

WBG STAFF COMMENTS ON ARTICLE 12B

We welcome the opportunity to comment on the draft Article 12B of the United Nations Model Tax Convention.

General Remarks

A number of WBG member countries have introduced, or are considering introducing, digital service tax (DST) regimes, and we believe they will welcome the insertion of the proposed new Article 12B to the UN Model Tax Convention concerning the taxation of the digital economy.

Some countries view the DST as an interim measure pending an international consensus on the taxation of the digital economy. This is a way to preserve and increase revenues and to introduce some degree of fairness by taxing the income of large multinational enterprises that in some cases have deep engagement with their citizens but little or no taxable presence under current conventions. The introduction of DSTs also recognises concerns about the ability of developing economies to engage with an internationally developed multilateral regime that looks very complex and that may do little to increase their tax revenue. For such countries DSTs provide an opportunity to unilaterally develop more straightforward approaches that are better tailored to their policy needs, administrative capacities and the characteristics of their local economies.

The development of a treaty article such as Article 12B will be in line with the policy rationale of jurisdictions wishing to use more straightforward domestic rules to exercise taxing rights over income generated in their economies. Moreover, a new treaty article provides an agreed international framework within which jurisdictions can adopt aligned approaches, leading to international consistency of treatment and a mechanism to mitigate double taxation. Although a new article 12B may take time for countries to implement through bilateral treaties, it has immediate signalling effects that will be welcomed by many developing economies.

We consider that existing approaches in the UN Model Convention concerning the taxation of non-resident service providers, in particular Article 12A, provide a plausible conceptual grounding for many aspects of DSTs. It is plausible to characterize numerous digital transactions as the provision of a service, whether provided to a user of an online marketplace, an advertiser placing adverts on a digital platform, a driver using an online booking app, a hotel or travel provider utilizing online booking platforms or to individuals or businesses purchasing cloud computing services. DSTs typically seek to tax the fees derived from these services. This framework, adopted in Article 12B, provides a clear and direct route to the taxation the digital economy, based on the income derived by digital service platforms from citizens of a jurisdiction. In this light, Article 12B can be seen as an incremental extension of Article 12A, explicitly recognising purely digital service provision and incorporating business-to-consumer as well as business-to-business service transactions.

Specific Comments

1. Collection of DSTs

The commentary to Article 12B recognises that enforcement and collection of DSTs through a withholding tax mechanism may be appropriate for business-to-business transactions, such as those envisaged in Article 12A, but are more problematic to apply to business-to-consumer transactions.

For this reason, it would make sense to consider other collection mechanisms. Some countries, for example, require the MNE digital service provider to nominate a specified entity to take

responsibility for registering, reporting, and paying DSTs. Requiring the foreign service provider to pay the tax due directly follows the model that is already used for the collection of indirect tax (VAT) due when a consumer purchases digital services from a foreign supplier. Other countries place responsibility on financial intermediaries such as credit card providers, but this is problematic as financial institutions struggle to identify the transactions that should be subject to withholding¹. Consequently, this approach seems better suited as a back-up measure, to be used in cases of non-compliance, rather than the primary collection mechanism.

We suggest exploring using similar, or the same, online portals to those used for reporting and paying VAT on digitally provided services. For example, in the EU, an online portal, known as the mini one-stop-shop (MOSS), allows suppliers to register, submit quarterly returns, and pay the VAT due. The same approach could be used to allow non-resident digital service providers to register and report their liability for a DST, and to make their payments through the same portal.

2. Widening the DST allocation mechanism

Article 12B provides a jurisdiction with a taxation right over the fees paid for automatic digital services made by that jurisdiction's residents. Most country DSTs in practice use a more market-based allocation mechanism for certain categories of digital transactions – in particular, fees for advertising and for the sale of data. This approach generally allocates an aggregated measure of global income between jurisdictions. In such cases, the total worldwide income arising to a platform from a category of income (such as total advertising revenue) is allocated to a specific jurisdiction according to a specified formula. This might be based, in the case of advertising for example, on the location of users or the devices in which the advertising is intended to be viewed. Where such an approach is adopted, it will be necessary also to consider how the location of a user, or a device, is to be determined². This might be based on, for example, the users' IP addresses, or billing address, or residential address. Solutions to this problem have already been developed for VAT, where the location of the consumer has to be determined. An allocation approach makes sense where the DST seeks to capture value derived from, for example, the volume of the market, and may be particularly appropriate to tax income arising from advertising revenue or the sale of market or user data.

In order to ensure the continued relevance of Article 12B for these aspects of DSTs, we would suggest that the United Nations considers expanding it to embrace these types of allocation mechanisms. We would suggest that this will entail removing the limitation of the scope of the Article to "income arising" in the Contracting State. This could be made in an alternative provision included in the Commentary on Article 12B, available to countries having adopted a DST based on the approach described above. Such DSTs have been designed with the fact that digital businesses monetize their interaction with users in ways that do not involve direct payment by users of their services in mind. Specifically, this may not involve any payments flowing from the jurisdiction in which the user is located. For example, if a business in country A pays a digital service provider in Country B to host advertisements targeting consumers in Country C, no income arises in Country C, even though it might be argued that the service provider partly carries out the advertising services in

¹ In fact, in many countries financial institutions have strongly opposed acting as withholding agents for this kind of transactions.

² In any case, and even if the criteria used for determining the source of digital services income remains being the residence of the payer of the services, guidance should be provided as how the digital service providers should determine the residence of the payer.

Country C by engaging with Country C's consumers. That is why DSTs generally allocate a share of the global income, rather than taking payments flowing from a jurisdiction as their starting point.

More importantly, we consider that a narrow scope based on "income arising" could disproportionately impact developing countries. While some payments for online advertising will be made by local businesses in developing economies, they will often be made by large MNEs with a global footprint. It is common for such payments to be centralised and paid by MNE group members outside of the jurisdiction in which the target users are resident. Under these circumstances, the developing economy would have no taxing rights despite that the digital services may have a strong connection with users in that country. Similarly, payments for certain intermediation services relating to accommodation and tourism may also be centralised by global accommodation chains or tourism operators, despite that the underlying accommodation or tourism service is provided in a developing economy. Many developing economies have substantial tourism sectors and may focus on domestic taxation of digital services on this sector. Under the proposed wording of Article 12B, a developing economy's taxing rights may be significantly diminished despite that the digital services relate to underlying accommodation and tourism services in that country³. Exploration of a broader scope could alleviate these concerns. It could also safeguard against possible incentives for digital service providers or customers to ensure payment of fees are routed through jurisdictions that do not impose source taxation on those payments.

³ For this reason, the ATAF suggested approach to drafting DSTs allocates digital service fees earned by intermediaries to the jurisdiction in which the accommodation is located: *Digital services revenue derived from users, no matter where located, in respect to the facilitation of rental or use of real property located in [COUNTRY]*.