# Developing Countries' Perspectives on the Digitalization of the Economy —Focusing on the U.N. Initiatives—

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## Abstract

Developing countries have a strong interest in the international taxation, particularly how to address taxation issues related to the digitalization of the economy, to satisfy the fiscal needs under the Sustainable Development Goals (SDGs), which are targeted for achievement in 2030. In exploring a new taxation approach to address taxation issues raised by the digitalization of the economy, developing countries emphasize that the due consideration should be given to a fair allocation of tax revenue, a simple design of taxation system, and administration capacity of developing countries. In order to achieve a worldwide consensus on how to address those taxation issues, it is essential to develop the solutions that reflect developing countries' perspectives and conditions. This article examines the background of developing countries' position on this matter and how the U.N. Model Tax Convention which reflects the developing countries' international taxation policy, has addressed this matter thus far. This article also examines the relationship between taxation and trade/investment rules, since the new taxation approach needs to be consistent with the existing trade/investment rules, with focus on the relationship between taxation and international investment agreements, which is a specific matter to developing countries, to explore the new desirable taxation approach for developing countries.

Keywords: Sustainable Development Goals (SDGs), U.N. Tax Committee, U.N. Model Tax Convention, Significant Economic Presence (SEP), Taxation and Trade/Investment Rules

## I. Introduction

The Committee of Experts on International Cooperation in Tax Matters ("UN Tax Committee") of the Economic and Social Council (ECOSOC) of the United Nations has played a leading role in promoting the international tax system and its administration of developing countries. The United Nations adopted the 2030 Agenda for Sustainable Development Goals (SDGs) in September 2015, which contains a set of 17 SDGs and 169 targets. The SDG 17 is to "strengthen the means of implementation and revitalize the global partnership for sustainable development," and as a fiscal policy, the target 17.1 is to "strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection." The Addis Ababa Action Agenda, which represents an integral and complementary part of the 2030 Agenda,[1] emphasizes the importance of cooperation and dialogue among national tax authorities on international tax matters to mobilize and effectively use domestic public resources. To this end, the work of the UN Tax Committee has been further enhanced to strengthen developing countries' effectiveness and operational capacity for tax policy as well as tax administration.

Given the fact that developing countries have a strong interest in the international taxation, increased number of developing countries actively participate in the OECD/G20 Inclusive Framework on BEPS,[2] which is the post-BEPS initiative, to seek for consensus-based and long-term solutions to the tax challenges arising from the digitalization of the economy.

The new joint initiative was also designed to intensify the cooperation between International Organizations on tax issues for developing countries. The Platform for Collaboration on Tax (PCT), established in April 2016, is a joint initiative of the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the United Nations (UN), and the World Bank Group (WBG) to strengthen their ability to provide capacity-building support to developing countries, and helps them deliver jointly developed guidance.[3] It also increases their ability to share information on operational and knowledge activities around the world.

The UN Tax Committee established the Subcommittee on Tax Challenges related to the Digitalization of the Economy,[4] since this is one of the top priority topics for developing countries, and assigned the following three workstreams;

- 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 the context of its work, the UN Tax Committee submitted the comments on the OECD

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[1] The Third International Conference on Financing for Development (Addis Ababa, Ethiopia, 13–16 July 2015) endorsed the Addis Ababa Action Agenda for the global framework for financing development post - 2015.

[2] As of December 2019, 137 members participate in the OECD/G20 Inclusive Framework on BEPS.

[3] For more details on the activities of PCT, *see* Mitsuhiro Honda, "The Platform for Collaboration on Tax: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses, International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), World Bank Group (WBG)," Sozeikenky, No. 825, p. 307, 2018.

[4] "The Subcommittee is mandated to draw upon its own experience as a body widely representative of affected stakeholders and engage with other relevant bodies, and interested parties with a view to:

- Analyzing technical, economic and other relevant issues;
- Describing difficulties and opportunities especially of interest to the various affected agencies of developing countries;
- Monitoring international developments;
- Describing possible ways forward; and
- Suggesting measures and drafting provisions related to the digitalization of the economy, regarding:
  - Income taxes;
  - Double tax treaties, and
  - VAT as well as other indirect taxes."

*See* E/C. 18/2019/CRP.16, Co-coordinators' Report on Work of the Subcommittee on Tax Challenges related to the Digitalisation of the Economy.

Secretariat's proposal of the "Unified Approach" under the Pillar One in the Public Consultation Document of 9 October, 2019.[5] The comments emphasize that the due consideration should be given to a fair allocation of tax revenue, a simple design of taxation systems, and administration capacity of developing countries.[6]

In order to achieve a worldwide consensus on how to address those taxation issues, it is essential to develop the solutions that reflect developing countries' perspectives and conditions.[7] This article therefore examines the background of developing countries' position on the tax challenges related to the digitalization of the economy, and how the U.N. Model Tax Convention which reflects the developing countries' international taxation policy, has addressed this matter thus far. This article also examines the relationship between taxation and trade/investment rules, since the new taxation approach needs to be consistent with the existing trade/investment rules, with focus on the relationship between taxation and international investment agreements, which is a specific matter to developing countries, to explore the new desirable taxation approach for developing countries.

## II. Developing countries' position on the digitalization of the economy

### *II-1. Significant Economic Presence*

#### II-1-1. Concept of Significant Economic Presence

BEPS Final Report on Action 1 (Addressing the Tax Challenges of the Digital Economy)[8] develops the concept of Significant Economic Presence ("SEP"), as an option to address the broader direct challenges raised by the digitalization of the economy, in addition to a withholding tax on digital transactions and "equalization levy." This option will create a taxable presence in a country when a non-resident enterprise has a SEP in the source country, which will replace the current concept of the permanent establishment (PE) requiring the physical presence in the source country. The new digital nexus, i.e. SEP will be created on the basis of digital factors (e.g., a local domain name, a local digital platform, local payment options) and user-based factors (e.g., monthly active users, online contract conclusion, data collected), combined with a factor based on the revenue derived from remote transactions into the country.

The attributable profits to the SEP will be taxable in the source country, in a similar

[5] OECD (2019), Public Consultation Document, "Secretariat Proposal for a 'Unified Approach' under Pillar One", 9 October 2019-12 November 2019. https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf.

[6] OECD website, https://www.oecd.org/tax/beps/public-comments-received-on-the-secretariat-proposal-for-a-unified-approach-under-pillar-one.htm.

*See* Annex for the UN Tax Committee's Comments to the OECD Secretariat on the "Unified Approach" as proposed by the Secretariat in its Public Consultation Document of 9 October.

[7] *See* Masao Yoshimura, Professor of Hitotsubashi University, "Classroom for Economy, Tax Issues on the Digitalization of the Economy, Part II, Nihon Keizai Shimbun (10 December, 2019).

[8] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

manner as those attributed to the traditional PE.[9] In determining the income attributable to the SEP, the Final Report explored the methods based on fractional apportionment and modified deemed profits methods.[10] Since fractional apportionment methods on the basis either of a predetermined formula, or on the basis of variable allocation factors determined on a case-by-case basis, which will be significantly different from the current international standards, i.e. the separated accounting methods, these methods were not pursued further. The taxation approach on the basis of the SEP could be combined with a withholding tax on digital transactions, as a primary collection mechanism and enforcement tool to support the application of the new digital nexus option, i.e. net-basis taxation.[11]

### II-1-2. Three proposals for the "Pillar One"

The taxation approach on the basis of the SEP has been supported by developing and emerging countries, and treated as one of the three proposals for the "Pillar One," which will be creating a new taxing right for the market/user jurisdiction to address the tax challenged raised by the digitalization of the economy.

The following OECD's documents addressing the tax challenges of digitalization of the economy; "Policy Note" (23 January 2019),[12] "Public Consultation Document" (13 February – 6 March 2019),[13] and "Programme of Work" (31 May 2019)[14] develop three proposals for the "Pillar One": (i) user participation; (ii) marketing intangibles; and (iii) SEP for the basis of a new taxing right for the source country taxation.

It is reported that (i) the "user participation" proposal was proposed by the U.K., (ii) the "marketing intangibles" proposal was by the U.S., and (iii) the "SEP" proposal was supported by developing and emerging countries, such as India.

The "Public Consultation Document" illustrates the business models, key fact patterns and factors that each three proposals focus as follows:

(i) the "user participation" proposal: social media platform; search engines; online marketplaces, etc.;

(ii) the "marketing intangibles" proposal: a highly digitalized business drivers revenue from sales and marketing activities targeting a particular market jurisdiction in which it does not have a taxable presence; the same highly digitalized business has a local presence but operates it as a limited risk distributor; or consumer product business not traditionally thought of as a highly-digitalized business, operating either remotely or

[9] Ibid., paragraphs 277-281.
[10] Ibid., paragraphs 284-291.
[11] Ibid., paragraphs 292-301.
[12] OECD (2019), Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD, Paris, www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challengesdigitalisation.pdf.
[13] OECD (2019), Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, 13 February - 6 March 2019.
[14] OECD (2019), Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/programme-of-work-to-develop-aconsensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm.

through a limited risk distributor, etc.;

(iii) the "SEP" proposal: factors that evidence a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means.

The "Public Consultation Document" compares the three proposals to note the commonalities between (i) the "user participation" proposal and (ii) the "marketing intangibles" proposal, as they can be conceptualized in a similar way and both use a residual profit split methodology for allocating profit. On the contrary, (iii) the SEP proposal uses the fractional apportionment or modified deemed profits methods in determining the income attributable to the SEP, this approach has not been further explored in the work.

### II-1-3. The 2018 Tax reform in India

In India, the Income tax-Act, 1961[15] was amended by the Finance Act 2018 to bring in the concept of "Significant Economic Presence"[16] to establish "business connection" in the case of non-resident in India. Accordingly, significant economic presence shall mean:[17]

- any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India if the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed; or
- systematic and continuous soliciting of its business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

The taxation approach based on the SEP will enable developing countries to address the tax challenges related to the digitalization of the economy, however, it is noted that establishing the clear scope of the SEP and determining the attributable profits would be difficult for administrative purposes. In this respect, the definition of the SEP developed by the 2018 Tax Reform in India should be noted.

## *II-2. The "Unified Approach"*

With taking into account the commonalities of the three proposals for the "Pillar One," on 19 October 2019, the OECD Secretariat proposed the "Unified Approach" to design a solution that attract support from all members of the Inclusive Framework.[18]

The UN Tax Committee submitted its comments to the OECD Secretariat on this "Unified Approach," emphasizing that the due consideration should be given to a fair allocation of tax revenue, a simple design of taxation system, and administration capacity of developing countries and strongly suggested considering ways in which the general idea of the

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15 Section 9(1)(i).

16 For more details on India's responses to the tax challenges raised by the digitalization of the economy, *see* Eimon Ueda, "Economic and Social Digitalization, and India's Taxation - Focusing on International Taxation Issues -," Financial Review, Vol. 143: Digital Economy and New Trends in Taxation, p192, 2020.

17 Press Information Bureau, Government of India, Ministry of Finance, Taxation of Digital Business, 12, Feb. 2019. https://pib.gov.in/Pressreleaseshare.aspx?PRID=1564086

18 *Supra* note 5.

"Unified Approach" can be remodeled into a simpler approach, e.g. through the use of withholding taxes.

With respect to the scope, the UN Tax Committee 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, and questions whether restricting the scope to consumer facing business would meet the interest of developing countries. It is also 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.

With respect to the new nexus and country level revenue thresholds, the UN Tax Committee cautions against too-high thresholds, as that would prevent developing countries from taxing substantial profits attributable to their markets, and 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, B and C, the UN Tax Committee note the following views;

- Amount A: 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. Amount A should be on a business line and regional/market basis; and the possibility of applying a fractional apportionment to routine profits should be suggested.
- Amount B should be an agreed minimum compensation for marketing and distribution activities and not an elective safe harbor for taxpayers
- Amount C: the UN Tax Committee 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, and 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.

In conclusion, the UN Tax 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. This seems to reflect developing countries dissatisfaction on the "Unified Approach," as it does not fully take into account of the SEP proposal.

## III. UN Model Tax Convention and Tax Challenges related to the Digitalization of the Economy

The UN Model Tax Convention[19] reflects the international tax policy of developing countries and has the different provisions from those of the OECD Model Tax Convention, as regard the taxation on the business income, and personnel service income, etc. These pro-

[19] United Nations, "Model Double Taxation Convention between Developed and Developing Countries 2017."

visions are considered as the possible basis to respond to tax challenges related to the digitalization of the economy.[20]

The paragraph 4 of Article 13 (capital gains) allows the source country to tax the gains from the alienation of the shares of a company, the property of which consists principally immovable property. The Platform for Collaboration on Tax ("PCT") explores the legal design and drafting principles for developing countries to tax the gains from the alienation of offshore indirect transfer ("OIT") of the foreign companies which own the immovable property located in the country.[21]

## *III-1. Business Income*

The UN Model and the OECD Model Conventions have the same taxing principles on the business income, i.e. only profits attributable to permanent establishment (PE) may be taxed in the source country. However, the UN Model Tax Convention amplify the scope of the PE and the taxable business income by including a limited force of attraction rule.[22]

### III-1-1. The scope of PE

Article 5 (permanent establishment) of the UN Model Tax Convention provides the broader scope of the PE than those of the OECD Model Tax Convention, such as the 6-month threshold of the construction site PE, the service PE,[23] the agent PE for maintenance of a stock of good, the insurance PE. In particular, the service PE is considered as one of the significant different scopes of the PE between the two Models.[24] Under the provision of the service PE,[25] the furnishing of services by an enterprise through employees or other personnel engaged by the enterprises for a period of more than 183 days, without any fixed place of the business in the source country, will constitute the PE. The UN Model Convention already incorporates the nexus rule which does not need the physical presence in the

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[20] *See* Jinyan Li, "Protecting the tax base in the digital economy," United Nations Handbook on Selected Issues in Protecting the Tax Base on Developing Countries, Second Edition, 2017.

[21] The Platform for Collaboration on Tax, "The Taxation of Offshore Indirect Transfers- A Toolkit," https://www.tax-platform.org/sites/pct/files/publications/PCT_Toolkit_The_Taxation_of_Offshore_Indirect_Transfers.pdf.

[22] *See* Keiji Aoyama, "Rising of emerging countries and international tax law," Hiroshi Kaneko, Editor-in-Chief, Lecture on Modern Tax Law, Vol. 4, International Taxation, Nihonhyoronsha, 2017; Keiji Aoyama, "Comparison of the Model Tax Conventions of the OECD and the UN," Sozeikenkyu, No. 730, p. 242, 2010.

[23] The UN Model Tax Convention provides the service PE since its publication in 1980 to originally clarify the scope of the PE. *See* Klaus Vogel on Double Taxation Conventions, E. Reiner & A. Rust eds., 4th edition, Kluwer 2015, Art. 5, paragraph 399. Approximately 60% of the tax treaties between the UN member states provide the provisions of the service PE. *See* W. F. G. Wijinen & J.J.P. de Goede, The UN Model in Practice 1997-2013, 68 Bull. Intl. Taxn.4, at 118 (2014), Journals IBFD.

[24] OECD Model Tax Convention provides the Service PE as the alternative provisions in the Commentary on Article 5 in the 2008 update. See Commentaries on the OECD Model Tax Convention, Article 5, paragraphs 132-169.

[25] Article 5(3)(b) of the UN Model Tax Convention provides: "The term "permanent establishment" also encompasses: …(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned."

In the 2017 update of the UN Model Tax Convention, the words "(for the same or connected project)" in subparagraph (b) was removed as the "project" limitation was easy to manipulate and created difficult interpretative issues and factual determinations for tax authorities.

source country, prior to the current work to review the existing nexus rule to address the tax challenges raise by the digitalization of the economy.

### III-1-2. The scope of taxable business income

Article 7 of the UN Model Tax Convention amplifies the scope of the attributable profits to the PE by including a limited force of attraction rule, which is different from the attribution rules provided by the corresponding Article in the OECD Model Tax Convention. This allows the country in which the PE is situated to tax not only the profits attributable to that PE but other profits of the enterprise, i.e. profits from sales of the same or similar kind as those through that PE, or other business activities carried on in the market jurisdiction of the same or similar kind as those effected through the PE.[26] By deeming all online or digital activities as "same or similar" for purpose of Article 7, it would be possible to allocate the taxing right to the market jurisdiction on the business income originated from the digital business.[27]

Article 7 (4) of the UN Model Tax Convention allows to determine the profits to be attributable to the PE by apportioning the total profits of the enterprises by reference to various formula,[28] which is familiar with the fractional apportionment used by the SEP proposal in determining the income attributable to the SEP. Accordingly, the SEP proposal should be noted as an acceptable approach under the business income provision of the UN Model Tax Convention.

## *III-2. Taxation of income from services*

Article 12A (Fees for technical services) of the UN Model Tax Convention, added in the 2017 update, does not have a corresponding provision in the OECD Model Tax Convention. This laid down the principle that the Contracting State in which any payment in consideration for any service of a managerial, technical or consultancy nature may tax those payments in accordance with the provisions of its domestic law.

This provision will allow developing countries to tax payments related to cross border services, and as the counter measures against the BEPS (Base Erosion and Profit Shifting), to tax digital transactions (which include digital cross border services) for developing countries.[29] Since the rules under Article 7, together with Article 5 of the UN Tax Model Conven-

[26] Article 7 (1) of the UN Model Tax convention provides; "The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the 16 Article 7 other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment."

[27] *Supra* note 20, pp. 516-518.

[28] Article 7 (4) of the UN Model Tax Convention provides "In so far as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article."

Table1. Comparison of the UN and the OECD Model Tax Conventions

| | UN Model Tax Convention | OECD Model Tax Convention |
|---|---|---|
| The scope of the PE | Construction sites PE (including supervisory activities, more than 6 months)<br>Service PE (including consultancy services, more than 183 days)<br>Secure order - type Agent PE<br>Insurance PE | Construction site PE (more than 12 months)<br>—<br>—<br>— |
| Taxation rules | PE principle<br>A limited force of attraction rule<br>Arm’s length principle<br>Limitation on internal payments<br>Apportion method<br>The question of the mere purchase should be settled in bilateral negotiations. | PE principle<br>Attribution rule<br>Arm’s length principle (Authorized OECD Approach)<br>—<br>—<br>— |

tion, give limited scope for taxing income from services, in particular without a PE in the source State, this provision will allow the source State to tax fees for technical services. This Article is also to clarify the distinction between the payment in consideration for services of a managerial, technical or consultancy nature, and royalty payment for “information concerning industrial, commercial or scientific experience.”

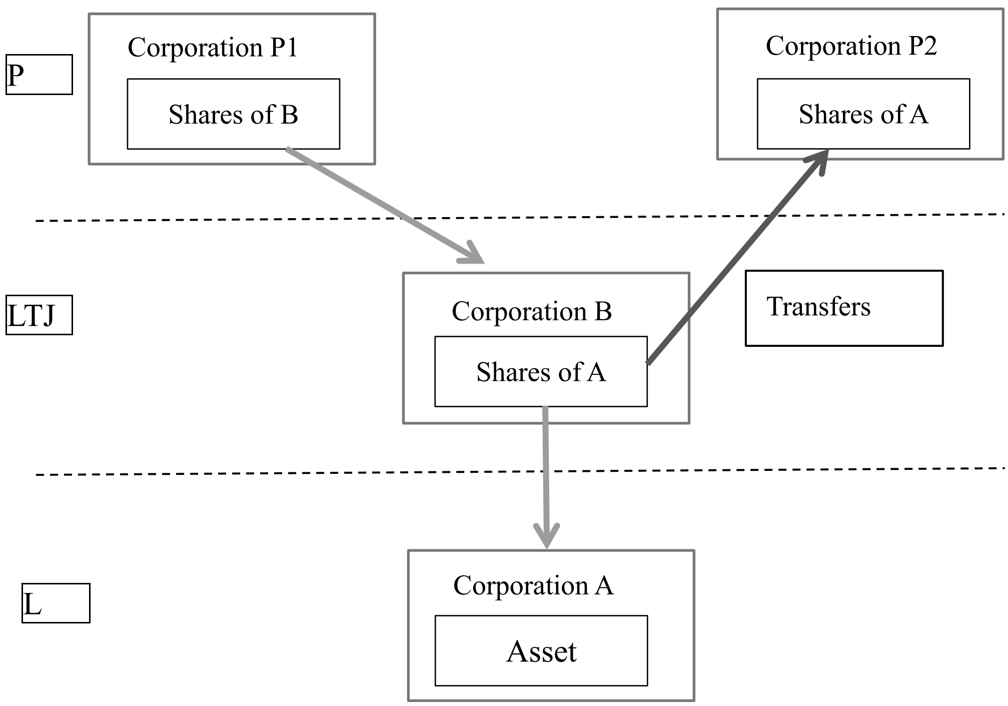
Article 12A was added in the main text of the UN Model Tax Convention, not an alternative provision in the Commentary. The future developments in developing countries’ tax treaty network is worthy of note.[30]

[29] *See* Article 12A Commentary, paragraphs 2-15. The views against Article 12A was also described in the Commentaries, paragraphs 16-22.
[30] Japan’s tax treaties with India (Article 12) and Pakistan (Article 13) have the same provision to Article 12A of the UN Tax Model Convention.

## *III-3. Taxation of Offshore Indirect Transfers*

Article 13 (4) in both Model Tax Conventions provide that gains on indirect transfers of immovable property may be taxed by the country in which that property is located. However, the number of developing countries' tax treaties with this provision is still relatively low,[31] and developing countries need to develop domestic legislations to tax gains on indirect transfers of immovable property. Accordingly, the "PCT" published the report ("A Toolkit for OIT")[32] that outlines the model approaches to the taxation of offshore indirect transfers by the country in which the underlying asset is located on 4 June 2020.

Figure1. Example of OIT structure[33]




A Toolkit for OIT proposes two common model of domestic tax law framework for developing countries.[34]

31 *Supra* note 21. It remains the case that the relevant provision is found only in around 35% of all double tax treaties. Article 9 (Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property) of the MLI has increased the number of tax treaties that include Article 13(4) of the relevant Model Tax Treaties. For the view emphasizing the practical importance of the taxing of indirect offshore transfer, *see* Wei Cui, "Taxing Indirect Transfers: Improving an Instrument for Stemming Tax and Legal Base Erosion," 33 Va. Tax Rev.653 (2014), "Taxation of non-residents' capital gains," United Nations Handbook on Selected Issues in Protecting the Tax Base on Developing Countries, Second Edition, 2017.

32 *Supra* note 21.

33 Based on the "Figure 1: Stylized Example of an OIT Structure" in A Toolkit for OIT, p11.

34 *Supra* note 21, pp. 35-53.

- Model 1 (taxation of a deemed direct sale by a resident): This model seeks to tax the local entity that directly owns the asset, by treating that entity as disposing of, and reacquiring, its assets for their market value where a change of control occurs (e.g. because of an offshore sale of shares or comparable interests).
- Model 2 (taxation of the non-resident OIT seller via source rule): This model seeks to tax the non-resident seller of the relevant shares via a non-resident assessing rule. Model 2 must be supported directly or implicitly by a source of income rule, which provides that a gain is sourced in the location country when the value of the interest disposed of is derived, directly or indirectly, principally from immovable property located in that country.

As the enforcement/collection rules, A Toolkit for OIT suggests the reporting system with information exchange mechanism, the withholding tax system on the capital gains of shares, the agent of the non-resident seller, or other legal protections, such as restricting the registration, etc.

A Toolkit for OIT also suggests the definition of “immovable property” to include a lease of land or buildings, exploration prospecting, development right relating to land or buildings, or natural resources, or information relating to a right. The taxation of OIT will be a one potential response by developing countries to tax challenges related to the digitalization of the economy.

## IV. Relationship between taxation and trade/investment rules

The new taxation approach to respond to tax challenges raised by the digitalization of the economy needs to be consistent with existing trade/investment rules as well as the international investment agreements,[35] which is a specific matter to developing countries.

The “Global anti-base erosion proposal” in the “Pillar Two” includes a tax on base eroding payments which consists of an undertaxed payments rule and a subject to tax rule in tax treaties. As the BEAT in the U.S., which has the similar mechanism with an undertaxed payments rule, has been claimed as again the tax treaty obligations and thus should be modified by the provisions of the elimination of double taxation and non-discrimination.[36] Accordingly, it will be necessary to explore the relationship between the tax treaty obligations and the undertaxed payments rule.

[35] In the Contract Manufacturing (Rairyo-Kako) Case (Tokyo High Court Decision on Aug. 30, 2011, Shomu-Geppo, Vol. 59, No.1, p.1), the National Tax Agency (NTA) applied the CFC rules by attributing the income of the Hong Kong subsidiary to the Japanese parent company (the taxpayer), where the Hong Kong subsidiary concluded an agreement with a Chinese company to engage a local factory located in South China in contract manufacturing of the product. The taxpayer claimed that the Japanese CFC rules violated the most favored nation (MFN) obligations of the Hong Kong – Japan bilateral Investment Treaty (BIT). While the Tokyo High Court held that the application of the CFC rules taxing a resident company would not be prevented by the MFN clause of the BIT, the different view was expressed by the international economic law scholar. *See* Akira Kodera, “Anti-tax heaven legislation and Bilateral Investment Treaty,” Minoru Nakazato, Editor, Frontier of Anti-tax heaven legislation, Yuhikaku, 2013. The Supreme Court rejected the appeal on 11 December 2013.

[36] *See* H. David Rosenbloom and Fadi Shaheen, “The BEAT and the Treaties,” Tax Notes Int’l, Oct. 1, 2018, p. 53.

## *IV-1. General Agreement on Trade in Services (GATS)*

### IV-1-1. The scope of GATS[37]

In general, the GATS applies to measures by member countries "affecting trade in services" and "trade in services" is defined as the supply of a service:

(a) from the territory of one member country into another;

(b) in the territory of one member country to a service consumer of any member country;

(c) by a service supplier of one member country through commercial presence in another member country;

(d) by a service supplier of one member country through presence of natural persons in another member country.

Among the above four modes, the service presence in another member country is the most typical and large-scale trade in service activities. As the service suppliers usually make the necessary investments for the commercial presence, the GATS is considered to apply to the investments related to supplying the services. The commercial presence in another country for supplying services involves the direct taxation consequences in the country, which is clearly different from the trade in goods that is covered by the General Agreement on Tariffs and Trade (GATT). The GATS requires most-favored-nation (MFN) treatment (Article II) with respect to services and services suppliers of member countries as the general obligation and the Market Access (Article XVI) and National Treatment (Article XVII) as the specific commitments.

### IV-1-2. Taxation measures and the GATS

Article XIV (General Exception) of the GATS provides that, subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:

(d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;[38]

(e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.[39]

According to the footnote to Article XIV(d), measure to impose or collect taxes equita-

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[37] *See* Mitsuhiro Honda, "Investment Treaties and Taxation Measures: on the Subject of "Contract Manufacturing (Rairyo-Kako) Case (Tokyo High Court Decision on Aug. 30, 2011)," Tsukuba Law Journal, No. 15, p.47, 2013.

[38] The background for this exception is explained as follows; the U.S. claimed that the GATS provisions should not prevent the taxation rights in sovereign state as much as possible. *See* Ministry of foreign Affairs, Economic Bureau, the First International Organization Division, "Treaties on WTO Agreements," Institute for Japan's International Problem, 2003, pp. 472−473.

bly or effectively include measures which:

(i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
(ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
(iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
(iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
(v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
(vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

The footnote prescribes that the tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.[40]

With respect to the relationship between the national treatment of GATS and taxation measures, the following two points should be pointed out.[41] First, Article XIV(d) applies only with respect to "direct taxes" and not indirect taxes. Therefore, it is unclear whether a tax levied by a country on services provided abroad and generally shifted to domestic consumers constitutes an indirect tax. Second, the footnote to Article XIV (d) indicates that whether taxable items are "sourced or located" in a country for purposes of its tax law is determined under that country's domestic law. If the services performed outside the country by non-residents even where the income is considered to be sourced in another country, under that country's domestic law, that country's taxation will raise the question of the national treatment under the GATS unless it falls into the other items in the footnote.

As noted above, it is necessary to take into account the Article that provides the excep-

[39] The background for this exception is explained as follows: it is not practical to extend the same treatments to all other GATS member countries by applying the MF, as the tax treaty benefits are provided based on the reciprocal basis with assuming the different tax treatments between the two countries. *See* Kunihiko Miyake, "Treaties on WTO, General Agreement on Trade in Services (GATS)," Ministry of foreign Affairs, Economic Bureau, 1996, p. 140.

[40] Based on the indicated measures, the following taxation measures will fall into the exception to the national treatment; for example, the different scope of the taxable income arising the different residence status, the withholding tax only applicable to non-resident, the anti-tax avoidance taxation measures, the transfer pricing taxation measures, etc. Ibid., p. 140.

[41] *See* Brian J. Arnold, "Taxation of income from services," United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries, Second Edition, United Nations, 2017, pp. 114-121.

tion from GATS obligations in developing the new taxing approach, including the new "taxing right" to address tax challenges raised by the digitalization of the economy.

## *IV-2. Bilateral Investment Treaty (BIT)*

### IV-2-1. Taxation measures under BIT[42]

In general, the articles of transparency, expropriation, and fair and equitable treatment of Bilateral Investment Treaty will be applicable to taxation measures.

The transparency obligation requires the publication of laws, administrative procedures and other administrative and judicial decisions. It was reported that emerging and developing countries have such tax practices, as assessments based on the secret rulings, unofficial private rulings, tax liabilities determined by negotiating with tax officials, and inconsistent interpretations caused by absence of the official interpretation of tax laws, etc. The transparency obligation of the BIT is expected those tax problems caused by the unclear tax system and administrative practices, that investors will face in the investment destination country.

Under the expropriation obligation, a country may not expropriate or nationalize property, except for a public purpose; in accordance with due process of law; in a non-discriminatory manner; on payment of prompt, adequate, and effective compensation. Such compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation. The expropriation obligation is expected as a safeguard against the cases in which the investment destination country utilizes taxation measures to achieve the same effect of expropriation or nationalization of investment property.

The fair and equitable treatment obligation is an obligation that the host country to accord "fair and equitable treatment" to investments of nationals or companies of the other country.[43] Specifically, this obligation[44] is considered to include paying a careful attention to the protection of investment property, following the due process of procedures, protection of the right to a trial, prohibition of arbitrary and capricious measures, living up to investor's reasonable expectation.[45]

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[42] *See* Mitsuhiro Honda, "BIT and Taxation Measures - focusing on the provisions applicable to taxation measures," Zeimujirei, Vol. 47, No. 1, p. 35, 2015; Keigo Fuchi, "Interaction of the International Taxation and the trade/investment agreements," International Aspect of Income Taxation, p. 168, Yuhikaku, 2016; Eiichiro Nakatani and Ryo Tanaka, "Intersection between International Economic Law and International Tax Law," Hiroshi Kaneko, Editor-in-Chief, Lecture on Modern Tax Law, Vol. 4, International Taxation, Nihonhyoronsha, 2017.

[43] Akira Kodera, "Fair and equitable treatment - the general treatment of investment property," Akira Kodera, editor-in-chief, Bilateral Investment Treaty- Legal Protection by Arbitration, Sanseido, 2010.

[44] *See* the website of the Ministry of Economy, Trade and Industry, Trade Policy Bureau, Economic Partnership Division, "Outline of BIT and Japan's Initiatives," March 2016. http://www.meti.go.jp/policy/trade_policy/epa/pdf/BITrsrc/bitoverview.pd.

[45] There are two views on the fair and equitable treatment; one view is that this is a customary international law's minimum standard of protection that a country shall accord to a national of other contracting country; other view is that this is more than a customary international law's minimum standard of protection. *See* Junji Nakagawa, et al., International Economic Law, 2$^{nd}$ edition, Chapter 13, Yuhikaku, 2012. Since the fair and equitable treatment obligation it too vague to apply to taxation measures, there is the view claimed that taxation measures should be carved-out from this obligation in the BIT. *See* Takuji Tanaka, "International Taxation in the International Economic System," Financial Review, Vol. 94, pp.163-165, 2009.

### IV-2-2. Fair and equitable treatment and taxation measures

In the OEPC case,[46] the fair and equitable treatment provision of the BIT was applied to the taxation measures in favor of the taxpayer.

(i) The facts of the dispute

In 1999, OEPC, a U.S. company, entered into a participation contract with Petroecuador, a State-owned corporation of Ecuador, to undertake exploration for and production of oil in Ecuador. OEPC applied regularly to the Servicio de Rentas Internas (SRI) for the VAT refund paid on purchases required for its exploration and exploitation activities under the contract and the final exportation of the oil produced, and received such refunds on regular basis.

However, in 2001, the SRI issued the “Resolutions” that stopped all subsequent VAT refund applied by OEPC and other companies in the oil sector and required the return of the amount of past VAT refund, because VAT refund was already accounted for in the participation formula under the Contract.

OEPC filed the lawsuits in the tax court objecting the “Resolutions” is inconsistent with the Ecuador’s domestic legislation, as well as stated arbitration proceedings against the Ecuador, claiming the BIT between the U.S. and the Ecuador.[47] OEPC claimed that the SRI’s denying resolutions of the VAT refund failed to meet the reasonable expectations of investors, and thus breached the fair and equitable treatment, as well as being against the provisions of no less favorable treatment, impairment, and expropriation.

(ii) Tribunal’s decision

The Tribunal at first reviewed the claims status under the exclusion of taxation measures in Article X, and noted that reference in paragraph 1 of Article X to “strive to accord to fairness and equity” in respect of tax policies concerning the treatment of the investment by the host country is not devoid of legal significance. The Tribunal also found that, because of the relationship of the dispute with the observation and enforcement of the investment Contract in this case, it has a jurisdiction to consider the dispute in connection with the merits insofar as a taxation matter covered by Article X may be concerned.

The tribunal noted that the fair and equitable treatment “is desirable in order to maintain

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[46] Occidental Exploration and Production Company v. The Republic of Ecuador, LCIA Case No. UN 3476, Final Award, 1 July, 2004,

[47] Treaty between the United States of America and the Republic of Ecuador Concerning Encouragement and Reciprocal Protection of Investment, signed on August 27, 1993 and in force since April 22, 1997.

Article X provides the treatments of taxation measures as follows:

1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.
2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:

(a) expropriation, pursuant to Article III;
(b) transfers, pursuant to Article IV; or
(c) the observance and enforcement of terms of an investment Agreement or authorization as referred to in Article VI (1) (a) or (b), to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.

a stable framework for investment and maximum effective utilization of economic resources," and thus the ability of the legal and business framework is an essential element of fair and equitable treatment. The tribunal also noted that the framework under which the investment was made and operates has been changed in an important manner by the actions adopted by the SRI without a sufficient consultation. Accordingly, it held that Ecuador has breached its obligations to accord fair and equitable treatment under Article II (3) (a) of the Treaty.

The Digital Service Tax (DST) has been introduced in several countries as a temporal measure to address tax challenges raised by the digitalization of the economy. Since the DST primarily aims at the specific business model of MNEs, such GAFA, the question was already raised with respect to the fair and equitable treatment of the BIT.[48] Therefore, it is necessary for developing countries to take into account the BIT's transparency, expropriation, and fair and equitable treatment whose essential element is to keep the legal and business framework certainty, in exploring the new taxation approach.

## *IV-3. Tax treaties*

With respect to the relationship between the Base Erosion and Anti-Abuse Tax ("BEAT")[49], introduced by the TCJA in 2017 and the U.S. Model Tax Treaty, H. David Rosenbloom (NYU) and Fadi Shaheen (Rutgers Law school) ("Rosenbloom and Shaheen") believe that the BEAT's conflicts with the nondiscrimination provision and its inconsistency with the Foreign Tax Credit ("FTA") provision of U.S. tax treaties do not constitute treaty overrides. Therefore, they conclude that for calculating the BEAT, deduction for otherwise deductible payments to related persons resident in treaty countries, and foreign tax credits for foreign taxes paid to treaty countries should be allowed.[50]

On the other hand, Reuven S. Avi-Yonah (University of Michigan) and Bret Wells (University Houston Law Center) ("Avi-Yonah and Wells") respond that BEAT is not a treaty violation, and even if were, it is a treaty override. They conclude that the BEAT applies without any treaty limitations.[51]

Each view of Rosenbloom and Shaheen, and Avi-Yonah and Wells are summarized as

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[48] *See* GIBSON DUNN, "Digital Services Tax may violate Investment Treaty Obligations." https://www.gibsondunn.com/digital-services-taxes-may-violate-investment-treaty-protections/.

[49] The BEAT is the excess of 10% of a "modified taxable income base" over the regular tax liability for the tax year. "Modified taxable income" is taxable income of the taxpayer computed under the usual rules but determined without regard to any "base erosion payments," which are deductible payments to foreign related persons, including interests, royalties, service fees, depreciation and amortization for property and amortization deductions for property acquired from foreign related persons, reinsurance payments to foreign related persons, net operating loss deductions reflecting those payments, and specific payments to related expatriated entities. If the corporation has average annual gross receipts of $500 million or more for the three-year period and a "base erosion percentage" of 3% or more, they are subject to the BEAT.

[50] *Supra* note 36.

[51] *See* Reuven S. Avi-Yonah and Bret Wells, "The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen," Tax Notes Int'l, Oct. 22, 2018, p.383, Avi-Yonah, "Beat it: Tax Reform and Tax Treaties," University of Michigan Public law Research Paper No. 587 (Jan. 4, 2018), Bret Wells, "Get With the BEAT," Tax Notes, Feb.19, 2018, p. 1023; Mitsuhiro Honda, "The BEAT and the tax treaties," Sozeikenkyu, No. 838, p. 247, 2019. This topic was discussed in the 2019 IFA Congress in London, Seminar I: Recent developments in international taxation.

follows.

### IV-3-1. Treaty Coverage

According to Rosenbloom and Shaheen, the argument that the BEAT is not covered tax would be difficult, since the Model article 2 (taxes covered), paragraph 4 states that the convention also applies to "any identical or substantially similar taxes that are imposed after the date of signature of this convention in addition to, or in place of, the existing taxes." Congress and the courts assumed the Alternative Minimum Tax ("AMT") to be covered by the U.S. treaties, and congress expressly overrode the treaties if a conflict existed. Since the BEAT is substantially similar to the AMT, an argument that the BEAT is not covered would be difficult to sustain. Even if the BEAT is not covered tax, the nondiscrimination Article 24 applies to "taxes of every kind and description," it would be still subject to challenge on nondiscrimination grounds.

Contrary to Rosenbloom and Shaheen, Avi-Yonah and Wells argues that the BEAT's base is different from that of the income tax, thus it is unclear whether the BEAT is an income tax covered by treaties. Further, it would not be considered an income tax under IRC section 901, because it is not imposed on net income.

### IV-3-2. The Foreign Tax Credit Article

Rosenbloom and Shaheen state that the lack of FTCs against the BEAT violates the treaty obligation under article 23(2). According to the U.S. Model technical explanation, the treaty language says that the post-treaty domestic law amendments cannot change the "general principle thereof," which means the principle of the allowance of a credit, like the AMT.

On the other hand, Avi-Yonah and Wells argue that the BEAT is an FTC limitation because it does not allow those credits against its liability, and it also does not change the general principle of the FTC. They point out that the IRS had a long-standing position that the limitation in old section 59 on the ability to use FTC regime complied with article 23 because of the following phrase; "subject to the limitation of the laws United States (as it may be amended from time to time without changing the general principle hereof)." The Tax Court also said that the limitation on the availability of U.S. FTC relief under old section 59 did not violate the relief from double taxation in article 23.

### IV-3-3. The Nondiscrimination Article

Rosenbloom and Shaheen note that the BEAT is computed without deductions for payments to foreign related persons but envisions no disallowances for identical payments to domestic related persons, thus appears to fall squarely within the ambit of article 24(4). Accordingly, for calculating the BEAT, deductions for otherwise deductible payments to related persons resident in treaty countries should be allowed.

Avi-Yonah and Wells argue that the BEAT does not violate the nondiscrimination for the following four reasons: First, the BEAT applies to payments from U.S. parents to foreign subsidiaries, so it is not limited to payments by foreign MNEs. Both foreign and U.S. MNEs are harmed by the BEAT. Second, the BEAT is not different from the old earnings stripping rule (IRC section 163(j)), which is similar to the thin capitalization rules of other countries, and is an exception to nondiscrimination. Third, the BEAT is not equivalent to a denial of a deduction because its rate is 10%, and the denial of a deduction would have increased tax by 21%. Finally, foreign related parties are not subject to U.S. tax jurisdiction, thus are not comparable to U.S. related parties.

### IV-3-4. Treaty Override

Rosenbloom and Shaheen argues that in *Cook*,[52] the Supreme Court indicated that there is a clear cannon of construction against treaty override by implication, and that for a later statute to override a treaty, legislative silence is not enough, Congress must express a clear intention to override a treaty. However, in the TCJA, Congress did not express explicit intent to override treaties, whether in the statute or in the legislative history, the court would be reluctant to treaty override.

On the other hand, Avi-Yonah and Wells indicates that the U.S. Supreme Court has long held that treaties and laws are equal and that a later law prevails. The general U.S. rule is therefore that any statute that is later in time than a treaty and that conflicts with it in some way is a treaty override.

### IV-3-5. Conclusion

Rosenbloom and Shaheen conclude that, for calculating the BEAT, deduction for otherwise deductible payments to related persons resident in treaty countries, and foreign tax credits for foreign taxes paid to treaty countries should be allowed.

In contrast, Avi-Yonah and Wells argue that the conclusion is wrong for two reasons: The BEAT is not a treaty violation, and even if were, it is a treaty override. In calculating the BEAT, deductions for otherwise deductible payments to related persons resident in treaty countries and FTCs for foreign taxes paid to treaty countries should not be allowed.

Although the issue of a treaty override is a specific to the U.S., the issues of treaty coverage, and if so, the treaty obligations such as FTC and nondiscrimination, need to be analyzed in exploring the new taxation approach to address the tax challenges arising the digitalization of the economy.

## V. Desirable taxation approach for developing countries

The UN Tax Committee emphasized that, in response to the "Unified Approach," the due consideration should be given to a fair allocation of tax revenue, a simple design of taxation system, and administration capacity of developing countries. From the viewpoint of allocating a fair share of tax revenue to developing countries, as a market jurisdiction, it would be necessary to take into account the developing countries' market size, to determine

[52] Cook v. United States, 288 U.S. 102(1933).

the level of a revenue threshold for the new nexus.

It would be desirable to take advantage of the existing framework of the U.N. Model Tax Convention, to address the developing countries' request for a simple design of taxation systems, and considerations for capacities of developing countries. In this respect, the SEP should be a basis for a new taxation approach to respond to tax challenges in a market jurisdiction, since the concept of SEP is already incorporated in the business income taxation of the U.N. Model Tax Convention. In addition, developing countries have an option of combining the taxation of income from services and offshore indirect transfers to address tax challenges raised by the digitalization of the economy.

It is necessary for a new taxation approach to be consistent with the existing trade/investment rules, in particular, the exception to the MFN/NT obligations in the GATS, the transparency, expropriation, and fair and equitable obligations in the BIT which is a specific matter for developing countries. A new approach should also be consistent with the obligations for eliminating the double taxations and nondiscrimination under the tax treaty.

In order to achieve a worldwide consensus on how to address tax challenges raised by the digitalization of the economy, it is essential to develop the solutions that reflect developing countries' perspectives and conditions. Given the fact that the U.S. perspective to the current project is getting uncertain, although they have a significant impact to the development of the international taxation, the process of achieving the worldwide consensus to the new tax approach is noteworthy.

【Annex】

UN Tax Committee Comments submitted to the OECD Secretariat on the "Unified Approach" as Proposed by the Secretariat in in its Public Consultation Document of 9 October.

The UN Committee of Experts on International Cooperation in Tax Matters[53] and its Subcommittee on Tax Challenges related to the Digitalization of the Economy in its October meetings in Geneva, reiterated the three workstreams 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

[53] 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.

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 interest of developing countries. The comments provided do not necessarily represent those of the Unites Nations, including ECOSOC, or the UN Member States, including those nominating the Members of the Committee.

- The Committee commends the OECD Secretariat:
  - 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
  - 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 continue 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 discussion on the Unified Approach and the economic impact, e.g. through regional workshop.
- The Committee appreciate in general an approach that would give greater recognition to new ways in which companies make profits through remote means, and thus increase the rights of market and user jurisdictions to tax 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 quantity and scope of the fixed return related to Amount B should be determined fairly and carefully so as not to harm developing countries be 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 as provided on 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:
  - ○ 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;
  - ○ 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;
  - ○ is concerned that a revenue threshold of €750 million will unnecessarily restrict the possibility of tax companies that deliver a substantial amount of digital services to developing countries;
  - ○ suggests considering lower thresholds applicable to "regional" MNEs that may be more important for a particular group of countries;
  - ○ 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
  - ○ 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:
  - ○ cautions against too-high thresholds, as that would prevent developing countries from taxing substantial profits attributable to their markets;
  - ○ 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:
  - ○ is unable to take a definite position on the apportionment of non-routine profit, as this would depend on a different quantity 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;
  - ○ encourages the Inclusive Framework to consider determining Amount A on a business line and regional/market basis; and
  - ○ suggests not to exclude the possibility of applying a fractional apportionment also to routine profits.
- With respect to Amount B, the Committee:
  - ○ urges that Amount B is an agreed minimum compensation for marketing and distribution activities and not an elective safe harbor for taxpayers; and

    - emphasizes the importance of a clear definition of the activities covered by "marketing and distribution."
- With respect to Amount C, the Committee:
    - 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;
    - 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
    - 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:
    - 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
    - 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.