



## SOUTH CENTRE TAX INITIATIVE

### **Comments on Session Paper relating to tax consequences of the digitalized economy – issues of relevance for developing countries**

#### **Background**

The South Centre, an intergovernmental organisation of, by and for the Global South in 2016 launched the South Centre Tax Initiative (SCTI) (<https://taxinitiative.southcentre.int>). This is the organisation's flagship program for promoting cooperation among developing countries on international tax matters. The program aims at the important need to increase collaboration among developing countries on international tax issues and reform processes.

With a focus on network building, the SCTI is centered on activities to promote and support intensified, better coordinated, and more institutionalized approaches to South-South cooperation in tax matters, so as to enable developing countries to become full participants for substantive norm-setting in international taxation matters.

#### **Overview**

The SCTI offers its comments on E/C.18/2020/CRP.25<sup>1</sup> (Tax consequences of the digitalized economy – issues of relevance for developing countries). This document from the Co-coordinators of the Subcommittee on Tax Challenges related to the Digitalization of the Economy provides updates on recent developments and seeks discussion and guidance on:

- any consequences for the Committee's work of the developments at the OECD/G20 Inclusive Framework on BEPS;
- the paper prepared for the 19th Session but not finalized at Subcommittee level and not discussed by the Committee at that Session (paper E/C.18/2019/CRP.16);
- the note submitted by Committee member Mr. Bansal at Attachment 2; and
- any other issues regarding tax issues related to the digitalization of the economy.

Attachment 2 of CRP.25 rightly raises the following key issues for developing countries in the Unified Approach (UA) to Pillar One:

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<sup>1</sup> <https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-06/CICTM%2020th%20CRP.25%20%20Digitalized%20Economy.pdf>

### *Arbitrary elimination of routine profits*

Amount A of Pillar One removes routine profits from allocation to market jurisdictions. There is no rationale offered for this. Further, the UA does not provide either methodology or theoretical justification or datasets through which this distinction can be enforced.

### *Irrational introduction of global thresholds*

Amount A is subject to many thresholds. However, this marks a major departure from international tax practice where only local thresholds are applied. The EUR 750 million proposed revenue threshold suffers from many practical problems which have been explained in Attachment 2 and can result in developing countries being unable to subject MNEs to the new taxing right. **The SCTI supports the proposal in the Attachment to have only local thresholds and not have any global revenue threshold or global in scope revenue threshold or a de minimis amount for total global profit.**

### *Dispute resolution*

Under UA any dispute between two jurisdictions over Amount A will likely affect the taxation of Amount A in multiple jurisdictions. Attachment 2 rightly raises concerns over the proposed dispute resolution mechanism. The “early determination” Panel has serious design issues on sovereignty and legitimacy and whether developing countries can accept outcomes of such a Panel without being effectively represented on it.

### *Treaty concerns*

The legal design of implementing UA too suffers from serious problems. As pointed out in page 11 of the document,

“On implementation, having a new multilateral convention for UA is a welcome idea. However, as the experience with the multilateral convention to implement BEPS related tax treaty changes shows, there is no assurance on all countries signing and ratifying such multilateral convention within a timeline or even ever. The Statement refers to a critical mass of countries that may be required to join, however; Amount A determination in UA is conceived in a manner that requires hundred percent mandatory joining of the new Convention by all countries. This can never be guaranteed. Without all countries joining such Convention, UA can never be effectively implemented for Amount A.”

### *Alternative proposal*

The proposal in Attachment 2 put forth for taxation of the digital economy has the following key elements:

- (1) It seeks to restrict in scope activities to automated digital services in respect of revenue derived directly from the market jurisdictions, not through a subsidiary or a permanent establishment.
- (2) The nexus for a taxing right in respect of such automated digital services may be deemed in a market jurisdiction only on the basis of local revenue derived, which may be commensurate with size of market, as proposed in UA. No

other thresholds be kept. The local revenue be defined to take into account multi sided business models.

- (3) The taxable profits be determined by each jurisdiction by applying global profit rate of in-scope activities of MNE Group on the local sales revenue and attributing a percentage of the same to market jurisdiction. This can be done through fractional apportionment method.
- (4) Elimination of double tax relief to continue to be governed by existing treaty provisions.

Regarding implementation, it suggests the following approach,

“Above proposal will require a new Article in tax treaties, which will define the nexus and also the determination of profits. Such new Article may be inserted in the UN Model Convention. Since, implementation through bilateral amendments will take time, a parallel process can be a multilateral convention put forward by UN that is open for signature by all countries. Such Convention can operate exactly like MLI, i.e. it will amend covered tax treaties of signatory countries. This system will give flexibility to countries to opt for the new system voluntarily. Unlike, here, there is no requirement of all countries joining the new convention for it to operate effectively. New taxing right will operate only in those countries where such taxation is permitted by domestic law. Countries may need to bring about changes in domestic laws to have similar taxing right in the first place.”

The alternative proposal thus would be implemented through a UN-led convention that gives greater flexibility to countries and has fewer administrative requirements and less design complexity as compared to the UA. As it takes local sales revenue as the starting point for profit allocation it has the potential to result in some tangible and definite gains in supplementing resources of developing countries. **The SCTI welcomes the alternative proposal as outlined in Attachment 2 as an additional option which can be considered at the international level as a solution to the issue of taxing the digitalized economy.**

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