



SOUTH CENTRE TAX INITIATIVE

Comments to the FACTI Panel Interim Report

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 centred on the convening of an Annual Forum of developing country officials working in tax policy and administration, and 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.

Systemic Solutions

How can the international community promote coherence across existing and/or new legal and institutional frameworks?

There is an opposing tension between the relationship between the measures developing countries need to take to stem illicit financial flows and the deregulation promoted by Free Trade Agreements (FTAs) and the limitations to the States' regulatory space created by International Investment Agreements (IIAs). This is especially so when the regulatory burden to tackle illicit financial flows and abusive tax planning is completely shifted to developing countries. Hence the Panel should reiterate the need to preserve the States policy space in particular by guaranteeing their right to regulate financial flows.

Architecture for tax cooperation

How can international tax cooperation be more inclusive and universal given the array of existing arrangements and institutions?

The UN Committee of Experts on International Cooperation in Tax Matters must be upgraded into an intergovernmental tax body. The legal procedure for doing so has been outlined in a prior South Centre submission.¹

As an interim measure, more resources must be allocated to the Tax Committee's Secretariat so it can better discharge its functions.

There can be greater transparency on the voting mechanisms used by the UNTC Members on making decisions. At present these are accessible only through the periodic reports on the Committee sessions.

A UN Convention modelled on the Multilateral Instrument (MLI) of the OECD can be used to 'plug in' the draft Article 12B on taxation of Automated Digital Services (ADS) into existing bilateral tax treaties. Such a Convention could in the future be used to more speedily 'plug in' updates to the Model Convention into bilateral treaties.

There needs to be transparency within the Steering Group of the G20/OECD Inclusive Framework. At present it is not clear how decisions are made. The IF can consider devising rules of procedure or working methods both for the Steering Group and the Working Parties.

How can the role of regional arrangements be enhanced to further promote international tax cooperation?

There is a welcome trend of regional organisations such as CIAT and ATAF towards developing Model Tax Conventions and policy guidance on specified legislation such as VAT. These can be built upon further, and such model conventions can act as poles to reflect regional needs and interests. Countries can refer to these in addition to the Model Tax Conventions of the UN and OECD and refer to them when developing national models through a "best available" approach.

However, a matter of concern is the membership by even developed countries of these regional organizations, which can sometimes dilute the ability of developing countries members to effectively articulate their issues.

Taxation of the Digitalized Economy

What are the effective international tax policy and institutional responses to address the questions of allocation of taxing rights in the context of digitalizing economies?

Draft Article 12B which has been prepared by the UN Tax Committee provides a simple and administrable option for developing countries. The provision has both a

¹ https://uploads-ssl.webflow.com/5e0bd9edab846816e263d633/5ef2869957587f41b54fb390_INPUT%20OF%20SOUTH%20CENTRE%20TAX%20INITIATIVE.pdf

gross and net basis taxation feature which countries can incorporate into their treaties. It is a far simpler and administrable solution than the Two Pillar Approach.

There is also a proposal to update Article 12 of the UN Model Tax Convention and include the term “software payments” in the definition of royalties. This would enable developing countries to tax these payments as royalties and not business profits. This would also take into account significant State practice, as almost 669² bilateral tax treaties treat software payments as royalties. Developing countries would be able to benefit from the rise in software sales that are happening post-COVID.

Within the Inclusive Framework, it is worth considering whether progress on Amount B and Pillar Two can take place independently from Amount A. Though it must be noted that the implementation of Amount B entails a risk. It generalises as acceptable a type of corporate structure which was before considered risky in the OECD Guidelines (Chapter IX), which are low risk distributors. Notwithstanding, certain forums have defended Amount B as a solution as it could be the case that in some low income countries it is considered necessary to fix a margin, as that could have previously been inexistent.

It is important to reiterate that in Pillar Two the Subject to Tax and Undertaxed Payments rules must come first in the rule order as these would benefit developing countries, which are the largest victims of tax avoidance and evasion. Placing the Income Inclusion Rule (IIR) first could risk potentially transferring resources to high income countries.

Similarly, when considering the issue of the digitalized economy, the FACTI panel may also consider the issue of the indirect effect of reducing the tax base deriving from the formal labor market. An emerging issue of the digital economy is the increase of informal labor, which in turn will affect income tax collection.

Given the difficulty in agreeing multilateral solutions that are acceptable to all parties, how should States respond in the short- and medium-term to the increased digitalization of the economy?

Taxation is a sovereign issue and countries are free to take what measures they see fit. Chapter 7 of the BEPS Action 1 report outlined three safeguard measures that countries could take till a multilateral solution was found. These are: (1) equalization levy (2) significant economic presence (3) withholding taxes on digital transactions. Inclusive Framework members can and have been using these safeguard measures.

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<https://static1.squarespace.com/static/5a64c4f39f8dceb7a9159745/t/5f7c92387c37a46f7466b74e/1601999417666/UN+MC+Royalties+final.pdf>

Those outside of the Inclusive Framework – which includes half of Africa – have been continuing with what measures are appropriate to protect their revenue requirements.

It is important for developing countries to strengthen regional cooperation on taxation negotiations (as they already do on trade) and policy harmonization so that any short or medium term responses are regional/ sub-regional, to minimize retaliatory measures by advanced countries.

The new draft Article 12B of the UN Model Tax Convention provides an additional option States can consider for taxing the digitalized economy.

International tax dispute settlement

What are your views on ways to improve international tax dispute settlement?

Non binding mediation and expert advice may be considered as ways to strengthen Mutual Agreement Procedure (MAP). The Panel could consider drawing recommendations/ideas on strengthening capacity building for developing countries taking as an example the role of the African Legal Support Facility (ALSF) in supporting African Union (AU) members on the same.

What is your assessment of arbitration in tax dispute settlement and how it could be applied?

Mandatory and binding arbitration must be opposed and they are unacceptable to developing countries. Experiences from other international dispute resolution systems, in particular investor-state dispute settlement systems, have shown unintended consequences of mandatory and binding arbitration. Such consequences include lack of transparency, consistency, predictability and correctness of arbitral decisions, which in turn have reduced the regulatory space of States. Therefore, mandatory and binding arbitration is not a suitable option, as it will result in the detriment of developing countries' interests.

The experience from Investor State Dispute Settlement (ISDS) in particular implies that the final 'say' on what a domestic tax regulation means will not be with the State adopting the regulation, but with an ad-hoc tribunal. This is a damaging and negative way forward.

Data production and publication

What role do you see for authoritative global data and statistics on both cross-border taxation and tax cooperation in enabling more effective taxation to finance sustainable development?

Lack of wealth data remains a major challenge, and the 2020 UN Human Development Report had also pointed to this. It is important that more efforts be taken for its effective recording.

How can information exchange provisions be better tailored to developing country contexts, circumstances and needs?

The present structure of automatic exchange of information within the CRS MCAA imposes a ‘hidden bilateralism’³ within a multilateral agreement. By in effect making it voluntary for countries to decide whom they want to share with, many developing countries have no way of accessing financial account information located in tax havens, many of which are colonies of the developed countries. This aspect must be removed and the Convention on Mutual Administrative Assistance in Tax Matters must be genuinely multilateral.

How can all actors be held accountable for production, sharing and use of tax information?

While the use of tax haven blacklists, notably by the European Union (EU), has been heavily politicized, they can also be used as a tool by developing countries to ensure that tax information is shared. The experience of Ecuador can be an example in this regard⁴ and can serve as a reference for other developing countries. Tax haven blacklists by developing countries are not only useful to ensure information is shared, but also for the implementation of anti avoidance rules.

Impunity for grand corruption

What could be done at the international level to address the impunity of high-level public officials involved in grand corruption?

There is a need to also consider the role of the countries hosting the offenders. The offence might be committed in countries experiencing corruption, but offenders might be located outside of such jurisdictions. Such elements have been clearly recognised in the preamble of the UNCAC: “Convinced that corruption is no longer a local matter but a transnational phenomenon that affects all societies and economies, making international cooperation to prevent and control it essential.”

It is important to also consider the role of the private and financial sector in driving and facilitating corrupt practices by public officials and institutions. Sharing good national and regional State practices on the fight against corruption and considering the work of the Implementation Review Mechanism (IRM) of the UNCAC could be important tools for the FACTI Panel future endeavours.

³ <https://www.southcentre.int/tax-cooperation-policy-brief-4-september-2018/>

⁴ <https://www.southcentre.int/tax-cooperation-policy-brief-1-may-2018/>