Comments of Belgium on the Co-Leads' Draft Issues Note concerning Workstream II of the INC on the first protocol

Abstract

Belgium welcomes the Co-Leads' Draft Issues Note on Workstream II and supports ongoing efforts to address the challenges of taxing cross-border services in a globalised and digitalised economy. Belgium stresses the need for further economic analysis—particularly regarding the distinction between gross and net taxation—and calls for clearer definitions of the used key concepts. It emphasizes the importance of accommodating the diverse economic and developmental contexts of Member States through differentiated and flexible approaches, supported by capacity building.

Belgium agrees with the current description of tax rules and motivations for reform but highlights that bilateral tax treaties should not be seen as barriers to taxation. Belgium recommends exploring the obstacles developing countries face in amending such treaties.

In considering new approaches, Belgium urges caution in using "value creation" as a basis for nexus, advocating for a broader view of the global value chain. It reaffirms the importance of guiding principles such as tax neutrality, economic efficiency, and administrative simplicity. It is most important for the further work of the INC to analyse the economic impact of the imposition of gross-based withholding taxes. Belgium remains committed to active participation in shaping a balanced and inclusive first protocol.

I. Introduction

Belgium welcomes the opportunity to provide comments on the issues note prepared by the Co-Leads of Workstream II. We appreciate the efforts made in this note to identify the problems that countries are facing today in relation to the taxation of services in the globalised and digitalised environment.

II. General remarks.

1. **Need for further thorough economic analysis:**
   We advocate that further economic analysis is needed on the basis of which taxing rights are to be allocated. The underlying economic principles (such as tax neutrality) are also particularly relevant in applying gross or net taxation on services. A thorough discussion on gross vs. net taxation was deemed necessary by participants of the intersessional sessions of the workstream but couldn't take place yet. We reiterate the necessity that this discussion should take place in depth.

2. **Need for clear delineation of the issues**:
   We believe it is very important to clearly define the issues that the protocol aims to address and the concepts that are used to approach the issues. For example, the use of a concept like 'value creation' can be problematic since there is currently no common understanding or definition of this concept.

3. **Need for differentiation:** Member States exhibit significant differences in their economies, levels of development, and capacities. Therefore, one single approach may not be suitable for all. The scoping exercise should assess whether the protocol ought to provide differentiated solutions tailored to the unique circumstances of each Member State. Strengthening capacity building might also help certain Member States with the difficulties they encounter. Incorporating more flexibility within the protocol could promote broader participation to the protocol.

III. On the current rules for taxation of income from cross-border services and reasons for change

We agree that Section III(a) describes the current rules for the taxation of services (the nexus arising from physical presence vs. gross based source taxation) and the reasons behind the call for change, as they were discussed during the intersessional sessions of the workstream.

Concerning paragraph 11, in our view bilateral tax treaties are not intended as a barrier to tax cross-border services. Bilateral tax treaties exist to remove barriers to trade such as double taxation and withholding taxes, while ensuring effective taxation in the appropriate jurisdiction. It remains important to emphasize the important role that existing treaties play in helping to stimulate innovation and economic growth which are essential for domestic revenue mobilisation in all jurisdictions. With respect to the difficulties that developing countries face in modifying or terminating bilateral tax treaties, as referenced in paragraph 11, it would be valuable to provide a more detailed analysis of the underlying reasons for these difficulties and to explore potential solutions to address them.

IV. On the development of new approaches

Value creation is proposed as a possible tool to establish nexus in the issues note. The question should not be merely where value is created, but who can claim part of the value chain, looking at taxation from the point of view that value creation is situated within a global value network. The policy objective of aligning the taxation of profits with the process of value creation has provided a positive source rule that income should be taxed where real economic activities take place and the negative source rule that no profit should be allocated to shell entities.

As such, the Arm's length Principle already builds on concepts of value creation, taking into account the functions, assets and risks of the different market contributors. However, we recognize that the picture may not be complete and that there may be some room for improvement. Certain aspects that could be further investigated upon is how the market side of trade contributes to the concept of value creation, taking into account the ideas that have already been previously developed in other international fora.

Belgium agrees that important goals of new approaches should be the elimination of barriers to cross-border trade and investment, ensuring economic efficiency and ensuring tax neutrality, and simplicity and administrability. Levying taxes at source on certain digital services income could only be justified by certain objectives, such as preventing the MNEs from aggravating residual profits that arise from the location-specific advantages of the market jurisdiction(s). The imposition of gross-based withholding taxes can result in economic distortive outcomes and can be a significant barrier to trade and investments, since it creates uncertainty and a risk of double taxation for businesses. Therefore, it is most important for the further work of the INC to analyse the impact of the imposition of gross-based withholding taxes. Taxation on a net base is generally fairer, based on economic principles. We look forward to discussing the issue of gross-basis taxation vs. net-basis taxation.

We also welcome the fact that the workstream will further explore whether it is appropriate to apply different rules with respect to different types of services or as between services and sales of goods.

Belgium will remain committed to actively contributing to the development of the first protocol.