Novazi, J Civil Legal Sci 2022, 11:11

Journal of Civil & Legal Sciences

ISSN: 2169-0170

Review Article

Open Access

The New OECD Nexus Rule or a Fox in Sheep's Clothing: A Critique of Revenue Threshold

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Abstract

In October 2021, the OECD published its 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the economy'. The Pillar One proposal aims to re-allocate profits of the largest most profitable multinational enterprises ('MNE') to jurisdictions where the customers and users of those MNEs are located. This dissertation aims to evaluate whether the OECD's Pillar One proposal of a new nexus based on a revenue threshold adequately addresses the tax challenges of the digital economy in relation to the profits generated by non-resident companies in a foreign market jurisdiction. The dissertation evaluates the effectiveness of using a revenue threshold as a proxy for significant and sustained engagement by a MNE in the absence of a qualified level of physical presence. This dissertation argues that the OECD's move towards a new nexus based on a revenue threshold is an anti-climax when considered in light of the OECD's 'Tax Challenges Arising from Digitalisation - Report on Pillar One'. Pillar One's Amount A represents a move away from addressing the challenges of the digital economy by making the taxation of MNEs the singular focus of the project and will disproportionately affect developing economies as well as the rest of the digital economy that falls outside of the scope of Pillar One. In light of the aforementioned, this dissertation will also argue that the OECD has failed to address practical enforcement challenges relating to the application of a revenue threshold especially in relation to tax administration, compliance with privacy regulations and technological capabilities needed by developing countries.

Keywords: Arm's Length Principle; African Tax Administration Forum; Base Erosion Profit Shifting; European Union; Gross Domestic Product; Multilateral Convention; Multinational enterprise; Non-Resident Enterprise; Mini One Stop Shop Scheme; The Organisation for Economic Co-operation and Development; Permanent Establishment; South African Revenue Service; Small and medium enterprise; Value Added Tax;

Introduction

In October 2021, the OECD published its 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the economy'. Pillar one aims to re-allocate profits of the largest most profitable MNEs to jurisdictions where the customers and users of those MNEs are located [1]. Moreover, Pillar One only places MNEs with a global turnover above €20 billion and profitability above 10% within its scope. The new 'special purpose' nexus rule allocates 'Amount A' to any market jurisdictions in which the MNE derives at least €1 million in revenue. However, extractives and regulated financial services are excluded from the scope of Pillar One. The threshold for the special purpose nexus rule has been reduced for smaller jurisdictions with a GDP lower than €40 billion, to €250000 [2]. Therefore, the application of a revenue threshold for the special purpose nexus rule forms the basis of this dissertation. The move towards a new nexus based on a revenue threshold is an anti-climax when considered in light of the OECD's Pillar One Blueprint Report. Pillar One represents a move away from addressing the challenges of the digital economy by making the taxation of MNEs the singular focus of the project and will disproportionately affect developing economies as well as the rest of the digital economy that falls outside of the scope of Pillar One. This is a highly problematic move as the adoption of a revenue threshold completely disregards the OECD's work on addressing challenges of the digital economy, due to its general application and inability to address specific challenges that were previously identified by the OECD. Moreover, the new nexus only applies to a small group of MNEs and to a limited portion of their profits. This means that for the rest of the digital economy, things remain unchanged and riddled with ambiguity. The new nexus has the potential to exclude developing countries which may result in developing countries retaliating against this unfavourable outcome by either adopting their own unilateral measures or adopting the new rules but applying an aggressive interpretation of the MLA. The Pillar One proposal fails to address the identified challenges of new business models, minimal need for physical presence in market jurisdictions, increased reliance on intangible assets by business and the increased importance of data and user participation in value creation [3]. The OECD initially charmed the international tax community by presenting a buffet of challenges and potential solutions of the digital economy and in 2021, we settle for a one course meal solution that will only apply to 100 MNEs. This dissertation aims to evaluate whether the Pillar One proposal, based on a revenue threshold adequately addresses the tax challenges of the digital economy in relation to the profits generated by non-resident companies in a foreign market jurisdiction. It evaluates the effectiveness of using a revenue threshold as a proxy for significant and sustained engagement by MNEs in the absence of a qualified level of physical presence. By providing a comprehensive critique of the Pillar One, this dissertation aims to highlight the concerns of developing countries and to support more holistic solutions to addressing the challenges of the digital economy. This dissertation seeks to answer how effective the revenue threshold would be in addressing the challenges of the digital economy and in enabling market jurisdictions to tax the business profits of MNEs. It also aims to provide a critique of the OECD's move away from addressing the challenges of the digital economy by making the taxation of MNEs the singular focus of the project. This dissertation will be limited to the recommendations made

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Received: 24-Oct-2022, Manuscript No. JCLS-22-79648; **Editor assigned:** 25-Oct-2022, PreQC No. JCLS-22- 79648 (PQ); **Reviewed:** 08-Nov-2022, QC No. JCLS-22-79648; **Revised:** 14-Nov-2022, Manuscript No. JCLS-22-79648(R); **Published:** 21-Nov-2022, DOI: 10.4172/2169-0170.1000359

Citation: Novazi Z (2022) The New OECD Nexus Rule or a Fox in Sheep's Clothing: A Critique of Revenue Threshold. J Civil Legal Sci 11: 359.

by Pillar One with a particular focus on Amount A. The dissertation will also limit its inquiry to the 2017 Model Tax Convention on Income and on Capital. The author has chosen to consider OECD development made up until 1 July 2022. The inquiry is born out of the landmark agreement reached in October 2021 and the Statement on a Two Pillar Solution. It is also borne out of Nigeria's decision to adopt its own approach to taxing non-resident enterprises by adopting 'significant economic presence' as a litmus test for determining nexus [4].

Literature review

The research question is pursued by way of a desktop study of relevant literature such as academic books, legislation, legal journals, international tax law, tax treaties, tax model conventions, commentaries from the OECD and OECD reports. This dissertation aims to evaluate whether the Pillar One Proposal, based on a revenue threshold adequately addresses the tax challenges of the digital economy in relation to the profits generated by non-resident companies in a foreign market jurisdiction. Three considerations form the basis for the inquiry, namely: The first is that a revenue threshold does not adequately address the tax challenges of the digital economy; The second is that a revenue threshold may not be an appropriate indicator of significant and sustained engagement with market jurisdiction; and The third is that the proposal has tax administration and enforcement challenges that have not been addressed. The dissertation is divided into the following three parts, Chapter two introduces the theoretical framework that provides the justification for how taxing rights are allocated amongst jurisdictions. Firstly, this chapter considers the two fundamental concepts that govern the taxation of business profits in cross-border transactions, which are the nexus and profit allocation rules. The chapter further discusses the nexus framework for business income taxation that has been established in Articles 5 and 7 of the OECD Model 2017 and the application of the ALP [5]. Secondly, chapter two discusses the challenges of the digitalised economy as identified by the OECD, in relation to the current nexus rule. The challenges identified will later be used to evaluate whether Pillar One effectively achieves its key objectives. Chapter three discusses and examines the Statement on a Two Pillar Solution and some of the milestones that were achieved by the OECD. This chapter also lays the foundation for a comprehensive critique which will be provided in Part two. Chapter four begins by arguing that the revenue threshold is an inaccurate way of demonstrating a qualified connection between a taxpayer and with the market jurisdiction [6]. The chapter goes on to provide a substantive critique of the new nexus proposal based on Scope and size; Revenue threshold as an inappropriate measure of significant and sustained engagement in the market jurisdiction; Effects of the revenue threshold on developing economies; Classification of income and source rules; Tax residency and Permanent establishment threshold. Chapter five will discuss some of the challenges that MNEs and affected states will be confronted with in applying the revenue threshold from a tax administration and enforcement perspective whilst considering the impact of complying with relevant data protection regulations. Chapter five also considers whether OECD countries and developing countries will have the technological capabilities to enforce Pillar One. It will consider tax collection systems used by EU tax authorities to collect VAT (i.e., MOSS) and compare it to South Africa's SARS E-Filing system. Chapter five aims to highlight the challenges confronted by developing countries in collecting VAT to forecast of the challenges they will face in collecting Amount A.

Discussion

By way of conclusion, the final chapter comments on this dissertation's overall findings. Chapter six reiterates various challenges to adopting a revenue threshold and the impact that the application of the proposal will have on enterprises that fall outside of its scope. There are two fundamental concepts that govern the taxation of business profits in cross-border transactions, which are the nexus and profit allocation rules. The nexus rules determine when a state can exercise its tax jurisdiction over a NRE which can be measured by applying the PE threshold [7]. This then enables the relevant state to apply profit allocation rules in the form of the ALP to analyse the functions performed, assets used, and risks assumed by each enterprise and/or PE. As a general rule in tax, for a jurisdiction to be able to tax an enterprise it must establish a jurisdictional claim over the enterprise's income. There are two ways to assert such a claim. A jurisdictional claim may be asserted through a nexus in the form of source jurisdiction, where income is taxable under the law of a country because a nexus has been established between the country and the income or activities that generated the income. As such, a country that imposes taxes based on source jurisdiction, taxes income arising or having source in its country. Contrary to source jurisdiction, when a country establishes a nexus based on residence jurisdiction, the taxpayer is typically taxable on its worldwide income, without reference to the source of the income; as such it is taxed on both domestic source income and foreign income. Essentially, a connection is established between the taxpayer, who is the beneficiary of the income and the country of residence based on characteristics such as place of incorporation [8]. According to Guedes, the tax nexus is the qualified connection between the country that wishes to exercise its taxing power with a taxpayer, or the facts connected to the origin of the taxable object. The justification behind establishing a tax nexus finds its foundation in the benefit theory, which is the most coherent justification for the imposition of tax. According to Pinto, the benefit theory is the concept that 'jurisdiction's right to tax rests on the totality of the benefits and state services provided to taxpayers that interact with a country'. As such, in the digital economy, several NREs enjoy benefits provided by market jurisdictions and they do not pay their fair share of taxes, as they lack the element of a physical presence in the market jurisdiction. These benefits can vary from the legal systems, and intellectual property rights to general infrastructure and a supply of energy to name a few. The nexus framework for business income taxation has been established in Articles 5 and 7 of the OECD Model 2017. Article 7(1) therefore provides that, 'profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein'. This means that in terms of Article 7 of the OECD Model 2017, business profits derived by an enterprise are taxable exclusively by the state of residence unless the enterprise carries on a business in the source state through a PE situated therein, thus the application of the nexus rule in relation to business profits. A nexus rule is defined with reference to a threshold that determines the circumstances in which a foreign enterprise is considered to have a sufficient level of economic activity to justify taxation in a state. The threshold requirements are contained in Article 5 of the OECD Model 2017.The current threshold requirements are contained in Article 5 of OECD Model 2017. Article 5(1) defines a permanent establishment as a 'fixed place of business through which the business of an enterprise is wholly or partially carried on'. Article 5(2) goes on to provide a non-exhaustive list of examples of PEs such as a place of management, a branch, an office, a factory, a workshop and a place of extraction of natural resources. Furthermore, Article 5(5) of the OECD Model 2017 defines a dependent agent that constitutes a deemed PE for a NREs, provided that all the relevant requirements are met [9]. The article goes on to authorise source states to impose taxes on the income attributable to a deemed PE. As such, the taxation of business income is exclusively allocated to the state of residence of the enterprise, unless it has a PE in the source state or a dependent agent. The aforementioned concepts disregard the digitalisation of the economy that has increased the possibility for NREs to operate remotely and exploit their market jurisdictions without paying taxes in those jurisdictions. Once the right to tax has been established, the relevant jurisdictions must determine how profits of the NREs will be allocated. The profit allocation rules apply once it has been established that a particular jurisdiction should be allowed to tax the profits of a NRE and the rules serve the purpose of determining the relevant share of profits that will be subject to taxation based on the ALP (i.e. that an arm's length amount is charged between related parties). The ALP is often applied when a jurisdiction has taxing rights over the profits of a resident taxpayer under Article 9 or when business profits are attributable to the PE of a NRE in terms of Article 7. The ALP is an analysis of the functions performed, assets used and risks assumed by each associated enterprise and/or PE. As such, the analysis aims to establish the exact nature and location of functions performed by people, taking into account assets used and risks assumed as proxies that reflect economic activities and value creation. The new nexus rule is said to go over the ALP, as such, it is important to examine how the new nexus rule will address the challenges presented by the digital economy. This chapter has discussed the two fundamental concepts of nexus and profit allocation rules in relation to business profits by briefly examining the nexus framework established in Articles 5 and 7 of the OECD Model 2017 [10]. The discussion lays the foundation for this dissertations critique of the OECD's proposed new nexus and revenue threshold. Pillar One aims to address the tax challenges of the digitalisation of the economy that were identified for direct taxes in the 2015 BEPS Action 1 report which observed that digitalisation exacerbated BEPS. In addition to the aforementioned, the report held that digitalisation raised challenges relating to how taxing rights on income generated from cross-border activities should be allocated among jurisdictions. As such, Pillar One aims to adapt the international income tax system to be more effective in taxing new business model's, it aims to achieve the aforementioned objective by revising the profit allocation and nexus rules that applies to the taxation of business profits [11]. The revision of the profit allocation and nexus rules would enable market jurisdictions to have taxing rights over MNE profits provided that there is an active and sustained participation in the relevant jurisdiction. Pillar one aims to address the deficiency that exists in the current nexus rules. The current rules rely on a qualified physical presence to demonstrate an economic link between a NRE and the source state. As such, the economic link justifies the exercise of taxing rights of the source state even though the application of such a rule is no longer effective in the digital economy. Following the Unified Proposal, in October 2020, the OECD developed a 'Unified Approach' to Pillar One, which was designed to adapt taxing rights by taking into account new business models and expanding taxing rights of market jurisdictions. The Unified Approach encompasses three types of table profits that may be allocated to a market jurisdiction described as Amount A, Amount B and Amount C. For purposes of this dissertation, the discussion and analysis will be limited to Amount A and in particular the scope, nexus, quantum and revenue sourcing rules. Pillar One's scope is limited to MNEs with a global turnover above €20 billion and a profitability above 10%. According to the OECD, the turnover threshold may be reduced after seven years to €10 billion however, this is dependent on the successful implementation of tax certainty on Amount A. Furthermore, it is important to note that the Extractives and Regulated Financial Services have been excluded from the scope of the proposal. Pillar one also establishes a new nexus rule that facilitates the allocation of Amount A to a market jurisdiction provided that firstly, the MNE falls within the aforementioned scope and secondly, that it derives at least €1 million in revenue from the jurisdiction in question. In an attempt to make the proposal more inclusive for developing economies, smaller jurisdictions with a GDP lower than €40 billion have a reduced nexus threshold set at €250 000. The new nexus rule therefore determines whether a jurisdiction qualifies for the Amount A Allocation. Once it has been established that a jurisdiction qualifies for Amount A, only 20-30% of the in-scope MNE's residual profits will be allocated to the market jurisdiction using a revenue-based allocation key. The residual profit is defined as profit in excess of 10% of revenue. In order to determine whether a MNE satisfies the nexus test for Amount A in a jurisdiction, the revenue sourcing rules are applied to identify the market jurisdiction for a given type of revenue [12]. According to the Draft Model Rules, the revenue must be sourced using Reliable Method based on the MNE's specific facts and circumstances. The revenue source rules rely on the allocation keys, which are rules that reasonably approximate the source jurisdiction and mitigate disputes between jurisdictions. In applying all the aforementioned factors, it can then be established whether a MNE has significant and sustained engagement in the market jurisdiction. The revenue threshold in the market jurisdiction is the primary indicator for a significant and sustained engagement and for the allocation of the tax base under Amount A. This is because if a MNE does not fall within the scope, one cannot apply the other factors As such, the revenue threshold forms the basis of the new nexus rule. It is essential to be cognisant that the new nexus rules will not alter the existing nexus rules, as it has been designed to be a stand-alone provision to limit any unintended spill-over effects on existing tax rules. Pillar One's scope is limited to MNEs with a global turnover above €20 billion and a profitability of above 10% and the MNE must derive at least €1 million in revenue from the market jurisdiction. However, the key question is whether this proposed framework will be effective in solving the identified challenges of the digital economy. The new nexus rule has been praised for establishing a new nexus based on a revenue threshold as its main criterion as opposed to a physical presence. Furthermore, the proposal is said to likely increase international investment tax neutrality, as it seeks to change the location of corporate taxation to where customers are located. Commentators argue that the resultant effect is that MNEs would neither be able to control the location of the customers nor to choose in which jurisdiction they have a taxable presence. This proposal has the potential to render current tax planning structures ineffective under the current tax rules. Moreover, tax competition between states will also be reduced as governments will be empowered to set their tax policies more independently without fear of losing internationally mobile profits and investments [13]. However, Pillar One represents a move away from addressing the challenges of the digital economy by making the taxation of MNEs the singular focus of the project, as it applies to MNEs with a global turnover in excess of €20 billion and profitability of over 10% and Amount A only captures MNEs that derive at least €1 million in revenue from a jurisdiction. Furthermore the challenges Pillar One set out to address were challenges of new business models, minimal need for physical presence in market jurisdictions, increased reliance on intangible assets by businesses and the increased importance of data and user participation in value creation. The new nexus and Amount A are a drastic deviation from what the OECD initially set out to achieve. The failure to address the concerns raised below will result in developing countries bearing the brunt and the rest of the digital economy will be remaining riddled in ambiguity. The classification of income and the application of source rules plays an essential role in the application of the nexus rules. It is the first step that must be addressed before one can determine tax treatment of income, tax residency, attribution of profits, or the allocation of taxing rights. The OECD in its Action 1 report identified the characterisation of payments under the new business models as a major challenge raised by the digital economy. In particular, it found that digital products or the means of delivering services created uncertainties in relation to the proper characterisation of payments especially in the case of cloud computing. The OECD is yet to provide income classification solutions for the digital economy and particularly in cloud computing in the case of mixed contracts or new deployment models such as Integration Platform as a Service or Business Process as Service where recipients have access to different services and rights. The new nexus rule does not address the issues relating to the classification of income for out-of-scope MNEs. This is essential for identifying jurisdictions that can exercise taxing rights in market jurisdictions in relation to the digital economy, particularly for enterprises that fall outside of the scope of Pillar One. As such, it is essential to consider some of the challenges raised by the digital economy concerning source rules and to determine whether the application of the revenue threshold sufficiently addresses such challenges. The new taxing right proposed under Amount A, will result in undesirable and unnecessary complications in applying the nexus rules simply to reallocate the profits of 100 MNEs to market jurisdiction. The costs of implementing such a proposal will outweigh the benefits. What is needed instead is a proposal that does not target the largest MNEs but rather adopts a more inclusive approach that considers what constitutes a large MNE from a developing country's perspective. Commentators are of the opinion that the first question to be considered in relation to the Pillar one is whether the revenue test is an accurate way of demonstrating a qualified connection between a taxpayer and the market jurisdiction. Samari argues that any new nexus established should be created based on functions and/or cost with an emphasis on marketing in the local market as opposed to being based on sales. He, therefore, opines that the volume of revenue generated in a market jurisdiction does not necessarily demonstrate that there has been a sustained and significant involvement in the economy of specific market jurisdiction. Although Samari makes a compelling argument, the OECD considers a revenue threshold to be a reliable indicator of a taxpayer's engagement in any given market on the basis that the advancement of technology has led to the disregarding of commercial frontiers [14]. Furthermore, the logic followed by the OECD seems to be supported by several countries such as Austria, Belgium and Brazil, who introduced and/or proposed the taxation of the digital economy using revenue threshold as a nexus. One may surrender to the argument that a revenue threshold is indeed a reliable indicator of a qualified connection and market jurisdiction however; the effectiveness of such an indicator depends on the qualifying amount set as the revenue threshold. Therefore, it is necessary to determine what it means to have significant and sustained engagement. For there to be a significant engagement; the MNEs must meet the qualifying revenue amount of €20 billion and then the profitability threshold of 10%. This means that a nexus will be established regardless of whether or not the revenue forms a significant percentage of the MNE's overall revenue. Furthermore, this means that MNEs that fall within the scope will face great compliance costs. Similarly, MNEs that fall short of the scope will also need to undergo a similar exercise to prove that they fall outside of the scope. Thus, the impact of the new nexus may compromise the tax principle of neutrality. This chapter will therefore determine whether the proposed revenue threshold makes use of an appropriate amount that takes into consideration the needs of developing economies. Firstly, the current scope of Pillar One applies to MNEs that have more than €20 billion of global turnover and a profitability of 10%. Albeit the threshold will be reduced to €10 billion after seven years, it can be argued that the proposed revenue threshold is a great departure from the objectives set out in the OECD's Pillar One Blueprint Report, where the OECD emphasised that the proposed design was intended to 'protect the interests of smaller jurisdictions, and in particular developing economies and their desire to benefit from the new taxing right'. It is therefore not sufficient for the OECD to claim that the interests of developing countries are protected on the basis that it has set a reduced nexus for developing economies, because Pillar One still poses a risk to the tax base of developing countries particularly African countries. The failure to realise the unintended consequences of this proposal means that the profits that would be reallocated to market jurisdiction under Amount A would be relatively small for developing countries, particularly African countries. The aforementioned has been previously raised by the ATAF. As such, the current proposal lacks fairness in its attempt to reallocate new taxing rights to market jurisdiction. According to an article by KPMG, the World Bank has reported that jurisdictions that fall within the €40 billion GDP threshold comprise less than 2% of the total global GDP. Furthermore, this combined with the defined scope means that Amount A is likely to apply to approximately 100 of the biggest MNEs. Accordingly, the failure to take account of the interests of developing countries may lead to the creation of uncoordinated unilateral measures which will adversely affect the general efficiency of the international tax system. Secondly, the new revenue threshold is largely skewed in favour of developed countries as it fails to consider that MNEs that may be considered to be SMEs for a developed country may not necessarily qualify as such in the economies of developing countries. Although the nexus permitting the allocation of Amount A to market jurisdiction is to be set at €250 000 for smaller jurisdictions with a GDP of less than €40 billion, MNEs would still need to fall into the scope by meeting the €20 billion global turnover requirement. This essentially excludes developing countries from benefiting from the new rules and will prove to be particularly detrimental to them. The new provision needs to explore what it means to be a large MNE from a developing country's perspective by examining the impact those enterprise that are considered to be SMEs from the perspective of developed countries, have on developing or emerging economies. Thirdly, the application of a revenue threshold does not address most of the challenges that have been raised by the digital economy, with the resultant effect being that with the exception of 100 companies that fall into the scope of Amount A, the nexus rules remain unchanged for the rest of the digital economy. This is because MNEs that fall outside the scope of Amount A would still have to pay taxes on profits in their resident jurisdiction or source jurisdiction where they have PEs established. Furthermore, because the new nexus rules apply in addition to the existing nexus rules, it over complicates an already complicated international tax framework, as there will not be two sets of rules that can be used to calculate the tax base of an enterprise since Amount A is not based on the ALP. The proposal will therefore not be effective in dis-incentivising MNEs to shift profit to low tax jurisdictions since a large portion of business profits will still be taxed per the existing rules operating within the Model Tax Convention parameters [15]. Lastly, the revenue threshold proposal fails to address, the challenges around the allocation of taxing rights between residence and source jurisdiction. African countries generally tax on a source basis. It has been argued by ATAF that the current nexus and profit allocation rules are weighted in favour of residence jurisdiction to the detriment of source jurisdictions. As such, countries such Nigeria have taken a unilateral approach to taxing the digital economy. Nigeria adopted the 'significant economic presence as a litmus test for determining nexus in its effort to ensure that NREs participating in the country's digital economy pay tax on revenue generated from their activities in Nigeria. The current recommendations, therefore, fail to address the current imbalance in the allocation of taxing rights. Perhaps Article 12(B) of the UN Model Double Taxation Convention between developed and developing Countries (2021) should be considered, to address the shortcomings of Pillar One in relation to developing economies. To understand the shortcomings of the proposal in relation to the allocation of taxing rights, one must examine if the proposal addresses the challenges raised by the digital economy in relation to tax residency. In order to allocate taxing rights amongst states, one must determine the enterprise's tax residency and whether its activities in a particular jurisdiction create a PE either in the form of a fixed place PE or a dependent agent. Albeit the new nexus rules largely eliminate this inquiry for in scope-MNEs, the inquiry into an enterprise's residency remains relevant for all the enterprises that fall outside of the scope of the new nexus rules. Article 4 of the 2017 Model Tax Convention does not define the term 'resident', as such the determination of tax residency is determined by applying domestic laws of the relevant contracting states, which largely follow the 'the place of incorporation' and/or 'place of effective management' approach. Where there is a conflict or competing claims between contracting states in determining the residency of a company, Article 4(3) provides a tie-breaker rule, in cases where two contracting states' domestic laws both treat a taxpayer as their tax resident. Digitalisation has challenged the idea that the incorporation and/or the effective management of a company can be used as a satisfactory criterion for determining corporate residency. Not only is this construct formalistic but according to Koukouliotio, it can be subject to manipulation and may be located in different jurisdictions and thus increasing the risks of dual resident entities. The digitalisation of businesses has eroded the factual basis for identifying corporate residence because in the digital age business operations, director meetings, and employee activities can all be undertaken remotely without the need for any physical presence. For example, when determining the tax residency of cloud providers, it may be inappropriate to use the place of physical location as the exclusive determinative criterion. This is because, the cloud infrastructure used may create physical presence across different regions and since the services are provided online, cloud providers do not require a physical presence where their consumers are located. The challenge is further exacerbated by the fact that the effective management of cloud businesses is not confined to a specific location as effective management is often performed in jurisdictions that are unrelated to where the business operations are located. It is argued by Koukouliotio, that an economic nexus approach would better justify the allocation of taxing rights to where significant economic activities occur and where value is created, instead of placing reliance on physical presence. The income-generating activities of cloud business are better captured under the significant economic presence model where a taxable presence could be created in different jurisdictions by placing reliance on an established economic nexus. These challenges will therefore have a spill over effect when it comes to determining whether a PE has been established. Apart from taxing a jurisdiction based on the tax residency of an entity, jurisdictions can exercise taxing rights based on source entitlement. The basis of the source entitlement is that a jurisdiction may be entitled to tax a NRE when it performs activities within its geographical borders. To give effect to source taxation, the definition of a PE in Article 5 determines when a cross-border activity may give rise to source taxation. The application of the new nexus rule will leave the definition of PE and the application of PE unchanged for the rest of the entities that fall outside of the new nexus scope. Article 5 of the OECD Model defines PE as, 'a fixed place of business, through which the business of an enterprise is wholly or partly carried on'. In applying the definition there are three requirements that need to be met for a PE to be established: The existence of a place of business; The existence of a 'fixed' place of business; and The carrying on of the business of the enterprise 'through' this fixed place of business. Therefore, for a state to tax the business profits of a NRE, it must prove that a PE has been established. The PE concept is a threshold that applies objective factors to determine when a NRE is regarded as participating in the economic life of a state and when such participation should award taxing rights to the state concerned. Article 5 also makes provision for a PE to be established indirectly through the actions of a dependent agent. As such, under the 2017 Model Tax Convention, the taxing rights of a source state are limited to the profits attributable to PE. The new nexus rule should be harmonised with the current PE rules provided in Article 5 of the 2017 Model Tax Convention. This is because the PE nexus in Article 5 makes use of a connecting factor in the form of physical presence or a person acting as a dependent agent to establish a taxing right. Although the OECD has moved in the right direction by creating a new non-physical nexus, a more effective solution would be a complete revision of the PE definition because the new nexus is a standalone provision and does not reform the existing PE definition in Article 5. This means that the treaties that follow the aforementioned definition will remain unchanged. Furthermore, amending the definition of PE would enable the OECD to provide clarity as to the level of engagement a NRE would need in the market economy to be subjected to tax in the market jurisdiction. The OECD is of the opinion that changing the PE definition in the Model Tax Conventions would not only overcomplicate the tax system but it would be difficult to obtain international consensus. However, the cost of the digital economy remaining in ambiguity outweighs the former; as such the OECD needs to solve these challenges particularly in relation to cloud services. Under the current rules, cloud providers that operate servers that provide cloud services will establish a PE at the location of the servers, because the servers constitute an essential and significant part of the services they provide to users. However, even if a server PE has been established, the assets and risks that are attributable to the PE are those directly associated with the server hardware which means that little or no profit is attributable to the PE. The aforementioned was one of the findings of the OECD's Report on Attribution of Profits. Koukouliotio argues that the location of servers is not an appropriate factor to be used to determine the pre-tax income generated from cloud services because the jurisdiction where the income is generated is often unrelated to the place where the servers are located. Relying on server location for attributing taxing rights to jurisdiction, incentivises cloud providers to structure their operations so that they are taxed in favourable tax regimes, by simply placing their servers in jurisdictions with favourable tax rates. The application of the new nexus rules does not address many of the concerns raised by cloud businesses, of particular importance is that most cloud providers do not always own the servers they use, as such the location of the servers cannot be used to create a PE in such instances. The OECD follows a formalistic approach that places reliance on the physical location of servers and premises which is often irrelevant for cloud business. A better way to tax cloud providers would be to amend the current rules so that a PE is created in the jurisdiction where consumers of cloud providers are located. This follows the Unified Approach, which aims to attribute taxing rights to market jurisdictions based on a sustained and engaged involvement by MNEs in the market jurisdiction. Although the new nexus proposal establishes a non-physical presence in the market jurisdiction for MNEs, the application is limited to MNEs that fall within its scope. The proposed revenue threshold would essentially replace the existing thresholds based on a fixed place of business, duration of service activities, or the conclusion of contracts by dependent agents for in-scope MNE's. The impact of the new nexus will therefore be marginal due to its limited application, and it would therefore be more impactful to amend Article 5 and therefore changing the way business profits are taxed under Article 7.

Conclusion

This chapter has discussed the challenges that the OECD must address pertaining to tax administration and data privacy compliance. Furthermore, it has suggested that the OECD should develop a centralised tax system that allows all relevant stakeholders to input and access data for the efficient administration of Amount A. In conclusion, the OECD's Pillar One proposal of a new nexus based on a revenue threshold fails to be addressing the challenges of the digital economy. The criteria that should be used to evaluate the effectiveness of this proposal are the challenges that the OECD aimed to address when it initiated the proposal. A proposal that is likely to target 100 MNE's, cannot be said to be addressing the challenges of the digital economy. This is especially because Pillar One fails to engage with challenges relating to new business models, minimal need for physical presence in market jurisdictions, increased reliance on intangible assets by business and the increased importance of data and user participation in value creation for out-of-scope MNEs. As such, the challenges of the digital economy remain unchanged and as a result, Pillar One represents a move away from addressing the challenges of the digital economy. If one is to accept such a proposal with a limited scope, it is worth noting that a new nexus based on a revenue threshold does not adequately addresses the tax challenges in relation to the profits generated by NREs in a foreign market jurisdiction. Firstly, the revenue threshold does not provide solutions relating to the classification of income for out-of-scope countries. Secondly, it fails to protect the interests of developing countries. Thirdly, it fails to engage with the conflicts of determining tax residence of an enterprise in the digital economy, where the incorporation or effective management of enterprises is no longer an effective criterion to determine residency. Lastly, the application of the new nexus rule leaves the definition of a PE and the application of PE is unchanged for the rest of the entities that fall outside of the new nexus scope. As such, this dissertation has recommended that the new nexus rule should be harmonized with the current PE rules provided in Article-5 of the 2017 Model Tax Convention. In addition, this dissertation has provided a recommendation to the tax administration and enforcement challenges relating to the administration of Amount A from a data privacy compliance and technology perspective. Moreover, this dissertation recommends that in the event that Amount A is enforced, the OECD should consider developing a centralised tax system to facilitate collaboration and cooperation across different tax jurisdictions and make data accessible to multiple jurisdictions whilst unifying the processing of data. This will enable the OECD to provide guidelines for the processing of personal data on the system and guidance in relation to the level of automation that can be used without breaching privacy rights. Depending on the activities of public organizations that protect the rights of individuals to information, and hence the right to information on their health, they can be divided into public organizations of broad and narrow orientation. Public organizations of broad orientation deal with all legal assistance to individuals in violation of their rights in the medical field, as for narrow organizations, they are usually limited to a certain group of individuals, or a certain range of activities carried out. There are also various charitable organizations, funds, foundations, which are guided in their activities by the Law of Ukraine "On Charity", and the All-Ukrainian Council for the Protection of Patients' Rights and Safety in the medical field.

Acknowledgement

None

Conflict of Interest

None

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