Workstream II – cross-border services

Workstream II abstract

This submission, made on behalf of the global labour movement (ITUC and PSI), calls for an ambitious protocol that addresses the core weaknesses of the current international tax system, especially for taxing cross-border services in a digitalised economy.

Existing standards—built around transfer pricing and permanent establishment rules— are outdated and structurally biased against source jurisdictions. While the OECD's Pillar One attempted partial reforms, it fell short due to its narrow scope and continued reliance on flawed principles. The UN process offers a vital opportunity to correct these imbalances.

We propose a framework based on optionality, where jurisdictions can adopt one or more models depending on capacity and context. These should include:

1. A Significant Economic Presence (SEP) model, with nexus based on digital sales and profit apportionment using employment and sales;
2. Source-based withholding, as a simpler tool for revenue collection where netbasis taxation is infeasible, though potentially temporary;
3. Digital services taxes (DSTs) as short-term measures during the transition to more long-term tax solutions, with safeguards against regressive impacts;

We caution against framing the challenge as one of capacity alone. Trade unions at workplace level have direct experience of how tax administrations across all most jurisdictions struggle with the complexity and manipulability of current rules. What is needed is systemic reform that prioritises fairness, and progressive outcomes. The protocol must define a broad scope for both services and taxes, with SEP at its core.

Our responses to paragraph 23 of the issue note are as follows:

On subquestion (a): **The issue note gives a good overview of current rules, but fails to highlight their fundamental weaknesses.** We agree that Section III(a) of the issue note accurately describes the existing rules governing taxation of cross-border services. However, it does not go far enough in acknowledging how these standards fail to address the realities of today's digital economy.

In particular:

- The current international tax framework, including traditional transfer pricing rules and permanent establishment concepts, systematically disadvantages source jurisdictions, especially those in the Global South.
- While initiatives like the OECD's Pillar One recognised the limits of the arm's length principle in a digitalised economy, they failed to correct those flaws in a meaningful way.
- Pillar One introduced a partial move towards unitary taxation and new sourcing rules, but its scope was too narrow, and it retained problematic co-existence with transfer pricing.

The UN has a unique opportunity to go further and do better—by developing rules that reflect real economic activity, apply more broadly and address long-standing imbalances in the global tax system.

On subquestion (b): **The most important considerations are to go beyond residence vs source debates and ensure progressive outcomes.** Developing new rules for taxing cross-border services must be guided by two overarching objectives:

1. Moving beyond the residence vs source binary, by anchoring tax rights in economic presence; and
2. Ensuring that taxation is progressive and equitable, with multinational enterprises contributing their fair share and avoiding regressive tax shifts onto workers and consumers.

There is no one-size-fits-all solution, and a range of approaches may be appropriate depending on context. The protocol should reflect this through optionality—that is, a series of mechanisms that jurisdictions can select from, depending on their administrative capacity, policy goals, and level of digital integration. This principle of optionality is also discussed in Workstream III and should apply here.

<u>We suggest the following panel of policy options:</u>

1. Significant Economic Presence (SEP) based on a reformed nexus and formulary apportionment

This should be the primary model advanced under the protocol.

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- SEP should reflect digital sales and deliberate market engagement as indicators of taxable presence, even without physical infrastructure.
- Profits should then be apportioned globally, based on real value creation— principally through employment and sales.
- Further discussion will be needed to determine the weighting of each factor.

2. Source-based gross taxation through withholding

Withholding tax at source can help capture revenue where services are consumed, especially in cases where net-basis administration is not feasible.

- It is easier to enforce for lower-capacity tax authorities and avoids reliance on complex transfer pricing methods.
- It is also likely to offer only a temporary solution, as residence jurisdictions may seek to limit the tax base to narrowly defined categories of services.

3. Digital services taxes (DSTs)

DSTs remain a necessary transitional tool for countries seeking to protect their tax base in the short term.

- Yet they can also be regressive in effect and risk retaliation from some jurisdictions.
- Where they are used, safeguards should be included to prevent the cost being shifted to workers and communities.

Additionally, we reject the argument implied in the issue note that capacity building alone will enable Global South administrations to apply transfer pricing rules effectively. In our experience, including from union perspectives in OECD countries, the core problem is not capacity, but the structural dysfunction of the rules themselves. Transfer pricing relies on subjective and easily manipulated, which even well-resourced tax authorities struggle to apply effectively.

As an illustration, company-level trade unions in high tax jurisdictions frequently encounter manipulation of the functional analysis, with a misclassification of labour intensive entities as low-value contributors. Such manipulation shifts income away from countries where real economic activity and employment occur. This suppresses workers' claims to a fair share of the value they help generate. It also results in underpayment of corporate taxes. In our experience, such practices are widespread and tax administrations around the world, in developed and developing economies alike, lack the capacity to systematically reassess transfer pricing rules in each instance. On sub question (c): **The scope of the protocol should be broad and inclusive, with SEP as a central pillar.** The protocol should not restrict itself to narrow definitions of taxable services or tightly circumscribed tax types. Instead, we recommend a **broad definition of services**, including both business-to-business and consumer-facing activities, as well as automated digital services.

Furthermore, optionality within the protocol (as discussed in Workstream III) could help accommodate different administrative capacities and policy preferences.

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