

UN INC Workstream II – Taxation of income derived from the provision of cross-border services in an increasingly digitalised and globalised economy

Co-Leads' Draft Issues Note – Ireland's comments

Abstract

Ireland thanks the Co-Lead, Chair and Secretariat of Workstream II for their ongoing work in facilitating the scoping discussion on the first early protocol.

Ireland acknowledges that the international tax system must evolve to fit modern business models and the effects of the digitalisation of the economy. Ireland considers that further consideration is required in a number of areas regarding the current rules for the taxation of services which we believe are not adequately described in the current Section III (a) of the issues note. These can be summarised as follows;

- It is a commonly accepted principle of international taxation that value creation must be aligned with substance and there must be sufficient taxing rights in the jurisdiction where the infrastructure, resources, and services that support these value creating activities are hosted. Significant resources are employed to facilitate a business environment which supports innovation and value creation, and this should be appropriately examined and considered as part of this work.
- The imposition of gross-based withholding taxes can be a significant barrier to trade and investment, due to the uncertainty they create for businesses. We remain concerned that the issues paper does not adequately examine the economic rationale behind existing mechanisms and the economic impact of the changes proposed. Bilateral tax treaties form a foundational element of our international taxation architecture. They seek to remove barriers to trade, such as double taxation, while ensuring effective taxation in the appropriate jurisdiction, and play a key role in stimulating enterprise, growth and revenue generation. Detailed further analysis is required on this issue to support work on the development of the protocol.
- Finally, Ireland considers that technical economic analysis of the underlying principles regarding gross-based or net taxation, and of the current macroenvironment, will be necessary in order to adequately advance this workstream in an inclusive manner. Further stakeholder views should continue to be sought and considered to facilitate relevant and targeted discussions in due course, which are future-looking in nature and allow outcomes which provide certainty to businesses globally.

Detailed comments:

Paragraph 12

- *This paragraph opens with “Developed countries often argue that the key to improving domestic resource mobilization in developing countries is capacity building and technical assistance so that they can apply transfer pricing rules to deny a deduction to the local payer to the extent that the relevant payment is not viewed as consistent with an arm’s length arrangement.”*

Ireland is supportive of capacity building work and technical assistance, to help developing countries overcome the practical challenges of applying the arm’s length principle, as we believe this is the most sustainable way for developing countries to apply that principle, and as such, ensuring appropriate returns are being allocated to their jurisdiction. . On the other hand, gross-based withholding taxes lead to double taxation outcomes which deter business investment and act as a barrier to growth.

In Ireland, if it is found that a payment exceeds an amount that is consistent with an arm’s length arrangement, then an adjustment is made that would achieve an arm’s length price, rather than denying a deduction for the payment.

- *The next paragraph states “However, participants from developing countries noted difficulties with this approach. They often find that there is a lack of comparable transactions between unrelated parties. Participants also mentioned the expense or unavailability of commercial databases, or that the information in such databases is not appropriate for the circumstances of developing countries.”*

We acknowledge that finding reliable comparables can be challenging for most jurisdictions, but we are hopeful that some of the work already undertaken by the OECD and the UN Subcommittee on Transfer Pricing will provide useful tools for jurisdictions. In particular, the OECD guidance on Amount B, provides jurisdictions with a pricing tool (pricing matrix) to assess whether the returns of baseline distributors represent an approximation of an arm’s length return. Equally, the guidance in Chapter VII on Low Value-Added Services provides useful guidance on the margin to apply to such services.

- *This paragraph also states “Some have questioned why they should incur those costs to apply transfer pricing rules that, in their view, put too much weight on activities that take place in the State of residence of the taxpayer or in third states and not enough weight on the contribution of the market where the services are consumed; they believe that there may be simpler and fairer rules that could be considered.”*

In Ireland, the application of transfer pricing rules does not take into account *only* functions, assets and risks but rather involves (i) an accurate delineation of the controlled transaction by reference to all of the economically relevant characteristics of that transaction (including – but not limited to – the functions performed, assets used and risks assumed by the relevant

parties); and (ii) a comparison of the accurately delineated transaction with comparable transactions between independent enterprises.

It is also important to note that over the past number of years, significant work has taken place to find a multilateral solution to the tax challenges arising from the digitalisation of the economy, and to recognise the contribution of the market to value creation. We consider it important to recognise the role of the consumer in value creation while safeguarding the continued rewards for investment and innovation across the value chain. This approach has been reflected through our engagement at preexisting work in other fora.

While Ireland has supported this work, we also recognise that the location of functions, assets and risks are crucial to value creation in a business. Locations where there is substantial investment in research and development can be a key driver of this value creation. Other key considerations include: the location of where the key decision making takes place, and the assumption of risk connected to those decisions, and additionally which entity provides the funding for the investment. The taxing rights of the jurisdiction which hosts the physical location of a business and its value creating activities must be respected in these discussions.

Paragraph 20

- *This paragraph draws ‘tentative’ conclusions – “Accordingly, the workstream tentatively concluded that it will need to define coverage of the protocol by reference to the nature of the tax, not what it is called.”*

Ireland does not consider it appropriate to draw any conclusions at this stage of the discussions, and believe this sentence should be redrafted, removing this reference.

Paragraph 22

- *This paragraph opens by identifying future discussions of the workstream, which have not been agreed – “Overall, the workstream was moving towards consideration of shared taxing rights with respect to income from the provision of services, which may recognize taxing rights for source countries subject to limits so that the residence State retains taxing rights.”*

In summarising the discussions, the note is drafted in a way which implies that there is an agreement on future work of the Workstream, which we do not consider agreed or appropriate for inclusion in this document.

Other comments:

- **Paragraph 10:** reference to “*a delegate from a developing country*” regarding a 1968 meeting of Ad Hoc Group of Experts developing the UN Model Tax Convention – Ireland would query the relevance of this reference.
- **Paragraph 14:** states that “*Participants emphasized that the primary goal of any new rules should be to support domestic resource mobilization by providing for a fair allocation of taxing rights. Other goals are to eliminate barriers to cross-border trade and investment, economic efficiency and ensuring tax neutrality, and simplicity and administrability.*”, however, not all participants framed this as the primary goal during the intersessional meetings. It would be more appropriate to list this with the other goals as being noted by participants.
- **Multistakeholder consultations:** we can support the calls for economic analysis of the potential impacts of withholding taxes on cross-border services in several stakeholder submissions. Ireland supports continued stakeholder engagement throughout this process, and considering real-world examples of existing or emerging challenges will ensure a practical outcome, with solutions useful to taxpayers and tax administrations.