SOUTH CENTRE

Statement by the South Centre on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy

The South Centre takes note of the Outcome Statement by 138 member jurisdictions of the OECD/G20 Inclusive Framework (IF) made on 11 July 2023, on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. In this statement the South Centre highlights the inclusion of rules that have the practical effect of reducing the tax payable to developing countries under Amount A, the limitations of Pillar Two and other key aspects of the OECD proposed rules that require attention by developing countries before they decide to be tied up by such rules.

Part I – Multilateral Convention on Amount A of Pillar One

The IF Outcome Statement indicates that the Multilateral Convention (MLC) on Amount A of Pillar One is near completion, subject to a "small number of specific items". Of these, the foremost is the adjustment of withholding taxes into Amount A. There remains no rationale why such an adjustment must take place, because Amount A is a new taxing right to be paid over and above existing taxes, while withholding taxes are an exercise of existing taxing rights. The practical implication of this is that Amount A would mean an erosion, rather than increase, of taxing rights of developing countries. This would render the entire Amount A negotiation meaningless because it was supposed to result in an increase in taxing rights of developing countries.

This specific instance is part of a larger phenomenon that has taken place since the October 2021 Outcome Statement: the continuous inclusion of rules that have the practical effect of reducing the tax payable to developing countries under Amount A. There are a large number of such rules, as have been highlighted by the South Centre in its submissions to the public consultations of the Two Pillar solution.[1] These include making averaging mechanism a permanent feature, trying to apply averaging to revenues, the introduction of a prior period test, pre-implementation loss carry-forward, the expansion of excluded entities, the multiple reapplications of the scope thresholds for extractives and regulated financial services, and so on.

All of these have the practical effects of reducing the number of companies in-scope, and the tax these companies will pay. These also undermine the agreement of the October 2021 Statement by substantially altering what was agreed upon.

Revenue estimates by various organisations all indicate that Amount A will yield a small amount of revenue. The South Centre and the Coalition for Dialogue on Africa (CODA)

[1] https://taxinitiative.southcentre.int/publications-submissions/

did the world's first country level revenue estimates for the 84 combined Member States of the African Union and the South Centre, which are all developing countries.

The 2020 results showed that these 84 countries will obtain approximately $5 billion from Amount A with an EUR 20 billion threshold and more than twice, approximately $12 billion, from the United Nations' alternative of Article 12B.

However, since 2020 the Amount A rules have changed significantly. As mentioned, the trajectory has been to reduce the number of in-scope companies as well as the tax they would pay. It is highly likely that the final version of Amount A, as embodied in the MLC, will generate an even smaller amount of revenue for developing countries compared to the 2020 estimate.

It is therefore of utmost importance that each country conduct revenue estimates of Amount A contrasted with alternative policy measures such as Article 12B, digital services taxes and Significant Economic Presence (SEP) to determine which is the most appropriate policy solution.

The South Centre will work with like minded organizations to produce a revised set of country level revenue estimates for the final version of Amount A contrasted with Article 12B. These will be, at minimum, for all 55 South Centre Member States, to inform their decision-making.

It is strongly advised to all developing countries considering signing Amount A to wait for the OECD countries, especially the USA, to sign and ratify their own solution. Amount A is a redistribution of taxing rights, and there can be no tax to collect until the developed countries where the in-scope companies are headquartered agree to redistribute their taxing rights. A developing country which ratifies Amount A before developed countries do will only end up losing its taxing rights and gaining nothing in exchange.

Developing countries considering signing Amount A must also carefully scrutinize the amendment provisions in the MLC. If the legal procedure to change Amount A is complex and difficult, or if only certain portions can be amended while others are considered unchangeable, then it risks becoming outdated and unable to adapt to changing circumstances. A developing country entering this agreement risks being trapped in a Convention which may soon become outdated and prevents it from collecting much-needed revenues from the digital economy.

As noted in the Outcome Statement, the standstill agreement on introducing national measures such as digital services taxes is conditional upon at least 30 jurisdictions accounting for at least 60% of the Ultimate Parent Entities (UPEs) of in-scope MNEs signing the MLC before the end of 2023.

In practical terms, this means the USA must sign the MLC. As noted in the South Centre-CODA revenue estimates, the USA accounts for 37 of 76 in-scope MNEs, or 48%, for 2020. Revised estimates for 2023 show this number to be virtually unchanged at 46%. Thus, even if the rest of the countries accounting for in-scope MNEs sign the Amount A MLC, without the USA it cannot go forward.

It appears most unlikely that this will happen. The US government has never once clearly said it will sign the Amount A MLC, and recently the House of Representatives' Appropriations Committee voted to defund the OECD itself for "trying to tax American businesses". This is regrettable given that almost every single demand made by the USA has been incorporated into the Amount A rules and even then there is opposition to the minuscule tax to be paid as a result. It must be highlighted that the in-scope companies are not even paying taxes to the developed countries who are defending them, with Amazon paying zero in taxes to Europe and USA in multiple years despite making billions in sales revenues.

Developing countries, and even developed countries like Canada, will likely seek to proceed with unilateral or national digital tax measures beyond December 2023. Any unilateral coercive measures against them, such as the USA's threat of Section 301 trade sanctions, must be strongly and unambiguously condemned and opposed as violations of international law.

The South Centre will work closely with its Member States who have already introduced digital taxes – like Nigeria, Tanzania, Uganda, Colombia, India and Pakistan – to firmly defend their interests and sovereign right to implement tax policies as seen fit. It will also work with its other Member States who are considering initiating such taxes, such as Sri Lanka, and support them in this process. The South Centre will also work closely with international organizations such as the G-24, Coalition for Dialogue on Africa (CODA), African Tax Administration Forum (ATAF) and the West African Tax Administration Forum (WATAF) to further the common interests of developing countries and promote South solidarity to overcome pressure from the Global North.

There have been disturbing reports of the IMF arm-twisting Sri Lanka to drop its plans for a Digital Services Tax. It is condemnable that a developing country in the middle of a debt crisis which is trying to raise revenue to overcome its crisis is being pressured by the very organization which is giving it loans; effectively ensuring it will always remain in a debt trap. Other developing countries in debt distress must be wary of similar IMF pressure being applied on them. The South Centre stands ready to support its Member States in need.

Subject to Tax Rule under Pillar Two

It is welcome that the Subject to Tax Rule (STTR), an initiative of developing countries, has a scope that includes all services. This is likely the result of a far superior version of the STTR being approved in the United Nations and being included in the UN Model Tax Convention. The OECD version of the STTR has scope restrictions, rate restrictions of 9% and various conditionalities such as mark-up and materiality thresholds. The UN version by contrast has no scope restrictions, no rate restrictions, is applicable solely by source (developing) countries and has no conditionalities that restrict its application.

Global Anti Base Erosion (GloBE) Rules and Qualified Domestic Minimum Top Up Tax (QDMTT)

The Global Anti Base Erosion (GLoBE) Rules and the QDMTT under Pillar Two are also likely to be irrelevant for most developing countries. They are misleadingly and incorrectly called "minimum taxes" by the OECD. The reality is that even with these taxes implemented, an MNE can still do tax avoidance and pay zero taxes to the developing country where these rules are implemented. The GLoBE and QDMTT tax base is a modification to financial accounting net income, in other words declared profit. If profits are shifted out through tax avoidance techniques such as excessive interest or royalty payments, then there will be no tax to collect under the GLoBE and QDMTT rules. 15% of a tax base which is zero will result in zero tax collection. Developing countries considering introducing these rules should be fully aware that these rules are not a minimum tax as advertised and are still fully vulnerable to Base Erosion and Profit Shifting (BEPS) risks.

A far more appropriate alternative to QDMTT are Alternative Minimum Taxes (AMT), especially those based on turnover. They are easy to implement and guarantee tax collection, unlike QDMTT.

It is likely the QDMTT was introduced into the GLoBE rules to prevent developing countries from introducing AMTs, which would have meant that the large MNEs of the Global North would have to actually pay taxes to developing countries. There is a similarity between Amount A, whose key objective is to stop Digital Services Taxes (DST), and QDMTT, whose key objective is to stop AMT. Both rules of the OECD are highly complex to implement and hold minimal revenue potential for developing countries compared to the alternatives of DSTs and AMTs, which have significantly higher revenue potential.

Implementation Support

The South Centre stands ready to support its Member States in policy advisory for digital tax and minimum tax measures appropriate for developing countries.

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