Intergovernmental Negotiating Committee on the United Nations Framework Convention on International Tax Cooperation

Submission on "*Fair allocation of taxing rights, including equitable taxation of multinational enterprises*"

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Abstract

Philip Baker has warned that the work of the UN on the Framework Convention might lead to two parallel international tax regimes in conflict with each other. But as the parallel existence of the UN and OECD model conventions shows, such a conflict is not inevitable. If the UN wanted to follow this parallel route, it should begin with the OECD two pillar solution and modify it to suit the interests of developing countries, in the ways explored below.

The adoption of the Terms of Reference (ToR) by the UN General Assembly marks an important step in the UN's work on a new Framework Convention on international tax cooperation. The voting and statements issued by particular jurisdictions demonstrate that there is not full consensus of UN member jurisdictions on the ToR and the next steps for development of the Framework Convention. However, consensus is not required, and a substantial majority of the General Assembly voted in favor of the draft ToR.

Is there a way for the UN to go forward without a full-fledged rift with the OECD that could render the proposed Framework Convention unworkable? In the absence of agreement, OECD members will be reluctant to grant double taxation relief for any taxes imposed under the aegis of the Framework convention, and the result could be the collapse of the international tax regime without an adequate replacement. Philip Baker has warned that we could face two separate parallel regimes, writing that "the failure to reach anything like consensus does not bode well for a successful outcome to this process of reforming the international tax architecture: To the contrary, one can say that the process is now something of a disaster ."[1] He further predicted that—

> In the worst-case scenario, in four years` time we find ourselves with two parallel international tax regimes. On the one hand, the UN regime only has support from the Global South. It comes up with solutions which are acceptable to those countries but are utterly unacceptable to the Global North. For example, the first early protocol makes provision for a withholding tax on virtually all cross-border services. Global North countries prove unwilling to amend their double taxation conventions to accommodate this withholding tax; and for those countries (such as the US) that operate a credit system, no credit is given for the tax withheld. As a consequence, businesses operating in the Global South and supplying services either withdraw from those markets or (if the markets are too large to withdraw from) gross up the cost of services to reflect the fact that they will be subject to an unavoidable withholding tax. The overall result is to damage the economies of the Global South countries.[2]

But the worst-case scenario is not inevitable, because one can imagine the UN and the OECD working in parallel to each other without causing the collapse of the international tax regime.

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[1] Philip Baker, International Tax Reform: Could We Face Two Separate Parallel Regimes? Tax Journal 1676 (September 6, 2024).
[2] Ibid.

A good example for the latter approach would be the way the UN model convention developed since 1980. The original UN model was drafted by Stanley Surrey and the Harvard International Tax Program with explicit reference to the OECD model but with deviations to fit the interests of developing countries. The current UN model is about 80% identical to the OECD model, but with important differences.[3] For example, the UN model did not follow the OECD in deleting Article 7(4) and 14 because those provisions give developing countries more flexibility in adopting exceptions to the arm`s length standard and the permanent establishment threshold.[4] Recently, the UN also developed new articles 12A and 12B that are intended to broaden the scope of cross-border services subject to tax at source.[5]

Another example of potential parallel action between the Global North and the Global South is Digital Services Taxes (DSTs). Since the pillar 1 Multilateral Tax Convention cannot come into effect without US ratification, it is likely that many countries including the EU, other members of OECD, and many developing countries will join France, the UK, and others in adopting DSTs in 2025. This could mean a trade war with the US, but it also can mean a peaceful co-existence if the US relents and allows foreign tax credits to DSTs given their low rate and lack of overlap (i.e., each country only applies its DST to services provided to consumers or users within it).[6]

If the UN wanted to follow this parallel route, it should begin with the OECD two pillar solution and modify it to suit the interests of developing countries. That is what the EU and the US meant when they wrote that "to function effectively and sustainably, we also need to ensure that the Framework Convention takes account of work on international tax cooperation that continues in other fora" and "we had also hoped to see a stronger reflection to the principle of complementarity, considering the extensive work and expertise of other forums."[7]

Specifically, in pillar 1, large developing countries like India and China would benefit from Amount A, but there is no reason to accept the current limits of only applying Pillar 1 to

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[3] See Omri Marian, *The Making of International Tax Law: Empirical Evidence from Natural Language Processing*, 24 FLA. TAX. REV. 151 (2020).
[4] See Avi-Yonah and Zach Pouga Tinhaga, *"Unitary Taxation and International Tax Rules,"* in J. Chaisse and M. Lang (eds.), International Taxation: Law and Practice in Hong Kong and China 19 (Kluwer, 2015); revised version in S. Piciotto (ed.), Taxing Multinational Enterprises as Unitary Firms (ICTD, 2017). Note that because of this as well as the rejection of the "authorized OECD approach" to Article 7, since 2010 actual treaties are more similar to the UN than to the OECD model. See Marian, supra.
[5] On these see Avi-Yonah, *The Usefulness of Pillar 1,* 115 Tax Notes Int`l 1205 (August 19, 2024).
[6] See Avi-Yonah, *Should Digital Services Taxes Be Creditable?* 113 Tax Notes International 1469 (March 11, 2024) and Avi-Yonah, *Once More: Digital Services Taxes Should Be Creditable,* 115 Tax Notes Int`l 1357 (August 26, 2024).
[7] EU delegation to the UN, Explanation of Vote; US Mission to the UN, Explanation of Vote.

about 100 multinationals or to only apply formulary apportionment and get rid of the PE and ALS limitations for 25% of their profit. Therefore, I would suggest that the UN Framework build on the OECD multilateral convention (MLC) by applying the pillar 1 Amount A formula to all the profits of all the multinationals subject to pillar 2 (about 8,000). The revised pillar 1 can then be implemented by either unilateral action (where there is no treaty or where the treaty can be overridden) or by a UN drafted MLC, which can be based on the draft OECD MLC with the changes suggested above and can like the OECD MLC override treaties.[8]

Pillar 2 is more controversial because it is designed to limit tax competition, but it will be hard for developing countries to prevent developed countries from implementing it unilaterally given that developed countries are home to most multinationals and therefore can apply the IIR to them and are also large markets and therefore can apply the UTPR. Thus I would suggest that developing countries focus on the QDMTT (to turn off the IIR and UTPR) and try to improve it by (a) eliminating the SBIE, which as is biased against countries like Singapore that do not have a lot of tangible investment[9], (b) using the Qualified Refundable Tax Credits exception to attract investment[10], and (c) expanding the scope of income subject to the QDMTT by adopting an expanded pillar 1 (i.e., applying formulary apportionment to all income), since pillar 2 does not define how much income can be subject to a QDMTT.[11]

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[8] See Avi-Yonah, The Usefulness of Pillar 1, supra; Avi-Yonah, *After Pillar One,* British Tax Review 3:243 (2023). For how the UN can change multiple treaties see Hafiz Choudhury, **The History and Prospects of the U.N. Fast-Track Instrument**. This option however creates more risk of double taxation than DSTs because the amounts involved are higher, although it is conceivable that some OECD members will also adopt formulary apportionment unilaterally, as suggested by the EU Commission in its BEFIT proposal.
[9] Note that the US has just abolished its SBIE in the current tax legislation.
[10] For how to do this see Avi-Yonah, *Pillar 2 and Specific Benefits for Multinationals,* 115 Tax Notes Int`l 507 (July 22, 2024).
[11] See Avi-Yonah and Ajitesh Kir, *Building the Gateway: Why the Two Pillars Need Each Other,* 52 Intertax 591 (2024).