

**South Centre Inputs on Workstream II - Taxation of Services: Co-Lead's Draft
Options Paper (21 Jan 2026)**

February 2026

I. Background

The [South Centre](#) is the intergovernmental organization of developing countries that helps developing countries to combine their efforts and expertise to promote their common interests in the international arena. The South Centre has [55 Member States](#) coming from the three developing country regions of Africa, Asia, and Latin America and the Caribbean. It was established by an [Intergovernmental Agreement](#) which came into force on 31 July 1995. Its headquarters are in Geneva, Switzerland.

The South Centre in 2016 launched the [South Centre Tax Initiative](#) (SCTI). This is the organization's flagship project for promoting South-South cooperation among developing countries in international tax matters.¹

II. Abstract

The South Centre welcomes the [Co-Lead's Draft Options Paper \(21 Jan 2026\)](#) and submits inputs in support of Workstream II on the taxation of income derived from cross-border services. Drawing from our research and country-level evidence for our Member States, the South Centre notes that existing treaty restrictions significantly constrain source taxation of services and have resulted in substantial revenue losses for developing countries.

The protocol for taxing cross-border services can provide a much-needed solution to update existing tax treaties and can be drafted in the following manner:

- 1) Scope:
 - a. Taxes Covered: Only income taxes and their functional equivalents. VAT and other indirect taxes to be excluded.
 - b. Services Covered: All cross-border services, especially including automated digital services. No exclusions should be allowed.

¹ Queries may be addressed to taxcooperation@southcentre.int

- 2) Nexus: Should be done on the basis of “Significant Economic Presence” laws as used by various developing countries including South Centre Member States India, Nigeria and Colombia. Revenue and user thresholds can be used to trigger nexus regardless of physical presence.
- 3) Differentiation of Services: Services can be grouped into the following three functional categories:
 - a. Automated Digital Services
 - b. Remotely delivered traditional services
 - c. Services requiring physical presence
- 4) Method of Taxation: The protocol should include a menu of options which can be applied in combination, including:
 - a. Gross Basis
 - b. Net Basis:
 - i. Deemed Profit Methods
 - ii. Fractional apportionment
 - iii. Formulary apportionment
- 5) Implementation: This can be via the UN Fast Track Instrument completed by the UN Tax Committee.

III. General Comments

The South Centre commends the Co-lead, secretariat, and Intergovernmental Negotiating Committee (INC) for the progress under WS II and for the preparation of the [Co-Lead's Draft Options Paper \(21 Jan 2026\)](#). The paper articulates key considerations concerning scope, nexus, method of taxation, and implementation, and provides a constructive basis for advancing negotiations on the Protocol.

Discussions at the Fourth Session highlighted the inadequacy of existing international tax rules on taxation of cross-border services. For many South Centre Member States and other developing countries, existing treaty provisions continue to constrain effective source taxation of services. Workstream II presents an opportunity to address these inadequacies and asymmetries in a balanced and coherent manner.

IV. Specific Comments

This section first presents relevant research by the South Centre on the subject matter and then makes specific comments on the scope, nexus, differentiation of services, method of taxation, and implementation:

A. South Centre Research on Taxation of Services

The South Centre has conducted extensive research on taxation of services and the impact of tax treaty restrictions on services on its 55 Members States who are all developing countries. It is evident that treaty restrictions limit taxation of services at source. A 2024 study on [The Implications of Treaty Restrictions of Taxing Rights on Services, Especially for Developing Countries](#) indicate significant cumulative revenue losses between 2005–2021 of approximately USD 6.1 billion for Argentina, USD 11 billion for Brazil, USD 894 million for Colombia, USD 1.1 billion for Kenya, and USD 5.8 billion for Nigeria due to treaty limitations on taxing cross-border services.

The imposition of withholding taxes is necessary to protect source taxing rights and is also likely to reduce base-eroding payments. Contrary to the claims advanced in the ICC study², withholding taxes do not necessarily lead to an overall reduction in cross-border trade. The IMF study by Liu et al³. does not find an aggregate decline in total service imports but rather, it indicates effects concentrated in payments that are particularly susceptible to profit shifting. Moreover, the ICC analysis does not cover most developing countries and overlooks the positive impact of additional tax revenues on GDP and development outcomes.

A study on Digital Services Taxes (DST) and Amount A, titled, [A Toss Up? Comparing Tax Revenues from the Amount A and Digital Service Tax Regimes for Developing Countries](#), estimates the country level revenues for the 85 combined member states of South Centre, African Union, African Tax Administration Forum (ATAF), and West African Tax Administration Forum (WATAF), under DSTs and Amount A of OECD's Pillar 1. The study indicates that DSTs can provide on average three times higher revenues than Amount A for South Centre and African Union Member States. This is attributable to Amount A's high thresholds and restrictive design features. Recent statements by US

² ICC & OXFORD ECONOMICS, ECONOMIC IMPACT OF ARTICLE 12AA: NEW UN TAX MODEL PROVISION ON CROSS-BORDER SERVICES - ICC - INTERNATIONAL CHAMBER OF COMMERCE (2026), <https://iccwbo.org/news-publications/report/economic-impact-of-article-12aa-new-un-tax-model-provision-on-cross-border-services/>.

³ LI LIU, ALEXANDER KLEMM & PARIJAT LAL, SHAPING SERVICES TRADE: THE HETEROGENOUS EFFECTS OF WITHHOLDING TAXES (2025). <https://www.imf.org/en/publications/wp/issues/2025/10/24/shaping-services-trade-the-heterogenous-effects-of-withholding-taxes-571345>

officials that Amount A is “dead” are further evidence that the OECD-led regime is incapable of producing effective results for developing countries and that the UN protocol on services must be designed to work on the basis of a “coalition of the willing”. It is also regrettable that developing countries lost out on 15 years’ worth of tax revenues from the digital economy by putting their national measures on pause and waiting for a solution from the OECD-led regime.

A research paper on [Analysis of Imbalanced Tax Treaties of Developing Countries: Insights from Tax Treaties Explorer Database](#), jointly produced by the South Centre and Geneva Graduate Institute, identifies restrictive and imbalanced tax treaties between the South Centre’s Member States and OECD Members. It also examines the specific provisions that make these treaties imbalanced, particularly those relating to permanent establishment and withholding taxes, thereby demonstrating how treaties constrain revenue mobilization by South Centre Member States.

A 2025 study, [The Taxation of the Digital Economy in Practice: Digital Services Taxes and Other Measures](#), drawing from case studies of South Centre Members Colombia, India, Nigeria and Tanzania, as well as two non-Members Kenya and Nepal, and documents how these developing countries administer DSTs and Significant Economic Presence (SEP) taxes. The study indicates significant revenue mobilization from DSTs and SEPs. Drawing on these country experiences, it proposes important elements when designing taxes on digital services including for the protocol, which cover the scope, sourcing rules, taxation options, elimination of double taxation, and cooperation between states on administrative matters.

B. Comments on design elements

Below are the specific comments the design elements in the options paper. These elements are also outlined in our research.

1. Scope

The Protocol should have a broad scope covering income derived from all cross-border services including digital services and automated digital services. It should cover income taxes and taxes with the same economic effect while excluding indirect taxes like VAT and sales taxes.

It should not introduce exclusions as this would undermine the objective of fair allocation of taxing rights and perpetuate existing treaty imbalances. It could also lead to aggressive lobbying to exclude important services.

2. Nexus

Nexus discussions may proceed concurrently with those on the scope, as both are closely linked.

Physical presence should not be the sole basis for taxation. As highlighted by several delegations from developing countries, including Kenya and others, modern business models allow sustained economic participation in a market without physical presence. Thus, the nexus rules should allow for taxing rights to be established without physical presence, and give due justice to source countries from where the income arises. This can draw on the experiences of South Centre Members India, Nigeria and Colombia, who use revenue thresholds and digital presence indicators such as user interaction, user data, local domain name, or local payment option to trigger nexus under their Significant Economic Presence Laws.

The protocol can thus provide consistent revenue or user thresholds to trigger nexus regardless of physical presence, taking into account economies of different countries. Lower thresholds can be set for poorer countries.

The term “value creation” should be approached cautiously, as already indicated by India and other delegates in the Fourth Session negotiations. It has no universally accepted definition, and in practical terms is used for profit attribution, not for defining nexus, which is different. During the BEPS era, “value creation” has been interpreted narrowly to emphasize only supply-side activities, excluding market contributions.

A combination of factors such as revenues and user participation can be used to establish nexus, rather than reliance on a single test, as it provides greater stability and reduces avoidance opportunities.

3. Differentiation of services

Services can be differentiated but it is important to minimize having different tax treatments for different services to reduce complexity and disputes over characterization.

The protocol could have broad functional categories of services, such as:

- Automated digital services (eg - online advertising, cloud computing and other services mentioned in Article 12B of the UN Model Tax Convention)
- Remotely delivered traditional services (eg – teaching, legal advisory, accountancy, etc);
- Services requiring physical presence (eg – construction, engineering, surgeries, etc).

Concerns about different profit margins across sectors can be addressed through the design of the method of taxation rather than through differential treatment of services. The same service can have different profit margins in different jurisdictions. An approach allowing both gross and net basis taxation can mitigate concerns regarding low-margin services. Gross taxation can safeguard revenue, while providing an option for taxpayers to elect net basis taxation where expenses are duly supported and non-base eroding payments are deductible.

4. Method of taxation

As outlined in our research⁴, the protocol should support simplified compliance models recognizing the capacity constraints faced by many developing countries, and provide countries with an acceptable set of tax options to choose from depending on country priorities and capacity. These may include different form of gross and net basis:

Gross Basis:

- Withholding tax (WHT) on gross payments, and DSTs.

Net Basis:

The Co-Leads' Draft Options Paper makes no mention of how net basis will work, implying the continuation of the Arm's Length Principle (ALP). This should be avoided at all costs since the ALP and its accompanying transfer pricing system has proved incapable of providing an effective solution for determining taxable profits from the digitalized economy. Thus, net basis in the protocol should provide alternative methods, and the following can be considered:

Deemed profit methods, which are proven to offer predictable and administrable outcomes.

Fractional apportionment building on the net method of Article 12B(3) of the UN Model Tax Convention. However, "qualified profits" under Article 12B's net method are only 30%

⁴ FAITH AMARO, VERONICA GRONDONA & SOL PICCIOTTO, THE IMPLICATIONS OF TREATY RESTRICTIONS OF TAXING RIGHTS ON SERVICES, ESPECIALLY FOR DEVELOPING COUNTRIES (2024), (page 55). https://www.southcentre.int/wp-content/uploads/2024/10/RP211_The-Implications-of-Treaty-Restrictions-of-Taxing-Rights-on-Services-Especially-for-Developing-Countries_EN.pdf.

of the amount resulting from applying the MNE's profitability ratio to the local revenues. There is no reason why only 30% should be allocated. The protocol can be improved by increasing this allocation to 100%. Thus, a simpler and more equitable solution for determining net profits would be to simply apply the MNEs' segmental or group profitability ratio to the local revenues.

Formulary apportionment building on technical work on Amount A of OECD's Pillar 1 and UTPR of Global Minimum tax of Pillar 2. These rules are complex, insufficient and inadequate for developing countries, but provide technical progress which can be simplified and built upon for designing a simple formulary apportionment of profits from cross-border services.

Such a simplified apportionment could work as follows:

1. The MNE's profits are first consolidated at the group level. This can be done by either simply taking the MNEs group profit as contained in the consolidated income statement or by summarizing the profits in the country by country report. However it must be noted that the latter option will likely reduce the global tax base due to loss consolidation.
2. The MNEs' profits are then apportioned to countries and jurisdictions using a formula that contains apportionment factors. The most commonly proposed apportionment factors are sales, tangible assets and number of employees and payroll cost. These are also contained in existing Country by Country Reports (CBCR) and can be immediately used. A fourth apportionment factor can be the number of users (e.g – number of Facebook, Google, etc users per jurisdiction) and this can be included for highly digitalized businesses.

The protocol should provide flexibility in choice of taxation options and in implementation timelines, allowing for phased adoption based on domestic readiness.

5. Implementation

The evidence consistently shows that treaty restrictions significantly limit source taxation of services and result in substantial revenue losses for developing countries⁵. Therefore, effective reform requires a multilateral solution.

Bilateral renegotiation of treaties is often slow, resource-intensive, and dominated by economic power asymmetries. Thus, a multilateral mechanism is more effective. The Protocol should therefore apply multilaterally. It can be implemented through the UN Fast-Track Instrument (FTI) as completed by the UN Tax Committee. Through the UN FTI group renegotiation of bilateral tax treaties is possible and this can change the dynamics and reduce the power asymmetries faced by developing countries. This also ensures timely implementation, promotes coherence and inclusivity while allowing appropriate flexibility for States.

The protocol's key objective should be to remove the restrictions faced by developing countries through their existing tax treaties, and thus allow them to begin taxing cross-border services, particularly digital services. If the protocol cannot fulfil this key objective, the existing trend of treaties being bypassed or even terminated may continue, further destabilizing the international tax system.

The protocol should not apply in situations where countries have no treaty. In such a case the domestic law applies, as indicated by Nigeria on behalf of the African group and others during the Fourth Session.

States that do not sign the Protocol would not be bound by its provisions, and their existing treaties would remain unaffected.

The rules must be designed in a way that they can be taken forward by a “coalition of the willing”, and need not require universal adoption in order to work. Such an approach is also consistent with the optional nature of the protocols.

⁵ *Id.*; Aiwei Feng, Shristi Joshi & Quinn McGannon, *Analysis of Imbalanced Tax Treaties of Developing Countries Insights From the Tax Treaties Explorer Database*, (2024), <https://www.southcentre.int/wp-content/uploads/2024/09/Graduate-Institute-South-Centre-Tax-Report-2024.pdf>.