Chair
The Intergovernmental Negotiating Committee on the UN Framework Convention on International Tax Cooperation
Co-Leads
Workstream II of INC/Tax

Draft Issues Note on "Taxation of Income Derived from the Provision of Cross-border Services in an Increasingly Digitalized and Globalized Economy"

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Abstract

This submission responds to the Workstream II Issues Note under the UN Framework Convention, providing input on the development of a protocol for the taxation of services. It supports defining the protocol's scope by reference to the nature of the tax, with a focus on income taxes, given the increasingly blurred line between traditional and digital services. This submission advocates for uniform rules over differentiated approaches to ensure simplicity, certainty, and administrability. It finds the description of current rules for taxing services to be comprehensive and highlights their limitations, particularly the reliance on physical presence and the arm's length principle. In response, it proposes a new nexus based on economic presence, leveraging revenue thresholds or user bases, and draws parallels with VAT/GST principles. The submission emphasizes the importance of recognizing market jurisdictions and domestic users, especially in less developed economies, based on international trade data. It calls for a fair allocation of taxing rights that reflects evolving business models and global trade realities, aiming to support a more equitable and effective international tax system.

Introduction

Thank you for the opportunity to contribute to the development of the first protocol under the UN Framework Convention, which aims to establish an enduring framework for the taxation of services.

The explanation of current rules, including those under bilateral tax treaties, effectively captures the challenges and limitations faced by countries at varying stages of development. Coupled with the review of proposed approaches to reforming the existing system, it underscores the persistent disparities between developed and developing nations.

This submission emphasizes the importance of identifying common ground or establishing shared principles for the taxation of services across jurisdictions. While we acknowledge the difficulties in achieving a truly global agreement on specific rules and ensuring their implementation at the national level, these challenges should not discourage countries from engaging in global dialogue. It is essential to explore development pathways that allow all members of the global community, or more precisely real people in our interconnected world, to benefit from and contribute to the ever-evolving global economy. The fundamental principles of equity in taxation, both across jurisdictions and among individuals, must not be overlooked in the pursuit of international tax reform.

Below is our feedback on the scope and key issues outlined in the Workstream II Issues Note ("The Note").

Scope of the protocol

The Note raises concerns regarding the ambiguity in classifying various types of taxes in practice, which can affect the application of relevant provisions of bilateral tax treaties and, consequently, source-state taxation. It seeks input on how best to define the subject matter of the first protocol. This submission supports the approach suggested by Workstream II, namely, defining the scope of the protocol by reference to the nature of the tax, as appropriate. This is particularly important given that a levy can be labelled in any manner a jurisdiction chooses, regardless of its underlying substance.

As indicated in the Terms of the Reference for the UN Framework Convention,[1] the protocol seeks to address one of the most salient features of the contemporary economy: international trade in services, which has grown exponentially over the past two decades.[2] To effectively develop the protocol, this submission argues that the focus should be on income taxes, covering services ranging from traditional services delivered via digital means to purely digital services.

[1] A/AC.298/2, UN General Assembly, 16 January 2025.
[2] UN Trade and Development (UNCTAD), *Global Trade Update*, December 2024; UNCTAD, "Global Trade Hits Record $33 Trillion in 2024, Driven by Services and Developing Economies", 14 March 2025. See also World Trade Organization, "Services Trade", available at https://www.wto.org/english/tratop_e/serv_e/serv_e.htm.

A broad scope is essential as the distinction between traditional and digital services is often blurred. Emerging technologies can transform conventional services into digital ones, making it difficult to establish classification criteria that will remain relevant as new service models evolve. Moreover, there is no clear policy rationale for including some types of services while excluding others. Doing so could undermine the protocol's purpose as existing rules would likely continue to apply in such cases.

While the taxation of income from cross-border services may overlap with the issue of taxing the digitalized economy, the two are conceptually distinct. The latter generally has a wider scope, potentially encompassing indirect taxes, particularly general consumption taxes, on services supplied by foreign businesses to resident consumers, as well as the income taxation of individuals working remotely or participating in the sharing or gig economy. Although general consumption taxes, such as value-added tax (VAT) or goods and services tax (GST), represent a major source of revenue for both developed and developing economies, and an increasing number of jurisdictions have adopted rules to tax cross-border supply of services including digital services, there is still no international framework to coordinate the implementation of such rules, apart from soft law developed by the OECD (i.e. *The International VAT/GST Guidelines* (2017)). The lack of coordination can lead to inconsistencies, unintended double taxation, or non-taxation.[3] While an international agreement on VAT/GST is clearly desirable, it may be more appropriate to address this under a separate workstream.

As regards the possibility of adopting different rules for different types of services, this submission contends that a uniform approach may be more sensible and effective. Uniform rules would promote simplicity, administrative efficiency, legal certainty, and help prevent abuse. Experience with differentiated tax rules – such as under VAT/GST systems or in the characterisation of income and application of varying source rules – has shown that such approaches are vulnerable to inconsistency, loopholes, and manipulation when applied to economic activities of a similar nature.[4]

Reasons for change

The current rules for taxing income from cross-border services in developing countries generally differ from those applied in developed countries. In the former, such income is typically taxed where payments to non-residents are made and on a gross basis. By contrast, developed countries tend to tax such income based on where the services are performed – usually the location of the service provider or the state of residence – and on a net basis.

When bilateral tax treaties apply, treaties based on the OECD Model generally disallow source-state taxation of services income unless the non-resident taxpayer has a permanent

[3] See generally Yan Xu, "A Multilateral Option for VAT in International Trade?" (2022) 71(4) *International and Comparative Law Quarterly* 857; Yan Xu (ed.), *VAT in the Digital Era: Unilateral and Multilateral Options for Reform* (Oxford University Press, 2023).
[4] David A. Weisbach, "Line Drawing Doctrine and Efficiency in the Tax Law" (1999) 84(6) *Cornell Law Review* 1627.

establishment (PE) in the source state and the income can be attributed to that PE. This significantly limits source-state taxing rights. Many commentators argue that a tax framework based on physical presence no longer reflects the realities of modern business models, which increasingly rely on digital technologies that enable remote service delivery across borders. The 2021 UN Model (updated in 2025) introduced new provisions allowing gross-basis taxation on payments for services, which would enable and broaden source-state taxing rights. However, incorporating these new provisions into actual bilateral tax treaties remains uncertain and challenging, particularly for developing countries.

The Note provides a thorough and clear summary of the existing rules. It is widely acknowledged that the current rules – focused on physical presence – has become outdated and imposes significant restrictions on source-state taxation. In particular, determining business profits under the arm's length principle has created disproportionate difficulties and administrative burdens for many developing countries.[5] It is thus broadly recognized that the international tax rules must evolve to better reflect contemporary business practices and the economic and administrative realities faced by countries in today's digitalized global economy.

Considerations for development

In developing new nexus rules for services, it is critical to reach common ground or shared principles, though this may be challenging given the considerable differences in views and practices between developed and developing countries.

The Note discusses the potential application of the "value-creation" principle, introduced during BEPS 1.0. Although the principle remains vague, it may still serve as a useful foundation for formulating new nexus rules. Corporate theory – both in management studies and corporate law – generally recognizes that a firm's value is created by multiple stakeholders, including shareholders, employees, customers, users, communities, and others.[6] Stakeholder interest protection has also been reflected in legislative developments in various jurisdictions.[7] This broader view in corporate governance underscores that value creation for firms is a dynamic and multifaceted process, not necessarily attributed solely to either the supply or the demand side. New business models, especially those primarily using digital means, often generate revenue through the commercialization of user data or active user participation. Given the widespread digitization of the economy, a nexus based on economic presence could be developed – one that encompasses both the traditional nexus of physical presence and the modern use of digital or information technologies.

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[5] See generally Richard Collier and Joseph L Andrus, *Transfer Pricing and the Arm's Length Principle after BEPS* (Oxford University Press, 2017).

[6] See eg R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, 1984). John Elkington, *Cannibals with Forks: The Three Bottom Line of 21st Century Business* (Capstone, Oxford, 1997). Archie B Carroll, "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders" (1991) 34(4) *Business Horizons* 39; Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85(2) *Virginia Law Review* 247.

[7] For example, UK Companies Act 2006, sec 172.

In the past, the emphasis on physical presence was justifiable because economic activities in the source state could not occur without it. Today, an economic presence nexus could instead be defined using quantitative thresholds, such as a specified level of revenue, a number of users/consumers, or a combination of both. Some jurisdictions have already adopted such thresholds under their income tax or VAT/GST systems.[8]

When developing new rules, it is important to acknowledge that the objective is fair allocation of taxing rights, even though fairness itself is inherently subjective. To address this, objective factors, particularly those related to global trade in services, should be considered. Trade statistics show that services are driving global trade growth. In 2024, services grew by 9%, compared to 2% for goods.[9] Notably, developing economies led this global growth, outperforming developed countries.[10] Services now represent the largest source of economic value-added in most economies and are often the biggest employer in a society.[11] In 2023, services accounted for 30% of total exports in developed countries and 19% in developing countries.[12] While there are nuanced differences across and within country groups, services have clearly become a vital part of the global economy and represent a major share of national economic activity.

However, less developed jurisdictions have not fully benefited from this growth in international trade in services. To support these jurisdictions' economic development and revenue mobilization, greater recognition needs to be given to domestic consumers, users, and access to local markets – factors that would justify increased source-state taxation. International data on imports and exports of services, available from relevant organizations, could inform the design or negotiation of new rules.

The Note rightly acknowledges that jurisdictions where business activities take place should share the right to tax. A key challenge, however, is determining where business activity occurs. While there is currently no international consensus, guidance may be drawn from general principles in VAT/GST systems, where taxation is based on the location of the consumer. Although VAT/GST is a consumption tax, the place-of-supply rules can assist in identifying where business activity takes place under income taxation, especially since many countries, including developing ones, already have experience in applying such rules. This approach also aligns with goals of simplicity, administrability, and preventing abuse as the consumer's location is difficult to manipulate and promotes economic efficiency.

Importantly, the consumer's location is not necessarily tied to where payments are made. Since this is an income tax, expenses incurred in providing the services could be deductible, provided

[8] For example, even in the US which does not have a federal-level general consumption tax, many states have expanded their retail sales tax to include intra-state (and cross-border) sales of services. This has been achieved by introducing economic nexus rules based on sales revenues and/or the numbers of consumers, following the US Supreme Court's decision in the *Wayfair* case.
[9] UNCTAD (2025) (n 2).
[10] Ibid.
[11] UNCTAD, *Bulletin Trade in Services*, Issue 3, September 2024, p 13.
[12] Ibid.

non-resident taxpayers maintain contracts and documentation to support such claims. In the case of digital services, a simplified gross-basis taxation could be considered. Given the low marginal cost of deploying online platforms or digital operations in a given jurisdiction, this form of taxation may not cause significant economic distortions in the provision of cross-border services.[13]

We hope this feedback contributes constructively to policymaking in the ongoing discussion on international tax reform with respect to the fair allocation of taxing rights.

Thank you.

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[13] Wei Cui, "The Digital Services Tax: A Conceptual Defense" (2019) 73(1) *Tax Law Review* 69.