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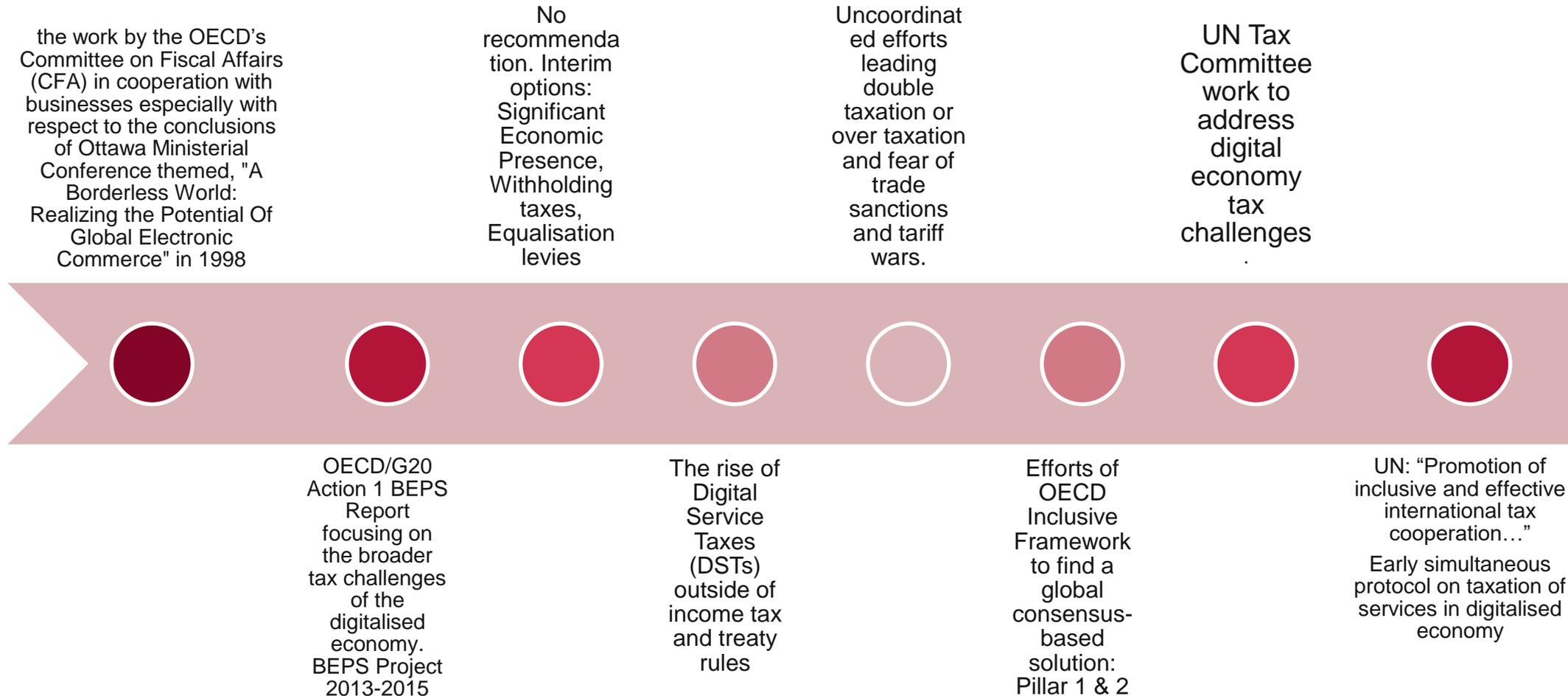
UN Work on the Digital Economy and Other Country Practices

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Bali, 25 September 2024

- ▶ Introduction and Background
- ▶ UN Approach to Digital Economy Taxation
 - ▶ Article 12 A
 - ▶ Article 12B
- ▶ Current work of the UN Tax Committee
 - ▶ Subcommittee on UN Model Convention
 - ▶ Sub Committee on digitalized and globalized economy
- ▶ Country practices
- ▶ Conclusion

Concerns for the exponential increase of digital businesses and e-commerce



The UN Approach to Taxation of the Digital Economy- Background

- ▶ The UN Tax Committee has traditionally sought to expand the taxing rights of developing countries to ensure taxation for the Sustainable Development Goals.
- ▶ At the 2008 Annual Session, the Committee of Experts on International Cooperation in Tax Matters set up a new subcommittee which was mandated to work on proposals for updating and improving Article 14 of the UN Model and the tax treatment of services in particular the treatment of fees for technical assistance.
- ▶ Work commenced in 2009 on taxation of services broadly in consultation with experts
- ▶ Article by article review of approaches taken in treaties to address fees for technical assistance e,g SADC MTC, Included in treaties as far back as 1972, Kenya- Denmark.
- ▶ Article 12A Fees for Technical Services was adopted as a new article under the 2017 UN Model

The UN Approach to Taxation of the Digitalized Economy- Background

- ▶ A sub-committee to discuss and deal with both the tax challenges of the digitalization of the economy and the tax administration issues related to the digitalized economy was established in the fifteenth session in October 2017.
- ▶ Article 12B ‘income from automated digital services’ was incorporated into the 2021 UN Model.
- ▶ Work continues in addressing tax challenges of the digital economy- in the current UN Tax Committee (2021- 2025)

Article 12A: Fees for Technical Services

- ▶ Allows contracting states to tax fees for technical services (managerial, technical, consultancy nature).
- ▶ Why?
 - ▶ **Previous Status-quo:** Income from services derived by an NR was taxable exclusively by its jurisdiction of residence unless its business was carried on through a PE or fixed base.
 - ▶ Introduced to address situation that substantial income is derived by an NR from source country without being subjected to tax in that country.
 - ▶ Concerns for intra-group payments which are deductible in the source- BEPS issue
 - ▶ Rethinking traditional concepts of allocation of taxing rights in the digitalised economy

Article 12B: Income from Automated Digital Services

- ▶ Allows countries tax income from certain digital services at gross rate negotiated bilaterally, also permits net basis of taxation.

▶ Why?

- ▶ Income from automated digital services was identified as a priority to enable jurisdictions preserve the domestic law taxing rights on income derived from highly digital business models.
- ▶ The focus is to capture income from automated digital services such as the online platforms, search engines etc.

Key Features of Article 12 A and B

Art. 12 A

- ▶ **Scope:** Technical, managerial, Consultancy, professional i.e. application by the service provider of specialized knowledge, skill or expertise (non-routine/customised services)
 - ▶ excludes routine services, B2C, artists and sportspersons and directors, payments for teaching in or by an education institution

- ▶ **Profit attribution:**
- ▶ Limited source taxation to % of gross amount.

Art. 12 B

- ▶ **Scope:** Automated digital services provided on the Internet or digital or other electronic network (minimal human intervention)
 - ▶ Excludes any activity without minimal human intervention in scaling
 - ▶ Not limited to services tailored to specific customers

- ▶ **Profit attribution:**
- ▶ Limited source taxation to % of gross amount or opt for net taxation which is tax on 30% overall profitability attributed to your jurisdiction of NR revenue

Comparing Article 12A and B: Scope

Art. 12 A

- ▶ **Nexus:**
- ▶ Services supplied to resident in source country (no physical presence required)

- ▶ **Sourcing Rules:**
- ▶ payments by residents or PE or fixed base of NR in source country

Art. 12 B

- ▶ **Nexus:**
- ▶ Services supplied to resident in source (no physical presence required)

- ▶ **Sourcing Rules:**
- ▶ payments by residents or PE or fixed base of NR in source country

OECD vs UN Response

	OECD	UN
Principle	Expand source taxation	Reinstate taxing rights lost
Implementation	Beyond treaty response- treaty rules run in parallel	Treaty response
Rule	Pillar 1- reallocation of taxing rights to market jurisdictions for a portion of above normal profits above 10%profitability and Euro 20 billion revenue	Introduction of Art 12A (2017), Art12B (2021)
Nexus	New bespoke nexus – revenues above €1m and € 250,000	Beyond physical presence- Nexus based on revenues from source (payments sourced)
Attribution of profit	Formulary apportionment introduced based on revenue	Possibility of tax on gross amount (outside Art 7) Art 12B: option to Deemed profits for net basis

Major Considerations

- ▶ Article 12A is contentious for OECD countries because it covers fees for services provided remotely without a physical presence in the source state.-
 - **possible overlap with Pillar one solution.**
- ▶ Article 12B is even more contentious and “technically and politically sensitive” for OECD countries and other members of the IF.
 - **Clear overlap with Pillar one solution**

not much uptake of Art. 12A in treaties between OECD countries
increased uptake of Art. 12A in treaties between non-OECD countries
predicted less uptake of Art 12B in treaties with countries that are part of IF

Limitations to the Application of both Articles

Needs to be incorporated in tax treaties. Depends on the negotiating capacity of developing countries. MFN use

Required inclusion of unilateral measures in domestic law – treaty cannot give you what your domestic law has not given you

The need to re-negotiate existing treaties before it can be implemented on existing treaties. Also administratively difficult, especially Article 12B net -taxation option: will rely on access to information

The possibility that the tax cost of the WHT imposed could be pushed to the customers in the market jurisdiction. (increases prices)

The possibility that the tax Application of the two options under article 12B could produce difference tax results.



These approaches do not significantly alter the existing nexus and profit attribution rules.

Are they sustainable solutions?

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- ▶ **The current work of the sub-committee is not particularly directed towards the context of digitalisation of the economy- focus is on :**
 - ▶ The Treatment of Services, Including Issues of Overlap: paused work consequential changes to the Commentaries until Article XX is finalised

- ▶ Began with a proposal that resumes work on expanding the Commentary on Article 14 to address:
 - ▶ That source country should not be restricted by the criteria of existence of a fixed base and length of stay and that revenue that exceeds a threshold should in itself be enough to trigger taxing rights.
 - ▶ That "fixed base", which is used in subparagraph (a) of paragraph 1, is not defined in the UN Model. Its meaning is understood to be similar, but not identical, to that of the term "fixed place of business".
 - ▶ Clarify if it covers just individuals or other entities –“ income derived by a resident

Approach taken to Address the Issue on Services

- ▶ Proposed reinstating a third criterion in Art 14(1)(c) 1980 Model on the amount of remuneration exceeding specified amount if received from the source country or PE or fixed based there. Modified so CAs can adjust thresholds from time to time.
- ▶ Was originally deleted in 1999 because of uptake and Time Value of Money
- ▶ The Committee later decided to pursue consideration of Article XX, which would potentially apply to all services, eliminating many of the overlap issues, It is also proposed that Article XX would replace Article 14.

Approved Work: To identify priority taxation issues related to the digitalized and globalized economy where the Committee may most usefully assist developing countries in differing situations.

Working Stream A

Options for a more multilateralised form of implementing specific provisions of UN MTC
Including schedules addressing particular provisions of UN MTC

Working Stream B

The relevance or otherwise of physical presence test in the context of an increasingly digitalised and globalised economy by proposing a new Article XX combining Articles 5(3)(b), article 12 A and 14

Working Stream C

Cross-border taxation issues involving remote workers
[work paused pending identification of a major challenge affecting developing countries and the magnitude of the problem]

Work stream A: The UN Fast Track Instrument

- ▶ A multilateral instrument for the implementation of specific model convention provisions flexible enough to accommodate various positions (fast and effective manner).
- ▶ Incorporating MTC proposals into bilateral treaties, without the hassle of separate bilateral negotiations.
- ▶ Comprised of:
 - ▶ The instrument itself (framework),
 - ▶ Specific amendments and alternative wordings provided for in each of the schedules; and
 - ▶ The amending protocols –actual agreement concluded between two or more Parties in the form prescribed by any such Schedule.

Concerns Raised on Fast Track Instrument

▶ **Concerns :**

- ▶ practicality of the fast-track instrument-constitutional and legal issues/constraints to modify treaties without ratification or follow procedure in art 4?
- ▶ only the Committee of Experts can amend the UN Model and that the Conference of Parties cannot reopen the discussion of the Committee or amend what the Committee has agreed
- ▶ Reservations to this Instrument are not permitted
- ▶ How does it fit into the work of the UN Framework Convention?

▶ **Alternatives:** Developing model protocols for bilateral treaties

Workstream B: Relevance of PE Test

- ▶ Articles dealing with services will be combined into a single article – Art. XX (Fees For Services)
 - ▶ The articles considered are articles 5 (3) (b), 12A and 14.
- ▶ Physical presence proxy for nexus is relevant for cross border trade of goods but not all services due to technology.
- ▶ Ensures a fairer allocation of taxing rights between residence and source states.
- ▶ Developing countries are disproportionately importers of services.

Reasons: simplification, increased coherence and BEPS concerns in applying AOA and allowing on certain intra-group payments(lack the administrative capacity)

Features: fees for services subject to Art 8,16 and 17 and excludes employees remuneration, B2C, ADS and insurance and allows limited source taxation of % on gross amount

▶ Tax issues raised by remote working:

- ▶ A lack of consistency in physical presence tests as a part of the requirements for taxation on non-resident employees by the country where employment is exercised.
- ▶ That when a resident employer pays salaries to remote workers abroad, the employer's country of residence may not tax the employee's employment income, even though it may be allowing the employer to deduct employment costs.
- ▶ Situations where remote working employees of an employer resident in one contracting state might create a PE or fixed base for their employers as a result of their working in the other contracting state.
- ▶ “Digital nomads” –can work from anywhere and move periodically from country to country without creating a taxable presence in any country.

Possible Solution: allow developing countries to exercise their existing taxing rights effectively e.g. additional taxing right for employer's jurisdiction and additional guidance in the commentary of Art. 5, 15.

Approach to Addressing the Tax Issues Created by Remote Workers

- ▶ Preferred option is a new paragraph 15(4) –to provide that the country where an employer is resident can tax the remuneration of a non-resident employee irrespective of whether the employer has a PE or fixed base in the other country.
- ▶ Would address the reduction of the tax base to the country of an employer (deductible by the employer) when an employee is fulfilling his or her duties in another country.

Notwithstanding the provisions of paragraphs 1 and 2, remuneration derived by a resident of a Contracting State in respect of an employment exercised in that State or in a third State may be taxed in the other Contracting State to the extent that the remuneration is paid by [or on behalf of] an employer who is a resident of that other State

- ▶ **Position on Digital Nomads:** due to informational difficulties it seems premature to take any action at this time to impose tax on the income of digital nomads.

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▶ Article 12 A fees for technical services

- ▶ treaties with the provision, included an article on technical services fees prior to incorporation in UNMTC in 2017.
- ▶ By 2012 , about **135** tax treaties included an autonomous article on taxation of technical services.

▶ Implementation from 2013-2023

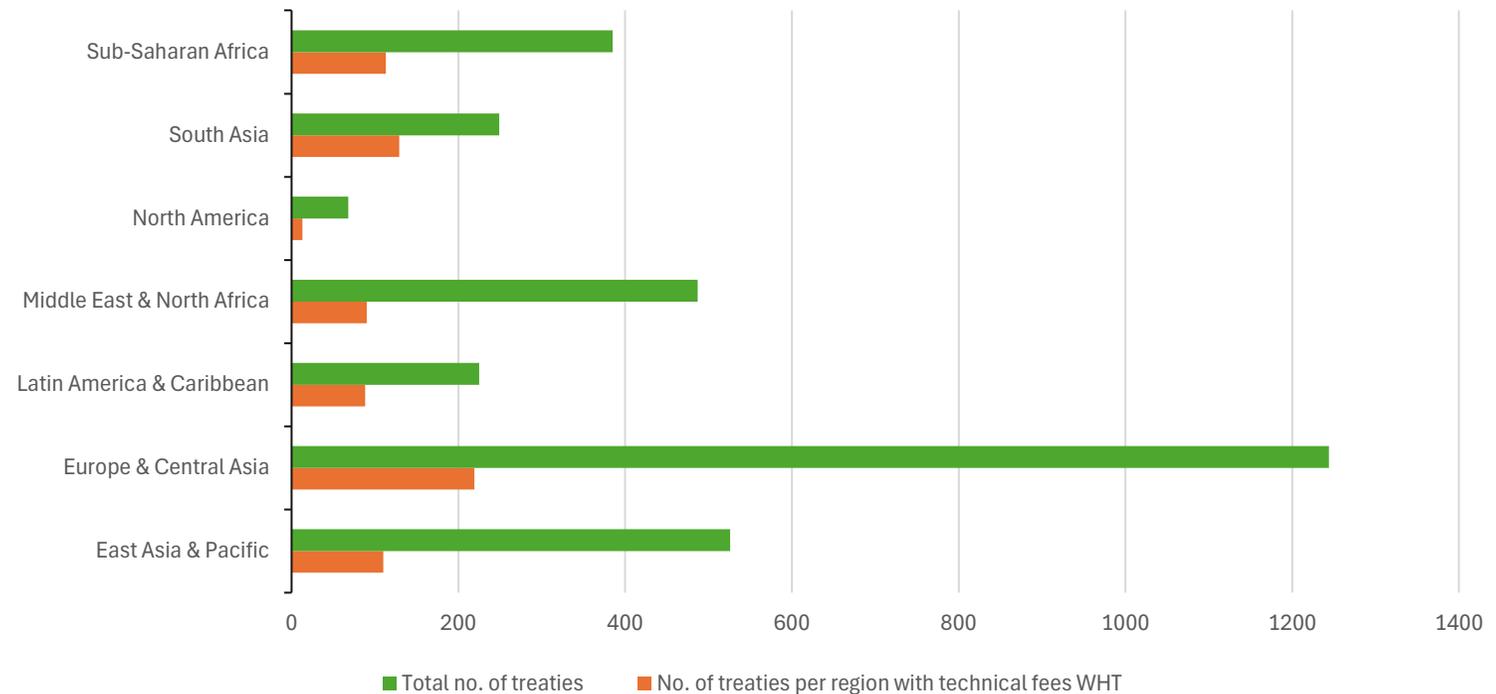
- ▶ Group A (non-OECD/non-OECD)
- ▶ Group B (non-OECD/OECD)
- ▶ Group C (OECD/OECD)

Breakdown

- 142 of 351 tax treaties (40%)
- 68 of 311 tax treaties (22%)
- 6 of 79 tax treaties (8%)

- Of **3184** treaties sampled 24% contain fees for technical services.
- Europe and Central Asia followed by South Asia have the highest rate of inclusion in their treaties
- Europe and Central Asia 219/1244 (18%)
- South Asia: 129/ 249 (52%)

Extent of Inclusion of Technical Fees WHT in Tax Treaties per Region



Source: ICTD data base

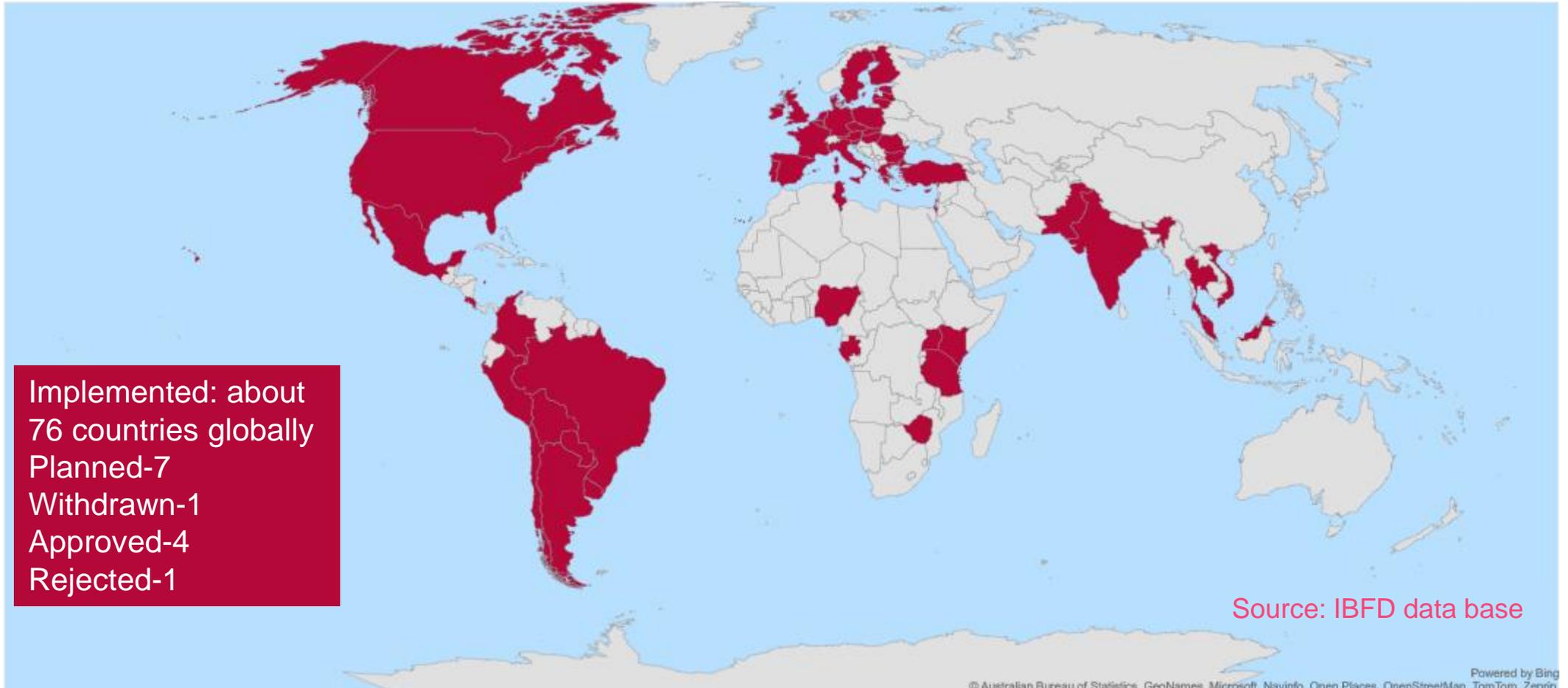
- ▶ Implementation of Article 12B
 - ▶ Fairly new and developed at the same time as work on OECD IF 2 Pillar solution.
 - ▶ Bilateral tax treaties [**so far, no country has it incorporated in their treaties**]
 - ▶ Multilateral approach through a UN Fast Track Instrument.
 - ▶ Proposed to be under the **Fourth Protocol** to the UN Fast Track Instrument

Country practices: Unilateral Domestic Measures

- ▶ Concerns of delays in developing a global solution on addressing the tax challenges of the digital economy.- 7 years since 2018
 - ▶ Responses include:
 - New Nexus based on Significant Economic Presence
 - Withholding taxes
 - Digital service taxes (EU proposal as interim measure – EU countries)
 - Specific regimes for large MNEs
- ▶ Concerns of entry-into-force of the MLC on Pillar 1.
 - ▶ Requires 30 signatories representing at least 600 points.- Total points 999
 - ▶ US has 486 points
 - ▶ US ratification is key to attaining the 600 points
- ▶ The October 2021 IF Statement had political agreement to remove DSTs and similar measures for **all companies**, and not introduce any in the future
- ▶ You won't get Amount A allocation if you introduce DST or similar measure

Taxing the digital economy: digital services tax, SEP, Equalisation levy

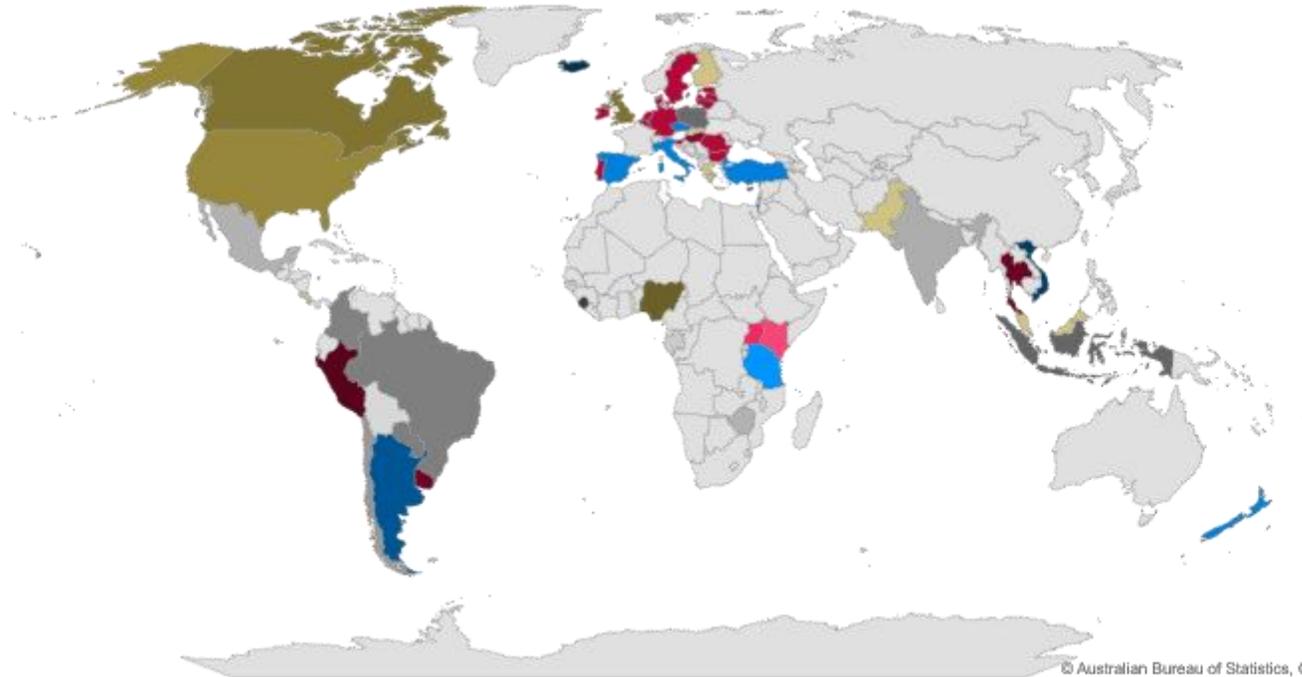
Few countries in Africa/ Asia have implemented income tax measures for the digital economy



Measures Adopted

Measures

- | | | |
|---|--|--|
|  Digital Service Tax |  Gross revenue tax (City of Buenos Aires) |  Digital tax |
|  Income tax (Reporting Obligations for Digital Platforms – DAC7) |  Corporate income tax-on foreign beneficiaries |  Withholding income tax (IRRF) |
|  Digital services tax (DST) |  Income tax (Reporting Obligations for Digital Platforms) |  Individual Income Tax |
|  Corporate income tax |  Corporate income tax (significant economic presence) |  Local turnover tax |
|  Income tax |  Digital services tax |  Corporate tax of Member States (on a significant digital presence - SDP) |
|  Digital levy |  Digital service tax (DST) |  Tax on videograms (“YouTube tax”) |
|  Tax on operators of transportation platforms |  Tax on on-demand music streaming platforms/services | |



Latin America, Central and North America

- ▶ Countries implemented some unilateral measures include, **Argentina, Bolivia, Brazil, Colombia, Peru, Chile, Brazil, Paraguay, Uruguay, Costa-Rica, Mexico, Canada, USA.**
 - ▶ The measures include tax on corporate income from digital services, withholding taxes, gross revenue taxes, and digital services taxes, device for use, view, or download of content.
 - ▶ Tax rate rates vary depending on whether its income tax, withholding taxes (3%) have lower rates while income taxes are as high as 40%.

Europe

- ▶ Several countries in Europe introduced digital service taxes as interim measures.
- ▶ Most countries in EU are implementing DAC 7 (Income tax reporting obligations for platforms)
 - ▶ Information to be used for income tax purposes

Country Practices:

Africa

- ▶ About 7 countries in Africa are implementing unilateral measures for the digital economy.
- ▶ Countries include **Nigeria, Tunisia, Uganda, Gabon, Tanzania, Kenya and Zimbabwe**
- ▶ Measures include digital service tax, significant economic presence, withholding tax and income tax.

Asia

- ▶ In Asia, several jurisdictions enacted unilateral direct tax measures targeting non-resident supplies of digital services.
 - ▶ Countries include **Hong Kong, India, Indonesia, Malaysia, Pakistan, Taiwan, Thailand and Vietnam.**
 - ▶ The measures withholding tax, general income tax, equalisation levy and significant economic presence, electronic transaction tax.
 - ▶ Withholding tax rates range from 0.1% (Vietnam) to 15% in (Thailand)

▶ **Indonesia:**

- ▶ Income tax (significant economic presence): not yet fully implemented, law enacted. Full implementation await regulations.
- ▶ Taxable events: e-commerce activities of non– residents.
- ▶ Taxable persons: foreign traders, foreign service providers and foreign e-commerce providers with significant economic presence.
- ▶ Rate(s): to be determined.

▶ **Article 38 of Multilateral Convention, Key features include:**

- ▶ structured as a selective tax on revenue (excise tax) and not income tax on profits.
- ▶ Treated outside the scope of tax treaties.
- ▶ are “turnover taxes” that apply to the revenue generated from taxable activities regardless of costs
- ▶ Tax is usually determined by location of customers/users (market-based criteria)
- ▶ Usually target non-resident owned business (directly or indirectly e.g high revenue thresholds, exemptions)

Does not include:

- ▶ Anti-avoidance rules on PE
 - ▶ Taxes on consumption like VAT
 - ▶ Taxes on a transaction per transaction basis
- ▶ **Article 37 (1)- existing measures should be removed for any company from date MC enters into**

effect



Overview of Challenges

SEP	Withholding Tax	Equalisation Levy	Digital Service tax
<p>may lead to double taxation.</p> <p>a nexus rule under the Income Tax so treaty provisions will override these domestic tax rules.</p> <p>Developing countries do not have the strong bargaining-position needed to compel a large MNEs to voluntarily comply with their unilateral rule</p> <p>Administrative constraints, by way of collection, debt recovery and enforcement</p>	<p>may lead to double taxation.</p> <p>High rates may lead to over-taxation</p> <p>may be grossed up by non-resident suppliers to pass on the tax cost/burden to the consumers/payers who then carry the economic burden.</p> <p>Not an effective collection mechanism for B2C transactions</p> <p>Will affect loss making entities</p>	<p>may lead to double taxation.</p> <p>may be grossed up by non-resident suppliers to pass on the tax cost/burden to the consumers/payers who then carry the economic burden.</p>	<p>may lead to double taxation.</p> <p>may increase in the price of imported services over the long term,</p> <p>threat of retaliatory tariffs on exports by parent countries of MNEs</p> <p>worked like excise taxes as they increase the prices of the covered services, thereby reducing local demand.</p> <p>Will affect genuine loss making entities.</p>

Conclusion

The UN Tax Committee has taken significant steps to address the tax challenges of digitalisation of the economy in favor of market jurisdictions, however such solutions have their limitations.

What happens if Pillar 1 fails?

If Pillar 1 succeeds, then there is need for consideration for effect of political commitments entered into when applying unilateral measures.-
concern for IF members who sign the multilateral convention

What happens under the UN Framework Convention?
Early protocol





Thank You!!!