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INSIGHT: Cross-Border Sales: Where's the Market Jurisdiction?

BY JEFFERSON VANDERWOLK

The OECD-led Inclusive Framework of 129 countries is considering three proposals, described in a public consultation document issued in mid-February, that would, according to that document, ''expand the taxing rights of the user or market jurisdiction'' in the context of taxing cross-border business income. The proposal getting the most attention is the so-called ''marketing intangibles proposal'' favored by the U.S.

The consultation document says this ''proposal would modify current profit allocation and nexus rules to require that the non-routine or residual income of [a multinational business] attributable to marketing intangibles and their attendant risks be allocated to the market jurisdiction.'' The document discusses possible ways of determining the amount of non-routine income attributable to marketing intangibles, and then says this amount ''would be allocated to each market jurisdiction based on an agreed metric, such as sales or revenues'' except in the case of income from the sale of advertising space, which would be allocated ''not by reference to the residence of the payer but by reference to the customers that are targeted by the advertisement.''

The ''agreed allocation metric,'' according to the document, ''would need to be a reasonable proxy for the relative value created in each jurisdiction . . . . The most straight-forward approach may be to allocate . . . based on sales or revenues, though other approaches involving users, expenditures in particular jurisdictions, etc., might also be considered.''

The proposal is not limited to any particular type of business or industry, but would apply ''in all situations in which businesses have significant marketing intangibles that can be attributed to customers of a jurisdiction.''

The OECD's description of the marketing intangibles proposal ends with a telling paragraph:

''To address concerns that the implementation of the proposal would result in significant controversy and double taxation for business, the proposal should offer taxpayers the possibility of early certainty on the taxation under this approach and come with a strong dispute resolution component.''

Identifying sales revenue attributable to customers in a particular country is presumably straightforward in certain business models—such as those involving the delivery of products directly to individual consumers resident in the country—but in other business models it is not at all clear where the ''market jurisdiction'' is.

For example, a manufacturer might make branded products that are components of different products made by other manufacturers, who sell to wholesalers or retailers in various countries. How could the component manufacturer know how much of its revenue was attributable to sales of the product incorporating its branded products in a particular country? It would have to try to trace the revenues using information provided by the intermediaries in the chain of sale, which would be difficult, if not impossible as a practical matter. If the relevant sales were simply the sales to the other manufacturers, on the other hand, it could not be said that those revenues were a reasonable proxy for the value created by the seller's marketing intangibles (i.e., its brand).

Even more difficult would be sales of services involving information, technology, or financing to multinational business customers. The seller might negotiate with a purchasing manager based in a global or regional headquarters, and deliver the services through a central access point, leaving it up to the client to ''distribute'' the service throughout its multinational operations via training, internal support functions, and the like. Where is the ''market jurisdiction'' to which the seller's income should be attributed in this case? Presumably the countries in which the customer has sub-

stantial operations would not agree to allocate the seller's income solely to the headquarters country for tax purposes. Yet tracing revenue to users of the services seems highly problematic in a case of this kind.

The current international tax framework generally avoids these issues by allocating a taxpayer's income to the various functions performed, assets used, and risks assumed by the taxpayer. If a manufacturer or service provider has no employees, agents, or assets in a country, then none of its income is allocated to that country for tax purposes, even if its products or services end up being consumed in that country. This result is consistent with the current standard for taxable presence in a country, which requires the physical presence of an employee, agent, or asset in the country.

Perhaps it is inevitable that these tax standards will be changed in response to new ways of doing business that use digital technologies to transcend physical limitations. However, a tax proposal that merely posits the idea of allocating income to ''market jurisdictions'' based on an unspecified metric is nowhere near being sufficiently developed to form the basis of an international agreement on corporate income tax reform that would be both justified as a policy matter and administrable as a practical matter.

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