For the kind attention of:

Mr. Ramy Mohamed Youssef, Chair of the Intergovernmental Negotiating Committee to draft a United Nations Framework Convention on International Tax Cooperation and two early protocols (INC) and Ms. Liselott Kana, Co-Lead of Workstream II.

Cc: Permanent Representatives and Observers to the UN in New York

11 July 2025

***Subject*: ETFE's submission regarding the Draft Issue Note of Workstream II (WS II – the protocol addressing the taxation of cross border services) of the Intergovernmental Negotiating Committee on the UN Framework Convention on International Tax Cooperation (UN FCITC).**

Please find below the submission of *Espacio de Trabajo para una Fiscalidad con Equidad (ETFE)*, a network from Argentina working on fiscal justice. We appreciate the opportunity to submit comments to this negotiating committee.

Abstract

Current frameworks, designed around physical presence requirements, systematically disadvantage developing countries by favoring non-resident multinational service providers over domestic firms. This has led to widening services trade deficits and significant tax base erosion (Amaro, Grondona, and Picciotto 2024).

The protocol must address three core challenges: First, the fundamental mismatch between digital service delivery models and physical presence nexus rules. Second, the systemic bias in tax treaties that privileges residence-based over source-based taxation (Doble Tributación Internacional. Inmovilismo o Adecuación a la nueva realidad Mundial. 2003; Figueroa 2002, 2004, 2012). Third, the growing asymmetry where high-income countries capture most benefits while developing nations suffer disproportionate revenue losses.

Key reforms should include (1) Simplified source taxation rights for all services regardless of classification; (2) Coordinated mechanisms for taxing digital services and excess profits; and (3) Robust anti-avoidance measures.

Crucially, the protocol must resolve the interplay between arm's length pricing, deductibility rules, and withholding taxes - currently exploited for tax avoidance. It should also resolve longstanding conflicts around foreign tax credits and the treatment of digital services taxes.

Introduction

The proposed protocol on taxing cross-border digital services under the UN FCITC presents a crucial opportunity to address fundamental flaws in current international tax rules. Services - particularly in our digital age - demonstrate the system's failures most starkly. While services inherently involve close customer relationships and increasingly rely on user data, current rules allow them to be delivered globally with minimal physical presence. This creates significant disadvantages for developing countries, as existing tax frameworks favor non-resident service providers and discourage local industry growth (Amaro et al. 2024; ICRICT 2025).

Services have become increasingly important for economic development, but international tax rules continue favoring foreign providers over domestic firms. This creates an uneven playing field that particularly harms developing countries, which are net importers of services, and thus where local service providers struggle to compete (Amaro et al. 2024; Figueroa 2012; ICRICT 2025).

Specific issues addressed in the public consultation

(a) whether Section III(a) comprehensively describes current rules for the taxation of services and the reasons behind the call for change, or whether there are additional considerations that should be taken into account in the workstream's discussions.

Recent research (Amaro et al. 2024) highlights that treaty-based restrictions on taxing imported services tend to have an asymmetric effect—impacting both services trade flows and tax revenues differently across developed and developing economies..

Modern service delivery - increasingly digital and borderless - generates stable revenues through subscriptions while collecting valuable user data. These developments have intensified the longstanding tension between residence- and source-based taxation. The OECD model's strict physical presence requirement (unchanged since 1963), while ostensibly promoting trade efficiency, facilitates tax avoidance through conduit entities in low-tax jurisdictions, and grants MNEs artificial competitive advantages over domestic providers

The current status of the international tax system has particularly harmed developing economies, where:

- Services trade deficits have widened (Amaro et al. 2024)

- Withholding tax protections have been eroded (Amaro et al. 2024; ICRICT 2025)

- Business service payments to non-residents directly shrink the tax base through deductions and limitations to withholding taxes on income at source.

This dynamic persistently favors Global North service exporters, over Global South ones.

The loss of tax revenues for developing countries is particularly significant for business services, fees which are deductible from the business income, directly reducing the source tax base if the income accrues to non-resident service providers.

In this respect, the mechanics of the problem could be clarified further in Section III.a.:

- i) the arm's length principle applies in respect of the valuation of international operations for the purpose of income tax. i.e. it's the price and in an extreme it can also be at question the operation itself..
- Ii) general deductibility rules constitute a different part of income tax law legislation, but even when they can be somehow interlinked with the arm's length principle, they are not limited by it.
- Iii) withholding taxes are generally applied to the payment which has been valued based on i)

In this way, i, ii and iii act as interlinked anti-avoidance mechanisms, although the rules defining them are different.

The problem of the abuse of cross border tax services for tax evasion and avoidance purposes benefits of course of the interlinkage of i, ii and iii together with tax treaties limiting the application of iii, although sometimes also of ii (e.g. the discrimination rule in tax treaties could result in an obstacle to apply distinct deductibility rules for related parties or for parties located in low or null tax jurisdictions). Tax treaties, through their article 9 (in both UN and OECD Models) also result in the necessary application of i.

Another issue that should be addressed in this section refers to the application of the credit or exemption rule. A great part of today's international tax politics could be sorted out if countries changed their own national rules in order to allow for an exemption or credit in the case in which the income has been taxed at source.

(b) *what considerations are most important in developing possible new rules for the taxation of services.*

The protocol should set rules for coordinating the taxation of income from cross-border services ensuring coherence in treatment between comparable services. Therefore, the protocol should result in (ICRICT 2025):

- Simplification of the right to tax at source payments for services, regardless of whether they may be classified as technical or professional, or delivered by an independent person or an enterprise.
- Development of coordinated mechanisms for the taxation of digital services.
- Coordinated taxation of windfall or excess profits.

To achieve this, the following alternatives should be considered in a *protocol to address taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy*:

- Strengthening Source Taxation: The 2025 UN Model now permits source countries to impose gross-basis taxes on service payments, reversing earlier approaches that required physical presence. In particular, the new Article 12AA of the UN model treaty, which provides for the application of withholding taxes on technical services and automated digital services, could be the basis for the protocol. An instrument such as the UN's Fast Track Instrument could help implement these protections broadly.
- Taxation of income from services attributable to a 'significant economic presence' (SEP), based on a (low) quantitative threshold (Issues Note para. 19).

This protocol should also address issues such as transparency and effective international cooperation for tax matters, including:

- Public country-by-country reporting:
  In this respect, the outcome of the 4FFD, "el Compromiso de Sevilla", refers in paragraph 28 f)to

  " ... work to strengthen country-by-country reporting of multinational enterprises, when applicable, including further evaluating the creation of a central public database for country-by-country reports"

- Extend the reach and effective implementation of the automatic exchange of information on income derived through digital platforms.

(c) *how the workstream can best define the scope of the protocol in terms of the taxes and services that it will cover.*

As outlined in Paragraph 20 of Section III(c) in the Issue Note, emphasis should be put on tax nature, rather than nomenclature, to avoid confusion.

Income taxes must form part of the scope. The OECD Model treats service income (e.g., management, technical, consultancy) as business profits, while the UN 2025 Model expands source-country taxation to technical services, transport, digital services, and insurance. Despite this comprehensive list, two unresolved issues warrant attention: (1) the need to allow for taxation at source in all service cases, including technical services without intellectual property transfers, and (2) the OECD countries' reluctance to cede taxing rights favoring source states (and thus disproportionately benefiting developing nations).

The protocol should also address income taxation under a "significant economic presence" (SEP) framework, applying low quantitative thresholds (Issue Note para. 19).

While digital services taxes (DSTs) are typically classified as transaction taxes (excluding them from treaties), their design—applying to gross revenues of large MNEs above specific turnover thresholds—effectively mirrors withholding taxes. Thus, DSTs which have been designed as income tax substitutes should be in scope for this protocol.

Regarding service coverage, the protocol must encompass all services, ensuring comprehensive applicability.

References

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