Inputs for Promotion of inclusive and effective tax cooperation at the United Nations

Radhakishan Rawal[1]

The comments contained in this note are given in response to *Call for public input: Promotion of inclusive and effective tax cooperation at the United Nations*[2] (referred to as Public Consultation: Inclusive and effective tax cooperation at the UN).

1. Overview

The inputs provided in this note are broadly divided in the following parts:

- Formation and operation of UN Tax Committee Intergovernmental (***UNTC – IGL***) (refer ***para 3***)
- Brownfield approach - Continuation of existing mechanism (refer ***para 4***)
- Identification of Issues – Catalogue of issues (refer ***para 5***)
- Approaches for acquiring or leveraging on technical depth (refer ***para 6***)
- Comments on Pillar One and Pilar Two (refer ***para 7***)
- Climate Finance Withholding Mechanism (***CFWM***) (refer ***para 8***)
- United Nations – Multilateral Instrument (***UN MLI***) for fast tracking changes to the existing tax treaties (refer ***para 9***)
- Involvement of tax professionals in Capacity Building – helping developing nations (refer ***para 10***)

2. General Analysis

The main reason behind the adoption by the General Assembly of the United Nations of the resolution on 30 December 2022[3] appears to be the reason that the interest of the developing countries is not adequately protected in the tax initiatives lead by OECD. While the current work on Pillar One and Two is happening under the Inclusive Framework, the Inclusive Framework is not inclusive in true sense.

In February 2021 the FACTI Panel issued a detailed report[4] highlighting various problems in the current tax system at global level and giving

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[2] Email dated February 18, 2023

[3] 77/244. Promotion of inclusive and effective international tax cooperation at the United Nations

[4] https://factipanel.org/docpdfs/FACTI_Panel_Report.pdf

various recommendations. Some issues and recommendations are summarised in ***Annexure A***.

Further, in a paper titled *WORLD TAX POLICY IN THE WORLD TAX POLITY? AN EVENT HISTORY ANALYSIS OF OECD/G20 BEPS INCLUSIVE FRAMEWORK MEMBERSHIP*[5] the author[6] has analyed various hypothesis and concluded that although there are more than 135 members involved in the Inclusive Framework, the developing countries may have joined due to coercion and the work of Inclusive Framework lacks inclusiveness.

The work of the Committee of Experts on International Cooperation in Tax Matters (current UN Tax Committee – ***UNTC***) is perceived to be protecting interest of the developing countries but the UNTC is not an intergovernmental committee.

Accordingly, the recent UN Resolution (77/244) focuses on a framework for international tax cooperation to be led by UN and adoption of intergovernmental processes. The suggestions in this note are accordingly made based on this broader perspective.

3. Formation and operation of UN Tax Committee Intergovernmental (UNTC – IGL)

An intergovernmental tax committee of UN (UNTC – IGL) may be established which would lead all global initiatives on taxation.

3.1 Decision making by the UNTC – IGL

Currently more than 135 countries, including the developing countries, are part of the OECD Inclusive Framework. However, it is perceived that the interest of the developing countries is not protected and the developed countries are able to dominate. The developed countries would participate in the UNTC – IGL as well and to get different outcomes the processes need to be set up in a manner that the interest of the developing countries is protected.

3.1.1 Approaches for decision making

The following approaches may be considered for the decision making by UNTC – IGL:

- Consensus based
- Simple majority
- Super majority

[5] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3918499

[6] *Shu-Yi Oei*

3.1.2 National human population as a parameter as against GDP

The two pillar solution is touted as being supported by over 135 Inclusive Framework members, representing more than 95% of global GDP.

Considering the fact that the tax revenues are to be utilised for the purpose of betterment of the human population of a country and hence human population may be the key parameter for decision making. For example, the rule could be made that:

- *a resolution at UNTC – IGL is treated as approved if countries representing more than 75% of the global population vote in favour.*

3.2 Timeliness decisions and implementation

The processes for operations of UNTC – IGL should be robust and ensure that decisions are taken and implemented in a timely manner.

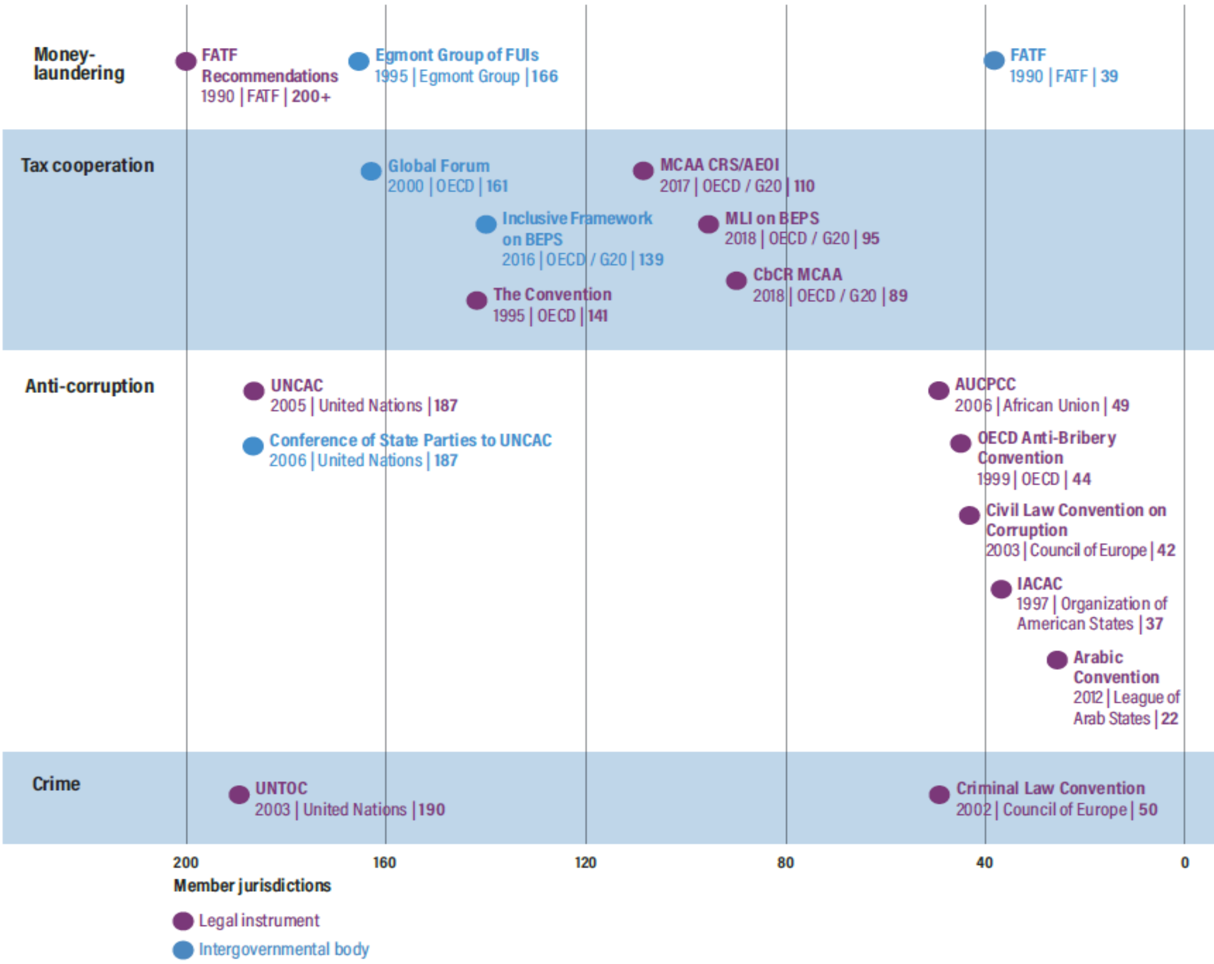
The operations of the UNTC of last few years suggest that the committee members from the developed countries have successfully managed to defer and delay work on issues, which are likely to reduce their taxing rights, for significantly longer period of time.

The best example of this delaying tactics is taxation of computer software as "royalties". The initial suggestion to treat consideration for usage of computer software as "royalties" under Article 12 was made way back in the year 2011 at the 7th Session of the UNTC and even after 12 years the definition of royalties in Article 12 is not allowed to be changed by using delaying tactics. A huge wastage of 12 years! An alternative provision was included in the Commentary but an attempt was done to even reverse that as well. The (lack of) progress on the issue is tabulated:

Year	Session	Particulars and document
2011	7th	UNTC acknowledged the need to further discuss Article 12 [E/2011/45-E/C.18/2011/6]
2013	9th	UNTC requested the Secretariat paper on Article 12 [E/2013/45-E/C.18/2013/6]
2014	10th	UNTC requested Secretariat to prepare a note giving proposed text for clarifying ICS equipment and software payments [E/C.18/2014/3, E/2014/45-E/C.18/2014/6]
2015	11th	Secretariat note was presented and a Sub-committee was formed [E/C.18/2015/CRP.7]
2016	12^{th}	The issue was placed in the agenda but discussion deferred to 14^{th} Session
2017		Sub-committee met in Brussels. Commentary on Art 12 ICS Equipment amended. Requested UNTC to take up software royalty in the next membership. [E/C.18/2017/CRP.5]
2018-21		Amendment to para 16 of the Commentary (Alternative provision)
2022	25th	Sub-committee requests further guidance from UNTC E/C.18/2022/CRP.24

4. Brownfield approach - Continuation of existing mechanisms

The FACTI Panel Report identifies certain existing mechanism for financial accounting, transparency and integrity.



It would not be possible or practical to adopt greenfield approach wherein all the instruments, treaties etc. are rewritten to tilt the balance in favour of developing countries. As against greenfield approach, adoption of brownfield approach would be advisable. Under this approach, the UNTC – IGL will not completely rewrite documents, instruments and attempt to create a fresh infrastructure but will address specific aspects of the existing mechanisms which are inappropriately favouring developed countries.

Examples of this approach could be as follows:

- Taxation of capital gains: Capital Gains article of the existing tax treaties may be amended to give more taxing rights to the source countries by adopting UN MLI mechanism[7].
- Taxation of royalties: Royalties article of the existing tax treaties may be amended to update definition of "royalties" to include consideration for usage of computer software by adopting UN MLI mechanism.
- Digital economy: The UNTC – IGL may decide to allow adoption of Article 12A of the UN Model in the tax treaties for levying tax on automated digital services in cases where the MNE is not within the scope of Pillar One.
- Digital economy: Alternatively, the UNTC – IGL may allow the market jurisdictions to continue the domestic Digital Services Tax (DST) or other similar measure for levying tax on MNEs which are not within the scope of Pillar One.

Mechanics:

- UNTC – IGL would have a universal membership i.e. it would be wider than that of the Inclusive Framework.
- A member State will have the ability adopt different stands different forums i.e. in the Inclusive Framework (which is perceived to be coercive by some commentators) and in UNTC – IGL.
- Population based voting rights in the UNTC – IGL will enable UN to override the work performed / decisions taken at other forums.
- The authority of the UNTC – IGL should be higher than that of the Inclusive Framework and this is possible if appropriate resolutions are passed by the UNTC – IGL.
- A resolution passed by UNTC – IGL should have the effect of overriding (making relevant change) to the Multilateral Convention for Pillar One and other similar instruments.

5. identification of Issues – Catalogue of issues

The FACTI Report also identifies various issues in the existing mechanisms which are contrary to the interest of the developing countries.

UNTC – IGL may maintain a Catalogue of issues which need to be addressed. This could be a running / dynamic list and the member States may regularly add new issues in the Catalogue.

The UNTC – IGL will decide the priority for / order in which the issues need to be resolved and attempt timely resolution of the issues.

[7] UN MLI is discussed in ***para 9***

6. Approaches for acquiring or leveraging on technical depth

While doubts are raised as regards whether OECDs work protects the interest of the developing countries, there is absolutely no doubt as regards the technical depth at OECD. The superior quality technical documents produced by the OECD is attributable to the large experienced teams / working parties / staff at OECD. It goes without saying that any institution desiring to lead the world tax agenda must possess such technical depth.

It is also acknowledged that as compared to OECD tax team the tax team at UN Secretariate is much smaller. To lead the world tax agenda the technical depth at the UN Secretariate must be enhanced. The approaches for achieving this are tabulated:

Approach 1	UNTC – IGL may give mandates to OECD to produce technical documents / solutions specifying the desired end result at policy level. The document / solution prepared by OECD may be evaluated by UNTC – IGL from the perspective of whether it would achieve the desired end results at policy level and whether it protects the interest of the developing countries. The document / solution may be approved by UNTC – IGL adopting the intergovernmental processes.
Approach 2	The initial drafts of the technical documents etc may be prepared by a sub-committee of UNTC – IGL / Secretariat. Technical experts from OECD may be included in the sub-committee or alternatively inputs of OECD may be obtained on the technical document and the document may be subsequently approved by UNTC-IGL adopting the intergovernmental processes.

These approaches which ensure balanced outcomes wherein the technical depth of OECD will be leveraged and at the same time interest of the developing countries will be protected by adopting population based voting rights mechanism.

7. Comments on Pillar One and Pilar Two

The work of Inclusive Framework on Pillar One and Two has significantly progressed. Although there are concerns as regards certain aspects not in favour of the developing countries etc, it would not be desirable to stop the work. Significant amount of good work done by the Inclusive Framework in last 2-3 years could be lost. Formation and operationalisation of UNTC – IGL may not happen immediately and hence the desired approach could be as follows:

- Not to disturb work on Pillar One and Two on the basis of the recent UN Resolution 77/244.
- Issues / aspects which require modification from the perspective of the taxing rights of the developing countries may be identified and included in the Catalogue of issues (refer ***para 5***) and may be addressed in a timely manner by the UNTC – IGL (refer ***para 4***).
- Allowing the source countries to exercise taxing rights under DSTs and other similar measures in the domestic law on the income earned by the MNE Groups which are outside the scope of Pillar One.

8. Climate Finance Withholding Mechanism (CFWM)

The developed countries have committed to provide funds to the developing countries towards climate finance. However, this climate finance commitment is not met by the developed countries. This funding issue can be addressed by adopting Climate Finance Withholding Mechanism (CFWM).

Millions of dollars flow from the developing countries to the developed countries every year as a result of trade and commerce carried on by the MNEs. The MNEs are required to pay tax on such income in the developed country (the residence country tax). Under the CFWM the amount equivalent to the residence country tax may be withheld by the developing country from the funds flowing to the developed country. The amount so withheld will be adjusted against the climate finance obligation of the developed countries. CFWM does not adversely impacts taxing rights of any country, it only diverts taxes towards climate finance obligations. CFWM also does not result in additional tax outflow for the MNEs, they will pay the same amount of tax to the developing country as against the developed country.

The Concept Note on CFWM is reproduced in ***Annexure B***.

9. United Nations – Multilateral Instrument (UN MLI)

In the recent years the UNTC has inserted substantive new provisions in the UN Model Tax Convention. However, there is no mechanism to fast-track insertion of these provisions in the existing tax treaties. This can be achieved by developing a UN MLI on the lines of BEPS MLI. The Concept Note on UN MLI is reproduced in ***Annexure C***.

The UNTC has started working on the development of a fast-track instrument (UN MLI). The UNTC – IGL needs to ensure that UN MLI is prepared and operationalised in a *timely manner* and delaying tactics are not adopted as is the case of royalties definition (refer ***para 3.2***).

10. Involvement of tax professionals in Capacity Building – helping developing nations

The issues faced by the developing countries often include issue of capacity, ability to understand complex technical documents. These issues can be resolved by involving tax professionals from larger developing countries. A mechanism can be developed to utilise knowledge of these large pool of professionals.

Annexure A

FACTI Panel Report - Summary of issues and recommendations[8]

Absence of intergovernmental form with "universal membership"

- The institutional environment is dominated by voluntary forums and bilateral tax treaties, which contain numerous imbalances.

Global Governance Arrangements

- The Global architecture is fragmented and uncoordinated. Some bodies are not universally inclusive.
- Current system is a patchwork, and a coherent ecosystem is required.
- There is no single globally inclusive intergovernmental forum for setting norms in tax matters.
- UN is an inclusive and universal body. It is uniquely positioned to address the issues. ECOSOC.
- FATF has near universal participation through its Associate Members, but these associate members do not enjoy formal equal representation when standards are set.

RECOMMENDATIONS

- ➢ Establish an inclusive and legitimate global coordination mechanism at ECOSOC that can address illicit financial flows on a systemic level.
- ➢ Building on existing structures, create an inclusive intergovernmental body on tax matters under the United Nations. (Upgrade UN tax committee)
- ➢ Intergovernmental body such as ECOSOC to coordinate the work of agencies outside the UN such as:
  - ✓ Inclusive framework on BEPS
  - ✓ Global Forum on Exchange of Information for tax purposes
  - ✓ Financial Action Task Force
- ➢ Global Forum to become "related organization" of UN, its professional staff to migrate
- ➢ UN Convention (MLI type)

Transparency - Problems with current CBCR mechanism

- Out of 137 members of Inclusive Framework on 85 have signed CbCR MCAA
- CbCR MCCA limits the use of data for purposes other than risk assessment
- Due to threshold of Euro 750mn, 85 to 90 percent of MNEs escape obligations under CbCR

RECOMMENDATIONS

- International anti-money-laundering standards should require that all countries create a centralised registry for holding beneficial ownership information on all legal vehicles. The standards should encourage countries to make the information public.
- Improve tax transparency by having all private multinational entities publish accounting and financial information on a country-by-country basis.

[8] This Annexure does not attempt to give a complete summary of the FACTI Panel Report

Fairness in taxation

- Developing countries are systemically disadvantaged in the current international tax architecture, rules are in favour of capital exporting countries resulting in large revenue losses to governments.
- Transfer pricing rules are too complex to effectively prevent aggressive tax planning.
- Gaps in any bilateral tax treaty might enable avoidance of capital gains tax.
- Tax competition continues to undermine the tax base. Need for minimum tax rule
- Proposed new rules on digital economy taxation at the OECD are excessively complex and not adapted to developing countries' needs.
- The proposed new UN model treaty rule to tax automated digital services is seen as providing a practical approach.
- Concerns abound about mandatory binding arbitration of tax disputes.

RECOMMENDATIONS

- ➢ The UN Tax Convention should provide for effective capital gains taxation.
- ➢ Taxation must be equitably applied on services delivered digitally – multilateral approach
- ➢ This requires taxing multinational corporations based on group global profit. (Fair formulaic approach as against TP)
- ➢ Create fairer rules and stronger incentives to combat tax competition, tax avoidance and tax evasion, starting with an agreement on a global minimum corporate tax. – Minimum rate of 20% to 30%
- ➢ Meditation and conciliation approach to resolve tax disputes

Enablers of illicit financial flows – professionals such as lawyers, accountants and representatives of financial institutions

- Enablers of IFFs are not held to account for their activities, due to gaps in enforcement and abuse of legal privilege.
- Self-regulation does not work.
- Many governments, particularly in haven countries, refrain from setting standards for appropriate conduct of enablers, despite the social costs.

RECOMMENDATIONS

- ➢ Governments should develop and agree global standards/guidelines for financial, legal, accounting and other relevant professionals, with input of the international community.
- ➢ Governments should adapt global standards for professionals into appropriate national regulation and supervision frameworks.

*Feb 2021 OECD Report – "Ending the Shell Game: Cracking down on the Professionals who enable Tax and White-Collar Crimes"

Civil Society and Media - RECOMMENDATIONS

- ➢ The international community should develop minimum standards of protection for human right defenders, anti-corruption advocates, investigative journalists and whistle-blowers. States should consider incorporating these standards in a legally binding international instrument.
- ➢ Civil society should be included in international policy making forums in an effective and efficient manner.

International cooperation and information sharing

- Trade mis-invoicing, deliberate misreporting etc. Challenges related to sharing of information between:
    - Custom officials of various countries and
    - Customs officials and other agencies of the governments
- International rules restrict usage and sharing of information to various government agencies.
- There are several gaps in automatic exchange of information due to exclusion of some developing countries from data networks.

RECOMMENDATIONS

- ➢ Developed countries should share information with developing countries without reciprocity. Developing countries generally do not have information about citizens of developed countries.
- ➢ Enable free exchange of information at the national level as standard practice to combat all varieties of illicit flows.
- ➢ Promote exchange of information internationally among law enforcement, customs and other authorities.

Data Collection and publication

- Glaring gaps in the publication of global tax data, under CRS
- Absence of neutral body with universal membership that takes responsibility for such tasks

RECOMMENDATIONS

- ➢ Establish a Centre for Monitoring Taxing Rights to collect and disseminate national aggregate and detailed data about taxation and tax cooperation on a global basis.

A body with universal membership such as IMF

Implementation Review - RECOMMENDATIONS

- ➢ Involve all relevant stakeholders such as civil society, academics and the private sector in reviews.
- ➢ Update the UN Convention Against Corruption (UNCAC) implementation review mechanism to improve comprehensiveness, inclusiveness, impartiality, transparency, and especially monitoring.
- ➢ Ensure impartiality and reduce risk of political bias in the reviews – mandate national experts, UN Office on Drugs and Crime (UNODC)
- ➢ Increase visibility and accessibility : Webcast implementation review group sessions and make available full review reports online

National Governance Arrangements - RECOMMENDATIONS

- ➢ Governments should create robust and coordinated national governance mechanisms that efficiently reinforce financial integrity for sustainable development and publish national reviews evaluating their own performance.

Annexure B

Carbon Finance Withholding Mechanism – Concept Note

-Radhakishan Rawal[9]

US$ 100 billion per year by 2020, is what rich countries pledged as funding support for climate change activities to developing countries back in 2009 at the Copenhagen climate summit. This target has not been met because too few industrialized countries are paying too little in contributions. And it is uncertain whether it can be met annually until 2025[10].

This Concept Note suggests a tried and tested mechanism of withholding tax for collection towards climate finance. The proposed mechanism can be termed as Climate Finance Withholding Mechanism (***CFWM***).

Executive Summary – Salient features of CFWM

- Every year international trade and commerce results in income worth millions of dollars flowing from the developing countries to the developed countries yet the funds which should flow from developed countries to developing countries towards Climate Finance Commitments are not flowing. Climate Finance Withholding Mechanism attempts to recover and divert funds from international trade and commerce towards Climate Finance Commitment in favour of the developing countries.
- Under the bilateral tax treaties, the developing countries are either not able to levy tax on such income / funds flowing from its jurisdiction or are able to levy only limited amount of tax. CFWM requires that amount equivalent to tax[11] levied by the developed country is retained in the developing country towards Climate Finance Commitment.
- CFWM does not result in additional tax outflow for the MNCs.
- CFWM does not adversely impact taxing rights of any country.
- CFWM adopts a soft approach to ensure compliance by MNCs. While the Climate Finance Recovery amount withheld is to be deposited with the tax authorities of the source country, the tax authorities of that country will not have the right to audit the MNC.
- CFWM will be linked to ESG obligations.
- A certificate from statutory / independent auditor and linkage with ESG obligations will ensure CFWM compliance by the MNCs.

[9] Author is Mumbai based Chartered Accountant and a former member of a sub-committee of the UN Tax Committee. Views expressed if any in this article are personal views of the author. Certain articles written by the author can be found at radhakishanrawal.com . This Concept Note was earlier published by South Centre and Tax Notes

[10] https://us.boell.org/en/2021/10/25/broken-promises-developed-countries-fail-keep-their-100-billion-dollar-climate-pledge . Also refer https://unfccc.int/sites/default/files/resource/docs/2009/cop15/eng/11a01.pdf And https://webassets.oxfamamerica.org/media/documents/bn-climate-finance-short-changed-191022-en.pdf?_gl=1*11rhcuo*_ga*MTA1NTYzNzA5LjE2NjY3OTk5MTI.*_ga_R58YETD6XK*MTY2NjgwNTcwMi4yLjAuMTY2NjgwNTcwMi42MC4wLjA.

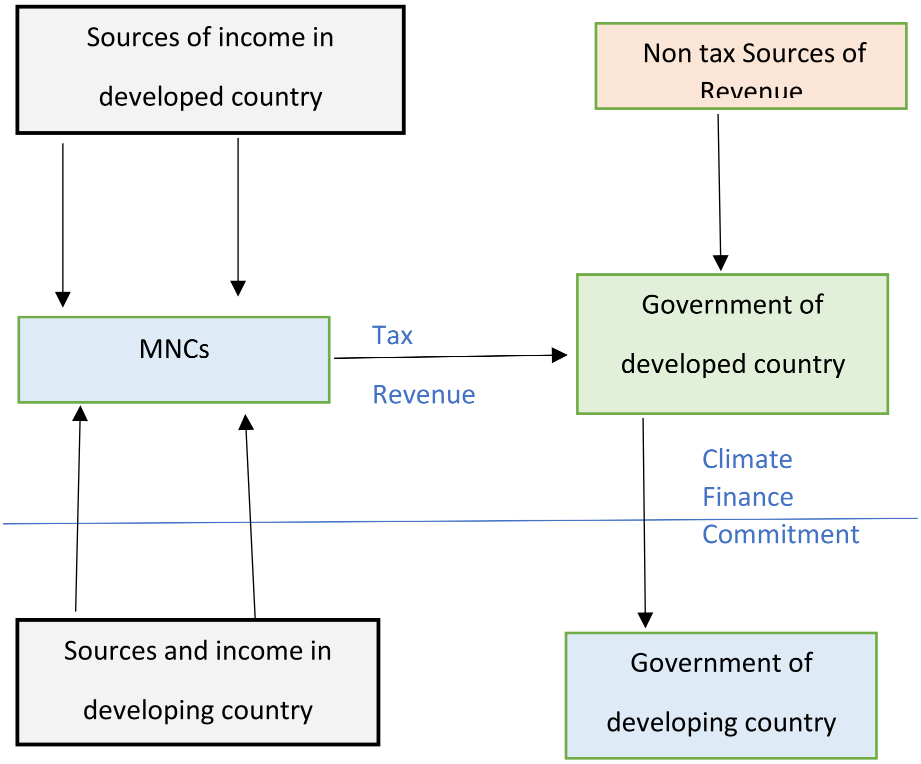
[11] incremental tax in case the developing country is also able to levy tax on such income

B.1 Withholding as a method of recovery

The easiest method of collection of taxes on income is withholding tax also known as deduction of tax at source. The payer of the income has to act as an agent of the government and is obliged to deduct tax from the amount payable by him and deposit with the government. The same mechanism can be explored for collection of funds towards climate finance from the developed countries.

B.2 How will Climate Finance Withholding Mechanism work?

The governments revenue can be broadly divided in two parts viz. tax revenue and non-tax revenue. The government uses this revenue for various purposes. The government of a developed country can generally be expected to use funds from this revenue to give climate finance to the developing countries. This is diagrammatically presented in the picture.



Under the suggested approach of CWFM, the recoveries for climate finance can done at the source of the tax revenue i.e. before the money flows from developing country to the MNC. The payer of the income from the developing country to the MNC in the developed country can deduct money towards climate finance at source from the amount payable by him and pay it to the government of the developing country. The amount to be recovered at source can be termed as Climate Finance Recovery (***CFR***).

B.3 Does it result in additional tax outflow for the MNCs?

CFR payments under the CFWM to the developing country by MNCs will not result in higher tax outflow by the MNCs. Every sovereign country is entitled to levy tax on income earned by non-residents from such country. In a cross-border transaction, the MNC could be liable to tax in source country or both source country or residence country.

When a bilateral double tax avoidance treaty exists between the two countries, the taxing rights are distributed between two countries and when the taxing rights are given to the source country, the country of residence has an obligation to mitigate double taxation. This could be either under "exemption method" or "credit method". The country of residence would generally mitigate double taxation even when a double tax avoidance agreement does not exist between two countries.

The country of residence generally has wider taxing rights as compared to the source country and MNCs generally will have an obligation to pay tax in the country of residence in addition to the tax payable in the source country. Under the CFWM this additional tax may be diverted to the source country as CFR. Thus, as against the MNC paying this additional tax in the country of residence, this additional tax amount will be withheld in the source country. Accordingly, CFWM will not result in additional tax cost to the MNCs.

B.4 Does CFWM take away taxing rights of any country?

CFWM does not take away or adversely impact taxing rights of any country in any manner. The rights of the developed country remain undisturbed under CFWM. All that happens under CFWM is that the amount of tax which the developed country could have gathered by exercising the taxing rights is diverted towards that country's Climate Finance Obligations. This is effectively an application of the taxes accruing to the developed countries towards their debts (i.e. Climate Finance Commitment) and does not reduce sovereign taxing rights of such countries. CFWM is only a cashflow management.

B.5 Illustrations

Climate Finance Withholding Mechanism can be explained on the basis of the following illustrations.

B.5.1 Illustration A – When source country does not have taxing rights

Facts

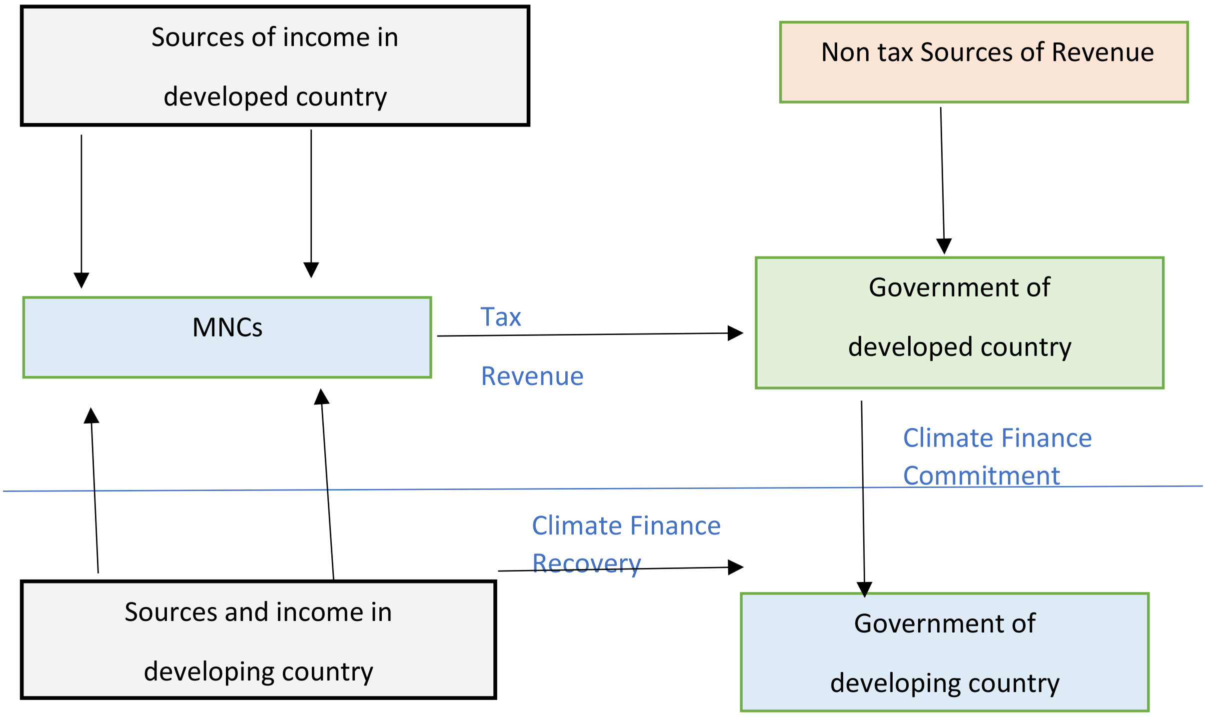
- A Ltd. is a tax resident of Country R and derives royalty income of USD 100 from Country S.
- AB Ltd., a subsidiary of A Ltd. in Country S, pays royalties to A Ltd.
- Under the bilateral tax treaty between Country R and Country S, Country S does not have the ability to levy tax on the royalties derived by A Ltd.
- A Ltd. pays tax of USD 17 in Country R on the royalties earned from AB Ltd.

Application of CFWM

- Under the CFWM, AB Ltd will deduct Climate Finance Recovery of USD 17 from the royalties payable to A Ltd and pay this amount to the Government of Country S.
- A Ltd. will get a credit of USD 17 in Country R and hence will not have to pay additional tax there.

Analysis

Ordinarily A Ltd would have paid tax of USD 17 in Country R and ideally the same may have travelled back to Country S towards Climate Finance Commitment. Under CFWM, the same amount of USD 17 is retained in Country R towards Climate Finance Commitment.



B.5.2 Illustration B – When source country does have taxing rights

Facts

- Z Ltd. is a tax resident of Country R and derives royalty income of USD 100 from Country S.
- ZZ Ltd., a subsidiary of Z Ltd. in Country S, pays royalties to Z Ltd.
- Under the bilateral tax treaty between Country R and Country S, Country S does have an ability to levy tax on the royalties derived by Z Ltd. to the extent of 5%.
- Z Ltd. is liable to pays tax of USD 17 in Country R on the royalties earned from ZZ Ltd.
- Z Ltd. gets a credit for USD 5 in Country R for the taxes paid in Country S. Z Ltd. pays incremental tax of USD 12 to the government of Country R as final tax liability.

Application of CFWM

- Under the CFWM, ZZ Ltd will deduct Climate Finance Recovery of USD 12 from the royalties payable to Z Ltd and pay this amount to the Government of Country S.
- Z Ltd. will get a credit of USD 12 in Country R for the amount withheld by ZZ Ltd. and hence will not have to pay additional tax there.

Analysis

Ordinarily Z Ltd would have paid additional tax of USD 12 in Country R and ideally the same may have travelled back to Country S towards Climate Finance Commitment. Under CFWM, the same amount of USD 12 is retained in Country S towards Climate Finance Commitment.

ZZ Ltd. will collect USD 5 as normal withholding tax and USD 12 as CFR. These amounts may be deposited in separate accounts maintained by the government of Country S.

B.6 Quantification issues

The illustrations in the preceding paragraph may appear very easy but there would be practical challenges in implementing it. The challenges would be related to quantification of tax payable by the MNC in the country of residence. The tax payable in the country of residence on an income derived from the source country is required to be determined as per the laws of the country of residence. At withholding stage this amount may not be available. Additionally, even when such an amount is available, it would be difficult for the person liable for withholding in the source country to verify the accuracy of such amount. This can be analysed on the basis of an illustration.

B.6.1 Illustration C – Absence of permanent establishment

Facts

- X Ltd. is a tax resident of Country R and derives business income of USD 100 from Country S.
- X Ltd does not have a permanent establishment in Country S. XX Ltd is X Ltd's business associate in Country S and X Ltd derives income of USD 100 from XX Ltd.
- Under the bilateral tax treaty between Country R and Country S, Country S does not have the ability to levy tax on the business income earned by earned by X Ltd in absence of X Ltd having a permanent establishment in Country X.

Issues

The following facts make quantification of amount to be withheld difficult:

- Under the CFWM, XX Ltd will have the obligation to withhold amount of tax, which X Ltd is liable to pay under the laws of Country R.
- Amount of USD 100 payable by XX Ltd to X Ltd is payable not for a single transaction but for various transactions between the parties through the year.
- X Ltd will be liable to pay tax on its net income and hence deductibility of various expenses incurred by X Ltd for earning income of USD 100 would also be relevant.

Solution

- The quantification of tax payable in Country R can be initially done only by X Ltd, which will be finalised / accepted by the tax authorities of Country R at a subsequent stage.
- X Ltd. can estimate the amount of tax payable by it on the income receivable from XX Ltd and inform XX Ltd the amount to be withheld towards CFR.
- XX Ltd will withhold CFR based on the information received from X Ltd and will deposit it with Country S government.

B.6.2 Adoption of Average rate of tax

Computation of net income specifically for the income earned from source country (i.e. out of USD 100 in Illustration C) may be difficult for various reasons including the following:

- Total income of the MNC may consist of several sources of income and income from another developing country may be one of the sources.
- The MNE may have incurred common expenses and identification of expenses specifically incurred for earning income from developing country could be difficult.

- Some businesses / transactions may result in losses.

Considering the above, average rate on the consolidated income of the entity may be adopted to determine CFR.

In Illustration C, if the gross total income of X Ltd from all sources is USD 1000 and total tax on such income us USD 130, then the average rate of tax would be 13%. Tax payable under the domestic law of Country R by X Ltd on income earned from Country S would be USD 13 and this amount will be payable by X Ltd as CFR in Country S.

During the year, based on the information provided by X Ltd., XX Ltd may withheld USD 10 as CFR from payments to X Ltd. At the year end when X Ltd. makes the final computation of income, the additional amount of USD 3 can be paid by X Ltd to XX Ltd for depositing with the government of Country S. Alternatively, the additional amount of USD 3 may be withheld from the subsequent years payments to X Ltd.

B.7 Verification issues

Illustration C may be used for the purpose of analysing the verification issues as well.

The issue is verification of correctness of the amount of CFR determined by X Ltd. As analysed in the preceding paragraph the amount of CFR will be calculated by X Ltd. on its own and will be informed to XX Ltd. Which authority should audit the computation done by X Ltd?

Two approaches for this issue are analysed in the ensuing paragraphs.

B.7.1 Approach A – Strict approach

Under this approach the tax authorities of Country S will examine the correctness of the computation of CFR computed by X Ltd. This is on the basis that under CFWM, Country S is entitled to receive CFR and accordingly it should also have the corresponding right to examine correctness of the computation and claim additional amount if the computation done by the MNC is not correct.

The difficulties with this approach include the following:

- Tax payable by X Ltd in Country R is to be determined as per the tax laws of Country R. The tax authorities of Country S would not have the ability to do that determination or development of such capabilities could be difficult.
- It would be extremely difficult for tax authorities of Country S to verify of various claims for deduction for expenses made by X Ltd.

B.7.2 Approach B – Soft approach

Under this approach the tax authorities of Country S will not be authorised to verify the CFR amount computed by the MNC.

- Under the Soft Approach, the mechanism for verification and ensuring that the CFR is appropriately discharged will be as follows:
  - Verification of tax liability in Country R on the income earned from Country S will be done by the tax authorities of Country R as is ordinarily done.
  - During the year, the MNC will calculate CFR on estimated basis and discharge CFR liability through the person from whom it earns income from Country S (i.e. XX Ltd in Illustration C).

- At the end of the year after filing its annual tax return in Country R, the MNC will determine whether any additional CFR is payable by it for the year and will address the shortfall if any by discharging the CFR liability in Country S.
- The annual return filed by the MNC may get audited by the tax authorities of Country R at a subsequent stage. If such audit results in any additional tax liability on the income derived from the source country, the MNC will discharge such additional tax liability by paying CFR in the source country.
- Every year MNC will obtain a certificate from its statutory auditor / independent auditor certifying that the MNC has appropriately determined and discharged its CFR obligation for the current as well as the earlier years.
- The companies are required to report various steps taken by it towards environment, sustainability and governance (ESG) – ESG Reporting. Payment of CFR in the source country can be included in the ESG Reporting. Adverse ESG Report will adversely impact the operations of the MNC including its reputation.
- Adverse certificate by the statutory / independent auditor and adverse ESG Report will act as a deterrent for the MNC.

B.7.3 Continued interest for the country of residence

The issue to be addressed is, if the amount of tax determined in Country R is to be paid to the Country S, would the country of residence be interested in ensuring that the tax is appropriately determined?

The answer would be "yes". This is for the reason that although the tax on income is ultimately paid in Country S as CFR, such payment effectively reduces the Climate Finance Commitment for Country R.

B.8 Does it result in more compliance by the MNCs?

CFWM does not increase the total liability of the MNCs. Further, once the procedures related to CFWM are settled, CFWM will also not significantly increase the compliance burden for the MNCs. As analysed in ***para B.7.2*** CFWM adopts a softer approach by relying on statutory auditor's certification to ensure that compliance burden on MNCs is kept minimum from the perspective of audit / assessment by the tax authorities of the source country. The company in either case has to compute the amount of final tax payable by it in the country of residence. Under CFWM the amount of incremental tax so determined will be paid to the government of the source country if that happens to be a developing country.

Various ESG initiatives suggest that the MNCs have taken climate issues very seriously and when reckoned against that the additional compliance for CFWM does not appear to be a challenge.

B.9 Why CFWM could be a better solution?

A mechanism like CFWM cannot be introduced without acceptance by the developed countries. A question which may arise is, if the developed countries accept their obligation to contribute towards climate finance, why the withholding mechanism is preferable as against the developed country directly making the payment (direct payment method)?

The arguments in favour of CFWM will include the following:

- A commitment to contribute as such already exists but that has not solved the problem. The developed countries made the commitment long back and the idea of CFWM has emerged only because it has not been fulfilled.
- Transferring large amounts of money from the developed countries could be difficult due to various processes and releasing such funds could be a difficult decision. CFWM automates the process and avoids discretion or decision making every time an instalment of money is to be released.
- As shown in the diagrams CFWM represents a short route for collection of funds.
- Withholding taxes at source has its own advantages; this is the reason why this method can be found in several matured tax systems.
- CFWM will also offer a steady and continuous flow of funds to the developing countries as against the direct payment method which involves discretion and has not given desired results.

It needs to be noted that the collections under CFWM will be directly dependent on the volume of international trade and commerce between the developed and developing country, especially the funds flowing from developing to developed country. Further, such an outflow could be much smaller in case of certain developing countries. In such situations, the countries will have to rely on other mechanisms from transferring Climate Finance funds to such developing countries. CFWM does not promise to solve all the issues for all the parties and it can be one of the mechanisms for routing Climate Finance funds to the developing countries.

B.10 Interplay between CFWM and STTR

Subject to tax Rule (STTR) is one of the four rules of Inclusive Frameworks Pillar Two. Under this Pillar Two STTR the source country is given taxing rights when income is not adequately taxed in the country of residence. Pilar Two STTR is still work in progress.

United Nations Tax Committee is also developing STTR (UN STTR) whose scope of broader than the Pillar Two STTR. UN STTR is also a work in progress.

There is no overlap between STTR and CFWM. STTR will be triggered when the country of residence does not adequately tax MNC. CFWM can be applied when the country of residence is adequately taxing the MNC.

B.11 Conclusion

This concept note contains initial thoughts on how Climate Finance Withholding Mechanism can be structured for channelising funds from the developed countries to developing countries towards Climate Finance Commitments. There could be a scope for significant improvement of this structure with the participation of various government authorities and international organisations. The mechanism is possible only if the respective governments agree for it. CFWM only addresses a cash flow issue and several other aspects of climate finance need to be addressed separately.

Author invites comments from other experts.

Annexure C

Conceptualizing a UN Multilateral Instrument

Radhakishan Rawal[12]

C.1 Background

With the completion of the 22nd Session of the United Nations Committee of Experts on International Co-operation in Tax Matters (UN Tax Committee or UNTC), in April 2021, the term of the current membership of the UN Tax Committee also comes to an end. During this term (i.e. 2017 to 2021), in addition to changes to the UN Commentary and other aspects, UNTC has managed to achieve the following key changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model):

- Article 12: Amendment[13] to the definition of "royalties"
- Article 12B: Insertion of new Article in the UN Model for taxation of automated digital services
- Article 13: Amendment for taxing rights on capital gains from indirect transfer

These changes will be incorporated in the UN Model in its next update, which will be done in, 2021.

The previous membership of the UN tax committee also achieved the following key changes in the UN Model:

- Article 12A: Insertion of new Article in the UN Model for taxation of fees for technical services
- Amendments to the UN Model relating to the OECD/G20 Base Erosion and Profit Shifting (BEPS) project

These changes were included in the UN Model in its 2017 update.

BEPS related amendments to the UN Model were predominantly adaptation in the UN Model of BEPS related changes adopted in the OECD's Model Tax Convention on Income and on Capital (OECD Model).

C.2 Need for UN Multilateral Instrument (UN MLI)

The changes to the UN Model have been achieved after significant hard work by the members of the UN Tax Committee. If these changes are not incorporated in the actual bilateral tax treaties signed by the countries, the work of the Committee will remain theoretical. There does not exist any mechanism to quickly introduce the amendment to the UN Model in all the existing tax treaties.

Under normal circumstances, countries would adopt these provisions in the existing tax treaties by negotiating Protocols. However, this will be a bilateral negotiation and can

[12] Author is a Mumbai based Chartered Accountant and views expressed in this concept note are personal views of the author and does not represent views of any organization. The tug of war between residence-based taxation and source based taxation appears to be never ending. Approach adopted by the author is apolitical, does not support either side and this Concept Note is written purely from technical perspective. This is an updated version of the Concept Note which was presented to FACTI Panel on April 20, 2021. This Concept Note was published by South Centre and Tax Notes

[13] This is a minority view and will be included in the only in the UN Commentary and not in the UN Model

takes several years to complete. A faster way to adopt this would be through multilateral negotiation and a Multilateral Instrument (MLI).

Unlike a bilateral tax treaty which is a treaty between two countries, an MLI is a treaty between several countries. MLI amends tax treaties of all the signatories simultaneously. For example, if country A has signed tax treaties with fifty other countries, if Country A and all fifty Countries intend to amend the tax treaties, MLI can amend all the tax treaties at one stroke. Each country needs to sign only once (i.e. the MLI) and complete the domestic law ratification process only once.

There is a clear need for a UN MLI to quickly amend the existing tax treaties to adopt the changes to the UN Model Convention from time to time in the existing tax treaties.

BEPS MLI[14] is one such Multilateral instrument recently developed by the Inclusive Framework. The scope of the current BEPS MLI is restricted to BEPS related changes to the tax treaties. However, it is fair to assume that once the fruits of BEPS MLI (i.e. the ease at which several tax treaties are amended simultaneously) are tested, attempts will be made to incorporate the future changes to the OECD Model, in the existing tax treaties through MLI route.

C.3 Recommendation of the FACTI Panel

In February 2021, the FACTI panel released its report containing 14 recommendations. The Report makes the recommendations for a UN Tax Convention which indicates MLI features. The relevant paragraphs are reproduced:

> *"To hasten implementation, the UN Tax Convention should contain provisions holding that its terms will be automatically incorporated into signatories' tax treaties, so that they would not need to renegotiate individual bilateral treaties."*[15]

> *"Fair taxation of digitalised economic activity requires equitable treatment of digital businesses and business models with traditional business. The formulaic approach to taxing rights described above would help achieve this. To strengthen multilateralism, additional proposals to allow taxation of automated digital services should be adopted in the UN Tax Convention. Countries are already moving ahead with digital services taxes. Therefore, incorporating provisions to address this in the UN Tax Convention will create a multilateral framework based on international agreement and enable additional countries to start taxing the digital economy with realistic prospects of obtaining substantial revenue."*[16]

C.4 Can a tax treaty be modified by more than one MLI?

The BEPS MLI came into force on July 1, 2018 and 95[17] countries have already signed it. If a UN MLI is introduced, several countries will have signed two MLIs. Hence, the question which arises, is whether a bilateral treaty can be modified by more than one MLI? Is co-existence of two MLIs possible?

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[14] Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

[15] Page no. 17, 18

[16] Page no. 24, 25

[17] Currently 139 countries are part of Inclusive Framework. MLI is also signed by countries which are not part of Inclusive Framework

The obvious answer appears to be "yes". Prima facie there is nothing which suggests that one bilateral tax treaty cannot be modified by (or be a Covered Tax Agreement[18]) for more than one MLI. Things may become little complicated, yet this seems doable.

The implementation mechanism for both Pillar 1[19] and Pillar 2[20] Blueprints contemplate MLI type instrument. This would not be the existing MLI but a standalone new MLI. Thus, the possibility of more than one MLIs modifying a bilateral tax treaty already appears to have been evaluated by the Inclusive Framework and is in the pipeline.

C.5 Approaches to UN MLI

Two possible approaches and related nuances are tabulated hereunder:

Approach	**Remarks**	**Remarks**
Comprehensive Approach The UN MLI will be comprehensive in nature. It will cover everything which is there in the BEPS MLI and will have additional provisions which are specific to the UN Model.	The main advantage of this approach would be that it would give a comprehensive solution and complications related to application of two MLIs to a single tax treaty would not arise. If UN MLI gives more flexibility to the Signatories, more countries may be willing to participate and adopt BEPS related measures as well. United Nations member states are 193. Inclusive Framework has 139 jurisdictions, not all of which are member states, and as of now only about 95 countries of the Inclusive Framework have signed MLI[21]. The flexibility is discussed in ***para C.7.2***.	This approach could however also create more complications, especially when further changes are done to the BEPS MLI. Further, BEPS MLI is already operational and has already modified several tax treaties.
Specific Approach Under this approach, the UN MLI will not deal with the issues which are already dealt with by the BEPS MLI. The BEPS MLI already takes into consideration specific	Potential overlap between UN MLI and BEPS MLI will be avoided under this approach. This is discussed in ***para C.6***.	The possibility of countries which did not participate in the Inclusive Framework or did not sign BEPS MLI adopting BEPS related measures through UN MLI

[18] Article 2(1)(a) of BEPS MLI defines the term "Covered Tax Agreement"
[19] Heading 10.2.2 page no. 207 of Pillar One Blueprint
[20] Heading 10.5.3 page no. 176 of Pillar Two Blueprint (in the context of Switch-Over Rule, which would be a treaty provision)
[21] MLI is also signed by countries which are not part of Inclusive Framework

features of the UN Model provisions for the Articles which are getting modified by the BEPS MLI. UN MLI will facilitate modification of only those provisions or Articles which are unique to the UN Model and not dealt with by the BEPS MLI.	Both the MLIs (BEPS and UN) will operate separately and it would be possible to expand scope of these MLIs in the future.	on account of additional flexibility would not be there under this approach. This is discussed in ***para C.7.2***.

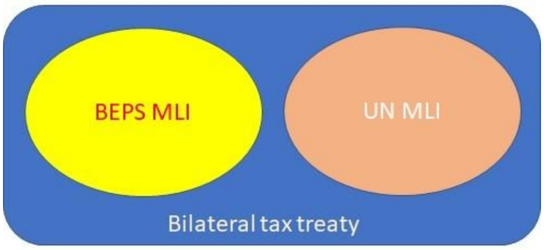
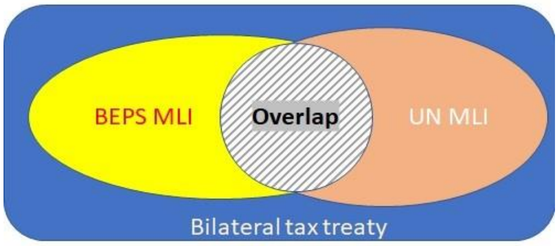
The Specific Approach appears to be a better approach. The subsequent part of this analysis proceeds on the basis that Specific Approach, as against Comprehensive Approach, would be followed.

C.6 Avoiding overlap between two MLIs

The table explains how overlap between the existing BEPS MLI and the proposed UN MLI be avoided.

Sr. No.	**Type of provision**	**Can be included in UN MLI?**	**Remarks**
1	Sub-paragraphs of Articles of the tax treaty which are already covered by the BEPS MLI [e.g. Article 5(4) dealing with auxiliary activities]	No Unless some additional changes are to be made.	In general, it would be advisable not to include those provisions in the UN MLI which are already dealt with by BEPS MLI.
2	Sub-paragraphs of Articles of the tax treaty which are not covered by the BEPS MLI [e.g. Article 5(2) listing places specifically included in the definition of permanent establishment]	Yes	Although BEPS MLI deals with Article 5(4), including other paragraphs of Article 5 in the UN MLI would generally be possible as there would be no overlap.
3	Articles which are unique to the UN Model and do not find place in the OECD Model [i.e. Article 12A, Article 12B]	Yes	
4	Provisions which are unique to the UN Model and do not find place in the corresponding Article of the OECD Model [e.g. Service PE provision in Article 5(3)(b) of the UN Model, definition of "royalty" including computer software in Article 12 etc.]	Yes	

5	Alternative provisions which are given in the UN Model Commentary [e.g. para 127 of the UN Commentary on Article 12A gives an alternative provision for para 6 of Article 12A]	Yes	
6	Future changes to the OECD and UN Model which are common to both the models	Yes	OECD and UN will have to coordinate and ensure that there is no overlap. Future changes which are common need to be included only in one of the MLIs (either UN or OECD), ideally the one which has more signatories.

Desired Approach	**Approach to be avoided**
	

C.7 Features of UN MLI

C.7.1 Broad structure

Hitherto the approach adopted for UN Model is to capitalize on the work done by the OECD and adopt the provisions from the OECD Model as well as extracts from OECD Commentary with such changes as may be required. The same approach can be adopted for the purpose of UN MLI as well.

- The broad structure, contours and approach would be adopted from the BEPS MLI. Articles 3 to 26 would be removed and required number of new articles would be inserted.
- The Signatories will have the option of identifying tax treaties which are to be made Covered Tax Agreement under the UN MLI.
- The Signatories will have the ability to make reservations and will have to make appropriate notifications.
- As compared to BEPS MLI, the UN MLI can attempt to give more flexibility. This is analysed in ***para C.7.2***.
- The domestic law provisions related to Ratification, Acceptance or Approval would be applicable.
- The Signatories will have the ability to initiate amendments to the UN MLI, call for conference of parties, withdraw from UN MLI etc.

- Consequent to the future changes to the UN Model Tax Convention, additional provisions would be added to the UN MLI.
- UN Secretariat will play the role of the Depository
- The basic feature of bilateral treaties will be retained i.e. treaty will get modified only if the both the parties to the treaty agree for such modification i.e. "the matching" happens.
- The possibility of "minimum standard" will be evaluated.

C.7.2 Additional flexibility

While the BEPS MLI offers various flexibilities to the Signatories, there are also certain restrictions. The main restriction appears to be that it does not allow adoption of selected MLI provisions for certain selected countries. The general approach is, either all the treaties offered for MLI (i.e. Covered Tax Agreement) get modified[22] or none[23]. The only exception to this could be cases where the existing treaties already address the issue in some manner.

For example, if a Country X has signed 80 tax treaties, have declared all 80 tax treaties as Covered Tax Agreement and if this country is interested in adoption of provisions of Article 9 of BEPS MLI only in 50 tax treaties and not all 80, it is not possible for Country X to achieve that result through BEPS MLI. Country X can either adopt Article 9 in all 80-tax treaty or none. If Country X treats only 50 tax treaties as Covered Tax Agreements, it can achieve the desired result as regards Article 9, but for the balance 30 tax treaties, none of the provisions of BEPS MLI would be applicable. It can be surmised that this inflexibility may have prevented some countries to sign MLI or make some or most of their tax treaties a Covered Tax Agreement.

The UN MLI can improve on this inflexibility of the BEPS MLI and allow Signatories to select countries for which it can adopt the UN MLI provision. This flexibility would be easily justified in the UN MLI for the reason that unlike BEPS MLI which contain predominantly anti-abuse type provisions, the UN MLI is focusing on distribution of taxing rights. ***Annexure C.A*** contains a sample provision giving such options.

C.8 How will the future tax treaties be read?

If the proposal of UN MLI is implemented, reading of tax treaties in the future will involve:

- Determination of whether the bilateral tax treaty is modified as a result of any bilateral amending protocol.
- Determination of whether the bilateral tax treaty is modified as a result of BEPS MLI.
- Determination of whether the bilateral tax treaty is modified as a result of UN MLI.

A synthesized text of bilateral tax treaty, incorporating modifications by both BEPS MLI and UN MLI, and by bilateral amending protocols, can also be contemplated.

C.9 Prior work

The Inclusive Framework generally works on a consensus-based approach and the participants are the governments of the respective countries. As against this, the current UN Tax Committee does not follow a consensus-based approach, but the views of majority and minority members are noted. Further, the twenty-five members of the UN

[22] Subject to matching

[23] There may be some exceptions to this

Tax Committee work in their individual capacity and do not represent respective governments, although they are nominated by the governments and in most cases are revenue officials.

To address these issues, one of the recommendations of the FACTI Panel is to update the status of the UN Tax Committee to that of an intergovernmental body. Accordingly, this may entail some further work and the updated UN Tax Committee (intergovernmental body / group) may get involved in the UN MLI.

C.10 Can the desired result be achieved in a different manner?

Prima facie it may be possible to achieve the purpose sought to be achieved (or substantial part of it) by the UN MLI in a different manner i.e. without creating a UN MLI.

Article 31 and Article 33 of the BEPS MLI facilitates amendment of BEPS MLI by the Parties thereto. Any Party can request Conference of Parties. If the request is supported by 1/3rd of the Parties within six months of the communication by the Depository of such request, the Conference will be called by the Depository.

Thus, instead of creating a new MLI altogether, UN specific provisions can be routed through the existing BEPS MLI. However, in this regards the following needs to be noted:

- Inclusion of provisions, which are not necessarily for addressing BEPS concerns but for distribution of taxing rights, may not be seen as consistent with the main objective for which the BEPS MLI was created.
- This approach may not be seen as consistent with broader objective of FACTI Panel recommendation, which appears to be that agency like UN, having universal membership, plays a larger role in global standard setting on the tax front.
- Procedural aspects:
  - BEPS MLI does not give further details as regards within what time the Conference of participants need to be called.
  - BEPS MLI does not give further details as regards the procedures to be followed at the Conference of Parties[24]. Whether there must be consensus for any change to BEPS MLI or a simple majority is sufficient.
  - Whether it will be possible to insert any provision in BEPS MLI which is not supported by OECD, would be a big question mark.

C.11 Approach on Article 12B

Approach for Article 12B will have to be different. This is the reason why 139 jurisdictions are already working in the Inclusive Framework on Pillar One. Article 12B in the UN Model will be seen as work of 25 committee members, in their individual capacity, as against participation of 139 governments in the Inclusive Framework.

In a situation where the Inclusive Framework succeeds in achieving the desired consensus and technical solutions on Pillar One, it would be reasonable to expect that these 139 countries would not be adopting Article 12B. In general these countries cannot be expected to adopt both the solutions (i.e. Pillar One of Inclusive Framework and Article 12B of UN) to address challenges of taxation of digital economy. However, theoretically it is possible that a country adopts both Pillar One and Article 12B. Article 12B is included in tax treaty with those countries which do not adopt Pillar One solution.

Article 12B would be relevant in the following situations:

[24] However, the Conference of Parties may do this.

- Article 12B can be the obvious Plan B for addressing challenges of taxation of digital economy. Thus, in a situation where the Inclusive Framework is not in a position to arrive at a consensus solution, the world will be left without any solution and then Article 12B can be evaluated by all the governments.
- Article 12B can be considered in certain specific situations even when the Inclusive Framework succeeds in arriving at a consensus. Pillar One of the Inclusive Framework will be applicable to MNEs with global revenue of Euro 750mn[25]. One of the criticisms of Pillar One is potential tax revenue leakage due to high thresholds. Thus, countries may be interested in adopting a simpler solution such as Article 12B for MNEs which do not satisfy the threshold agreed for Pillar One. This combination of Pillar One and Article 12B may have some complications and requires further analysis.
- If the consensus on Inclusive Framework takes too long and by that time the status of UN Tax Committee is updated to that of an intergovernmental committee, the required prior work for UN MLI is completed, then both Pillar One and Article 12B may be seen at par (may be with larger UN membership). The governments may then see Article 12B as a real alternative to Pillar One and evaluate it accordingly.

C.12 Conclusion

There is no scope for a differing views on the justification of UN MLI. Creation of UN MLI is the correct approach to regularly update the existing tax treaties with the changes made in the UN Model[26] from time to time. Hopefully, the UN and member countries find this useful and will work towards making UN MLI a reality.

Annexure C.A

Illustrative provisions of UN MLI[27]

Article 3 – Definition of royalties

1. A Covered Tax Agreement shall be modified to include the following definition of the term "royalties":

> "The term "royalties" as used in this Article means payments of any kind received as a consideration for:
>
> [TO BE COPIED FROM 2021 version of the UN Commentary]

2. The text described in paragraph 1 shall be included in a Covered Tax Agreement in place of the definition of the term "royalty" in the Covered Tax Agreement.

3. A Party may reserve the right:

[25] A lower threshold may also get adopted as per the Blueprint. If the threshold is increased to apply Pillar One only to top 100 companies, the potential utility of Article 12B would further increase.

[26] United Nations Model Double Taxation Convention between Developed and Developing Countries

[27] This annexure gives very basic examples of how the UN MLI articles may appear. This would undergo significant changes once legal draftsman get involved and all complexities are considered. For example, in certain tax treaties (e.g. India-Australia), the article dealing with royalties also deal with fees for technical services and the definition of "royalties" includes what is generally included in the definition of "fees for technical services" in addition to the normal definition of royalties.

(a) for paragraph 1 not to apply to all its Covered Tax Agreements;

(b) for paragraph 1 not to apply to its Covered Tax Agreements that already contain the definition described in paragraph 1.

4. Each Party shall notify the Depositary the list of Covered Tax Agreements, in which it intends to adopt the text described in paragraph 1. The text described in paragraph 1 shall be included in a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply that paragraph and have made such a notification with respect to the Covered Tax Agreement.

Article 4 – Taxation of digital economy (Article 12B of the UN Model)

1. A Covered Tax Agreement shall be modified to include the following Article in the Agreement:

TO reproduce final text of Article 12B as may be approved.

2. A Party may reserve the right for paragraph 1 not to apply to all its Covered Tax Agreements.

3. Each Party shall notify the Depositary the list of Covered Tax Agreements, in which it intends to adopt the text described in paragraph 1. The text described in paragraph 1 shall be included in a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply that paragraph and have made such a notification with respect to the Covered Tax Agreement.