

importance of tax certainty and the need for improved dispute prevention and dispute resolution tools. (OECD, 2020b, p. 10)

According to Leonardo Andrade, interviewed by LexLatin, each Pillar covers distinct aspects of taxation: Pillar One is about who and where, while Pillar Two is about how much (LexLatin, 2023). Therefore, the Model Rules combine the aspects of the Two Pillars to define the scope and measures that should be considered and implemented to ensure the Minimum Effective Taxation ("MET") on income tax (LexLatin, 2023), as defined below.

3.1. Pillar One – Re-allocation of taxing rights

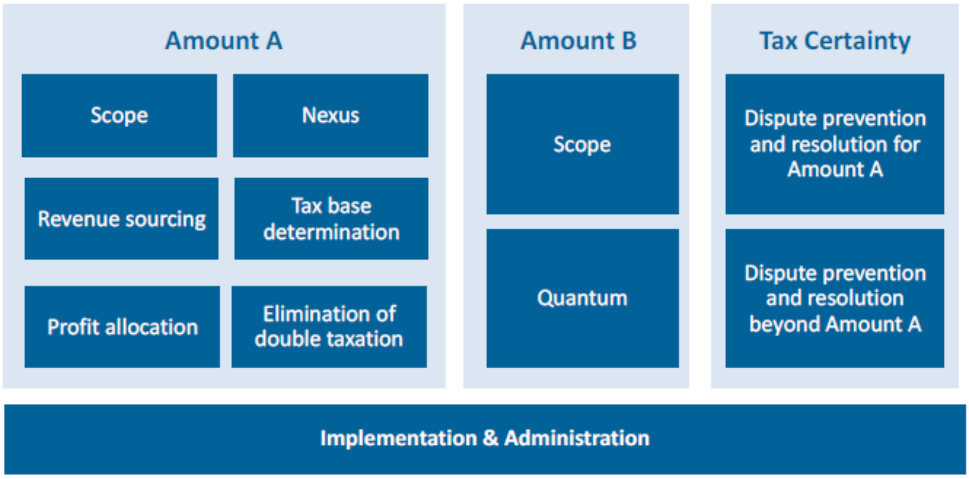
This pillar focuses on establishing new criteria for a fairer distribution of profits and allocation of taxing rights among jurisdictions regarding MNEs, including digital MNEs, updating the "*Nexus*" rule to be based on significant economic presence instead of permanent establishment and the "*Profit Allocation*" rule to allocate taxing rights to the jurisdictions where they have business activities and generate income and profit, as a way to recognise the value created by their digital activity (OECD, 2020b, p. 11).

Pillar One solution is comprised of three parts:

> [...] a new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level (Amount A); a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP (Amount B); and

processes to improve tax certainty through effective dispute prevention and resolution mechanisms. (OECD, 2020b, p. 11)

To effectively build this pillar, the OECD identified eleven aspects that need to be addressed, as per Figure 1 below, extracted from the Report on the Pillar One Blueprint (OECD, 2020b, p. 11):



Although the Report on the Pillar One Blueprint gives an extensive technical explanation about how the aspects above should be addressed, the OECD recognises that some issues need to be solved through political decisions, namely (i) the scope of Amount A, mostly regarding which kind of business should be subjected to these rules; (ii) the Quantum, or amount of profit to be allocated; and (iii) the extent of tax certainty (OECD, 2020b, p.11-12). The scope of Amount B, which was a pending issue, was further detailed in a separate report published by the OECD in February 2024.

For starting the implementation of this pillar, the Multilateral Convention to Implement Amount A of Pillar One ("MLC") was published by the OECD Inclusive Framework in October 2023 (OECD, 2023b) and was expected to be signed by the jurisdictions' members of the Inclusive Framework in June 2024, but this did not happen yet, delaying its entry in force, which was initially expected to happen in 2025 (European Parliament, n.d.).

3.2. Pillar Two - Global anti-base erosion ("GloBE") rules

The second pillar focuses on creating a global minimum threshold for corporate income tax to stop the "race to the bottom"[2], protect countries' tax bases, and reduce the incentives for MNEs to shift their profits to jurisdictions with favourable tax rates. The intention is to design a global approach to implement these rules comprehensively, avoiding the burden of amending hundreds of DTAs.

The GloBE Rules were released at the end of 2021 to define the scope and mechanisms of Pillar Two, including the Income Inclusion Rule ("IIR"), which consists of topping-up taxes on parent entities due to a low-taxed subsidiary overseas, and the Under Taxed Payments Rule ("UTPR"), which consists on topping-up taxes by denying tax deductions or tax adjustments if a subsidiary of the MNEs located in a low-tax jurisdiction is not subject to the IIR (EY, 2021).

[2] The race to the bottom can be described as a competitive behaviour of countries to attract companies to their jurisdiction by reducing their tax rates, pushing the other countries to do the same and, consequently, pushing the tax rates down.

The strategy is to top-up tax on profits resulting from activities in jurisdictions with an Effective Tax Rate ("ETR") below the minimum threshold of 15% (MET) (EY, 2021). The top-up IIR and UTPR taxes can be collected either by the jurisdiction where the subsidiary or the headquarters of the MNE Group is.

However, for a jurisdiction to be able to collect the top-up taxes, it must have a domestic minimum tax that follows the Pillar Two rules, the Qualified Domestic Minimum Top-Up Tax ("QDMTT") (Schjelderup & Stähler, 2023).

> Once a domestic minimum tax meets the QDMTT conditions, any QDMTT paid by an entity will be fully creditable against any liability under Pillar Two rules. This means that a QDMTT will effectively change the order in which jurisdictions are entitled to charge top-up taxes where the effective tax rate of an entity within Pillar Two falls below the 15% global minimum rate. (Schjelderup & Stähler, 2023, p. 4)

Schjelderup & Stähler (2023) also detailed how the Pillar Two rules would be applied:

> To know if top-up tax is owed, rules are needed to calculate the Effective Tax Rate (ETR) in each jurisdiction where the multinational enterprise operates. This requires first a calculation of the income that a subsidiary in a low-tax country has (called GloBE income) and, second, a calculation of the tax (referred to as "covered taxes") on that income. The ETR is then found by dividing the tax amount by the tax base (GloBE Income).

> Once the effective tax rate is calculated, the top-up tax rate percentage is the difference between the 15% minimum rate and the subsidiary's ETR. Income taxed at less than 15% would be targeted for additional taxation. That top-up tax percentage is then applied to the GloBE income in the jurisdiction, after deducting a Substance-based Income Exclusion (SBIE)[3]. The SBIE reduces the exposure to the minimum tax and is calculated as a percentage markup on tangible assets and payroll costs. Profits after the deduction of the SBIE are called excess profits, and the top-up tax owed is found by multiplying excess profits by the top-up tax rate. (p. 3)

To make it more visual, Vella et al. (2022, p.11) drafted some formulas. First, to calculate the ETR for the jurisdiction:

$$ETR = \frac{Adjusted\ Covered\ Taxes}{Adjusted\ GloBE\ Income}$$

[3] Article 5.3.2 of the OECD Model Rules (OECD, 2021) provides that "the substance-based income exclusion amount (SBIE) is based on the total of the payroll carve-out and the tangible asset carve-out for each constituent entity in a jurisdiction (excluding investment entities). This is based on the assumption that tangible assets and payroll are a good indicator of genuine economic activities. The payroll carve-out is equal to 5% of the constituent entities' eligible payroll costs of eligible employees that perform activities for the MNE Group in the jurisdiction, except payroll costs that are: capitalized and included in the carrying value of tangible assets (as they would be taken into account for the tangible asset carve-out); attributable to international shipping income and ancillary income that is excluded for Pillar Two GloBE purposes. [...] Eligible tangible assets include: property, plant, and equipment located in the jurisdiction; natural resources located in the jurisdiction; a lessee's right of use of tangible assets located in the jurisdiction; and a licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets. In order to qualify for the tangible-asset carve-out, the tangible assets must be located in the same jurisdiction as the constituent entity that owns them or has the right to use the assets." (Hadnum, 2022)

After obtaining the ETR, the next step is to calculate the Pillar 2 top-up (Vella et al., 2022, p.11):

*Top Up = Max (15% - ETR, 0) * (Adjusted GloBE Income - SBIE) - QDMTT*

These rules[4] would apply to companies "of an MNE Group with an annual revenue of EUR 750 million or more in the Consolidated Financial Statements of the UPE ["Ultimate Parent Entity"] in at least two of the four Fiscal Years immediately preceding the tested Fiscal Year." (OECD, 2021, p.8). The initial plan was to implement them into the countries' domestic legislation as of 2022, which did not happen.

However, this is not (yet) the end of fiscal paradises since Pillar 2 is only applicable to companies that reach the EUR 750 million annual revenue threshold and, thus, nothing will change, at least for now, to the other companies (LexLatin, 2023). Additionally, this also does not mean that the ETR of the MNEs subject to Pillar 2 rules will be at least 15%, since some carve-outs and deductions can be considered when calculating the ETR, for example, the SBIE.

> [...] Pillar Two will not bring the total amount of taxes paid on an MNC's [multinational company] excess profit in a low-tax jurisdiction up to the minimum rate of 15% as long as the Substance-based Income Exclusion

[4] The GloBE Rules has some exceptions, excluding Governmental Entities, International Organisations, Non-Profit Organizations, and Pension Funds of its scope either if they are a UPE of an MNE Group or not, and Investment Funds and Real Estate Investment Vehicles only if they are the UPE. Nevertheless, these companies should still be considered for determining the composition of the MNE Group and checking if the MNE Group exceeds the thresholds defined by the GloBE rules or not (OECD, 2021).

[SBIE] is positive. How close one gets to the minimum tax depends on the size of the elements in the SBIE calculation and the percentage share used. (Schjelderup & Stähler, 2023, p.4)

4. IMPLEMENTATION OF THE PROPOSED SOLUTIONS

Based on the discussions that arose due to the BEPS and resulted in the Proposed Solutions, the countries started to take some actions to adapt their tax systems and reflect the Proposed Solutions. It is important to note that the jurisdictions taking part in the Inclusive Framework are not required to adopt the Proposed Solutions.

However, if they decide to adopt such rules, it should be done following the Model Rules. Another aspect is that jurisdictions that are members of the Inclusive Framework must accept the use of the GloBE rules by other Inclusive Framework members (EY, 2021).

Despite the conjugated efforts of the jurisdictions that are members of the Inclusive Framework, OECD, and G20, the implementation of the Proposed Solutions is delayed. The Co-Chair of the OECD/G20 Inclusive Framework on BEPS, Tim Power, highlights that a multilateral process aiming at producing stability and based on consensus needs time to count with the participation of the interested parties in identifying issues and proposing solutions (EY, 2024).

According to LexLatin (2023), many of the tax experts they interviewed shared the view that Pillar One has been left aside. The discussions and implementation timeline has been extensively extended, likely because of its diminished monetary impact when compared to Pillar Two and the lack of interest of the US, since US companies would be especially affected by its provisions (LexLatin, 2023).

Furthermore, the countries' commitment to implement the Proposed Solutions to their domestic law differs considerably and is especially influenced by their potential loss in case of a late implementation (LexLatin, 2023). Thus, despite the potential increase in tax collection, it is still unclear how much the tax collection will increase in each jurisdiction and globally.

4.1. The case of EU

The European Union ("EU") Member States approved in December 2022, with the favourable vote of all jurisdictions but Hungary, which abstained from voting, the Directive 2022/2523 to ensure a global minimum level of taxation for MNEs and large-scale domestic groups (the "EU Directive"), as per the solutions proposed on Pillar Two (EY, 2022). Additionally, a statement restating the commitment of the EU to implementing the Two-Pillar Solution, including the MLC, was also approved (EY, 2022).

> The Council: REAFFIRMS the commitment of the EU to the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy as well as to the agreed implementation plan thereof and INVITES all members of the OECD/G20 Inclusive Framework on BEPS to live up to their commitment on both pillars;
>
> NOTES that since 2017 the EU has addressed the tax challenges arising from the digitalization of the economy and its continuous work has contributed to the global agreement on the Two-Pillar Solution; CONFIRMS

> its continued support of the work at the OECD Inclusive Framework on BEPS and fully commits to the successful accomplishment of the ongoing work on the elements of Pillar 1, including the multilateral convention [MLC];
>
> RECALLS our determination to have both Pillar 1 and Pillar 2 implemented as agreed in October 2021; to that end, WILL MONITOR closely the ongoing negotiations of the multilateral convention (MLC) on Pillar 1 and STRESSES that it will as necessary and regularly reassess the situation accordingly with a view to ensuring a swift solution on the tax challenges arising from the digitalization of the economy; [...]. (Council of the European Union, 2022a)

The main concerns of the EU Directive were to implement rules as close to the GloBE Rules as possible and to ensure compatibility with the EU law. Thus, the EU Directive applies both to entities registered in a jurisdiction member of the EU and to foreign entities that have a PE in an EU member state. To ensure that cross-border and domestic transactions are not being treated with discrimination, the EU Directive is also applicable to large domestic groups. That is, the EU Directive applies to any domestic or international large group that has a parent company or a subsidiary located in a jurisdiction member of the EU (European Commission, 2024).

Since the EU Directive closely follows the GloBE Rules, it applies similar thresholds and criteria. The EU Directive states that the MET rule applies to MNEs and domestic companies with annual revenues of at least €750 million (EY, 2022). It also includes the IIR and the UTPR for applying the top-up tax, which should be

collected each time that the MET due on the income is not reached by an entity of an MNE Group in a certain jurisdiction (Council of the European Union, 2022b).

The main differences between the EU Directive and the GloBE Rules are (i) the implementation timeline, which should start on or after December 2023 instead of the beginning of 2023; (ii) the inclusion of domestic entities groups in the scope of the directive; (iii) the option for states member of the EU to include a domestic top-up tax for companies located in their jurisdictions instead of the top-up through the IIR or the UTPR; (iv) extension to domestic entities of the IIR; (v) the option for member states that do not have more than 12 UPE that falls under the application scope of the EU Directive located in their jurisdictions for delaying the application of the IIR/UTPR rules for six consecutive years; and (vi) the inclusion of a framework for assessing the IIR regimes of non-EU countries to establish which jurisdictions have rules that can be considered as equivalent to IIR.

The EU Directive came into force on 01 January 2024 and is now under the 10 years transition rule, defined by the EU Taxation and Customs Union as follows:

> […] the substance carve-out starts off at 8% of the carrying value of tangible assets and 10% of payroll costs. For tangible assets, the rate declines annually by 0.2% for the first five years and by 0.4% for the remaining period. In the case of payroll, the rate declines annually by 0.2% for the first five years and 0.8% for the remaining period. (Taxation and Customs Union., n.d.)

Regarding Pillar One, the EU manifested its willingness to propose a directive for its implementation when the OECD proposals are “sufficiently mature” (European Parliament, n.d.).

4.2. The case of Brazil

Brazil is not a member of the OECD, but the country is working its way to join the organisation and is currently the non-member country participating in the highest number of OECD projects and adhering to the highest number of OECD legal instruments (Ministério Da Economia, 2022).

Brazil has been part of the Inclusive Framework since the beginning and the current government seems to be positive about including the Proposed Solutions in the domestic law.

The country approved Law 14.596 in 2023 to regulate the transfer pricing rules for entities in an MNE Group. This law brings to the domestic law some of the principles being discussed in the Inclusive Framework, especially the ALP and single tax principle[5], which are measures to avoid transfer pricing and double non-taxation, being in line with the solutions proposed by Pillar Two (LexLatin, 2023).

Brazil’s tax system is overly complex and includes several different federal, state, and municipal taxes, making it harder to compare with the tax systems of other countries (Oliveira, 2021). The country is currently discussing a tax reform to unify its

[5] The Single Tax Principle states that cross-border income and profits must be taxed at least once. (Avi-Yonah, 2015)

taxes, adopting the VAT, which would bring Brazil's tax system closer to the system adopted by most countries.

However, the ongoing tax reform does not include specific rules regarding the challenges in taxing digital business or steps to implement Pillar Two rules into Brazil's tax system (Oliveira, 2021). Thus, except for Law 14.596/2023, there is no tangible development regarding the implementation of Pillar Two into Brazilian law, unlike what was done by the EU.

4.3. The case of India

A good example of unilateral domestic action in line with BEPS recommendations is India's case. In 2016, the country adopted the concept of Significant Economic Presence ("SEP") and implemented an equalisation levy of 6% on online advertising and related services and, in 2020, a 2% equalisation levy on the online sale of goods and services (Vasal, 2021). This tax became commonly known as the "Google Tax".

The SEP was brought to the domestic legislation through the concept of "business connection". According to Vasal (2021) for Grant Thornton India, the OECD states that:

> […] a non-resident enterprise would create a taxable presence in a country if it has a SEP in that country on the basis of factors that have a purposeful and sustained interaction with the economy by the aid of technology and other automated tools. (Vasal, 2021)

However, the implementation of this tax in India's domestic legislation and its coexistence with the international tax treaties can result in a legislation overlap, since according to the international tax treaties, the "*nexus*" rules and, therefore, the PE requirement, are still applicable. Thus, if a non-resident company fulfils the requirements for the application of a tax treaty, like having an office or branch in the country, it would not be impacted by the SEP domestic rules and would not be obliged to collect taxes in India (Vasal, 2021).

The main application of the SEP rule would be for the cases in which no tax treaty is applicable, like when a company is from a country that has no tax treaties with India (Vasal, 2021). When the equalisation levy is applicable, no further income tax is due in India (Vasal, 2021).

However, with the implementation of Pillar Two solutions in many countries, India started to face a dilemma regarding its unilateral measure and the withdrawal or modification of such levies has been continuously discussed.

India, like China and the US, and unlike many economically relevant jurisdictions such as the UK, Canada, Australia, and all EU member states, has not yet made any commitments to implement the Pillar Two solutions (Baker, 2024a). A commitment in this regard was expected by the international community when the 2024/2025 Union Budget was announced on 23 July 2024, but it did not come.

India's Finance Minister Nirmala Sitharama, however, announced that the 2% equalisation levy will be abolished on 01 August of the same year, no longer applying

to digital companies, online education-providing firms, and software-as-a-service providers without a permanent physical presence in India (ETtech, 2024). The levy of 6% on online advertising and related services, however, remains in force.

Kumarmanglam Vijay, partner at JSA Advocates & Solicitors, said in his interview with The Economic Times that this decision

> […] to abolish the 2% levy while leaving the 6% equalisation levy imposed on online advertising revenues untouched is also in line with the global commitments of the Indian government's adherence to the Pillar Two consideration of the OECD. (ETtech, 2024)

Currently, India's corporate tax already exceeds the MET of 15%, being between 15% and 30% for local companies and 40% for foreign companies. Nevertheless, due to some tax treaties, tax incentives, tax credits, and other specificities, some companies pay less than the MET stated on the GloBE rules. Furthermore, there are Indian companies with subsidiaries or parent companies located in low-tax jurisdictions, which also result in MNEs operating in India paying less than the MET.

> India is losing more than USD 10.3 billion in taxes every year due to international corporate tax abuse and private tax evasion, according to a report by the State of Tax Justice (Business Today, 2020). (Jain, 2021)

Therefore, it is likely that the best way for India to benefit from the implementation of Pillar Two solutions is through the adoption of the IIR, which would

allow the India Government to collect top-up taxes from Indian MNE Groups with entities in low-tax jurisdictions (Baker, 2024b).

Nevertheless, there is no ongoing legislative proposal in India regarding the creation of domestic law reflecting and implementing the Pillar Two solutions (PWC, 2024) and, due to the complexity of the GloBE rules and the challenges that will arise from its implementation in the local law, likely, India will still take some time to do so.

5. POLICY ANALYSIS AND RECOMMENDATIONS

5.1. Economic Analysis

This paper does not focus on discussing the economic reasons behind the existence of taxation, or its social and legal basis. Nevertheless, it is important to highlight that taxes are mainly used for funding public services and activities, from state administration to health and education services. Therefore, an impact on the tax base impacts the tax collection, which will likely impact public investment and thus the general welfare of the population.

> [...] rights cost money. Rights cannot be protected or enforced without public funding and support. This is just as true of old rights as of new rights, [...]. (Holmes, 1999)

Hence, the economic impact of digitalisation on taxation needs to be seen as much more than just the shifting of profits or the erosion of the ETR paid by MNEs, but also as an event that impacts the countries' tax collection and public investment, leading to consequences in the development and growth of a nation.

It is undeniable that the financial development of a country is intricately linked to its development and economic growth rates. There is no way to talk about financial development in a globalised world without discussing international taxation and institutions.

> [...], insufficient financial development has sometimes created a "poverty trap" and thus become a severe obstacle to growth even when a country has established other conditions (macroeconomic stability, openness to trade, educational attainment, etc.) for sustained economic development (Jean Claude Berthelemy and Aristomene Varoudakis 1996). (Levine, 1997, p. 708)

Thus, before diving into the relevance of international taxation and institutions for financial development, a quick deviation to understand what is considered development and economic growth based on some economic models and how digitalisation changed it.

5.1.1. Economic Growth and Development

In a few words, economic growth can be “defined as annual rates of change in income (total or per capita)” (Debraj, 2014). Two of the most important economic growth models are the Solow Model and the Harrod-Domar Model, briefly summarised below.

The Solow Model, a Neoclassical Economic Growth model, considers that capital accumulation, labour force growth, and technological progress are the variables capable of impacting economic growth (Debraj, 2014). Meanwhile, the Harrod-Domar Model, a Modern Economic Growth model, focuses on the role of savings and capital-output ratio in driving economic growth (Debraj, 2014).

Despite focusing on different variables and conditions, these models mostly focus on variables regarding the production process, such as capital, investment, labour, and resources, to analyse economic growth. These variables make sense when the timeline of these theories is considered, as they were created in the first half of the twentieth century, in a world that was expanding its industrial potential and still had strong colonialist views.

Thus, other aspects, like history, geography, and sociological reasons were not taken into account or only briefly discussed by these theories.

Some economic theories developed at the end of the twentieth century, like the legal origin theories, bring some of these aspects to the table, especially when analysing the economic growth of colonised countries.

> Differences in legal tradition (Rafael LaPorta et al. 1996) and differences in national resource endowments that produce different political and institutional structures (Stanley Engerman and Sokoloff 1996) might be incorporated into future models of financial development. (Levine, 1997, p. 703).

Moreover, some more recent political economic theories also analyse broader variables, such as the institutional, political, and economic factors that impact the economic growth of a country. Regarding the relevance of institutions, North (1990) states that “they [the institutions] are the underlying determinant of the long-run performance of economies” (North, 1990).

Acemoglu (2012), for example, brings to the analysis the differences between institutions as one of the main reasons for differences in economic growth among countries, differentiating extractive institutions, which are “designed to extract incomes and wealth from one subset of society to benefits different subset” (Acemoglu, 2012, p.84), from inclusive institutions, which

> [..] create inclusive markets, which not only give people freedom to pursue the vocations in life that best suit their talents but also provide a level playing field that gives them the opportunity to do so. Those who have good ideas will be able to start businesses, workers will tend to go to activities where their productivity is greater, and less efficient firms can be replaced by more efficient ones. (Acemoglu, 2012, p.84)

His theory has some connections with the Solow Model regarding the importance of technology for economic growth, but he puts the variables differently. For him, inclusive economic institutions are what create the conditions for technological and educational increments to enable labour, property, and capital to increase productivity and generate sustained economic growth (Acemoglu, 2012).

> The ability of economic institutions to harness the potential of inclusive markets, encourage technological innovation, invest in people, and mobilize the talents and skills of a large number of individuals is critical for economic growth. (Acemoglu, 2012, p. 86)

With this more complex view regarding economic growth, it is possible to start understanding the concept of development and how it relates to economic growth and the changes in economic growth theories over the years.

Development is a recently created social-economic concept. Initially, it was understood as a synonym for economic growth, as per the use of this concept by Lewis (1954), Cairncross & Lewis (1956), and Rosenstein-Rodan (1944).

> Development, which had suffered the most dramatic and grotesque metamorphosis of its history in Truman's hands, was impoverished even more in the hands of its first promoters, who reduced it to economic growth. For these men, development consisted simply of growth in the income per person in economically underdeveloped areas. It was the goal proposed by Lewis in 1944 and insinuated by the United Nations Charter in 1947. (Esteva, 2009, p. 8)

Using the term "development" to describe the condition of a country only started in 1949 with US President Truman (Esteva, 2009). He was not the first to use it, but it was from his first speech as president onwards that the term stuck (Esteva, 2009).

The word development came from its use in biology and evolution carrying meanings that, wanting or not, reflected colonialism and North American/Eurocentric points of view, since it represents "a favourable change, a step from the simple to the complex, from the inferior to the superior, from worse to better" (Esteva, 2009); being

the underdeveloped countries (Asia, Latin America, and African countries) the bad and the so-called developed countries (mostly, EU and US) the good.

During the second half of the 20th century, other aspects of development, not only economic growth, started to be discussed, mainly the social and human (individual) aspects of development, focusing on the fulfilment of basic needs and conditions.

The discussion about development took different shapes and generated multiple policies over the past 70 years, the most recent being the Sustainable Development Goals ("SDG"), adopted by the member countries of the UN in 2015. The SDGs are managed by the UN Department of Economic and Social Affairs ("UNDESA"), which shows that economic and social matters are just as relevant for the concept of development in the view of today's international community.

This broader concept of development and the acknowledgement by the international community that a coordinated global effort is needed to achieve sustained development closely relates to the arguments of Acemoglu (2012) about the importance of institutions to pave the way for economic growth, and further, development.

Therefore, this global understanding explains why an international institution like the OECD is taking the lead on behalf of the countries in discussing BEPS and proposing solutions to face this problem together instead of individually, as an effort

to strengthen the international and domestic institutions as well as the international collaboration.

5.1.2. Economic Challenges of the Digitalisation

It is undeniable that digitalisation changed everything. When looking at the initial economic growth models, even the Solow model that considered technological developments as a variable to increase productivity, none of them could foresee the scenario we have today.

Technology not only increased labour productivity, but it changed labour, it changed the market, changed what is capital, asset, establishment, or even what is income and profit and the criteria to understand where that income and profit came from. It brought the Challenges to the table and changed the way businesses are done.

The scenario of uncertainty created by the existence of legal loopholes and lack of enforcement resulting from the inefficiency of applying traditional taxation methods to the digital business directly impacts economic growth and development, since it creates information asymmetry, transaction costs, and free rider problems.

> Governments work to ensure the highest level of growth for the highest level of well-being. Growth depends on investments, which includes foreign investments. As investments take into account, together with several other factors, taxation, governments are often under pressure to offer a competitive tax environment. (OECD, 2013b, p. 28)

Taking the above-mentioned concept of development to the financial and fiscal analysis of this paper, the existence of reliable financial institutions both at the international and domestic levels is essential for creating conditions to promote development.

When taxes are analysed from this perspective, taking into account that taxes are what finances the institutional efforts and that globalisation and international relations between companies and customers are unavoidable, the present topic becomes even more relevant. As stated by the OECD in its Action Plan on BEPS, “International tax law is therefore a key pillar in supporting the growth of the global economy.” (OECD, 2013a, p. 7).

Therefore, the creation and empowerment of institutions to solve these market failures and promote sustained development and economic growth is essential.

> Financial markets and institutions may arise to ameliorate the problems created by information and transactions frictions. Different types and combinations of information and transaction costs motivate distinct financial contracts, markets, and institutions. (Levine, 1997, p. 690)

5.1.3. Impact of the Proposed Solutions on Investment and Economic Activity

With the above-mentioned arguments in mind, the Inclusive Framework starts to make even more sense, as its core is to create guidelines that will allow domestic

and international institutions to coordinate their actions towards a shared goal: preventing the “race to the bottom” and protecting the countries’ tax base.

Since the project is just starting to be implemented by the jurisdictions that are members of the Inclusive Framework, the effective impacts of it cannot be assessed right now. Nevertheless, the OECD prepared an Economic Impact Assessment (the “Report”) to forecast, based on some illustrative assumptions, the potential impacts of the Proposed Solutions on tax revenues, MNE investment, and economic activity.

According to the Report, it is expected that the Proposed Solutions will generate a

> [...] small increase in the average (post-tax) investment costs of MNEs. [...] Overall, the negative effect on global GDP [“Gross Domestic Product”] stemming from the expected increase in tax revenues associated with the proposals is estimated to be less than 0.1% in the long term. (OECD, 2020a, p. 11)

The Report predicts that the Proposed Solutions could increase the “global corporate income tax (“CIT”) revenues by 1.9% to 3.2%, or about USD 50-80 billion

per year" (OECD, 2020a, p. 14)[6], as detailed in Table 1.1 of the Report (reproduced below).

Table 1.1. Overview of global tax revenue effects from the proposals

Estimates based on illustrative assumptions on the design and parameters of Pillar One and Pillar Two

Estimated global tax revenue gains		In % of global CIT revenues	In USD billion
Pillar One		0.2%-0.5%	5-12
Pillar Two	Direct revenue gains	0.9%-1.7%	23-42
	Additional gains from reduced profit shifting	0.8%-1.1%	19-28
	Total Pillar Two	1.7%-2.8%	42-70
Total Pillar One and Pillar Two		**1.9%-3.2%**	**47-81**
US GILTI regime		0.4%-0.8%	9-21
Total, including GILTI		**2.3%-4.0%**	**56-102**

It is worth mentioning that although the impact seems low, the biggest impact of the Proposed Solutions will be creating tax certainty for taxpayers and tax administrations by correcting the existing legal loopholes.

[6] "These estimates assume [...] that the US Global Intangible Low Tax Income ("GILTI") regime would coexist with Pillar Two and US MNEs would not be subject to the IIR under Pillar Two. [...] Taking into account the combined revenue gains of both pillars and the US GILTI regime, the total effect could represent about USD 60 - 100 billion per year or up to 4% of global CIT revenues." (OECD, 2020a, p. 14)

Tax certainty can prevent (a) tax and trade disputes based on legal loopholes and tax uncertainty and (b) the creation of unilateral and overlapping tax measures by the jurisdictions aiming to protect their domestic tax base (OECD, 2020a, p. 145).

Besides, tax uncertainty also brings advisory costs, since a high-level team of accountants, lawyers, and lobbyists will have to be engaged by the MNEs and governments to advise them regarding the confusing tax rules and to defend them in case of disputes and litigation. These costs are hard to measure, but they are definitely relevant and cannot be ignored.

Another expected result is that non-tax factors will become more relevant for investment decisions, such as “infrastructure, education levels or labour costs” (OECD, 2020a, p. 21). This can become an incentive for governments to invest in these aspects to attract foreign investments and MNEs to their countries.

With the implementation of a minimum ETR, there will likely be “some relocation of investment away from low-tax jurisdictions” (OECD, 2020a, p.142) because of the increase in the costs of investing in such places (OECD, 2020a, p. 21). Therefore, although the global investment may be only slightly impacted, the low-cost jurisdictions are likely to be considerably affected by this change, since their main competitive advantage was their low tax rate.

Additionally, the Report suggests that the additional tax revenues collected by the governments through the Proposed Solutions could have positive effects on the economy of the countries, especially of developing countries that are usually in

more constrained budgetary situations, since they would be able to use this revenue for investments, paying public debts, etc. (OECD, 2020a, p. 143). The Report does not bring an estimate of this revenue increase or its economic effects as this depends on the decision of each country regarding their budget allocation (OECD, 2020a, p. 143).

Furthermore, the Report recognizes that the Proposed Solutions may lead to an increase in costs for MNEs and governments since measures for compliance and management of the new requirements will be needed, but it does not estimate its extent (OECD, 2020a, p. 19).

Overall, the Report expects that the Proposed Solutions will not significantly affect the investment rates of the MNEs subject to these changes, but it will probably create a more competitive market between MNEs and domestic companies (OECD, 2020a, p. 144).

> [...] entities in MNE groups with a profitability rate between 0% and 10% would, on average, reduce their domestic investment rate by around 0.15 percentage points following a one percentage point increase in the jurisdiction's EMTR ["Effective Marginal Tax Rate"]. The size of this effect is almost half as large for entities in MNE groups with profitability ratios above 10% and more than three times smaller for entities in MNE groups with profitability rates above 15%. (OECD, 2020a, p.155)

Finally, the Report brings some expected impacts on the global economy if the Proposed Solutions are not widely adopted by the countries. One important remark made by the Report is that the scenario where the Proposed Solutions are not implemented cannot be understood as the current scenario (OECD, 2020a, p. 144) since we are only beginning to feel the effects and consequences of taxing digital businesses using traditional taxation methods.

According to the Report, the most likely consequences of not adopting the Proposed Solutions would be the already mentioned creation of multiple domestic taxes regarding digital business, which would probably result in overlapping tax legislation, leading to economic inefficiency, tax increases and trade disputes, likely reducing global investment and output (OECD, 2020a, p. 144).

The Report estimates that these negative effects could reduce the global GDP by around -0.1% to -1.2%, which is quite significant, especially when compared to the less than 0.1% reduction that is expected with the implementation of the Proposed Solutions (OECD, 2020a).

Moreover, it is important to note that the Report was published in 2020. Hence, it does not consider or reflect the impacts of COVID-19 on the economy and in the investment levels, since the pandemic was still ongoing when the Report was finished.

Lastly, some criticism is required when looking at the predictions highlighted above, as they are all based on illustrative assumptions and were prepared by the same institution that developed the project itself.

5.2. Legal Analysis

The main discussion regarding the legal aspects of the BEPS is that the taxes are imposed by the countries on companies according to their domestic legislation, as taxes are one of the main expressions of a country's sovereignty.

> Tax policy is not only the expression of national sovereignty but it is at the core of this sovereignty, and each country is free to devise its tax system in the way it considers most appropriate. (OECD, 2013b, p. 28)

However, in a connected world, powered by international trade, it is naive to think that a country's domestic legislation can be designed without considering external influence. To do so would result in legal, economic, and financial isolation, which nowadays can completely halt the economic activity and development of a country. "From a government perspective, globalisation means that domestic policies, including tax policy, cannot be designed in isolation." (OECD, 2013b, p. 28)

Therefore, considering the changes in the global economy resulting from the constant digitalisation of business and the previously mentioned relevance of institutions, both domestic and international, it is more than adequate, it is necessary, to discuss legislation on the international taxation of MNEs in a global forum, since it is a topic that concerns and affects all countries.

> “Globalisation has in effect caused products and operational models to evolve, creating the conditions for the development of global strategies aimed at maximising profits and minimising expenses and costs, including tax expenses. At the same time, the rules on taxation of profits from cross-border activities have remained fairly unchanged, with the principles developed in the past still finding application in domestic and international tax rules.” (OECD, 2013b, p. 27)

Nevertheless, the countries’ sovereignty to legislate their tax policies, the different political and economic legal preferences among the countries, their diverse domestic legislation, and their various positions as economic actors in the world cannot be ignored in this discussion.

5.2.1. Challenges in Harmonizing Taxation Laws

A big challenge is that some of the Proposed Solutions may be in discordance with the countries’ internal legislation, which would require a legislative procedure to amend the domestic law to adequate it to the novel solutions.

However, the internal processes for countries to change their tax law are often subject to strong political interests and disputes. Additionally, the proximity of elections, congress composition, the country’s current economic and social situation, and the country’s position as an international economic actor are all aspects that can impact the legislative procedure.

Likewise, as exemplified in the case of Brazil, there may be ongoing legislative discussions about changing the tax system of the country in a more profound way, which may lead the legislators to leave this international discussion about corporate income tax law on the side to focus on tax discussions that are more appealing to their public or the present needs of the country.

Another aspect that is considered by the countries when assessing the urgency for implementing international treaties in their domestic law is how much the implementation of such laws will impact their country. In the case of the Proposed Solutions, their analysis is focused on how much this will impact their tax collection and the tax incentives they currently have for corporations.

Naturally, countries seeing a bigger impact will work more effectively and with a bigger sense of urgency to see the Proposed Solutions implemented as fast as possible to their domestic law, as well as to proceed with other adjustments that may be required to the existing domestic law. On the other hand, countries that do not foresee a substantial impact on their tax collection with the implementation of the Proposed Solutions will not treat this as a priority and, therefore, are unlikely to invest time and money in implementing it.

Another challenge is the administrative burden that will result from the implementation of the Proposed Solutions since adhering to the law does not mean that the individuals working in the governmental institutions will be ready to work for their enforcement. This burden is even bigger for developing countries since most of them are still working to strengthen their institutions and enforce the law.

The enforcement of the new legislation by the domestic institutions will require the creation of informative material for companies and individuals as well as training for the government staff who will be monitoring the companies and enforcing the new law. This is not done overnight and requires investment and planning, thus delaying the implementation and the results.

However, it has been noted that, lately, governments and companies are adopting a more collaborative approach regarding tax matters, mainly to ensure compliance with the legislation and transparency from the companies, resulting in more legal certainty for all parties involved (OECD, 2013b, p. 31).

This cooperative approach can be valuable for speeding up the implementation process, since governments and companies will be able to share their thoughts and challenges along the way, reaching a result that is comprehensible and enforceable for both sides.

5.2.2. The Role of Law

The role of law in the scenario discussed in this paper is to create new behaviour guidelines for MNEs regarding their tax planning and for governments regarding their tax collection to reflect the changes resulting from the shift to a digital economy.

Basu (2015) summarizes this role of law in his famous citation: “The law works, to the extent that it does, by creating focal points in the game of life or the

economy game; and, further, this is the only way in which the law affects individual behavior and collective outcomes." (p.16)

The development of the BEPS Project and the creation of the Proposed Solutions are doing exactly what Basu (2015) states, creating new focal points for the behaviour of companies and governments regarding the taxation of international business, to make them more coherent with the current situation and to create more certainty for all the parties involved.

> New international standards must be designed to ensure the coherence of corporate income taxation at the international level. [...] There is a need to complement existing standards that are designed to prevent double taxation with instruments that prevent double non-taxation in areas previously not covered by international standards and that address cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. (OECD, 2013a, p. 13)

Nevertheless, as already mentioned in this paper, the enforcement and efficiency of these guidelines depend on the countries bringing the Proposed Solutions to their domestic legislation and starting to enforce this new regulation, since it is only then that they will start to be applied and accepted by the parties involved. However, as it was previously exposed, this is not happening at the pace that it was expected.

This delay in the implementation process is not a surprise and it is worsened by the several opt-outs of countries regarding sections of the Inclusive Framework and the attenuation of some of the individual BEPS Actions.

> Many rules proposed in the BEPS Action Plan were voluntary standards and were, therefore, not widely taken up by the member countries of the Inclusive Framework. This includes, for example, the optional provisions in the Multilateral Instrument to combat treaty shopping or the nonbinding guidelines to reform transfer pricing rules. [...] Anti-BEPS measures are only effective in limiting BEPS globally if they are implemented by a significant number of countries. (Laudage, 2023, p. 8)

Unfortunately, this is part of the international law game. However, it is important to recall that the BEPS Project is comprised of fifteen actions that are correlated and the positive results from this project and their impact on Action 1 cannot be ignored.

The adoption of the BEPS Multilateral Instrument ("MLI") (Action 15) by the jurisdictions members of the Inclusive Framework will speed the implementation of the adjustments that would be needed to over 1,650 treaties, transferring the resolutions in a much more efficient way than the renegotiation of each one of them (OECD, n.d.).

> The BEPS MLI entered into force on 1 July 2018. To date, 100 jurisdictions have joined the BEPS MLI, out of which 81 jurisdictions have

> ratified, accepted, or approved the BEPS MLI, and it covers around 1850 bilateral tax treaties. Around 650 additional treaties will be modified once the BEPS MLI will have been ratified by all Signatories. Signatories include jurisdictions from all continents and all levels of development and other jurisdictions are also actively working towards signature. (OECD, 2023a)

As of 27 June 2024, 103 countries have signed and eighty-five have deposited an instrument of ratification, acceptance, or approval of the MLI, which has entered into force in all these jurisdictions between 2018 and 2024.

The progress in the implementation of the MLI can be seen with good eyes and as a positive indicator that, eventually and with time, the Proposed Solutions will also be implemented by the countries and start to be applied in a relevant number of jurisdictions.

5.3. Considerations for Policymakers

Some considerations regarding the efficiency and equality of the Proposed Solutions must be made, especially regarding the role and the impact for the developing countries.

First, it is important to remember that one size solution does not fit all. The countries have diverse backgrounds, economic situations, economic activities, future perspectives, legal structures, social and financial needs, political interests, and different priorities, among many other aspects. Thus, it is impossible to find a solution

that will fit all countries the same way and that will be smoothly accepted and integrated into all domestic legislation.

For most developing countries, their main priority is still related to strengthening domestic institutions, enforcing the law, creating employment opportunities, developing local industries, creating basic infrastructure, attracting foreign investment, and reducing poverty. Therefore, for many of them, allocating resources to implement international tax laws that may not even have an effective return to them is not on top of their list.

Furthermore, it is important to remember that the US Tax Policy impacts the measures adopted by countries all around the world since many of the MNEs are based or have considerable operations there (PWC, n.d.). Thus, the fiscal, political, and economic scenario of the US cannot be ignored when discussing the implementation of tax measures for MNEs.

Likewise, the Proposed Solutions are, in the end, policy recommendations. They can be quite relevant, especially considering the international effort put into their creation, but they are still only recommendations. Therefore, it is unlikely that all countries will fully implement the Inclusive Framework, especially when it is considered that there is the possibility of opting out of some provisions or adapting them to adequate to the jurisdictions' goals (Clausing, 2015).

Additionally, the companies' tax planning capacity cannot be ignored, and this can considerably impact the effectiveness of the Proposed Solutions (Clausing,

2015). Companies have more resources and flexibility when compared to governments regarding tax planning, being always ahead in the battle for finding solutions to legally overcome any tax regulation that may impact their activities and profits (Zucman, 2015).

Nevertheless, it is noticeable that the companies are more concerned about compliance and risk management, which includes tax risk. According to the Generally Accepted Accounting Principles ("GAAP"), companies should make provisions for tax positions that are uncertain and that probably will be contested by the enforcement authorities (OECD, 2013b).

Considering that in most countries the big companies must publish their financial reports and disclose detailed information, this kind of provision is public and is subject to public knowledge and judgement. Thus, apart from the regulatory risk, which can result in fines and penalties, non-compliance with regulations also brings a reputational risk for companies, which can create even more long-term damage and deter future investments.

5.4. Future Directions for Policy Development

Considering that the implementation of the Proposed Solutions has just started, the countries, the OECD, and other international institutions must pay attention to the first results to make the necessary changes and adaptations as soon as possible.

Furthermore, it is important to start planning strategies to facilitate the implementation of the Proposed Solutions in countries that have less capabilities for doing so, which will often be the case in developing countries. The implementation of the Proposed Solutions by developed countries must be used as an example, but with caution, considering the remarkable differences in administrative capacity, socioeconomic needs, and political stability between countries.

In the case of developing countries, the creation of assistance and training programs for the implementation of the Proposed Solutions may be the trigger for its success. Programs for assisting the countries in the process of adapting their domestic law to reflect the Proposed Solutions while considering the countries' priorities and limitations, combined with programs for training the administrative personnel so they can enforce the legislation (Arias Esteban & Calderoni, 2021) and strategies to invest the "extra" money in the country's main needs are for sure needed.

And here, it is important to make a disclaimer. The assistance is needed not because the international institutions or the developed countries are better than the developing countries. No, not at all. But it is a matter of limited resources and experience since many of the today-called developing countries are new democracies that not long ago were exploited colonies that are still going through a process of social, financial, and political stabilisation, not having much time or resources to focus their efforts on matters as such.

Another aspect that must be considered is the economic position often occupied by developed and developing countries. While the first is usually the home of MNEs UPE, the latter is where most consumers are[7][8]. Thus, the developing countries are the ones losing a lot of revenue due to the impossibility of taxing digital businesses operating in their countries, while the developed countries are the ones benefiting from the income generated by the MNEs, even if they are not able to fully tax them. This relation can be considered as similar to a supplier-consumer relationship, and it needs to be remembered when assessing tax policies like the Proposed Solutions.

Therefore, considerations and adaptations must be made for the Proposed Solutions to be applicable in different countries. For example, the SBIE needs to comprise the particularities of the activity that is performed in each country while the QDMTT needs to be designed differently in each jurisdiction to comprise only the provisions that are relevant there, to prevent it from getting too complicated.

In short, now that the general scope of the Proposed Solutions is nearly concluded, it is necessary to start a more individualized approach with the jurisdictions to ensure effective implementation of the Proposed Solutions into their

[7] "China was home to over one billion social media users in 2023, making it the country with the largest audience. It is expected that by 2029, the number of social media users in the country will exceed 1.2 billion. However, within the next few years, India is expected to become the largest social media audience, reaching 1.3 billion by 2029. Nigeria's online networking audience is expected to grow from 47 million in 2023 to 114 million by 2029, an increase of over 142 percent." (Dixon, 2024)

[8] The e-commerce retail in developing countries such as Türkiye, Brazil, India, and Mexico is expected to grow more than 11% per year between 2024 and 2029, being the leaders in this aspect (Statista, 2024).

domestic legislation, with special attention to the developing countries, as they may require external technical support for this analysis and implementation. As mentioned before, the success of the Proposed Solutions lies in broad implementation by the countries.

6. CONCLUSION

This paper analysed the OECD BEPS Project Action 1 - Tax Challenges Arising from the Digitalisation of the Economy from a legal and economic perspective to understand its development and the main challenges for its implementation by the jurisdictions. It reviewed and considered the OECD work so far, based on the reports published between 2013 and mid-2024, when this paper was written.

As of today, the main result of the BEPS Project regarding Action 1 was the creation of the Proposed Solutions, composed by Pillar One and Two. The design of the Pillar Two solution was concluded and its implementation started in 2022. At the time this paper was written, Pilar One was still being discussed with just a few points to be agreed on by the jurisdictions that are members of the Inclusive Framework.

The BEPS Project and the Proposed Solutions are important developments for solving the issues that arose in the past decades due to the digitalisation of business and are an important sign of how countries are willing to collectively deal with and solve this problem.

However, projects of this magnitude are not easy and naturally face many challenges. During the analysis performed hereby, some legal and economic challenges were identified, such as:

(i) the domestic tax reforms that are required for transplanting the Proposed Solutions to the countries' internal legislation, which is affected by how the legislative process works in each jurisdiction and the factors that impact such

process, for example, the social, financial, and political situation of each country at the time of the discussion;

(ii) the difference in the countries' concern for quickly implementing the Proposed Solutions, which is affected by the potential impact the Proposed Solutions will have in each specific jurisdiction;

(iii) the lack of information about the individualised impact of the Proposed Solutions for each jurisdiction;

(iv) the lack of different/specific provisions considering the diverse socio-economic positions occupied by the countries in the globalised world;

(v) the administrative burden that this tax change may impose on governments, especially for developing countries;

(vi) the lack of a compulsory requirement for the implementation of the Proposed Solutions, worsened by the possibility of countries having opt-outs; and, finally,

(vii) the fact that the effects of the Proposed Solutions will only be tangible once a considerable number of countries have implemented it, closing the circuit for low-taxation and double non-taxation.

Therefore, although a lot has already been done, there is still a long road ahead in tackling the challenges regarding the taxation of digital businesses. Furthermore, it is imperative that the differences between developed and developing countries are considered and adaptations such as the specific scopes of the SBIE

and QDMTT are established, so that developing countries also have the means to duly implement the Proposed Solutions and benefit from its results.

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8. DEFINITIONS

The acronyms and terms defined in this exhibit shall be understood as having the meaning described below:

ALP	Arm's-length pricing
BEPS	Base Erosion and Profit Shifting
CIT	Corporate Income Tax
Consolidated Financial Statements	"Consolidated Financial Statements are financial statements that: (i) are prepared in accordance with IFRS or the GAAP of a specified country; (ii) are not prepared in line with such a standard but reflect adjustments of items and transactions to prevent any divergences from IFRS of more than €75 million; or (iii) would have been prepared if the entity were required to prepare statements in accordance with IFRS or a specified GAAP" (EY, 2021).
DTA	Double-Taxation Agreement
EBITDA	Earnings before interest, tax depreciation and amortisation
EMTR	Effective Marginal Tax Rate
EPS	Earnings per Share
ETR	Effective Tax Rate
EU	European Union
EUR	Euros
G20	The Group of Twenty (G20) is the premier forum for international economic cooperation. The group has as members: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, the Republic of Korea, Russia, Saudi Arabia, South Africa, Türkiye, United Kingdom, United States of America, European Union, and African Union.
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product

GILTI	US Global Intangible Low Tax Income
GloBE	Global Anti-Base Erosion
IMF	International Monetary Fund
IFRS	International Financial Reporting Standards
IIR	Income Inclusion Rule
MET	Minimum Effective Taxation
MLC	Multilateral Convention to Implement Amount A of Pillar One
MLI	Multilateral Instrument
MNEs	Multinational Enterprises
MNE Group	A group of entities that are located in more than one jurisdiction and are related to an MNE due to ownership or control; or an MNE that is a single entity but has PE on more than a jurisdiction. The entities of an MNE Group need to be included in the Consolidated Financial Statements of the UPE or be excluded from such statements due to size or materiality grounds or because the 3ntity is held for sale (EY, 2021).
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
QDMTT	Qualified Domestic Minimum Top-Up Tax
Report	Is the “Tax Challenges Arising from the Digitalisation of the Economy - Economic Impact Assessment” (OECD, 2020a)
ROE	Return on Equity
SBIE	Substance-based Income Exclusion
SDG	Sustainable Development Goals
SEP	Significant Economic Presence
UPE	Ultimate Parent Entity, which is the entity that is at the top of the ownership control chain
UTPR	Under Taxed Payments Rule

WACC	Weighted Average Cost of Capital