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**Committee of Experts on
International Cooperation in Tax
Matters**

Twentieth session

Virtual Session commencing 22 June 2020

Item 3(i) of the provisional agenda

**Tax consequences of the digitalized
economy – issues of relevance for
developing countries**

Summary

This paper from the Co-coordinators of the Subcommittee on Tax Challenges related to the Digitalization of the Economy provides updates on recent developments and seeks ***discussion and guidance*** on:

- any consequences for the Committee's work of the developments at the OECD/G20 Inclusive Framework on BEPS;
- the paper prepared for the 19th Session but not finalized at Subcommittee level and not discussed by the Committee at that Session (paper E/C.18/2019/CRP.16);
- the note submitted by Committee member Mr. Bansal at ***Attachment 2***; and
- any other issues regarding tax issues related to the digitalization of the economy.

Co-coordinators' Paper on Tax Issues related to the Digitalization of the Economy for the 20th Session of the UN Committee of Experts on Cooperation in Tax Matters.

As described in paper [E/C.18/2019/CRP.12](#) of 5 April 2019, the Subcommittee on Tax Challenges related to the Digitalization of the Economy, in order to achieve its mandate, seeks to:

- Propose guidance on:
 - o tax treaty issues;
 - o domestic law issues; and
 - o VAT issues;
- Adopt an approach:
 - o independent of similar work being pursued in other fora;
 - o while giving due consideration to developments which will inform its work
- Whereby the following guiding principles are to be followed:
 - o avoiding both double taxation and non-taxation;
 - o preferring taxation of income on a net basis where practicable; and
 - o seeking simplicity and administrability.

2. That paper was discussed during the 18th Session of the Committee in New York (23-26 April 2019). Based on the outcomes of that discussion it was decided that a further paper was to be prepared for discussion at the 19th meeting of the Committee in Geneva (15-18 October). That paper should contain:

1. Introduction, general background, reasons for the work and guiding principles;
2. Relevance and analysis (advantages and disadvantages) of work in other forums:
 - (a) Inclusive Framework on Base Erosion and Profit Shifting;
 - (b) International Monetary Fund;
 - (c) European Union;
 - (d) African Tax Administration Forum; and
 - (e) Others;
3. Possible alternative or modified approaches for allocation of taxing rights and nexus rules, including withholding taxes;
4. Conclusions.

3. Paper E/C.18/2019/CRP.16 was consequently prepared for the 19th Session of the Committee in Geneva. It contained the agreed chapters 1 and 2 (a-d). No submissions had been received for inclusion in proposed chapter 3. The paper was discussed in the Subcommittee and distributed to all Committee members, but the paper was not published on the UN website and not discussed during the Committee meeting.

4. During the discussion in Geneva much attention was given to the recent developments in the OECD/G20 Inclusive Framework on BEPS and the last drafts of papers on the Pillar 1 and Pillar 2 proposals. It was decided that the UN Tax Committee would submit comments to OECD on the proposals for Pillar 1.

5. Those comments were submitted to the OECD Secretariat on 12 November 2019 and were published as part of the submissions made to the OECD Secretariat. The Submission and its cover letter from the Committee Co-Chairs can be found at **Attachment 1** to this paper.

6. Since the submission of those comments the Subcommittee has not met. A note was received from one of its members, Mr., Rajat Bansal, with proposals for consideration and future work by the Committee. This note can be found at **Attachment 2** to this paper. As Members of the Committee serve in their personal/expert capacities, the note represents the personal views of the author only and not necessarily of anyone else.

7. Also, the work of the OECD/G20 Inclusive Framework on BEPS has continued. On the 31st of January a Statement was released containing an outline of the architecture of a Unified Approach on Pillar One and a Progress Note on Pillar Two. That statement can be found at <http://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf>

8. Finally, the UN secretariat will be holding a capacity building workshop to assist developing country advisers in addressing the tax policy and administrative issues involved, as will be outlined as part of Item 3 (g) of the Provisional Agenda.

9. The Co-coordinators of the Subcommittee propose that the Committee should discuss during the 20th meeting:

- Any consequences for the Committee's work of the developments at the OECD/G20 Inclusive Framework on BEPS;
- E/C.18/2019/CRP.16;
- The note submitted by Mr. Bansal at **Attachment 2**;
- Any other issues regarding tax issues related to the digitalization of the economy.

Attachment 1
(Committee submission)



12 November 2019

Dear Sir/Madam,

We write to you on behalf of the United Nations Committee of Experts on International Cooperation in Tax Matters (“the Committee”). The Committee is a group of 25 persons nominated by UN Member States and appointed to serve four-year terms in their personal capacities by the UN Secretary-General. A list of Members can be found at: <https://www.un.org/esa/ffd/tax-committee/tc-members.html>

The Committee has a broad mandate to generate practical guidance for governments, tax administrators and taxpayers on issues in international tax cooperation, working within the wider efforts to mobilize financing and other support for sustainable development. The Committee seeks to help prevent both double taxation and non-taxation, working to produce guidance that is relatively simple to understand and feasible to administer. Much of the work is carried out through our subcommittees set up to deal with specific issues.

The Committee has a subcommittee tasked to address tax consequences of the digitalized economy. The subcommittee had previously identified the crux of the issue as the inability of jurisdictions, under the physical presence criteria of tax treaties, to tax the business profits of certain new business models that did not require a physical presence in the market where profits were derived. When the Committee met during its 19th Session in Geneva from 15-18 October 2019, the OECD Secretariat was invited to present its recently released proposal to refine the Pillar 1 options into a single “unified approach” on nexus requirements, which seeks to build consensus for reforms among Inclusive Framework Members. The Committee agreed at the session to continue analyzing and providing comments on the OECD Secretariat and other proposals made, while carrying forward its own independent yet informed approach to work on taxation of the digitalized economy, with particular attention to implications for developing countries, especially the least developed and other countries in special situations.

In this context, we wish to share with you the attached comments with respect to the OECD Secretariat’s Public Consultation Document on Pillar 1, in response to your call for comments from interested parties. The comments are to be read as highlighting issues and concerns that, in the view of the Committee, should be taken into account for the benefit of developing countries and all stakeholders in tax systems. The comments provided do not necessarily represent the views of the United Nations, including the Economic and Social Council (ECOSOC), or the United Nations Member States, including those nominating the Members of the Committee. Nor do they seek to catalogue all issues under consideration by Committee Members, or to reflect final opinions of Members, individually or as a group, in an evolving landscape.

We hope these remarks assist your work. The Committee can be contacted via the Committee secretariat at taxffdoffice@un.org.

Your sincerely,
[signed]
Eric Mensah
Co-chairperson

[signed]
Carmel Peters
Co-chairperson

Tax Policy and Statistics Division,
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UN Tax Committee Comments submitted to the OECD Secretariat on the “Unified Approach” as Proposed by the Secretariat in its Public Consultation Document of 9 October.

The UN Committee of Experts on International Cooperation in Tax Matters¹ and its Subcommittee on Tax Challenges related to the Digitalization of the Economy, in its October meetings in Geneva, reiterated the three work streams that are implicitly reflected in their mandates:

- developing an independent view on tax challenges related to the digitalization of the economy and proposing possible solutions for these challenges;
- increasing awareness among the tax administrations of developing countries about these challenges and the possible solutions; and
- influencing the developments in other international fora asking special attention for the position and the needs of developing countries.

In that light, the Committee wishes to submit the following remarks with respect to the Public Consultation Document. The remarks are to be read as issues and concerns that in our view should be taken into account for the interests of developing countries. The comments provided do not necessarily represent those of the United Nations, including ECOSOC, or the UN Member States, including those nominating the Members of the Committee.

- The Committee commends the OECD Secretariat:
 - o for its ongoing efforts to develop a set of consensus-based measures in a multilateral agreement to adapt the international corporate tax system to challenges arising from digitalization of the economy; and
 - o for its increasing awareness that a worldwide consensus requires the participation on an equal footing of all interested jurisdictions.
- The Committee invites the OECD Secretariat to increase its efforts to include developing countries in the decision-making process and to pay full attention to the interest of developing countries, especially low-income countries. Even for countries that have few tax treaties, their participation in the discussion is important to make them aware of the importance to implement in their domestic legislation new rules and administrative procedures to collect the revenues from digital economy income created in their jurisdiction.
- The Committee also invites the OECD Secretariat to assist the Committee and the UN Secretariat in facilitating the participation of developing countries in discussions on the Unified Approach and the economic impact, e.g. through regional workshops.

¹ The Committee of Experts on International Cooperation in Tax Matters as a subsidiary body of the Economic and Social Council is responsible for keeping under review and update, as necessary, the United Nations Model Double Taxation Convention between Developed and Developing Countries and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries. It also provides a framework for dialogue with a view to enhancing and promoting international tax cooperation among national tax authorities and assesses how new and emerging issues could affect this cooperation. The Committee is also responsible for making recommendations on capacity-building and the provision of technical assistance to developing countries and countries with economies in transition. In all its activities, the Committee gives special attention to developing countries and countries with economies in transition. The Committee comprises 25 members nominated by Governments and acting in their personal and expert capacity. The members, who are appointed by the Secretary-General after notification is given to ECOSOC, for a term of four years, are drawn from the fields of tax policy and tax administration and are selected to reflect an adequate equitable geographical distribution, representing different tax systems.

- The Committee appreciates in general an approach that would give greater recognition to new ways in which companies make profits through remote means, and thus increases the rights of market and user jurisdictions to tax parts of the profits of multinational entities that obtain value from these jurisdictions.
- The Committee welcomes the approach to avoid costly discussions on the remuneration for marketing and distribution activities by introducing the so-called Amount B as a minimum compensation for these functions. However, the quantum and scope of the fixed return related to Amount B should be determined fairly and carefully so as not to harm developing countries by preventing them from exercising their legitimate right to tax.
- The Committee emphasizes the need for developing countries to have a reliable economic impact assessment of the Unified Approach on which they can base their position.
- The Committee understands that the Unified Approach was developed by the OECD secretariat and has not been endorsed by Members of the Inclusive Framework. Comments from the Committee are provided on a without prejudice basis.
- The Committee notes that elements in the significant economic presence proposal, which could be important for developing countries, are not included in the currently proposed Unified Approach.
- With respect to the scope, the Committee:
 - o is concerned that the choice to target consumer facing business does not seem to be principle based vis-à-vis the original objective of tax issues related to digital companies without physical presence;
 - o is of the opinion that it will be in the interest of developing countries that the economic threshold be low enough to include a substantial number of MNEs;
 - o is concerned that a revenue threshold of €750 million will unnecessarily restrict the possibility to tax companies that deliver a substantial amount of digital services to developing countries;
 - o suggests considering lower thresholds applicable to “regional” MNEs that may be more important for a particular group of countries;
 - o questions whether the concept of “consumer facing business” can be defined well enough to be administrable and enforceable and whether restricting the scope to consumer facing business would meet the interest of developing countries; and
 - o advises that any carve outs need to be principle based and carefully considered, whereby;
 - the carve out for extractives and commodities may be justified on policy considerations;
 - justification for financial services seems debatable; and
 - further discussion on carve outs is needed.

- With respect to the new **nexus** and country level revenue thresholds, the Committee:
 - o cautions against too-high thresholds, as that would prevent developing countries from taxing substantial profits attributable to their markets;
 - o supports the proposal that thresholds should be country specific, taking into account the respective size of the economy.
- With respect to the calculation of Amount A, the Committee:
 - o is unable to take a definite position on the apportionment of non-routine profit, as this would depend on the different quanta yet to be determined. However, it appears evident that the whole operation is only justifiable if Amount A will attribute a fair portion of the non-routine profits to market jurisdictions;
 - o encourages the Inclusive Framework to consider determining Amount A on a business line and regional/market basis; and
 - o suggests not to exclude the possibility of applying a fractional apportionment also to routine profits.
- With respect to Amount B, the Committee:
 - o urges that Amount B is an agreed minimum compensation for marketing and distribution activities and not an elective safe harbor for taxpayers; and
 - o emphasizes the importance of a clear definition of the activities covered by ‘marketing and distribution’.
- With respect to Amount C, the Committee:
 - o welcomes the possibility created for tax administrations to supplement Amount B and make the case that actual local activities justify a higher share than what is provided under Amount B;
 - o asks for attention to the fact that some developing countries, although aware of the importance of effective dispute avoidance and resolution mechanisms, will not be inclined to accept mandatory and binding arbitration as a matter of principle underpinned by sovereignty concerns; and
 - o cautions that this would become a bigger issue if amount C would not only cover Amount B but any element of the proposal.
- With respect to the avoidance of double taxation, the Committee:
 - o notes that the proposed Unified Approach requires further work to determine the mechanism by which other jurisdiction(s) will give up the profit reassigned to the market jurisdictions; and
 - o cautions that measures to avoid double taxation should not lead to double non taxation.

- The Committee is concerned about:
 - the complexity of the proposal;
 - the problems developing countries could encounter regarding implementation and administration and the coherence of their legal system;
 - their ability to obtain the information needed to enforce the Unified Approach and their effective engagement in the new administrative processes that will be required to ensure multilateral agreement on amounts to be reallocated;
 - therefore the Committee strongly suggests considering ways in which the general idea of the Unified Approach can be remodeled into a simpler approach, e.g. through the use of withholding taxes.

Attachment 2

(Note submitted by Mr. Bansal²)

Tax Consequences of the digitalized economy

The UN Committee has decided to work independently on the “Tax Consequences of digitalized economy” while taking note of work done in other forums. The complete contour/outline of Unified Approach (UA) is available now in the “Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to address the tax challenges arising from the digitalization of the economy” released by OECD on 29-30th January. In the 18th Session of the Committee, it was decided that a Member could propose alternative approaches that were either the same as, or different from, those before the IF or other forums, including a modified version of same approaches.

For the purpose of deciding further course of action by the UN Committee, the UA announced on 30th January is analyzed below.

UA dated 30th January 2020

The Public Consultation Document on UA released on 9th October, 2019 acknowledged that ‘ the current rules dating back to the 1920s are no longer sufficient to ensure a fair allocation of taxing rights in an increasingly globalized world’ and flagged the need to move ‘beyond the arm’s length principle’. These are welcome features of UA. However, while the aim of the proposal was to deliver a solution that is ‘as simple as possible’, in reality the UA will introduce great deal of complexity. Further, the expected modest revenue impact of UA does not justify the large-scale changes in the system of taxing MNEs not only for digital businesses but much beyond.

For Amount A, there is no sound basis for allocating only the non-routine profits to market jurisdictions. It is not possible to distinguish conceptually between routine i.e. locally generated and residual i.e. internationally generated profits of a multinational enterprise, as all profits are essentially the result of global activities of the firm. More importantly, the UA does not present either a robust methodology for separating the two, or theoretical foundation on which such distinction might rest, nor the data with which this might be rigorously done.

Determination of Amount A through a unitary approach is confined to the residual profits only while leaving transfer pricing methods intact for determining other taxable profits of the same MNEs in various jurisdictions through separate entity approach. Amount A is to sit above the ALP driven profits. This will on one hand require the existing methods of determination and dispute resolution to continue and on other hand introduce a completely new method of determination as well as dispute resolution.

New taxing right, i.e. Amount A is to operate subject to a number of thresholds. As per UA, this is with a view to ensure that the compliance and administrative burdens are proportionate to the intended benefits. MNE profits have always been subjected to taxation in other countries; however, only local thresholds applied, and global factors were rightly never a consideration.

If an MNE is engaged in in scope activities in a market jurisdiction, there does not seem to be

² As Members of the Committee serve in their personal/expert capacities, the note represents the personal views of the author only and not necessarily of anyone else.

any reason for putting a minimum cap of 750 euro on MNE group's global turnover or on in scope activity global revenue. If an MNE group has say 700 million Euro global revenue with revenue from one market country itself being 600 million euro, Amount A will not apply. On other hand, an MNE group with 800 million euro global revenue with revenues between 50-300 million euros in various market jurisdictions may be subject to Amount A, depending on local revenue crossing local threshold. This appears to be incongruous. Two different MNE group entities having identical local sales revenue in a market jurisdiction may be treated differently just because of difference in global revenue of the two MNE groups. It should be enough to have local thresholds and not have any global revenue threshold or global in scope revenue threshold or a de minimis amount for total global profit.

In terms of Scope, there would be two broad categories of businesses under ambit of Amount A, Automated digital services and Consumer facing businesses with certain sectors like extractives, commodities, financial services as carved out of latter. The policy justification is that these businesses are the ones that can, with or without the benefit of local physical operations, participate in a sustained and significant manner in economic life of a jurisdiction. The businesses in first category are stated to be providing digital services remotely to customers in markets using little or no local infrastructure but at the same time benefitting from exploiting powerful customer or user network effects, thereby generating substantial value from interaction with users and customers. For the second category of businesses, it is stated that though they continue to sell through physical distribution channels and support sales through television and banner advertising, there is an increasing use of digital technologies to more heavily interact and engage with customer base. While sales revenue is the only criteria for first category of businesses to create nexus, plus factors such as existence of physical presence of MNE in market jurisdiction or targeted advertising directed at marketing jurisdiction are required, in addition to sales threshold, for second category of businesses to create a nexus. The policy rationale for Scope for the second category is not transparent i.e. it does not answer questions on picking up the chosen streams of businesses only while leaving out rest from ambit of Amount A.

Elimination of double taxation in respect of Amount A will not be straightforward and it will not be possible to use corresponding adjustment approach of Article 9(2). This is due to Amount A being not premised on there being identifiable transactions between particular group entities. It will be necessary to determine which jurisdiction will have an obligation to eliminate any resulting double taxation and if there is more than one jurisdiction, the quantum of relief to be provided by each. To further complicate matters, Amount A will affect multiple jurisdictions that may not have existing bilateral treaties between them.

It is proposed to have exclusive filing in the ultimate parent jurisdictions only for Amount A, following the approach used for Action 13 CbC reporting. Further, in view of unitary determination of consolidated profits of MNE Group as a whole, any dispute between two jurisdictions over Amount A will likely affect the taxation of Amount A in multiple jurisdictions. Obviously, the existing bilateral mechanisms for dispute resolution will not be workable, thereby necessitating a much more complex multilateral dispute resolution mechanism. There is a proposal for early determination through a Panel for Amount A. However, how many countries can be practically represented on such a Panel say of 10 experts, when MNE operates in 100 countries would be a challenge. Without being represented on such Expert panels, how the solution can be accepted by all countries. This also raises sovereignty concerns. How many countries would be having experts to participate in such Panels and the required resources is another issue. Disputes in respect of whether in Scope for consumer facing businesses, segmentation of accounts for in scope activities and which countries are to give double taxation relief due to excess residuary profit residing there appear to be daunting for a multilateral

resolution.

On implementation, having a new multilateral convention for UA is a welcome idea. However, as the experience with the multilateral convention to implement BEPS related tax treaty changes shows, there is no assurance on all countries signing and ratifying such multilateral convention within a timeline or even ever. The Statement refers to a critical mass of countries that may be required to join, however; Amount A determination in UA is conceived in a manner that requires hundred percent mandatory joining of the new Convention by all countries. This can never be guaranteed. Without all countries joining such Convention, UA can never be effectively implemented for Amount A.

Lastly, the already complex matter is further complicated by unnecessarily tagging Amounts B & C along-with. An already complex problem has been further complicated by this.

Proposal

The UA supposes that market jurisdictions have right to tax only a portion of residuary profits. This is a debatable issue. Profits are essentially generated due to global activities of firm and sales or demand itself is a major contributor of profits. In other words, whether or not there are residuary profits earned by MNE, the market should get a portion of profits due to sales having taken place there. Keeping that aside, UA has not proposed any accurate way of determining residuary profits and it is based purely on approximations only. Further, the method to determine such residuary profits, elimination of double taxation and dispute resolution as proposed is highly complicated, difficult to administer and a complete departure from existing way of taxing foreign entities. Even after this complex exercise, the net revenue gain by market countries may be quite insignificant not commensurate with the effort. The new taxing right requires centralized determination which will require huge resources and coordination between countries. Such processes would need much more time also than the present system. What is therefore required is a simpler approach, which may also not be accurate but at least results in some tangible and definite gains in supplementing resources of developing countries. Following proposals are made for consideration by UN Tax Committee:

- (i) The in scope activities be confined to automated digital services only in respect of revenue derived directly from the market jurisdictions, not through a subsidiary or a permanent establishment. These activities be same as in para 22 of “Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to address the tax challenges arising from the digitalization of the economy’ released by OECD on 29-30th January, as below:
 - Online search engines;
 - Social media platforms;
 - Online intermediation platforms, including the operation of online market places, irrespective of whether used by businesses or consumers;
 - Digital content streaming;
 - Online gaming;
 - Cloud computing services; and
 - Online advertising services.

For other cases, the existing system of nexus determination and profit attribution continues.

- (ii) The nexus for a taxing right in respect of such automated digital services may be deemed in a market jurisdiction only on the basis of local revenue derived, which may be commensurate with size of market, as proposed in UA. No other thresholds be kept. The local revenue be defined to take into account multi sided business models.
- (iii) The taxable profits be determined by each jurisdiction by applying global profit rate of in-scope activities of MNE Group on the local sales revenue and attributing a percentage of the same to market jurisdiction. This can be done through fractional apportionment method.
- (iv) Elimination of double tax relief will continue to be governed by existing treaty provisions.

Above proposal will require a new Article in tax treaties, which will define the nexus and also the determination of profits. Such new Article may be inserted in the UN Model Convention. Since, implementation through bilateral amendments will take time, a parallel process can be a multilateral convention put forward by UN that is open for signature by all countries. Such Convention can operate exactly like MLI, i.e. it will amend covered tax treaties of signatory countries. This system will give flexibility to countries to opt for the new system voluntarily. Unlike, here, there is no requirement of all countries joining the new convention for it to operate effectively. New taxing right will operate only in those countries where such taxation is permitted by domestic law. Countries may need to bring about changes in domestic laws to have similar taxing right in the first place.