The **BEPS** Monitoring Group

COMMENTS ON PILLAR ONE – AMOUNT A: DRAFT MULTILATERAL CONVENTION PROVISIONS ON DIGITAL SERVICES TAXES AND OTHER RELEVANT SIMILAR MEASURES

These comments by the BEPS Monitoring Group (BMG) respond to the public consultation document issued by the OECD Secretariat on behalf of the Inclusive Framework on BEPS, on the proposed Pillar One Amount A Tax Certainty Framework. The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, and Oxfam. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It has been drafted by Sol Picciotto and Jeffery Kadet, with contributions and comments from Juliana Midori Kuteken and Abdul Muheet Chowdhary.

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SUMMARY

These draft articles would be included in the multilateral convention (MLC) to implement a new taxing right (Amount A), allowing states that decide to join the MLC to tax around 100 of the largest and most profitable multinational enterprises (MNEs) on a share of their 'residual' profits (25% of global profits over 10%), based on sales. In exchange, participating states would be required to withdraw any digital services taxes (DSTs) listed in Annex A of the MLC. Also, if they subsequently introduce any DSTs or 'relevant similar measures', as defined in these draft articles, they would lose their Amount A allocations.

Negotiations are continuing on some dozen issues, including the criteria for de facto discrimination, which we suggest should include a purpose test. and we urge further clarification also on others, in particular whether withholding taxes on fees for services would be treated as relevant similar measures.

Each country should carefully evaluate its potential gains from Amount A against the losses from measures proscribed under the MLC, following a full public debate. From the available evidence, our expectation is that many countries will find their projected allocation of Amount A from the MNEs in its scope to be insufficient. The narrower the scope of the proscription of alternative measures, the more likely it would be that countries would join the MLC, although its complexity will also be a deterrent, especially for low capacity countries.

General Comments

Purpose and nature of the proposals

Pillar One has been described as ‘revolutionary in its concept’ by the OECD Secretary-General, in our view rightly.[1] However, as we have also pointed out, the proposals for its implementation are fundamentally flawed. This is because they would apply only to a very small number of multinational enterprises (MNEs), and reallocate taxing rights to only a share of their so-called ‘residual’ profits, described as Amount A. Aside from this small reallocation, the remainder of their profits, as well as all the profits of all other MNEs, would continue to be allocated under the current unfair and ineffective rules. The complex rules for determining and allocating Amount A would be contained in a multilateral convention (MLC).[2]

In exchange for what they might gain from Amount A, the MLC would impose obligations on participating countries to withdraw, and never in future apply, digital services taxes (DSTs) and ‘relevant similar measures’. The terms of these proscriptions are the focus of this consultation.

Hence, this MLC would leave existing international tax rules untouched, and only create a *lex specialis* to reallocate taxing rights among the participating countries in respect of the MNEs that would be in its scope. In itself, this would be a deeply disappointing outcome to the unprecedented ten-year effort to reform international tax rules through the project on base erosion and profit shifting (BEPS). More positively, the work on both Pillars has entailed designing the building blocks for a new approach to taxation of MNEs, by treating them in accordance with the economic reality that they are unitary enterprises, and to move towards allocating the rights to tax their global profits among countries where they have real activities, through formulary apportionment.[3]

Importantly also, Pillar Two creates a global minimum tax (the GloBE) which, despite its flaws, will put a floor under the competition to reduce corporate tax rates, and we hope might even reverse it. The implementation of Pillar Two is now well under way, with the agreement by EU member states to enact a directive to implement the GloBE, as well as its adoption by Japan and in legislation tabled by other countries such as Canada, Switzerland and the UK. Low- and middle-income countries, for most of which we consider Pillar Two is unsuitable, due to its complexity and one-sided design, in our view should consider adopting alternative compatible measures, such as their own form of minimum corporate tax.

Although developed in parallel, the two Pillars are independent, as was made clear in the Statement on a Two Pillar Solution issued in October 2021. Even Amounts A and B of Pillar One are separable since Amount B may be implemented by interested states irrespective of whether Amount A is implemented through any multilateral convention.

The work done by the OECD secretariat, under the guidance of the Inclusive Framework on BEPS and subsidiary bodies, has been highly technical. Public consultations have been directed mainly at the specialist tax advisers for MNEs and, like this one, have requested comments on ‘the technical design’ of the provisions. However, this consultation is also stated to be ‘in the interest of transparency’. Despite their technical focus, the proposals

[1] OECD (2022), OECD Secretary-General Tax Report To G20 Finance Ministers And Central Bank Governors, Indonesia, July 2022, p. 5.
[2] See our comments on *Amount A of Pillar One*, August 2022, available at https://www.bepsmonitoringgroup.org/news/2022/8/24/amount-a-of-pillar-one
[3] See Sol Picciotto, and Jeffery Kadet (2022), 'The Transition to Unitary Taxation', *Tax Notes International*, 108: 453-61.

clearly have wide-ranging policy implications, and deserve careful scrutiny and debate also by non-specialists. The work as it has progressed has been reported to Finance Ministers and Leaders of the G7 and G20 groups, which have both expressed a commitment to implementation of its outcomes. However, these are essentially governmental statements of policy, and these bodies include only a minority of the members of the Inclusive Framework, which itself has no accountability to any political body.

Debate will be inescapable if, as intended, the MLC is completed and signed in a few months' time. However it could only enter into effect as binding international law following ratification by the critical mass of states, which generally entails legislative approval. Before this takes place, it is clearly very important for there to be a genuine public debate, and evaluation of the implications of the MLC. Each country must carefully evaluate the bargain embodied in the MLC from its own perspective, and we urge them to do so.

The scope of the obligations

Two types of obligation are proposed. The first, in article 37, requires all parties to the MLC to withdraw, immediately upon its entry into force for them, the measures to be explicitly listed in Annex A. The List has not been provided yet, but this obligation seems relatively straightforward. In addition to the general DSTS that have been introduced by a significant number of countries, some have also enacted more specific taxes, for example on digital financial transactions such as mobile money, or on telecommunications transactions. The issuing of a list of the DSTs that would be within the scope of the MLC should make clear to each Inclusive Framework member which taxes would have to be withdrawn if it wished to participate in the MLC. Each country should then be able to compare estimates of what it would gain from Amount A with what it would lose by withdrawing any listed tax, and decide whether to join the MLC.

We note, however, that article 37.2.a states that this listing 'shall not be considered as evidence as to whether or not that measure is described in paragraph 2 of article 38'. This means that the listing will not help in clarifying the potential scope of proscriptions under article 38. The net cast by article 38 could extend more widely than the types of tax listed under article 37, or indeed more narrowly.

Footnote 2 raises the question of whether these existing measures could continue to be applied against MNEs with ultimate parent entities (UPEs) in jurisdictions not party to the MLC. We do not yet know the threshold of ratifications that will be needed for the MLC to come into effect. In view of its implementation mechanisms, this is likely to be quite high. However, if this threshold is reached while one or more states with UPEs have not ratified, we see no reason why they should benefit from the lifting of DSTs.

The second obligation, in article 38, is more complex, because it extends into the future. It covers any 'digital services tax or relevant similar measure', in addition to those listed in Annex A. Any party to the MLC for which such a measure is in force and in effect during a Period would be (a) denied any allocation of profit under Amount A with respect to that Period, and (b) prohibited from itself applying any domestic law provision implementing tax under Amount A.

This formulation seems designed to overcome the objection raised by the G24 group of developing countries, and the South Centre, to creating an obligation not to enact future measures. The G24 pointed out that such an obligation would 'effectively constrain future law-making powers of sovereign jurisdictions' and that '[s]etting such a high legal bar runs the risk of undermining the consensus solution … and will raise constitutional concerns in various jurisdictions'. Hence, they recommended that any commitment not to enact future measures 'should be in the nature of political commitments only'.[4]

The formulation now proposed would not in its terms prohibit parties from enacting any measures. Instead, it would deny a party that actually applied such a measure the right to benefit from an allocation of Amount A, or to apply tax under a domestic law provision implementing Amount A. Hence, parties would remain formally free to enact any tax measure they chose; but if a measure is considered to constitute a 'digital services tax or relevant similar measure', a party applying such a measure would not benefit from the MLC's provisions for allocation of taxing rights under Amount A. In principle, this would allow even a state party to the MLC to opt to apply alternative taxes in lieu of benefiting from Amount A. However, the obligation to withdraw listed taxes under article 37 would remain.

Footnote 3 raises the question of how measures imposed by subnational jurisdictions should be addressed. In some countries subnational jurisdictions have extensive tax powers, and in some cases they have enacted DSTs, even if the state itself has opposed DSTs enacted by other states. It seems to us that such measures must also be treated as proscribed by the MLC. Failure to do so would create a major asymmetry, and it is important that the same standard is applied to all countries equally.

We note that footnote 4 states that consideration will be given to whether full denial of Amount A benefits is appropriate in all circumstances, or whether denial should be in some way proportional to the scale of any offending measure that a signatory jurisdiction might retain or initiate. We support this latter approach since it will give jurisdictions, including importantly low-capacity jurisdictions (LCJs), reasonable flexibility to both protect their tax base and participate in the MLC to the extent sensible for their particular circumstances.

Article 38 would be open-ended, applying to all future tax measures. A measure would be considered a 'digital services tax or relevant similar measure' if it fulfils all the three criteria in article 38.2, unless it falls within any one of the three exemption tests in article 38.3. Although not in formal terms a prohibition on a party from enacting any tax measures, these provisions would to some extent exert a chilling effect on a party's policymaking on tax. It is therefore very important that the scope of this proscription should be as clear as possible.

The power to determine whether this condition applies and that a party does have a proscribed digital services tax or relevant similar measure in effect, is given to the Conference of the Parties to be created under the MLC, and this determination would be made following procedures that are still under development. A significant number of details of the definition also remain under consideration, as mentioned in a dozen footnotes.

The proscription is not limited to taxes relating to digitalised transactions. It covers any tax, other than one treated as an income tax, that applies either explicitly or in practice 'exclusively or almost exclusively to non-residents or foreign-owned businesses' and applies 'primarily by reference to the location of customers or users, or other similar market-based criteria'. Hence, the broad aim is to proscribe taxes that in practice apply to sales by non-residents in the local market. We note that footnote 5 indicates that there is ongoing work to define 'resident' for these purposes. This term is of course a key one in international tax, and has existing and well-known definitions and interpretations in the OECD and UN model conventions. We recommend that the ongoing work should not seek a new definition, but

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[4] Comments of the G-24 on the Progress Report on Amount A of Pillar One, submitted for the Public Consultations on August 15, 2022; South Centre Comments on Progress Report on Amount A of Pillar One, 18 August 2022. https://www.southcentre.int/south-centre-comments-on-progress-report-on-amount-a-of-pillar-one-18-august-2022/

should refer to these existing definitions, and clarify any necessary modification or refinement needed for the MLC.

A tax would not be proscribed if it is considered a tax on income under the party’s domestic law. Taxes within the scope of existing income tax treaties are also excluded, although the scope of this is still under consideration, as mentioned in footnote 10. In our view it is essential that any and all taxes permitted by existing treaties should be excluded. Capital-importing countries have long sought to protect the source tax base, and the UN model convention includes important provisions to this end that have been included in a large number of treaties, especially those with developing countries. We see no rationale for any taxes within the scope of existing treaties to be included the MLC’s proscription, and urge the rejection of this suggestion.

One of the specific exclusions is of rules to counter artificial structures to avoid a taxable presence. This would likely cover, for example, the UK’s diverted profits tax, or Australia’s multinational anti-avoidance tax. Also excluded are taxes on consumption, such as value added or sales taxes, as well as generally applicable transaction taxes applied by unit or transaction rather than by value. Hence, a tax on purchases of international airline tickets might be proscribed if a country were served only by foreign-based airlines, but might be exempt if it applied at a flat rate rather than by value.

Hence, the proscription focuses on taxes on payments in respect of specific categories of transactions that in practice affect ‘exclusively or almost exclusively’ non-residents. This is in effect a criterion of de facto discrimination. Five of the issues still under consideration concern this issue. It is of particular concern to countries with small economies and low-income countries, which can find their markets, or some sectors of them, dominated by non-resident suppliers.

Non-discrimination rules are notoriously indeterminate, especially when they apply broadly to de facto discrimination, as does the proposed provision in article 38.2.b.ii. The criterion proposed is that the tax ‘is applicable in practice exclusively or almost exclusively to non-residents’, while footnote 7 states that there is ongoing work to examine whether this can be further clarified. In our view this approach is inappropriate, particularly in the context of taxation. Countries frequently apply measures targeted at non-residents, for the purpose of ensuring competitive equality with residents involved in the same activities. We suggest that instead the test of whether a measure is discriminatory should have regard to its purpose. For example, a tax on airline tickets such as that mentioned above should be regarded as legitimate, even if in practice it would apply only or primarily to non-resident airlines.

Withholding taxes on payments for services

In view of the narrow scope of Amount A, it is important that countries should retain their freedom to tax income at source, subject only to specific obligations they have accepted in bilateral tax treaties. Most countries tax all income earned from activities in the country, including by non-residents. Taxation of non-residents in practice generally takes the form either of direct taxation of the net income of a permanent establishment (if there is one), or of a withholding tax on the payment. Greater clarity is needed as to whether or in what circumstances a withholding tax on payments to non-residents would be proscribed under these proposals.

The proscription applies particularly to transactions involving services, whether digitalised or not. It is entirely legitimate for countries to tax income from services performed in their jurisdiction, whether the non-resident services provider maintains a permanent establishment or not. Indeed, this is important particularly to ensure competitive equality with local services providers. If the income from the services is not taxed because the provider has no local taxable presence, payments for business services erode the source tax base. Furthermore, revenues from services can relatively easily be attributed to offshore entities to escape tax, so this is a major source of BEPS. Developing countries became aware of this problem earlier and more acutely, due to the imbalance in cross-border trade in services. OECD countries conversely have sought to protect 'their' services providers from source taxation.

Digitalisation further exacerbated this problem, so that it was finally foregrounded in the BEPS project. In the absence of any other potential solution, numerous states adopted or proposed digital services taxes. The objection to these DSTs came mainly from the US, on the grounds that they unfairly discriminated against US-based MNEs. On this basis, the US threatened retaliatory action against states implementing DSTs, but under trade rules. The scope of Amount A has now been extended to cover all services, but it is not clear whether or to what extent states participating in the MLC are expected in exchange to abjure taxation of revenues from all services through withholding taxes. The term 'relevant similar measures' is indeterminate, so it is important for the scope of the proscription in article 38 to be made as clear as possible.

For example, the first criterion in article 38.2 is that 'the application of such tax, or the amount of tax imposed, is determined primarily by reference to the location of customers or users, or other similar market-based criteria'. A withholding tax may be formulated as applicable to income derived from the performance of services in the country, but for ease of administration it is required to be paid by the customer, since it will generally be a resident. The place of performance of services can appropriately be defined as the place of delivery of the service, which particularly in the case of personal services is typically the location of the customer. Indeed, this is the general principle followed in the proposed sourcing rules for Amount A income.[5] It is not clear whether a tax on revenue from services performed in a country, defined in terms of the location of the customer, and collected by means of a withholding from the payment, is intended to be proscribed by article 38.2.a.

Secondly, withholding taxes are commonly applied to the gross amount of the payment, but have generally been applied at a lower rate, or formulated in some other way to make the tax theoretically equivalent to a tax on net income.[6] It is important to clarify whether such a tax would be treated as a tax on income, and hence fall outside the proposed proscription in article 38.2.c.

These clarifications are essential to enable countries to decide whether to join the MLC. Developing countries in particular need to know whether and in what circumstances a withholding tax on payments for services is compatible with, or must be considered an alternative to Amount A. This is especially important in relation to the provisions of article 12B of the UN model tax convention allowing taxation of payments for automated digital services, which include an option for its application to deemed net income. This has been designed to take account of the perspectives and concerns of developing countries in particular, and many of them may choose to enact domestic taxes of this type, ensuring compatibility with their tax treaties, if necessary by inclusion of this provision.

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[5] OECD (2022), *Progress Report on Amount A of Pillar One, Two-Pillar Solution to the Tax Challenges of the Digitalisation of the Economy, OECD/G20 Base Erosion and Profit Shifting Project,* OECD, Paris, https://www.oecd.org/tax/beps/progress-report-on-amount-aof-pillar-one-july-2022.pdf. Schedule E, especially section 6.

[6] As headline corporate tax rates have fallen, withholding tax rates in some countries have not kept pace.

Evaluating the costs and benefits of participation

These scope provisions are also important because they apply to the covered measures as a whole. Participating countries would be prevented from applying such measures to any MNEs, not just those within the scope of Amount A which would have a share of their profits reallocated.

It is clearly important that all countries should be able to evaluate the costs and benefits of participation in the MLC. Estimates until now have suggested that the revenues that would be reallocated under Amount A would reach only some $100-120b.[7] However, a public presentation by webinar by the OECD Secretariat on 18 January 2023 gave a somewhat higher estimate, suggesting that (based on 2021 data) 82-108 MNEs would be in scope, with some $200b reallocated, indicating total tax revenue gains of $21-36b.[8] The OECD expects to publish the full economic impact assessment in the near future. Accurate estimates of the amounts that would be allocated to individual countries are particularly difficult, because no data are available on the source of revenues from sales under the rules developed for Amount A. Nevertheless, some estimates have been made,[9] and the OECD Secretariat's full economic impact assessment is expected to include a jurisdictional breakdown. However, it is clear that the net amounts reallocated even to large countries will be relatively small, while for most small countries they will be tiny.

Each country should compare its potential gains to those from possible alternatives, including both DSTs and withholding taxes on services, a wide scope for which would be enabled under treaties incorporating articles 12A and 12B of the UN model. Hence, much depends on the interpretation of the criteria for determining which taxes are proscribed under article 38. In particular, countries will need to pay careful attention to the effect of the criteria for proscription of 'relevant similar measures' in the proposed article 38 on taxes that they apply to revenues derived from the jurisdiction, especially withholding taxes on payments for services, as discussed in the previous section. If indeed the intention of article 38 is to proscribe withholding taxes on all payments for services, many countries are likely to find this disproportionate in exchange for their share of the Amount A reallocations from the MNEs in scope.

The more specific taxes that have been enacted or are contemplated by many countries on various kinds of digitalised transactions or services, are of course more likely to fall under the MLC's proscriptions, although much depends on the interpretation of article 38, particularly the criteria for de facto discrimination in article 38.2.b.ii. Nevertheless, they may consider that such taxes are easier to administer, and would generate greater tax revenues, than the allocation they would receive from Amount A.

From the available evidence, our expectation is that many countries will find their projected allocation of Amount A from the MNEs in its scope to be insufficient. The narrower the scope of the proscription of alternative measures, the more likely it would be that countries

[7] An academic study estimates that 100 MNEs would be in scope, with roughly $100b of aggregate profit reallocated (Michael Devereux and Martin Simmler (2021), "Who Will Pay Amount A?" EconPol Policy Brief 36: European network for economic and fiscal policy research), p. 4; the IMF found that 140 MNEs could be in scope, with $150b reallocated (IMF (2022), 'Coordination Across Borders', *Fiscal Monitor*, ch. 2, p30); a study for the South Centre found that 76 MNEs would be in scope, with a reallocation of $110b in 2020 ($94b in 2019, and $111b in 2018) (Vladimir Starkov and Alexis Jin (2022), 'A Tough Call? Comparing Tax Revenues to Be Raised by Developing Countries from the Amount A and the UN Model Treaty Article 12B Regimes' South Centre Research Paper 156, p. 20).

[8] See https://www.oecd.org/tax/beps/webinar-economic-impact-assessment-two-pillar-solution.htm

[9] See notably Suranjali Tandon and Chetan Rao (2022) 'Evaluating the Impact of Pillars One and Two', South Centre Research Paper 165. https://www.southcentre.int/research-paper-165-4-october-2022 .

would join the MLC, although its complexity will also be a deterrent, especially for low capacity countries. We have noted that this public consultation document solely provides a draft for Articles 37 and 38, so we are of course unaware of what other provisions the Task Force on the Digital Economy will include within the MLC. While perhaps these other not-yet-released provisions will counter this, we understand that Articles 37 and 38 would give an effective choice to signatory jurisdictions.

Article 37 would apply to specific existing or proposed taxes, which would be explicitly listed. This makes it possible to make at least some plausible estimates of the costs of joining the MLC. Article 38 creates more uncertainty, due to the need to interpret the principles it lays down. Hence, we urge that further work should focus on making it as clear as possible how it is intended to apply in relation to relevant taxes already widely in use, particularly withholding taxes on payments for services.

However, we recognise that it has been designed to allow even participating states to retain some freedom of choice, since they could still introduce new alternative measures, with the sole ‘cost’ being the foregoing of any allocation of Amount A. We commend this acceptance of the point urged by the G24, that the MLC should be designed to allow states to retain their tax sovereignty. We recommend that the remaining provisions of the MLC, and the modalities of its implementation, should similarly respect each country’s rights to determine its own tax policies, in a spirit of cooperation and interdependence.