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Two Pillar Solution for Taxing the Digitalized Economy: Policy Implications and Guidance for the Global South

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SOUTH CENTRE

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TWO PILLAR SOLUTION FOR TAXING THE DIGITALIZED ECONOMY: POLICY IMPLICATIONS AND GUIDANCE FOR THE GLOBAL SOUTH

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ABSTRACT

The taxation of the digitalized economy is the single most important topic in international tax negotiations today. The OECD has devised a "Two Pillar solution" to the problem. Pillar One is focusing on a reallocation of taxing rights to market jurisdictions, which are largely expected to be developing countries, and Pillar Two is instituting a global minimum tax. The Pillar One solution, known as Amount A, will be codified into a Multilateral Convention (MLC) and is expected to be placed before countries for signature in early 2023. The solution ushers in a new paradigm in the taxation of multinational enterprises but has immense complexity and likely minimal revenue gains for most developing countries. It will also require them to give up the right of unilateral tax measures on all out-of-scope companies, meaning they will only be able to tax the fewer than 100 companies likely to be in-scope, if at all. The decision to sign or not is thus a historic one, as it will lock developing countries into a constricted new framework, at a time when revenue needs are especially critical to recover the economies from COVID-19 in the context of a turbulent state of the global economy.

However, the United Nations too has a solution, known as Article 12B. This operates in a different manner and is a minor modification to the existing decentralized international tax system which is based on bilateral tax treaties, and which developing countries are more familiar with. It is also likely to generate far higher revenues than Amount A, and does not restrict any of their sovereign taxing rights. This Research Paper assesses the various implications for developing countries from adopting the OECD's or the United Nations's respective solutions and concludes with a possible global South response to the Two Pillar solution.

L'imposition de l'économie numérique est aujourd'hui le sujet le plus important des négociations fiscales au niveau international. L'OCDE a conçu une « solution reposant sur deux piliers » pour résoudre ce problème. Le premier pilier consiste à réattribuer des droits d'imposition aux pays sources, dont une grande partie devrait être constituée de pays en développement. Le deuxième consiste à instaurer un impôt minimum à l'échelle mondiale. Cette solution, connue sous le nom de « Montant A », doit être codifiée dans une convention multilatérale dont la signature est prévue au début de l'année 2023. Si elle a le mérite d'inaugurer un nouveau paradigme en matière d'imposition des entreprises multinationales, cette solution s'avère particulièrement complexe du point de vue de sa mise en œuvre et les gains en matière de revenus seront probablement minimes pour la plupart des pays en développement, qui devront par ailleurs renoncer au droit qui est le leur de prendre des mesures fiscales unilatérales à l'égard des entreprises qui n'entrent pas dans le champ d'application de la convention. Cela signifie qu'ils pourront taxer, si tant est qu'ils puissent le faire, uniquement les entreprises susceptibles d'être concernées par la convention, soit moins d'une centaine. Ses pays sont donc placés devant un choix historique, qui peut les contraindre, s'ils signent la convention, à limiter leur pouvoir d'action, à un moment où les besoins en recettes sont particulièrement critiques pour redresser des économies mises à mal par la pandémie de COVID-19 dans un contexte économique mondial instable.

Une autre solution existe qui résulte de l'ajout, dans le Modèle de convention des Nations Unies, de l'article 12B, qui fonctionne d'une manière différente et constitue une modification mineure du système fiscal international décentralisé existant, qui repose sur des conventions fiscales bilatérales et que les pays en développement connaissent mieux. Elle est également susceptible de générer des revenus bien plus élevés que le montant A, et ne limite pas leur souveraineté en matière fiscale. Le présent document

de recherche évalue les diverses implications pour les pays en développement de l'adoption des solutions proposées respectivement par l'OCDE et les Nations Unies et conclut par une réponse possible à la solution reposant sur deux piliers pour l'ensemble des pays en développement.

La fiscalidad de la economía digital es el tema más importante de las negociaciones que se mantienen en la actualidad sobre fiscalidad internacional. La OCDE ha ideado una "solución de dos pilares" para el problema. El Pilar 1 se centra en una redistribución de la potestad tributaria en las jurisdicciones de mercado, que previsiblemente serán países en desarrollo en su mayoría, y el Pilar 2 trata la cuestión de aplicar un tipo impositivo mínimo. La solución del Pilar 1, conocida como Importe A, se codificará en un convenio multilateral que se espera se presente a los países para que lo firmen a principios de 2023. La solución marca el inicio de un nuevo paradigma en la fiscalidad de las empresas multinacionales, aunque tiene una gran complejidad y probablemente conlleve un aumento mínimo de los ingresos para la mayoría de los países en desarrollo. Este planteamiento también les exigirá renunciar al derecho de aplicar medidas fiscales unilaterales a todas las compañías que estén fuera del alcance, con lo que solo podrán cobrar impuestos a tan solo las 100 sociedades que probablemente estén dentro del ámbito de aplicación, si acaso. La decisión de firmar o no es por lo tanto histórica, ya que encerrará a los países en desarrollo en un nuevo marco restringido, en un momento en el que las necesidades de ingresos son especialmente críticas para que las economías se recuperen de la crisis de la COVID-19 en un contexto de situación turbulenta de la economía mundial.

Sin embargo, las Naciones Unidas también han concebido una solución, conocida como Artículo 12B. Su funcionamiento es diferente y consiste en una leve modificación al sistema descentralizado de fiscalidad internacional existente, que se basa en convenios bilaterales fiscales, y con el que los países en desarrollo están más familiarizados. También es probable generar muchos más ingresos que con el Importe A, y no limita ningún aspecto de su potestad tributaria soberana. Este documento de investigación evalúa las distintas consecuencias para los países en desarrollo fruto de adoptar las soluciones respectivas de la OCDE o la ONU, y concluye con una posible respuesta del Sur Global a la solución de dos pilares.

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INTRODUCTION

On 8 October 2021, 136 members of the Organisation for Economic Co-operation and Development (OECD)/Group of Twenty (G20) Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) released a statement on the "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy"[1], along with a detailed implementation plan. Agreements on a few remaining aspects are pending, but for the most part the deal is now largely complete.

With this, a historic negotiation, which has broken many new grounds in international taxation, is nearing its end. It also witnessed new forms of mobilization by developing countries in the IF, with the Group of Twenty-four (G24) coordinating the overall engagement of developing countries; additionally the African Tax Administration Forum (ATAF) on behalf of the African Union (AU) provided support to African countries that joined the BEPS process. The Two Pillar Solution seeks to provide a solution to the world on the vexed issue of taxation of the *digitalized* economy. Contrary to popular perception, this is no longer about taxing the tech sector or companies that are mammoth tax-avoiders[2] such as the FAANGs (Facebook, Amazon, Apple, Netflix and Google). It is about re-working certain fundamental aspects of the international tax system so it is more suited to an economy very different from the one of the 1920s, when the foundations of the international tax system were established by the League of Nations. The *digitalized* economy implies that economic activities are gradually shifting online. Goods such as books and music, once purchased as hard copies, are now available in online formats. Services by definition are intangible and the rise of the internet and digital communications has greatly boosted the cross-border supply of services. Digitalization and the use of digital technologies play core roles in production, growth and profit for the majority of businesses including Multinational Enterprises (MNEs) while transforming their strategies and structures.

This has raised fundamental tax challenges, because existing international tax rules require businesses to be *physically present* in a jurisdiction in order to have a "nexus" or taxable presence. Further, the *allocation of profits* to a subsidiary of an MNE is based on transfer pricing rules, which have been unable to keep pace with an economy where increasingly value is generated through intangible assets. For example, Netflix can streamline movies without being physically located in the jurisdictions where its viewers are and Airbnb does not need to own real estate for delivering their respective services.[3]

To solve these challenges, the Two Pillar solution seeks to *reallocate taxing rights* by redefining the rules of *nexus* and *profit allocation*. This is a welcome development and is part of a larger struggle by governments to increase revenue mobilization through

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[1] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy", October 2021, Paris. Available from https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm.
Kenya, Nigeria, Pakistan and Sri Lanka have as of this writing not yet agreed.

[2] See https://fairtaxmark.net/silicon-six-end-the-decade-with-100-billion-tax-shortfall/.

[3] Abdul Muheet Chowdhary, "Ending Extreme Poverty by Ending Global Tax Avoidance", SouthViews N°227 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/southviews-no-227-29-september-2021/.

corporate taxation. Alongside this is the long-term struggle of developing countries for a fairer allocation of taxing rights *vis a vis* developed countries where the majority of MNEs are headquartered.

However, the Two Pillar solution is not the only nor even the optimal policy option available to countries. The United Nations (UN) Tax Committee updated the UN Model Tax Convention with a new Article 12B for taxing Income from Automated Digital Services[4]. This provides an alternative solution which is simpler in design and has much higher potential revenue benefits. A third option could be regionally agreed measures negotiated by global South regional blocs. For example, ATAF has provided a "suggested approach” to African countries for drafting Digital Services Tax legislation.[5] Countries can also continue to maintain unilateral measures for taxing the digitalized economy if they are not satisfied with the multilateral options available to them.

This research paper, thus, seeks to act as a decision-making guide for developing country policymakers. It is structured as follows: Section I situates the negotiation on the taxation of the digitalized economy within the broader setting of an imbalanced international tax system which has traditionally over-allocated taxing rights to developed countries. The challenges of taxation of the digitalized economy are a manifestation of the imbalance and unfairness found in the global economic system, including rules on international trade, investment protection and investor-state dispute settlement, development aid and debt.

Section II examines the OECD Inclusive Framework in the context of which the Two Pillar solution is being negotiated and how it structurally disadvantages developing countries.

Section III evaluates the Two Pillar solution itself from both a political and technical perspective and assesses its implications, particularly the pros and cons for developing countries if they decide to adhere to it.

Section IV contains a similar assessment for the UN Tax Committee’s alternative solution, Article 12B, and how it could be applied by developing countries.

Section V concludes with a recommendation for developing countries on the strategy they can adopt in respect of the Two Pillar Solution.

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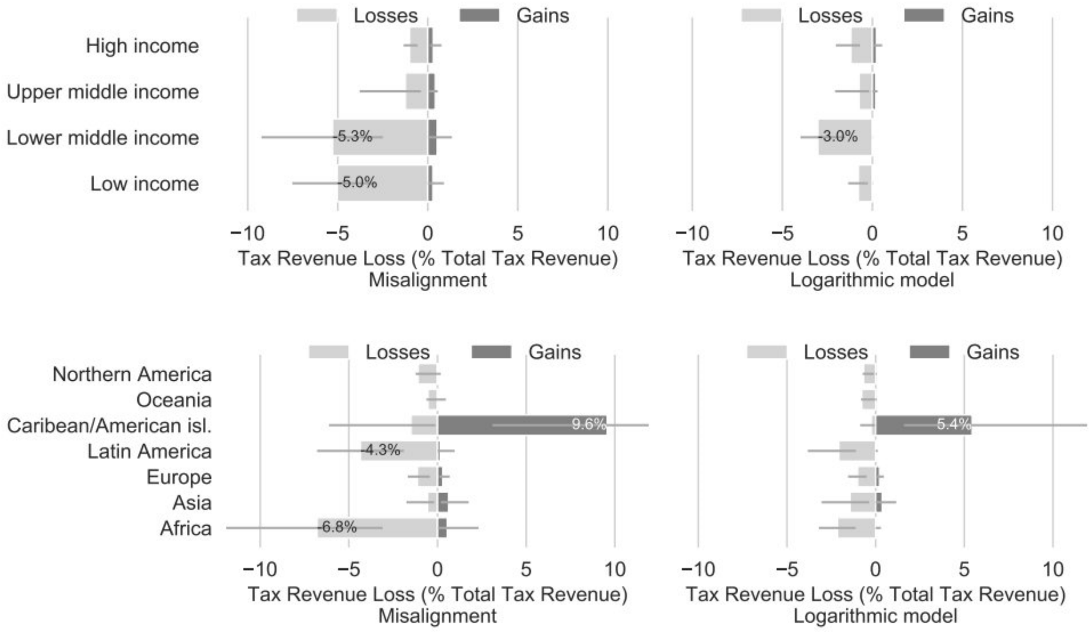
[4] See Abdul Muheet Chowdhary, “UN Tax Committee provides draft guidance on taxing the digitalized economy”, *SouthNews*, August 2020. Available from https://mailchi.mp/southcentre/southnews-un-tax-committee-provides-draft-guidance-on-taxing-the-digitalized-economy-224551?e=0fb8a9986b.

[5] ATAF, “ATAF Suggested Approach to Drafting Digital Services Tax Legislation”. Available from https://events.ataftax.org/index.php?page=documents&func=view&document_id=79.

I. AN UNFAIR AND IMBALANCED INTERNATIONAL TAX SYSTEM

It has long been known that lower income countries lose the highest share of tax revenues to tax abuse under rules set by the richer countries, under an international tax system that favors the latter in terms of allocation of taxing rights between countries, which benefit their multinational corporations over countries in the global South where they make profits from their activities. This has continued to be borne out by evidence. Jansky and Garcia-Bernardo[6] (2021) show that lower middle-income and low-income countries are disproportionately affected by multinational corporate profit shifting. In terms of regions, Africa is the worst affected, followed by Latin America (see Figure 1).

Figure 1: Tax Revenue Loss as a Percentage of Total Tax Revenue



Notes: Tax revenue loss as a percentage of total tax revenue for countries in different income groups (top row) and different geographical regions (bottom row), as estimated by the misalignment (left side of graph) and logarithmic (right side of graph) models. Confidence intervals show 95% intervals, calculated via bootstrapping.

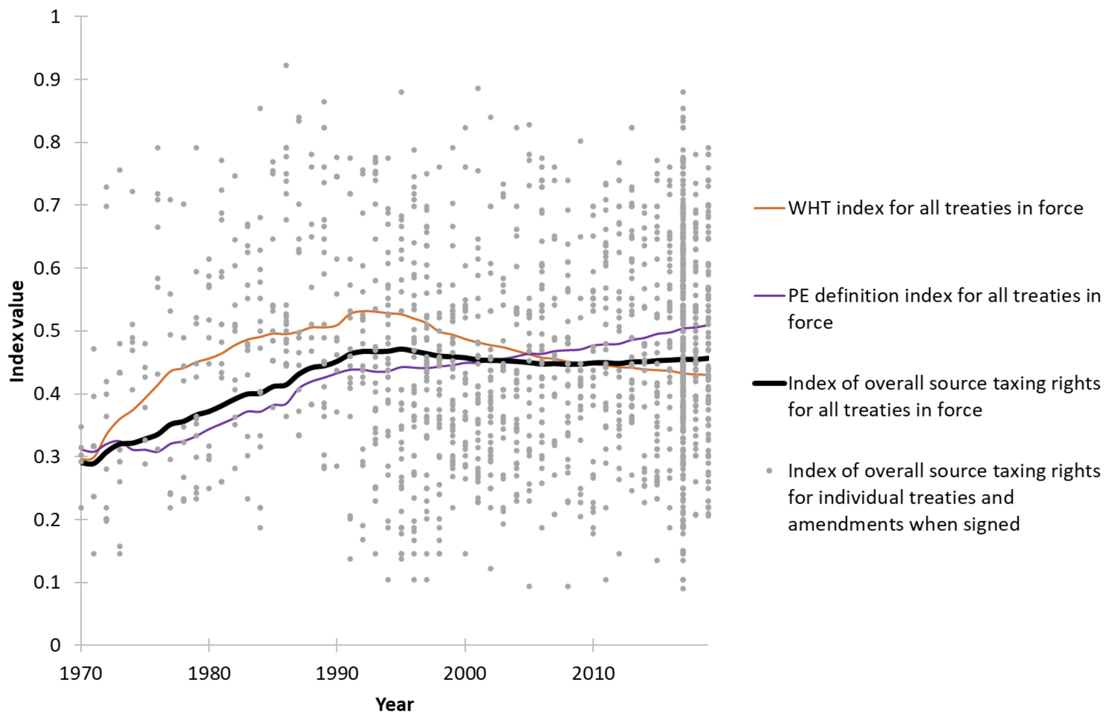
Source: Jansky and Garcia-Bernardo (2021)

[6] Petr Jansky and Javier Garcia-Bernardo, "Profit Shifting of Multinational Corporations Worldwide", IES Working paper 14/2021, Prague. Available from https://t.co/KjogAwgIWw?amp=1.

Under-allocation of taxing rights to developing countries

The scale of tax abuse is further aggravated by the over-allocation of taxing rights to the developed countries. Hearson[7] (2021) shows the allocation of taxing rights to G-24[8] countries in their bilateral tax treaties using the Tax Treaties Explorer.[9] This is based on a scoring system with 0 closely resembling the OECD Model and low withholding tax rates and 1 resembling the UN Model with higher withholding tax rates (see Figure 2).

Figure 2: Overall trends in G-24 treaties



Source: Hearson (2021)

From Figure 2, it is clear that Withholding Taxes (WHT) have been declining over time, possibly making it more difficult for developing countries to collect revenues from non-residents. This is because withholding taxes are normally applied on passive income such as interest, dividends and royalties where costs and expenses are difficult to determine as there is no Permanent Establishment (PE).[10]

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[7] Martin Hearson, "Tax Treaties of G-24 Countries: Analysis Using a New Dataset", G-24 Working Paper (Washington DC, G-24, 2021). Available from https://www.g24.org/wp-content/uploads/2021/06/G24-treaties-WP_Final.pdf.

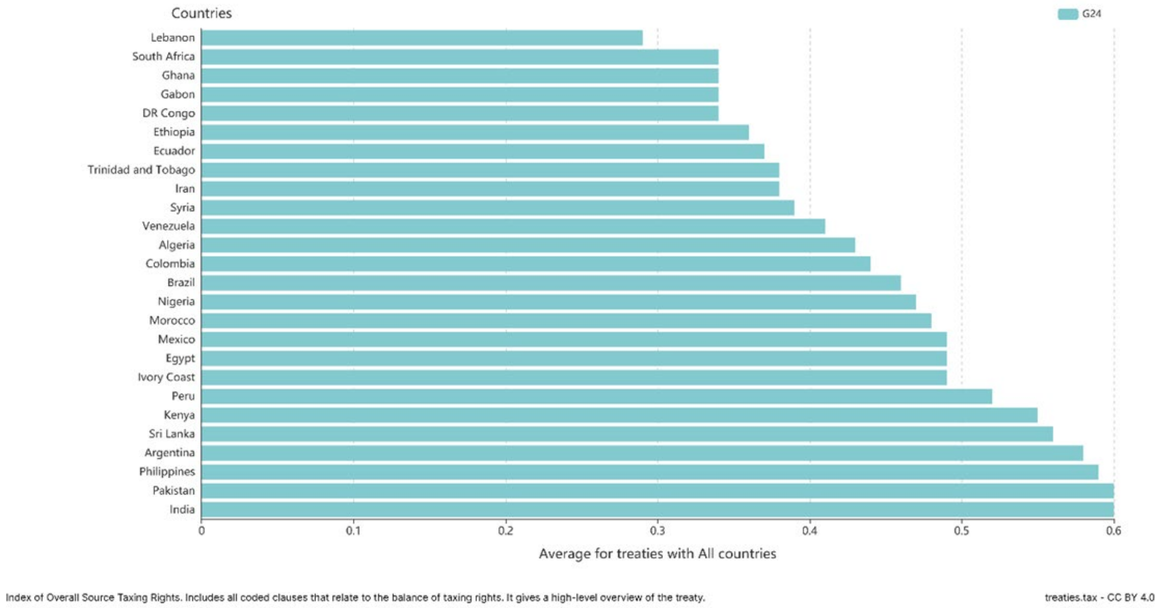
[8] The Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24) coordinates the position of developing countries on monetary and development issues in the deliberations and decisions of the Bretton Woods Institutions (BWI). (https://www.g24.org/mandate/)

[9] International Centre for Tax and Development (ICTD), World Bank, G-24, Tax Treaties Explorer, database. Available from https://www.treaties.tax/en/.

[10] South Centre, "Comments on Discussion Draft: Taxation of Software Payments as Royalties", Geneva, March 2021. Available from https://www.southcentre.int/wp-content/uploads/2021/03/South-Centre-Comments-on-Software-Payments-as-Royalties.pdf.

A country-wise score can be seen in figure 3, with Lebanon, South Africa, Ghana and Gabon having the lowest scores on taxing rights, and India, Pakistan, Philippines, Argentina and Sri Lanka having the highest.

Figure 3: Index of overall source taxing rights: G-24 country averages



Source: Hearson (2021)

There remain entrenched systematic disadvantages for developing countries contributing to asymmetries in global taxation. A key aspect of this is the continuing failure to ensure relevance of global tax rules to diverse economic contexts and needs: the current rules best serve the interests of *capital-exporting* countries where MNEs are headquartered, and fail to address the situation of *capital-importing* countries that are host to foreign investments.

Additionally, the failure of international tax rules to keep up with changes in the global economy as a result of globalization and digitalization has created gaps in corporate taxation rules that are advantageously used of by MNEs for fiscal extraction. The gaps in global financial architecture are closely linked to the lack of inclusive global governance and rule-making.

The United Nations High Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (UN FACTI Panel)[11] found that gaps in existing global financial rules render them unfit for purpose and create a system that enables tax minimization practices and base erosion and profit shifting (BEPS) by MNEs away from countries where they generate wealth to offshore destinations where there is low or zero taxation. This contradicts a principle enunciated

[11] FACTI Panel, "Financial Integrity For Sustainable Development", Report, February 2021. Available from https://www.factipanel.org/explore-the-report.

by the G20 in their St. Petersburg Declaration,[12] and all UN Member States in the Addis Ababa Action Agenda,[13] that multinational enterprises be taxed "where their activities occur".

Developed countries continue to facilitate Illicit Financial Flows

The Addis Ababa Action Agenda on Financing for Development underscored the central role of domestic resource mobilization (DRM) in achieving development. Ultimately, the primary source of domestic public revenues is taxation. As a result of illicit financial flows (IFFs), which includes corporate profit shifting, the ability of governments to mobilize domestic revenues to finance national development is greatly undercut. The scale and impact of IFFs on developing countries has been documented by several reports.

Thus, the African Union (AU) / Economic Commission for Africa (ECA) High Level Panel on IFFs from Africa (Mbeki Panel) estimated IFFs from Africa at USD 50-60 billion per year in 2015;[14] this was found to have grown to USD 88.6 billion by 2020.[15] The Mbeki Panel found 65% of IFFs are due to commercial practices through trade and tax abuse by MNEs, including BEPS practices.

The FACTI Panel has estimated that USD 500-650 billion in corporate tax revenue is lost globally annually,[16] while the State of Tax Justice report puts this figure at USD 312 billion for 2021.

The role of economic ideology and policies of international institutions dominated by the global North in shifting power and resources away from developing countries to rich countries is critical to understand the current situation. In the dominant global narrative, the problem of dirty money is caused by corruption and offshore tax havens located in the global South i.e. tropical islands. However, the majority of tax havens, euphemistically called "global financial centers" are within OECD countries or jurisdictions under their political control e.g. British, United States and Dutch overseas territories and dependencies. The State of Tax Justice 2021 report shows that OECD

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[12] OECD, "Tax Annex To The St. Petersburg G20 Leaders' Declaration", St. Petersburg, September 2013. Available from https://www.oecd.org/g20/summits/saint-petersburg/Tax-Annex-St-Petersburg-G20-Leaders-Declaration.pdf. Para. 7.

[13] UN, "Addis Ababa Action Agenda of the Third International Conference on Financing for Development". Final Outcome, July 2015. Available from https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf. Para. 23.

[14] AU/ECA, "Report of the High Level Panel on Illicit Financial Flows from Africa", Final report, 2015. Available from https://www.unodc.org/documents/NGO/AU_ECA_Illicit_Financial_Flows_report_EN.pdf.

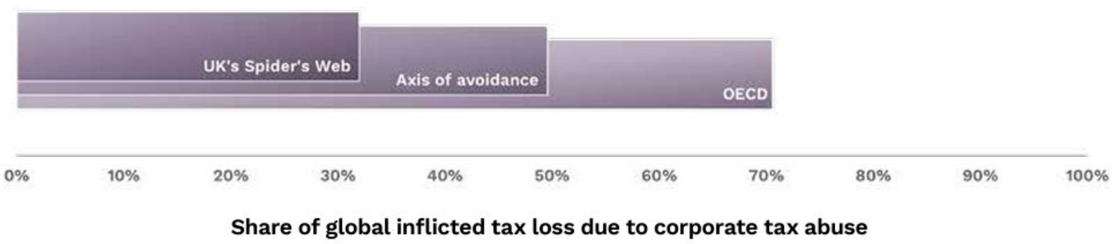
[15] United Nations Conference on Trade and Development (UNCTAD), "Tackling Illicit Financial Flows for Sustainable development in Africa", Report 2020. Available from https://unctad.org/system/files/official-document/aldcafrica2020_en.pdf.

[16] Tax Justice Network (TJN), Global Alliance for Tax Justice (GATJ), Public Services International (PSI), "The State of Tax Justice 2021", Report, November 2021. Available from https://taxjustice.net/reports/the-state-of-tax-justice-2021/.

members were found to be responsible for facilitating 78% of the tax losses countries suffer a year, which includes tax avoidance by wealthy individuals.[17]

The major contributors to IFFs from the OECD are the United Kingdom and its "Spider's Web" (its Overseas Territories and Crown Dependencies which includes the tax havens of Cayman Islands, British Virgin Islands, Jersey and the City of London)[18] (see Figure 4).

Figure 4: Country groups responsible for global inflicted tax loss due to corporate tax abuse



Source: State of Tax Justice (2021)

The FACTI Panel further found that the role of professionals such as bankers, lawyers, accountants, auditors and other financial services providers enables the burgeoning offshore system. The majority of these professionals and their regulatory institutions are based in and controlled by the global North, and are opaque and unaccountable. The role of global banks, particularly in the US,[19] in international money laundering and IFFs in general has been highlighted in recent years, for example, in various exposés like the Panama and Paradise Papers, LuxLeaks, FINCEN and CumEX scandals.[20]

The deregulation of the financial sector under neoliberal policies set by international financial institutions in the past four decades has played a role in reducing controls on private actors in the financial system, and led to what has been called "Casino capitalism" resulting in the growth of oversized financial sectors, with adverse effects for the global

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[17] Marc Bou Mansour, "Losses to OECD tax havens could vaccinate global population three times over, study reveals", *Tax Justice Network*, November 2021. Available from https://taxjustice.net/2021/11/16/losses-to-oecd-tax-havens-could-vaccinate-global-population-three-times-over-study-reveals/.

[18] Marc Bou Mansour, "Losses to OECD tax havens could vaccinate global population three times over, study reveals", *Tax Justice Network*, November 2021. Available from https://taxjustice.net/2021/11/16/losses-to-oecd-tax-havens-could-vaccinate-global-population-three-times-over-study-reveals/.

[19] Nicole Sadek, "US lands top spot as world's biggest enabler of financial secrecy in new index", *ICIJ,* May 2022. Available from https://www.icij.org/investigations/pandora-papers/us-lands-top-spot-as-worlds-biggest-enabler-of-financial-secrecy-in-new-index/?utm_source=ICIJ&utm_campaign=b14741e29e-20220531_WeeklyEmail&utm_medium=email&utm_term=0_992ecfdbb2-b14741e29e-82355005&ct=t().

[20] FinCEN Files. Available from https://www.icij.org/investigations/fincen-files/.

economy even for countries hosting offshore facilities. As noted in a previous South Centre report: “It could be argued however that MNEs use tax havens extensively to structure their operations such that increasingly even the developed countries are deprived of the tax revenue. The existing system is often exploited to generate what is known as ‘stateless income’ that is not taxed anywhere.”[21]

Excessive financial globalization and growth of an oversized financial sector intersecting with the interests of local and global elites has generated a toxic eco-system of excessive wealth and power for a few, which resulted in growing inequality between and within countries and reduced the ability to achieve inclusive and just development for the majority of the world population and to take actions to protect the planet against global challenges such as climate change.

This situation has been aggravated over time by the digitalization of the economy, which has created new tax challenges for developing countries. The “Two Pillar solution” negotiated in the IF will be presented to developing countries for a decision on implementation. It is imperative that it be analysed exhaustively, having in view the characteristics and orientation of the very forum where it was negotiated.

[21] South Centre, “Assessment of the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalization of the Economy”, Report by SCTI’s Developing Country Expert Group, August 2020. Available from https://www.southcentre.int/wp-content/uploads/2020/12/Assessment-of-the-Two-Pillar-Approach-to-Address-the-Tax-Challenges-Arising-from-the-Digitalization-of-the-Economy-reduced.pdf.

II. OECD/G20 Inclusive Framework - An Unequal Forum for Developing Countries

G77 demand for UN-led international tax negotiations consistently ignored

Developing countries through the Group of Seventy-Seven Plus China (G77+China) have long called for an inclusive global forum to make rules for international taxation. The specific demand is for the role to be played by the UN as an inclusive, legitimate forum in which nearly all countries are members. That demand was reiterated in 2021 when the G77+China tabled a draft resolution in the UN General Assembly calling for the UN Tax Committee to be converted into an intergovernmental body with experts representing their respective governments.[22]

Despite its shortcomings, the UN remains the sole global institution in which developing countries can participate on agenda-setting and decisions on equal footing and where rules for decision-making are transparent. Further, the UN has convening power to mobilize requisite expertise, as it has done on important global issues such as climate change. The FACTI Panel had also recommended a UN Tax Convention to initiate the process for a UN-led framework on international rule-making. Building on this idea, a UN Framework Convention on Tax Cooperation (UN FCTC) has been proposed as a way forward.[23]

Unfortunately, these demands for inclusion and equal participation in tax norm setting have been disregarded, and Group pf Seven (G7) members continue to dominate policy making through the OECD. The OECD has been chosen by advanced economies as the *de facto* forum to determine new rules for international taxation. Coercive practices such as European Union (EU) blacklists or aid-related pressure have been used to push developing countries into the OECD BEPS 'Inclusive Forum'. A 2020 study estimates the IF is 15% larger due to these practices.[24]

At present, the IF has a membership of 141 jurisdictions, which is often wrongly covered by the media as 'countries'. The reality is that the IF has 124 countries as of December 2021 and 17 jurisdictions, with majority of the latter being overseas territories or dependencies controlled by G7 countries.[25]

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[22] UN, "General Assembly's session Report", Seventy-sixth Session, October 2021. Available from https://undocs.org/en/A/C.2/76/L.28. Para. 19.

[23] Abdul Muheet Chowdhary, Sol Picciotto, "Streamlining the Architecture of International Tax through a UN Framework Convention on Tax Cooperation", Tax Cooperation Policy Brief N°21 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/wp-content/uploads/2021/11/TCPB21_Streamlining-the-Architecture-of-International-Tax-through-a-UN-Framework-Convention-on-Tax-Cooperation_EN.pdf.

[24] Matthew Collin, "Does the threat of being blacklisted change behavior?", Working Paper 139, Global Economy & Development, June 2020. Available from https://www.brookings.edu/wp-content/uploads/2020/06/EU_working_paper_139_mcollin.pdf.

[25] Tove Maria Ryding, "Who is really at the table when global tax rules get decided?", Briefing Paper, Eurodad, October 2021. Available from

Multiple governance challenges plague the Inclusive Framework

Critics of the OECD IF note that developing countries involved in the Two Pillar negotiations, dubbed BEPS 2.0, were excluded[26] from most of the initial BEPS process, despite calls to open it up, and had to join the IF on the condition that they would implement standards set within BEPS 1.0 despite that they had no say in negotiating them. Analysis of the IF governance arrangements show no or limited influence over the agenda and decisions from developing countries[27], the partiality of the OECD Secretariat towards proposals from OECD members,[28] and the exclusion of proposals by developing countries including those made through the G24 and ATAF in the proposals finally taken forward by the OECD throughout the process.[29] Table 1 shows the limited participation of non-OECD countries in IF bodies.

Table 1: Involvement of Non-OECD Countries in Inclusive Framework Bodies as of September 2021

Group Name	Non-OECD country represented in Chair/Co-Chair or Vice Chair?	Non-OECD country representation in Bureau Members
Task Force On The Digital Economy (TFDE)	Yes, 1/5 (China)	3/9 (Brazil, Cote d'Ivoire, India)
Working Party No. 1 On Tax Conventions And Related Questions	Yes, 2/6*	No functioning Bureau
Working Party No. 6 On The Taxation Of Multinational Enterprises	Yes, 1/4 (Nigeria)	4/22 (Argentina, Brazil, India, China)
Working Party No. 10 On Exchange Of Information And Tax Compliance	Yes, 1/3 (India)	1/7 (China)

*Working Party 1 has a formal Steering Group which has co-Chairs and four Vice-Chairs which include China and Argentina, though this data is not publicly available.

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https://d3n8a8pro7vhmx.cloudfront.net/eurodad/pages/2492/attachments/original/1633674614/global-tax-rules-october.pdf?1633674614.

[26] See https://www.eurodad.org/bepsfacts.

[27] Rasmus Corlin and others, "At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations", Working paper 115, ICTD, December 2020. Available from https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/15853/ICTD_WP115.pdf?sequence=9.

[28] South Centre, "Comments ont the OECD Secretariat Proposal for a Unified Approach under Pillar One", Comments to the OECD, November 2019. Available from https://www.southcentre.int/scti-submission-november-2019/.

[29] South Centre, "Statement by the South Centre on the Two Pillar Solution to address the Tax Challenges arising from the Digitalisation of the Economy", Statement to the OECD, October 2021. Available from https://www.southcentre.int/statement-october-2021-3/.

Source: On-Line Guide to OECD Intergovernmental Activity, (https://oecdgroups.oecd.org/Bodies/ListByNameView.aspx?book=true, accessed April 2022)

Further, the proceedings of the IF plenary and of the Steering Group are completely opaque. As some delegates told the authors, decisions are not taken on a voting basis. The Steering Group has no known rules of procedure or any public record of its deliberations. Citizens have no way of knowing what their representatives have argued in these bodies, what positions they have taken and what they have agreed to. It is fundamentally undemocratic, claims to “equal footing” notwithstanding.

Following the recent agreement by G7 leaders with the OECD BEPS Pillar 1 and 2 proposals, it was observed that the majority of developing country representatives gave conditional support to the outcome subject to the effective consideration of their concerns, but the OECD announced them as an unqualified agreement reached by the consenting jurisdictions.[30] Further, great efforts were taken to appease and accommodate the interests of tax haven members of the OECD like Ireland, while the same treatment was not afforded to developing countries like Pakistan, Nigeria and Kenya. Delegates revealed on condition of anonymity that developing countries were given an “accept all or reject all” option and so were forced to accept even if they deeply disagreed with many aspects of the Two Pillar solution. This points to a larger systemic problem with the OECD’s “consensus” approach to decision-making.[31] There are reports of a possible threat of sanctions on countries that do not agree to the G7/OECD tax proposed rules.[32]

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[30] Abdul Muheet Chowdhary, “Developing Country Demands for an Equitable Digital Tax Solution”, Tax Cooperation Policy Brief N°19 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-19-october-2021/.

[31] Abdul Muheet Chowdhary, “Developing Country Demands for an Equitable Digital Tax Solution”, Tax Cooperation Policy Brief N°19 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-19-october-2021/.

[32] Kevin Pinner, “Global South Groups Decry Idea of Sanctions for Digital Taxes”, *Law360*, March 2022. Available from https://www.law360.com/articles/1472064/global-south-groups-decry-idea-of-sanctions-for-digital-taxes.

III. ASSESSMENT OF THE TWO PILLAR SOLUTION

Overview

On October 8, 2021, 136 jurisdictions joined the OECD/G20 IF on BEPS Statement on a '*Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy'*. This statement was based on the agreement reached in July of the same year, with some differences.

Some jurisdictions which had not subscribed to the July 2021 Statement, did join the October Statement. However, some other jurisdictions, e.g. Nigeria, Kenya and Sri Lanka, did not support either of them.

In a nutshell, Pillar 1, the 'Unified Approach' consists of a set of rules for the distribution of the tax base of the most relevant groups of multinational entities (GMNEs); and Pillar 2, GloBE (Global anti-Base Erosion) rules, consists of a set of rules for taxing income that has been taxed at a rate below 15%.

While the original focus was to "address the tax challenges arising from the digitalization of the economy", the change in the direction of Pillar 1 towards addressing the distribution of the tax base of the most relevant GMNEs had already been made in the July 2021 statement.

The solution agreed in July 2021 was applicable to all GMNEs (extractives and regulated financial services excluded) with turnover above EUR 20 billion and profitability above 10%, with a commitment to reduce the turnover threshold to EUR 10 billion after 7 years. In the original estimations of July 2021, 112 GMNEs had been found to be in-scope with these thresholds. The difference between the July and the October Statement lies in a new reference to the use of an averaging mechanism for the calculation of the thresholds.

The 'Unified Approach' is composed of 3 elements. In the first place, 'Amount A' relates to an attribution of the taxing rights to market jurisdictions in respect of a portion of the non-routine profits obtained worldwide by the GMNEs. For a jurisdiction to be eligible for a portion of the Amount A to be distributed, a 'Nexus' has to be verified. As a general rule, those market jurisdictions with a turnover of the GMNEs above EUR 1 million will be eligible to receive a part of Amount A. For smaller jurisdictions with a gross domestic product (GDP) below EUR 40 billion, a lower threshold of EUR 250,000 will be deemed to have a nexus.

The portion of the revenue to be allocated to market jurisdictions was defined in the October Statement to be 25% of the residual profits in excess of 10%.

Differences arising in the estimation of Amount A will be sorted out using both a dispute prevention and dispute resolution mechanism. Dispute resolution will be binding, except for jurisdictions with a very low level of international disputes (that are not peer reviewed in respect of BEPS Action 14), which may opt for an elective binding mechanism.

Another element of Pillar 1 is Amount B, which will consist of a definition of fixed margins of profitability for certain in-country low risk marketing and distribution activities.

The Pillar 1 proposal involves the coordination of the removal of unilateral measures, and other similar relevant measures, towards 2023 or the coming into force of the Multilateral Convention for the implementation of Pillar 1.

Regarding unilateral measures – which are the sovereign rights of every country - at present, at least 12 countries have introduced digital service taxes (DSTs), 15 countries have withholding taxes on digital transactions, and 4 countries have modified their Permanent Establishment (PE) definitions to enable nexus without physical presence.[33]

Pillar 2, on the other hand, is meant to address BEPS challenges and is designed to guarantee that multinational entities pay a minimum tax of 15%, regardless of where they are located. In the July statement, the tax was meant to be at least 15%. However, in the October Statement, the rate was finally set at 15%.

Pillar 2 is composed of three rules: income inclusion rule (IIR), undertaxed payment rule (UTPR) and subject to tax rule (STTR).

The GloBE rules will be applicable to GMNEs with turnover above €750 million. However, since Pillar 2 will not require an agreement, and it will have the status of a common approach, jurisdictions willing to apply the rules to groups with turnover below €750 million will be able to do so.

The July 2021 statement already indicated that Pillar 2 would consist of a top-up tax on the Ultimate Parent Entity (UPE) in relation to the low tax profits of a group entity located in another jurisdiction (the IIR); and the possibility of denying the deductibility or requiring an equivalent adjustment when the jurisdiction receiving the payment is not taxing the related income or taxes it below 15%, and only when the profit is not taxed under the IIR (UTPR).

The UTPR will operate only in cases in which the IIR is not applied, i.e. mainly when the UPE is in a low income jurisdiction, but also in cases in which the UPE is located in a jurisdiction not implementing Pillar 2.

However, it should be noted that if the UPE jurisdiction has not implemented Pillar 2, the rules indicate that the second level in the control chain can apply the IIR. Therefore, the UTPR is a second order rule: it will only be applicable once it is verified that none of the jurisdictions with a higher hierarchy in the control chain is applying the IIR.

Pillar 2 also includes a complementary rule based on double tax treaties, the subject to tax rule (STTR). The STTR allows jurisdictions to impose a withholding tax on certain intragroup payments that are subject to a tax lower than the minimum.

The objective of this rule is to restrain the application of the benefits of a tax treaty when the income at the residence jurisdiction is not subject to a tax in line with the minimum rate of the STTR (9%). The rule will not be applicable to payments made to individuals.

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[33] A. Amar, V. Grondona, "Economía digital y tributación: el caso argentino en el marco de la experiencia internacional", LC/TS.2021/122-LC/BUE/TS.2021/3, Santiago, ECLAC, 2021. Available from https://repositorio.cepal.org/bitstream/handle/11362/47355/1/S2100573_es.pdf.

Pending issues

In relation to Pillar 1, the Task Force on the Digital Economy (TFDE) is working on the Multilateral Convention (MLC) to be used for the implementation of Pillar 1, as well as on the necessary changes to be considered in domestic law.

The definition of an averaging mechanism, and whether it will be used in relation to the EUR 20 billion threshold or the 10% one, is one of the aspects that needs to be defined. The 112 GMNEs which seemed to be the target of the original definition of EUR 20 billion threshold will no longer be such, as most possible averaging mechanisms considered do in practice reduce the number of in-scope GMNEs.

According to both the July and October Statements, revenue is meant to be sourced to 'end market jurisdictions where services are used or consumed'. This implies that in the case of intermediate goods and services, the seller of the intermediate good or service should either know where the final good or service is sold, or else a macroeconomic allocation will need to be considered. A public consultation on revenue sourcing was launched in 2022. Its results are not definite.

Various aspects relating to tax base determination are also pending, and a public consultation has also been launched in 2022 in relation to this aspect of the proposed agreement. One of the issues under controversy relates to the amount of years of pre-regime losses and in-regime losses that will be admitted to be carried forward.

The mechanism to be used for the elimination of double taxation (credit or exemption) is still under discussion, as well as which jurisdictions will be deemed to be paying or relieving jurisdictions.

Aspects relating to the tax certainty mechanism are still pending to be defined as well, with issues of particular relevance to developing countries being the composition of the review and determination panels. There is the possibility of a decision involving the participation of the private sector.

In relation to Amount B of Pillar 1, the proposal needs to still be produced by the Advisory Group of the Standardised Benchmarking Project of the Forum on Tax Administration Mutual Agreement Procedure (FTA MAP) Forum.

No definition has been agreed yet on what are going to be considered 'unilateral measures' to be removed upon implementation of Pillar 1.

Finally, it is still to be defined what will be the minimum number of signatories to the Pillar 1 Multilateral Convention that will trigger the implementation of Pillar 1.

Overal, Pillar 2 is more advanced than Pillar 1. After the October statement, aspects relating to Pillar 2 that were still pending were mainly those of its implementation, such as the model rules for the determination of the effective tax rate, filing obligations, administrative safe harbours, the model treaty provisions for the implementation of the STTR and the related multilateral instrument.

Implications for developing countries of adopting the Two Pillar Solution

For the sake of clarity and simplicity, the implications for developing countries can be divided into pros and cons.

Pros

Opportunity to influence the new international tax order: Without doubt, the Two Pillar solution marks a paradigm shift in international taxation. It has broken new ground in many different aspects of the way MNEs are taxed, such as the introduction of global formulary apportionment, allocation of taxing rights through a multilateral treaty and large-scale multilateral dispute resolution, to name a few. Each of these presents new concepts that tax administrations will have to learn eventually. Nonetheless, the precise framing of the solutions has, for the most part skewed to advantage advanced economies and thus, inordinantly benefit rich countries[34]. Path dependency theory suggests that once the initial "building blocks" are laid and solidified, they will be more difficult to change in the future.

Hence, participation by developing countries in shaping the new tax order is essential, because no one else will speak for them or promote their interests. Application of the Two Pillar solution can give them valuable practical knowledge on its limitations and how it can be subsequently improved. This will enable them to become fuller participants in the monitoring and review meetings so it can be refined and made more suitable to developing country needs.

Multilateral solution with reduced political risk: Since it is an agreement with the backing of the world's most powerful countries, applying it avoids negative political repercussions, such as trade sanctions by the United States.

Move towards Unitary Taxation: Progressive civil society actors have long advocated that MNEs be taxed as single entities rather than a network of unrelated subsidiaries, as is currently done. Pillar One takes a step in this direction by recognizing MNEs as single entities and taking consolidated group profit as the starting point for profit allocation. However, it is contestable whether the profit allocation method is indeed formulary apportionment or it is closer to a residual profit split. These changes are too little, and it is an insufficient adoption of the principle of unitary taxation. It also marks a major concession by OECD countries and has the potential to be expanded further in the future. The demand for full formulary apportionment with a formulaic allocation based on sales, employees, assets and users can be sustained. Incrementalism is the nature of multilateral negotiations and it is likely to be the same in this case.

Experience with multilateral dispute resolution: The multilateral dispute resolution system through the review and determination panel mechanisms creates a paradox: by participating in them countries can improve MAP expertise; however, to ensure favorable outcomes at the same time requires a minimum level of MAP expertise. Nevertheless, the shift towards unitary taxation, which is progressive, may necessitate some form of

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[34] Independent Commission for the Reform of International Corporate Taxation (ICRICT), "Open letter to G20 leaders: A global tax deal for the rich", October 2021. Available from https://www.icrict.com/press-release/2021/10/12/icrict-open-letter-to-g20-leaders-a-global-tax-deal-for-the-rich.

multilateral dispute resolution; hence, acquiring hands-on knowledge can be valuable for tax officials from developing countries.

However, this is also one of the red lines for developing countries: Nigeria publicly stated[35] that one of the reasons it did not agree to the October Statement was due to the fact that there were domestic law prohibitions on multilateral binding dispute settlement. This has also been reiterated by other countries as well as groupings such as the G-24.[36]

The noted unbalances reflect the long-standing structural problems with international arbitration that developing countries have faced. The entire system is seen as favouring the developed countries, and this fact is also borne out through the experience of bilateral investment treaties, which also sometimes involve tax disputes.

Cons

Overall reallocation of taxing rights prioritizes rich countries: This is the single largest con which arguably over-rides all the pros. Both Pillars directly and unambiguously privilege the global North in the allocation of taxing rights. In Pillar One, only a very tiny portion of profit (25% of residual profit) will be re-allocated to market jurisdictions, with no possibility of any increase in the future. In Pillar Two, the “first claim” on taxing undertaxed income has been given to headquarter jurisdictions which are mainly developed countries. Only if they refuse, do source jurisdictions get the chance, which is unlikely in most cases. The coming into force of such a blatantly one-sided agreement can permanently cement global inequality in taxing rights. It spells doom for the revenue needs of developing countries, at a time when they are in an extreme resource crunch, recovering from a historic pandemic-induced crisis.

Ban on unilateral measures on all companies: In a move that has no policy rationale, or any rationale for that matter, the Two Pillar solution seeks to prohibit countries from imposing unilateral measures like DSTs or “other similar relevant measures” on all companies, not just on those in-scope. Jurisdictions that have already initiated such measures can continue them till the coming into force of Pillar One or 31 December 2023, whichever is earlier.

However, countries that have not taken any unilateral measures now have no options whatsoever and will be deprived of an important revenue source. This is especially as the digitalization of the economy has accelerated during the COVID period when remote working became necessary in many industries.[37]

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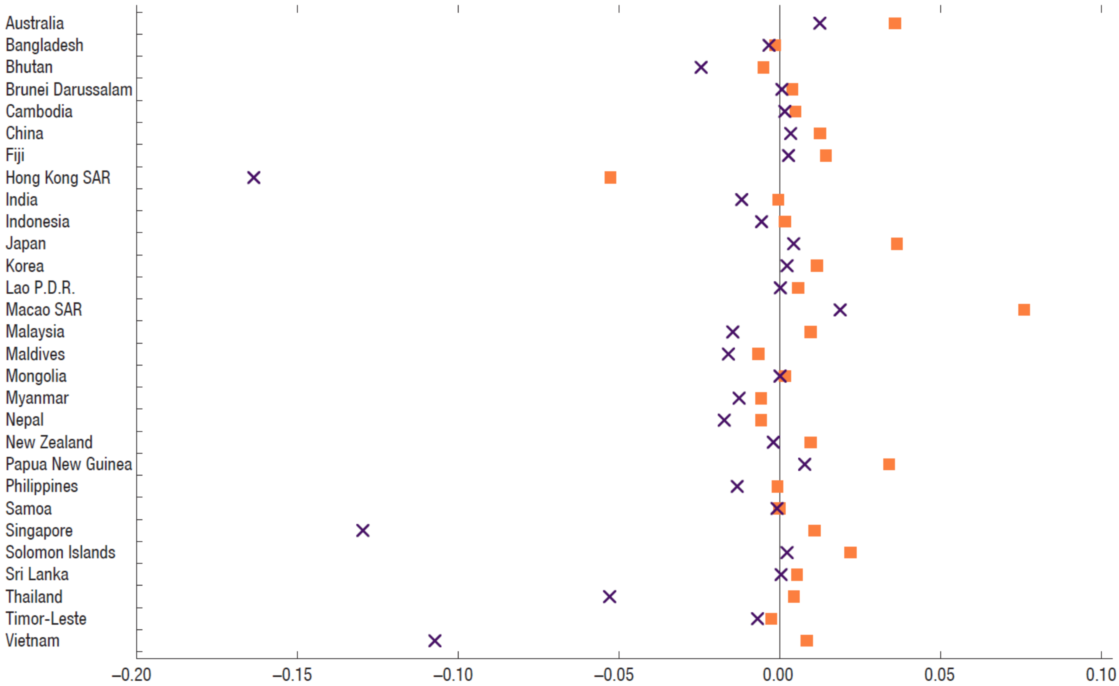
[35] Zainab Shamsuna Ahmed, Minister of Finance, Budget and National Planning of the Federal Republic of Nigeria, “Statement on the OECD/IF Two-Pillar Solution”, Statement at the First African Fiscal Policy Forum, December 2021. Available from https://taxinitiative.southcentre.int/wp-content/uploads/2021/12/Statement-by-Mrs.-Dr.-Zainab-Shamsuna-Ahmed-Honourable-Minister-of-Finance-Budget-National-Planning-Nigeria.pdf.

[36] G-24, “Comments of the G-24 on the Pillar One and Pillar two proposals being discussed by OECD/G20 Inclusive Framework on BEPS”, Comments to the OECD, May 2021. Available from https://www.g24.org/wp-content/uploads/2021/06/Comments-G-24-to-BEPS-IF-SG-May-2021_FINAL.pdf.

[37] UNCTAD, “COVID-19 and E-Commerce: A Global Review”, Report, 2021. Available from https://unctad.org/system/files/official-document/dtlstict2020d13_en_0.pdf.

Agreeing to the Two Pillar solution thus means limiting policy options and giving up future policy space on an unjustifiably large scope. This is damaging in particular because countries are giving up much more than they are getting in return. It is a disproportionate deal in the classic sense. Most revenue assessments of Pillar One show a minimal increase in tax collection, and an IMF study[38] for Asia-Pacific countries has shown that the gains if any hover near zero and Bangladesh, Bhutan, India, Indonesia, Malaysia, Maldives, Myanmar, Nepal, New Zealand, Philippines, Singapore, Thailand, Timor-Leste and Vietnam will actually lose revenue (see Figure 5).

Figure 5: Potential Revenue Effects on Asian countries of Pillar 1, Amount A (% of GDP)



Source: IMF (2021)

Problems of administrability: Both Pillars, but especially Pillar One, will be exceedingly complex to administer and even developed countries will likely find it challenging. The Two Pillar solution is a shift away from the decentralized nature of the present international taxation system, which developing countries are already familiar with[39], and into new and more difficult terrain. This can have real implications for revenue collection

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[38] Era Dabla-Norris *et al.*, “Digitalization and Taxation in Asia”, Departmental Papers, IMF, September 2021. Available from https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2021/09/13/Digitalization-and-Taxation-in-Asia-460120.

[39] Rajat Bansal, “Article 12B-A Tax Treaty Solution by the UN Tax Committee for Taxing Digital Incomes”, Tax Cooperation Policy Brief N°16 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-16-july-2021/.

and dispute resolution. Coupled with the lack of financial integrity and transparency of most MNE accounting information available to developing countries, and the often greater resources MNEs typically have, that additional complexity is a major con that will create even more disparity in capacities between developing country revenue administrators and MNEs.

Dispute resolution: As mentioned, the mandatory and binding multilateral dispute resolution system may be a red line for some countries, such as Argentina, Bolivia, Venezuela, Ecuador[40] and Nigeria, to name a few, in view of sovereignty concerns or else, because their domestic legal regimes may not allow it. The composition of the panels remains to be determined and indications – including past experience - are that it will be dominated by developed countries.[41] Developing countries will likely find the process challenging, especially given that the in-scope companies are the 100 largest in the world. These MNEs have enormous resources to defend their case and reduce their tax liabilities.

Moreover, developing countries will have to confront hurdles on two fronts – the MNEs themselves and the home jurisdictions that support them. If the panels are imbalanced, and the resolution system resembles private arbitration as in the case of investment tribunals, then developing countries can have little hope. In practical terms, they may be hard-pressed to identify when they are losing revenues, and when they take action their findings may be challenged in a dispute resolution system where they are bound to lose. The requirement for most developing countries to accept mandatory arbitration represents the loss of significant future policy space for little or no revenue gains.

Low global minimum corporate tax of 15%: Pillar Two is worthless for developing countries as it gives the priority to headquarter jurisdictions/developed countries in taxing the undertaxed income. In the few cases where developing countries can benefit, such as through the Subject to Tax rule or where the Under Taxed Payments rule is applicable, the low rate of 15% would not generate sufficient revenues. The rate is detached from developing country realities as the average effective tax rates of most developing countries are closer to 25%.[42]

The 15% rate is an appeasement of OECD tax havens like Ireland and ignores the consistent demands of a rate of between 20-30% as has been demanded by ATAF[43],

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[40] Spyridon E. Malamis, Cai Qiang Cai, "International Tax Dispute Resolution in Light of Pillar One: New Challenges and Opportunities" *Bulletin for International Taxation* (IBFD, February 2021). Available from https://www.ibfd.org/sites/default/files/2021-09/OECD_International%20-%20International%20Tax%20Dispute%20Resolution%20in%20Light%20of%20Pillar%20One%20New%20Challenges%20and%20Opportunities%20-%20IBFD.pdf.

[41] See the presentation by Mathew Gbonjubola: https://www.youtube.com/watch?v=6Ny0NtszUfw&ab_channel=SouthCentreGVA.

[42] Sebastien Babou Diasso, "Global Minimum Tax Rate: Detached from Developing Country Realities", Tax Cooperation Policy Brief N°23 (Geneva, South Centre, 2022). Available from https://www.southcentre.int/tax-cooperation-policy-brief-23-11-february-2022/.

[43] ATAF, "A new era of international taxation rules – what does this mean for Africa?", ATAF Communication, October 2021. Available from https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa.

countries like Argentina,[44] the FACTI Panel and civil society organizations like the Independent Commission for the Reform of International Corporate Taxation (ICRICT). As has been pointed out by ICRICT repeatedly, the minimum runs the risk of becoming the maximum.[45]

Uncertainty whether developed countries will accede to Pillar One: It is unclear whether the developed countries that promoted the Multilateral Convention (MLC) to implement Pillar One will sign and ratify it. If all or some of the countries that are home of a large number of in-scope MNEs do not do it, as mentioned by the South Centre "the entire exercise is meaningless as they are the ones who have to reallocate profit to market jurisdictions."[46]

Further, for the MLC to come into force it needs a "critical mass" of countries that agree to it. As of this writing this number has not yet been defined. In any case, it can never be guaranteed how many countries will join the MLC and when the critical mass will be reached. It is unclear if the US, arguably the most important country in the agreement, will ratify the MLC.[47] A recent study showed that 55%[48] of the global reallocable residual profit will come from US-headquartered MNEs. This makes US ratification essential to the success of Pillar One. Conversely, there is no point for developing countries, or any other country, to accede if the US does not do so.

Long lock-in period and minimal scope of review: The only aspect of Pillar One which will be reviewed, seven years after the agreement comes into force, is the scope. The threshold is expected to be brought down to EUR 10 billion. However, apart from this no other element of Pillar One is to be reviewed. Developing countries through the G-24 had forcefully demanded that the quantum of Amount A be at least 30% of residual profit and had also proposed a "profit escalator" mechanism where the greater the profit, the larger the reallocation. This essential demand was ignored and has been removed from the scope of review. Overall, few fundamental proposals of developing countries were incorporated into the final outcome document and many key concerns have not been taken on board, unlike those presented by OECD members. This is a clear reflection of

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[44] Ollie A Williams, "Developing Countries Refuse To Endorse G7 Corporation tax Rate", *Forbes,* June 2021. Available from https://www.forbes.com/sites/oliverwilliams1/2021/06/30/developing-countries-refuse-to-endorse-g7-corporation-tax-rate/?sh=257b22ea4f0c.

[45] ICRICT, "Calls for an ambitious global minimum tax to stop the harmful race to the bottom", December 2019. Available from https://www.icrict.com/press-release/2019/12/9/m9fwnyj7krhupqbasqygn9kkx9msai

[46] South Centre, "Statement by the South Centre on the Two pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy", Statement to the OECD, October 2021. Available from https://www.southcentre.int/wp-content/uploads/2021/10/SC-Statement-on-IF-Two-Pillar-Solution-13-Oct-2021.pdf.

[47] Robert Goulder, "Pillar 1, Tax Treaties, And Congressional Approval", *Forbes,* August 2021. Available from https://www.forbes.com/sites/taxnotes/2021/08/11/pillar-1-tax-treaties-and-congressional-approval/?sh=2fcea62d348b.

[48] Vladimir Starkov, Alexis Jin, "How Would Amount A Affect U.S. Corporate Income Tax revenue?" *Taxnotes,* November 2021. Available from https://www.taxnotes.com/beps-expert/base-erosion-and-profit-shifting-beps/how-would-amount-affect-us-corporate-income-tax-revenue/2021/12/09/7cl6d.

the political accountability and institutional limitations of the OECD as a forum to develop multilateral tax rules.

IV. Assessment of the UN Tax Committee's Solution

Institutional limitations

In examining the UN Tax Committee's solution – Article 12B of the UN Model Tax Convention (MTC) – it is important to acknowledge the institutional limitations of the UN Tax Committee (UNTC). As noted, the UNTC is an expert body with individuals acting in their personal capacity. This means that its outputs are not intergovernmentally negotiated and hence non-binding. This is in stark contrast with the IF's outputs, which are not only negotiated by delegates but also endorsed by decision-makers at the highest levels such as Ministers of Finance and Heads of State, albeit only from G20 and OECD countries.

However, beyond the formalism, the UN Tax Committee in some ways enjoys *de facto* if not *de jure* intergovernmental status. Almost all of the Committee Members tend to come from tax administrations and ministries of finance and represent national interests. The UNTC's outputs are tensely negotiated and in recent years they have increasingly reflected the interests of developing countries, such as fees for technical services, capital gains on offshore indirect transfers and collective investment vehicles. These outputs are valuable for developing countries when they negotiate tax treaties and design and implement their international tax policy. So even if not intergovernmentally negotiated, and even when its recommendations in general do follow those of the OECD, the UNTC's recommendations still carry weight and provide legitimate policy options to developing countries. Notwithstanding this, as mentioned above, the longstanding G77+China demand for a UN intergovernmental tax body needs to be heard and such a body implemented.

Article 12B – Taxing income from Automated Digital Services

In April 2021, the UNTC in its 22nd Session finalized a tax treaty solution for taxing income from automated digital services (ADS). This took the form of an update to the UN Model Tax Convention via Article 12B. The key features of Article 12B have been described as follows by Rajat Bansal, the UNTC Member from India who spearheaded the process:

> The scope of the new provision on automated digital services covers online advertising services, supply of user data, online search engines, online intermediation platform services, social media platforms, digital content services, online gaming, cloud computing services and standardized online teaching services amongst other digital services that may fall within the general definition in the provision. The incidence of taxation is on the basis of location of the payer for the automated digital services.
>
> The new provision has two options for taxation, first by way of withholding tax at the time of each payment and second by way of net annual income of the foreign entity computed on the basis of revenue derived locally from the market

jurisdiction and the global profitability of the multinational enterprise (MNE) group. Taxpayer can choose whichever option suits it more."[49]

Article 12B thus bears close resemblance to the Digital Service Taxes that have proliferated as a reasonable and practical policy option for taxing the digitalized economy that have begun bringing in revenue for countries. However, it goes beyond that and gives effect to the G-24's original proposal of **fractional apportionment**,[50] wherein the revenue derived from the jurisdiction was to be allocated as profit using a formulaic approach. Article 12B thus contains a simple formula for calculating the qualified/net profits using the fractional apportionment method, to which the domestic tax rate can be applied. Article 12B(3) states:

> "…the qualified profits shall be 30 percent of the amount resulting from applying the beneficial owner's profitability ratio or the profitability ratio of its automated digital business segment, if available, to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where the beneficial owner belongs to a multinational group, the profitability ratio to be applied shall be that of the group or, if available, of the business segment of the group relating to income covered by this Article."

The formula is described in Equation 1.

$$Net\ or\ qualified\ profits = 0.3 * (Locally\ derived\ Revenue * profitability\ ratio)$$

Here, the 30% closely corresponds to the G-24's fractional apportionment formula which sought to allocate MNE income with 1/3rd divided equally between sales, assets and employees[51], and where relevant, users. The 30% used in the formula though is applicable only to sales. However, this is seen as a step forward by some developing countries, as it specifically highlights the role of demand as a basis for profit attribution.[52] From this point of view, the OECD's transfer pricing guidelines have been designed to attribute profit only on the basis of supply side factors through the Functions, Assets and Risks (FAR) approach. This has meant allocating profits to the developed countries which are highly industrialized and often the countries of production and export of final goods. They do not adequately attribute profits to developing countries for their production of primary and intermediate goods. They have also been designed to

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[49] Rajat Bansal, "Article 12B-A Tax Treaty Solution by the UN Tax Committee for Taxing Digital Incomes", Tax Cooperation Policy Brief N°16 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-16-july-2021/.

[50] G-24, "Comments of the G-24 on the OECD Secretariat Proposal for a Unified Approach to the Nexus and Profit Allocation Challenges Arising from the Digitalisation (Pillar 1)", Comments to the OECD, November 2019. Available from https://www.g24.org/wp-content/uploads/2019/12/G-24_Comments-on-OECD-Secretariat-Proposal-for-a-Unified-Approach.pdf.

[51] Veronica Grondona, Abdul Muheet Chowdhary, Daniel Uribe, "National Measures on Taxing the Digital Economy", Research Paper 111 (Geneva, South Centre, 2020). Available from https://www.southcentre.int/research-paper-111-may-2020/.

[52] See https://www.oecd.org/tax/beps/oecd-invites-public-input-on-the-implementation-framework-of-the-global-minimum-tax.htm.

disproportionately allocate profits to intangible property, which in practical terms would benefit the developed countries where a large portion of intangible assets are generated.

The explicit recognition of demand as a basis of profit allocation[53] would then mark what has been called a "paradigm shift in the global income allocation system".[54] This would then be positive for developing countries which are net importers of final goods and services. Under this understanding, even when the formula only incorporates sales and not assets and employees, this would not be a major loss as supply-side factors would already be covered to some extent under existing transfer pricing rules.

The Pillar One consensus also reflects this, with income allocation through the revenue sourcing rules[55] solely on the basis of sales, and this approach has been used in Article 12B as well.

However, the fact remains that developing countries in many cases heavily rely on agriculture, and produce primary and intermediate goods and services. Their participation in the production of such goods is not recognized under revenue sourcing rules based on sales. A more comprehensive allocation formula which includes assets and employees/labour, will be more beneficial for developing countries.

Implications for developing countries of adopting Article 12B

Pros

Potentially increased revenue collection: Developing countries may be able to collect higher revenues under Article 12B as compared to Pillar One. Developing countries are also likely to gain higher revenues with the gross basis method, which is identical to the digital service taxes, even with an extremely low rate.

Table 2 shows how much revenue can be gained, for instance, by Kenya through the application of either methods, as applied to the real-life example of Alphabet, Google's parent company. The estimation makes three assumptions: (1) Kenya and the US have a tax treaty with Article 12B included (2) a 3% withholding rate under Article 12B's gross basis method and (3) 1.6% of Alphabet's global revenues being derived from Kenya.

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53 South Centre, "Statement by the South Centre on the Two pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy", Statement to the OECD, July 2021. Available from https://www.southcentre.int/statement-july-2021/.

54 Richard S Collier, Michael P Devereux, "On why it really is such a big deal", Oxford University Centre for Business Taxation, July 2021. Available from https://oxfordtax.sbs.ox.ac.uk/article/on-why-it-really-is-such-a-big-deal.

55 See https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-nexus-revenue-sourcing.pdf.

Table 2: Application of OECD and UN Tax Solutions to Google in Kenya

Alphabet				
	%	**Pillar One (Amount A)**	**Article 12B Gross Basis Method**	**Article 12B Net Basis Method**
		(million USD)		
MNE Global Revenues for 2020		182,527	182,527	182,527
Profit Before Tax (PBT)		40,269		
PBT Margin (%) (PBT/Global Revenues)	22			
Residual profit [PBT – (Revenues * 10%)]		22,016.3		
Quantum of Amount A (25% of Residual Profit)		5,504		
<u>Kenya</u>				
Local revenues % (hypothetical)	1.6			
Local revenues (Local revenue % * Global Turnover)			2,920.4	2,920.4
Amount A allocated to Kenya (Local revenues % * Quantum of Amount A)		88		
Hypothetical withholding rate under Article 12B gross basis method	3			
Net Profit under Article 12B Net basis method [30% * (PBT Margin * Local revenues)]				192.7
Statutory corporate income tax rate	28			
Final tax liability		24.6	87.6	53.9

Source: Alphabet Revenues (https://abc.xyz/investor/static/pdf/2021Q4_alphabet_earnings_release.pdf)

Thus, it can be seen that Article 12B's net basis method provides more than *double* the revenues as compared to Pillar One. Similarly, even with a minimal rate of 3%, which is commonly used by countries applying DSTs, the gross basis method provides more than *triple* the revenues from Pillar One. From a purely revenue standpoint, the choice is clearly in favor of Article 12B.

However, the scope of Article 12B is more limited than Pillar One, as it applies only to Automated Digital Services (ADS). Hence, if the individual taxpayer specializes in ADS, 12B may possibly yield more revenue. Though it remains to be seen whether at a macro level, such as at the national level, it will generate substantially higher revenues than Pillar One.

Easier to implement: Article 12B is easier to implement at the domestic level. As it is an update to the UN Model Tax Convention, this basically requires a bilateral negotiation between the source and residence countries involved. There is no complex multilateral ratification process involved as is the case with Pillar One or for the Subject to Tax Rule under Pillar Two. While this does entail more effort as treaties have to be individually renegotiated, and then ratified, the country retains freedom of choice and can cherry-pick its efforts instead of getting locked into the Pillar One framework.

At the domestic level, both the gross and net basis method are far easier to implement than the immensely complex methodology involved in Pillar One. Both only require information on locally derived revenue, which can be obtained from financial institutions, and in case of the net basis method the profitability ratio can be easily obtained from financial accounts especially in the case of larger taxpayers such as the FAANGs. A withholding tax has been recommended in the Commentary on Article 12B as a practical way of enforcing the tax.

Builds on existing international tax system: Article 12B is ultimately an update to a bilateral tax treaty, which is in line with the current system of international tax which is decentralized and State-centric. Countries choose what tax policies they want to include in their tax treaties through bilateral negotiations and there is no one size fits all solution. International tax standards such as Model Conventions act only as guidelines. This has enabled considerable innovation, decentralization and flexibility such as Article 12A on Fees for Technical Services, which was adopted in several treaties before being included into the UN MTC.

More importantly, developing countries are familiar with this system.[56] What Pillar One by contrast seeks is a complex overhaul from the existing paradigm. This is unfamiliar territory for the world as a whole and developing countries will likely find it much harder to adapt.

Respects State sovereignty: As noted, Pillar One implies giving up unilateral measures on all companies, not just those in scope. This is utterly unjustified and puts unacceptable restrictions on State sovereignty by eroding fiscal policy and regulatory space even further. Pillar One seeks to also straightjacket countries into a rigid and complex to implement solution and enforce compliance through a mandatory and binding arbitration system. Article 12B does not have any of these complications and firmly respects State sovereignty in tax matters.[57]

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[56] Rajat Bansal, "Article 12B-A Tax Treaty Solution by the UN Tax Committee for Taxing Digital Incomes", Tax Cooperation Policy Brief N°16 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-16-july-2021/.

[57] Kuldeep Shama, "The Tax Sovereignty principle and Its Peaceful Coexistence with Article 12B of the UN Model Tax Convention", Tax Cooperation Policy Brief N°14 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-14-june-2021/.

Cons

Low political acceptance: Since the Two Pillar solution has been politically agreed to by 137 IF jurisdictions and endorsed by the G20's Finance Ministers and subsequently Heads of State, there is powerful political support for its implementation. Article 12B by contrast has been negotiated by a group of experts acting in their individual capacity. It lacks the political support which the Two Pillar solution has.

However, this is a con only for a subset of developing countries, namely: (1) IF jurisdictions which agreed to the October Statement and (2) developing country members of the G20. This is because these countries politically agreed to implement Pillar One and turning around on this may be a little difficult. However, this would not be unusual in the world of politics, where drastic changes in political commitments are expected, in light of conditional endorsement of many developing countries given the outstanding concerns expressed about the final deal and that no legal commitments have been made as yet. It would be eminently justifiable if Inclusive Framework members contravene the October Statement and proceed with alternative solutions. They are not legally obligated to abide by the Statement and are primarily accountable to the citizens of their countries.

Further, there is opacity about the revenue implications of the Two Pillar deal. There are no country-level estimates publicly released by the OECD. IF Members cannot be expected to sign a 'blank cheque', that too at a critical juncture when many countries are facing potential debt distress and a global recession is expected by early 2023.[58]

Aside from these two categories, there is no such political barrier to the adoption of Article 12B vis-à-vis Pillar One.

Difficulty of updating bilateral treaties through negotiations: A common critique of Article 12B that is made is why a residence country where the digitalized company is based would give up its taxing right in favor of the source country. It is argued that bilateral negotiations are unlikely to succeed. Further, the residence country, which in most cases would be a developed country, would likely push the source country towards Pillar One as a solution.

While this is a legitimate criticism, it must be pointed out that this is a general critique of any distribution of taxing rights in favor of developing countries during a treaty negotiation. There is nothing particularly unique about the case of Article 12B, with the exception that there is a major, OECD-promoted alternative.

Notwithstanding it is true that the negotiation of the multilateral convention in relation to Pillar One is undergoing, while the bilateral negotiations for the introduction of Article 12B may take years, and may result in various different outcomes, as one country may succeed in introducing Article 12B with one treaty partner and may not succeed with the next treaty partner.

Accordingly, the same reasons that apply to any allocation of taxing rights during a treaty negotiation will apply in this case: the failure to negotiate a treaty would mean that if the source country initiates unilateral measures, there would be no elimination of double

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58 See https://www.cnbc.com/2022/06/09/recession-will-hit-in-first-half-2023-the-dow-is-headed-lower-cfos.html.

taxation for the taxpayer. They would be deprived of all the standard benefits that come from a tax treaty: certainty, elimination of double taxation through the credit or exemption method, dispute resolution through MAP, non-discrimination, etc.[59]

However, in the case of an existing treaty, the failure to introduce Article 12B will result in a limitation of treaty rights for the source country; i.e. even if it does introduce unilateral measures, it will not be able to apply them in cases where it has a treaty in place.

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[59] Rajat Bansal, "Are alternatives available? Exploring the UN solution on Automated Digital Services", South Centre, 2021. Available from https://taxinitiative.southcentre.int/wp-content/uploads/2021/05/South-Centre-Event-on-UN-approach-15th-JUne-2021-Rajat-Bansal.pdf.

V. Conclusion – A Global South Response to the Two Pillar Solution

Thus, given the pros and cons of each approach, what can be a way forward for the global South? The key elements of the response are provided below.

Revenue Impact Assessment

Developing countries face a moment of truth in 2022; one that will affect their revenues for possibly decades to come. This is the choice of whether to accede or not to the Two Pillar solution.

At a minimum, the choice of accession should be preceded by an assessment of the revenue impacts from Pillars One and Two separately.

For Pillar One, there must be a clear and comprehensive cost-benefit analysis which looks at the revenue gains from Amount A contrasted with the full range of alternative policy options, in particular Article 12B of the UN Model Tax Convention and unilateral measures like Digital Service Taxes (DSTs). A list of unilateral measures and their functioning is contained in South Centre Research Paper 111.[60] The final decision must take into account revenue gains and also administrative ease, i.e. the solution must be practical to implement.

The same exercise can be carried out for Pillar Two. As mentioned, the sole benefit for developing countries in this Pillar is the Subject to Tax rule. However, this will only benefit developing countries which (a) have a wide tax treaty network and (b) have withholding rates on the covered taxes lower than 9%. The impact assessment must examine whether there are clear benefits accruing and if not whether other options such as Alternative Minimum Taxes can be more beneficial.

The impact assessment must also be shared publicly, especially with Members of Parliament and legislators. Their approval will be required in case the country decides in favor of either or both Pillars and they must be able to take an informed decision in this regard.

Sign Pillar One only after ratification by US and OECD countries

Pillar One will work only if the developed countries agree to give up their taxing rights and redistribute revenues to developing countries. If they do not, there will be no revenues to redistribute. Thus, developing countries which are considering signing must wait until each and every one of the OECD countries, especially the United States, ratifies the Pillar One Multilateral Convention. As mentioned earlier, the US' ratification is critical to the success of Pillar One as more than half the revenues are expected to come from US based MNEs. However, developing countries should wait until all the

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[60] Veronica Grondona, Abdul Muheet Chowdhary, Daniel Uribe, "National Measures on Taxing the Digital Economy", Research Paper 111 (Geneva, South Centre, 2020). Available from https://www.southcentre.int/research-paper-111-may-2020/.

OECD countries ratify, because more ratifications equals more revenue to redistribute; the converse is also true. Only then should they begin to consider whether or not to sign, as the gains will be real instead of hypothetical. In any case, developing countries should beware the worst-case scenario where only they ratify the Pillar One MLC and the developed countries do not.

Comprehensive review of Two Pillar solution

However, even if some countries decide not to implement the Two Pillar solution, the political likelihood that it will proceed amongst the largest economies in the world is quite high. It is a reality that now cannot be wished away. Thus, a pragmatic approach would be to call for a comprehensive review of the solution such that the most harmful aspects are reformed.

At present, the review of Pillar One will take place only seven years after the agreement comes into force and the only aspect to be revisited is the scope, i.e. the threshold of EUR 20 billion and profitability above 10%. This is insufficient and other aspects need to be reviewed, in particular the quantum of Amount A which is what will be redistributed to market jurisdictions.

Pillar Two has no review mechanism whatsoever. This too needs to change and it must have a provision for periodic review for questions such as rate and rule order.

It is unusual in the field of law that a law is regarded as "final". Virtually every law, whether domestic or international, has some mechanism of amendment. It is indeed strange and unacceptable that this does not apply to the Two Pillar solution which is about taxation, one of the most important functions of the State and in need of periodic review.

It is likely that OECD countries will exert political pressure on those countries which decide not to join the Two Pillar solution. This will especially be the case for IF Members, but even non-IF Members could be under pressure to join the IF and sign up. ATAF has publicly stated[61] that such political pressures should not be applied on African countries which should be able to take independent decisions.

Thus, from the outset, *countries which decide against the Two Pillar solution can make clear that they will consider joining only on the condition that the agreement has a mechanism for comprehensive review*. In the case of Pillar One, this would mean that *the Multilateral Convention must have a clause that will enable amendments to any part of the Convention*, as is usually the case in international law, for example in Articles 31 and 33 of the BEPS MLI (Multilateral Instrument).[62] [63]

Pillar Two is enforced only through the STTR and Model Rules, and *there must be scope for periodic updation of these* as well, similar to the way the UN Model Tax Convention

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[61] ATAF, "A new era of international taxation rules – what does this mean for Africa?", ATAF Communication, October 2021. Available from https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa.

[62] Radhakishan Rawal, "Conceptualizing a UN Multilateral Instrument", Tax Cooperation Policy Brief N°15 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-15-june-2021/.

[63] See https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

is updated. While the developed countries will push for the Inclusive Framework to be the forum where these periodic updates take place, it would be in the interest of developing countries to move this discussion to the United Nations.

Even countries which decide in principle to join the Two Pillar solution can consider this approach of conditional acceptance. Even large G20 economies have been unhappy with many aspects of the Two Pillar solution, as expressed through G-24 Statements, and would like to see it improved with time.

The threat of "walking away" can and should be used as leverage. The reality is that for once, developing countries do have some advantages. Though the developed countries are large markets, the developing countries too are emerging as market jurisdictions that cannot be ignored by the MNEs of the global North. They have a substantial share of consumers and are the ones who can take unilateral measures. They are also the ones who are being induced to give up their taxing rights. Normally, in international economic negotiations the concessions of giving up rights have to be made by developed countries which is rarely done. Thus, developing countries can and should press this unique advantage to the maximum.

Further, the OECD process is in need of legitimacy and is under more scrutiny than hitherto from wider publics, including in the global North. Though the deal reflects some shift in principles, i.e. recognition of markets as a basis for allocating taxing rights, these are minimal. The need for ensuring a just deal is more compelling given the need for increased Domestic Resource Mobilization (DRM) universally in light of the post pandemic recovery and the stark contrast with the exponential growth of profits of large digital MNEs.

Unilateral measures on companies out of scope of Pillar One

The push by developed countries for ending unilateral digital tax measures on *all* out-of-scope companies is unjustifiable and must be removed. There must be no such restriction. There is simply no rationale as to why a developing country must give up this precious sovereign right. It only reinforces the view that Pillar One has been designed to protect US tech companies from taxation in foreign jurisdictions.

Developing countries can and should consider making their accession to Pillar One conditional on retaining the right of unilateral measures. In other words, to only join Pillar One if unilateral measures are allowed on all out-of-scope companies. This will provide them with much needed revenues and to see for themselves which is the better solution for taxing the digitalized economy.

Broaden scope to include financial services

The extractives exclusion from the scope of Pillar One is based on a legitimate demand from developing countries. This must continue to be retained, and it must be clearly specified that agricultural activities are out of scope as well.

However, there is no clear reason as to why regulated financial services are out of scope. This is certainly not based on a demand from developing countries. The financial sector in past decades has ballooned exponentially and is today many times the size of the real economy. The derivatives market alone is valued at hundreds of trillions of dollars, with the Over the Counter (OTC) derivatives market in 2020 valued at close to USD 600 trillion, almost seven times global nominal GDP.[64] It too, like the tech sector, must pay its fair share of taxes. The scope of Pillar One must be broadened during the review and include financial services as well.

Assessment of trading relations with the United States

To date, the only country which has threatened other countries for applying national or unilateral digital tax measures is the United States. It has threatened to impose trade sanctions through the Special 301 mechanism. These are unilateral coercive measures which have been condemned by the targeted countries.[65] The US then went on to initiate procedures to apply such sanctions but put them on hold[66] till the negotiations came to an end, dangling a proverbial sword on the heads of targeted countries. These sanctions, if applied, would affect those countries' exports to the US.

However, the growing reality is that for many countries, especially from the global South, it is increasingly China rather than the US which is their largest trading partner. From this perspective, it would be helpful for countries to factor in the hard numbers of their trade relations on the United States to see whether the threat would be truly substantial.

Assessment of debt and Official Development Assistance (ODA) dependencies with the OECD countries

While the other OECD countries have not taken the measures the US has, there is the possibility that conditionalities be imposed in relation to loans and ODA to induce acceptance of either one or both Pillars. In the past, the EU indirectly enforced OECD rules on its aid recipients.[67] [68]

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[64] See https://stats.bis.org/statx/srs/table/d5.1.

[65] See, e.g. South Centre Statement, "South Centre Calls For Stop To Unilateral US Pressure Against South's Use Of Trips Flexibilities", 10 October 2014. Available from https://www.southcentre.int/question/south-centre-calls-for-stop-to-unilateral-us-pressure-against-souths-use-of-trips-flexibilities/.

[66] Andrea Shalal, "U.S. suspends French tariffs over digital services tax", *Reuters*, January 2021. Available from https://www.reuters.com/article/us-usa-trade-france-idUSKBN29C2KQ.

[67] Martin Hearson, Joy W Ndubai, Tovony Randriamanalina, "The Appropriateness of International Tax Norms To Developing Country Contexts", FACTI Background Paper 3, July 2020. Available from https://assets-global.website-files.com/5e0bd9edab846816e263d633/5f15ce8eb2cdd17906f5da17_FACTI%20BP4%20Appropriateness%20of%20tax%20norms.pdf. Pages 21 and 22.

[68] C Melville, "Comments on the FACTI Panel Interim Report on Financial Accountability, Transparency and Integrity", November 2020. Available from https://uploads-ssl.webflow.com/5e0bd9edab846816e263d633/5fac658cbaf76a8b8bb6d6e2_Comments%20on%20the%20FACTI%20Report%209November2020.pdf. Pages 9-10.

ODA flows are and must be seen as complements and not substitutes for tax revenues. Countries should not have to choose between the two. However, if they begin to affect national sovereignty on a fundamental aspect such as revenue collection, then developing countries must carefully assess strategies to avoid giving up their taxing rights on a significant segment of the economy which may only grow in the future. A careful cost-benefit analysis could be extremely useful. Having revenue assessments that provide data on revenue gains from Pillar One, Article 12B and possible unilateral measures will enable a comparison of the difficult trade-offs involved in the short-term and long-term.

Given the power imbalance and range of levers at the disposal of developed countries to push developing countries into accepting deals disadvantageous to them, it is in the interest of the G77+China and its regional blocs to strengthen existing mechanisms to negotiate a common position and respond collectively to the deal like in the World Trade Organization (WTO) and other forums.

National measures based on Article 12B

Countries which are dissatisfied with Pillar One can consider the next best alternative – Article 12B. The offer can be made to developed countries to include this in the bilateral tax treaty. If they refuse, then the country can simply introduce this into its domestic law, as has been done with the Digital Service Taxes. Either the gross or net basis approach can be used. However, the net basis method may be better for some developing countries. This is because a key critique of the US has been that the DSTs are on revenues rather than profits, which according to them is out of line with international standards. This statement is patently untrue, as many items of income such as dividends, royalties, interest, fees for technical services, etc are taxed on a gross basis for the same reasons as it has been for digital services: the unavailability of a permanent establishment. This is based on international standards such as the UN Model Tax Convention.

Other national measures

The advantage of undertaking national measures based on Article 12B is that it would be in line with international standards laid down by the United Nations. However, countries have full sovereignty over taxation and can introduce any measure they see fit. Civil society organizations such as the Tax Justice Network, ICRICT and Public Services International have advocated for options such as excess profits taxes[69] and formulary apportionment through unitary taxation.[70] These can also be considered.

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[69] Marc Bou Mansour, “Losses to OECD tax havens could vaccinate global population three times over, study reveals”, *Tax Justice Network*, November 2021. Available from https://taxjustice.net/2021/11/16/losses-to-oecd-tax-havens-could-vaccinate-global-population-three-times-over-study-reveals/.

[70] See https://publicservices.international/resources/news/psi-proposes-a-new-approach-for-taxing-multinationals?id=10363&lang=en.

Strengthening the role of the G24 and G77+China and relations between tax negotiators and policymakers

As evident throughout the OECD negotiation, the outcomes are ultimately determined by political considerations based on geopolitical interests. The OECD Secretariat reports politically to OECD members, including the biggest economies that are additionally able to forge political consensus in the exclusive forums of the G7 and G20. It is also reported by developing country negotiators that OECD Secretariat consultations with them are often fragmented, informal, rushed and not transparent, giving no space for internal or consultations with other developing countries. Attempts by developing countries to coordinate positions similarly to G7/ G20 and negotiate collectively in the BEPS process have been limited and need to be increased.

The link between many political leaders and policy makers with tax officials from the global South in the IF process can and should be further strengthened. This is vital so that policymakers are fully informed of what is at stake so as to be able to guide and back their delegates.

The developing countries lack a political forum equivalent to the G7 or G20. The G77+China does not play this role in relation to tax negotiations. In recent years the G24 has begun filling this gap, which is most welcome. However, its fledgling role requires support and its links with the G77+China need to be enhanced, so the developing countries too have such a forum.

It is important for global South governments to ensure negotiating teams include tax administrators, finance policy makers and foreign affairs representation throughout the process, and to establish coordination and reporting mechanisms for developing countries' regional blocs and the G77+China as a whole.

Shifting the negotiation venue to the UN

The present system of international tax rule making has become simply too complex, with the OECD IF, the Global Forum on Transparency and Exchange of Information, the OECD's Committee of Fiscal Affairs and the UN Tax Committee. Each of these produces different international tax standards, has differing compositions, rules and procedures. However, the Secretariat for all these bodies except the UN Tax Committee is the OECD Secretariat. Thus, the OECD Members exercise significant influence over the standards produced out of these bodies. The UN Tax Committee's Secretariat as of 2022 has several ex-OECD officials, which has the practical implications of OECD standards continuously being promoted into the UN.

Thus, as stressed above, for the sake of harmonizing the international tax rule-making system, and to bring all countries on the same table, on a genuinely equal footing, and served by a truly neutral Secretariat, it is essential that the longstanding G77 demand for a UN intergovernmental tax body be implemented. This has also been recommended by the FACTI Panel, and a recent proposal by the South Centre calls for a UN Framework

Convention on Tax Cooperation[71] as a way to bring this plethora of institutions under unified and democratic control.

[71] Abdul Muheet Chowdhary, Sol Picciotto, "Streamlining the Architecture of International Tax through a UN Framework Convention on Tax Cooperation", Tax Cooperation Policy Brief N°21 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/tax-cooperation-policy-brief-21-november-2021/.

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