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Redistributing Taxing Rights to the Global South through the Digitalized Economy
By Carlos Protto

A historic discussion is underway within both the United Nations (UN) and the Organisation for Economic Co-operation and Development (OECD) on redistributing taxing rights to the Global South through proposals on taxing the digitalized economy. An overview of the issues at stake is provided in this *SouthViews* by Carlos Protto, Member of the UN Committee of Experts on International Cooperation in Tax Matters and Argentina's representative in the Steering Group of the OECD/Group of Twenty (G20) Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The text is based on his presentation at the international virtual seminar[1] co-organized by the South Centre on "Equity in Global Tax Regimes and Implications for the SDGs" held on 7 October 2020. The recording is available here: https://www.youtube.com/watch?v=3wAESmfvRN4&ab_channel=uomlive.

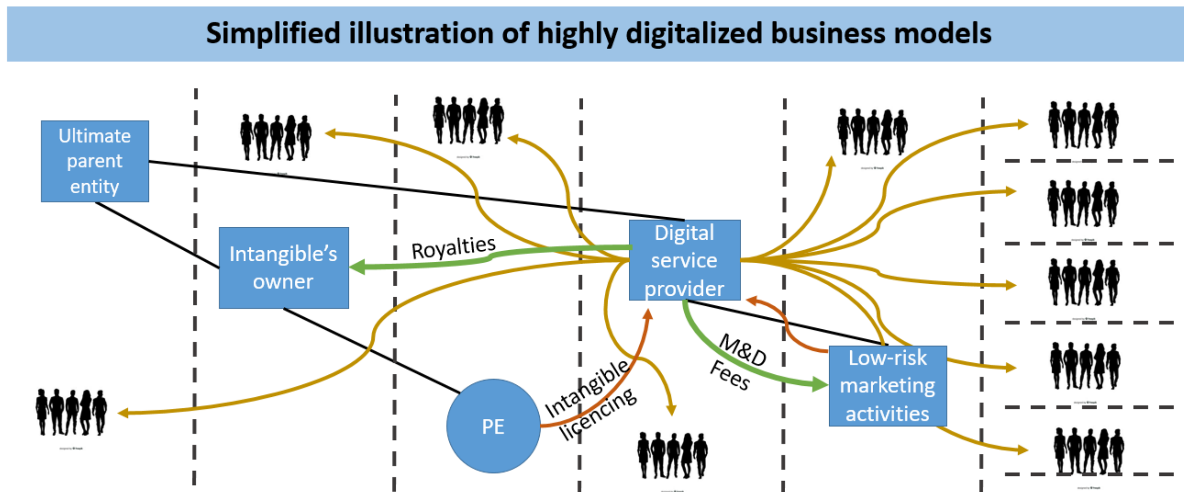
Fiscal tools, and in particular the role taxation plays in designing a strategy, are key elements to promote economic growth. Revenue collection allows economies to finance growth-driven policies that contribute to mobilizing resources in the achievement of the Sustainable Development Goals (SDGs). In contrast, Base Erosion and Profit Shifting (BEPS) activities by taxpayers prevent governments from reaching equality (directly) and reducing poverty (indirectly), depriving States of developing their strategic agenda towards sustainable growth.

Inefficiencies of the current international tax system to tax highly digitalized MNEs

Domestic tax laws, relying on a paradigm that was developed at the end of the 19th Century, do not levy taxes on non-residents on income derived remotely. Legislations generally define as locally sourced income those derived from the performance of business activities within its jurisdiction. Moreover, tax treaties prevent the taxation of business profits at source in the absence of a permanent establishment (a specific type of physical presence) to which can be attributed those profits.

[1] Additional seminar details are accessible here: https://taxinitiative.southcentre.int/event/seminar-equity-in-global-tax-regimes-and-implications-for-the-sdgs/

In this context, the increasing digitalization of the economy raises concerns among governments since Multinational Enterprises (MNEs) rely more and more on novel business models that do not require physical presence to derive income from market jurisdictions. Since new digitalized business models allow multinational enterprises to derive income from remote engagement in markets without any physical presence therein, MNEs are not subject to taxes in the jurisdictions where those markets are located (and, in some cases, nowhere), depriving States of obtaining resources and achieving the SDGs.



Reasons for a consensus-basis global solution

In the Final Report on Action 1 of the BEPS Project, business models with high reliance on intangibles and providing digitalized services have been identified to exacerbate BEPS risks that may not necessarily be addressed by already developed measures. This remaining issue of the BEPS Action Plan requires further work to be undertaken.

MNEs conduct business in a global scale and in multiple markets. In a globalized world, the solution governments might agree upon should take into account this multilateral aspect and be implemented in a coordinated manner. For that reason, there is a need for working on a global solution to address the tax challenges of digitalization.

The lack of success in providing a global consensus-based solution would give place to the proliferation of unilateral uncoordinated measures leading to inconsistency in the international tax system, uncertainty and presumably chaos, with its inevitably undesired impact on investment, trade and economic growth, which all jurisdictions would suffer from.

Developments undertaken by the G20/OECD Inclusive Framework

Since an Interim Report was presented to the G20 by the Inclusive Framework in March 2018, a two-pillar global solution is being developed, which should have been presented in 2020, but due to the COVID-19 pandemic situation, and the lack of political agreement, delivery has been postponed until mid-2021.

On the one hand, Pillar One of the global solution aims to settle new nexus and profit allocation rules to tax the income derived by multinational enterprises from remote engagement in markets without any physical presence therein. However, under this Pillar (Amount A of the Unified Approach on Pillar One), only a portion of the profits (those exceeding normal returns) of some in-scope MNEs (those with global annual revenue above € 750 Million) would be subject to tax in market jurisdictions.

On the other hand, Pillar Two of the global solution focuses at introducing a minimum level of corporate taxation through mechanisms that allow jurisdictions to tax the income derived by a multinational enterprise that has not been taxed at that minimum level in other jurisdictions. This objective would be achieved through an income inclusion rule according to which ultimate parent entities will be taxed on the income derived by their subsidiaries when they are taxed in their respective jurisdictions below an agreed minimum effective tax rate. This mechanism is based on the Global Intangible Low-Taxed Income (GILTI) regime introduced in the Tax Code of the United States of America, by the Tax Cuts and Jobs Act, in 2017.

Developments undertaken by the United Nations Tax Committee

Recognizing that the measures developed by the Inclusive Framework's two-pillar approach are extremely complex and might not substantially increase collection in developing countries, the UN Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee) has committed to provide developing countries a tool enabling them to easily tackle the tax challenges of the digitalization of the economy.

The main purpose of its initiative is to develop a simple rule which is closely linked to the problem it intends to solve (the tax-treaty barrier that prevents source States from levying taxes on business profits in the absence of physical presence) allowing taxpayers and tax administrations to easily assess the tax obligation in each jurisdiction. Accordingly, a bilateral tax-treaty provision has been developed allocating limited taxing rights to the jurisdictions from where automated digital services are remunerated. This proposal (draft Article 12B of the United Nations Double Tax Model Convention) confirms taxing rights to those States where beneficial owners are residents and also grants limited source taxation:

- on gross basis over payments sourced in that State; or
- on net basis over qualified profits derived in that State, upon requirement by the MNE.

Guiding principles for a sound consensus-basis global solution

Investment - being a booster of sustainable growth, and ultimately, to mobilize resources that may contribute in achieving the sustainable development goals - should not be negatively affected by the implementation of the new tax standards. The more accurate a tax measure is, the more complex its implementation might become, increasing the risk of uncertainty.

While designing the new nexus and profit allocation rules, an eye has to be kept on tax predictability to prevent disputes that might damage taxpayers and tax administrations as well as the international tax system as a whole.

Since the solution requires a global implementation, needs and capacities of developing countries should be contemplated. The standards framing the consistency of the international tax system for the following decades should not leave anyone behind and allow all jurisdictions to increase collection to mobilize the resources needed to achieve the SDGs.

A consensus-based solution can not only play an important role to ensure fairness and equity in our tax systems and fortify the international tax framework in the face of new and changing business models, but also it can help strengthen governments' ability to raise tax revenues that might help put their finances back on a fair and sustainable footing.

The public pressure on governments to provide a framework that ensures that large, internationally operating, and profitable businesses pay their fair share of taxes - and do so in the right place under new international tax rules - has increased as a result of the current COVID-19 pandemic. At the same time, a consensus-based solution could provide businesses with much needed tax certainty in order to aid economic recovery.

Author: Mr. Carlos Protto has a Bachelor's Degree in Economics, University of Buenos Aires, Argentina and a Master's Degree in Tax Management, Solvay Brussels School, Belgium. He is Director of International Tax Relations at the Argentine Ministry of Economy where he also served as Director of Direct Taxation. As such, he is in charge of negotiating and interpreting Argentine tax treaties. He is a current Member of the United Nations Committee of Experts on International Cooperation in Tax Matters. Since 2009 he represents Argentina at the Organisation for Economic Co-operation and Development Committee of Fiscal Affairs/Inclusive Framework on Base Erosion and Profit Shifting (BEPS), being a current Member of its Steering Group. He is also the Argentine representative at the Group of Experts on Taxation of MERCOSUR.

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For more information, please contact Anna Bernardo of the South Centre: Email bernardo@southcentre.int**, or telephone +41 22 791 80 50.**

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