taxnotes® international

Volume 95, Number 3 ■ July 15, 2019



# Going the Way of the Polaroid: Digital Taxation and the End of the Arm's-Length Principle?

by Christian Kaeser, Jeffrey Owens, and Sam Sim

Reprinted from *Tax Notes International*, July 15, 2019, p. 211

# Going the Way of the Polaroid: Digital Taxation and the End of the Arm's-Length Principle?

by Christian Kaeser, Jeffrey Owens, and Sam Sim

Christian Kaeser

Jeffrey Owens

Sam Sim

Christian Kaeser is global head of tax with Siemens and an honorary professor at Vienna University of Economics and Business (WU). Jeffrey Owens is the head of the Global Tax Policy Center at the Institute for Austrian and International Tax Law of WU. Sam Sim is on the Asia board of Tax Executives Institute and is based in Singapore.

The views expressed in this article are solely those of the authors and do not necessarily reflect those of their employers or organizations.

This article synthesizes the discussion that took place during a May 17 fireside chat event by the WU Global Tax Policy Center at the Institute of Austrian and International Tax Law. Kaeser was a guest speaker at the event, which was an initiative of the Digital Economy Tax Network, a multi-stakeholder forum.

In this article, the authors discuss proposals to use formulary apportionment to tax the digitalized economy and consider whether their departure from the arm's-length principle spells the end of that long-held cornerstone of international taxation.

> "Things fall apart, the centre cannot hold;
> [Formulary apportionment]
> is loosed upon the world."
>
> — Adapted from "The Second Coming"
> by W.B. Yeats

The disruption of digitalization has challenged the arm's-length principle, a bedrock principle of the international tax system that has been the common basis on which tax administrations and taxpayers attribute profits on at least a third of world trade that takes place within multinational enterprises.[1]

While there is no consensus yet on how to address complex digitalized business models and

[1]The U.N. Conference on Trade and Development has addressed those issues in several of their annual *World Investment Reports*, with estimates of about one-third of world trade being intra-firm and possibly as much as 80 percent being within global value chains (both intra- and inter-firm trade). *See* "80% of Trade Takes Place in 'Value Chains' Linked to Transnational Corporations, UNCTAD Report Says," UNCTAD/PRESS/PR/2013/001 (Feb. 27, 2013).

the issues arising therein, proposals to overhaul the nexus and attribution rules have placed formulary apportionment, or variations of it, firmly back on the global agenda.

This article considers whether those digital tax proposals sound the final death knell to the arm's-length principle or merely mark another stage in its evolution as the only acceptable principle around which global consensus may coalesce. It reviews the efforts to update profit attribution rules for a digitalized world with quasi-formulary apportionment approaches in the historical context of the arm's-length principle's resilience for more than a century. As the tax world shifts from addressing shortcomings in international tax principles in the base erosion and profit-shifting project to reopening the debate about a fair allocation of profits among countries, the arm's-length principle may yet again prove its continued relevance as a "broad church" that all countries can subscribe to, whatever their persuasions regarding residence- or source-based taxation.

## I. A Classical Notion That's Become Obsolete?

Observers have traced the genesis of the arm's-length principle to the 1920s, with one of the earliest international tax references being the commentary on the permanent establishment article of the League of Nations' 1928 draft model income tax treaty, involving the exception for activities of an independent agent.[2] In the 1940s, conventions on model tax treaties in Mexico and London adopted similar provisions.[3] Over the years, the authoritative statement of the arm's-length principle in article 9(1) of the OECD model tax convention and the corresponding OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations have found acceptance globally.[4]

### A. Inherently Flawed Concept

The dominance of the arm's-length principle does not paper over its clear weaknesses. Critics say the principle is inherently flawed and self-contradictory.[5] The Coase theorem of economics holds that multinational groups maximize profit by internalizing dealings that would have been more costly than transacting with unrelated parties. Therefore, it is flawed to equate and compare transactions between related parties with uncontrolled, independent third-party transactions. That also explains why transfer pricing has struggled to address the benefits arising from "group synergies" that are well observed in business economies of scale, X-efficiencies, and mergers and acquisitions by integrating across internal business units.[6] Moreover, the need to use comparable uncontrolled transactions clearly limits the practicability of the arm's-length principle analysis when information on independent transactions is unavailable or when independent parties do not transact in the same manner.[7]

### B. Administrability and Compliance

A more common challenge, particularly for developing countries and nongovernmental organizations, is that the arm's-length principle is too complex, is too resource-intensive to administer and follow, and disadvantages local auditors because of information asymmetry. As a consequence, the arm's-length principle is perceived to be easy for MNEs to manipulate to base-erode and shift profits to low-tax jurisdictions.

On the flip side, when taxpayers defend the arm's-length principle in audits, the discussions often depart from the theoretical ideal and reflect the reality that many countries and their field

---

[2] Michael Graetz and Michael O'Hear, "The 'Original Intent' of U.S. International Taxation," 46 *Duke L.J.* 1021, 1089 (1997).

[3] Jefferson VanderWolk, "The Arm's-Length Standard Enters Its Second Century," *Tax Notes Int'l*, Mar. 4, 2019, p. 961.

[4] MNEs have also found the arm's-length principle useful in assessing the profitability of their subsidiaries.

[5] "The arm's length principle is viewed by some as inherently flawed because the separate entity approach may not always account for the economies of scale and interrelation of diverse activities created by integrated businesses." Chapter 1, para. 1.10 of the 2017 OECD transfer pricing guidelines.

[6] *See, e.g.*, Shaz Ansari, Martijn Schouten, and Ernst Verwaal, "Unlocking Synergies Between Business Units: Internal Value Creation at Royal Vopak," 15 *Strategic Change* 353 (Nov. 2006).

[7] Empirical evidence that the industry as a whole does not take into account the costs of stock options in cost-sharing arrangements, contrary to the IRS assertions in *Xilinx v. Commissioner*, 125 T.C. 37 (2005), *aff'd*, 598 F.3d 1191 (9th Cir. 2010), is a clear example.

examiners do not strictly apply the principle and the OECD transfer pricing guidelines to the full extent that they profess to, even in developed countries. Some practitioners think negotiated settlements with local authorities resemble "horse trading" rather than principled applications of the arm's-length principle comparability analyses.

The OECD transfer pricing guidelines acknowledge those weaknesses and note several areas in which transfer pricing is not an exact science. They examine alternatives to the arm's-length principle, decisively concluding that "no legitimate or realistic alternative to the arm's length principle has emerged. Global formulary apportionment, sometimes mentioned as a possible alternative, would not be acceptable in theory, implementation, or practice."

### C. Formulary Apportionment in a Digital World

That consensus position of OECD member states and most non-member states seems at odds with digital taxation proposals, which appear to have put some variants of formulary apportionment back on the global tax agenda. Observers insisting on the arm's-length principle appear to be like engineers who have stubbornly held on to obsolete technology, refusing to countenance new solutions offered by formulary apportionment, which is simpler to administer. The argument is that formulary apportionment of more profits to market countries than would be contemplated under the arm's-length principle, which is seen as failing to address the challenges of the digital economy (despite the BEPS project), is the only way to achieve global consensus and head off unilateral actions by countries in enacting inconsistent digital taxes.

What is significant now is that unlike earlier complaints about the arm's-length principle by some (mostly developing) countries, the impetus for change is coming from leading economies, with digital tax reform being led by the EU and the OECD Task Force for Digitalised Economy (TFDE) under the aegis of the more than 120 countries that are part of the OECD inclusive framework. In a January policy note preceding the release of its February public consultation draft, the TFDE acknowledged that a proposal involving a second pillar was needed to address gaps that had not been closed by BEPS actions 8-10. Some commentators have even argued that instead of being criticized as unilateral action inconsistent with BEPS, adopting tools that target allocation of profits to low-substance and low-taxed entities — via the diverted profits tax, for example — could alleviate pressure on the profit allocation method and allow more time to achieve consensus on the appropriate taxation of the digital economy.[8]

Even so, the immense challenge of achieving global consensus can be understood when the director of the OECD's Centre for Tax Policy and Administration says the OECD is unsure about the arm's-length principle.[9] Further, the balance of economic power has shifted, and former developing countries such as China and Brazil are no longer happy with an allocation of tax rights based on an international framework that dates to the 1920s.[10]

Does all that spell the end of the arm's-length principle? Can the principle rise to what is perhaps the most serious challenge since its inception? Its history could help answer those questions.

## II. A Death Foretold

### A. A Successful Evolution

The digitalization of the economy is not the first technological disruption to the arm's-length principle: Globalization, the revolutionary technologies of electrification, and the invention of the transistor brought great changes in 20th-century commerce. Indeed, the e-commerce and internet boom of the late 1990s and early 2000s involved many of the characteristics identified by the TFDE in a 2018 interim report as challenges posed by the digitalized economy — scale without mass, a heavy reliance on intellectual property, and harnessing the network effects of user participation and user data. Also during that

[8]The argument, improbable as it sounds, is that if MNEs can no longer escape taxation by manipulating where risk and development, enhancement, maintenance, protection, and exploitation functions are located, they might report their profits in a way that is closer to economic reality. *See* Jonathan Leigh Pemberton and Jan Loeprick, "Low Tax Jurisdictions and Preferential Regimes: Policy Gaps in Developing Economies," World Bank Policy Research Working Paper 8778 (Mar. 2019).

[9]VanderWolk, *supra* note 3.

[10]*See, e.g.*, Sam Sim and Soo Mei-June, *Asia Voices: BEPS and Beyond* (2017).

period, MNEs developed complex global supply chains tapping into the comparative advantages of emerging markets, offshoring, and business process outsourcing.

Through it all, the arm's-length principle has proved resilient — so resilient, in fact, as to survive the period of unprecedented consensus following World War II that established global trade and tax treaty frameworks without coming under serious challenge. In other words, the prime period when global formulary apportionment may have had a real shot at being adopted worldwide has not come to pass. Multilateralism is waning. Economic weight is becoming more diffused as the center of economic gravity shifts away from the G-7 to the G-20 and the Brazilian, Russian, Indian, and Chinese (BRIC) economies.

The secret to the longevity of the arm's-length concept lies in the fact that it is flexible while also being principle-based. Here are some examples:

- *Working Around Inherent Weakness*. A frequently cited problem is the lack of actual real-world comparables — that is, either there is no available data, or independent parties simply do not transact in the same manner as the controlled transaction. The OECD 1995 transfer pricing guidelines started with three traditional methods: the comparable uncontrolled price/transactions method, the resale price method, and the cost-plus method. The lack of comparables and comparable data then saw the development of the transactional net profits methods: the profit-split method and the transactional net margin or comparable profits method (TNMM/CPM).

  The 2010 OECD transfer pricing guidelines elevated those methods to be on par with traditional methods.[11] The profit-split method is still frequently misused as an easy way out when independent transactions would have been available, even if those comparables are hard to find or analyze (for example, hard-to-value intangibles). Even so, it and TNMM/CPM have been broadly accepted over the years, with TNMM/CPM now the most commonly used method in competent authority proceedings. That evolution is true testimony to the adaptability of the arm's-length principle and its ability to overcome its inherent weaknesses.

- *Adapting to New Business Models*. The liberalization of global capital markets in the Reagan/Thatcher years, the rise of global trading in financial markets, and the daily movement of billions in potential profit and loss positions by traders in financial institutions with an extensive network of branches make it difficult to appropriately attribute profits to PEs. The profit-split method was expanded in the form of U.S. global trading regulations and in the Authorised OECD Approach (AOA) in the Attribution of Profits to Permanent Establishment Guidelines, which treated branches as separate entities for transfer pricing purposes. The PE guidelines were finalized in 2010, crystallizing key concepts such as significant people functions and key entrepreneurial risk-taking functions.

  Chapter IX of the OECD transfer pricing guidelines was also finalized in the same period, emphasizing concepts such as the control and management of risk and assuming risks by being able to take losses. Those concepts were later adapted to attribute profits from intangible-related returns as being able to control development, enhancement, maintenance, protection, and exploitation (DEMPE) functions, as well as the ability to control and bear risks in the development and use of the intangibles in BEPS actions 8-10.

- *Coping Pragmatically With Changing Attitudes*. The OECD's evolving attitude toward safe harbor provisions is instructive.

---

[11] *See* Chapter 1, para. 1.9 of the 2017 OECD transfer pricing guidelines:

> Nevertheless, there are some significant cases in which the arm's length principle is difficult and complicated to apply, for example, in MNE groups dealing in the integrated production of highly specialised goods, in unique intangibles, and/or in the provision of specialised services. Solutions exist to deal with such difficult cases, including the use of the transactional profit split method described in Chapter II, Part III of these Guidelines in those situations where it is the most appropriate method in the circumstances of the case.

> After examining the pros and cons of safe harbors, in its 1995 and 2010 transfer pricing guidelines the OECD recommended against those harbors because while they "could accomplish a number of objectives relating to the compliance with and administration of transfer pricing provisions, they raise fundamental problems . . . [they] are generally not compatible with the enforcement of transfer prices consistent with the arm's length principle."
>
> Despite OECD objections, several countries adopted safe harbor rules. In May 2013 the organization revised its stance on safe harbors, recognizing that "in cases involving smaller taxpayers or less complex transactions, the benefits of safe harbours may outweigh the problems raised by such provisions."[12]

With those adaptations, one might argue that at no time did the OECD transfer pricing guidelines ever reflect a pure application of the arm's-length principle. Exceptions and compromises abound, as is expected of any consensus document that must inform the application of a "pure" principle with a realistic understanding of how it can be applied with reasonable certainty and administrability for a diverse group of countries.

Despite that, the 2017 OECD transfer pricing guidelines state that "the view of OECD member countries continues to be that the arm's length principle should govern the evaluation of transfer prices among associated enterprises" and that "while it may not always be straightforward to apply in practice, it does generally produce appropriate levels of income between members of MNE groups, acceptable to tax administrations." Further, the OECD said its members believe that there is no legitimate or realistic alternative to the arm's-length principle: "Global formulary apportionment, sometimes mentioned as a possible alternative, would not be acceptable in theory, implementation, or practice."

So why has the specter of the death of the arm's-length principle arisen again so shortly after the finalization of the 2017 OECD transfer pricing guidelines? And why has some variation of formulary apportionment been placed back on the global agenda by governments, NGOs, and corporations as a potential solution to taxing the digitalized economy?[13]

## B. Understanding the Proposed Changes

The answer to those questions cannot lie in the desire to abandon the arm's-length principle. The idea of a common consolidated corporate tax base, more than 10 years in the making, amply demonstrates how difficult it is to achieve political consensus in Europe, the most harmonized group of countries in the modern world.

Even if some form of global formulary apportionment can be agreed on, a U.S. experience shows that it might not be an unqualified success. Since the advent of the multistate compact and the three-factor formula of property, payroll, and sales to apportion income, states have not applied that formula consistently. Most states ignore the first two factors and place an overwhelming emphasis on sales, and it took court orders to strike down some attempts to apply alternative formulations.[14]

The 2017 OECD transfer pricing guidelines point out that the arm's-length principle is so well entrenched as a substantial body of common understanding among taxpayers, tax administrators, and courts that abandoning it could lead to the same harm digital tax proposals are meant to avoid — that is, unfettered unilateral action and a breakdown of international consensus:

> A move away from the arm's length principle would abandon the sound theoretical basis described above and threaten the international consensus, thereby substantially increasing the risk of double taxation.

[12] OECD, "Revised Section E on Safe Harbours in the Chapter IV of the Transfer Pricing Guidelines," at para. 4.127 (May 16, 2013).

[13] See the response of Johnson & Johnson at the March TFDE consultations in Paris.

[14] *See* Todd Lard and Ted Friedman, "The Collision of Formulary Apportionment and Transfer Pricing," COST Pacific Northwest Regional State Tax Seminar (2017).

> Experience under the arm's length principle has become sufficiently broad and sophisticated to establish a substantial body of common understanding among the business community and tax administrations. This shared understanding is of great practical value in achieving the objectives of securing the appropriate tax base in each jurisdiction and avoiding double taxation. This experience should be drawn on to elaborate the arm's length principle further, to refine its operation, and to improve its administration by providing clearer guidance to taxpayers and more timely examinations. In sum, OECD member countries continue to support strongly the arm's length principle.

Any serious alternative to the arm's-length principle must satisfy three criteria. First, it must be principle-based, or there will be disparate versions or irreconcilable unilateral interpretations. Second, it must be capable of gaining global acceptance and consensus, including by reassuring the BRIC economies that they will get a fair share of taxing rights. Third, it must be administrable, including by giving tax administrations the ability to obtain and use taxpayer information.

Based on those criteria, the arm's-length principle has no substitute as the basis for international consensus. Global formulary apportionment is certainly not viable. At best, therefore, the quasi-formulary apportionment proposals on the table must be interpreted as either one or both of two concepts. The first idea is that the arm's-length principle will continue to evolve and be adapted for the needs of digitalized business models. The second is merely a means to achieving the appropriate allocation of profits among countries commensurate with value creation, recognizing that the arm's-length principle was never meant to be an end in itself. It should coexist with or yield to other approaches that achieve the same objective. This perspective finds support in U.S. legislation, with the arm's-length principle being articulated only in Treas. reg. section 1.482-1(b)(1), which is subordinate to section 482 standards of "clearly reflecting income" and being "commensurate with income" for intangibles.

In that regard, the proposed quasi-formulary apportionment is simply not the same worldwide formulary apportionment that could be a substitute for the arm's-length principle. It is a limited adaptation of the arm's-length principle, just like placing transaction net profits methods on par with traditional methods and accepting noncompliant safe harbors so that a greater share of profits can be allocated to market countries than would otherwise have been under that principle — business conducted through a website involves little, if any, functions, assets, or risks in the market countries. Without that kind of political compromise, it might be impossible to achieve global consensus on how to tax the digital economy.

## III. Apportionment and the Arm's-Length Principle

It is against that background that two new suggestions for formulary apportionment must be properly analyzed and understood: the TFDE's February public consultation document and India's new fractional formulary apportionment concept in the Public Consultation on the Proposal for Amendment of Rules for Profit Attribution to Permanent Establishment issued by the Central Board of Direct Taxes in April.

The TFDE consultation document addresses three formulary apportionment approaches:

- The user participation proposal could "rely on formulas that would approximate the value of users, and the users of each country, to a business." A formulary approach is seen as a pragmatic way to allocate profit to a novel driver of value that helps avoid country disputes based on their subjective views of value generated by user participation.
- Allocation under the marketing intangibles approach could be accomplished using a revised residual profit-split analysis that involves more mechanical approximations rather than a full facts-and-circumstances analysis. Those approximations could include using cost-based methods to allocate a portion of non-routine or residual profit attributable to marketing intangibles, as well as more formulaic approaches, such as using fixed contribution percentages.

- A new type of residual profit-split method that would carve out a portion of the non-routine residual returns to be attributed to market jurisdictions based on user participation and marketing intangibles based on sales or revenues, or through other methods involving users and expenditures in particular jurisdictions.

None of those proposals go so far as to suggest a wholesale rejection of the arm's-length principle. They do, however, raise conceptual issues, such as bifurcating the analysis between that principle and applying a quasi-formulary allocation to a portion of the same profit pool and accurately delineating between routine and residual profits. Although each suggestion can be thought of as deviating from the principle or involving noncompliant carveouts, the overarching concern is coming up with an administrable solution to allocate more profits to market jurisdictions. All three proposals are limited to either select digital activities (user participation) or to the portion of the non-routine or residual profit that is specifically carved out for market jurisdictions. Conventional transfer pricing analyses continue to allocate the bulk of the profit to activities and factors other than user participation and marketing intangibles.

India has proposed that the profits for a PE in India be determined by apportioning the profits derived from India by equally weighting sales, employees, and assets under the following formula:

Profits attributable to operations in India = Profits derived from India x [SI/3 * ST + (NI/6 * NT) + (WI/6 * WT) + (AI/3 * AT)]

Where:

SI = sales revenue derived by Indian operations from sales in India

ST = total sales revenue derived by Indian operations from worldwide sales

NI = number of employees of Indian operations who are located in India

NT = total number of employees of Indian operations located worldwide

WI = wages paid to employees of Indian operations who are located in India

WT = total wages paid to employees of Indian operations located worldwide

AI = assets deployed for Indian operations that are located in India

AT = total assets deployed for Indian operations located worldwide

The formula is adjusted for digitalized business models by extracting some proportion from each of the three factors and attributing it to users, a fourth factor.

Like the TFDE consultation document, the Indian proposal is not intended to be a wholesale repudiation of the arm's-length principle. It is meant to provide guidance on the attribution of profits to PEs. India does not recognize, nor has it adopted, the AOA in attributing profits to a PE under model article 7. Otherwise, the arm's-length principle remains generally applicable to transfer pricing in India. There are still doubts regarding whether the position in the consultation document is consistent with India's obligations under treaties it has concluded based on model article 7.

In summary, none of the proposals to use partial or quasi-formulary apportionment to tax the digital economy reject the arm's-length principle, although some potential solutions have been said to represent a clear move away from the arm's-length principle.[15] None of the proposals rely on or leverage the information from the country-by-country reports, as many observers had feared — that is, that CbC reporting is an open invitation to apply global formulary apportionment.

On the contrary, the proposals should be properly understood as limited modifications designed to attribute more profits to users, user participation, and market countries. At best, they are limited and partial, not global, suggestions that can be seen as pragmatic, administrable approaches to specific concerns — whether for PEs or digital business models — for which the arm's-length principle had proven inadequate. No one is questioning the new functional analysis approach based on an accurate delineation of

[15] *See, e.g.*, IMF, "Corporate Taxation in the Global Economy," Policy Paper No. 19/007 (Mar. 10, 2019).

transactions as established by BEPS actions 8-10 nor suggesting large-scale revisions to the 2017 global transfer pricing guidelines.

## IV. Conclusion

### A. Integral Part of International Tax Debate

The above line of reasoning leads to a broader question: Are those digital tax proposals a continuation of BEPS — that is, BEPS 2.0 — or an entirely new project? If they are adaptations of the arm's-length principle, then they can be seen (like the earlier work on attributing profits to PEs) as complementary streams of work to address digitalization that go beyond BEPS to effect a limited reallocation of tax rights in favor of market countries.

The May program of work adopted by the 129 members of the inclusive framework explores technical questions to be resolved through the two proposed pillars (which are not mutually exclusive solutions). The first pillar involves potential solutions for determining where tax should be paid and on what basis (nexus), as well as what portion of profits could or should be taxed where clients or users are located (profit allocation). The second pillar involves the design of a global anti-base-erosion system to ensure that MNEs pay a minimum level of tax. According to an OECD release, the second pillar will purportedly provide countries with a new tool to protect their tax bases from profit shifting to low- or no-tax jurisdictions and is intended to address remaining issues identified by the BEPS project.

Therefore, if global consensus forms around a pillar 1 solution, particularly the one regarding marketing intangibles, which has strong U.S. support, what will emerge is then merely a further adaption of the arm's-length principle to address digital transactions, albeit with some limited formulary adjustments to allocate more profits to the market countries.

On the other hand, if the minimum tax in pillar 2 is adopted, that would be a new overlay on the arm's-length principle's allocation of income. The global minimum tax should be the exception, rather than the rule, if it is to truly function as an anti-base-erosion measure. In fact, for the United States to accept that tax, its rate should not be lower than the 13.125 percent rate in the U.S. global intangible low-taxed income regime. Therefore, if in 2018 the average combined statutory corporate rate was 21.4 percent,[16] and most countries have effective rates higher than 13.125 percent,[17] the arm's-length principle will continue to apply to most transactions.

### B. Reform Reinforces the Arm's-Length Principle

That said, the program of work must reconcile the core BEPS goal of aligning profits and tax with where value is created with the digital reform imperative to "allocate revenue to countries that provide large user bases for the world's digital corporate giants."[18]

Any consensus solution must also:

- reflect the right balance between precision and administrability for jurisdictions at different levels of development, underpinned by sound economic principles and conceptual bases;
- ensure a level playing field among all jurisdictions;
- agree on rules that do not result in double taxation, nor result in taxation when there is no economic profit.

The January 2020 deadline gives the OECD little time to build an agreeable global digital tax architecture, especially given the complexity of performing impact assessments and economic analyses of the proposals before countries decide. It is clearly impossible to draft, much less agree on, anything more than a limited modification to the arm's-length principle.

Because of the tight timeline, a practicable approach might be to present the G-20 with some high-level principles that would guide countries in implementing whatever consensus proposals emerge, while making it clear that further work is required to achieve consistent implementation. That work could take the form of detailed guidelines that set out a peer review mechanism

[16] OECD, "Corporate Tax Remains a Key Revenue Source, Despite Falling Rates Worldwide" (Jan. 15, 2019).

[17] *See* Petr Janský, "Effective Tax Rates of Multinational Enterprises in the EU" (Jan. 22, 2019).

[18] Staff, "At Fukuoka Meeting, G20 States May Ink Tax Policy For Internet Giants Based on Users in Each Nation," *The Japan Times*, May 30, 2019.

(based on the success of the Global Forum on Tax Transparency and the Global Forum Against Harmful Tax Practices in bringing conformity to BEPS action 5). It could be coupled with extending the work under BEPS action 14 to help countries adopt more effective dispute resolution mechanisms.

Reconciling the original BEPS recommendations with a digital consensus solution will probably stretch well beyond 2020. The work becomes more complex if both pillars are adopted: The pillars must be reconciled with each other, as well as with the OECD multilateral instrument, model convention, and commentary; the 2017 OECD transfer pricing guidelines must be revised to incorporate modifications to the arm's-length principle; and all those changes must be sequenced with domestic legislation to implement pillar 2. An uncoordinated pace of adoption is almost as disruptive to the coherent operation of an international tax framework as are unilateral measures.

Whatever the case, any prediction that the arm's-length principle will go the way of the Polaroid in the digital era is premature. Its continued centrality as a concept that all countries can subscribe to remains unchallenged — and ironically, further entrenched by the tight timeline of the digital tax proposals. The arm's-length principle remains the only standard that reflects a compromise in allocating tax rights in a digital world. To borrow from Churchill, the arm's-length principle may well remain the worst form of allocating tax rights among states, except for all the others. ■