

## Inputs to Ad Hoc Committee

### Radhakishan Rawal<sup>1</sup>

The comments contained in this note are given in response to *CALL FOR INPUTS: Ad Hoc Committee to Draft Terms of Reference for a UN Framework Convention on International Tax Cooperation*<sup>2</sup>.

#### 1. Specific issues to be addressed

One of the major grouse against BEPS project is that the agenda was set by few countries and that agenda was forced on all the countries. Consultation on the issues to be included in the TOR will address this issue and will give equal opportunity to all the member states.

The issues summarized in the ensuing paragraphs *could be addressed by a UN framework convention on international tax cooperation (UNFC)* and can be included on the TOR.

#### 1.1 Taxation of digital economy

The biggest issue which remains unaddressed today is taxation digital economy. OECD IF's Pillar One (P1) attempts to address it but it is believed that it is unlikely to get desired political consensus. Additionally, it is too complicated and contains certain unreasonable propositions. In absence of P1 becoming operational, more countries will resort to Digital Service Taxes (DSTs). This will soon lead to tariffs and trade wars which is on hold as of now.

Potential solutions are summarized in the ensuing paragraphs:

##### 1.1.1 Accept DSTs as a solution and grant credit in the country of residence

A simple solution to come of the current situation is to accept DSTs as an appropriate exercise of taxing right by the source countries. The country of residence should give credit for the source country DSTs, under its domestic law.

This approach will not require any changes to the tax treaties. There is nothing unusual in this approach as it simply follows the basic standard wherein the country of source is able to levy tax on the income arising in

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<sup>2</sup> Email dated March 1, 2024

its territory and the country of residence gives credit for the source country taxes under its domestic laws subject to restrictions.

An improved version of this approach could be to standardize DST provisions which could be adopted in the domestic laws of the member states.

### **1.1.2 Article 12B of the UN Model**

Alternative solution could be to adopt Article 12B of the UN Model in the tax treaties through UN MLI<sup>3</sup>.

### **1.1.3 P1 + DSTs**

Another alternative could be to further work on OECD IF's P1 to address concerns of the developing countries.

One of the major concerns is that the countries are required to give up their taxing rights under DSTs and in return may not get any (or commensurate) taxing rights under P1. This could be addressed by allowing source countries to apply DSTs on MNEs not qualifying for P1.

## **1.2 United Nations – Multilateral Instrument (UN MLI)**

In the recent years the UNTC<sup>4</sup> 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 UNTC has started working on the development of a fast-track instrument (UN MLI). It needs to be ensured that UN MLI is prepared and operationalised in a *timely manner*.

## **1.3 Remote Worker Permanent Establishment (RW-PE)**

COVID-19 impacted humanity in many ways and one such impact is wide acceptance of the concept of Work From Home (WFH) by the corporate sector. This new normal also creates new tax challenges for the Multinational Enterprises (MNEs) and the biggest issue is a permanent establishment risk.

The existing treaty provisions are likely to result in widespread litigation on these issues. It is desirable that a new provision is introduced in the tax treaties to tackle these issues. The suggested remote worker permanent establishment provision adopts a very simple measurable threshold for determination of permanent establishment and also attempts to balance taxing rights of the country of source as well as residence. A simple standardised approach could be adopted for

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<sup>3</sup> UN Fasttrack Instrument / UN MLI

<sup>4</sup> Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee – UNTC)

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determining the profits attributable to such permanent establishment. Concept note<sup>5</sup> on RW-PE explains the proposal in greater detail.

#### **1.4 Subject to tax rule (STTR)**

STTR is an important part of OECD IF's Pillar Two and is understood as protecting the interest of developing countries. While the GloBE rules have become operational, STTR does not seem to have become operational. Even though the final version of STTR and related MLI is available, this does not seem to have been adopted by any country. This could be for the reasons such as the narrow scope of STTR (as compared to UN STTR), requirement of minimum profit margins for the recipient etc.

The requirement of giving taxing right to the source country only if the MNE earns minimum profits appears to be irrational. The settled principle is that the PE shall discharge profits attributable to it in the source country even if the entity has made overall losses at the head office level. Similar approach is desirable for STTR.

The possibility of improving P2 STTR to make it more acceptable to the developing countries or alternatively adopting UN STTR may be considered.

#### **1.5 Climate Finance Withholding Mechanism (CFWM)**

The developing countries require huge amounts to realign its economy in view of global warming. This climate finance needs can be addressed by adopting CFWM<sup>6</sup>.

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.

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<sup>5</sup> [https://www.southcentre.int/wp-content/uploads/2023/07/TCPB34\\_Conceptualizing-Remote-Worker-Permanent-Establishment\\_EN.pdf](https://www.southcentre.int/wp-content/uploads/2023/07/TCPB34_Conceptualizing-Remote-Worker-Permanent-Establishment_EN.pdf)

<sup>6</sup> [https://www.southcentre.int/wp-content/uploads/2023/01/TCPB28\\_Climate-Finance-Withholding-Mechanism\\_EN.pdf](https://www.southcentre.int/wp-content/uploads/2023/01/TCPB28_Climate-Finance-Withholding-Mechanism_EN.pdf)

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## **2. General Statements**

The following statements / principles / rationale can be applied for various procedural and substantive aspect of the work of the Ad Hoc Committee.

### **2.1 Rich and wealthy to pay higher tax**

G20 finance ministers and central bank governors have started discussing international coordination on a minimum tax on super-rich individuals<sup>7</sup>. The rationale behind such discussion is not difficult to explain.

Ideally this principle should be applied at a country level as well. However, what is done is exactly opposite. The developing source countries are deprived of taxing rights even on the income originating in such countries. This is achieved through tax treaties which have become obsolete due to technological advancement.

If the source countries are allowed to levy tax on the income accruing, arising, originating within the territories of such countries, most of the problems would become easy to resolve. The residence countries need to give credit to the MNE for the income taxed in the source countries. The MNE would ordinarily be happy to pay taxes in the source country so far as tax credit is granted. This would give most desired certainty to business houses, reduce the tendency of grossing up taxes and passing it on to the end customers in the source country.

### **2.2 Brownfield approach - Continuation of existing mechanisms**

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 Ad Hoc Committee will not attempt to 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.

### **2.3 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

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<sup>7</sup> <https://www.taxnotes.com/tax-notes-today-international/individual-income-taxation/g20-finance-ministers-advance-minimum-wealth-taxation-talks/2024/03/01/7j8c4>

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 following approach may be considered:

- OECD may be mandated to produce initial technical documents / solutions specifying the desired end result at policy level.
- Such document / solution may be evaluated by Ad Hoc Committee 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 Ad Hoc Committee adopting the intergovernmental processes.

#### **2.4 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 one of the key parameters for decision making. For example, the rule could be made that:

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