

Conceptualizing a UN Multilateral Instrument

By Radhakishan Rawal *

1. Background

With the completion of the 22nd Session of the United Nations (UN) Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee or UNTC), in April 2021, the term of the current membership of the UN Tax Committee also comes to an end. During this term (i.e. 2017 to 2021), in addition to changes to the UN Commentary and other aspects, the UNTC has managed to achieve the following key changes to the United Nations Model

Double Taxation Convention between Developed and Developing Countries (UN Model):

- Article 12: Amendment¹ to the definition of “royalties”
- Article 12B: Insertion of new Article in the UN Model for taxation of automated digital services
- Article 13: Amendment for taxing rights on capital gains from indirect transfer

Abstract

Recent changes to the United Nations (UN) Model Tax Convention have resulted in provisions that are more advantageous for developing countries in raising revenue through international taxation, i.e. taxation of foreign income. These include taxation of income from automated digital services, software payments, capital gains and others. Normally, these would be incorporated into bilateral tax treaties through time-taking negotiations. A UN Multilateral Instrument (MLI) provides a speedy manner for updating multiple tax treaties through a single negotiation. This will help developing countries in collecting revenue more quickly. This Policy Brief discusses the possible structure of such an MLI.

Les récentes modifications apportées au modèle de convention des Nations unies concernant les doubles impositions entre pays développés et pays en développement ont donné lieu à l'introduction de dispositions plus avantageuses pour les pays en développement en matière d'imposition des revenus, en permettant en particulier l'imposition des revenus étrangers. Il s'agit notamment des revenus tirés des services numériques automatisés, des rémunérations sur les logiciels, de plus-values et autres. Ces dispositions sont généralement intégrées, au terme de longues négociations, dans les conventions fiscales bilatérales. Une convention des Nations Unies, en tant qu'instrument multilatéral, permet en une seule négociation de modifier plusieurs conventions fiscales et contribue ainsi à ce que les pays en développement puissent percevoir plus rapidement des recettes fiscales. Le présent rapport sur les politiques examine la forme qu'un tel instrument multilatéral peut revêtir.

Los cambios que ha sufrido recientemente la Convención Modelo de las Naciones Unidas sobre la Doble Tributación entre Países Desarrollados y Países en Desarrollo han dado lugar a disposiciones más favorables a los países en desarrollo, al aumentar los ingresos fiscales a través de la imposición de tributos internacionales, por ejemplo, en la imposición de tributos a los ingresos procedentes del extranjero. En esta imposición se incluyen, entre otros, los impuestos sobre los ingresos procedentes de servicios digitales automatizados, pagos de programas informáticos y plusvalías. Normalmente, estos impuestos se incorporarían en convenios fiscales bilaterales a través de largas negociaciones. En cambio, un instrumento multilateral de las Naciones Unidas permitiría actualizar de una manera más acelerada varios convenios tributarios por medio de una sola negociación. Esto ayudará a los países en desarrollo a recaudar ingresos con mayor prontitud. En este informe sobre políticas se aborda la posible estructura de un instrumento multilateral de esa índole.

* Author is a Mumbai based Chartered Accountant and views expressed in this Policy Brief are personal views of the author and do not represent views of any organization. The tug of war between residence-based taxation and source-based taxation appears to be never ending. Approach adopted by the author is apolitical, does not support either side and this brief is written purely from a technical perspective. This is an updated version of a Concept Note which was presented to the High Level Panel on International Financial Accountability, Transparency and Integrity (FACTI Panel) on April 20, 2021.

Acknowledgements and thanks are due to the helpful and detailed comments and suggestions of Rajat Bansal and Carlos Protto, Members of the United Nations Tax Committee. The comments of Rajat Bansal have been published separately under Annexure B.

These changes will be incorporated in the UN Model in its next update, which will be done in 2021.

The previous membership of the UN Tax Committee also achieved the following key changes in the UN Model:

- Article 12A: Insertion of new Article in the UN Model for taxation of fees for technical services
- Amendments to the UN Model on matters addressed by the Organisation for Economic Co-operation and Development (OECD)/Group of Twenty (G20) Base Erosion and Profit Shifting (BEPS) project.

These changes were included in the UN Model in its 2017 update.

BEPS related amendments to the UN Model were predominantly adaptation in the UN Model of BEPS related changes adopted in the OECD's Model Tax Convention on Income and on Capital (OECD Model).

2. Need for a UN Multilateral Instrument (UN MLI)

The changes to the UN Model have been achieved after significant hard work by the members of the UN Tax Committee. If these changes are not incorporated in the actual bilateral tax treaties signed by the countries, the work of the Committee will remain theoretical. There does not exist any mechanism to quickly introduce the amendment to the UN Model in all the existing tax treaties.

Under normal circumstances, countries would adopt these provisions in the existing tax treaties by negotiating protocols. However, this will be a bilateral negotiation that can take several years to complete. A faster way to adopt this would be through a multilateral negotiation and a Multilateral Instrument (MLI).

Unlike a bilateral tax treaty which is a treaty between two countries, an MLI is a treaty between several countries. MLI amends tax treaties of all the signatories simultaneously. For example, if country A has signed tax treaties with fifty other countries, if Country A and all fifty Countries intend to amend the tax treaties, MLI can amend all the tax treaties at one stroke. Each country needs to sign only once (i.e. the MLI) and complete the domestic law ratification process only once.

There is a clear need for a UN MLI to quickly amend the existing tax treaties to adopt the changes to the UN Model Convention from time to time in the existing tax treaties.

BEPS MLI² is one such Multilateral Instrument recently developed by the Inclusive Framework. The scope of the current BEPS MLI is restricted to BEPS related changes to the tax treaties. However, it is fair to assume that once the fruits of BEPS MLI (i.e. the ease at which several tax treaties are amended simultaneously) are tested, attempts will be made to also incorporate the

future changes to the OECD Model in the existing tax treaties through the MLI route.

3. Recommendation of the FACTI Panel

In February 2021, the High Level Panel on International Financial Accountability, Transparency and Integrity (FACTI Panel) released its report containing 14 recommendations. The Report makes recommendations for a UN Tax Convention which contains MLI features. The relevant paragraphs are reproduced:

*"To hasten implementation, the UN Tax Convention should contain provisions holding that its terms will be automatically incorporated into signatories' tax treaties, so that they would not need to renegotiate individual bilateral treaties."*³

*"Fair taxation of digitalised economic activity requires equitable treatment of digital businesses and business models with traditional business. The formulaic approach to taxing rights described above would help achieve this. To strengthen multilateralism, additional proposals to allow taxation of automated digital services should be adopted in the UN Tax Convention. Countries are already moving ahead with digital services taxes. Therefore, incorporating provisions to address this in the UN Tax Convention will create a multilateral framework based on international agreement and enable additional countries to start taxing the digital economy with realistic prospects of obtaining substantial revenue."*⁴

4. Can a tax treaty be modified by more than one MLI?

The BEPS MLI came into force on July 1, 2018 and 95⁵ countries have already signed it. If a UN MLI is introduced, several countries would have signed two MLIs. Hence, the question which arises is whether a bilateral treaty can be modified by more than one MLI? Is co-existence of two MLIs possible?

The obvious answer appears to be "yes". *Prima facie* there is nothing which suggests that one bilateral tax treaty cannot be modified by (or be a Covered Tax Agreement⁶) more than one MLI. Things may become little complicated, yet this seems doable.

The implementation mechanism for both Pillar 1⁷ and Pillar 2⁸ Blueprints contemplate an MLI type instrument. This would not be the existing MLI but a standalone new MLI. Thus, the possibility of more than one MLI modifying a bilateral tax treaty already appears to have been evaluated by the Inclusive Framework and is in the pipeline.

5. Approaches to the UN MLI

Two possible approaches and related nuances are tabulated hereunder:

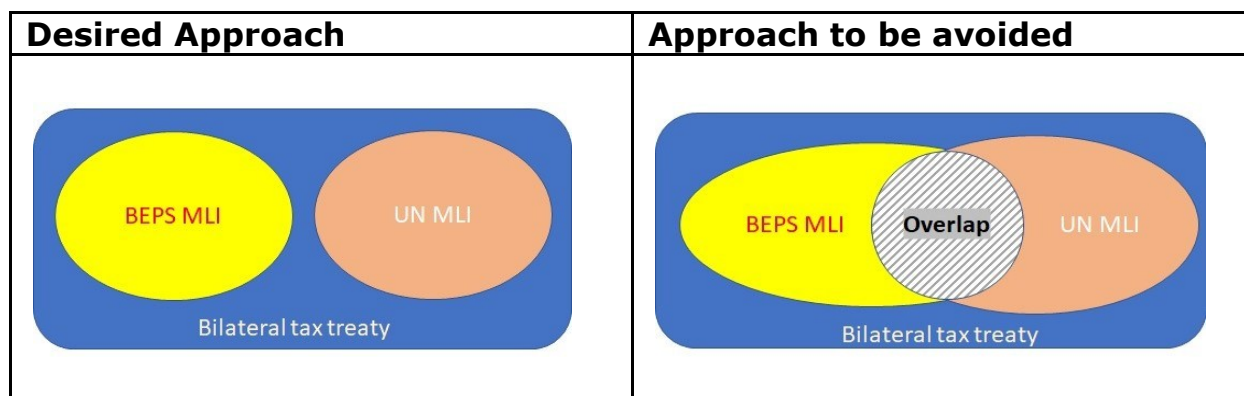
Approach	Remarks	Remarks
<p>Comprehensive Approach</p> <p>The UN MLI will be comprehensive in nature. It will cover everything which is there in the BEPS MLI and will have additional provisions which are specific to the UN Model.</p>	<p>The main advantage of this approach would be that it would give a comprehensive solution and complications related to application of two MLIs to a single tax treaty would not arise.</p> <p>If the UN MLI gives more flexibility to the Signatories, more countries may be willing to participate and adopt BEPS related measures as well. United Nations member states are 193. The Inclusive Framework has 139 jurisdictions, not all of which are member states, and as of now only about 95 countries of the Inclusive Framework have signed the MLI⁹. The flexibility is discussed in part 7.2.</p>	<p>This approach could however also create more complications, especially when further changes are done to the BEPS MLI.</p> <p>Further, the BEPS MLI is already operational and has already modified several tax treaties.</p>
<p>Specific Approach</p> <p>Under this approach, the UN MLI will not deal with the issues which are already dealt with by the BEPS MLI. The BEPS MLI already takes into consideration specific features of the UN Model provisions for the Articles which are getting modified by the BEPS MLI.</p> <p>The UN MLI will facilitate modification of only those provisions or Articles which are unique to the UN Model and not dealt with by the BEPS MLI.</p>	<p>Potential overlap between UN MLI and BEPS MLI will be avoided under this approach. This is discussed in part 6. Both the MLIs (BEPS and UN) will operate separately and it would be possible to expand scope of these MLIs in the future.</p>	<p>The possibility of countries which did not participate in the Inclusive Framework or did not sign the BEPS MLI adopting BEPS related measures through the UN MLI on account of additional flexibility would not be there under this approach. This is discussed in part 7.2.</p>

The Specific Approach appears to be a better approach. The subsequent part of this analysis proceeds on the basis that the Specific Approach, as against the Comprehensive Approach, would be followed.

6. Avoiding overlap between two MLIs

The table below explains how overlap between the existing BEPS MLI and the proposed UN MLI can be avoided.

Sr. No.	Type of provision	Can be included in UN MLI?	Remarks
1	Sub-paragraphs of Articles of the tax treaty which are already covered by the BEPS MLI [e.g. Article 5(4) dealing with auxiliary activities]	No Unless some additional changes are to be made.	In general, it would be advisable not to include those provisions in the UN MLI which are already dealt with by the BEPS MLI.
2	Sub-paragraphs of Articles of the tax treaty which are not covered by the BEPS MLI [e.g. Article 5(2) listing places specifically included in the definition of permanent establishment (PE)]	Yes	Although the BEPS MLI deals with Article 5(4), including other paragraphs of Article 5 in the UN MLI would generally be possible as there would be no overlap.
3	Articles which are unique to the UN Model and do not find place in the OECD Model [i.e. Article 12A, Article 12B]	Yes	
4	Provisions which are unique to the UN Model and do not find place in the corresponding Article of the OECD Model [e.g. Service PE provision in Article 5(3)(b) of the UN Model, definition of "royalty" including computer software in Article 12 etc.]	Yes	
5	Alternative provisions which are given in the UN Model Commentary [e.g. para 127 of the UN Commentary on Article 12A gives an alternative provision for para 6 of Article 12A]	Yes	
6	Future changes to the OECD and UN Models which are common to both the models	Yes	OECD and UN will have to coordinate and ensure that there is no overlap. Future changes which are common need to be included only in one of the MLIs (either UN or OECD), ideally the one which has more signatories.



7. Features of the UN MLI

7.1 Broad structure

Hitherto the approach adopted for the UN Model is to capitalize on the work done by the OECD and adopt the provisions from the OECD Model as well as extracts from the OECD Commentary with such changes as may be required. The same approach can be adopted for the purpose of the UN MLI as well.

- The broad structure, contours and approach would be adopted from the BEPS MLI. Articles 3 to 26 would be removed and required number of new articles would be inserted.
- The Signatories will have the option of identifying tax treaties which are to be made Covered Tax Agreements under the UN MLI.
- The Signatories will have the ability to make reservations and will have to make appropriate notifications.
- As compared to the BEPS MLI, the UN MLI can attempt to give more flexibility. This is analyzed in *part 7.2*.
- The domestic law provisions related to Ratification, Acceptance or Approval would be applicable.
- The Signatories will have the ability to initiate amendments to the UN MLI, call for conference of parties, withdraw from the UN MLI etc.
- Consequent to the future changes to the UN Model Tax Convention, additional provisions would be added to the UN MLI.
- The UN Secretariat will play the role of the Depository.
- The basic feature of bilateral treaties will be retained i.e. treaty will get modified only if both the parties to the treaty agree for such modification i.e. “the matching” happens.
- The possibility of “minimum standard” will be evaluated.

7.2 Additional flexibility

While the BEPS MLI offers various flexibilities to the Signatories, there are also certain restrictions. The main restriction appears to be that it does not allow adoption of selected MLI provisions for certain selected countries. The general approach is, either all the treaties offered for MLI (i.e. Covered Tax Agreement) get modified¹⁰ or none¹¹. The only exception to this could be cases where the existing treaties already address the issue in some manner.

For example, if Country X has signed 80 tax treaties, have declared all 80 tax treaties as Covered Tax Agreements and if this country is interested in adoption of provisions of Article 9 of BEPS MLI only in 50 tax treat-

ties and not all 80, it is not possible for Country X to achieve that result through the BEPS MLI. Country X can either adopt Article 9 in all 80 tax treaties or none. If Country X treats only 50 tax treaties as Covered Tax Agreements, it can achieve the desired result as regards Article 9, but for the balance of 30 tax treaties, none of the provisions of the BEPS MLI would be applicable. It can be surmised that this inflexibility may have prevented some countries to sign the MLI or make some or most of their tax treaties a Covered Tax Agreement.

The UN MLI can improve on this inflexibility of the BEPS MLI and allow Signatories to select countries for which it can adopt the UN MLI provision. This flexibility would be easily justified in the UN MLI for the reason that unlike BEPS MLI which contains predominantly anti-abuse type provisions, the UN MLI is focusing on distribution of taxing rights. *Annexure A* contains a sample provision giving such options.

8. How will the future tax treaties be read?

If the proposal of a UN MLI is implemented, reading of tax treaties in the future will involve:

- Determination of whether the bilateral tax treaty is modified as a result of any bilateral amending protocol.
- Determination of whether the bilateral tax treaty is modified as a result of the BEPS MLI.
- Determination of whether the bilateral tax treaty is modified as a result of the UN MLI.

A synthesized text of a bilateral tax treaty, incorporating modifications by both the BEPS MLI and UN MLI, and by bilateral amending protocols, can also be contemplated.

9. Prior work

The Inclusive Framework generally works on a consensus-based approach and the participants are the governments of the respective countries. As against this, the current UN Tax Committee does not follow a consensus-based approach, but the views of majority and minority members are noted. Further, the twenty-five members of the UN Tax Committee work in their individual capacity and do not represent respective governments, although they are nominated by the governments and in most cases are revenue officials.

To address these issues, one of the recommendations of the FACTI Panel is to update the status of the UN Tax Committee to that of an intergovernmental body. Accordingly, this may entail some further work and the updated UN Tax Committee (intergovernmental body / group) may get involved in the UN MLI.

10. Can the desired result be achieved in a different manner?

Prima facie it may be possible to achieve the purpose sought to be achieved (or a substantial part of it) by the UN MLI in a different manner i.e. without creating a UN

MLI.

Article 31 and Article 33 of the BEPS MLI facilitates amendment of BEPS MLI by the Parties thereto. Any Party can request a Conference of Parties. If the request is supported by 1/3rd of the Parties within six months of the communication by the Depository of such request, the Conference will be called by the Depository.

Thus, instead of creating a new MLI altogether, UN specific provisions can be routed through the existing BEPS MLI. However, in this regards the following needs to be noted:

- Inclusion of provisions, which are not necessarily for addressing BEPS concerns but for distribution of taxing rights, may not be seen as consistent with the main objective for which the BEPS MLI was created.
- This approach may not be seen as consistent with the broader objective of the FACTI Panel recommendation, which appears to be that an agency like the UN, having universal membership, plays a larger role in global standard setting on the tax front.
- Procedural aspects:
 - ◊ BEPS MLI does not give further details as regards within what time the Conference of participants needs to be called.
 - ◊ BEPS MLI does not give further details as regards the procedures to be followed at the Conference of Parties¹². Whether there must be consensus for any change to the BEPS MLI or a simple majority is sufficient.
 - ◊ Whether it will be possible to insert any provision in the BEPS MLI which is not supported by OECD, would be a big question mark.

11. Approach on Article 12B

The approach for Article 12B will have to be different. This is the reason why 139 jurisdictions are already working in the Inclusive Framework on Pillar One. Article 12B in the UN Model will be seen as work of 25 committee members, in their individual capacity, as against participation of 139 governments in the Inclusive Framework.

In a situation where the Inclusive Framework succeeds in achieving the desired consensus and technical solutions on Pillar One, it would be reasonable to expect that these 139 countries would not be adopting Article 12B. In general these countries cannot be expected to adopt both the solutions (i.e. Pillar One of the Inclusive Framework and Article 12B of the UN) to address challenges of taxation of the digital economy. However, theoretically it is possible that a country adopts both Pillar One and Article 12B. Article 12B is included in a tax treaty with those countries which do not adopt the Pillar One solution.

Article 12B would be relevant in the following situations:

- Article 12B can be the obvious Plan B for addressing challenges of taxation of the digital economy. Thus, in a situation where the Inclusive Framework is not in a position to arrive at a consensus solution, the world will be left without any solution and then Article 12B can be evaluated by all the governments.
- Article 12B can be considered in certain specific situations even when the Inclusive Framework succeeds in arriving at a consensus. Pillar One of the Inclusive Framework will be applicable to multinational enterprises (MNEs) with global revenue of Euro 750mn¹³. One of the criticisms of Pillar One is potential tax revenue leakage due to high thresholds. Thus, countries may be interested in adopting a simpler solution such as Article 12B for MNEs which do not satisfy the threshold agreed for Pillar One. This combination of Pillar One and Article 12B may have some complications and requires further analysis.
- If the consensus on the Inclusive Framework takes too long and by that time the status of the UN Tax Committee is updated to that of an intergovernmental committee, the required prior work for the UN MLI is completed, then both Pillar One and Article 12B may be seen at par (may be with the larger UN membership). The governments may then see Article 12B as a real alternative to Pillar One and evaluate it accordingly.

12. Conclusion

There is no scope for differing views on the justification of a UN MLI. Creation of a UN MLI is the correct approach to regularly update the existing tax treaties with the changes made in the UN Model¹⁴ from time to time. Hopefully, the UN and member countries find this useful and will work towards making the UN MLI a reality.

Annexure A

Illustrative provisions of a UN MLI¹⁵

Article 3 – Definition of royalties

1. A Covered Tax Agreement shall be modified to include the following definition of the term “royalties”:

The term “royalties” as used in this Article means payments of any kind received as a consideration for:

[TO BE COPIED FROM 2021 version of the UN Commentary]

2. The text described in paragraph 1 shall be included in a Covered Tax Agreement in place of the definition of the term “royalty” in the Covered Tax Agreement.

3. A Party may reserve the right:

(a) for paragraph 1 not to apply to all its Covered Tax Agreements;

(b) for paragraph 1 not to apply to its Covered Tax Agreements that already contain the definition described in paragraph 1.

4. Each Party shall notify the Depository the list of Covered Tax Agreements, in which it intends to adopt the text described in paragraph 1. The text described in paragraph 1 shall be included in a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply that paragraph and have made such a notification with respect to the Covered Tax Agreement.

Article 4 – Taxation of digital economy (Article 12B of the UN Model)

1. A Covered Tax Agreement shall be modified to include the following Article in the Agreement:

To reproduce final text of Article 12B as may be approved.

2. A Party may reserve the right for paragraph 1 not to apply to all its Covered Tax Agreements.

3. Each Party shall notify the Depository the list of Covered Tax Agreements, in which it intends to adopt the text described in paragraph 1. The text described in paragraph 1 shall be included in a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply that paragraph and have made such a notification with respect to the Covered Tax Agreement.

Annexure B

- Comments by Rajat Bansal, UN Tax Committee Member

The Policy Brief proposes a multilateral instrument to swiftly incorporate recent updates/changes in the UN Model Tax Convention as a result of work by the current and previous membership, in the existing bilateral tax treaties. The Policy Brief looks at the experience of the BEPS MLI which is already in existence to give effect to tax treaty related changes brought about by the Base Erosion and Profit Shifting Project for proposing a UN MLI.

Comments

1. Idea of modifying existing tax treaties through a multilateral instrument is feasible.
2. Since the BEPS MLI is already in existence for some time, already signed by as many as 95 countries, already entered into force and has already modified matched covered tax agreements in respect of BEPS tax treaty related provisions, combining both the UN Model related changes and BEPS changes in the proposed UN MLI is not practicable. Even otherwise, it may be difficult to offer changes agreed in two different forums i.e. OECD and UN under one umbrella agreement. Policy Brief rightly discards combined MLI in favor of a specific UN MLI.
3. As regards provisions that can be covered through the UN MLI, it is possible to include changes recommended in para 6 of the Policy Brief. The experience of the BEPS MLI however shows that other than minimum standards, i.e. anti-abuse provisions (preamble, Principal Purpose Test (PPT)) and Mutual Agreement Procedure (MAP) provisions, signatory countries have not generally opted for other provisions through MLI. One reason is, of course, lack of flexibility, i.e. the reservations and options could not have differentiation towards different countries. But even if such flexibility were there, whether countries would indicate such differentiation upfront is unlikely. Countries seem to prefer bilateral negotiations to have a differentiated approach towards each country.
4. There is no need to make the proposal to have UN MLI contingent to up-gradation of the UN Tax Committee to an intergovernmental body. Up-gradation of the UN Tax Committee to an intergovernmental body has been a long standing demand which has not been successful despite strong effort by the Group of 77 (G77) last time. On the other hand, the United Nations Model Tax Convention, even though developed by the Committee of Experts and not by an intergovernmental body, has wide acceptance in tax treaty negotiations between developing and developed countries all over the world. There can be a UN MLI for swift implementation of the UN Model Tax Convention, in particular Article 12B which seeks to address the challenges of taxation of digital economies. Such MLI can be under the aegis of the United Nations itself. Since the choice to sign or not

sign such UN MLI is entirely open for countries, it's not material that the provisions offered through the UN MLI are the creation of the UN Tax Committee of Experts and not an intergovernmental body.

5. There is no need to make Article 12B adoption by countries through the UN MLI contingent to Inclusive Framework (IF) Pillar 1 agreement, for the reasons mentioned in the Policy Brief. The choice between Article 12B and the other forum's solution may be based on which one is better for them in terms of less complexity and adequate share of tax revenue rather than aspects such as who has developed which solution. In any case, it does not appear that consensus if any achieved in IF Pillar 1 work is to be mandatorily adopted by all the participant countries. It did not happen that way in the BEPS Project where though the recommendations in thirteen Action Plans were by consensus, later adoption or implementation was entirely optional except for minimum standards.

Endnotes:

- ¹ This is a minority view and will be included only in the UN Commentary and not in the UN Model.
- ² Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
- ³ Page no. 17, 18
- ⁴ Page no. 24, 25
- ⁵ Currently 139 countries are part of Inclusive Framework. MLI is also signed by countries which are not part of Inclusive Framework.
- ⁶ Article 2(1)(a) of BEPS MLI defines the term "Covered Tax Agreement"
- ⁷ Heading 10.2.2 page no. 207 of Pillar One Blueprint
- ⁸ Heading 10.5.3 page no. 176 of Pillar Two Blueprint (in the context of the Switch-Over Rule, which would be a treaty provision)
- ⁹ MLI is also signed by countries which are not part of the Inclusive Framework.
- ¹⁰ Subject to matching
- ¹¹ There may be some exceptions to this.
- ¹² However, the Conference of Parties may do this.
- ¹³ A lower threshold may also get adopted as per the Blueprint. If the threshold is increased to apply Pillar One only to top 100 companies, the potential utility of Article 12B would further increase.
- ¹⁴ United Nations Model Double Taxation Convention between Developed and Developing Countries
- ¹⁵ This annexure gives very basic examples of how the UN MLI articles may appear. This would undergo significant changes once legal drafters get involved and all complexities are considered. For example, in certain tax treaties (e.g. India-Australia), the article dealing with royalties also deal with fees for technical services and the definition of "royalties" includes what is generally included in the definition of "fees for technical services" in addition to the normal definition of royalties.

This brief is part of the South Centre’s policy brief series focusing on tax policies and the experiences in international tax cooperation of developing countries.

Efforts to reform international cooperation in tax matters are exhibiting a distinct acceleration. The direction of change must recognize and incorporate innovations in developing country policies and approaches, otherwise the outcomes will obstruct practical paths to development.

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The South Centre
International Environment House 2
Chemin de Ballexert 7-9
PO Box 228, 1211 Geneva 19
Switzerland
Telephone: (4122) 791 8050
E-mail: south@southcentre.int
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