SCHOOL OF LAW
International Tax Risk Management Curriculum

Secretariat of the Ad Hoc Committee
UN Framework Convention on International Tax Cooperation,
United Nations Headquarters, New York 11 July 2025
Via Email: inc-tax@un.org

Re: Workstream 2 Comment Letter to the UN Ad Hoc Committee Drafting the International Tax Cooperation Convention Regarding Business Perspectives on Workstream I (Framework Convention), Workstream II (Protocol on Cross-Border Services and Royalties), and Workstream III (Protocol on Dispute Avoidance/Resolution)

Dear Chair and Distinguished Members of the Ad Hoc Committee:

We appreciate the opportunity to provide input on the development of Workstream II of the UN Framework Convention on International Tax Cooperation. We applaud the Intergovernmental Negotiating Committee's inclusion of academic researchers as stakeholders to attend the sessions. We are academic researchers in international tax policy, and we write to offer independent business-aligned perspectives on all three workstreams, separately as requested, under negotiation. We include below a robust discussion of our Workstream II comments, along with proposed convention language, to contribute to the ongoing discussions of the International Tax Cooperation Convention. Our comments and recommendations are submitted in our personal capacity and do not represent an official statement or position of Texas A&M University or our respective employers.

Regarding Workstream II – Protocol on Cross-Border Services and Royalties. Regarding Workstream II – Protocol on Cross-Border Services and Royalties. The protocol should strike a balance between source-country taxing rights and the need to avoid double taxation and unnecessary complexity. We therefore support an optional gross-or-net system for services, allowing income to be taxed either through a modest gross withholding or, at the taxpayer's choice, on net profit. This flexibility mitigates the shortcomings of pure gross taxation—acknowledged by the UN Tax Committee as "less than ideal"—by permitting profit-based assessment when appropriate.

Scope must be clear: "fees for technical or business services" should be precisely delineated to prevent overlapping national interpretations that breed complexity and disputes. Likewise, "royalties" should be narrowly confined to proper intellectual property licenses, excluding routine payments for software or digital services that lack a copyright transfer, thereby averting overbroad source taxation. Absent such clarity, enlarging source taxing rights could dampen services exports, including from developing countries, and trigger unintended economic effects.

Safeguards are essential. The protocol should set a reasonable withholding-rate ceiling and oblige residence states to grant double-tax relief—credit or exemption—for income already taxed at source. Combined with the gross/net option, these measures will promote neutrality and investment, ensuring that cross-border service providers are not disadvantaged compared to local businesses.

Thank you for considering our comments and recommendations. We are hopeful that the Ad Hoc Committee will integrate our business-aligned views as it drafts the Convention and protocols. We strongly support the UN's efforts to promote inclusive and effective tax cooperation, and we remain at your disposal for any further input or clarification that may assist the Committee. We welcome the opportunity for a representative from our cohort to participate and provide input at the forthcoming first session consultation, scheduled for 4–8 August 2025.

Sincerely,

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Workstream II: Protocol on Taxation of Cross-Border Services and Royalties

Workstream II addresses one of the thorniest areas – how to allocate taxing rights on cross-border services and royalties. Businesses recognize the challenges that digitalization and globalization pose to the traditional paradigm of permanent establishment, and we support equitable solutions. However, we caution that overly expansive source taxation of services, especially on a gross basis, could backfire, leading to double taxation, reduced trade in services, and even harm to the economies of developing countries that the rules intend to help. We recommend a balanced approach built on clear scope definitions, optionality between gross and net taxation, and preservation of double tax relief.

Scope and Definitions – Services. The protocol should precisely define what payments are within its scope. We note that in the Draft Issues Note for this workstream, there was an inclination to "keep the services protocol broad in scope," i.e., to cover all cross-border services, not only highly digital services. From a business perspective, a blanket approach covering "any service, irrespective of where performed or the nature of the service" (as seen in the proposed UN Model Article XX) raises serious concerns. Such breadth would bring *all* service fees into potential source taxation, greatly expanding withholding tax obligations and complexity.

Different countries would likely interpret what constitutes "fees for services" differently, causing immediate uncertainty and potentially leading to tax disputes. Moreover, many developing countries today are competitive exporters of services (e.g., in IT, outsourcing, creative industries); their growth could be stifled if partner countries impose new withholding taxes on those service exports. In light of these risks, we urge that the protocol's scope be carefully circumscribed.

One option is to limit the application of source-country taxing rights to services of a particular character (for example, automated digital services or technical consultancy, as was initially considered), or to impose a materiality threshold (such as a de minimis amount or duration below which no tax applies, akin to a services permanent establishment threshold of X days). If the intent is genuinely to cover all services, then robust definitions and exclusions are needed: for instance, clarify that services ancillary to goods (e.g. training provided with the sale of equipment) or services already taxed under other articles (like international transport or natural resource extraction) are excluded to avoid double coverage. Clear definitions will prevent the protocol from inadvertently capturing transactions it should not and will facilitate uniform application by tax authorities.

Scope and Definitions – Royalties. Similarly, the royalties article in the protocol should align with international norms and be limited to genuine intellectual property uses. We specifically recommend that the definition of "royalties" *exclude* payments for standard software or cloud services that do not involve the transfer of IP rights.

The latest (2025) UN Model's expansion of "royalties" to include software payments, *"including payments that do not relate to the use of copyright in the software,"* has alarmed businesses. Treating every software or digital product payment as a royalty subject to withholding would be a stark departure from the OECD approach. It could lead to double taxation (since the payer's country withholds tax, but the payee's country views it as business profits).

To avoid this, the protocol should either stick to the traditional definition (covering payments for the use of, or right to use, copyrights, patents, trademarks, etc.), or at least clarify that payments for personal or business use of software (without reproduction/distribution rights) are not royalties. Additionally, consider carving out payments for services that might have royalty-like elements (e.g., fees for software customization, which are services, not royalties). A clear separation between the services article and the royalties article will prevent overlaps where a payment might be ambiguously classified as both. Ambiguity in this area is a sure recipe for cross-border disputes.

Optional Gross vs. Net Taxation for Services. A pivotal recommendation from a business community perspective we submit is to allow flexibility in the taxation of services by permitting taxpayers to elect net-basis taxation in lieu of withholding. The UN Model's new Article 12AA approach advocates gross-basis withholding on service fees as a straightforward solution widely adopted by many source countries. Yet, as the Draft Note itself acknowledges, *"the gross taxation approach may not be ideal"*– mainly because it taxes revenue without regard to profits and can over-tax high-cost, low-margin services.

To reconcile source countries' desire for a straightforward collection mechanism with the need for fairness, the protocol could incorporate an elective regime. For example, a non-resident service provider could either accept a modest withholding (say, not exceeding a specific rate) on its gross fees *or* opt to be taxed on net profits (by filing a return in the source country, perhaps limited to income attributable to services performed in that country).

Some countries already operate such schemes domestically or in treaties, often referred to as "refundable withholding tax" or a net election. Including this option would be a game-changer for tax neutrality. It ensures that when the withholding tax on gross receipts would overshoot the actual profit (and thus represent double taxation, since the residence country typically taxes the net income), the business can seek taxation on net income instead. This preserves source taxing rights for countries that prefer the simplicity of withholding, while protecting taxpayers from extreme outcomes. The elected net taxation could be conditioned on specific requirements (e.g., the taxpayer provides necessary books and proof of expenses, or perhaps only available to related-party service fees to prevent abuse), details that can be ironed out in commentary. The key point is that flexibility will reduce instances of unfair tax burdens while still allowing source countries to tax income earned within their borders.

Notably, an elective approach also addresses administrative capacity concerns: countries with limited capacity may lean on the simplicity of withholding, while more advanced administrations – possibly through bilateral mutual agreement – can accommodate net taxation where appropriate. Over time, as capacity grows, more states can migrate to net taxation without the need for renegotiation of the treaty framework.

Double Tax Relief and Coordination. The protocol should stipulate that any source taxation of services or royalties must be accompanied by double tax relief in the country of residence. This could be achieved by a clause in the Convention's main text requiring Parties to eliminate double taxation by credit or exemption. In the context of services withholding, double taxation is a serious concern. If one country withholds 10 percent on gross income and the other taxes the net income at 25 percent, there can be excess taxation if the credits do not fully align. The Convention cannot directly change domestic credit rules, but by making double tax relief a treaty obligation, it empowers taxpayers to claim treaty-based relief.

Additionally, to prevent "multi-layer" taxation, the protocol could specify that intermediary payments for services are not each subject to withholding. For example, if a subcontractor in State A provides services to a firm in State B, which in turn provides services to a client in State C, we want to avoid cascading three levels of withholding on the same ultimate service. Clear sourcing rules and tie-breaker provisions (perhaps through a look-through for intermediate entities when they add no significant value) could help alleviate this issue. The ICC has explicitly warned of *"double and multilayer taxation, if withholding tax is applied to each service payment made"* down a chain. The protocol drafters should heed this by designing rules to tax the service income *once* at source, not repeatedly at each step.

Rate Limits. While the specific withholding rate may be left for negotiation, it is worth considering a ceiling rate in the Convention or protocol to prevent excessively high taxes on services/royalties. The OECD's proposed Subject to Tax Rule (STTR) uses 9 percent as a nominal cap for certain payments; the UN might choose a different number. But including a reference (even in commentary) that rates should be "moderate and consider typical profit margins" would reflect a business-aligned view that the tax on gross should approximate the tax on net income. Excessive gross rates virtually guarantee double taxation (since few countries give credit for more tax than what would be due on the net profit).

Economic Impact and Periodic Review. As a final proposal note on Workstream II, we strongly support the suggestion (raised by business groups) that the UN conducts or commissions an economic impact assessment of the new service and royalty provisions. This study should evaluate how the rules affect investment, trade in services, and tax revenues for different country groups. It can guide potential adjustments (the Convention could mandate a review conference after, say, five years to consider refinements in light of real-world experience). Such data-driven evaluation will ensure the protocol meets its objectives without unintended harm.

Proposed Treaty Text (Workstream II)

To illustrate the above concepts, we propose the following clause revisions:

- *Definition clause:* "The term 'fees for cross-border services' means payments for services of any kind, wherever performed, *but does not include* payments to an enterprise of the other Contracting State if such payments are attributable to a permanent establishment of that enterprise in the first State or are covered under Articles [Royalties], [Shipping], [Employment Income], or other provisions of a tax treaty between the Contracting States." (This excludes amounts taxed on another basis or through a local PE.)
- *Taxing right clause:* "Fees for cross-border services arising in a Contracting State and paid to a resident of another Contracting State *may be taxed* in the first Contracting State on a gross basis at a rate not exceeding [X] percent. *However*, the beneficial owner of the fees, being a resident of the other Contracting State, may elect by notice to the competent authority of the first State to be taxed on a net income basis with respect to such fees, in which case the provisions of Article [Business Profits] (and, if applicable, Article [Permanent Establishment]) shall apply to the profits from such services as if the enterprise had a permanent establishment in the first State." (This establishes the optional gross/net mechanism – a core recommendation herein.)
- *Relief clause:* "The State of residence of the service provider shall allow a credit against its tax on the income of the service provider for the tax paid in the source State on fees for cross-border services, in accordance with Article [Relief of Double Taxation] of this Convention, to ensure income is not taxed twice." (This reinforces double tax relief.)
- *Royalties definition clause:* "The term 'royalties' means payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including software to the extent of rights to exploit a copyright), patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. The term does not include payments for the mere use of, or access to, software or digital content where no rights to reproduce or distribute the software/content are granted to the user." (This aligns with the OECD approach and excludes standard software-as-a-service payments from being treated as royalties.)

These textual suggestions aim to strike a workable compromise: source countries gain a broad but controlled right to tax services and royalties, while taxpayers gain clarity, an option for fair taxation on net income, and assurance against double taxation. In effect, it would transform the current patchwork (where some treaties have technical services clauses and some do not) into a coherent multilateral rule, without undermining global investment.

In summary, Workstream II's protocol should strike a balance between flexibility and clarity. By doing so, it can achieve its goal of updating international tax rules for the modern economy, *without* sacrificing the principles of neutrality or imposing undue burdens that hinder cross-border trade in services. The business community is prepared to support rules that are clear, fair, and administrable – and the above recommendations are offered in that spirit.