‘Loyalty, Exit, and Voice’ in Global Tax Governance: Justifying the Need for ‘Qualified Loyalty’

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ABSTRACT

The digital economy generally influences how multinational corporations conduct their foreign businesses, and this, in turn, affects how countries exercise their taxing rights effectively over incomes sourced within their jurisdictions. Countries have responded to this problem in different ways; some have shown commitment to cooperation-based solutions, while others have resorted to unilateral measures. Drawing on Albert Hirshman’s work, this paper analyzes different approaches to this digital tax problem and coins a new concept of ‘qualified loyalty’ to justify a relatively moderate unilateral tax measure that balances the protection of national interests with the commitment to global cooperation. It argues that ‘qualified loyalty’ is neither entirely pro-tax cooperation nor anti-tax cooperation, but a middle ground that combines elements of ‘loyalty’ and ‘exit’. It analyzes two benefits that a tax policy based on ‘qualified loyalty’ offers within the context of Canada’s tax policy and approaches to the problem.

KEYWORDS: *international tax cooperation, digital service tax, OECD, retaliatory taxation, BEPS Inclusive Framework.*

I. INTRODUCTION

One reality of the digital economy is that the technology-based business models currently employed by the multinational corporations (MNCs) in their cross-border economic activities differ markedly from the models of the 20th century, when the League of Nations designed the international tax system (the 'ITS') that has endured till the present moment.[1] Given this stark difference, the ITS, in its current form, seems incapable of identifying when digital-based MNCs conduct business in foreign jurisdictions outside their residence, because the ITS relies on the physical activities or presence of those MNCs to determine the foreign jurisdictions where they carry on business.[2] Consequently, the ITS limitation in ascertaining when digital-based MNCs conduct business in foreign jurisdictions affects the fair allocation of taxable incomes arising from cross-border economic activities to the jurisdictions of origin.[3] The ITS

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1 The use of the international tax system here means the interaction of discrete national tax systems. It is used simply for convenience purpose and does not suggest that there is indeed a coherent international tax system. For further readings on how the League of Nations design the international tax system, see Nick J. Teo, *The United Nations in Global Tax Coordination: Hidden History and Politics* (Cambridge: Cambridge University Press, 2023); Sunita Jogarajan, *Double Taxation and the League of Nations* (United Kingdom: Cambridge University Press, 2018).

2 The international tax system uses the concept of permanent establishment to determine when multinational corporations carry on business in foreign jurisdictions. See Arthur J. Cockfield, "The Rise of the OECD as Informal World Tax Organization Through National Responses to E-Commerce Tax Challenges" (2006) 8 Yale JL & Tech 136 at 144; Dale Pinto, "The Need to Reconceptualize the Permanent Establishment Threshold" (2006) 60:7 Bull For Intl Taxation 266 at 268; António Carlos dos Santos & Cidália Mota Lopes. "Tax Sovereignty, Tax Competition and the Base Erosion and Profit Shifting Concept of Permanent Establishment" (2016) 25:5/6 EC Tax Rev 296; Kobetsky Michael, *International Taxation of Permanent Establishments: Principles and Policy* (UK: Cambridge University Press, 2011).

3 If a place of business has not been correctly identified, it will be difficult to fairly allocate incomes to the place of business. For further reading on the role played by the doctrine of permanent establishment in allocating incomes arising from cross border economic activities, see Cockfield, "The Rise of the OECD as Informal World Tax Organization, *supra* note 2. On the need to reform the doctrine for proper identification of place of business and fair allocation of incomes, see Arthur Cockfield, "Reforming the Permanent Establishment Principle Through a Quantitative Economic Presence Test" (2003) 38 Can. Bus. LJ 400.

has been designed in a way that such incomes are allocated to and taxed in jurisdictions where MNCs conduct business in a manner that allows the jurisdiction to properly exercise its taxing right on the income sourced in it and does not impose on the MNCs the burden of paying tax on the same income in more than one jurisdiction.[4]

The ITS limitation in ascertaining where digital-based MNCs conduct business (outside their place of residence) and, consequently, the incomes sourced from that place, is what this paper describes as the digital tax problem. One can summarize the approaches employed by countries and institutions to address this problem into two categories. The first is a cooperative approach, which is pioneered and coordinated by the Organization for Economic Cooperation and Development (the 'OECD').[5] The ongoing UN-led cooperation on the same problem is also an example of the cooperative approach.[6] This paper, however, adopts the OECD-led cooperative approach for argument purposes because of its sustained and rich historical work on the digital tax problem. The second approach to the problem is a unilateral approach, adopted by some countries through the enactment of digital services tax (DST) legislation or similar tax measures.[7]

The two approaches define countries' behavioural response to the digital tax problem. Countries participating in the cooperative approach and that have not taken other measures show 'loyalty' to the cooperative process. Countries participating in the cooperative approach but have adopted a unilateral approach, or those not participating in the cooperative

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4 *Ibid.*

5 Organization for Economic Cooperation and Development, Press Release, "International Community Strikes a Ground-breaking Tax Deal for The Digital Age" (8 October 2021), online: <eaccnl.eu/oecd-international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age/> [perma.cc/7CCB-UMRZ].; OECD, OECD/G20 Base Erosion and Profit Shifting Project, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Paris: OECD, 2021).

6 Leopoldo Prada, "International Cooperation on Tax Matters at the United Nations: A Turning Point in History?" (2024) Caribbean Tax J.

7 Wei Cui, "The Canadian Digital Services Tax" in C. Eliffe, ed, *International Tax at Crossroads* (Cheltenham: Edward Elgar, 2023); Reuven Avi-Yonah & JJ Wang, "A Perfect Storm: Executive Orders and Tax Law" (2025) U Michigan Law & Econ Research Paper Forthcoming; Reuven Avi-Yonah, Young Ran (Christine) Kim & Karen Sam, "A New Framework for Digital Taxation" (2022) 63:2 Harv Intl LJ 279.

approach at all, are showing 'exit' from the cooperative process. This paper proposes a middle ground between 'loyalty' and 'exit', described as 'qualified loyalty', as another approach to the digital tax problem. I use this concept to describe a tax policy that adopts a moderate DST as a temporary measure. I describe the policy as 'qualified loyalty' because it balances the competing interests between committing to tax cooperation and protecting tax bases through unilateral measures.

While acknowledging the benefits of the cooperative approach to addressing the digital tax problem because of its multilateral effects, this paper further argues that there are two reasons or benefits why DST should be adopted as an interim unilateral measure. Firstly, it argues that adopting a relatively modest DST is now necessary, given the long time it has already taken, and may continue to take, to find a global solution to the digital tax problem. Secondly, adopting the DST can be a learning curve, offering some practical benefits in understanding the evolving technology-based business models, tracing their economic activities, particularly those of foreign MNCs, and administering the applicable tax in a manner mutually beneficial to tax authorities and taxpayers. The argument for the second reason assumes that the cooperative approach and the DST will use the significant economic presence test, such as MNCs' revenues, rather than the physical presence test, in addressing the problem. The paper explores these two reasons within Canada's tax policy and approach to the digital tax problem.

The ensuing parts of the paper are divided into four sections. The first section sets the stage by explaining the concept of 'qualified loyalty' in global tax governance. Given that I coined 'qualified loyalty' from Albert Hirschman's framework of 'exit, voice, and loyalty',[8] this section briefly explains Hirschman's framework, how existing international tax literature has generally applied it to global tax governance,[9] and how I use it differently to explain countries' responses to the digital tax problem. The second section analyzes 'qualified loyalty' in detail, arguing that a tax policy

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8 Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge: Harvard University Press, 1970); Albert O. Hirschman, "Exit, Voice, and Loyalty: Further Reflections and a Survey of Recent Contribution" (1974) 13:1 Soc Science Information 7.

9 Tarcício Diniz Megalhães, "International Tax Law Between Loyalty, Exit, and Voice" (2021) 44:1 Dal LJ 49.

adopting the temporary DST is 'qualified loyalty', combining the features of 'loyalty' and 'exit'. Thus, such a tax policy is neither entirely pro-tax cooperation nor anti-tax cooperation. The section also considers the potential retaliation to the temporary DST and how it might be addressed.

The third section proceeds to analyze 'qualified loyalty' in the context of Canada's approach to the digital tax problem. It shows how Canada's tax policy combines some features of 'loyalty' and 'exit'. It explains that Canada's participation in the OECD-led cooperative efforts is a form of loyalty to tax cooperation, but the enactment of its DST Act in June 2024 (the 'Act'), which is currently being repealed,[10] has some elements of 'exit'. It argues that if Canada had retained the Act as a temporary measure, its tax policy would have perfectly exemplified the 'qualified loyalty'.

Notwithstanding the repeal of the Act, the fourth section analyzes how the Act would have achieved the two benefits of 'qualified loyalty'. It shows how the digital economy limits the government's taxing rights enshrined in Canada's Income Tax Act[11] and how the Act has come to fill that gap. Also, it shows how the government will be better positioned to implement a global solution when available by using the Act as a learning curve to build robust experience in administering a new tax policy for the digital tax problem. Ultimately, the section presents these two benefits as an alternative reason why the Act should be retained until there is an acceptable global solution to the digital tax problem.

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10 Canada Rescinds Digital Service Tax to Advance Broader Trade Negotiations with the United States see <canada.ca/en/department-finance/news/2025/06/canada-rescinds-digital-services-tax-to-advance-broader-trade-negotiations-with-the-united-states.html> [perma.cc/8ZQD-4HM2]. As of the time of writing this paper, the government has introduced Bill C-15, which will officially repeal the Act. See <parl.ca/DocumentViewer/en/45-1/bill/C-15/first-reading> [perma.cc/47TH-G4QC].

11 *Income Tax Act*, RSC 1985, c 1 (5th Supp).

II. GLOBAL TAX GOVERNANCE IN THE ERA OF DIGITAL ECONOMY: 'LOYALTY' OR 'QUALIFIED LOYALTY'?

A. Albert Hirschman's Framework of Exit, Voice, and Loyalty

Hirschman's framework of 'Exit, Voice, and Loyalty' is well known for explaining how people respond differently to firms' products or to the government's policies with which they are dissatisfied. Hirschman groups these behavioural responses into three; (a) 'loyalty', where the dissatisfied people show their commitment to the products or policies by doing nothing and hoping improvement can happen within;[12] (b) 'exit', where they express their grievances by leaving the group or association to which they initially belong or by abandoning the products that were once their favourites;[13] and (c) 'voice', where they demonstrate their grievances by criticizing the governments or the firms for their flawed policies or products respectively.[14]

The framework is based on the reality that a firm's product or an organization's services may decline in quality and utility.[15] The 'exit' and 'voice' strategies are the main active reactions to the decline in quality, with each of them having some significant influences on political and economic dynamics.[16] The goal is for the firm or the organization to address the decline by paying attention to the responses of either 'exit' or 'voice'. Loyalty is less reactive than the other two options, but it does not mean that members who opted for loyalty are not interested in reforms. Loyal members stay longer, hoping for internal improvement, before they activate 'voice' or 'exit'.[17]

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12 Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 79.

13 *Ibid* at 4.

14 *Ibid* at 30.

15 *Ibid* at 4.

16 For further reading on how Hirschman's 'exit' can explain political outcomes, see Albert O. HG Hirschman, "Exit, Voice, and the State" in Jeremy Adelman, ed, *The Essential Hirschman* (Princeton: Princeton University Press, 2016) at 309–30. Hirschman's framework has also been used or expanded in other areas, such as labour-management relationship. See Virgina Doellgast, *Exit, Voice, and Solidarity: Contesting Precarity in the US and European Telecommunications Industries* (Oxford: Oxford University Press, 2023).

17 Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 79.

B. Hirschman's Framework Application to Global Tax Governance

Although Hirschman grounds his work in political and economic dynamics,[18] Tarcício Diniz Megalhães shows that the framework can be used to explain tax scholars' normative arguments regarding countries' behavioural patterns in global tax governance.[19] Similar to Hirschman's categorization, Megalhães groups these scholarly works on countries' normative behavioural patterns into 'tax cooperation' exemplifying 'loyalty', 'tax competition' exemplifying 'exit', and the BRICS' evolving criticism of the OECD's work exemplifying 'voice'.[20] In doing so, Megalhães draws on the works of Reuven S. Avi-Yonah, Yariv Brauner, Tsilly Dagan, and others.[21]

According to Megalhães, in tax cooperation, scholars such as Avi-Yonah and Brauner argue that countries should demonstrate their loyalty by supporting the cooperative efforts coordinated by the OECD, for example, to address their concerns about the ITS.[22] The other argument from scholars, such as Dagan, concerns exiting the cooperative efforts and moving to competition, in which countries can unilaterally address the flaws in the ITS, since there is no guarantee that the cooperation is beneficial to them.[23] The criticism of the ITS by BRICS countries, individually or collectively, and some other actors, represents 'voice'. The dissatisfied actors continue to participate in global tax governance, but they use their influence to criticize the ITS, arguing that it favours developed countries.[24] Megalhães contends that a combination of these three strategies is good for the ITS instead of withdrawing from the cooperative efforts.[25]

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18 *Ibid* at 19. One of Hirschman's goals in the framework is to argue that the usefulness of 'exit' is not limited to economics and 'voice' is not limited to political science.

19 Megalhães, "International Tax Law Between Loyalty, Exit, and Voice", *supra* note 9.

20 *Ibid*.

21 *Ibid*.

22 *Ibid* at 55–58.

23 *Ibid* at 58–63.

24 *Ibid* at 63.

25 *Ibid* at 68.

C. Hirschman's Framework and Countries' Different Responses to Digital Tax Problems

Hirschman's framework can be used to explain the digital tax problem and the different approaches adopted to address it.[26] The digital tax problem is the decline in the quality of the ITS. Given its limitation to ascertain when digitally enabled MNCs conduct business in source countries, the ITS has not satisfied the interests of countries that rely on it in exercising their taxing rights. For over a century, the ITS has been the basis for determining whether MNCs conduct business in source countries under the doctrine of permanent establishment, a concept ubiquitous in bilateral tax treaties.[27] Countries, particularly the source countries, where the MNCs conduct business without a physical presence, are dissatisfied with the digital tax problem. These countries can be described as those responding to flawed policies or products in the context of Hirschman's framework.

The institutions, such as the OECD or the UN, coordinating global tax governance can be likened to an association or a firm, whose policy or product is the subject of dissatisfaction.[28] I adopt the OECD for my analysis, given its preeminent and prominent role in designing, shaping, and aligning the ITS with the realities of the digital economy. Although the OECD is not really the cause of the digital tax problem,[29] this paper posits, for analysis purposes, that the OECD should assume a role similar to that of an association or a firm in the context of Hirschman's framework because of its expected role that it would coordinate efforts that will address the digital tax problem. Hirschman's framework focuses on how customers' responses to the decline in quality alert a firm and trigger the firm's action to remedy it, rather than the source of the decline.[30] The analysis on how to pay

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26 Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 3. Hirschman states the framework is not limited to economics and political context, and that it could be applied to voluntary associations, such as the one under reference in this paper.

27 Arvid A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (Deventer: Kluwer Law International, 1991); Dale Pinto, "The Need to Reconceptualize the Permanent Establishment Threshold", *supra* note 2.

28 Hirschman, *Exit*, *Voice*, *and Loyalty*, *supra* note 8 at 3.

29 The problem is one of the consequences of the disruptive digital economy and is beyond the OECD.

30 Hirschman, *Exit*, *Voice*, *and Loyalty*, *supra* note 8 at 31.

attention to responses to the decline in quality and remedy should be more important than analyzing the source of the decline. The same argument should apply to the digital tax problem; it is the responses triggered by the digital problem that should be important, not whether the OECD caused it.

With the G20's political support, the OECD undertook several initiatives, including establishing the BEPS Inclusive Framework in 2016, a special-purpose forum comprising OECD and non-OECD countries, to address the digital tax problem, among other things.[31] Given the OECD's creation of the BEPS Inclusive Framework as a special-purpose forum, I will narrow my analysis to it. The BEPS Inclusive Framework has advised its participating countries to support its cooperative efforts and refrain from unilateral responses to the problem.[32] Some countries remain committed to the cooperative efforts and have not taken unilateral responses to the problem. The behavioural pattern of these countries could be described as 'loyalty'. They hope that cooperation-based solutions, such as those the BEPS Inclusive Framework champions, will resolve the problem.

There is another category of participating countries in the BEPS Inclusive Framework that have 'exited' the cooperative efforts by taking a unilateral response to address the problem.[33] It is an 'exit' because the unilateral response is not the 'product' that the BEPS Inclusive Framework presents. By shifting to a unilateral response, those countries have 'stopped

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31 Allison Christians & Laurens Van Apeldom, "The OECD Inclusive Framework" (2018) Bull for Intl Taxation 226; Mosquera Valderrama I.J., Dries Lesage & Wouter Lips, (2018) "Tax and Development: The Link between International Taxation, The Base Erosion Profit Shifting and the 2030 Sustainable Development Agenda", Working Paper Series W-2018/4, online: <cris.unu.edu/sites/cris.unu.edu/files/W-2018-4.pdf> [perma.cc/KW82-S8LP].

32 OECD/G20 Base Erosion and Profit Shifting Project, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalising of the Economy* (October 2021) <https://www.oecd.org/en/about/news/announcements/2021/10/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.html> [perma.cc/M7RN-9YAH]. ; OECD, *The Multilateral Convention to Implement Amount A of Pillar One: The Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2023) at 77.

33 OECD Multilateral Convention, *supra* note 32 at 91. The Convention mentions countries that have adopted Digital Service Tax as unilateral measure, such as the United Kingdom, Austria, India and Spain.

buying the firm's product', using Hirschman's language.[34] Some countries did not even join the BEPS Inclusive Framework, suggesting that they prefer a unilateral response to cooperation.[35] The most popular unilateral response is the enactment of the DST. One main similarity between the DST and the Convention is that both rely on the MNCs' significant economic presence test to address the digital tax problem.

The third category of countries is those that criticized the work of the BEPS Inclusive Framework while they remain members of the forum.[36] This exemplifies 'voice' in Hirschman's work. Hirschman recognizes that the 'voice' of dissatisfaction could be made to the management of the firm or association, another authority that supervises the management, or to anyone 'who cares to listen'.[37] It seems the last category of person to whom the dissatisfaction could be directed is broad and includes people outside the purview of the firm. It is therefore not necessary that the criticisms should be directed to the BEPS Inclusive Framework.

The 'voice' response to the BEPS Inclusive Framework is most visible in the criticisms of developing countries at the UN, led by the African Group, which have now resulted in the ongoing UN cooperative efforts.[38] The criticism is 'voice' rather than 'exit' because those who champion it are still part of the BEPS Inclusive Framework. Directing the voice to the UN does not make it any less of a voice since it could be directed to 'anyone who cares to listen'.[39]

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34 Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 4. Exit is not limited to leaving the association. It also means when a customer stops buying a firm's products. Thus, the fact those who adopted a unilateral measure contrary to the BEPS Inclusive Framework are still part of the forum does not make it any less of exit.

35 There are 193 countries according to the UN, while there are 148 members in the BEPS Inclusive Framework as of December 5, 2025. This shows that some countries have not joined the Inclusive Framework. See OECD, Members of the OECD/G20 Inclusive Framework on BEPS <https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/beps/inclusive-framework-on-beps-composition.pdf> [perma.cc/6P74-WWCG].

36 Mark Bour Mansour, "Live Blog: UN Vote On New Tax Leadership Role" (Tax Justice Network, 2022) online (blog): <taxjustice.net/2022/11/22/[redacted]-live-blog-un-vote-on-new-tax-leadership-role/> [perma.cc/NJZ5-KSD5].

37 Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 4.

38 Mansour, "Live Blog: UN Vote On New Tax Leadership Role", *supra* note 36.

39 Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 4.

III. Between Loyalty and Exit: Analyzing and Recommending the Middle Ground ('Qualified Loyalty')

There should be a middle ground between 'loyalty' and 'exit'. I describe the middle ground as 'qualified loyalty'. It is the combination of elements of 'loyalty' and 'exit'.[40] I conceptualize this to mean a situation in which an individual or a country takes a temporary position contrary to that of the firm or association they criticize, while still showing support for the firm or the association. I explain in the following paragraphs how 'qualified loyalty' applies to how countries in the BEPS Inclusive Framework respond to the digital tax problem. While the 'qualified loyalty' may apply in other contexts of global tax governance or other areas, I ground this framework in the cooperative efforts to address digital tax problems.[41]

A country can combine some features of 'loyalty' and 'exit' in its approach to the digital tax problem. Such a country will join and participate in the BEPS Inclusive Framework, as 'loyalty', and disclose to the coordinating institution and other participating countries that it will continue to implement its DST legislation, as 'exit', pending the realization of a cooperation-based solution. By joining the Inclusive Framework, the country has embraced some elements of 'loyalty', believing that solutions to the digital tax problem can be found within the BEPS Inclusive Framework. By enacting DST legislation, the country has taken a form of 'exit' by not subscribing to the position of the BEPS Inclusive Framework.

But since the DST is temporary and will give way to a cooperation-based solution when it becomes available, it cannot be said that the country has embraced 'loyalty' in its entirety, nor 'exit' in totality. Rather, the country

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40 Hirschman argues that a member may resort to voice while remaining loyal to the firm or association. So, loyalty may activate voice and make exit less likely. This suggests that there could be a combination of loyalty and voice. However, it seems impossible to combine exit and loyalty. Exit occurs when loyalty reaches a breaking point. See Hirschman, *Exit, Voice, and Loyalty*, *supra* note 8 at 82–90.

41 Megalhães analyzes that BRICS members had previously combined 'loyalty' and 'exit' by following the BEPS recommendations but implementing them in their own ways. The kind of combination of 'loyalty' and 'exit' in the 'qualified loyalty' is different. See Megalhães, "International Tax Law Between Loyalty, Exit, and Voice", *supra* note 9 at 64.

has embraced the middle ground between 'loyalty' and 'exit', which I describe as 'qualified loyalty'. The 'loyalty' is qualified in the sense that the country supports ('is loyal to') the work of the institution (the Inclusive Framework, in this sense), but 'qualifies' its 'loyalty' by reserving the right to temporarily have a unilateral measure that it will step down when the expected loyalty-based solution becomes available.

Given the unique feature of the digital tax problem affecting a country's tax base and its consequential effects on its revenue projections, I argue that the 'qualified loyalty' is worth considering. The digital tax problem constrains a country's ability to exercise its taxing rights, particularly its source taxation rights. It threatens countries' tax sovereignty by eroding their tax bases. Tax sovereignty is the ability of a country to exercise its taxing rights on profits arising from economic activities occurring within its territory, whether the profits are earned by its residents or non-residents (known as source taxation) and profits earned by its residents, whether earned at home or abroad (known as residence taxation).[42] Most countries' tax legislation is based on these taxing rights.

The 20th-century business models influenced the design of the ITS. Thus, the physical presence or physical activities of economic transactions determine the threshold that triggers the exercise of a country's taxing rights, particularly the source taxation rights.[43] For example, a foreigner's economic transactions in a country in which he or she is not a resident must meet a threshold, measured by physical activities or physical presence of the transactions, and is technically known as permanent establishment (PE), before the country can impose tax on profits arising from those transactions.[44] However, under the current digital economy, the foreigner can conduct his or her economic activities in the other country through digital means without maintaining physical presence there. This means that profits arising from digitally enabled transactions are not captured and

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42 Ke Chin Wang, "International Double Taxation of Income: Relief Through International Agreement 1921-1945" (1945) 59:1 Harv L Rev 73.

43 Michael, *International Taxation of Permanent Establishments*, *supra* note 2; Martin B. Tittle, *Permanent Establishment in the United States: A View Through Article V of the U.S-Canada Tax Treaty* (United States: Vandeplas Publishing, 2007).

44 *Ibid.*

taxable under the current ITS since the taxpayers do not have physical presence and PE.[45]

It is true that the digital tax problems are best resolved through cooperative efforts, given their multilateral consequences. An important point for consideration is how long a country can or should wait for a cooperative solution. The longer a country waits, the more potential tax losses it incurs. It is hard to predict when the solution will be available. It is equally unjustifiable to shift blame to anyone for any delay in achieving the solution, as the cooperation is driven by political negotiations. The trends in events regarding the OECD-led cooperative efforts on the digital tax problem are proof that (a) there may be no accurate prediction of when the result will be available; (b) it is reasonable to expect a delay in achieving the result; and (c) no one, including the BEPS Inclusive Framework, can be blamed for any delay.

Although the OECD started working on the digital tax problem before 2015, its work began to take shape in 2015 with the release of the 15 action pillars, the first of which focuses on the digital tax problems.[46] Another important milestone is the establishment of the BEPS Inclusive Framework in 2016.[47] Several deadlines for finalizing and implementing proposed solutions have been set, but none have been met.[48] Many milestones have been achieved since the beginning of the work, but a key achievement is the release of the Convention in 2023, which is the instrument that was supposed to be domesticated as tax legislation in the participating

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45 Cockfield, "Reforming the Permanent Establishment Principle Through a Quantitative Economic Presence Test", *supra* note 3.

46 Christians & Van Apeldom, "The OECD Inclusive Framework" *supra* note 31; Mosquera Valderrama I.J., "Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative" (2018) 72:3 Bull for Intl Taxation, IBFD Publication.

47 *Ibid.*

48 By the OECD statement of October 8, 2021, the Convention was expected to be open for signature in 2022 and Amount A would come into effect into 2023. See OECD/G20 Base Erosion and Profit Shifting Project, Statement on a Two-Pillar Solution, supra note 32. In another statement of July 11, 2023, the OECD states that the Convention would be open for signature in 2023 and come into force in 2025. See the July 11 2023 statement online: <oecd.org/en/about/news/announcements/2023/07/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.html> [perma.cc/UD49-G52V].

countries.[49] While the BEPS Inclusive Framework was working on the digital tax problem, the UN began its cooperative efforts on the same issue and has made considerable progress.[50] It is uncertain whether the Convention would eventually be implemented or abandoned. If the Convention is abandoned, it is uncertain whether the UN work will follow the same pattern. I strongly believe in cooperation as the best way to resolve the digital tax problems, but the reality is that the result may be delayed.

The delay is no one's fault. Unlike domestic tax policy, there is no sovereign entity in the global system with the power to impose tax and determine when it will be operational. The BEPS Inclusive Framework is established to facilitate discussions, not to impose a tax policy on the participating countries.[51] So, political negotiations drive international tax policy, such as the Convention, and participating countries consider their national and common interests in the cooperative efforts.

Given that such political negotiations may be prolonged, and the digital tax problem remains unresolved or is even exacerbated, a temporary measure is plausible for two reasons. First, it helps a country to protect its tax base from exploitation by foreign economic actors. By extension, this will enable the country to track all economic activities and realize tax revenues that would otherwise have been lost due to the digital tax problem. Second, the temporary measure will familiarize the country with the new policy and enable it to evaluate its administrability and acceptability. The second point is based on the assumption that the temporary measure and the cooperation-based result will use the same approach in resolving the digital tax problem. For example, the Convention uses the significant economic presence test to trace the source of profits and allocate taxing rights.[52] A country that has a unilateral measure that relies on the same significant economic presence test will be in a better position to operationalize the Convention or even determine whether the Convention will not create any burdens on the administration of the tax. I expand on these benefits in section III of this paper, analyzing them within the context of Canada's tax policy.

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49 OECD Multilateral Convention, *supra* note 32.

50 Prada, "International Cooperation on Tax Matters at the United Nations", *supra* note 6.

51 Christians & Van Apeldom, "The OECD Inclusive Framework", *supra* note 31.

52 OECD Multilateral Convention, *supra* note 32.

The temporary measure should, however, be relatively modest. It is hard to set parameters for modesty, but the tax rate for the temporary measure should be low to avoid significant double taxation, as digitally enabled MNCs may be required to pay tax on the same income to their residence countries. The scope of the temporary measure should also be broad to apply to both resident and non-resident businesses to avoid being labelled discriminatory against specific MNCs.

A. Potential Retaliatory Tax Measure

While the temporary unilateral measure might be justified for the reasons given earlier, the jurisdiction, which corporations feel the greater impact of the measure, may see it differently. The affected jurisdiction may retaliate or threaten to retaliate by imposing an additional tax burden on corporations and citizens of the jurisdiction adopting the unilateral measure, hoping that corporations and citizens will lobby their government to abandon the measure.

This is correct about DST and the threatened retaliation it triggered from the US, as the majority of US firms are affected by the measure.[53] For example, it has been reported that 17 out of the 27 firms affected by France's DST are US corporations.[54] The US is known for using retaliatory tax measures as a tactic when a foreign country's tax policy treats US corporations less favourably, such as when France treated its corporations better than US corporations in the 1930s, leading to the enactment of section 891 that is currently in the Internal Revenue Code,[55] or when advertising expenses incurred by US broadcasters operating in Canada are denied in Canada.[56]

In its usual style of employing retaliatory tax tactics, the US president has threatened to invoke Section 891 through his executive order of January

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53 Reuven Avi-Yonah, "Retaliatory Taxation: What Should EU Do?" (2025) 53: 6&7 Intertax 494.

54 See the statement of the Computer & Communication Industry Association, France's Proposed Digital Services Tax Increase, online (pdf): <ccianet.org/wp-content/uploads/2025/10/CCIA-Explainer-on-Frances-Proposed-Digital-Services-Tax-Increase.pdf> [perma.cc/Q6KN-4BQY].

55 Derek Devgun, "International Fiscal Wars for the Twenty-First Century: An Assessment of Tax-Based Trade Retaliation" (1996) 27:2 Law & Pol'y in Intl Bus 353 at 357.

56 *Ibid* at 356.

20, 2025, instructing the Secretary of the Treasury to investigate whether any foreign country subjects US citizens or corporations to extraterritorial or discriminatory taxes.[57] The US president considers DST to be discriminatory, and if further steps are taken in this regard, invoking section 891 will affect many countries with DSTs, particularly those where US corporations or citizens conduct business.

This may be the first time that the US will have to invoke section 891 against multiple countries, as there is now a proliferation of DSTs. Unlike when the US had at different times retaliated against individual countries for their offensive tax policies,[58] the US will be dealing with many advanced economies at the same time. It is uncertain if retaliating against countries like France, the UK, Italy, and others with DSTs simultaneously will be sustainable.

The potential retaliatory measure could be addressed by first ensuring that the DST is not discriminatory and is reasonably broad, applying to corporations in the country adopting it and to foreign companies. Second, the tax rate should be the average of the other DST rates. If the rates are substantially similar across countries and DST is not discriminatory, it may be unsustainable for the US to retaliate against all these countries simultaneously.

IV. CANADA'S TAX POLICY AND 'QUALIFIED LOYALTY'

As a G20 country, Canada is part of the G20's foundational collective efforts to reform the ITS and address the digital tax problem after the global financial crisis.[59] The G20's intervention resulted in its alliance with the OECD and ultimately culminated in the establishment of the

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57 Avi-Yonah, "Retaliatory Taxation: What Should EU Do?", *supra* note 53. The Secretary of the Treasury is required to consult with the Secretary of Commerce and the United States Trade Representative.

58 Devgun, "International Fiscal Wars for the Twenty-First Century: An Assessment of Tax-Based Trade Retaliation", *supra* note 55.

59 Jonathan Luckhurst, *G20 Since the Global Crisis* (New York: Macmillan Palgrave, 2016) at 1- 3; OECD, *A Decade of the BEPS Initiative: An Inclusive Framework Stocktake Report to G20 Finance Ministers and Central Bank Governors* (Paris: OECD Publishing, 2025).

BEPS Inclusive Framework.[60] Through its membership in four different institutions – the G20, the G7, the OECD, and the BEPS Inclusive Framework - that are interested in cooperative efforts on the digital tax problem, Canada has demonstrated its 'loyalty' and commitment to cooperation. Even when some G20 countries, such as the UK,[61] France,[62] and Italy,[63] adopted unilateral measures through their DSTs, Canada did not adopt any unilateral measures. It waited long enough to adopt a unilateral measure by enacting the Act in June 2024.[64] Assuming the Act was not repealed, the Act would be a form of Canada's exit. The combination of Canada's loyalty to cooperation and its enactment of the Act as a temporary measure will be qualified loyalty.

Adopting the Act – and similar unilateral measures from other countries – contradicts the position of the BEPS Inclusive Framework.[65] To facilitate the implementation of this Convention, the BEPS Inclusive Framework encourages its members to either abandon their existing DSTs or refrain from enacting new ones if they do not already have a DST in place.[66] It could be argued that the G7 and the G20 countries, given their economic and political leadership and their foundational role in initiating and monitoring the developments on the Convention, should have refrained from such a unilateral measure and promoted the cooperative

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60 G20, *G20 Finance Minister and Central Bank Governors Communiqué, Ankara* (5 September 2015) online: www.g20.utoronto.ca/2015/150905-finance.html [perma.cc/V7AT-VJ7G]. . For further reading of the 2015 Addis Ababa Action Agenda, which influenced the creation of the Inclusive Framework, see United Nations, United Nations Department of Economic and Social Affairs, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development,* (New York: United Nations, 2015).

61 The UK enacted its digital service tax (DST) in 2020. See OECD Multilateral Convention, *supra* note 32 at 91.

62 *Ibid.* France enacted its DST in 2019.

63 *Ibid.* Italy enacted its DST in 2020. Other countries noted by the OECD are India, Spain, Tunisia, and Austria. Also see Cui, "The Canadian Digital Services Tax", *supra* note 7 at 245.

64 Reuven S. Avi-Yonah, "Much Ado: Why the United States Should Calm Down About DSTs" (2023) Tax Notes Intl 903.

65 OECD Multilateral Convention, *supra* note 32.

66 *Ibid.*

solution offered by the Convention.[67] However, those countries need to protect their tax bases while cooperation efforts are underway. Their position in implementing the unilateral measures, assuming they are designed as argued in this paper, will be qualified loyalty.

One of the positive attributes of the Act, according to scholars such as Reuven Avi-Yonah, is its non-discrimination, as it applies to both resident and non-resident taxpayers.[68] This should have ordinarily addressed any concerns that are traditionally raised against DSTs that they target some corporations from specific countries.[69] From this perspective, the Act can be described as relatively modest. Regarding the tax rate, the Act's rate is 3%, similar to France[70] and Italy,[71] but higher than the UK's 2%.[72] The Act's rate is within the average of these comparable G7 countries, but the lower the rate can go, the more modestly we can achieve, thereby avoiding a significantly burdensome tax obligation for MNCs.

The United States, however, considers all DSTs, including the Act, discriminatory because it believes they specifically target its giant technology companies, such as Google, Meta, and Apple.[73] On January 20, 2025, the United States president issued an executive order directing the Secretary of the Treasury, the Secretary of Commerce, and the United States Trade Representative to 'investigate whether any foreign country subjects United States citizens or corporations to discriminatory or extraterritorial taxes pursuant to section 891 of Title 26, United States Code' ('Executive

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67 The alliance between the G20 and the OECD that resulted into the establishment of the Inclusive Framework is not hidden. Wei Cui has established that the G7 influenced some of the works in the Inclusive Framework, such as the recommendation of the global minimum tax. See Wei Cui, "New Puzzles in International Tax Agreement" (2022) 75:2 Tax L Rev 201.

68 Avi-Yonah, "Much Ado: Why the United States Should Calm Down About DSTs", *supra* note 64.

69 *Ibid*.

70 Alexander Szivos, "The Landscape of Digital Service Taxation" (2025) Regional L Rev 113 at 116.

71 *Ibid* at 115.

72 *Ibid* at 115.

73 Avi-Yonah, "Much Ado: Why the United States Should Calm Down About DSTs", *supra* note 64.

Order').[74] The discriminatory taxes in this context refer to DSTs.[75] If the United States had exercised its power under section 891 of Title 26 of the United States Code by doubling the tax rate on citizens and corporations of the country with perceived discriminatory taxes, the other country could retaliate by doubling its tax rate or imposing new tariffs on the United States citizens and corporations.[76]

The United States appears to disagree with the scholarly view that the Act is non-discriminatory, as the Executive Order does not exempt any DST.[77] Media reports indicate that the United States planned to impose tariffs on Canada and France due to their DSTs.[78] Canada had previously responded to the United States' tariffs, imposed for other non-tax reasons, by placing tariffs on imports from the United States.[79] So, if the United States had implemented the Executive Order, Canada might have considered imposing further retaliatory tariffs against the United States.

The preliminary question that crossed minds at that time was whether Canada should repeal the Act to avoid an imminent retaliatory tax or tariff from the United States and preserve its relationship with the United States. The question was important, given that the two countries have a long history of integrated trade relationships and strong political ties, and that the then imminent trade war arising from the Act could threaten the ties. Canada anticipated tax revenues from the Act, but shifting to a different tax policy of abandoning the Act could result in a loss of revenue. Another question that could be asked then was whether it was truly worth sacrificing those expected revenues that could support Canada's public expenditures for the sake of preserving the relationship with the United States?

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74 The White House, America First Trade Policy, (January 20, 2025) online: <whitehouse.gov/presidential-actions/2025/01/america-first-trade-policy/> [perma.cc/AT2Y-FA25] ('Executive Order).

75 Avi Yonah, "Retaliatory Taxation What Should EU Do?", *supra* note 53.

76 Reuven Avi-Yonah & JJ Wang, "A Perfect Storm: Executive Orders and Tax Law" (2025). U Michigan Law & Econ Research Paper Forthcoming.

77 Executive Order, *supra* note 74.

78 "Trump Plans Tariffs on Canada, France over Digital Services Taxes", Reuters (February 13, 2025) online: <reuters.com/business/trump-plans-tariffs-canada-france-over-digital-services-taxes-2025-02-13/> [perma.cc/4XR7-6QHZ].

79 Wyatte Grantham-Philips, "Trump Has Imposed Sweeping Tariffs. Here's a Timeline of How We Got Here", CBC, online: <cbc.ca/news/politics/trump-trade-tariffs-timeline-1.7481280> [perma.cc/CX3A-UFNR].

These questions are now overtaken by the subsequent events after the Executive Order. On June 29, 2025, Canada announced that it would repeal the Act to support its trade negotiations with the United States.[80] It has introduced Bill C-15 to repeal the Act. It is not clear whether the United States Executive Order prompted the decision to repeal the Act. However, the government states that the repeal of the Act is:

> ...in anticipation of a mutually beneficial comprehensive trade arrangement with the United States. Consistent with this action, Prime Minister Carney and President Trump have agreed that parties will resume negotiations with a view towards agreeing on a deal by July 21, 2025.[81]

The Act is a clear example of how a country can demonstrate its 'qualified loyalty' in global tax governance. Canada states that it is committed to multilateral agreements ('loyalty') and that the Act is a stopgap measure ('qualified loyalty'). Thus, the Act should have been retained for the reasons I discuss in greater detail in the next section.

The other point to note is that there is nothing inherently wrong with the Act – and any other DSTs - and the United States' countermeasures to the Act and similar DSTs. Both countries' unilateral tax policies aim to prioritize their national interests. However, a greater problem arises from using unilateral measures to protect these interests. Historically, unilateral measures have not been the best solution for global tax problems, even when the international community was less integrated than it is today.[82] It could be argued that having unilateral measures may constrain global cooperation. The other argument is that if no result is forthcoming from cooperation, unilateral measures are considered. The unilateral measures may even expedite cooperation, as the coordinating institution should be

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80 "Canada Rescinds Digital Service Tax to Advance Broader Trade Negotiations with United States", online: <canada.ca/en/department-finance/news/2025/06/canada-rescinds-digital-services-tax-to-advance-broader-trade-negotiations-with-the-united-states.html> [perma.cc/8ZQD-4HM2].

81 *Ibid.*

82 See Michael J. Graetz & Michael M. O'Hear, "The Original Intent of U.S. International Taxation" (1997) 46:5 Duke LJ 1021 at 1023; Reuven S. Avi-Yonah, "Structure of International Taxation: A Proposal for Simplification" (1996) 74:6 Tex L Rev 1301 at 1303; Yariv Brauner, "An International Tax Regime in Crystallization" (2003) 56:2 Tax L Rev 259 at 260; and Victor Thuronyi, "International Tax Cooperation and a Multilateral Treaty" (2001) 26:4 Brook J Intl L 1641.

interested in avoiding the proliferation of unilateral measures by quickly facilitating a common solution.

V. Justifying 'Qualified Loyalty' in Global Tax Governance

A. It Protects a Country's Taxing Rights in the Interim

The core argument here is that 'qualified loyalty' protects a country's taxing rights until a cooperation-based result is available. Given that cooperative efforts may take time, protecting the taxing right in the interim is appropriate. Applying this to Canada's tax policy, the Act protects Canada's taxing rights, and that protection should be maintained until a cooperation-based solution is achieved. To demonstrate this, I analyze the validity of Canada's taxing rights through its Income Tax Act ('ITA'), and how the Act fills the gap in exercising those taxing rights in the digital economy. If there is no concern about the legitimacy of the ITA or concerns about its compliance with the international taxation standards, there should be no concern about the Act. Like the ITA, the Act asserts Canada's taxing rights and protects its jurisdiction from being exploited by digital-enabled businesses.

Before enacting the Act, the ITA was the primary tax framework through which the government exercised both its residence and source taxation rights. The ITA imposes a tax on incomes earned by Canadian residents and non-residents.[83] While residents pay tax on their worldwide income,[84] non-residents pay tax on incomes earned in Canada, technically described as sourced incomes.[85] In addition to the ITA, Canada has a network of bilateral tax treaties that provide relief to taxpayers and other administrative convenience when a taxpayer may be subject to tax in Canada and a treaty partner country.[86] Through the network of tax treaties, Canada relaxes its otherwise strict tax policy measures in the ITA. For

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83 S. 2(1) and 2(3) of the ITA.

84 S. 3 of the ITA.

85 Sections. 2(3) and 115 of the ITA.

86 Kim Brooks has an excellent collection of scholarly papers discussing tax treaties, their features and purpose in international taxation. See Kim Brooks, "International Tax: Tax Treaties" (2024) Schulich Law Scholars.

example, where non-resident taxpayers manufacture or produce in Canada, they are deemed under paragraph 253(a) of the ITA to be carrying on business in Canada and must pay tax on incomes arising from the economic activity, irrespective of the level of the economic activity.[87] But where there is a tax treaty, the treaty usually states that the activities must reach a particular threshold (that is, Permanent Establishment 'PE') before the non-resident's tax obligation on the economic activities arises.[88] The treaty thus raises the bar and exempts from taxation some economic activities that would have been taxable under s. 253 – because they are below the PE threshold stated in the treaty.

The Act complements the ITA by providing a taxing framework for digital-enabled businesses that are not provided for in the ITA. Carrying on business by a non-resident company under s. 253 and the PE threshold in Canada's tax treaties are defined in terms of the non-resident company's physical presence or activities in Canada.[89] With the advent of technology, non-resident companies may no longer require physical presence to operate in Canada. Thus, non-resident companies that leverage technology to operate in Canada without a physical presence cannot be taxed under ss. 2(3) and 253 of the ITA. Thus, the digital economy erodes Canada's taxing rights, at least with respect to sourced income, which the country has traditionally exercised under the ITA.

The Act is restorative: it restores the taxing right eroded by the digital economy. To do this, it employs the significant economic presence test to define what 'carrying on business' under s. 253 and 'PE' in tax treaties should mean in the digital economy.[90] The test uses revenues earned by non-residents instead of physical presence to determine when they are 'carrying

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87 S. 253 and 2(3) of the ITA.

88 For example, see Convention Between Canada and France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (May 2, 1975, and amended by the protocols signed on January 16, 1987, November 30, 1995, and on February 2, 2010) online: <canada.ca/en/department-finance/programs/tax-policy/tax-treaties/country/france-convention-consolidated-1975-1987-1995-2010.html> [perma.cc/T4ZT-ARPJ].

89 *Ibid.*

90 S. 10 of the Act.

on business'.[91] This test relies on various economic factors, including non-resident corporations' revenues, to determine the necessary degree of connection or nexus that market jurisdictions should have before they can exercise their taxing rights.[92] The Act applies to four specific categories of services: online marketplace services, online advertising services, social media services, and the sale of user data.[93] While non-resident businesses that produce or provide these categories of services can have physical structures in Canada and therefore come under s. 253; the businesses located outside Canada can also provide these services in Canada without physical presence and are, therefore, not taxable under s. 253.

In comparison, the Convention also encompasses the services within the scope of the Act as well as other businesses, such as transport, intangible property, and immovable property, which are not included in the Act.[94] Although the Convention covers a broader range of services, there is no guarantee it will generate more tax revenue than the Act. Additionally, other businesses falling under the Convention – and not under the Act - can still be regulated by the existing tax regime, as operating such businesses without a physical presence is impossible.[95] For instance, non-resident corporations engaging in international transport—whether by shipping or aviation—require a definite physical presence in Canada. Even in the absence of the Convention, Article 8 of Canada's network of tax treaties can regulate the taxation of incomes arising from those activities.[96]

The Act is similar to the Convention with respect to the use of the significant economic presence test, such as revenues, to determine a threshold that triggers source taxation rights.[97] Taxpayers' revenues generated from their users and consumers in Canada play a key role in

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91 *Ibid.*

92 *Ibid.*

93 See sections 13–19 of the Act.

94 See Annex D of the OECD Multilateral Convention, *supra* note 32.

95 For instance, section 6 of Annex D indicates that the address of the immovable property corresponds to the jurisdiction where the revenue is generated. This suggests that the business depends on the physical presence of the immovable property.

96 See Article 8 of the Canada – UK Tax Treaty.

97 OECD Multilateral Convention, *supra* note 32.

determining their eligibility under both the Convention and the Act.[98] An innovative feature of the Convention and the Act is their utilization of technological tools such as the Internet Protocol and device geolocation to track the revenues generated from digital-enabled businesses, such as advertising services.[99] The technological mechanisms identify the locations where users reside based on their device data.[100]

One of the main differences between the two tax instruments is that the Convention permits corporations to use other reliable indicators to trace their revenues to jurisdictions where those revenues arise, whereas the Act did not provide this kind of flexibility.[101] The Act restricted the indicators that taxpayers can use to those explicitly mentioned in section 11, which can reasonably indicate that users are located in Canada.[102] The Act established a closed framework by restricting revenue tracing mechanisms to specific methods. This would have allowed the tax authority to closely monitor revenue tracking and accurately assess the actual revenue generated in Canada. This is particularly important for determining whether registration of corporations under the Act is mandatory.[103] In contrast, taxpayers can leverage the Convention's flexibility by using other reliable indicators.

The Act adopted, at least, three approaches in asserting Canada's full taxing rights. The first is avoiding the classification of taxpayers' profits into residual or routine for the purpose of determining which profits should be taxable in Canada. By way of comparison, the Convention divides the profits of eligible corporations into two categories: routine profits and residual profits.[104] It assumes that residual profits are generated in market

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98 *Ibid.*

99 See Article 7 and Annex D of the OECD Multilateral Convention, *supra* note 32.

100 *Ibid.*

101 *Ibid.* See Article 6(3)(b)(ii) of the Multilateral Convention. Taxpayers may use indicators beyond those in Article 7 and Annex D, as long as they can demonstrate their reliability and obtain acceptance from the certainty review panel.

102 S. 11 of the Act.

103 See section 41 of the Act. This section vests the tax authority's power to determine whether a taxpayer should register under the Act. The effective way to exercise this power is to use revenue generated by the taxpayer to determine if it has reached the required threshold.

104 Avi-Yonah, "A New Framework for Digital Taxation", *supra* note 7.

jurisdictions and allocates 25% of these residual profits to those jurisdictions.[105] Unlike the Convention, the Act did not categorize profits into routine and residual. It adopted a revenue-based system, making all revenues sourced or traced to Canada taxable at 3%, with a fixed deduction of $20 million.[106]

Secondly, the Act did not consider a taxpayer's profitability when determining its eligibility to pay tax.[107] Under the Convention, eligible MNCs must have a profitability ratio of at least 10% before they are eligible to pay tax.[108] This means that corporations that would have been exempt under the Convention because their profitability is below 10% would be taxable under the Act. The Act targeted many taxpayers by lowering the revenue threshold and dispensing with the profitability requirement.

The third one was the proactive taxpayers registration system. Efficient tax collection often begins with accurately registering taxpayers and monitoring their businesses for audit and compliance purposes. The Act mandated compulsory registration for taxpayers who meet the eligibility criteria explained above and those who meet the global revenue threshold but have in-scope revenue of $10 million.[109] This requirement would have helped expand the taxpayer database, capturing those who are immediately taxable and those potentially taxable. If there was a conflict about a taxpayer's eligibility for registration, the tax authority would have the authority to make a definitive determination and register the taxpayer if it believed it was registrable.[110] The possible rationale for registering taxpayers who are not immediately subject to tax—due to their in-scope revenue being $10 million—is to monitor their activities closely. This way, authorities can identify the precise moment these taxpayers reach the eligibility threshold. This strategy reflects the government's proactive approach and vigilance in ensuring that no tax revenue is lost.

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105 *Ibid.*

106 S. 24 of the Act; s. 7 of the Digital Services Tax Regulations.

107 S. 10(1)(a) and (b) of the Act and sections 3 and 4 of the Digital Services Regulation. A taxpayer is eligible to pay tax if it meets the global revenue threshold of €750,000,000 and the in-scope revenue threshold of $20,000,000.

108 Avi-Yonah, "A New Framework for Digital Taxation", *supra* note 7.

109 Section 41 of the Act; s. 5 of the Digital Services Tax Regulations.

110 Section 44 of the Act.

In light of the above analyses, it appears that the Act would have applied to more taxpayers than the Convention and, consequently, would have the potential to generate more tax revenue. It is important to clarify that I am not overly assertive that the Act would have generated more revenue than the Convention, nor was there statistical support to prove it would. Likewise, no statistics suggest that the Convention would yield better outcomes in terms of revenue than the Act. My argument that the Act could generate more revenue is based on its application to a larger number of taxpayers than the Convention.

B. It helps a country to assess the administrability and acceptability of the cooperative solution

Adopting a qualified loyalty can provide a country with a steady learning curve, enabling it to have a deeper understanding of the administrability and acceptability of the tax policy for digital businesses. Given that the digital economy is fast-paced, there is a justifiable reason for implementing a tax measure that assesses incremental reforms in this emerging economy and how they suit the uniqueness of the country, rather than waiting for a global solution that may not be readily available. This argument is based on the assumption that the global solution and the temporary DST will adopt the same approach to the digital tax problems, just like how the Act and the Convention use the significant economic presence test to determine the meaning of 'carrying on business' in the source country.[111]

The purpose of tax cooperation is not to replace domestic tax policy, and any results achieved through cooperative efforts will certainly undergo the domestication process in the participating countries. Consistent with this position, the BEPS Inclusive Framework has recommended that the participating countries domesticate the Convention.[112] The outcome of the UN-led cooperative efforts will likely follow the same pattern. The domestication process provides a country with an opportunity to evaluate whether the cooperation-based solution aligns with its national interests.

A country that has adopted 'qualified loyalty' is better positioned to adequately evaluate the administrability of the cooperation-based solution,

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111 OECD Multilateral Convention, *supra* note 32.

112 *Ibid.* For a further reading on the process of domestication of a treaty, such as the Convention, in Canada, see Laura Barnett, *Canada's Approach to The Treaty Making Process* (Ottawa: Library of Parliament, 2021) 2-3.

as it is already familiar with the framework. For example, the Act and the Convention rely on technological devices and other mechanisms to monitor the activities of non-resident taxpayers to determine when they carry on business in the source country.[113] The temporary implementation of the Act would have constituted a pilot phase through which the government would gain experience and build its administrative competence in monitoring economic activities and taxing incomes arising from those activities. Given that technological development is rapidly rising, the economic activities that leverage technological devices will radically change patterns and dynamics. Adequate monitoring of those activities, and of any patterns they may adopt, is an important consideration for effective tax implementation.

Administrability is also about the simplicity of tax compliance. The government would have gained invaluable insights from taxpayers' potential complaints about compliance, which may be needed to simplify tax compliance. A country without a temporary measure may spend the first few years after domesticating the cooperative result to understand the operability of the result in its territory.

Qualified loyalty will also help a country to assess and compare the scope of taxpayers subject to each of the temporary DST and the global solution. One factor that may be of interest to a country when domesticating the global solution is whether the scope of taxpayers subject to the global solution is significantly lower than the scope of taxpayers under the temporary DST. Applying this argument to Canada, retaining the Act would have helped the government to determine whether the Convention would apply to fewer taxpayers and how this would affect its tax revenues.[114] Applying the Convention to fewer taxpayers might be a reasonable tax compromise and does not necessarily mean the government would reject the Convention. Canada's tax policy is known for making tax compromises, particularly for low-income countries.[115] Assessing the acceptability of the

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113 S. 11 of the Act

114 Canada's finance minister has stated that one of the reasons for the Act is to allow the government to collect tax revenues from MNCs that are not paying their fair share of taxes due to the challenges posed by the digitalized economy. See Janyce McGregor, Canada's Digital Services Tax Set for a Reckoning with U.S' CBC News, November 13, 2024, available online: <cbc.ca/news/politics/tuesday-dst-deadline-trump-1.7380857> [perma.cc/7AJN-QT98].

115 Kim Brooks, "Canada's Evolving Tax Treaty Policy toward Low-Income Countries" in

Convention would only help the government understand the compromise it is making and those benefiting from it.

VI. CONCLUSION

This paper argues that adopting a temporary DST to address the digital tax problem does not imply that the adopting country does not support cooperative efforts on the problem. It draws on Hirschman's framework to coin the concept of 'qualified loyalty' to provide a theoretical basis for the analysis. It explores this concept within the context of Canada's tax policy on the digital tax problem and concludes that the tax policy, particularly the enactment of the Act, is a perfect example of 'qualified loyalty'. It argues that the Act should have been retained until there is a global solution for two reasons. First, the Act restores the government's taxing rights that have been eroded by the digital economy. Second, the Act could be a learning curve for the government to build competence on the administrability of the global solution when it is available, as the Act's approach to addressing the problem may be similar to that of the global solution.

Arthur J. Cockfield, ed, *Globalization and its Tax Discontents: Tax Policy and International Investment* (Toronto: University of Toronto Press, 2010) 189 at 196–199.