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VIA E-MAIL

UN Committee of Experts on International Cooperation in Tax Matters

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Re: Comments on proposed Article 12B

Dear Committee Members,

The Digital Economy Group ("**DEG**")[1] is writing in anticipation of the further work to be undertaken by the UN Committee of Experts on International Cooperation in Tax Matters ("**CoE**") with respect to the pending inclusion of an Article 12B on Automated Digital Services in the 2021 UN Model ("**Art. 12B**") as developed by the Subcommittee on Tax Issues Related to the Digitalization of the Economy (the "**Subcommittee**") and described in the Co-Coordinators' Report prepared in advance of the October CoE meeting.[2] We note that the report on the 21st session of the CoE indicated that the CoE voted at that meeting to include an Article 12B in the 2021 UN Model.[3] We also note from the Co-Coordinators' March 11, 2021 update that it is expected the Subcommittee will present a final version of proposed Art. 12B to the full CoE for decision at the CoE meeting of April 19-28, 2021.[4]

As our comments below indicate, we believe that the CoE should not adopt Art. 12B as part of the UN Model, due to both policy and technical considerations. If Art. 12B is included in the UN Model, the DEG supports allowing those CoE members who do not support the proposal to express their views through normal UN procedures for documenting minority views. We

[1] The DEG is an informal coalition of leading U.S. and non-U.S. companies that provide digital goods and services to global customers. The DEG's current membership comprises the following companies: Airbnb, Inc., Amazon.com, Inc.; Expedia, Inc.; Facebook, Inc.; Google, Inc.; Microsoft Corporation; Netflix, Inc.; RELX Group PLC.; Salesforce.com Inc.; Spotify AB; and Stripe, Inc.

[2] Committee of Experts on International Cooperation in Tax Matters, Economic and Social Council, Twentieth Session (October 20-23 and 26-29, 2020), Co-Coordinators' Report, E/C.18/2020/CRP.41, dated Oct. 10, 2020 (hereinafter the "**Co-Coordinators' Report**"), *available from* https://www.un.org/development/desa/financing/documents.

[3] Committee of Experts on International Cooperation in Tax Matters, Economic and Social Council, Official Records, 2021, Supplement No. 25A, *Report on the twenty-first session* (Virtual Session - 20-29 October 2020), E/2021/45/Add.1-E/C.18/2020/4 (hereinafter the "**21st Session Report**"), *available from* https://www.un.org/development/desa/financing/documents, para. 107.

[4] Update Message from Co-Coordinators of the Subcommittee on Tax Challenges Related to the Digitalization of the Economy - William Babatunde Fowler and Aart Roelofsen (Mar. 11, 2021), *available from* https://www.un.org/development/desa/financing/documents.

note that UN Practices and Procedures provide that minority views may be reflected in the final document.[5] In fact, the Drafting Group responses to various comments by Subcommittee members included in Annexes 2 and 3 of the Co-Coordinators' Report confirmed in several instances that minority views can be expressed. We also note an update from the Co-Coordinators that a minority view will be included in the Commentary.[6]

We were pleased to see the many perceptive written comments made by several members of the Subcommittee and reproduced in the Co-Coordinators' Report. We believe that many of those comments should be included in any minority view commentary. In this letter, we would like to provide some further observations on those Subcommittee member comments which might be included in the new Art. 12B Commentary to reflect minority views, if the inclusion of Art. 12B is approved.

Our letter starts with comments on particular aspects of Art. 12B which we suggest could be considered for inclusion in the minority view commentary. The second part of our letter provides sample text to express some of the concerns noted by Subcommittee members as reported in the Co-Coordinators' Report.

PART I: Aspects of Art. 12B that Warrant Discussion in any Minority View Commentary

I. A model convention should be used to harmonize implementation of agreed principles and practices

The purpose of a model convention is to express a position on allocation of taxing rights that enjoys an appropriate degree of international acceptance. The fact that a model convention expresses accepted norms is essential for that model to carry legitimacy as the foundation for negotiations between contracting states. Although the UN Model is meant to provide guidance especially for developing countries, the UN Model should avoid including as a model Article a theory of taxation that is highly unusual in actual practice. The role of the two leading models of taxation (the UN Model and the OECD Model) is to ensure consistency on how countries trade and impose taxation.[7] The Models diverge only when it is important to "exemplify, and allow a close focus upon, some key differences in approach or emphasis *as exemplified in country practice*."[8] Art. 12B does not promote consistency among countries' practice and does not exemplify current country practice. If anything, the Article disturbs current practice and attempts to establish new practice between countries, both within and outside treaty law.

National level imposition of a withholding tax on the business profits of a specifically defined business sector as proposed in Art. 12B is highly unusual in international practice. In our view,

[5] Co-Coordinators' Report, p. 47.

[6] Update Message from Co-Coordinators of the Subcommittee on Tax Challenges Related to the Digitalization of the Economy - William Babatunde Fowler and Aart Roelofsen (Nov. 2020), *available from* https://www.un.org/development/desa/financing/documents.

[7] United Nations (2017), *United Nations Model Taxation Convention between Developed and Developing Countries* (referred to herein as the "**UN Model**"), Introduction, para. 2.

[8] *Id* (emphasis added).

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the purpose of a model treaty is not advanced by including unusual or even unique taxation theories.

The 21st Session Report discloses what perhaps is the principal motivating factor for the proponents of this proposal. The Report states: "It was suggested that the proposed provision could be a useful guide to countries looking to develop domestic legislation on taxation of Automated Digital Services, even without having an extensive treaty network."[9] If that indeed is the purpose, we believe that including Art. 12B in the UN Model is not the appropriate path towards that goal. We agree with the comment by a Subcommittee member that if the CoE desires to provide legislative development tools to developing countries without treaty networks to design domestic tax policy, the CoE should act through designing and supplying legislative development toolkits or other support initiatives, not through amendments to the UN Model.[10]

II. The CoE should not propose provisions that have little or no chance of being adopted in practice

As Subcommittee members noted, it is unlikely that this article will be agreed to in bilateral negotiations with those states in which the more significant digital service providers are resident.[11] In contrast, many treaties around the world do include provisions included in the UN Model that deviate from the OECD Model, such as allowing a withholding tax on royalties (Art. 12(2)), allowing withholding tax at source of rental payments for the use of industrial, commercial or scientific equipment (Art. 12(3)), including a services PE (Art. 5(3)(b)), and allowing a withholding tax at source on technical service fees (Art. 12A). In those areas, the UN Model has presented an accepted alternative starting point for bilateral discussions, because those terms are regarded as legitimate areas for negotiation by the contracting states, with real prospects for agreement by the contracting counterparty.

In contrast, we are concerned that including a provision that is not likely to be accepted by any relevant state in which digital service providers are resident raises questions whether the UN Model will continue to be regarded as a realistic foundation for negotiation. Instead, it could create the perception that the UN Model is being used to encourage domestic law changes as opposed to setting agreed standards. This is in stark contrast to the UN Model stated goal of being "balanced in its approach."[12]

We also are concerned that including Art. 12B could be used improperly by some advocates to argue that gross-based withholding taxes on digital services will now be an "approved" tax by the United Nations. Although the United Nations represents 193 UN Member States, we understand that only 12 of the current 25 CoE members voted to include Art. 12B in the UN Model. We suggest that the minority view commentary explicitly state that the minority does

[9] 21st Session Report, para. 104.

[10] Co-Coordinators' Report, p. 31.

[11] Co-Coordinators' Report, p. 32.

[12] UN Model, Introduction, para. 13.

not regard the introduction of Art. 12B as a model treaty provision to constitute an endorsement of any domestic tax policy decision.

III. Economic attributes of providers of automated digital services

The digital services providers that would be in scope of this provision are active businesses, which incur all the ordinary and necessary costs of their businesses, including software and hardware development, production, infrastructure investment, sales and marketing, customer support, and all other relevant business operations. As such, income from "automated digital services" represents income items that are burdened by normal ordinary and necessary business expenses, just as is the case with other business enterprises. The published financial statements of any major digital services enterprise disclose the capital investments and operating expenses necessary to operate the business and maintain the competitiveness of their service offerings.

The Drafting Group suggests that businesses within scope incur low or no marginal costs to expand their revenue.[13] We believe that the eventual Art. 12B Commentary should be carefully reviewed to avoid misleading overgeneralizations. All digital services businesses must make significant incremental investments to improve their service offerings and expand their customer bases. By definition, all digital service suppliers require an investment in computing infrastructure, which they either purchase or engage third party providers to supply. Additional customer growth requires continuous engineering to improve the market offering, and additional customer sales and support personnel.[14]

One easily identified example to prove the point is the reference in the draft Commentary to a platform offering a "music catalogue".[15] Platforms that offer access to music or other proprietary content incur incremental licensing fees for every new subscriber. Accordingly, their marginal costs inevitably increase proportionately with new subscribers.

We agree with the Drafting Group comment that companies engaged in providing digital services "may require a large degree of upfront human involvement and capital inputs" in order to develop and provide the service.[16] We would supplement that statement by noting that in addition to upfront investment costs to develop the business, digital services enterprises also incur material ongoing costs to continuously improve their services and delivery.

Despite the very significant investment and operating costs incurred by digital service providers, the definition of transactions in scope of Art. 12B essentially is based on a definition that looks to whether the enterprise incurs a particular type of expense at a moment in time.[17] We find it hard to reconcile those two points and suggest that the minority comment on that contradiction.

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[13] Co-Coordinators' Report, proposed Paragraph 4 Commentary, para. 35.

[14] *See* Co-Coordinators' Report, p. 51.

[15] Co-Coordinators' Report, proposed Paragraph 4 Commentary, para. 35.

[16] *Id*.

[17] Co-Coordinators' Report, Draft Art. 12B(4), p. 9, and proposed Paragraph 4 Commentary, para. 35.

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IV. Expression of policy justification

Several Subcommittee members expressed concerns about the lack of a clear policy basis for this proposal.[18] We note that in response to these comments, the Drafting Group stated that the justification for introducing Art. 12B based on BEPS issues has been withdrawn. We agree that this tax cannot be based on any BEPS policy foundation.[19]

The remaining policy foundation seems to be that tax nexus should be allocated to market states due to their status as a market, and we share the concerns of several Subcommittee members with such a proposition.[20] In order to achieve transparency as to the policy justification for Art. 12B, we believe that the Commentary should more clearly express the policy foundation adopted by the majority. In any event, if the policy justification behind Art. 12B is to reallocate taxing rights over cross-border payments to acknowledge the contributions of the market state, that justification does not apply uniquely to profits arising from the provision of automated digital services.

V. Net income election

While in principle we agree with the point that a net income election can relieve the unwarranted tax burden on low margin or loss-making companies, that relief will come at significant administrative burden. We are concerned that companies that will suffer the highest effective tax rate effect by virtue of being subject to a withholding tax as described in Art. 12B will also incur disproportionate administrative expense to prepare and file tax returns in order to claim a refund. In many countries, the process to claim a refund for overpaid taxes is lengthy and administratively costly, in some cases taking years to process a refund. The fact that such companies will not be relieved of the financial burden until a refund is in fact paid exacerbates the disproportionate burden placed on less profitable companies.

1. Destination based taxation and formulary apportionment

We note the policy proposal behind Art. 12B in general, and the net income election in particular, apparently is to embrace destination based taxation, implemented through formulary apportionment. The draft Commentary to Paragraph 3 states that the 30% allocation of total profits to the market state is based on applying a three factor formula assigning equal weight to assets, employees and revenue.[21]

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[18] *See, e.g.*, Co-Coordinators' Report, p. 29.

[19] Since 2017, U.S. parented groups in general have included the worldwide income of their offshore affiliates in U.S. taxable income through the GILTI rules, subject to a modest carveout for returns based on investment in tangible assets. A similar result will be implemented by all participating members of the Inclusive Framework through the Pillar 2 mechanism now under discussion; *see also* Co-Coordinators' Report, p. 37 (dissatisfaction with the rate in the other state is a Pillar 2 concern and is not related to the preference for source taxation). Despite the Drafting Group's statement that BEPS concerns are no longer the policy basis for Art. 12B, the Drafting Group's response to that comment suggests that at least the Drafting Group still adheres to that justification.

[20] *See* Co-Coordinators' Report, pp. 31, 46, 57.

[21] Co-Coordinators' Report, proposed Commentary on Paragraph 3, para. 30.

This policy foundation conflicts with the long-standing norms of profit attribution as expressed in Art. 9 of the UN Model. An allocation of 30% of consolidated group profit from the transaction dramatically over allocates profits to a jurisdiction with no functions, assets, or risks. If the group has established an affiliate in the jurisdiction, then total profit allocation will exceed the 30% ratio. The profits of the related enterprise established in the jurisdiction will, of course, be subject to tax in that state under normal principles. The profits of that entity also will be included in the calculation of consolidated group profits. There is no suggestion in the draft Art. 12B Commentary, however, that the taxable profits under Art. 12B will be reduced by the amount of profits already subject to tax as reported by group entities established in the taxing state. Accordingly, the proposed profit attribution will establish systemic over taxation, even beyond the 30%, for any group that has established an associated enterprise in the taxing state.

If the CoE wishes to embrace the principle of destination based taxation and formulary apportionment, we suggest that in the interests of transparency, the Commentary express this policy foundation more directly. We, of course, see no reason to apply destination based taxation and formulary apportionment to one sector of the economy and not to any other.

In any event, the allocation percentage should not be designated in the model convention itself, but should be left for individual negotiation by the treaty partners, in the same way as is suggested for the withholding tax rate.

2. Profitability ratio based on consolidated group results

CoE members who oppose the proposal may wish to point out the extraordinary and unprecedented element that the allocable tax base could be determined on a group basis, as opposed to being based on the profits of the entity that is subject to tax. This rule defining single entity taxable profits on the basis of a consolidated group's income exists nowhere in the UN Model or international practice today (outside, of course, formulary apportionment concepts). As with the incorporation of destination based taxation and formulary apportionment theories to justify tax nexus and the 30% determination, we suggest that the CoE should refrain from endorsing these concepts without a fuller analysis of the merits of the proposal.

The current proposal under Amount A of the Pillar 1 work would determine the amount of profits to be allocated to the market state on the basis of an apportionment based on group results.[22] As the work on Pillar 1 has made clear, however, that proposal cannot succeed unless that proposal is accepted on a multilateral basis, includes strong double tax relief through the identification of the "paying entities" and agreement by the jurisdictions of residence of those "paying entities" to provide double tax relief, and includes robust dispute prevention and resolution mechanisms. The Art. 12B proposal contains none of these elements, and cannot do so since it provides a model only for bilateral treaties.

[22] OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (October 12, 2020) (hereinafter, "**Blueprint**"), *available at* https://doi.org/10.1787/beba0634-en.

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3. Clarification that net basis taxation election is by right

The Draft Art. 12B(3) states that a taxpayer may "request" the source state to impose tax on the apportioned profits at "the tax rate provided for in the domestic laws of that State". Art. 12B(3) should clarify that the intended rate should be the normal corporate tax rate that applies to other types of business profits and that a State should not be permitted to enact a different rate that would apply only to automated digital services income.[23]

The net income tax alternative should be by election of the taxpayer in advance, not by permission of the taxing state authority. It is not uncommon in countries where a withholding tax is not a final tax to allow the taxpayer at its option to file a net income return in substitution for a gross-based tax. We are not aware of any case where the taxpayer is not allowed to make the net based election as a matter of right.

We note that the Drafting Group did state that taxpayers have an "absolute choice" to make this election.[24] It would be useful to clarify this point in the final Commentary.

To ensure efficient administration of the tax, Art. 12B should include a mechanism to allow an enterprise to make the election for net based taxation in a way that will avoid payors withholding on payments made during the course of the year. One possible mechanism would be to allow recipients to provide the withholding agent with a certificate that such enterprise is the beneficial owner of the payment and is subject to net based taxation on such payment.[25] Other mechanisms would need to be designed where the enterprise will receive many small payments from customers, such as consumer oriented businesses.

4. Loss carryforwards and the profitability ratio

We note the question regarding the application of carried forward losses relating to the consolidated group profits subject to apportionment in this proposal. The Drafting Group responded that carried forward losses are not to be recognized.[26] This approach inevitably will result over time in a profit allocation base which exceeds the actual group profits. Even formulary apportionment models apportion losses as well as profits.

The proposed rule that a tax authority may select the highest profitability ratio as shown in the financial books of any of the enterprise, the consolidated group, or a segment of either, will lead to further distortions and overtaxation. Given that those calculations will normally involve entities other than the beneficial owner of the payment, the normal exchange of information

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[23] Art. 24 (Non-Discrimination) would generally prohibit a State from taxing a permanent establishment of a resident of the other Contracting State "less favorably" than the taxation levied on comparable enterprises of the taxing State, and we believe the same limitations, including no higher rate, should apply to Article 12B(3).

[24] Co-Coordinators' Report, p. 49.

[25] As an example, a foreign person that is the beneficial owner of U.S. source income that is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States must give Form W-8ECI (Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States) to the withholding agent to avoid withholding on such income.

[26] Co-Coordinators' Report, p. 50.

provision of the treaty will not be sufficient to develop the necessary information to apply these proposed rules.

5. Administrative mechanisms

We note the suggestion that financial intermediaries may be responsible for collecting and remitting the withholding tax on payments made by individuals.[27] Given that the definition of ADS includes many services purchased by consumers, the enforcement of withholding taxes on consumer payments will be an important element of the overall enforcement mechanism. We suggest that the proposal to impose the compliance obligation on financial intermediaries should not be included in a UN document unless appropriate consultations have been had with the affected institutions.

We note the financial intermediary collection model has been used in only a few jurisdictions around the world, principally for enforcing the obligation of nonresident suppliers to collect VAT on cross-border sales of digital goods and services to consumers. In several countries in Latin America, for example, the implementation of such regimes has been challenging.[28] In those countries where it exists, the normal mechanism is for the financial intermediary to add on the amount of VAT, and make a separate charge to the consumer for that amount. For example, that mechanism applies in the case of the Argentina "PAIS" tax mentioned in the 21st Session Report.[29] Imposing that approach on financial intermediaries therefore causes the cost of the withholding tax to be borne directly by the consumer.

6. Double tax relief

The general objectives of bilateral tax treaties and the UN Model Convention include mitigating or eliminating double taxation and facilitating cross-border trade and investment.[30] Art. 12B frustrates both of these goals without providing effective ameliorating tools.

We suggest that the minority commentary include a description of the difficulties taxpayers will face in obtaining effective double tax relief for a tax of the sort described in Art. 12B. A profit attribution mechanism that allocates a deemed net income amount based on group-wide profitability ratios contemplates that the tax imposed on the enterprise which is the beneficial owner of the payment, and thus subject to tax, may have no relationship to the taxable profits of that entity as shown in its own accounts, even assuming all transfer pricing is conducted at arm's length. As such, the purpose and result of this net income option is to tax profits arising in other group entities.

Accordingly, any double tax relief cannot be achieved solely through the bilateral arrangements that would exist under Art. 23, as the profits being taxed may well be earned by other entities

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[27] Co-Coordinators' Report, p. 61.

[28] For example, in Colombia financial intermediaries have not yet started to collect VAT on certain supplies made by foreign suppliers, which has caused disruption in the implementation of the amended VAT law in Colombia.

[29] 21st Session Report, para. 109.

[30] *See e.g.*, UN Model, Introduction, para. 6.

in the group, residing in different states that also tax that income. In bilateral negotiations, in order to avoid double taxation, the state of residence of the taxpayer would need to grant effective double tax relief for the taxes paid, even if the profit base for that tax is determined by reference to other group entities. CoE members opposed to the proposal may wish to include in their minority comments that full double tax relief will not be achieved unless the Contracting State in which the taxable enterprise resides is willing to grant this extraordinary relief.

The complexities of this system and the absence of effective double tax relief will encourage suppliers of automated digital services to insist on gross-up clauses in their contracts, which will allocate the cost of the tax to the in-market customers. In addition to the increased cost of the supply to in-market customers, grossing up supply values also leads to VAT complexities around determining the VAT base in those cases where the supply is also subject to VAT.

VI. Profit attribution to actual PEs under Art. 12B(5)

The Co-Coordinators' Report shows that there is no agreement among the Subcommittee as to the consequences of the nonresident operating through an actual PE, and the amount of profits to be attributed to that PE.[31] Several Subcommittee members commented on this, noting that normal principles would indicate that no or minimal profits could be attributable to such a PE, given that lack of human intervention at the time of the delivery of the service.[32] In response, the Drafting Group members observed that the attributable profits would be 100% of the profits derived in the market state.[33]

Art. 12B(5) constitutes a critical element of the overall architecture of Art. 12B. It would have been preferable for the Subcommittee to have formed a consensus view as to how profits would be attributable to an actual PE, and included that view in the treaty itself or the Commentary. In the absence of such an agreement, and given the divergence of views on the Subcommittee as to the meaning of this critical part of Art. 12B, we suggest that the Art. 12B Commentary express the view that any treaty entered into between Contracting States including an article based on Art. 12B reach concrete agreement between the Contracting States as to how profits would be attributable to a PE that exists within the scope of Art. 12B(5). At the very least, the Commentary should confirm that neither the withholding tax allowable under Art. 12B(2) nor the tax on the deemed profit provided for in Art. 12B(3) will apply with respect to any revenues from automated digital services that are taken into account in calculating the profits attributable to an actual PE under Art. 7 (i.e., neither of those Art. 12B taxation measures will operate as a "floor" on the tax liability of an entity with an actual PE deriving automated digital service revenues).

[31] Art. 12B generally provides that paragraphs 1, 2 and 3 of Art. 12B do not apply if the taxpayer carries on business through a PE established in the market state and the ADS income is attributable to the PE.

[32] *See* Co-Coordinators' Report, pp. 57, 60 (minimal profit attribution), p. 33 (anticipating that the profits attributable to a PE would be only a "small portion" of the enterprise's profits).

[33] Co-Coordinators' Report, p. 60.

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VII. Inclusive Framework interaction

We note the comment from the 21st Session Report that some CoE members "thought it was better that the outcomes of [the OECD / IF work] be awaited to ensure that any UN alternative would be consistent with a multilateral approach."[34] We agree, and continue to believe that the work at the OECD, through the Inclusive Framework, provides the best (and perhaps only) path to a global consensus resolution to the debate over the taxation of the digitalized economy. We agree with those members who expressed the view "that the proposed article was unlikely to be effective as it was a bilateral provision that sought to address a multilateral problem."[35]

As a corollary to that point, it can be noted that the many references by the Drafting Group to the OECD / IF Approach under Amount A cannot support the policy decisions that underlie Art. 12B. The OECD / IF approach is a truly multilateral proposal, to be agreed by all participating countries under a multilateral convention, with effective double tax relief and robust dispute prevention and resolution mechanisms. None of those features exist in the Art. 12B proposal. We suggest that the minority view commentary include the observation that concepts developed in the OECD / IF work thus cannot be used as a policy foundation or explanation for Art. 12B.

We are also concerned that Art. 12B has adopted several concepts now under discussion by the Inclusive Framework, including the definition of "income from automated digital services" in paragraph 4, when there is no agreement by the Inclusive Framework on that definition. We believe that the UN Model should not adopt as a foundational definition a term that is still undergoing debate at the international level.

Finally, we note that Art. 12B and the OECD / IF proposals overlap, and thus are inconsistent with each other. If the membership of the Inclusive Framework, currently 139 members,[36] agrees to the Blueprint multilateral instrument implementing Amount A, there would be no basis for additional taxation as contemplated by Art. 12B, as the tax bases of those two regimes clearly overlap. Additionally, it is possible that the IF may define those "relevant unilateral actions" to be removed as a condition for agreement in a way that would preclude countries participating in the OECD / IF consensus solution from modifying their domestic law to include a tax within the scope of Art. 12B.[37]

<u>PART II: Proposed Minority Report Commentary on Art. 12B Paragraphs</u>

Given the serious flaws with this proposal, we believe that in the interests of transparency, the minority (if it indeed turns out that a majority of the current CoE continues to support this proposal) should submit a comprehensive statement of their views to be included in the Article

[34] 21st Session Report, para. 107.

[35] 21st Session Report, para. 106.

[36] *See* Members of the OECD/G20 Inclusive Framework on BEPS (updated Feb. 2021), *available at* https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

[37] Blueprint, para. 808 ("It is expected that any consensus-based agreement under Pillar one must include a commitment by members of the Inclusive Framework to implement this agreement and at the same time to remove relevant unilateral actions.").

12B Commentary. The points noted above in this letter provide observations on specific aspects of the proposed Article. We believe all of them would be useful comments to include in the minority view commentaries, in order to highlight the deficiencies in the Article which will need to be addressed by Contracting States that may contemplate introducing an Art. 12B in their treaty. Given that one expressed reason of the proponents to include the proposed Article in the UN Model is to provide guidance to developing countries to produce their own model legislation on the taxation of digital services, it is only appropriate that the deficiencies in that approach be given equal treatment in the UN work and be reflected in the Commentary that accompanies any adopted version of Art. 12B.

For your consideration, we have provided the following general statements which CoE Members may wish to consider as expressing the minority views in accordance with UN Practices and Procedures. These high level policy statements could be supplemented with the more specific comments on the mechanics of the proposal included earlier in this letter.

> [x]. Despite the inclusion of Article 12B in the United Nations Model Convention, a [large] minority of the members of the Committee do not agree with the policy justifications expressed for the Article. These members do not agree with the justification for a new withholding tax based on enterprises' ability to engage in substantial business activities in the market country without a fixed place of business there, or to conclude contracts remotely through technological means with no involvement of individual employees or dependent agents. These members are of the view that the expressed policy foundation of Article 12B to recognize contributions of the market State does not justify a tax uniquely on Automated Digital Services. Further, there is no sound policy basis for a gross-based tax on ordinary business income, as "income from automated digital services" normally will be burdened by ordinary and necessary business expenses and require substantial upfront and ongoing capital investment.
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> [x]. In the view of these members, Article 12B's material expansion to apply gross basis taxation to digital services departs from the justification used for other withholding taxes as it seeks to impose withholding tax on ordinary active business profits of a specific business sector instead of on income items of a particular character, which is the case for all other items of income subject to tax under Article 11, Article 12, or Article 12A.
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> [x]. Those members that oppose Article 12B consider that if a shift of tax nexus rights is justified in order to reflect the contributions of the market State to the profits of the enterprise, that reasoning cannot justify a tax that applies to only a single business sector. The market contributes in the same way for all goods and services sold into the market. These members observe that the allocation of 30 percent of group consolidated profits for net taxation under Paragraph 3 far exceeds any reasonable profit attribution to a location with no functions, assets, or risks.
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> [x]. Those members do not agree that Article 12B creates a level playing field by ensuring that both resident and nonresident companies pay tax on the provision of automated digital services, as that justification ignores the fact that digital service

providers resident outside the taxing State are taxed also in the their State of residence. Accordingly, Article 12B in no way creates a level playing field; its purpose is only to reallocate taxation rights from the State of residence to the State of the payor for one specific business sector. The Commentary's suggestion that countries adopt a "modest" withholding tax rate to be agreed during bilateral negotiations is not likely to address this issue since the suggested 3% or 4% tax rate is not a modest rate when applied to gross revenue. These members are particularly concerned that Article 12B would create a barrier that deters nonresidents from accessing a market altogether, thereby distorting competition between resident and nonresident firms.

[x]. The mandate of the United Nations Model Convention is to include model treaty provisions that can serve as a guide for countries in negotiating their bilateral treaties. The minority views this mandate as carrying the obligation to ensure that any Model Convention article is based on sound tax policy and can be implemented by tax administrations without leading to unreasonable disputes, unfairness, and uncertainties. In that regard, the members opposing the inclusion of Article 12B recommended that the Committee await the outcomes of the OECD / Inclusive Framework work on addressing the tax challenges of the digitalized economy to ensure that Article 12B would be consistent with a multilateral approach. These members are concerned that Article 12B, if adopted by countries in their bilateral treaties or domestic legislation, would add another layer of taxation that would run counter to the goals of developing a consensus-based position at the OECD. These members were also concerned that Article 12B cannot be regarded as complementary or consistent with the OECD / IF work because it does not include a mechanism to avoid double taxation that would arise once Pillar One and Pillar Two are implemented.

[x]. Further, the dissenting members do not agree with the suggestion that Article 12B could be a useful guide to countries looking to develop domestic legislation on taxation of Automated Digital Services, especially for those countries that do not have widespread treaty networks to govern double taxation concerns. The introduction of Article 12B should not be seen as an endorsement or an encouragement for national governments to adopt gross-based withholding taxes on digital services as an "approved" tax by the United Nations.

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Thank you again for the opportunity to provide these comments. We would be pleased to discuss these matters with you further at your convenience.

Yours sincerely,

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