

How 'Digital Trade' Rules Would Impede Taxation of the Digitalised Economy in the Global South

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TWN
Third World Network

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ABBREVIATIONS

3D	Three dimensional (printing)
AEOI	automatic exchange of information
AI	artificial intelligence
ASEAN	Association of South-East Asian Nations
ATAF	Africa Tax Administration Forum
BEPS	Base Erosion and Profit Shifting
CbC	Country-by-country (reporting)
CETA	Canada EU Trade Agreement
CGE	Computable general equilibrium
COVID-19	Coronavirus disease in 2019
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CRS	Common Reporting Standard
DEPA	Digital Economic Partnership Agreement
DST	Digital services tax
ECIPE	The European Centre for International Political Economy
EOIR	exchange of information on request
EU	European Union
FATF	Financial Action Task Force
FATCA	Foreign Account Tax Compliance Act
FTA	free trade agreement
G20	Group of 20 countries
G24	Group of 24 developing countries
GAFA	Google, Apple, Facebook, Amazon
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GST	goods and services tax
GTAP	Global Trade Analysis Project
HS	Harmonised System for classification of traded goods
ICRICT	Independent Commission for the Reform of International Corporate Taxation
ICT	Information and communication technology
IMF	International Monetary Fund
IP	intellectual property
ITC	The International Trade Commission (US)
MAATM	Mutual Administrative Assistance in Tax Matters
MC11	Eleventh Ministerial Conference of the WTO
MC12	Twelfth Ministerial Conference of the WTO
MNE	multinational enterprise
OECD	Organisation for Economic Cooperation and Development

PE	Permanent establishment
RCEP	Regional Comprehensive Economic Partnership
SARS	South African Revenue Service
SDG	Sustainable Development Goal
SSA	Sub-Saharan Africa
TCJA	Tax Cuts and Jobs Tax Act 2017 (US)
TIEA	Tax Information Exchange Agreements
TPPA/TPP	Trans-Pacific Partnership Agreement
TRIMS	Trade-Related Investment Measures
TRIPS	Agreement on Trade-related Aspects of Intellectual Property Rights
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
USMCA	UN-Mexico-Canada Agreement
USTR	United States Trade Representative
VAT	value-added tax
WTO	World Trade Organization

OVERVIEW

PART 1. Strengthening the capacity of developing countries to **protect and broaden their tax base** is essential for financing sustainable development and achieving the **sustainable development goals (SDGs)**. Governments need revenue to perform their roles and responsibilities as part of the social contract, which includes ensuring sustainable livelihoods. The creation of regional and national **strategies for digital industrialisation** that can fuel the development of business, jobs and consumption, and generate revenue in a dynamic process, require support, investment, vision and policy space.

The targets set by the SDGs underscore the urgency of developing an international system for the **fair allocation of taxing rights** over the incomes of multinational companies that are utilising digital technology, especially as large companies from developed countries hold monopolistic positions in their markets. That is especially important for countries of the Global South. There is a long-standing imbalance in this distribution as between developing and developed countries, which has been greatly exacerbated by the shift to the services economy and especially digitalisation.

That compounds an even longer history of **aggressive tax avoidance** by multinational enterprises (MNEs) which have expanded around the world by exploiting legal grey areas such as the concepts of residence of legal entities and the source of income, and loopholes in international tax rules designed nearly a century ago. **Redesigning of these rules to ensure that MNEs are taxed fairly**, based on where their real activities take place, entails the **reassertion of taxation at source**. That approach has long been advocated by developing countries, but rejected until now by the developed countries, which are both home countries of MNEs and the main providers of preferential tax regimes enabling the channelling of profits offshore.

PART 2. **New rules** are being developed in free trade agreements (FTAs) and proposed in the World Trade Organization (WTO) **in the name of 'electronic commerce' or 'digital trade'** that will constrain the governance, regulation and taxation of the digitalised economy. Existing rules that restrict the regulation of trade in services, including financial services, as well as agreements on foreign

investment and intellectual property rights, pose additional challenges for lawmakers and tax authorities.

This report provides a composite **overview of these trade provisions**, including relevant exceptions and limitations, that are most relevant to taxing the digitalised economy, drawing on existing agreements and from proposals known to have been raised in various plurilateral negotiations at the WTO:

- Rules from **‘electronic commerce’ or ‘digital trade’** chapters include, with minimal limitations: a permanent ban on customs duties on electronic transmissions; cross-border transfer of information related to a business; the right to use servers and other computing facilities in the business’s country of choice; and non-disclosure of their source codes and algorithms.
- **Trade in services and financial services** chapters may: prohibit requirements for offshore service providers to have a local presence in countries where they operate or take a particular legal form if they do have a presence; prevent differential treatment between competing offshore services and suppliers from different countries or preferences for domestic competitors; and prescribe how laws of general application, including tax laws, are administered.
- Investment measures cannot cap the level or duration of **royalty payments** in licence contracts between a foreign investor and another person in the territory, including related parties.
- **Process-related obligations** include the right of foreign states and their MNEs to comment on proposed new tax measures in the name of ‘transparency’, and procedures and criteria for making new regulations.

The protection for policy space in existing WTO agreements is limited and uncertain. **Tax exceptions** in recent multi-chapter and mega-regional agreements are variable and especially complicated, creating a legal minefield of complexity, layered on top of the increasingly complex array of trade rules that apply to digital technologies, owners, services, and transactions.

To date, relatively little attention has been paid to the **consequences of trade rules for countries’ tax regimes** in the context of digitisation. **Innovations**, such as new modalities for taxing the income of digitalised corporations operating from offshore and the adoption of digital services taxes, have **increased the urgency** of examining these issues.

PART 3. Developing countries in the WTO and many FTAs are being asked to agree to a **permanent moratorium on levying customs duties on electronic transmissions** without a fully informed understanding of the possible impact on their public finances and the potential of their domestic enterprise sector to participate in those digital activities. That proposal constitutes the most immediate threat from trade rules to developing-country public finances and to their industrial development.

Successive UNCTAD (United Nations Conference on Trade and Development) studies have warned that converting the moratorium into a permanent ban would have **serious future economic and development impacts**. This report supports that finding, although it projects a slightly lower-level short-term impact. It places greater emphasis than UNCTAD on the potential for the moratorium to **diminish the tax policy space of developing countries** permanently and to disable tax policy over a wide swathe of internationally traded goods or services. This risk arises because:

- developing countries are more dependent on trade tariffs than developed countries;
- there is considerable ambiguity in the scope of the current moratorium;
- the growth rate for digitalised products has been and will continue to be massive;
- although existing estimates of losses of tariff revenue from the moratorium appear to be relatively small at the present time, there is potential for explosive growth in the future;
- contrary estimates from developed-country analysts that there would be net losses from **not** continuing the moratorium use methodologies that are laden with problematic assumptions;
- non-tariff impacts on development, and the policy space for developing countries to diversify their economies, are not adequately factored into those assessments;
- the huge range in the estimated impacts of a moratorium on a country-by-country basis across the Global South and unclear future trends reinforce the importance of retaining policy space; and
- claims that it is technically problematic to levy customs duties on electronic transmissions are overstated.

All of these arguments militate against a permanent moratorium on tariffs on electronic transmissions.

PART 4. MNEs have devised numerous techniques to reduce to **very low levels their effective tax rates on corporate income**, especially on their foreign subsidiaries in source countries. Agreeing a **new methodology for allocating profits among the tax jurisdictions** where an MNE operates is especially important due to digitalisation, which makes it easier to fragment MNE operations and locate activities such as treasury functions, management of intellectual property, content creation, platform operating and data processing in convenient jurisdictions or havens, and pay little or no tax in countries where revenues are generated. This was encouraged by the OECD (Organisation for Economic Cooperation and Development) approach to taxation of MNEs, based on the arm's-length principle, which insists on treating each subsidiary or branch of an MNE as if it were a separate entity.

The OECD has dominated moves to reform corporate income tax, with the UN Tax Committee playing only a minor secondary role. Although developing countries have now been allowed into the room through the so-called **Inclusive Framework on Base Erosion and Profit Shifting (BEPS)**, this remains housed at the OECD and dominated by the traditional perspectives of capital-exporting countries. This has marginalised developing countries even though their perspective on the need to tax where activities take place is now more relevant than ever. In 2019 the **G24 group** of developing countries, supported also by the **African Tax Administration Forum (ATAF)**, put forward an outline for an alternative approach to MNE taxation based on 'significant economic presence'. This would require a shift towards treating MNEs in accordance with the economic reality that they operate as unitary enterprises and allocating taxation rights using factors that reflect a balance of demand side (sales) and supply side (employees, users, physical assets).

The OECD Secretariat has **proposed a 'Unified Approach'** which, although now starting from the MNE's global profits, would retain the arm's-length principle, subject only to the use of formulaic methods to allocate some additional taxing rights to the user/market jurisdiction. Early assessments suggest the amount of taxes raised overall from MNEs would not increase by a sizeable amount, but these taxes would be distributed differently across countries, with the proportion to low- and middle-income countries increasing slightly. This would fail to achieve the aims of simplicity, stability and certainty, or an equitable allocation of tax, both between countries and between MNEs and local business. The fate of the Unified Approach remains uncertain following US rejection of the proposed approach and temporary withdrawal from the discussions.

Trade laws that protect footloose digital MNEs from having to maintain a local presence where they operate or take a specific legal form where they are present, and guarantee they can hold data in their jurisdiction of choice, including tax/data

havens, will assist corporations to **impede or circumvent** any significant progress towards effective reform of international corporate taxation. Digitalised MNEs insist they are computer technology companies, and many developing countries have extensive trade in services commitments on computer and related services and/or cross-border supply of services. These may be cited to prevent tax authorities from adopting measures that, for example, deem an MNE to have a significant economic presence, or setting thresholds that target only large foreign digital MNEs where that creates a competitive disadvantage, leaving governments to rely on vague and often complex exceptions. The high degree of legal uncertainty about the scope and meaning of these obligations creates **fertile ground for challenges**.

PART 5. Countries have become impatient or unhappy with the failure to make progress through the OECD on taxing the income of digitalised corporations and begun to adopt alternatives.

Transaction-based **digital services taxes** (DSTs) target income or revenue from designated online activities, principally services delivered via the Internet, especially advertising; digital platform or interface services or an Internet marketplace; and the collection and exploitation of data by an Internet provider. The tax has the potential to conflict with national treatment, market access and local presence rules in trade in services agreements. Ambiguous classifications of commitments in schedules add to the legal uncertainty. Proposed e-commerce rules prohibit requirements to hold information within the jurisdiction and access to source codes and algorithms that may be essential to assess liability based on the domestic share of globally integrated activities, including user-generated data. The available exceptions provide limited protection. Transparency rules would empower digital corporations and their parent states to lobby against such laws.

The US has launched investigations under **Section 301 of the Trade Act 1974** into ten countries' versions of a DST. An earlier investigation into France's tax indicates the kind of legal arguments the US is likely to make using existing and proposed trade rules:

- the tax is discriminatory and unreasonably burdensome on US companies and negatively impacts on their competitive position;
- it violates international tax norms through its extraterritoriality, taxing revenue not income, and penalising US companies for their commercial success;
- the premises of the tax that digital MNEs do not pay corporate income tax and that users are deprived of the value of their data are flawed, so the tax is not a legitimate policy response; and

- unilateral action has impeded the chance of achieving multilateral consensus in the OECD.

Value-added taxes (VATs) create less controversy, with agreed OECD guidelines on their application to digitalised supplies from abroad. They are also less vulnerable in trade-law terms, provided they are carefully designed, and governments do not portray them as targeting foreign corporations (a ‘GAFA’ tax) and protecting local firms. While some developing countries have successfully implemented them, they still require digital MNEs to cooperate when they cannot be required to have a local presence. A VAT also has adverse distributive consequences.

In another innovative tax-related measure to disrupt the tax avoidance strategies of digital MNEs, some developing-country governments have moved to **cap royalty payments** between related parties. New rules on performance requirements in recent FTAs seek to keep that option open to the corporations by restricting the ability of host governments to limit the size or duration of royalty payments contained in licence contracts between related parties located within their country.

PART 6. The difficulty of **accessing tax-relevant information** on persons or companies in foreign jurisdictions has long enabled large-scale tax evasion by individuals and abetted aggressive tax avoidance by companies, with a particularly iniquitous effect on developing countries.

Recent **reporting requirements and information-sharing initiatives**, especially under the auspices of the Global Forum on Transparency and Exchange of Information for Tax Purposes, have begun prising open that door. These include the Common Reporting Standard, Exchange of Information on Request, Mandatory Disclosure Rules, Country-by-Country Reporting and Beneficial Ownership Registers. As with the Inclusive Framework, those developments have mainly been led by developed countries and reflect their needs and circumstances. Developing countries will need additional tools to access necessary information from offshore digital MNEs.

Trade rules on the digital economy may pose further barriers to improved transparency, particularly of the data value chains, and **compound the difficulties** that already confront the tax authorities **in developing countries to access the information** they require. Reporting and information-sharing initiatives may encounter obstacles under existing and proposed trade rules on discrimination (national treatment and most-favoured-nation treatment), local presence, legal form of local presence, location of data, administration of services regulations, and the exceptions. The **WTO dispute brought by Panama against measures Argentina adopted** on the basis that Panama was non-cooperative on sharing tax-related information shows the potential for countries that facilitate aggressive tax planning

to bring costly and complex trade disputes. Despite the recognition that tax revenue is of utmost importance and developing countries especially need to protect their tax base, the Panel and Appellate Body disagreed about how to apply the relevant trade in services provisions and made no rulings on the exceptions, so that the rules remain a legal minefield mired in uncertainty.

PART 7: Many new tax initiatives are experimental and face strong resistance from digital MNEs and the US government. There are already many examples where **states, principally the US, have exploited their dominance through threats** of a trade dispute, conducted unilateral trade investigations, imposed sanctions and retaliated through withdrawal of aid or other benefits, such as access for temporary migrant workers.

The US made its intentions clear in June 2020 by launching a raft of unilateral investigations under Section 301 of the Trade Act 1974 against countries that are adopting digital services taxes, and almost simultaneously withdrawing temporarily from the Inclusive Framework negotiations to agree on new rules for taxing digital corporations and in the same letter threatening retaliation against four EU member states if they implemented their taxes. Digital MNEs themselves have threatened to withdraw technological and other services and investments, on which countries and consumers have come to depend. That **power imbalance** would be exacerbated under proposed ‘transparency’ rules in trade agreements that oblige governments to provide **digital companies and powerful states with the opportunities to comment on proposed new laws**, regulations and procedures before they are adopted.

Tax justice demands a broad examination of policies and processes that impact on the ability of governments from the Global South to protect and enhance the fiscal social contract. Moves to develop new international tax norms currently offer little prospect that they will address those needs. Developing countries need **regional and national strategies to strengthen Domestic Revenue Mobilisation**, enhance their domestic industrial capacity, bridge the digital divide and reduce dependence on the dominant corporations.

There is a **high degree of legal uncertainty and complexity** for governments, legislators and tax authorities who want and need to develop effective and just ways of taxing the digital economy but are confronted with current and potential trade rules that seriously constrain their policy space. That uncertainty compounds the risks that **decision-makers may be chilled** from taking measures they consider necessary to protect their revenue base and implement their development strategies, and for the world to achieve the SDGs.

Given the rapid and unpredictable evolution of the digital sector, the dominance of an oligarchy of mainly US corporations, and a systemic digital divide, it is **unconscionable to call for developing countries to accept further constraints**

on their ability to regulate for their development. All countries, but especially those from the Global South, should **refrain from participating in a process of trade negotiations** that is likely to limit their flexibility and ability to tackle inequality through sustainable financing of economic and social rights for their citizens and to maximise the development opportunities that digital technologies can bring. **Moves to reinterpret existing trade rules** and commitments in expansive and unanticipated ways **need to be resisted** and **tax exceptions** to existing trade rules **need to be revisited** to increase their relevance and effectiveness in the digitalised economy.

To be truly responsive to the challenges and opportunities that a transforming digital economy poses for development, all governments, but particularly in the Global South, **need trade policies that positively preserve their policy space** to innovate and to re-evaluate their strategies on a national and regional basis on a regular basis. There are different and genuinely pro-development options for addressing the growing cross-border trade in digital products. Especially in a post-COVID-19 environment, **targeted and synchronised tax and trade policies** need to prioritise economic and social rights and ensure that companies, especially the powerful digital MNEs, are genuinely contributing to achieving those goals.

INTRODUCTION

THE 21st century presents countries of the Global South with multiple challenges not of their making: an existential climate crisis, structurally embedded inequalities of wealth and income, fallout from geopolitical conflicts and trade wars, contagious financial crises – and now the unpredictable long-term social and economic consequences of the COVID-19 pandemic.

Also high on the list of challenges is the exponential growth of data-driven technologies within a fragile, highly integrated and digitally-dependent global economy that is dominated by giant multinational enterprises (MNEs), especially from the United States (US) and China.

The COVID-19 emergency, with its lockdowns, falling commodity crisis, declining remittances and capital flight, has heightened the economic and fiscal crises confronting the Global South. The pandemic has exposed the massive underfunding, lack of capacity, and unpreparedness of public health services and social safety nets after decades of imposed austerity.

Already heavily-indebted developing countries face the prospect of yet more debt with associated conditionalities or finding new sources of revenue. Neutralising the tax avoidance practices of digital MNEs and securing a share of their profits from the burgeoning digitalised economy is an obvious starting point.

A fiscal paradox

The fourth industrial revolution¹ presents a fiscal paradox for developing countries. On one hand, digital technologies have the potential to improve economic and social well-being and advance the Sustainable Development Goals. To achieve that, and bridge the deep digital divide, developing countries will need proactive digital industrialisation strategies.² Those strategies will require, at a minimum,

¹ This term has been adopted to describe the latest momentous changes in global capitalism. For an early articulation see Klaus Schwab (2016), 'Fourth Industrial Revolution: What it means and how to respond', World Economic Forum, 14 January 2016. Available at: <https://www.weforum.org/agenda/2016/01/the-fourth-industrial-revolution-what-it-means-and-how-to-respond/>

² UNCTAD (2018), *Trade and Development Report 2018. Power, Platforms and the Free Trade Delusion*, UNCTAD, Geneva, Chapter III

domestic support for fledgling businesses, technology transfer and training, and investment in the domestic infrastructure. They will also need access to, and an ability to utilise, the data generated within their countries. These imperatives will make massive demands on the public purse at a time when governments face pressure to overcome the disruption caused by the fallout from COVID-19, and by digitisation itself.

At the same time, the tax base of countries in the Global South is being undermined by the amorphous nature of the digital economy and the tax minimisation strategies of the corporations that control it. Developing countries that already struggle to maintain effective tax regimes risk falling further behind.

As the share of digital services in their economies grows, national regulators, including tax authorities, will have to develop innovative strategies and rules to maintain, let alone expand, the tax base. That is a daunting challenge given the exponential growth in cross-border transactions, the ethereal form of the Internet, the arm's-length nature of activities on the platform economy, the anonymity of cross-border digital service providers, the mercurial identity and location of many tech companies, and the un-valorised nature of the all-valuable and privately-owned data that is mined from countries and people across the world.

At the nucleus of this challenge are the digital technology giants like Google, Amazon, Facebook, Apple, Uber and others that have established a first-mover dominance over the digital ecosystem. While most businesses suffered during the COVID-19 lockdown, almost all the technology giants reported increased sales and subscriptions.³ The OECD cites projections that the 'sharing economy' of Uber, Airbnb and the like will be worth around \$335 billion by 2025.⁴ Yet these corporations pay taxes at egregiously low effective tax rates.⁵ They want global rules to keep it that way. Binding and enforceable trade agreements provide one means of doing so.

Global trade rules for the digitalised economy

As with previous industrial revolutions, there is no level playing field. The majority of economic benefits and earnings are expected to continue flowing to the dual digital hubs of the US, which dominates developed markets, and to China,

³ Veronica Grondona, Abdul Maheet Chowdhary and Daniel Uribe (2020), *National Measures on Taxing the Digital Economy*, South Centre Research Paper 111, May 2020 at 4 citing Steve Covach (2020), 'Big Tech's earnings prove it's immune to the coronavirus', *CNBC News*, 4 May 2020. Available at: <https://www.cnbc.com/2020/05/04/big-techs-earnings-prove-its-immune-to-the-coronavirus.html>

⁴ OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018, Inclusive Framework on BEPS*, 195

⁵ 'US in last-ditch effort to quash Brussels tax demand on Apple', *Financial Times*, 25 August 2016, Available at: <https://www.ft.com/content/1081af60-69f3-11e6-a0b1-d87a9fea034f>; 'Apple increases profit, still pays zero tax in NZ', *NZ Herald*, 29 January 2018, Available at: https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11984006

which will dominate in developing countries' markets.⁶ National policy-makers now face an added threat: that international trade agreements will restrict how governments can regulate the digital economy.

Proposed new rules on electronic commerce, and expansive interpretations of existing trade in services rules, could entrench the current imbalance, and further deplete the tax base in the Global South, stymie innovative tax strategies, and seriously undermine governments' ability to fund their development needs and social obligations.

The most obvious issue for revenue collection is whether the temporary World Trade Organization (WTO) moratorium on tariffs on electronic transmissions, which has been rolled over since 1998, is terminated, renewed or made permanent and enforceable. The moratorium guarantees tariff-free cross-border trade in digital products at a time when the scope of those transactions has been expanding and continues to do so through new production technologies like 3D printing. The scope of the moratorium and its future fiscal impacts are heavily disputed. In addition to reiterating concerns about the longer-term impacts on revenue, this report emphasises an equally important consequence: making the moratorium permanent would foreclose the policy space for developing countries to apply tariffs for fiscal and development purposes at a time when they need it most.

The past decade has also seen the significant expansion of trade rules that are designed to restrict the ability of governments to regulate the digitalised economy and consolidate the dominance of existing MNEs. This new digital trade regime, which has already been adopted in some free trade agreements (FTAs) and is being proposed in the WTO, would exacerbate the harmful tax practices of MNEs within a deeply integrated digitalised economy.

These rules could prevent governments from requiring offshore digital services suppliers to have a local presence in their country or take a particular legal form if they are present. Governments could no longer control the location, and consequently the rules, that govern access to and use of data – the raw material for the digital economy – that is sourced from their country. Nor could they cap the royalties paid under certain licensing arrangements between related entities that foreign firms use for tax avoidance and shifting profits offshore. The source codes and algorithms in the software through which corporations organise and conduct their business, or harvest and utilise data that countries want to tax, could be kept secret from regulators and tax authorities.

In addition to their direct impacts on the revenue base, these and other proposed rules would undermine the ability of countries to build their own infrastructure and use digital technologies to advance their development prospects. Governments could not require foreign firms to use the local computing facilities,

⁶ Kai-Fu Lee (2017), 'The Real Threat of Artificial Intelligence', *New York Times*, 24 June 2017. Available at: <https://www.nytimes.com/2017/06/24/opinion/sunday/artificial-intelligence-economic-inequality.html>

including servers, they have established with public funds to help strengthen their national capacity, or to include inputs from local businesses and tech start-ups. Other requirements for technology transfer, or training of locals that would transfer proprietary knowledge, could also be prohibited.

New approaches to taxing the digitalised economy and the digital MNEs could also conflict with existing rules on non-discrimination and market access in agreements on trade in services, including financial services. Expansive interpretations of the commitments countries made over two decades ago, when most of today's digital technologies and services were unimaginable, seek to impose new obligations without the need for new negotiations, something that developing countries have consistently resisted. New wording and scheduling techniques in FTAs provide an alternative pathway to achieve the same goal.

The exceptions to these new and existing rules, as they apply to taxation measures, are limited in scope, inconsistent across agreements and legally uncertain with no jurisprudence to assist their interpretation.

Beyond these substantive policies, 'trade' rules are increasingly directed to the process of decision-making and administration. How general tax regulations are administered could be challenged as unreasonable and not objective or impartial, and administrative fees could be deemed excessive. There is pressure to conduct narrowly defined impact assessments to weigh the costs and benefits of proposed measures based on 'objective' evidence, which makes innovation difficult and contestable. Seemingly benign terms such as 'regulatory quality' and 'best practice regulation' seek to institutionalise developed-country models of light-handed and self-regulation.

In the name of 'transparency', foreign states and firms could be guaranteed the right to comment on proposed new laws, such as digital services taxes. Such rules have very little to do with real trade. Instead, they formalise the leverage of the big tech companies to threaten investment disputes or withdrawal of services, and opportunities for governments, in particular the United States, to threaten unilateral investigations and trade sanctions, with the goal of chilling the decisions of other sovereign governments.

Governments seeking to rely on the taxation or other exceptions to those agreements are likely to find that very difficult, due to the technical complexity of these exceptions and the legal grey areas this creates. The complex web of trade agreements means a single tax measure would need to comply with a country's obligations in the WTO and all its FTAs that contain some or all of these rules, which may not be consistent. Divergent tax and related exceptions may add further layers of inconsistency and legal complexity.

These existing and proposed 'digital trade' rules could severely and permanently disadvantage developing countries by eroding their revenue base and constricting their policy space for digital development. It is a travesty that many of

these new trade rules are now being promoted as a vehicle for development. Complementary rules have been proposed in the plurilateral negotiation by some WTO Members on ‘investment facilitation for development’,⁷ which also lacks a WTO mandate, and on disciplines on the domestic regulation of services.⁸

Parallel developments on global tax rules

Developed-country governments have led moves for over a decade to agree on global and regional solutions to the kind of tax minimisation strategies of MNEs that trade rules for the digital economy would facilitate. These international trade and tax negotiations have taken place in silos, with only the US taking a coherent position in both to protect the interests of its MNEs.

In the tax arena, there is widespread recognition that the international corporate tax system is broken, as countries face enormous difficulties and engage in vigorous debates over the appropriate tax policies for the digitalised economy. The old *laissez faire* attitude to the operations of digitalised corporations has slowly given way to questions of how to (re)introduce accountability (over the use of data for example) and (re)build state capacity to regulate the digital industry. This has generated a tug of war over tax rules which, as with trade rules, is taking place within institutions that are dominated by the Global North.

The Organisation for Economic Cooperation and Development (OECD) and the Group of 20 (G20) have established an Inclusive Framework on Base Erosion and Profit Shifting (BEPS). There are many developing countries among its 137 members who participate in its deliberations. Despite this, the Inclusive Framework tends to be dominated by the perspectives and expertise of the Global North and builds upon fundamental principles that were originally developed in the absence of the Global South. Other international institutions, notably UNCTAD and the Group of 24 (G24) developing countries, have been relegated to a secondary role. Any rules that developed countries might agree on will therefore not be designed for developing countries. Nor is there any guarantee that developed-country states will share the data, or technologies and capabilities, needed to monitor and regulate the digital economy.

The Global North is itself not united. The complicated manoeuvres that the US and its digital companies have brought to the tax reform process – as they have to the trade rules – show how determined they are to protect their first-mover advantage. International tax initiatives in the OECD and European Union (EU), as well as between national authorities, have failed to reach a consensus.

⁷ See the WTO archive for relevant documentation. Available at: https://www.wto.org/english/news_e/archive_e/infac_arc_e.htm

⁸ See WTO archive for published documentation. Available at: https://www.wto.org/english/news_e/archive_e/jssdr_arc_e.htm

In frustration, individual countries and regional groupings in Europe, India and across Africa have struck out on their own and proposed innovative new digital taxes. These initiatives are still experimental and are spreading rapidly, often with national variations. There are risks. Measures that are adopted with the dominant incumbents in mind might instead confirm their position by warding off smaller competitors that cannot comply,⁹ or reduce digital participation when it needs to grow. There is also potential for governments to exploit digital taxes as a means to restrict citizen engagement through social media platforms.

The tension between tax and trade rules may be coming to a head. The US, and its major digital companies, have already invoked a mixture of trade-speak and raw power to threaten and implement retaliation against tax-related measures they deem to involve unfair or discriminatory trade practices.¹⁰ The proposed new substantive constraints on regulating the digital economy, alongside procedural requirements that further empower these actors, would significantly increase their leverage to challenge innovative digital taxes. The US's announcements in June 2020 of investigations into ten countries' digital services taxes, and temporary withdrawal from the OECD's Inclusive Framework negotiations to agree on new rules for taxing the digital MNEs, are ominous.¹¹

Both sets of international negotiations – on tax and trade – are occurring in 'real-time', meaning actions and discussions taking place right now are of urgent significance to developing countries. Before the 'e-commerce' trade agenda advances any further, it is essential for all countries, in particular for the Global South, to step back and undertake rigorous regulatory and fiscal risk assessments of the proposed rules.

Outline of this report

The aim of this report is to alert developing countries, especially, to the legal arguments they may face as they adopt new rules to tax the digitalised economy, and the added legal and political risks attached to proposed new rules on digital trade and reinterpretations of existing trade in services rules and commitments.

⁹ Heido Tworek (2020), 'A New Blueprint for Platform Governance', Centre for International Governance Innovation, Ontario, 24 February 2020. Available at: <https://www.cigionline.org/articles/new-blueprint-platform-governance>

¹⁰ Sergei Klebnikov (2020), 'U.S. Threatens New Tariffs on Cars in Response to France's Digital Tax', *Forbes*, 22 January 2020, Available at: <https://www.forbes.com/sites/sergeiklebnikov/2020/01/22/us-threatens-auto-tariffs-in-response-to-frances-digital-tax/#65fd20f911a1>; Patrick Hatch (2018), 'Amazon reopens US site to Australian shoppers after "Amazon Tax"', *Sydney Morning Herald*, 22 November 2018. Available at: <https://www.stuff.co.nz/business/world/108779793/amazon-reopens-us-site-to-australian-shoppers-after-amazon-tax>

¹¹ Steven Mnuchin, US Treasury Secretary (2020), Letter to the Ministers of Finance of the French Republic, Spain and the Italian Republic and the Chancellor of the Exchequer of the United Kingdom, 12 June 2020. Available at <https://www.politico.eu/wp-content/uploads/2020/06/CLEAN-US-letter-DST-120620201.pdf>

To date, most concerns about taxation in the trade arena have focused on the fiscal impact if tariffs on imports of digital goods are banned permanently. There have been very few published analyses of what these developments might mean for public revenue, policy space, digital industrialisation and the Sustainable Development Goals (SDGs). This report seeks to help bridge that gap. It has been prepared by a multi-disciplinary team of economic, tax and trade law experts from different parts of the world, with the goal of stimulating discussion across a range of government agencies, international institutions, academia, business, trade unions and civil society. It tackles these challenges in seven parts.

Part 1 identifies the major challenges that the digital revolution poses for public finance and tax authorities, especially in the Global South, and for the SDGs that provide a measuring stick for assessing progress towards tax justice from a development perspective. Part 2 introduces the most relevant existing and proposed trade rules that affect taxation of the digitalised economy. It aims to enable readers, but especially tax and trade officials, to relate the discussion of digital tax issues to the trade rules, and to assess the extent to which they may constrain their governments' options. Readers who want a more general understanding of the issues might skim that part and revert to it on particular legal matters of interest that arise in later parts. Table 1 provides a quick cross-reference to where the trade rules and tax options are discussed in this report.

Part 3 provides new analysis of the implications for national tax revenue, digital development and the policy space of developing countries if the temporary moratorium on customs duties on electronic transmissions became permanent. Initiatives towards more effective corporate income tax of digital companies that are being developed at the OECD under the Inclusive Framework, and proposed by the G24, and how they would interact with digital trade rules, are canvassed in Part 4. This is followed by discussion in Part 5 of the development of digital services taxes, including the US's arguments against France's version of the tax, moves to apply value-added taxes to cross-border digital transactions, and moves in several countries to cap royalty payments used as a means of profit shifting by transnational digital companies. Each of these is assessed against the trade rules.

Part 6 examines the extent to which moves to ensure that governments can access critical information and require disclosure may be constrained by existing and proposed trade rules. This includes a review of the only WTO dispute that has judged contemporary taxation measures against the obligations and exceptions in the General Agreement on Trade in Services (GATS), in which Panama challenged restrictions imposed by Argentina on the grounds of non-cooperation in the disclosure of tax-related information.

The final Part identifies the main sources of leverage that MNEs and their parent states, especially the US, use to influence the decisions of other governments on taxing the digitalised economy, and the potential chilling effect that may have

on regulatory decisions. This discussion includes unilateral investigations by the US under Section 301 of the Trade Act 1974, as well as trade rules on ‘transparency’ that aim to ensure they are consulted when countries are developing digital tax measures that might affect them. The report offers some concluding reflections on these developments and cautions against the precipitate adoption of trade rules that will fetter developing countries’ options for digital development, tax justice and achieving the SDGs.

1

TAX JUSTICE AND SUSTAINABLE DEVELOPMENT

TAX justice is central to the affairs of the individual state and to the relationship between states in the global political economy.¹ Tax justice advocacy recognises that the social contract between citizens and governments, traditionally reinforced by the payment of taxes in return for the fulfilment of economic, social and human rights obligations by government, requires a fair and progressive tax system that can deliver quality, gender-responsive public services for all. Public policies and the mobilisation, and effective use, of domestic resources are central to the pursuit of sustainable development for *all* countries.² However, strengthening the capacity of *developing* countries to protect and broaden their tax base is a priority for financing sustainable development and achieving the SDGs.

1.1 Domestic Revenue Mobilisation

The targets set by the SDGs underscore the urgency of developing an international system for the fair allocation of taxing rights. The ability of developing countries to protect their tax bases and collect sufficient tax revenue is compromised by several factors. A fundamental obstacle to revenue mobilisation is rooted in inequitable power structures that are linked to ‘widespread perceptions of unfairness, corruption and a lack of transparency that compromise compliance and enforcement mechanisms’.³ Large and powerful economic players have been able to secure special tax treatment and exploit their connections into powerful political networks to protect their investments. Exempting the economic elites, including large MNEs, from the payment of taxes fosters distrust in government and makes it

¹ Jeremy Leaman and Attiya Waris (2013), ‘Why Tax Justice matters in Global Economic Development’, in Jeremy Leaman and Attiya Waris (eds), *Tax Justice and the Political Economy of Global Capitalism. 1945 to the Present*, Berghahn Books, 1

² UN (2015), *Addis Ababa Action Agenda of the Third International Conference on Financing for Development*, UN, July 2015, 10. Available at: https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf

³ Sanjeev Gupta and Mark Plant (2019), ‘Enhancing Domestic Resource Mobilization: What are the real obstacles?’, 30 April 2019, Center for Global Development. Available at: <https://www.cgdev.org/blog/enhancing-domestic-resource-mobilization-what-are-real-obstacles>

even more difficult to encourage tax compliance amongst the informal sector and micro, small and medium enterprises.⁴

Another factor is the impact of globalisation and competition on developing countries whose tax and financial systems are weak. Highly mobile MNEs have frequently abused that weakness, using sophisticated strategies of tax and regulatory arbitrage to foster competition between countries that are seeking to attract foreign direct investment and fuelling a race to the bottom in tax rates and regulations on investments. Tax policy-makers and administrators already struggle to understand these shifting business models and the global value chains that restrict their ability to collect tax revenue. Now they find the digitalisation of the economy has facilitated even more sophisticated tax and regulatory arbitrage strategies. Complex structures also exploit mismatches in national tax laws and international tax treaties to facilitate tax avoidance. Investment treaties may provide additional protection for foreign investors if governments seek to increase their tax contributions and make them responsible for social and environmental harms.

A further pressing challenge is the allocation, as between developing and developed countries, of taxing rights over the incomes of multinational companies that are utilising digital technology, especially as large companies from developed countries hold monopolistic positions in their markets. Because digital technology enables the provision of intangible products and services across national borders, these corporations can extract value and profits from markets and economies in which they may have little or no physical presence or permanent establishment. That shields the income of these corporations from corporate income tax in the source country, even as they earn millions of dollars from customers in that country. Moreover, the digitalised nature of the business and the increasing importance of intangible property assists MNEs to provide services through subsidiaries in low-tax jurisdictions and to skirt around rules in their parent company's country of residence that aim to make income generated outside the country subject to its domestic tax laws.⁵ The 'de-materialisation' of economic transactions on which taxes and tariffs have traditionally been levied is seriously impairing public finances everywhere. A large proportion of these economic activities takes place in developed countries other than where the digital company is headquartered, hence the effort by countries like France to develop a targeted tax to claw back some tax revenue from these large digital companies.

Countries in the Global South are an order of magnitude more vulnerable. Because these new technologies are rarely sourced in developing countries, they are less capable of observing and regulating them, and have much more limited experience in public policy-making and digital governance.

⁴ Gupta and Plant 2019

⁵ These are known as 'anti-deferral' rules. The US addressed this problem of Global Intangible Low-Taxed Income (GILTI) in the Tax Cuts and Jobs Act 2017. A similar measure is one limb of the global anti-base-erosion tax currently under consideration by the Inclusive Framework in the OECD (see Part 4: 4.2).

African countries have identified particular tax challenges arising from cross-border services where the supplier has no or only minimal presence in the country.⁶ The African Tax Administration Forum voiced concerns in 2019 that existing OECD rules on establishing a nexus and profit allocation are weighted too heavily in favour of the residence jurisdiction to the detriment of themselves, as source jurisdictions.⁷ The African Union has highlighted the erosion of the tax base through illicit financial flows as MNEs shift profits to artificially low-tax jurisdictions and the increased potential for money laundering through non-financial digital tools for money transfers, such as online and mobile banking, electronic payments, cryptocurrencies and online gambling services.⁸ Many countries lack sufficient regulatory, economic and administrative tools to address these practices.

1.2 Digital industrialisation

Domestic Revenue Mobilisation is a crucial objective. But it is not an end in itself. Governments need revenue to perform their roles and responsibilities as part of the social contract, which includes ensuring sustainable livelihoods. Equally, strong economies fuel the development of business, jobs and consumption that generate further revenue in a dynamic process. Socially responsible investment recognises the need to balance profitability for foreign investments with benefits to the host country, including the sharing of technology and paying an equitable proportion of its profits as tax.

The digitalised economy has the potential to provide new opportunities for the Global South to achieve these outcomes, but they will not materialise without clear and effective digital industrialisation strategies. The McKinsey Global Institute observed in 2017 that China's development and adoption of digital technology using conventional measures was 'only in the middle of the global pack', rated at 59 of 139 on the World Economic Forum's Networked Readiness Index. Yet, this ranking disguised China's role as a leading force in several areas, such as the rapid rise in electronic commerce transactions and mobile payments.⁹ These results would not have been possible without the state prioritising these sectors as part of its industrial policy over several decades.

⁶ Africa Tax Administration Forum (ATAF) (2019), 'ATAF Technical Note - The tax challenges arising in Africa from the digitalization of the economy', ATAF/ CB/TN/01/19, para 1.1. Available at: <https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/Tech%20Note%2017012019.pdf>

⁷ ATAF 2019, para 1.4

⁸ African Union (2019), 'Domestic Resource Mobilization: Fighting against Corruption and Illicit Financial Flows', African Union, 103. Available at: https://au.int/sites/default/files/documents/37326-doc-k-15353_au_illicit_financial_flows_devv10_electronic.pdf

⁹ McKinsey Global Institute, 'China's Digital economy. A leading global force', Discussion paper, August 2017, 1. Available at: <https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/China/Chinas%20digital%20economy%20A%20leading%20global%20force/MGI-Chinas-digital-economy-A-leading-global-force.ashx>. See also Longmei Zhang and Sally Chen (2019), 'China's Digital Economy: Opportunities and Risks', IMF Working Paper WP/19/16, January 2019

While China's scale and resources are atypical for the Global South, its achievements show that developing countries have a lot of ground to catch up on and suggest that substantial catch-up is feasible only if they can apply tools of industrial policy, among which tariffs are a standard element.

There are many barriers. In 2018 UNCTAD's *Trade and Development Report* warned that 'the rapid pace of digitalization is leaving many policymakers unprepared'. Consequences may include 'falling further behind the technological frontier, stalled economic catch-up or even marginalization from the global economy. The tendency for market concentration and the emergence of a vicious Medici circle of reinforcing economic and political power in the digital world compounds that threat'.¹⁰

The development of digitalisation strategies requires support, investment, vision and policy space. An academic survey in 2019 evaluated the digitalisation strategies of 17 African countries. It identified three particular challenges that Africa faces in the digital space and strategic responses to them:¹¹

- First, some countries responded to the lack of resources to develop adequate infrastructure by focusing on inclusive access to the Internet and the expansion of broadband capabilities.
- Second, because most African nations are too small as markets to nurture globally competitive players efforts were being directed to development of innovative entrepreneurship in the form of start-ups.
- Third, the strong unmet need for human resources with world class digital skills had encouraged strategies to promote development of the information and communication technology (ICT) sector.

African countries also identified the need for a broader approach to digital technology and its penetration into the traditional sectors of industry and agriculture. For instance, South Africa's strategy makes reference to the digitalisation of industry, mining, agriculture, utilities and ocean-related industries.¹²

One critical gap in countries' digitalisation strategies identified by the survey was the lack of infrastructure for modern data processing. Big data analytics is fundamentally important to contemporary digital developments, such as search engines, platforms and artificial intelligence. Africa faces some serious disadvantages: the hot climate is not suited to hosting data centres, power generation is not reliable,

¹⁰ UNCTAD (2018), *Trade and Development Report 2018. Power, Platforms and the Free Trade Delusion*, UNCTAD/TDR/2018, Geneva, 94

¹¹ Vladimir K Korovkin (2019), 'National digital economy strategies: A survey of Africa', Observer Research Foundation, *ORF Issue No. 303*, July 2019, 1, 7-9

¹² Korovkin 2019, 8

and countries need to make significant investment. As of 2018 Africa hosted only two of the world's top-500 supercomputers and they were in South Africa. That creates a systemic dependency on offshore processing capabilities and cloud computing services.

There have been some significant innovations by businesses and governments, despite these challenges, such as mobile money services, discussed below. However, Africa will only be able to seize the opportunities provided by digital technologies if it can overcome these barriers, build the capacity of its people, and find ways to access digital markets despite the power of the incumbents to marginalise, exploit or exclude.

The survey identified the need for African countries nationally and regionally to analyse the barriers and challenges they face more systematically and address problems of human capital, market fit and digital ecosystems.¹³ That work needs to be done before they can engage on an equal basis in negotiations about the rules for the digital economy in the WTO or FTAs, especially when those rules have the potential to impede digital development strategies and countries' ability to generate domestic revenue to fund them.

1.3 The Sustainable Development Goals

All Members of the WTO are Member States of the United Nations (UN). In 2015, the UN adopted the 17 Sustainable Development Goals as part of a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030.¹⁴ The goals recognise that action in one area affects outcomes in others and that development must balance social, economic and environmental sustainability. As UNCTAD's *Digital Economy Report* in 2019 observes: 'Digital developments will have implications for virtually all the SDGs and will affect all countries, sectors and stakeholders.'¹⁵

The SDGs therefore provide an important measure against which to evaluate the impacts of proposed trade rules for the digital economy on the Global South. That applies in particular when assessing impacts on Domestic Revenue Mobilisation. If developing countries are to prioritise sustainable development policy objectives they need a flexible regulatory environment for both tax and trade – one that can ensure adequate safeguards for citizens' economic and social rights, the domestic market and the tax revenue base.

¹³ Korokvin 2019, 9

¹⁴ For more see UNDP, 'Sustainable Development Goals'. Available at: <https://www.undp.org/content/undp/en/home/sustainable-development-goals.html>

¹⁵ UNCTAD (2019), *Digital Economy Report 2019. Value Creation and Capture: Implications for Developing Countries. Overview*, UNCTAD/DER/2019, Geneva, 3. Available at: <https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=2466>

SDG 17: Resource mobilisation recognises that the SDGs can only be realised with strong global partnerships and cooperation, and sets the ***Strengthening of Domestic Resource Mobilisation*** as a key target for financing the goals.¹⁶ In particular, **Target 17.1** identifies the need for international support to developing countries to ***improve domestic capacity for tax and other revenue collection***.¹⁷ This commitment to sustainable financing recognises the importance of Domestic Resource Mobilisation for financing development as a source of income that is more stable and sustainable, and that will in turn strengthen the legitimate relationship between citizens and the state and foster good governance.¹⁸

Participating donor countries made commitments in 2015 in the Addis Ababa Tax Initiative to support developing countries to set realistic plans at the national level to achieve SDG 17.1 targets. SDG **Indicator 90** highlights the importance of transparency of beneficial ownership to achieving that outcome.¹⁹

Despite these promises, there is a noticeable trend in the Global South towards unilateral initiatives to tax the digital economy. That is mainly in response to the inequity of the arm's-length tax principle that facilitates transfer pricing and tax avoidance by digital MNEs, and the inability of developing countries to collect sufficient information to determine the tax liability of the companies generating income, especially the online platforms. Several countries have taken measures suited to their capabilities, particularly the capacity of their revenue authorities to make assessments. Some appear to be highly successful [see Part 5: 5.1.2, 5.2]. However, the African Tax Administration Forum has observed that many of these unilateral measures 'can be hard to apply without international cooperation, because in some cases they are levied on actors with no established presence in a country, making it difficult to compel companies to pay without intergovernmental intervention'.²⁰

These innovative taxes may also have downsides. Some could even be counter-productive when viewed in the broader context of the SDGs, in particular improving social well-being, addressing the digital divide and inequality, and facilitating small businesses, especially for women and remote communities.

For example, one of the most significant and widely accessed products of the digitalised economy has been mobile money, which has enabled those who were financially excluded from formal financial institutions to access savings, borrowing facilities and transfer services on their phone. Some governments have developed taxes on a share of the income being generated in the mobile money sector. In

¹⁶ See SDG Goal 17: <https://sustainabledevelopment.un.org/sdg17>

¹⁷ SDG Target 17.1: Strengthen domestic resource mobilisation, including through international support to developing countries to improve domestic capacity for tax and other revenue collection

¹⁸ Addis Tax Initiative (2015), 'Financing for Development Conference: The Addis Tax Initiative – Declaration', ATI, 1. Available at: <https://www.addistaxinitiative.net/sites/default/files/resourses/ATI-Declaration-EN.pdf>

¹⁹ Indicator 90. *Proportion of legal persons and arrangements for which beneficial ownership information is publicly available*

²⁰ Mark Hearson (2019), 'Africa responds to the Inclusive Framework's digital tax agenda', International Centre for Tax and Development. Available at: <https://www.ictd.ac/blog-author/martin-hearson/>

Zimbabwe, the Minister of Finance introduced a mobile money tax (money transfer tax) in 2018 that was applicable to all online cash payments at 2% of the value of each payment.²¹ Similar indirect taxes have been introduced in Kenya, Tanzania, Uganda and other countries. However, a study of the impact of Uganda's tax, which came on top of already high Internet costs, showed a drop of around 30% in Internet users during the six months after its introduction, with flow-on effects to economic growth and taxes foregone.²²

Digital taxes can also serve ulterior political purposes. In 2018, Uganda proposed to introduce a social media or Over the Top tax (referred to by the President as the 'gossip tax') requiring individuals in Uganda to pay a tax of US\$200 (US 5 cents) per day – equivalent of a kilogramme of maize – to access over 60 online platforms, including Facebook, whatsapp and twitter.²³ The strategy, since adopted by a number of other governments, has been criticised as an effort to prevent the public from mobilising on online platforms and to curb free speech.²⁴

These initiatives, good and bad, affirm the importance of ensuring a commitment to the SDGs remains the driver for taxation measures, nationally, regionally and internationally, in fulfilment of the social contract between the state and its citizens.

Target 17.10: Global trade rules calls for the promotion of a *universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the WTO, including through the conclusion of negotiations under its Doha Development Agenda*. The stated aim of the Doha Development Agenda, launched in 2001, is to reform the multilateral trading system to redress, in particular, the barriers and opportunities for developing countries in international trade.²⁵ This development priority reinforces the long-standing commitment to special and differential treatment of developing countries in the WTO and acknowledges the need to do more to address development asymmetries. That recognition is of particular importance to enhancing sustainable financing, since rules set in the trade and investment space can contribute to, or undermine, the enabling conditions for sustainable development. Despite target 17.10, the promises of the Doha Development Agenda remain unfulfilled and major developed countries now are refusing to engage further in the negotiations.²⁶

²¹ Chris Donkin (2018), 'Zimbabwe unveils new mobile money tax', *MobileWorldLive*, 2 October 2018, Available at: <https://www.mobileworldlive.com/money/news-money/zimbabwe-unveils-new-mobile-money-tax/>

²² Alice Munyua (2019), 'Disconnecting the Connected: How Regulatory and Tax Treatment of Over-the-Top Services in Africa Creates Barriers for Internet Access', 25 November 2019, Mozilla Open Policy and Advocacy Blog. Available at: <https://blog.mozilla.org/netpolicy/2019/11/25/disconnecting-the-connected-how-regulatory-and-tax-treatment-of-over-the-top-services-in-africa-creates-barriers-for-internet-access/>

²³ Munyua 2019

²⁴ Munyua 2019. See also: <https://www.theguardian.com/global-development/2019/feb/27/millions-of-ugandans-quit-internet-after-introduction-of-social-media-tax-free-speech>

²⁵ WTO, 'The Doha Round – Briefing Notes', WTO. Available at: https://www.wto.org/english/tratop_e/dda_e/status_e/brief00_e.htm

²⁶ Mainly developed country Members of the WTO refused to reaffirm the Doha mandates at the 10th Ministerial Conference in 2015. WTO, 'Nairobi Ministerial Declaration, Adopted 19 December 2015', WT/MIN(15)/DEC, para 15

Specifically addressing the digital economy, the Doha Round's mandate reaffirmed the WTO's 1998 Work Programme on Electronic Commerce as the appropriate mechanism for ongoing exploration of trade-related digital issues.²⁷ That was reiterated at the Ministerial Conference of the WTO in Buenos Aires in December 2017.²⁸ Yet, the same developed countries that want to declare the Doha Development Round dead are ignoring the Work Programme on electronic commerce and negotiating new far-reaching rules for the digital economy in the WTO without a mandate.²⁹

SDG9: Infrastructure and industrialisation commits states to *build a resilient infrastructure, promote inclusive and sustainable industrialisation, and foster innovation*. The rapid spread of the digitalised economy has stimulated the development of policies to regulate and/or to further enable it. As developing countries respond to these opportunities, they are confronted by a systemic digital divide.³⁰ According to UNCTAD, at the end of 2018 more than half the world's population (3.9 billion people) had access to the Internet. But there was a gaping difference between the under-connected and the hyper-digitalised countries: over 80% of people in developed countries were online in 2018, compared with 45% in developing countries and only 20% in least developed countries.³¹ Africa and Latin America together accounted for less than 5% of the world's co-location data centres.³²

The same issues arise with control of software and data. Data, and the software and algorithms that are generated through that data, have become essential for development purposes and for solving societal problems, particularly those related to the SDGs. They are becoming prerequisites for efficient and competitive production in industrialised agriculture, manufacturing and services. Data-driven automation, artificial intelligence and additive (3D) manufacturing allow the production of higher-value goods more cheaply. Even in ordinary goods, intangible property such as trademarks and brand marketing return the overwhelming proportion of profits; that is heightened for smart products that are operated through software and which in turn generate more data. Data also informs the value chains that open up new opportunities for value addition or business. Digital development without the country's ability to control and harness data that is generated in its territory is a contradiction in terms.

These clear gaps in access to and development of the digital space in developing economies signal a need for a contextualised, balanced and tailored approach to

²⁷ WTO Doha Ministerial Declaration, Adopted 14 November 2001, WT/MIN(01)/DEC/1, para 34

²⁸ WTO (2017), 'Work Programme on Electronic Commerce, Ministerial Decision of 12 December 2017', WT/MIN(17)/65

²⁹ WTO (2017), 'Joint Statement on Electronic Commerce, 13 December 2017', WT/MIN(17)/60

³⁰ UNCTAD *Digital Economy Report 2019*, 1

³¹ UNCTAD *Digital Economy Report 2019*, 3. See also 'Sustainable Development Goal 17 – Progress and Info', 2019. Available at: <https://sustainabledevelopment.un.org/sdg17>

³² UNCTAD *Digital Economy Report 2019*, 3

policy-making that simultaneously emphasises the growth of local markets, the protection of consumers and workers, and the broadening of the domestic tax base.

SDG5: Gender equality aims to *achieve gender equality and empower all women and girls*, recognising that their empowerment is crucial to sustainable economic growth and development. The uneven playing field between women and men comes at a significant economic cost as it weighs, in particular, on economic growth. That requires an end to all gender discrimination in every sphere. **Target 5.4** recognises and values unpaid care and domestic work through the provision of public services, infrastructure and social protection policies. That target cannot be achieved unless governments have the domestic resources to do so.

Target 5.A aims to undertake reforms to ensure women have equal rights to economic resources, as well as access to ownership and control over land and other forms of property, which are essential for small businesses and rural livelihoods. There are parallel challenges in the paid workforce. Although there are more women than ever in the labour market, there are still large inequalities in some regions, with women systematically denied the same work rights as men.³³ The gaps in labour force participation between men and women remain large; for instance, no advanced or middle-income economy has reduced the gender gap to below 7%.³⁴ The digital economy risks widening that gender gap: an International Monetary Fund (IMF) commentary calculates that women, on average, face an 11% risk of losing their jobs due to automation, compared to 9% of men.³⁵

Target 5.B promises to enhance the use of enabling technology, in particular ICT, to promote the empowerment of women. The design of digital policy has the potential to impact on the distribution of opportunities and income between women and men. The changing way people work, as digitalisation, artificial intelligence and machine learning are eliminating jobs involving low- and middle-skill routine tasks through automation, will be particularly challenging for women.³⁶ These challenges will require governments to prioritise the protection of labour, especially women, during the post-COVID-19 recovery and in the longer term. A key initiative to foster gender equality and empowerment in this area is to bridge the digital gender divide through public investment in capital infrastructure and ensuring equal access to finance and connectivity.³⁷ Again, governments need the fiscal resources and policy space to do so.

³³ SDG Goal 5: Gender Equality. Available at: <https://www.undp.org/content/undp/en/home/sustainable-development-goals/goal-5-gender-equality.html>

³⁴ Christine Lagarde and Jonathan Ostry (2018), 'Economic gains from gender inclusion: Even greater than you thought', 28 November 2018, IMF Blog. Available at: <https://blogs.imf.org/2018/11/28/economic-gains-from-gender-inclusion-even-greater-than-you-thought/>

³⁵ Era Dabla-Norris and Kalpana Kochhar (2018), 'Women, technology and the future of work', IMF Blog, 16 November 2018. Available at: <https://blogs.imf.org/2018/11/16/women-technology-and-the-future-of-work/>

³⁶ Mariya Brussevich, Era Dabla-Norris et al (2019), 'Gender, Technology and the Future of Work', IMF Staff Discussion Note, October 2019. Available at: <https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2018/10/09/Gender-Technology-and-the-Future-of-Work-46236>

³⁷ Dabla-Norris and Kochhar 2018

SDG 10: Income inequality commits to reduce inequality within and between countries.³⁸ Despite the Millennium Development Goals,³⁹ income inequality is still rising.⁴⁰ Narrowing these disparities requires sound policies that empower lower-income earners and promote economic inclusion of all. Yet the significant wealth generated by digital advances is being captured by a small number of individuals, companies and countries.⁴¹

UNCTAD warns that any value realised through the digital economy is unlikely to be equitably distributed: workers with limited digital skills will be at a disadvantage, local firms may face stiff competition from large companies and MNEs, and a number of jobs will be lost to automation. The net impact will depend on the level of development and digital readiness of countries and their stakeholders. It will also depend on the policies adopted and implemented at national, regional and international levels.⁴²

Closing the digital divide has to focus on protecting the needs of the lowest-income earners and lifting them out of poverty.⁴³ Policies that enhance the ability of large companies and MNEs to continue to profit from the status quo will drive greater inequality. To address income inequality at its root it is not enough to reform financial regulation or the tax rules themselves. It is also essential to transform corporate behaviour through commitments and obligations to protect and respect the economic and social rights of the citizens in the countries where they have economic activity.

It is indisputable that tackling all forms of inequality, including gender inequality, cannot be done without effective sustainable financing through Domestic Resource Mobilisation. However, the inequality debate does not always recognise the crucial importance of realigning private international capital flows with public policies to enable inclusive and sustainable private sector investment.⁴⁴ This imperative aligns with UNCTAD's updated Investment Policy Framework for Sustainable Development in 2015, which recognised that investment policies need to place inclusive growth and sustainable development at the heart of efforts to attract and benefit from investment.⁴⁵

In parallel, UNCTAD has argued that international investment treaties that grant foreign investors enforceable rights with no corresponding responsibilities,

³⁸ See SDG Goal 10. Available at: <https://www.undp.org/content/undp/en/home/sustainable-development-goals/goal-10-reduced-inequalities.html>

³⁹ Available at: <https://www.un.org/millenniumgoals/>

⁴⁰ *World Inequality Report 2019*, World Inequality Lab, Paris. Available at: <https://wir2018.wid.world/>

⁴¹ UNCTAD *Digital Economy Report 2019*, v

⁴² UNCTAD *Digital Economy Report 2019*, 4

⁴³ UNCTAD *Digital Economy Report 2019*, v

⁴⁴ 'Addis Ababa Action Agenda of the Third International Conference on Financing for Development', United Nations, 2015, paras 35-36. Available at: https://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

⁴⁵ UNCTAD (2015), *Investment Policy Framework for Sustainable Development*, UNCTAD, Geneva. Available at: https://unctad.org/en/PublicationsLibrary/diaepcb2015d5_en.pdf

and can result in crippling arbitral awards, need termination or root and branch reform.⁴⁶

In order to reduce inequality, UN Member States have also committed to improving the regulation and monitoring of financial markets and institutions and encouraging development assistance and foreign direct investment to regions where the need is greatest.⁴⁷ That realignment will again require a change of behaviour by MNEs and strengthening of the digital domestic economy.

SDG 17.15: Protecting policy space for development commits Member States to *respect each country's policy space and leadership to establish and implement policies for poverty eradication and sustainable development*. Taxation is one of only three inherent powers of the state. It is essential that countries have the right, as well as the capacity, to exercise their sovereign right to pass tax laws based on their respective economic needs, their pursuit of tax justice, and their ability to achieve their other public responsibilities and policy objectives.

The SDGs signal the need for a shift in approach, not just for **tax** policy-makers, but also for **trade** policies that often, implicitly and explicitly, impact on the ability to mobilise domestic resources. A preoccupation with free trade ideology can lead to dangerous policies that begin to treat the development agenda and the strengthening of tax policies as barriers to trade. The goals commit states to prioritise the fair allocation of taxing rights that will enable countries, particularly developing countries, to finance sustainable development. Developing new global standards for revenue mobilisation in the digital era can only be done through inclusive consultation that is informed by national contexts, so as to ensure that the new regime helps to achieve the SDGs and facilitates countries' support for domestic businesses, whilst encouraging greater tax and financial transparency that is key to tackling harmful tax practices.

The African Group have put on record in the WTO that the existing multilateral trade rules already constrain their domestic policy space and the ability to industrialise.⁴⁸ The Doha Round was meant to reduce those constraints, but that promise appears to have been abandoned. Instead, developing countries are being asked to adopt even more restrictive rules in the guise of 'e-commerce for development'. Given the rapid and unpredictable evolution of the digital sector, the dominance of an oligarchy of mainly US corporations, and a systemic digital divide, it is unconscionable to call for developing countries to accept further constraints on their ability to regulate for their development. Those calls cannot be reconciled with the proponents' commitments as Member States of the UN to the SDGs.

⁴⁶ UNCTAD (2019), 'Reforming Investment Dispute Settlement. A Stocktaking', *IIA Issues Note*: March 2019, Issue 1

⁴⁷ UNCTAD (2015), *Investment Policy Framework 2015*

⁴⁸ WTO (2017), 'The Work Programme on Electronic Commerce: Statement by the African Group', 6 December 2017, WTO, WT/MIN(17)/21 (African Group Statement). Available at: <https://www.tjm.org.uk/documents/briefings/mc11-work-programme-on-electronic-commerce-statement-by-the-african-group-6-december-2017.pdf>

2

TRADE RULES IN THE DIGITAL ECONOMY

THE foundations of the current international trade regime were laid in 1995 when the World Trade Organization (WTO) came into being. That was just four years after the Worldwide Web was first opened to the public. Few WTO Members could have predicted how the Internet and digital technologies might evolve over the next three decades or the challenges that would pose for their national regulators. Novel agreements such as the General Agreement on Trade in Services (GATS) were still being absorbed. Developing countries sought to limit their exposure to what they saw as rules designed to benefit transnational corporations through foreign investment; remote supply of services from across the border was a secondary matter, as it mainly involved postal delivery or rudimentary communications technologies.

That was also the context in which WTO Members first adopted the temporary moratorium on customs duties on electronic transmissions in 1998, alongside the Work Programme on Electronic Commerce. The moratorium applied to the practice of levying customs duties as at that time. That decision has been rolled over effectively every two years, while the technologies and transactions that are subject to it have grown in unimagined ways. Now there is pressure to make the moratorium permanent and apply it to today's digital technologies and transactions, the implications of which are the subject of Part 3.

Aside from the moratorium, the current focus of attention in the trade policy arena is on new rules being developed in FTAs and proposed in the WTO in the name of 'electronic commerce' or 'digital trade'. These rules aim to constrain the governance and regulation of the digitalised economy. The application of existing rules on trade in services, including financial services, as well as agreements on foreign investment and intellectual property rights, also pose new challenges for tax regimes in the digital era. Those rules can overlap, replicate or even conflict with the e-commerce provisions and may neutralise some of their apparent exceptions.

These developments have produced a complex web of regional and bilateral trade agreements with variable obligations and complicated and divergent exceptions. Relatively little attention has been paid to their consequences for countries' tax regimes. Potential challenges to innovation, such as the adoption of

a digital services tax to address the tax avoidance strategies of peripatetic digital MNEs, make it imperative to examine these issues.

2.1 The advent of digital economy trade rules

The new trade rule-book has been several decades in the making. In the late 1990s the US began moves to externalise its domestic law that protects digital technologies and transactions from regulation and consolidate the global dominance of its technology corporations. The US Trade Representative (USTR) formalised this position in what it called the 'Digital 2 Dozen' objectives.¹ These were first codified in the chapter on Electronic Commerce in the Trans-Pacific Partnership Agreement (TPPA) that 12 countries signed on 4 February 2016. The Agreement also contained digitally-infused upgrades on trade in services, financial services and telecommunications, customs duties, and technical barriers to trade.² Although the US withdrew from the TPPA, the remaining 11 countries left those rules intact in the renamed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).³

The TPPA provided the template for subsequent bilateral and mega-regional agreements involving the US. Other TPPA parties, notably Japan, Australia and Singapore, incorporated them into their own FTAs. The US-Mexico-Canada Agreement (USMCA) signed in November 2018 guaranteed even stronger protections for the digital industry.⁴ The EU's negotiating mandates adopted a variation on the same rules. Although the EU insists on stronger privacy protections for personal information,⁵ it also pressures countries to adopt stronger open-ended trade in services commitments on computer and related services.⁶

A number of developing countries have resisted demands to adopt similar rules in other recent negotiations, which suggests a growing understanding of their implications. Notably, the Electronic Commerce chapter in the 16-country Regional

¹ USTR, 'The Digital 2 Dozen'. Available at: <https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2016/digital-2-dozen>

² Trans-Pacific Partnership Agreement, signed on 4 February 2016. Available at: <https://www.mfat.govt.nz/en/about-us/who-we-are/treaties/trans-pacific-partnership-agreement-tpp/text-of-the-trans-pacific-partnership>

³ The Comprehensive and Progressive Agreement for Trans-Pacific Partnership, entered into force on 30 December 2018. Available at: <https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/cptpp/comprehensive-and-progressive-agreement-for-trans-pacific-partnership-text-and-resources/>

⁴ The United States-Mexico-Canada Agreement, signed on 30 November 2018. Available at: <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement>

⁵ For example, the EU's proposed text on Digital Trade in negotiations for an EU-Australia Free Trade Agreement, dated 10 October 2018. Available at: https://trade.ec.europa.eu/doclib/docs/2018/december/tradoc_157570.pdf

⁶ Jane Kelsey (2019), 'Understanding the EU's Understanding on Computer and Related Services', Third World Network, Penang. Available at: https://www.twn.my/title2/FTAs/Services/Full%20report%20for%20TD%20series_FORMAT_Ver6-FIN-09012020.pdf

Comprehensive Economic Partnership (RCEP) omits certain core rules, strengthens the security exception, and is not enforceable.⁷ That outcome is particularly significant because the negotiating parties include China, India and the ten ASEAN countries.

Today, developing countries are under intense pressure to participate in a Joint Statement Initiative on Electronic Commerce in the WTO,⁸ even though those negotiations lack a formal mandate. First-mover developed countries began pushing for formal negotiations in mid-2016. Their attempt to secure a mandate at the 11th Ministerial Conference in November 2017 was rebuffed by a number of developing countries. A group of Members then announced they would begin exploratory work on electronic commerce, with a view to launching negotiations.⁹ In 2019 that exploratory work morphed into negotiations at the WTO, still without a mandate but with support from the Director-General.¹⁰

In an attempt to enhance the legitimacy of the breakaway process, these negotiations have been depicted as a pro-development initiative. However, as of March 2020, just over half the WTO Members have attended meetings. Those 84 countries included all 37 OECD Members and just four least developed countries.¹¹ South Africa and India, among many other developing countries, continue to reject the process as illegitimate.¹² China has participated actively, to the US's displeasure, and has advocated measures broadly consistent with the RCEP.¹³ Many proposals in the Joint Statement Initiative mirror the main elements from recent FTAs.¹⁴

⁷ The leaked final but unscrubbed text of this chapter is analysed at: Jane Kelsey (2020), 'Important differences between the RCEP electronic commerce chapter and the TPPA and lessons for e-commerce in the WTO'. Available at: <https://www.bilaterals.org/?important-differences-between-the>

⁸ WTO Ministerial Conference, 'Joint Statement on Electronic Commerce', WT/MIN(17)/60, 13 December 2017

⁹ WTO WT/MIN(17)/60

¹⁰ WTO 'Joint Statement on Electronic Commerce', WT/L/1056, 25 January 2019

¹¹ As at June 2020 the 84 participants in the Joint Statement on Electronic Commerce initiative were: Albania; Argentina; Australia; Austria; Bahrain, Kingdom of; Belgium; Benin; Brazil; Brunei Darussalam; Bulgaria; Burkina Faso; Cameroon; Canada; Chile; China; Colombia; Costa Rica; Côte D'Ivoire; Croatia; Cyprus; Czech Republic; Denmark; El Salvador; Estonia; Finland; France; Georgia; Germany; Greece; Honduras; Hong Kong, China; Hungary; Iceland; Indonesia; Ireland; Israel; Italy; Japan; Kazakhstan; Kenya; Korea, Republic of; Kuwait, the State of; Latvia; Lao People's Democratic Republic; Liechtenstein; Lithuania; Luxembourg; Malaysia; Malta; Mexico; Moldova, Republic of; Mongolia; Montenegro; Myanmar; Netherlands; New Zealand; Nicaragua; Nigeria; North Macedonia; Norway; Panama; Paraguay; Peru; Philippines; Poland; Portugal; Qatar; Romania; Russian Federation; Saudi Arabia, Kingdom of; Singapore; Slovak Republic; Slovenia; Spain; Sweden; Switzerland; Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu; Thailand; Turkey; Ukraine; United Arab Emirates; United Kingdom; United States; and Uruguay.

¹² South Africa, India, Indonesia and Egypt declined to sign the 'Osaka Declaration on Digital Economy' initiated by Japan as the chair of the G20 in June 2019. See Graham Greenleaf (2019), 'G20 Makes Declaration of "Data Free Flow with Trust": Support and Dissent', *Privacy Laws and Business International Report*, 160, 18-19. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3514407

¹³ WTO, Joint Statement on Electronic Commerce. Communication from China, INF/ECOM/32, 9 May 2019

¹⁴ The facilitators' reports, and some of the negotiating documents, are being posted on the WTO website under the symbol INF/ECOM/. A number are only accessible to WTO Members.

There is no clarity at this stage on the prospects for agreement on any text or if so, by when, especially with the disruptions arising from COVID-19. That hiatus provides an opportunity to assess the implications of the TPPA template and other FTAs, and proposals tabled at the WTO, for national and international tax law and policy in developing countries. Other plurilateral negotiations in the WTO, especially disciplines on the Domestic Regulation of Services and on Investment Facilitation, need to be treated as part of the broader legal and political package.

2.2 Principal trade rules relevant to taxing the digitalised economy

This report concentrates on the trade rules that are most relevant to taxing the digitalised economy. In such a large and complex area, it is not possible to discuss all the potentially relevant trade rules or all the forms of taxing the digitalised economy that are currently under discussion. This report provides a composite of the multiplicity of provisions in existing agreements and the proposals understood to have been made in the plurilaterals, including relevant exceptions and limitations. Table 1 cross-references these rules to where they are discussed in this report.

From the *'electronic commerce' or 'digital trade' chapters* these provisions are:

- a permanent ban on customs duties on electronic transmissions;
- a presumption of unrestricted cross-border transfer of information related to a business and prohibitions on requirements to hold data locally;
- the right to use servers and other computing facilities located in any country, and no requirements to use local computing facilities, including servers; and
- non-disclosure of source codes and algorithms.

The relevant rules in the *trade in services and financial services chapters*:

- prevent requirements for offshore service providers to have a local presence or
- take a particular legal form if they have a presence, and
- 'reasonable, objective and impartial' administration of laws of general application.

A prohibition may apply to **performance measures on foreign investments** that restrict the amount or duration of royalties payable under a private licensing contract between the foreign investor and another person in the territory.

There are also process-related obligations on **transparency and regulatory coherence**.

Uncertain and uneven protection from these rules are found in:

- rule-specific policy flexibilities,
- country-specific schedules of commitments or annexes of non-conforming measures,
- exceptions for taxation and prudential measures,
- the essential security exception and
- the general exception.

This analysis is not a legal opinion on the interpretation and application of those rules. That would be impracticable, unrealistic and unwise. Some of the rules are totally novel. There is a dearth of WTO case law to assist even the interpretation of existing trade in services rules and the relevant exceptions with regard to taxation measures. There has only been one such dispute, which Panama brought against Argentina (*Panama v Argentina*) over eight tax and fiscal measures. Unhelpfully, the WTO dispute panel and the Appellate Body reached conflicting interpretations of the key threshold test to be applied to the pivotal non-discrimination rules.¹⁵ The arguments in and outcomes of that dispute are reviewed in Part 6. The report also explores the trade law issues relating to the US's 'Section 301' investigation into France's digital services tax (in Parts 5 and 7), lessons from the application of value-added taxes, using examples from three developed countries in Part 5, and India's moves to cap the royalty payments that would be transferred to offshore entities (also in Part 5).

¹⁵ *Argentina – Measures relating to trade in goods and services*, Panel report, WT/DS453, R, 30 September 2015 (hereafter '*Panama v Argentina*, Panel Report'); *Argentina – Measures relating to trade in goods and services*, Appellate Body Report, WT/DS453/AB/R, 14 April 2016 (hereafter '*Panama v Argentina*, Appellate Body Report'). Available at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds453_e.htm. See also 'WTO Appellate Body Reverses Panel Findings in Argentina-Panama Financial Services Row', 20:14 *Bridges*, 21 April 2016. Available at <https://www.ictsd.org/bridges-news/bridges/news/wto-appellate-body-reverses-panel-findings-in-argentina-panama-financial>

2.3 Electronic commerce rules

Corporations and high-worth individuals seek to maintain absolute control of all their information and determine where in the world it is held under what rules. That is especially true of the dominant tech companies. One motive is to maximise the strategic and commercial value of data itself, the raw material of the digital economy. A second is to engage in tax and regulatory arbitrage, sometimes involving billions of dollars.

Hence, the number one objective for new trade rules has been to guarantee data mobility, with restrictions being described pejoratively as ‘forced data localisation’. That guarantee would apply across the entire spectrum of businesses: from operators of search engines, digital market-places and social media to digitalised services like retail, advertising, professions, tourism, the operation of automated mining and manufacturing, and the functioning of smart cities and smart products. There are two complementary rules:

2.3.1 Unrestricted cross-border movement of information

This rule has been evolving. In some EU agreements there is no right to transfer information offshore, just provision for future negotiations on the issue.¹⁶ The TPPA/CPTPP provision requires state parties *to allow* the transfer of information offshore, including personal information, for the conduct of a covered business, but would still permit a requirement for a business to retain a local copy of information.¹⁷ Some later agreements would not allow such requirements, either at all¹⁸ or only to protect the privacy of personal data.¹⁹

2.3.2 Unrestricted location of servers

The tech industry also wants to *process* or *store* information anywhere in the world. So a complementary rule prohibits a government from requiring a business to use or locate computing facilities, such as servers, in its territory for the processing or storage of information. This rule could neutralise the flexibility of a data transfer rule that allows a requirement for at least a copy to be held in the source country.

¹⁶ For example, the EU Japan Economic Partnership Agreement, entered into force 1 February 2019, provides for negotiations within three years of entry into force on whether to include provisions on ‘free flow of data’ (Article 8.81).

¹⁷ TPPA/CPTPP Article 14.11

¹⁸ The USMCA says governments shall not ‘prohibit or *restrict*’ cross-border transfer of information. Requiring a local copy might be considered a ‘restriction’ (Article 19.11). This distinction may prove immaterial: where a dual repository is considered too expensive or impractical, it might constitute a measure that ‘*affects* trade by electronic means’ that breaches the provision anyway (USMCA Article 19.2.2; see also TPPA/CPTPP Article 14.2.2).

¹⁹ The EU proposal to Indonesia prohibits requirements to process or hold data in the country or use local servers, subject to the right to adopt safeguards to ensure the protection of personal data and privacy. EU-Indonesia FTA negotiations, ‘Factsheet: EU proposal for provisions on cross-border data flows and protection of personal data and privacy’, July 2018, Article 2. Available at: https://trade.ec.europa.eu/doclib/docs/2018/july/tradoc_157130.pdf

Governments cannot even specify which countries are, or are not, acceptable repositories of data generated in their territory; it is worth noting that some tax havens are becoming data havens as well, making information difficult to access by tax authorities and other regulators.²⁰

These twin obligations have the potential to impact on the ability of tax, competition and financial regulators to access information and evaluate its integrity, as discussed in Part 6. The rules are subject to three common limitations.

- E-commerce chapters usually exclude information '*held or processed by or on behalf of a government*', including measures related to its collection.²¹ Information that is collected and held by government agencies, including tax authorities, is therefore excluded from the rules. It is doubtful whether this exclusion would extend to information that a government requires to be collected pursuant to regulation or a contract, but does not itself hold or process. It seems clear that the exception would not extend to requirements that taxable businesses retain within the country the kind of information that is needed for compliance with, say, a digital services tax, such as the number of local users or uses, or the value of the data those users have generated in relation to targeted advertising. This carve-out would also not cover other relevant information or data that the government may wish to access, such as property transactions, gambling, student loans, futures trading, royalty payments or related party loans, which are held by the private individual or firm or by third party intermediaries.
- The second limitation, for *financial information*, is especially sensitive. The US Treasury insisted that information that belongs to a financial institution or financial service supplier was excluded from the TPPA's e-commerce chapter, including from its data transfer and local server provisions.²² That is because of difficulties the US encountered with information that was held offshore when Lehman Brothers collapsed in 2007. A similar approach is adopted in the e-commerce chapters of a number of FTAs, but not all.²³

²⁰ World Bank research shows that countries like Monaco, British Virgin Islands, Gibraltar and the Isle of Man are now hosting the largest number of secure Internet servers. Cited in George Turner, 'The Offshore Wrapper – Data havens and new crackdowns on tax avoidance', 7 August 2017. Available at: <https://www.taxjustice.net/2017/08/07/offshore-wrapper-data-havens-new-crackdowns-tax-avoidance/>

²¹ TPPA/CPTPP Article 14.2.3(b)

²² A 'covered person' for the purposes of the financial services chapter of the TPPA/CPTPP does not include a financial institution or a cross-border financial service supplier, as defined in the financial services chapter (Article 14.1)

²³ For example, financial institutions are excluded from the e-commerce chapter in the Australia Indonesia FTA, but not in the EU Japan FTA

However, other rules could neutralise that carve-out in the e-commerce chapter. The GATS Annex on Trade in Financial Services, copied into most FTAs, defines financial services to include the provision and transfer of financial information and financial data processing services.²⁴ A number of developing countries have made trade in services commitments not to restrict the cross-border supply of such services.²⁵ Indeed, it could be argued that almost all financial services rely on the international movement of data. Restrictions on movements of information and requirements to use local servers would constitute measures that affect the supply of those services. There is a risk that countries which require data to be held locally could be accused of breaching the trade in services rules on national treatment, and possibly on market access (see below at para 2.4.3-4).

Another GATS-related text, the plurilateral Understanding on Commitments on Financial Services, stops governments from preventing the transfer or processing of financial information where that is necessary for the business of the financial services firm.²⁶ Very few developing countries have adopted that Understanding.²⁷ Versions of it have been incorporated in recent FTAs. For example, the TPPA/CPTPP Annex that sets out reservations and commitments on financial services requires a Party to allow a financial institution to *transfer* information into and out of the territory for data processing, if that is required in the course of its business; however, the government does not have to allow the data to be *stored* offshore.²⁸

It is unclear how financial services and institutions are being treated by WTO Members participating in the plurilateral negotiations on e-commerce. That is a crucial question for developing countries that have GATS commitments on financial services.

- Third, there is protection from these two rules for measures a government has adopted to achieve a '*legitimate public policy objective*'. Taxation, in its broad sense, would be likely to qualify. However, the legitimacy of a specific

²⁴ GATS Annex on Financial Services, para 5(a)(xv)

²⁵ Aaditya Mattoo (1998), 'Financial Services and the WTO. Liberalization Commitments of Developing and Transition Economies', World Bank, August 1998, Table 4

²⁶ GATS Understanding on Financial Services, para 8. Available at: https://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm

²⁷ As of 2010, the only developing country Members that had made commitments in accordance with the Understanding were Nigeria and Sri Lanka, and these commitments had important limitations. Any additional developing countries would have done so as part of their accessions. See Council for Trade in Services, Committee on Financial Services, 'Financial Services. Background Note by the Secretariat', S/C/W/312, 3 February 2010, footnote 29. Available at: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DPaspx?language=E&CatalogueIdList=97149,81750,29540&CurrentCatalogueIdIndex=1&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True

²⁸ TPPA/CPTPP Annex 11-B Section B

tax measure may not be accepted if it is not widely used internationally or its merits are disputed.²⁹ For example, the US has argued that the French digital services tax is inconsistent with international taxation norms because it taxes the ‘extraterritorial’ revenue from the onshore activities of an offshore digital firm (see Part 5).³⁰

Further, the actual measure must be considered effective to achieve the specific objective. That could be a problem for proactive and innovative approaches to address the taxation of digital corporations. Even if the measure satisfies those criteria, it must also not impose any greater restrictions than are necessary to achieve the objective.³¹ The US and its industries are always likely to argue that voluntary and self-regulatory arrangements are the least burdensome effective approach.

There is yet another element to this limitation: the measure might still be disallowed if it is applied in a way that constitutes ‘arbitrary or unjustified discrimination’. Argentina lost its WTO tax dispute to Panama because it applied its law on tax information-sharing differently in relation to Panama than to other countries with whom it had not concluded an information-sharing arrangement (see Part 6).³² Discrimination in these provisions is not limited to discrimination on the basis of national origin; it could involve differential treatment of services that are engaged in similar practices, for example applying measures to data mining by digital interfaces and search engines but not by those who collect data generated by smart products. Governments would also have to avoid measures that could be seen as disguised ways of providing benefits to their local operators, including of computing facilities.

If these limitations fail to provide protection, governments would have to resort to the general or security exceptions (see below, paras 2.8-2.9).

2.3.3 Source codes and algorithms

These are central to the conduct of digitised activities and businesses, including digital platforms and marketplaces, transnational and multimodal supply chains, high-frequency speculative trading, and the legal and accounting professions. They are also the means of targeting, collecting, analysing and utilising data, the value of which some governments are now seeking to tax.

²⁹ ‘Legitimate’ has been interpreted in the WTO dispute on *Canada – Patent Protection of Pharmaceutical Products* (DS114) to mean widely recognised state practice. Available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds114_e.htm

³⁰ USTR (2019), ‘Section 301 Investigation. Report on France’s Digital Services Tax’, 2 December 2019. Available at: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

³¹ TPPA/CPTPP Article 14.11.3(b)

³² *Panama v Argentina* Panel Report; confirmed in *Panama v Argentina* Appellate Body Report

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TPPA/CPTPP Article 14.11.3(b)

³¹ *Panama v Argentina* Panel Report; confirmed in *Panama v Argentina* Appellate Body Report

³²

The wording has changed over time. The TPPA/CPTPP allows the owners of the source code to keep them secret, including from governments. The USMCA extends that protection to the algorithms embedded in the source code.³³ Some agreements limit the protection to certain kinds of code;³⁴ others have a more blanket ban on compulsory disclosure.³⁵ Significantly, the final e-commerce chapter of RCEP, which includes China, India and ASEAN, has no source code provision at all.³⁶

In recognition that this rule could pose major difficulties for monitoring, compliance, investigations and enforcement, some jurisdictions, such as the US, preserve the ability of some government agencies to access software for enforcement purposes, including for taxation.³⁷ The USMCA goes furthest and allows regulatory bodies, including tax authorities, to require disclosure for a *specific* investigation, inspection, examination or enforcement. However, source codes and algorithms are complex and opaque, and may require external expertise to decode and analyse them. The USMCA exception is subject to safeguards against unauthorised disclosure, which could prevent the granting of access to non-government analysts.³⁸

2.4 Trade in services

The development of new trade rules for the digital economy aims to supplement, clarify and extend existing trade rules, some of which have a similar effect, overlap or may even be incompatible. It is uncertain even at the most basic level whether similar digital products should be classified as goods (software or movies that can be transmitted both in compact disks or through streaming), a service (such as entertainment that can be provided physically or remotely), intellectual property (the content of the movie or software), or all three. This affects which agreement's rules, and the accompanying schedules and exceptions, apply.

³³ USMCA Article 19.16.1 covers the source code of software and 'an algorithm expressed in that source code'

³⁴ The TPPA/CPTPP prohibits governments from requiring the disclosure of source code used in *mass-market software*, or in products containing such software, as a condition of their import, sale or use. It would not extend to the bespoke software used by corporations or professionals for the purposes of inventory, accounting and other records in which tax authorities are most interested. TPPA/CPTPP Article 14.17

³⁵ EU Japan Free Trade Agreement Article 8.4

³⁶ Kelsey 2020

³⁷ US law, for example, authorises the copying of source code of software used for accounting, tax planning, tax returns and compliance in certain circumstances for the purpose of analysis and, with a court order, remove it from the place of business for review by external experts. 26 U.S. Code § 7612 - Special procedures for summonses for computer software. Available at: www.law.cornell.edu/uscode/text/26/7612

³⁸ USMCA Article 19.16.2 reads: *Nothing in this article shall preclude a regulatory body or judicial authority of a Party from requiring a person of the other Party to preserve or make available the source code of software, or an algorithm expressed in that source code, to the regulatory body for a specific investigation, inspection, examination enforcement action or judicial proceeding, subject to safeguards against unauthorized disclosure*

The GATS and cross-border services chapters of FTAs, in particular, complement and overlap the e-commerce texts by constraining how governments can regulate digitally-enabled and digitally-enabling services and the foreign firms that supply them, including for taxation purposes. Some rules are long-standing, but have new significance in the digitalised economy; several rules are new. Almost all are part of the USTR's Digital 2 Dozen demands.

2.4.1 The basics of trade in services

Trade in services covers situations where foreign firms supply services to another country's consumers. Digitalised services are most commonly delivered by a foreign supplier remotely from across the border, such as someone in Uruguay buying an e-book online from Amazon in the US or using Facebook's services that are operated out from Ireland (known as mode 1). But the rules also apply when the customer is using the service outside their country, such as storing data in offshore servers or a resident using an app with a local account while offshore (mode 2), the service is supplied by a foreign investment (mode 3), or it is delivered by a non-resident temporarily in the country (mode 4).

The rules apply broadly to any *measure* (a law, regulation, rule, procedure, decision, administrative action, or any other form) that has an *effect* on the supply of a service in one of those four modes. Basically, everything tax authorities do could be considered a 'measure' and most of those tax measures would have an *effect* on the commercial operations of an international service supplier or foreign digital firm operating across the border or inside the country. If tax-related measures come within the scope of the trade in services agreement or chapter, governments must comply with the relevant rules or invoke exclusions, reservations and exceptions to justify measures that breach its obligations.

2.4.2 Classification of services

Trade in services agreements have three core rules that relate to discrimination between services and service suppliers of other parties (most-favoured-nation treatment) and between foreign and domestic services and suppliers (national treatment), and access by foreign services and suppliers to a country's market and its ability to grow its market share (market access).

The GATS rules on national treatment and market access apply to those services sectors and modes of delivery in which governments make commitments. A service is defined by the sector (such as retail distribution, accountancy, hotel accommodation, advertising) or the technology that enables delivery (for example, computer, audio-visual or telecommunication services). A country's commitment of specified services to each of the core trade in services rules (national treatment, market access, local presence) determines the legal constraints within which its tax authorities have to operate (see below at 2.4.2, 2.6).

Because the commonly used services classification system dates back to 1991 the nature and extent of a country's commitments can be uncertain. This creates particular problems when digital companies engage in several services simultaneously and a country only has commitments to one of them.³⁹ Is Uber a computer-related service, a transportation or a restaurant service, or all of them? Is Google only a computer service, even though it is the largest online advertising platform in the world? What about Amazon, Airbnb or Alibaba?

Domestic courts may determine the classification of an activity for tax purposes and a trade panel might classify it quite differently under the trade rules. For example, the Argentine tax authorities issued two preliminary options in 2018 that Uber was a transportation, not an inter-mediation, service, and as a result was deemed a permanent establishment for tax purposes.⁴⁰ But it is quite possible that Uber would be treated as an intermediary computer service in a trade dispute, meaning Argentina's trade in services obligations would depend on whether it had made commitments to other countries' service suppliers on that sector. Which classification would apply, and whether the resulting treatment was consistent with a tax treaty for the purposes of an exception, would ultimately be decided by a panel of trade law experts.⁴¹

Developing countries need to be vigilant about how their obligations are defined in the trade context. They also need to reject claims from developed countries, and the WTO Secretariat, that commitments governments made several decades ago should constrain their ability to regulate digital technologies and activities that they never envisaged, and services they could never have imagined, at the time they negotiated the commitment. What a government agreed to in 1994 based on what it knew then about technology should not create open-ended and unintended consequences for their regulatory space today and into the future. It would be antithetical to the recognition of development asymmetries in the WTO to argue that those commitments should apply to the regulation of unforeseen digital technologies and services – yet that is what developed countries try to claim.⁴²

³⁹ WTO, Services Sectoral Classification List, 10 July 1991, MTN.GNS/W/120. Available at: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=179576&CurrentCatalogueIdIndex=0&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True

⁴⁰ Guillermo Teijeiro and Juan Manuel Vázquez (2019), 'Argentina/OECD/International – Taxation of the Ride-Sharing Economy: Source taxation through Service Permanent Establishment Provisions Revisited – the Case under the Argentine Treaty Network', *Bulletin for International Taxation* 73(12), 4 December 2019

⁴¹ Some agreements, such as TPPA/CPTPP, require such questions to be referred to the parties to resolve, and the dispute panel only determines the matter if the parties cannot agree. See 2.8.3 below.

⁴² Jane Kelsey (2018), 'The development implications of TPP-style e-commerce rules for the GATS acquis', *Journal of International Economic Law* 21(2), 273-295

2.4.3 Most-favoured-nation (MFN) treatment

This rule requires the services or service suppliers from one Party to an agreement to be given the best treatment that another Party gives their competitors from any other Party/country.⁴³ There are three particular ways that the MFN obligation could apply to taxation:

- The domestic tax regime treats the services and suppliers of some countries less well than those of other countries, for example to counteract tax avoidance and evasion through tax havens or low-tax countries (as in *Panama v Argentina*);
- Regional economic integration agreements or FTAs give the services and firms of the parties better treatment than those from other countries, for example not requiring a local presence; and
- Double Taxation Treaties that embody special tax arrangements between the parties.

The reference point for comparing the tax treatment of one service or supplier to another is crucial. In the GATS, the comparator is ‘*like services or services suppliers*’. In the only GATS dispute involving a tax measure, Panama accused Argentina of discriminating against its services firms compared to those from other countries; as Box 6.1 explains, the dispute panel and the Appellate Body reached conflicting interpretations of the threshold test for ‘likeness’.

To add to the uncertainty, the TPPA/CPTPP uses a different test: it compares services and service suppliers in ‘*like circumstances*’, which ‘depends on the *totality of the circumstances, including* whether the relevant treatment distinguishes between services or services suppliers on the basis of *legitimate public welfare objectives*’.⁴⁴ ‘Public welfare objectives’ is new language not found in previous trade in services agreements. Although taxation is generally considered a legitimate public *policy* objective, it may not be considered a legitimate public *welfare* objective. The specific taxation measure might also not be considered *legitimate*, either, because it is novel or not broadly accepted.⁴⁵

⁴³ Sometimes MFN is limited to other Parties to the agreement and sometimes it applies to the best treatment given to any country, even a non-party.

⁴⁴ Footnotes to Article 9.4 (National Treatment) and Article 9.5 (Most-Favoured-Nation Treatment)

⁴⁵ ‘Legitimate’ has been interpreted in the WTO dispute on *Canada – Patent Protection of Pharmaceutical Products* (DS114) to mean widely recognised state practice. Available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds114_e.htm

There is no WTO jurisprudence to help interpret this phrase. The term has been used in investment agreements and chapters of FTAs to limit the scope of the indirect expropriation rule; those annexes contain an illustrative list that refers to public health, safety and the environment objectives, which are hard to relate to tax.⁴⁶ Further, the word ‘including’ in the TPPA/CPTPP means that other circumstances would also be considered, and those factors may complement or contradict the public welfare objectives. These variations between agreements make it even more difficult for tax authorities to predict how differential treatment of countries might be interpreted.

Agreements may provide exceptions for some or all of these arrangements, with or without conditions; but again that is not uniform. Where a tax-related measure breaches MFN treatment and the country has no reservation to protect those measures, it will have to rely on the tax, general, prudential and/or security exceptions (see 2.8, 2.9 below).

2.4.4 National Treatment

Governments that put foreign firms at a competitive disadvantage compared to their domestic counterparts through more onerous tax-related rules, decisions and procedures face potential challenges under the national treatment rule. Governments and tax authorities are allowed to treat foreign firms or their services and investments differently from their domestic equivalents to achieve the same outcome, but not if it affects their relative competitiveness. The application of seemingly neutral laws might also adversely affect the competitive position of foreign firms.

The WTO’s jurisprudence is not a helpful guide when comparing foreign and domestic services and suppliers because the Panel and Appellate Body took fundamentally different approaches to interpreting the terms ‘like’ and ‘less favourable treatment’ in Panama’s dispute against Argentina (See Box 6.1). Again, FTAs add complexity. The TPPA/CPTPP uses the same comparator for national treatment as for MFN, which refers to legitimate public welfare objectives.⁴⁷ Such divergences create real problems for regulators in predicting compliance with their obligations across agreements. Whether the national treatment rule applies in turn affects the applicable exceptions.

2.4.5 Market access

A digitalised MNE may not have any local presence in a country where it supplies services. That absence can create jurisdictional, transparency and enforcement problems for regulators and tax authorities. If it does establish a presence, it may simply be an agency or a subsidiary that supplies marketing and

⁴⁶ For example, TPPA/CPTPP Annex 9-B, para 3(b)

⁴⁷ For example, GATS Article XVII.3

support services. Under the GATS market access rule a government cannot require a foreign firm to establish through a particular legal form, such as a subsidiary that has legal characteristics specified in domestic law or as a joint venture, as a condition of allowing it to supply a service, such as computer-related or advertising services. The same rule is in most FTAs.

The market access rule also prevents restrictions on the size or growth of the market in a particular service. Examples that might violate the market access rule include a very high tax on a service that is designed to restrict demand, and hence prevent market dominance, or a two-tiered tax that escalates significantly when a service supplier reaches a certain size or quantum of transactions, with the goal of limiting its market share.⁴⁸

2.4.6 Local presence

It can be difficult enough to tax foreign firms when they have a local presence. It is much more difficult when they have no local presence and cannot be required to have one. Yet the global digital economy operates across borders through search engines, digital platforms and marketplaces, diffused supply chains and electronic payment platforms, and revenue is commonly channelled through a chain of low-tax offshore entities. Some digitalised companies may have no local presence at all, for example streaming services such as Netflix or cloud computing. Others that have substantial sales may maintain a local presence, but the local entity would claim for tax purposes to be only providing support services, while payments from customers are channelled to an offshore affiliate that claims to have no local presence. Part 4 explains how the structure Uber adopted for tax minimisation purposes relates to these trade rules.

Some countries may respond to these tax avoidance strategies by requiring a local presence. The TPPA/CPTPP and other recent FTAs seek to preclude that by adopting a new rule that prevents a government from requiring a cross-border supplier of a service, such as Airbnb, Uber or Google, to have a local presence in its country.⁴⁹ Several e-commerce plurilateral proponents want to include a similar prohibition in the GATS,⁵⁰ but it is unclear how they could do so without amending the Agreement.

Others suggest that a new rule is unnecessary, because the GATS can already be interpreted to prohibit a local presence requirement as a measure that ‘affects’

⁴⁸ These restrictions are mirrored in FTAs, but sometimes split between the services and investment chapters.

⁴⁹ For example, TPPA/CPTPP Article 10.6: ‘No Party shall require a service supplier of another Party to establish or maintain a representative office or any other form of enterprise, or to be resident, in its territory as a condition for the cross-border supply of a service’

⁵⁰ For example, WTO, Work Programme on Electronic Commerce, ‘Trade Policy, the WTO and the Digital Economy’, Communication from Canada, Chile, Colombia, Côte d’Ivoire, the European Union, the Republic of Korea, Mexico, Montenegro, Paraguay, Singapore and Turkey, JOB/GC/116, 13 January 2017, 6, para 20

the cross-border supply of a service where a WTO Member has made a commitment in the relevant mode and sector. Requiring a local presence is discriminatory because it is directed only at offshore suppliers and may breach national treatment if it negatively affects that supplier's competitive position. A local presence requirement might also be considered equivalent to a ban on cross-border supply of the service, in breach of the market access rule.⁵¹ These speculations reinforce the importance of developing countries continuing to insist that commitments they made in 1994 do not apply to services and technologies they could never have envisaged at that time.

National tax authorities might address these constraints by deeming cross-border delivery of services to take place in the country, for example through a substantial economic presence rule (see Part 4: 4.2.2) and tax income derived from such operations as arising there. That approach faces several potential trade in services problems:

- Deeming an offshore entity to have a permanent establishment for tax purposes would be a measure affecting the cross-border supply of that service and is likely to adversely affect the foreign firms' position vis-à-vis domestic competitors. The Appellate Body in *Panama v Argentina* rejected the Panel's view that the objective of a domestic tax measure to level the playing field between the foreign and domestic firms was relevant to determining a breach of national treatment, and said it should be argued in relation to the exceptions (see Part 6: Box 6.1).
- The tax authority must be able to access the relevant information. The e-commerce rules discussed above in para 2.3 could also prevent the government from requiring the company to hold the relevant information inside its country, except in limited circumstances.
- It is very difficult to enforce any civil or criminal penalty on an offshore company that has no presence in the country. In its WTO dispute with Argentina, one of Panama's objections was to the collection of tax on earnings abroad from persons who did not make a tax return in Argentina.⁵² Even serving legal documents on a non-resident is a lengthy, complex and costly diplomatic process. For example, Swiss-based online ticket reseller Viagogo has drawn out the legal proceedings brought by New Zealand's competition and consumer protection authority, initially refusing to accept service of legal documents in

⁵¹ Rudolf Adlung and Hamid Mamdouh (2018), 'Plurilateral Trade Agreements: An escape route for the WTO?', *Journal of World Trade* 52:1, 85-112

⁵² *Panama v Argentina* Panel Report, para 71

New Zealand, then refusing to recognise the New Zealand court's jurisdiction, then conceding jurisdiction pending a full hearing, with the enforceability of any final judgement against it likely to pose yet another hurdle.⁵³

- A domestic law imputing a domestic presence might be challenged under a country's double taxation treaties. The question of when a non-resident entity can be considered to have a taxable presence is currently highly contentious. For example, Argentina's tax authority in 2018 issued preliminary tax opinions that non-resident companies providing ride-sharing platforms can be considered to have a taxable presence (a 'permanent establishment') in Argentina, but this creates a possible conflict with Argentina's tax treaty with the Netherlands.⁵⁴ The Inland Revenue Department in New Zealand has conceded such conflicts might occur;⁵⁵ if so, New Zealand would lose the standard protection for rights and obligations under double taxation treaties in the tax exceptions of its trade treaties.

2.4.7 Domestic regulation of services

Services firms have long wanted trade rules to restrict additional forms of regulation, including licensing and technical standards. That would cover regulations that set the conditions for supplying a service or requirements designed to secure or enhance compliance with the tax regime. A number of developing countries have resisted the development of those rules in the WTO,⁵⁶ although a breakaway group of Members are negotiating their own domestic regulation text which they intend to include in their GATS schedules.⁵⁷ Few FTAs have adopted such rules.

Some existing domestic regulation rules are already problematic. The GATS and many FTAs require all measures of general application that *affect* trade in services to be *administered in a reasonable, objective and impartial way*. That would include the administration of taxation measures in relation to offshore digital services suppliers, such as requirements to provide detailed information of ride-share transactions or user-data generated by nationals whether or not that data was

⁵³ *New Zealand Commerce Commission v Viagogo AG* [2019] NZHC 187; *ACCC v Viagogo AG* [2019] FCA 544. Available at <https://comcom.govt.nz/case-register/case-register-entries/viagogo>

⁵⁴ Teijeiro and Vázquez 2019

⁵⁵ Email communications, NZIRD to Dr Bill Rosenberg NZCTU, 26 February 2018. On file with Jane Kelsey

⁵⁶ Unless and until new rules are adopted, GATS Article VI:5 requires licensing and professional requirements and technical standards for services to be based on objective and transparent criteria and not be more burdensome than necessary to achieve the goal of quality – but those regulations can only be challenged on the grounds that the way they are being applied has nullified or impaired the benefits expected from the country's commitments and that could not have reasonably been expected when the commitment was made. That test would be very hard to satisfy

⁵⁷ Services Domestic Regulation, 'Note by the chairperson. Draft Reference Paper on Services Domestic Regulation', 12 July 2019

generated while the users were inside their country. The GATS limits that obligation to services committed in a Member's schedule, but the WTO plurilateral on domestic regulation aims to extend the commitments that are subject to this rule, and some recent FTAs apply it to administration of measures affecting all services.⁵⁸

2.5 Performance requirements on foreign investments

This report does not cover international investment agreements or the investment chapters of contemporary FTAs and the potential for digital MNEs to challenge tax-related measures through investor-state dispute mechanisms.⁵⁹ The focus here is on the new digital trade agenda. However, one investment provision in recent FTAs is highly relevant.

The WTO Agreement on Trade-Related Investment Measures (TRIMS) prohibits governments from imposing certain performance requirements as a condition of allowing the establishment or conduct of a foreign investment. The TRIMS applies only to measures relating to goods. Recent FTAs extend its scope from goods to services and apply the rule to investors from any country, not just the parties to the agreement. They also prohibit additional kinds of performance requirements, such as technology transfer or domestic content, which would preclude requiring inputs from local digital start-ups or local app developers.⁶⁰ However, governments can still condition a taxation or other advantage on the location of production, supply of a service, training of employees, building or expanding facilities, or research and development.⁶¹

Another new prohibited performance requirement restricts the ability of governments to interfere with royalty arrangements in private contracts that are structured to facilitate profit shifting by digital MNEs. Under the TPPA/CPTPP, a party cannot limit the quantum or duration of royalty payments in a private licensing contract between a foreign investor and a 'person in its territory', who might be a national or a non-resident, including a related party.⁶²

⁵⁸ For example, the EU Japan FTA, Article 8.74

⁵⁹ Claire Provost (2016), 'Taxes on trial. How trade deals threaten tax justice', Transnational Institute, February 2016. Available at: http://www.s2bnetwork.org/wp-content/uploads/2015/10/taxes_on_trial_briefing_web.pdf

⁶⁰ TPPA/CPTPP Article 29.4.7. There is an exception if the performance requirement is 'necessary' (the least burdensome means among those that are reasonably available) to secure compliance with a law *that is itself consistent with the rest of the TPPA*, or 'necessary' for public health, environment or conservation reasons, TPP Article 9.10.3(d). The General Exception does not apply to the investment chapter in the TPPA/CPTPP

⁶¹ TPPA/CPTPP Article 9.10.3(a)

⁶² TPPA/CPTPP Article 9.10.1(i). This prevents a Party from setting the rate or amount of a royalty, or the duration of a term, under an existing licence contract that is freely entered into between the foreign investor and a person in the territory (including a subsidiary), if the requirement is imposed or enforced in a way that involves a non-judicial government body directly interfering with the licence contract

There is an exception for a ‘*legitimate public welfare objective*’,⁶³ the same novel term used for the national treatment and MFN provisions. Because there is no precedent and no WTO jurisprudence, the scope of this exception remains unclear. The term ‘legitimate’ could rule out a measure that is not widely used by other governments or whose merits are internationally contested. Further, the measure must not be applied in an arbitrary or unjustifiable manner, for example by inconsistent application to different kinds of investments, legal entities or services, or be a disguised barrier to trade or investment to benefit local competitors.⁶⁴ Parties can limit the application of this rule and other performance requirements in their schedules.

Whether, where and how this royalties provision might be incorporated into the WTO is problematic,⁶⁵ and to date it does not appear to be included in any of the WTO e-commerce proposals. It remains confined, for now, to a number of recent FTAs.

2.6 Scheduling a country’s commitments

The GATS and trade in services chapters in FTAs allow a party to formulate its commitments so as to limit its exposure to the national treatment, market access, and sometimes MFN⁶⁶ rules. Some FTAs may make additional rules subject to the schedules, such as those on local presence and/or performance requirements on foreign investors. Schedules setting out a country’s commitments, or reservations to application of the rules, have to be negotiated and agreed between the parties. These protections follow two different approaches:

- Under the *positive list* approach used in the GATS and some FTAs, the country commits distinct service sub-sectors to each rule, differentiating between the modes of delivering them (for example, making a commitment to allow the supply of retail distribution services in mode 3 through a local commercial

⁶³ TPPA/CPTPP Article 9.10.3(h)

⁶⁴ Similar terminology is used in the General Exception, discussed below

⁶⁵ The existing TRIMS is limited to goods as part of the GATT and there is no applicable taxation exception. An attempt to expand the TRIMS would require a formal amendment to the GATT, which logically could not incorporate services-related performance requirements. It would be difficult to represent this as an intellectual property rule for inclusion in the TRIPS agreement, because it is framed as a performance requirement on foreign investors. Anyway, that would require an amendment to TRIPS and there would be no relevant tax exception that applies. Including these new performance requirements in the GATS would also require an amendment, unless they were brought in through the back door. One suggested path for proposed new e-commerce rules is as an ‘additional commitment’ in Members’ schedules of commitments. However, introducing a substantive investment rule and an amendment to a core agreement through that route would violate the intention and substantive provisions of the WTO’s legal rules and be a serious abuse of the nature and purpose of GATS schedules

⁶⁶ The US, for example, has excluded taxation measures from its MFN obligation in its GATS schedule: GATS/EL/90, 15 April 1994

presence, but not in mode 1 across-the-border). They can inscribe specific limitations on a sector and/or mode, including for tax-related purposes at the time the schedule is negotiated. Subsequent changes are almost impossible.⁶⁷ As noted earlier, some developed countries, commentators and the WTO Secretariat claim that positive list commitments apply to whatever new technologies or services are subsequently developed in that sector, such as social media, robotic surgery, 3D printing or drone delivery services, even if they could not have been envisaged at the time the commitment was made. Developing countries have vociferously objected to this interpretation of ‘technological neutrality’ when it has been raised in the WTO.⁶⁸

- More recent FTAs often use a *negative list* in which parties must identify what measure, sector or activity is *not* covered by the rules. Negative lists usually have two annexes: one allows the country to preserve the existing non-compliant measures that are listed (at a ‘standstill’), although new liberalisation may automatically be locked in (a ‘ratchet’); the second annex preserves the right to maintain specified non-compliant measures and adopt new ones, thus preserving policy space. A policy space reservation under the second annex could, for example, retain the right to regulate on digital or fiscal/taxation matters, or to maintain measures specific to a cross-border digital service – but there are very few annexes, to date, that do so.

If there is no reservation in either annex, the government must fully comply with the rules. Negative lists therefore increase the country’s exposure to the rules and foreclose the government’s ability to regulate new services or technologies or re-regulate existing ones, unless it has explicitly preserved the right to do so (see the example of India’s caps on royalty payments discussed in Part 5: 5.3).

Where a country adopts a tax-related measure that affects a service that is committed through a positive or negative list schedule, and it breaches the specified trade in services rules, it will need to rely on the tax exception or another exception to defend its action (see below 2.8-2.9).

⁶⁷ In theory, changes might be made later with the consent of other state parties, but this requires their agreement and compensatory liberalisation may be required. There are very few examples where schedules have been amended

⁶⁸ Kelsey 2018, 290-294. See for example: Committee on Trade and Development, Note on the meeting of 27 October and 8 November 2000, WT/COMTD/M/31, 14 December 2000, para 57; Committee on Trade in Financial Services, Report of the Meeting Held on 16 May 2003, S/FIN/M/40, 30 June 2003, para 28; Committee on Trade in Financial Services, Report of the Meeting Held on 6 October 2003, S/FIN/M/42, 12 November 2003

2.7 Transparency

Many recent FTAs,⁶⁹ and the plurilateral proposals at the WTO on e-commerce,⁷⁰ domestic regulation⁷¹ and investment facilitation⁷², have provisions or whole chapters on ‘transparency’. These aim to institutionalise and normalise a requirement for prior consultation with other Parties *and their interested persons* (in practice, their corporations) over proposed new regulations. This obligation facilitates corporate lobbying and threats by foreign businesses of capital flight, capital strike, or the withdrawal of popular services with the aim of chilling the government’s regulatory decisions. These provisions also assist powerful states to use their domestic mechanisms and market power to intimidate other countries. Part 7 illustrates how governments (principally the US) have threatened retaliatory sanctions, and how digital companies have threatened to block popular services to local consumers, if new tax measures proceed.

There has been considerable resistance to this requirement. In most agreements the obligation is ‘to the extent possible’ and ‘subject to domestic law’, or an explanation must be given where prior comment has not been sought. Proposals in other WTO plurilaterals on Domestic Regulation of Services⁷³ and Investment Facilitation⁷⁴ would require a government ‘to the extent practicable and in a manner consistent with its legal system’ to publish in advance any laws and measures of general application that are relevant to the agreement, or enough detail to alert Members and ‘interested persons’ as to whether their interests may be significantly affected. To the ‘extent practicable’ and ‘in a manner consistent with its legal system’ the government would also need to provide reasonable opportunity to comment and those comments would have to be considered, with governments encouraged to explain the purpose and rationale for the law or regulation they do adopt. Note the wording used is ‘in a manner’ not ‘to the extent’ consistent with its legal system.

The Regulatory Coherence chapter in the TPPA/CPTPP magnifies that effect.⁷⁵ The concept of ‘good regulatory practices’, developed in the OECD, starts from a

⁶⁹ For example, TPPA/CPTPP Article 10.11 in the Cross-border Services chapter and TPPA/CPTPP Chapter 26 Transparency

⁷⁰ ‘Joint Statement on Electronic Commerce: Snapshot – July 2018’, 8, on file with Jane Kelsey

⁷¹ WTO (2019), Services Domestic Regulation, ‘Note by the Chairperson. Draft Reference Paper on Services Domestic Regulation’, 12 July 2019, paras 15-20, on file with Jane Kelsey

⁷² WTO (2019), ‘Investment Facilitation for Development, draft text’, INF/IFD/RD/39, September 2019, 9, para 3.4, on file with Jane Kelsey

⁷³ WTO (2019), ‘Services Domestic Regulation’, paras 15-20

⁷⁴ WTO (2020), ‘Structured Discussions on Investment Facilitation for Development. Communication from the European Union’, INF/IFD/RD/46, 27 February 2020

⁷⁵ A leaked version of the initial text sought to impose much stricter, enforceable obligations. See Jane Kelsey (2011), ‘Preliminary analysis of the draft TPP chapter on regulatory coherence’, 23 October 2011. Available at: <https://itsourfuture.org.nz/wp-content/uploads/2013/09/JK-Memo-on-Reg-Coh.pdf>

presumption of light-handed market-based regulation that informs policy development processes and regulatory impact assessments. Publication of exposure drafts is intended to provide opportunities for comment by ‘interested persons’, including foreign corporations.⁷⁶ Following resistance from developing-country parties, this chapter was diluted and is not subject to dispute settlement. However, the streamlined draft text for the Investment Facilitation plurilateral in the WTO has similar language.⁷⁷ This model of ‘best practice’ regulation can make it hard for countries to pursue innovative measures to address tax avoidance, because there is no established evidence base to call on and new measures and processes are likely to be considered as creating additional burdens.

Even where contingent language is used, such as ‘endeavour’ or ‘to the extent practicable’ or the chapter is unenforceable, these provisions still impose legal obligations. Governments will be pressured to comply in meetings of committees of the parties, bilaterally or during their domestic policy-making. Information gathered through these interventions may also form part of the evidence basis for trade disputes, or even investment disputes before investor-state arbitral tribunals.⁷⁸

2.8 Tax exceptions

Where a government’s tax-related measures have been found in breach of the substantive trade rules it will need to rely on the available legal exceptions, which operate as defences. The limited tax-related exception in the General Agreement on Tariffs and Trade (GATT) is concerned with border taxes and the neutral application of internal charges on goods.⁷⁹ The tax exception in the GATS is part of the General Exceptions;⁸⁰ it is also limited, and its legal substance and application raise complex questions, especially in the digital era. Non-tax objectives in the WTO’s General Exceptions and Security Exception may also be relevant to tax-related measures.

All contemporary FTAs have one or more kinds of tax exception. Some are built into specific articles and apply only to those provisions, while others are particular to a chapter. There is usually a stand-alone exceptions chapter for the entire agreement. Because negotiating parties can tailor these exceptions to their sensitivities, they vary across agreements. With no uniform structure or legal content within or across agreements, tax authorities may be faced with divergent rules and flexibilities that apply to the same measure. Multiple and potentially inconsistent provisions may apply in different agreements even involving the same countries. It

⁷⁶ TPPA/CPTPP Article 25.5

⁷⁷ WTO (2019), ‘Investment Facilitation for Development. Draft text’

⁷⁸ Jane Kelsey (2013), ‘The Trans-Pacific Partnership Agreement: A Gold-Plated Gift to the Global Tobacco Industry?’, *American Journal of Law and Medicine* 39, 237-264

⁷⁹ GATT Articles II.2 and III.2

⁸⁰ GATS Article XIV(d)

is also possible for several exceptions to apply to the same tax-related measure and these may differ across agreements.

The tax exceptions in recent multi-chapter and mega-regional agreements have become especially complicated as they attempt to adapt pre-existing exceptions to new rules on digital services (including financial services), investments and electronic commerce. That has created a legal minefield of complexity, layered on top of the increasingly complex array of trade rules that apply to digital technologies, owners, services, and transactions. Even welcome additions that increase the flexibility for tax authorities to treat foreign and local individuals or entities differently, especially in cross-border digital transactions, increase the legal uncertainty, and will be affected by the rules on how overlapping agreements should be treated.

2.8.1 The GATT tax exception

Aside from the GATT's limited exception relating to border taxes, and the neutral application of internal charges on goods,⁸¹ any breach would have to rely on the tangential categories of policy objectives in the Article XX: General Exceptions, such as 'public morals' or measures to secure compliance with laws that are *themselves* permissible under the GATT. The measures must be '*necessary*' to achieve either of those objectives, and not constitute arbitrary and unjustifiable discrimination between countries where the same conditions prevail or disguised barriers to trade.⁸² There is a very low success rate for Members who have relied on the General Exceptions in WTO disputes.⁸³

It is important to note that the moratorium on customs duties on e-transmissions appears not to be directly within the scope of the WTO Dispute Settlement Understanding, since the current moratorium is not an agreement listed in the Appendix to the Understanding,⁸⁴ although it still imposes a legal obligation that may be subject to other forms of review and pressure.

2.8.2 The GATS tax exception

There is no stand-alone taxation exception in the GATS either. Taxation measures are explicitly addressed in two paragraphs of the General Exceptions. Their scope is very specific.

⁸¹ GATT Articles II.2 and III.2

⁸² *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, 1987, 34/S/83, p. 124, para 5.13 ; see discussion at WTO, Analytical Index of the GATT, p. 556, https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art20_e.pdf

⁸³ Members have been unsuccessful in 48 of 50 WTO disputes where they have invoked the General Exception. Public Citizen, 'Fatally flawed WTO Dispute System', November 2019. Available at: <https://www.citizen.org/wp-content/uploads/WTO-Disputes-Summary-November-2019-FINAL.pdf>.

⁸⁴ WTO, Understanding on Rules and Procedures Governing the Settlement of Disputes 1994, Annex 2 to the Agreement Establishing the World Trade Organisation, Article 1.2

- Article XIV (d) permits tax-related measures to discriminate between foreign and local services and suppliers for just one purpose: to ensure the ‘*equitable or effective imposition or collection*’ of *direct taxes* on total income, total capital, or elements of each.⁸⁵ This exception only applies to national treatment; it does not apply to measures that breach the market access or MFN rules or to other rules not discussed in this report, such as that on transfers and payments. A footnote provides a non-exhaustive list of measures that qualify as meeting that purpose in relation to direct taxes (see Box 2.1).⁸⁶ As a further limitation, this national treatment exception only applies to direct taxes; it does not allow discrimination in relation to *indirect taxes*, such as a value-added tax or the most common forms of a digital services tax.
- Paragraph (e) in the General Exceptions allows services and service suppliers from one WTO Member to be treated differently from those of another (breaching the MFN rule) where that is the result of provisions to *avoid double taxation* in either a double taxation treaty or an international agreement or arrangement by which the Member is bound. This exception only applies to measures addressing *double taxation*. An ‘international arrangement’ is not defined. Arguably, it includes international guidelines that are voluntarily adopted or implemented, such as agreements or commitments made under the Inclusive Framework on BEPS which may result in differential treatment of countries, but only to the extent they relate to double taxation. Whether a tax measure is for the avoidance of double taxation and otherwise complies with the tax treaty is crucial to the application of the exception.

Unlike other policy objectives in the General Exceptions, these tax exceptions are not subject to a ‘necessity’ (least-burdensome) test. However, to satisfy the requirements of paragraphs (d) and (e) a measure must still not be applied in a manner that constitutes a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail or a disguised restriction on trade in services.⁸⁷ The US investigation into the French digital services tax made frequent reference to its arbitrariness (see Part 5: 5.1.3).

⁸⁵ GATS Article XXVIII(o): ‘all taxes on total income, on total capital or on elements of income or of capital, *including* taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation’

⁸⁶ GATS Article XIV(d), footnote 6

⁸⁷ Public Citizen 2019. As of 2015, all but one of the nine cases that met one of the categories for application of the General Exception and satisfied the necessity test then failed to satisfy the chapeau. Lori Wallach and Todd Tucker (2015), ‘Only One of 44 attempts to Use the WTO’s General Exception to the GATT Article XX/ GATS Article XIV “General Exception” Has Ever Succeeded’, Public Citizen’s Global Trade Watch, August 2015, 2 and 5. Available at https://www.citizen.org/wp-content/uploads/general-exception_0-2.pdf

**Box 2.1 Direct taxation measures in the GATS exception for
National Treatment (Art XIV(d) fn 6)**

Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes *include measures* taken by a Member under its taxation system which:

- (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
- (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
- (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
- (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
- (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

There is no jurisprudence to assist in interpreting these tax exceptions. The *Panama v Argentina* dispute heard arguments on the Paragraph (e) exception, but did not make a determination. Nevertheless, the Panel made strong statements on the importance of effective revenue regimes and the risks from harmful tax practices, especially to developing countries, which should resonate for future examination of the exception, within its limited scope. The dispute is discussed further in Part 6: 6.2.

2.8.3 The scope of FTA tax exceptions

Some FTAs have comprehensive tax exceptions, for example: 'The provisions of *this Agreement shall not apply to any taxation measure*'.⁸⁸ Or the tax carve-out may be qualified, such as: '*Nothing in the agreement applies to any taxation measure, except*' those matters listed.⁸⁹ Another variation says '*except as provided in this*

⁸⁸ Singapore NZ FTA 2001. However, the definition of 'taxation measure' excludes excise duties adopted to protect domestic industry

⁸⁹ China NZ FTA 2008 Article 3.4

Article, nothing in this agreement shall apply to taxation measures'; the permitted measures are then defined to exclude customs duties and certain other provisions.⁹⁰ The Digital Economic Partnership Agreement between Chile, Singapore and New Zealand excludes all taxation measures from the agreement and clarifies that where any inconsistency with a tax convention arises the tax convention prevails.⁹¹

At the other extreme, the TPPA/CPTPP article⁹² carves in and out so many elements it can be likened to a Russian doll⁹³ and will be a regulator's nightmare:

- (i) Taxation measures are excluded from coverage of the Agreement (1st carve-out);
- (ii) Tax obligations arising from tax conventions are also excluded from coverage (2nd carve-out);
- (iii) Some tax measures carved out under both (i) and (ii) are brought back in for some provisions in some chapters;
- (iv) Some tax measures that are carved out under (i), but not carved out under (ii), are brought back in for some other provisions;
- (v) Exceptions are made to some of the provisions that are brought back under (iv).

The second carve-out is especially important given international initiatives on taxation of digital corporations (see Part 4). Unlike the GATS, this is not limited to double taxation provisions. 'Tax convention' is defined as a convention 'for the avoidance of double taxation or *other international taxation agreement or arrangement*'. 'Arrangement' is a vague term, which arguably covers the agreements and commitments arising from the BEPS project and the Inclusive Framework, although it is unclear whether that would extend to international arrangements that have secured limited uptake or regional initiatives. The international treaty or arrangement would prevail in the event of any inconsistency with the TPPA/CPTPP.

Whether there is such an inconsistency stands referred to the countries' designated tax authorities for a determination. The matter can only go to a dispute under the TPPA/CPTPP procedure after a six-month period for consultations over this question (unless extended to a year) and the dispute tribunal would be bound by any determination the Parties reached. If the Parties failed to agree, the applicability of the carve-out would be decided through the TPPA dispute procedure.⁹⁴

⁹⁰ Pacific Agreement on Closer Economic Relations – Plus, concluded on 20 April 2017, Article 11.5

⁹¹ Digital Economic Partnership Agreement, signed on 12 June 2020, Article 13.5

⁹² TPPA/CPTPP Article 29.4

⁹³ A term coined by William Park (2009), 'Arbitrability and Tax', in Loukas Mistelis and Stavros Brekoulakis (eds), *Arbitrability: International and Comparative Perspectives*, 179-205 at 189

⁹⁴ TPPA/CPTPP Article 29.4

International tax arrangements and conventions aside, the national treatment and MFN rules on services, financial services and investment (and a rule requiring non-discriminatory treatment of digital products⁹⁵) would apply to most taxation measures. The remaining flexibilities are limited and convoluted. A proviso allows parties to retain or renew existing measures that do not conform to those rules or to amend them in ways that do not decrease their conformity (a standstill).⁹⁶ Significantly, the adoption or enforcement of any new taxation measure aimed at ‘ensuring the equitable or effective imposition or collection of taxes’, including one that ‘differentiates between persons on the basis of their residence for tax purposes’, is protected so long as it does not ‘arbitrarily discriminate’ between persons, goods or services of the parties, but only in relation to certain provisions.⁹⁷ The examples of the US investigation into France’s Digital Services Tax and Panama’s WTO dispute against Argentina, discussed below in Parts 5 and 6 respectively, illustrate the potential problems that might arise with the terms ‘arbitrary’ and ‘discriminate’.

The almost impenetrable complexity of the TPPA/CPTPP taxation exception sounds a warning for developing countries being asked to negotiate multi-chapter agreements, especially where digital services, products, technologies and investments are spread across multiple chapters. Any countries that adopt a TPPA-style agreement, alongside their FTAs with other countries that take different approaches to tax exceptions, face a herculean task. The WTO dispute Panel and the Appellate Body could not even agree when interpreting the basic GATS rules applying to taxation measures. These agreements are far more complex and uncertain. There are serious risks that developing countries which would have to resort to such complex exceptions could be chilled from adopting tax measures they consider necessary to defend and enhance their fiscal well-being and development.

The scope of the exception in FTAs also depends on how key terms are defined. Most exceptions refer to ‘*taxation measures*’, but usually do not define a taxation measure. Where there is no tax-specific definition, interpretation would fall back on the agreement’s general definition of ‘measure’. That commonly follows the broad and non-exhaustive GATS definition that ‘*includes* any law, regulation, procedure, requirement, or practice’,⁹⁸ which would encompass the full spectrum of state actions that establish, operationalise and enforce the tax regime. That definition applies to determine the scope of both the rules and the exception. Again, there may be variations.

⁹⁵ TPPA/CPTPP Article 29.4

⁹⁶ TPPA/CPTPP Article 29.4.6(e) and (f)

⁹⁷ TPPA/CPTPP Article 29.4.6(h)

⁹⁸ GATS Article XXVIII(a); TPPA Article 1.3

Conversely, the scope may be limited by operative words. The total carve-out provision in the Singapore New Zealand FTA (cited above) appears to be quite comprehensive, applying to ‘any measure imposing direct or indirect taxes including excise duties as defined by the domestic laws of the Parties so long as these duties are not used for the purpose of protecting the domestic industry of the Party imposing the duties’.⁹⁹ However, to come within the exception the measure must *impose* the tax, so it appears not to extend to measures to restrict avoidance or facilitate the functioning of the tax regime.

Recent agreements have introduced new elements, apparently with digital technologies and digitalised services in mind. The EU-Canada Comprehensive and Economic Trade Agreement (CETA) has a lengthy defensive exception for taxation measures that are applied by any level of government.¹⁰⁰ Again, ‘taxation measures’ is not defined. The exception has four main elements:

- It allows discrimination between persons who are not in the ‘*same situation*’, ‘*in particular*’ their place of residence or locus of investment. However, ‘*in particular*’ may limit the potential scope of the ‘*same situation*’;
- It protects any taxation measure whose aim is to prevent tax avoidance or evasion, pursuant to domestic tax laws or international taxation agreements or arrangements;¹⁰¹
- There is a carve-out from the agreement for six categories of measures, three of which are particularly relevant to the digital economy: (i) measures that confer better tax treatment on consumption of a service because it is provided in the territory; (ii) better tax treatment of companies or their shareholders because the corporation is owned by residents of that party; and (iii) the imposition of equitable and effective tax compliance measures;¹⁰² and
- A standstill protects any existing non-compliant tax measure.¹⁰³

⁹⁹ Singapore NZ CEP, Article 78. That carve-out has been superseded by more restrictive and complicated exceptions in many of Singapore’s subsequent FTAs with the same parties.

¹⁰⁰ Available at: <https://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/>

¹⁰¹ CETA Article 28.7.2 and 3.

¹⁰² CETA Article 28.7.4(a) to (e)

¹⁰³ CETA Article 28.7.4(f)

2.9 Other exceptions

The technicalities and complexities of these tax-specific exceptions mean that governments may have to rely, as well or instead, on other exceptions as defences when they are found to have breached a trade rule. Three justifications are considered here: prudential measures, implementation of otherwise-compliant laws, and essential security.

2.9.1 Prudential measures

The prudential defence in the GATS is located in the Financial Services Annex¹⁰⁴ and in the financial services chapter of most FTAs. The standard definition of financial services includes cross-border financial trading, asset management, provision of financial information and financial data processing and related software, and advisory, intermediation and auxiliary services. However, the prudential defence extends beyond the specific annex or chapters to apply to the entire agreement. Two features affect its application in relation to taxation measures:

- First, ‘prudential reasons’ are not conclusively defined. There is an inclusive definition that refers to the protection of investors, depositors and policy holders to whom a fiduciary duty is owed. Some FTAs have wider definitions. A taxation measure that also has a prudential purpose might, therefore, be protected - although the existence of a specific and limited exception for taxation measures could militate against its treatment as prudential.
- Second, and more problematically, the measure must not be used as a means of avoiding the country’s commitments or obligations in the agreement. There are conflicting views on the meaning of this non-circumvention language. Some limit it to an obligation to act in good faith,¹⁰⁵ while others argue it effectively cancels out the flexibility in the exception.¹⁰⁶ Hybrid prudential and tax-related measures that restrict offshore data transfer or acceptable locations, or require use of local servers, a local presence or disclosure of source codes, could be challenged as avoiding obligations in the agreement. Some FTA texts have no second sentence at all¹⁰⁷ or substitute a ‘reasonable measures’ test.¹⁰⁸ There

¹⁰⁴ GATS Financial Services Annex Article 2(a)

¹⁰⁵ Armin Von Bogdandy and Joseph Windsor (2008), ‘Annex on Financial Services’, in Rüdiger Wolfrum et al (eds) *WTO – Trade in Services*, Martinus Nijhoff, Leiden, 655

¹⁰⁶ Todd Tucker and Lori Wallach (2009), *No Meaningful Safeguards for Prudential Measures in World Trade Organisation’s Financial Service Deregulation Agreements*, Public Citizen. Available at: <https://www.citizen.org/wp-content/uploads/prudentialmeasuresreportfinal.pdf>

¹⁰⁷ CARIFORUM-EU Economic Partnership Agreement, signed 15 October 2008, provisionally entered into force December 2008, Article 104

¹⁰⁸ North American Free Trade Agreement, entered into force 1 January 1994, Article 14.10

is no jurisprudence on the GATS exception to guide regulators, let alone on the FTAs.

2.9.2 Implementing otherwise-compliant laws

If a country's tax-related measure is not protected by a positive or negative list, and the taxation or prudential exceptions does not apply, it might look to other categories within the GATS General Exceptions provision, which is routinely imported *mutatis mutandi* into FTAs.

One option is the exception for *measures to secure compliance with laws or regulations* that are themselves not inconsistent with the GATS. That requires the underlying law or regulation to be permitted under the GATS.¹⁰⁹ The text illustrates this by referring to measures relating to fraudulent or deceptive practices, and to privacy in processing and disseminating personal information. However, it uses inclusive language in doing so. The Panel in *Panama v Argentina* agreed that the exception was not limited to those two objectives and would also cover measures to secure compliance with tax laws that are GATS-consistent.¹¹⁰

Measures relying on this exception must also satisfy a necessity test and the article's introductory language (the chapeau).¹¹¹ A measure is 'necessary' if there is no alternative measure reasonably available that would achieve that objective, either on its own or as part of a raft of measures.¹¹² That may be difficult to establish where some countries have adopted less burdensome tax-related measures to achieve the same objective. In addition, the measure must not be applied in a manner that constitutes a means of arbitrary or unjustifiable discrimination under like conditions or a disguised restriction on trade in services. In *Panama v Argentina*, the Panel determined that the differential treatment of Panama, by designating it as a non-cooperative country, from the treatment of other countries with which Argentina had not yet concluded an arrangement, constituted arbitrary and unjustified discrimination in violation of the chapeau (see Part 6: 6.2).

In the case of the GATS, the law or regulation being implemented by the tax measure being challenged only has to comply with the rules on trade in services. The compliance requirement is much more onerous in multi-chapter FTAs that include often-opaque obligations on e-commerce, services and investment, and use a negative list to protect policy space. Even if that hurdle is overcome, the tax measure would still need to meet the necessity test and not breach the chapeau.

¹⁰⁹ GATS Article XIV.2(c)

¹¹⁰ *Panama v Argentina* Panel Report, 148

¹¹¹ The General Exception has only been successfully argued twice in 50 WTO disputes: Public Citizen 2019.

¹¹² Ben McGrady (2009), 'Necessity Exceptions in WTO Law: Retreaded Tyres, Regulatory Purpose and Cumulative Regulatory Measures', *Journal of International Economic Law* 12(1), 153-173

Other possible policy justifications under the General Exceptions include measures adopted to protect public morals, such as tax on online gambling, or to protect public order, such as tax-related measures to prevent or identify money laundering, illegal fundraising,¹¹³ and drug trafficking using digital technologies.¹¹⁴ However, the public order objective must involve ‘a genuine and serious threat to one of the fundamental interests of society’.¹¹⁵ Again, a measure that falls within this category is still subject to a necessity test and the chapeau. As noted earlier, there are very few disputes where WTO Members have surmounted all these hurdles.¹¹⁶

2.9.3 National security

Some tax-related measures might also be considered a matter of national security, especially where they aim to counter cyber-crime or terrorist financing, or where the grave erosion of public revenue leaves the state unable to fund its core functions and vulnerable to internal unrest and/or external intervention.

The security exception in the GATT and GATS is limited to specific circumstances. The most relevant circumstance, an ‘emergency in international relations’, would be unlikely even to allow pre-emptive or precautionary measures or measures directed at private entities. Nor would it cover a rapid and catastrophic deterioration in a country’s fiscal position that threatens severe economic, social and political consequences, where it has been bleeding revenue through cross-border digital activities and the tax-related measures fall outside the agreement’s taxation exception. The government would need to resort instead to the ‘public order’ criteria in the General Exceptions, with its limitations.

If the government could fit the tax-related measure within one of the security categories, the need to take action to protect its security interests would be self-judging. However, the WTO panel in a dispute between Russia and Ukraine ruled in 2019 that actions taken under the security exception are still reviewable to test whether there is a plausible connection between the measure and the national security interest relied on, and to determine objectively whether an emergency in international relations exists.¹¹⁷ The US rejected that ruling and insists that the

¹¹³ OECD (undated) *Report on Abuse of Charities for Money-Laundering and Tax Evasion*. Available at: <https://www.oecd.org/tax/exchange-of-tax-information/42232037.pdf>

¹¹⁴ ‘Bank of Indonesia to ban Bitcoin transactions next year’, *Jakarta Post*, 6 December 2017. Available at: <http://www.thejakartapost.com/news/2017/12/06/bank-indonesia-to-ban-bitcoin-transactions-next-year.html>

¹¹⁵ GATS Article XIV(a) footnote 5

¹¹⁶ Public Citizen 2015; Public Citizen 2019

¹¹⁷ *Russia – Measures Concerning Traffic in Transit*, DS512/R, Panel report, 29 April 2019, paras 7.77, 7.82, 7.101, 7.139. Available at: https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds512_e.htm

exception, which it is relying on for digital-related measures in relation to China, is non-justiciable.¹¹⁸

Recent agreements, including the TPPA/CPTPP, have a much broader self-judging security exception that would protect a government's regulatory interventions on a much wider range of essential security grounds.¹¹⁹ The same wording in the Korea US FTA and USMCA has a footnote that requires an investor-state or state-state dispute panel to accept the Party's assertion that the security exception applies.¹²⁰ The RCEP e-commerce chapter includes an identical exception specifically for cross-border transfers of information and makes it explicit that a state's invoking of this provision cannot be examined.¹²¹

¹¹⁸ WTO (2019), 'Members adopt national security ruling on Russian Federation's transit restrictions', 26 April 2019. Available at: https://www.wto.org/english/news_e/news19_e/dsb_26apr19_e.htm

¹¹⁹ For example, TPPA/CPTPP Article 29.2

¹²⁰ KORUS Article 23.2, USMCA Article 32.2

¹²¹ RCEP, Chapter X Electronic Commerce, final unscrubbed version, Article 15.3(b). Available at <https://bilaterals.org/?rcep-e-commerce-chapter-text-41085>

Table 1: Cross-reference of digital tax measures and trade rules

Digital tax measure	Location in text	Trade law issues	Location in Part 2
Digital Services Tax	Part 5.1	Classification National treatment Market access Local presence Administration of domestic regulation Source codes Information transfer/local server Transparency Regulatory coherence GATS tax exception	2.4.2 2.4.4 2.4.5 2.4.6 2.4.7 2.3.3 2.3.1, 2.3.2 2.7 2.7 2.8.2
Value-added tax	Part 5.2	National treatment GATS tax exception General exception	2.4.4 2.8.2 2.9.2
Cap on royalty payments offshore	Part 5.3	Performance requirements on royalties GATS tax exception General exception	2.5 2.8.2 2.9.2
Uber tax strategy	Box 4.1	Schedules Local presence National treatment Market access Data transfer/local servers Source codes Royalties performance requirements Exceptions	2.4.2, 2.6 2.4.6 2.4.4 2.4.5 2.3.1/2.3.2 2.3.3 2.5 2.8.2
Unified approach to Corporate tax on digital MNEs	Part 4.2.2 Part 4.2.3	Classifications Schedules Local presence Market access – legal form National treatment Market access Administration of domestic regulation Data transfer/local servers Transparency GATS tax exception	2.4.2 2.4.2, 2.6 2.4.6 2.4.5 2.4.4 2.4.5 2.4.7 2.3.1, 2.3.2 2.7 2.8.2
<i>Panama v Argentina</i> dispute	Box 6.1 Box 6.2	Most-favoured-nation treatment National treatment General exception	2.4.3 2.4.2 2.7.2
Access to/disclosure of information	Part 6.3	Data transfer/local servers Local presence National treatment MFN Schedules Administration of domestic regulation GATS tax exception FTA tax exception	2.3.1/2.3.2 2.4.6 2.4.3 2.4.4 2.4.2 2.4.6 2.8.2 2.8.3
Lobbying	Part 7.1 Part 7.2	Transparency	2.7
Moratorium on customs duties	Part 3	Moratorium on customs duties	Part 3.2

3

THE MORATORIUM ON TARIFFS ON ELECTRONIC TRANSMISSIONS

A KEY demand of the plurilateral negotiations on e-commerce that are proceeding without a mandate in the WTO is to make the temporary moratorium on levying tariffs on electronic transmissions permanent. The US identified that as a priority for the ministerial conference in 2020 (MC12).¹ The ministerial was postponed due to COVID-19, but the pressure has continued. At a time when the increasingly integrated digitalised economy is undermining traditional forms of taxation that countries in the Global South have relied on, the proposal for such a ban constitutes the most immediate threat to both their public finances and their industrial development.

3.1 The significance of tariffs for development

Customs duties or tariffs have been collected on the cross-border trade in goods for hundreds of years. Tariffs are a form of transaction tax and, if applied to physical goods, are relatively simple and easy to apply. They are levied on the importer of the goods based on a percentage of the import price of those goods. Tariffs are imposed on the cross-border transfer of goods, but not on the cross-border rendering of services, which were not traditionally viewed as tradeable. Consequently, international trade rules treat goods as qualitatively different from services, subject to different kinds of tax, and the tax exceptions in agreements on goods and services reflect that.

Since 1947, when a small group of largely developed countries adopted the GATT, free trade agreements have progressively reduced tariffs,² either product by product or using an across-the-board formula. According to neoclassical economics, the shift in demand towards lower-priced imports and away from less efficient local producers is expected to improve the efficient allocation of capital and human resources. Consumers also benefit from lower import prices (assuming the cuts are

¹ 'US Engagement at the World Trade Organization. Remarks by Ambassador Dennis Shea', Asia Society, Washington DC, 6 February 2020. Available at: <https://geneva.usmission.gov/2020/02/07/u-s-engagement-at-the-world-trade-organization/>

² Other mechanisms, such as quotas and important licensing, were converted to tariffs or subject to separate rules

passed on by the middlemen, of which there is no guarantee). Countries need to realign their fiscal policies to compensate for lost tariff revenue by reducing expenditure or by finding new sources of revenue, commonly by introducing a consumption tax that applies equally to domestic and foreign-sourced goods and services.

The importance of tariffs as policy tools for the Global South has been historically recognised through the centrality of special and differential treatment to the GATT. Tariffs serve a range of economic, social and employment objectives, including to protect domestic producers by making imported products more expensive. They are easily collectable sources of revenue, especially for developing countries that have rudimentary income and corporate tax regimes alongside large informal economies. Despite decades of trade liberalisation and structural adjustment programmes, tariffs remain an important source of revenue in the Global South. The World Tariff Profiles for 2019 show the level of tariffs for most developed countries range between 2% and 6% compared to 10% to 15% for most developing countries.³ Some products have much higher bound tariff levels that set the maximum they can levy, even if the rate they apply is significantly lower.

When governments negotiate tariff cuts, they are necessarily informed by their assessment of economic, social and fiscal impacts, as far as negotiating asymmetries allow. That calculation was easier when trade negotiations were focused on traditional modes of cross-border trade in physical commodities, and governments and economists could anticipate trends and calculate the fiscal consequences. The rise of offshore digital marketplaces like Amazon significantly alters presumptions on which tariff commitments have been made, including the *de minimis* threshold below which imported goods are not subject to customs duties. This shift also affects the anticipated revenue from taxing domestic bricks-and-mortar businesses and from value-added taxes on consumption. Traditional forms of cross-border commodity exchange are also progressively being replaced by digital modes of transmitting products, including additive manufacturing printing or 3D printing. As digitised products have become intertwined with services and intellectual property it is debatable whether the Harmonised System (HS Codes) that classifies globally traded products even applies to them. All countries are grappling with these complexities, but the implications for developing countries are most severe.

³ WTO (2019) 'World Tariff Profiles'. Available at: https://www.wto.org/english/res_e/publications_e/world_tariff_profiles19_e.htm

3.2 The history of the moratorium

The moratorium on customs duties on electronic transmissions has a long history. At their second ministerial conference in 1998 WTO Members adopted a Ministerial Declaration on Electronic Commerce⁴ that resulted in a Work Programme on Electronic Commerce ‘to examine all trade-related issues relating to global electronic commerce’.⁵ Ministers also decided:

*Without prejudice to the outcome of the work programme or the rights and obligations of Members under the WTO Agreements, we also declare that Members will continue their current practice of not imposing customs duties on electronic transmissions. When reporting to our third session, the General Council will review this declaration, the extension of which will be decided by consensus, taking into account the progress of the work programme.*⁶

The terms used in the Declaration were not defined, but it refers to ‘customs duties’ and not ‘taxes’. A Secretariat paper produced at the time also stated that legally the moratorium did not apply to imported products ordered online but delivered in tangible form.⁷

Renewal of the moratorium became strategically linked to the renewal of another temporary moratorium, on the scope of disputes under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).⁸ At that time, the two moratoria were viewed as a quid pro quo. Both have been routinely rolled over by ministerial conferences since then.⁹

⁴ WTO Ministerial Conference, Second Session, ‘Declaration on Global Economic Commerce, Adopted on 20 May 1998’, WT/MIN(98)/DEC/2

⁵ WTO ‘Work Programme on Electronic Commerce, Adopted by the General Council on 25 September 1998’, WT/L/274

⁶ The moratorium appears not to be enforceable under the WTO’s dispute settlement system because it is a ministerial decision, and not one of the listed agreements to which the Dispute Settlement Understanding applies

⁷ General Council, ‘WTO Agreements and Electronic Commerce. Note by the Secretariat’, WT/GC/W/90, 14 July 1998, para 15

⁸ The WTO dispute settlement procedures allow members to initiate a dispute if they consider that measures by another member are impeding the objectives or nullifying the benefits of a covered agreement, even if there is no violation of its obligations. Under Article 64.2 of the TRIPS agreement WTO Members agreed not to bring non-violation nullification and impairment complaints during the first five years, from 1995 to 1999. There have also been proposals to have that moratorium made permanent. See ‘Proposal to Permanently Exclude Non-Violation and Situation Complaints under the WTO TRIPS Agreement. Background Note’, South Centre, 20 September 2017. Available at: https://www.southcentre.int/wp-content/uploads/2017/09/Ev_170925_SC-Workshop-on-E-Commerce-and-Domestic-Regulation_Presentation-Background-Note-on-Non-Violation-Sept-2017-Nirmalya-Syam_EN.pdf

⁹ While the moratorium lapsed on two previous occasions it was renewed retrospectively. The ministerial conferences that concluded without formal declarations were Seattle in 1999, with the moratorium retrospectively extended in the Doha Declaration 2001, para 34, and in Cancun in 2003, after which the moratorium was extended by a Decision of the General Council on 2 August 2004, WT/L/579, para 1(h).

The US first sought to make the e-commerce moratorium permanent in 1999.¹⁰ Over time it has gained support from other developed countries, notably Japan. An attempt to achieve this at the eleventh WTO ministerial conference in December 2017 (MC11) failed and the temporary measure was renewed for another two years, until December 2019.¹¹ However, the next WTO ministerial conference (MC12) was not scheduled until June 2020. At the General Council in December 2019, India and South Africa led the developing countries' opposition to a further renewal, saying the original quid pro quo was no longer valid and the impacts fell disproportionately on developing countries.¹² Ultimately, the moratorium was extended until the next ministerial. The postponement of the MC12 due to the COVID-19 pandemic deferred the battle over the moratorium to an as-yet undetermined date.

In parallel to these moves within the WTO, a number of FTAs, starting with the TPPA/CPTPP,¹³ have made the moratorium permanent for parties to those agreements. Many developing countries are under now pressure to agree to include this provision in their FTAs with the US, EU and others. That would have a flow-on effect of reducing the number of countries likely to oppose a permanent moratorium in the WTO and foster divisions among the Global South.

Some countries have rejected such demands. A particularly significant counter-precedent was set by the electronic commerce chapter in the 16-country Regional Comprehensive Economic Partnership (RCEP), involving China, India, South Korea, Japan, Australia, New Zealand and the ten ASEAN nations.¹⁴ The chapter was completed in 2019, although the agreement was not scheduled for signing until late 2020. Article 12 reiterates the parties' commitment to the WTO temporary moratorium, with any future adjustments to that position depending on outcomes within the 1998 WTO Work Programme on Electronic Commerce.¹⁵ Further, the entire RCEP e-commerce chapter is unenforceable.

¹⁰ WTO, 'Submission from the United States, Work Programme on Electronic Commerce', WT/COMTD/17, 12 February 1999, 3; General Council, 'Submission from the United States, Work Programme on Electronic Commerce', WT/GC/W/493/Rev.1, 16 April 2003, paras 20-22. For a detailed background see Sacha Wunsch-Vincent (2006), *The WTO, The Internet and Trade in Digital Products: EC-US Perspectives*, Hart Publishing, Oxford.

¹¹ WTO, 'Work Programme on Electronic Commerce, Ministerial Decision of 12 December 2017', WT/MIN(17)/65

¹² WTO Work Programme on Electronic Commerce, 'Moratorium on Customs Duties on Electronic Transmissions: Need for a rethink? Communication from India and South Africa', WT/GC/W/747, 13 July 2018; WTO Work Programme on Electronic Commerce, 'The E-Commerce Moratorium and Implications for Developing Countries. Communication from India and South Africa', WT/GC/W/774, 4 June 2019

¹³ TPPA/CPTPP Article 14.3

¹⁴ Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam. India has since withdrawn from the negotiation.

¹⁵ RCEP Electronic Commerce Chapter, Article 12. The leaked text is available at: <https://bilaterals.org/?rcep-e-commerce-chapter-text-41085>

3.3 Revenue implications of a permanent ban

Developing countries are being asked to agree to make the temporary moratorium permanent without a fully informed understanding of the possible impact on their public finances and the potential of their domestic enterprise sector to participate in those digital activities.¹⁶ Successive UNCTAD studies have warned that converting the moratorium into a permanent ban would have serious future economic and development impacts.¹⁷ This report supports that finding, although it projects a slightly lower level short-term impact; however, it places greater emphasis on the potential to diminish the tax policy space of developing countries permanently and to disable tax policy over a wide swathe of internationally traded goods or services. This risk arises because:

- (i) Developing countries are more dependent on trade tariffs than developed countries;
- (ii) There is considerable ambiguity in the scope of the current moratorium, especially the nature of what is being traded internationally, which gives rise to uncertainty and contest over its scope;
- (iii) Assuming the moratorium applies to ‘digitised products’, the growth rate for this type of ‘good’ has been and will continue to be massive;
- (iv) Although existing estimates of losses of tariff revenue from the moratorium appear to be relatively small at the present time, there is potential for explosive growth in the future;
- (v) Contrary estimates from developed-country analysts that there would be net losses from *not* continuing the moratorium use different methodologies that are laden with problematic assumptions;
- (vi) Non-tariff impacts on development, especially on the policy space for developing countries to diversify their economies into sectors that are facilitated by digital technology, are not adequately factored into current assessments;
- (vii) A huge range in the estimated impacts of a moratorium on a country-by-country basis across the Global South, and an unclear trend in the future, reinforces the importance of retaining policy space; and

¹⁶ During the December 2019 discussions, the US agreed to convene a workshop early in 2020 to assess its scope and the potential revenue implications. That was scheduled for 23-24 March 2020, but was postponed. Ravi Kanth (2019), ‘US offers quid pro quo on e-commerce moratorium’, *SUNS* #9023, 20 November 2019. Available at: <https://twm.my/title2/wto.info/2019/ti191117.htm>

¹⁷ UNCTAD, *Trade and Development Report 2018*, Chapter III; Rashmi Banga (2017), *Rising Product Digitalisation and Losing Trade Competitiveness*, UNCTAD (hereafter ‘UNCTAD 2017’). Available at: http://unctad.org/en/PublicationsLibrary/gdsecidc2017d3_en.pdf; Rashmi Banga (2019), ‘Growing Trade in Electronic Transmissions: Implications for the South’, Research Paper No. 29, UNCTAD/SER.RP/2019/1, February 2019 (hereafter ‘UNCTAD RP.29 2019’). Available at: https://unctad.org/en/PublicationsLibrary/ser-rp-2019d1_en.pdf

(viii) Claims that it is technically problematic to levy customs duties are overstated, as evidence from some countries shows.

All of these arguments militate against a permanent moratorium on tariffs on electronic transmissions.

3.3.1 On the importance of collecting trade tariffs

Customs revenues are a major proportion of developing-country public revenues. This is a pattern that is almost historically preordained.¹⁸ Collecting public revenues from goods that cross a border is easier than any other kind of tax.

Figure 1 compares countries' dependence on customs duties. Reading from the bottom of the graph, the US (1% dependence on customs duties) and Japan (0.9% dependence), who are leading proponents of making the moratorium permanent, have minimal dependence on customs duties. All the developing countries are lined up above these two countries, ordered according to the extent of dependence on customs revenue as a proportion of total tax revenue. Many developing countries are up to 30 times more dependent on customs revenues than the US or Japan. For example, Bangladesh near the upper third of the figure is 28.9 times more dependent than the US, the Philippines near the middle is 18.8 times and India near the bottom 12.7 times more dependent than the US. Towards the bottom, even the notable exceptions of China (1.9%) and Brazil (2.2%) are about twice as dependent as the US at 1.0%.

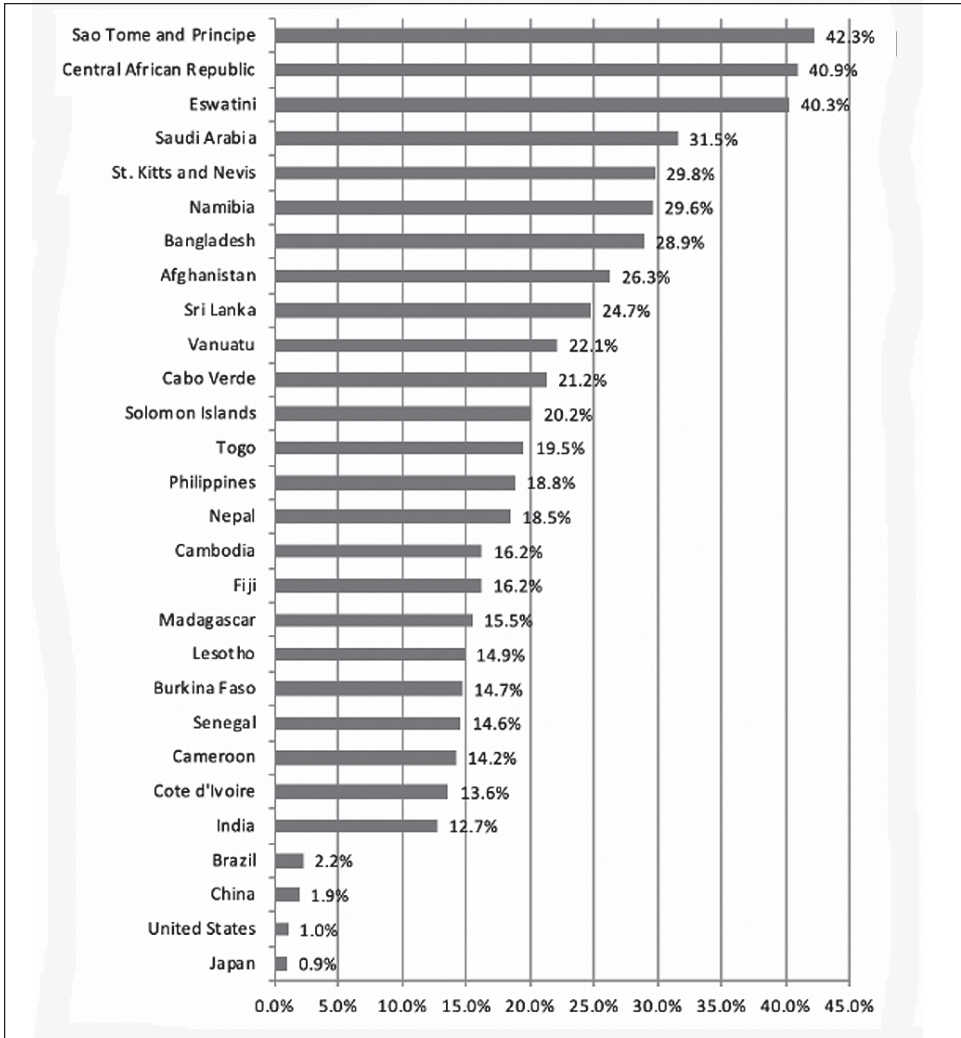
3.3.2 The contested scope of the moratorium

Serious and unresolved ambiguities currently make it impossible to determine the scope of the moratorium. The 1998 Work Programme defined '*electronic commerce*' to mean 'the production, distribution, marketing, sale or delivery of goods and services by electronic means'.¹⁹ The programme would operate through the WTO bodies responsible for four principal areas: Council for Trade in Goods, which focuses on tariff liberalisation, non-discrimination and non-tariff barriers relating to goods; Council for Trade in Services, which addresses regulatory measures affecting services; Council for TRIPS, dealing with intellectual property rights; and development matters in the Committee on Trade and Development.

¹⁸ In the United States, tariffs were the largest source of federal revenue from the 1790s to the eve of World War I, until it was surpassed by income taxes. South Centre (2012), 'Economic Partnerships Agreements in Africa: A Benefit-Cost Analysis', Analytical Note SC/TDP/AN/EPA/29, South Centre, Geneva, January 2012. Available at: https://www.southcentre.int/wp-content/uploads/2013/08/AN_EPA29_Economic-Partnership-Agreements-in-Africa_EN.pdf

¹⁹ WTO, 'Declaration on Global Electronic Commerce' (the moratorium), adopted on 20 May 1998, WT/L/274; WTO, 'Electronic Commerce Gateway' (the web page contains citations to various materials), https://www.wto.org/english/tratop_e/ecom_e/ecom_e.htm

Figure 1: Customs Duties as Share of Tax Revenue, Selected Countries (2016)



Source: Calculations by Co-author Manuel Montes

However, the moratorium (as distinct from the Work Programme) applied to *'the current practice of not imposing customs duties on electronic transmissions'*. None of the three key terms 'current practice', 'customs duties' and 'electronic transmissions' was defined. Despite various seminars, workshops and work programmes there is still no clarity on what they mean. These questions of scope have become much more acute because digitalisation has greatly accentuated two key trends: (i) the possibility for physical goods to be delivered in digital form, and (ii) the shift from sales of physical goods to the supply of services.

Two issues of interpretation are especially problematic. First, some commentators have sought to interpret the potential scope of the moratorium broadly to include the *digital delivery of services*, not just of *digitised products*.²⁰ That would expand the potential scope of the moratorium far beyond its original intention.

While the 1998 Work Programme defined *electronic commerce* in terms of goods and services, the moratorium applied to *'the current practice of not applying customs duties on electronic transmissions'*. The current practice was to apply customs duties to specified categories of goods described by HS codes that were bound under the GATT, subject to special and differential treatment. Although 'customs duties' are not defined in the GATT, the Article VII rules on customs valuation describe a dutiable item as 'merchandise', which in practice correlate to HS codes. The definition of 'customs duties' in the TPPA/CPTPP supports this interpretation: the term is defined as including 'any duty or charge of any kind imposed on or in connection with the importation of a *good ...*' and excludes any 'fee or charge in connection with the importation commensurate with the cost of services rendered'.²¹

Services transactions between foreign suppliers and domestic consumers are governed by *regulatory* disciplines under the GATS, whose rules do not address the liberalisation of customs duties. Technically, there is an area of cross-over between the two agreements: the supply of computer services, including consultancy, development and implementation of software, is classified as a service,²² whereas software in hard copy or digital form is a good, with an HS classification.²³ WTO rules on customs duties apply to the latter.

There is one element of the 1998 Work Programme that might suggest that customs duties do apply to services. In listing the topics to be addressed by each WTO body, the goods council was to consider 'customs duties and other charges as defined under Article II of the GATT'. The services council was also to consider

²⁰ Hosuk-Lee Makiyama and Badri Narayanan (2019), 'The Economic Losses From Ending the WTO Moratorium on Electronic Transmissions', No 3/Policy Brief, ECIPE. Brussels (hereafter 'ECIPE 2019')

²¹ TPPA Article 1.3

²² Sub-sector 1Bb in the classification used in the GATS Services Sectoral Classification List MTN.NGS/W/120, corresponding to UNCPProv 842

²³ For the GATT classification see HS code 49-HS 49119910 of Chapter 49

‘customs duties’, without any further elucidation. The accompanying note prepared by the Secretariat said it was only aware of one case where tariffs were applied to a cross-border service, which involved purchase by the US of ship repair services conducted offshore. However, the Secretariat treated this as indicating that customs duties could be applied and said there might be more unknown examples.²⁴ It further noted that ‘digital products’ are not restricted to digital goods and could include services.²⁵ The US subsequently corrected the Secretariat’s interpretation and ‘stressed that the US did not impose customs duties on services’.²⁶

Further, the core GATS rules on national treatment and market access do not directly apply to a customs duty on a digital product that is supplied as a service. Customs duties would need to be brought within the scope of the GATS indirectly as a ‘measure that affects the supply’ of that service and breach one of the GATS rules.²⁷ A discriminatory tax, including a tariff, could be a measure that affects the competitiveness of a foreign service supplier vis-à-vis their local counterpart. However, that would breach a Member’s national treatment obligations in the GATS only if the Member had taken commitments on the relevant service in mode 1 (cross-border supply). It is important to recall that developing countries insisted on the use of request-and-offer negotiations and positive list scheduling as a means to limit the scope of their GATS obligations.

It would be unreasonable and inequitable to extend coverage of the moratorium to services on the basis that such duties might have been possible in 1998, although even the Secretariat could find only one example, and to treat them as covered by GATS rules as a ‘measure affecting the supply’ of a service if a Member committed that service for that rule in that mode several decades ago. Indeed, the Secretariat itself, in a 2016 assessment of the fiscal implications of the moratorium, limited the scope to *digitisable goods*, and did not suggest that it might apply beyond that to services.²⁸

²⁴ Council for Trade in Services, ‘The Work Programme on Electronic Commerce. Note by the Secretariat’, S/C/W/68, 16 November 1998, paras 34-35

²⁵ There is no agreement between Members on where the boundary lies between digitised goods and services. One option is to treat all electronic transmissions that have physical counterparts, such as is the case with music, as goods, and the balance of transactions as services. Or they could all be treated as services, as the EU has recently proposed; see for example, Article X.3, EU Proposal to Indonesia; EU New Zealand Free Trade Agreement. Title [] Digital Trade, 25 September 2018, Article 7. Alternatively, all electronic transmissions could be treated either as goods or services without any distinction between the nature of what is being transmitted. The USMCA takes that side-step, saying the definition of electronic transmissions should not be understood to reflect a Party’s view that digital products are a good or are a service, leaving this definitional question in the too-hard basket for now. That might imply the extension of the moratorium to digitised goods and services under the USMCA, but it is not the terminology used in the 1998 moratorium

²⁶ Council for Trade in Services, ‘Report of the Meeting Held on 14 and 15 December 1998. Note by the Secretariat’, S/C/32, 14 January 1999, para 12

²⁷ Council for Trade in Services, S/C/W/68, paras 34-35

²⁸ General Council, ‘Fiscal Implications of the Customs Moratorium on Electronic Transmissions: the case of digitizable goods’, JOB/GC/114, 20 December 2016

There is a second disagreement on scope. Some developing countries have insisted that the scope of the moratorium is limited to the vehicle or medium of transmission and does not include the content being transmitted. At the MC11, Indonesia sought the insertion of a footnote to clarify that electronic transmissions do not include digital books, films, music, etc. The Director-General of the WTO reportedly assured Indonesia that the footnote was unnecessary because that interpretation was already clear. Indonesia subsequently put the Director-General's assurance on the WTO record:

*In regard to the discussion on the moratorium on customs duties on electronic transmissions, it is our understanding that **such moratorium shall not apply to electronically transmitted goods and services**. In other words, the extension of the moratorium applies only to the electronic transmissions and not to products or contents which are submitted electronically. The Indonesian Head of Delegation shared this understanding with the Director-General and his team yesterday and today, in which they responded with a positive confirmation.²⁹*

The Indonesian government subsequently introduced a new Chapter 99 to its customs tariff book on 'Software and other digital goods transmitted electronically', although it is yet to levy any product tariffs on these items.³⁰ Presumably this step is designed to allow them to charge tariffs on those goods in the future on the basis that they are unbound.³¹ Noting Indonesia's Statement, India and South Africa called in June 2019 for a common understanding on the scope of the moratorium before it came up for renewal later in the year.³²

Proponents of the permanent moratorium insist instead that the term 'electronic transmissions' covers digitised *products* themselves. The equivalent provisions in their own FTAs use varying definitions of their scope. The TPPA/CPTPP defines an electronic transmission as 'a transmission made using any electromagnetic means, including by photonic means',³³ and prohibits customs duties on 'electronic transmissions, including content transmitted electronically'. It defines customs duties to include a duty or charge of any kind or a surtax 'imposed on or in connection with the import of a *good*'.³⁴ It does not define 'content', which appears to be infinitely extendable as the digital technology evolves. The Digital Economic

²⁹ WTO, 'Statement by Indonesia. Facilitator's Consultation on Electronic Commerce, MC11 Declaration, and Other Relevant Plenary Sessions', WT/MIN/17(68), 20 December 2017. Emphasis added

³⁰ Indonesian Government Regulation number 17/PMK.010/2018 ('PMK-17'), enacted on 15 February 2018. Available at: <https://www2.deloitte.com/content/dam/Deloitte/id/Documents/tax/id-tax-info-apr2018.pdf>

³¹ However, they could also do this by adding another digit to existing HS-codes to reflect the same good, transmitted electronically.

³² WTO Work Programme on Electronic Commerce, 'The E-Commerce Moratorium and Implications for Developing Countries. Communication from India and South Africa', WT/GC/W/774, 4 June 2019, para 3

³³ TPPA/CPTPP Article 14.1

³⁴ TPPA/CPTPP Article 1.3

Partnership Agreement (DEPA) between Singapore, Chile and New Zealand is the same.³⁵

The USMCA provision is wider. It bans '*customs duties, fees and other charges*³⁶ on or in connection with the importation or exportation of digital products transmitted electronically' and defines 'digital products' as a 'computer programme, text, video, sound recording or other product that is digitally encoded, produced for commercial sale or distribution, and that can be transmitted electronically'.³⁷ These moves to constantly widen the scope of the moratorium may not matter so much for developed countries, which rely far less on tariffs, but it would have a significant impact on developing countries.

The EU's multiplicity of approaches highlights a further complexity. The EU's FTA with Japan simply says: 'The Parties shall not impose customs duties on electronic transmissions'.³⁸ The EU's proposal to the WTO e-commerce plurilateral from April 2019 follows the TPPA: 'members shall not impose customs duties on electronic transmissions, which include the transmitted content'.³⁹ However, the EU's approach in recent FTA negotiations is very different: 'Parties agree that *electronic transmissions are the supply of services* under the cross-border services chapter and neither party may impose customs duties on electronic transmissions'.⁴⁰ The implications of treating the moratorium as if it applies to services, rather than products under the GATT, are discussed above and again below. The point here is that developing countries are being pressured to adopt divergent, and potentially conflicting, versions of a permanent moratorium, which will heighten the already significant legal uncertainties.

Those legal risks are compounded by other features of recent FTAs. The WTO moratorium appears not to be enforceable as it is not one of the listed agreements to which the Dispute Settlement Understanding applies, although it is still a binding legal obligation.⁴¹ However, the ban on customs duties in FTAs is directly enforceable. Further, taxation exceptions in some FTAs exclude 'customs duties' from the definition of 'taxes and taxation measures',⁴² so the tax exception would not apply to measures that breached the ban under those agreements.

³⁵ DEPA Articles 1.5 and 3.2

³⁶ The TPPA (later the CPTPP), DEPA and USMCA say the ban does not preclude the imposition of internal taxes, fees, or other charges on content transmitted electronically, 'provided such taxes are imposed in a manner consistent with the Agreement'. In the TPPA/CPTPP and USMCA that means the tax measure must be consistent with the investment, e-commerce, financial services, telecommunications and transparency chapters – any of which might restrict the scope of the exclusion as a 'measure that affects' the relevant commercial activity. For example, TPPA/CPTPP Article 14.3.2

³⁷ USMCA Article 19.3

³⁸ Japan EU FTA Consolidated Text, 7 December 2017, Chapter 8, Article 3

³⁹ 'Joint Statement on Electronic Commerce. EU Proposal for WTO Disciplines and Commitments Relating to Electronic Commerce', INF/ECOM/22, 26 April 2019, para 2.5

⁴⁰ For example, Article X.3, EU Proposal to Indonesia; EU New Zealand Free Trade Agreement. Title [] Digital Trade, 25 September 2018, Article 7.

⁴¹ WTO, Agreement Establishing the World Trade Organisation. Annex 2: Understanding on rules and procedures governing the settlement of investment disputes, adopted at Marrakesh on 15 April 1994, para 2

⁴² TPPA/CPTPP Article 29.4.1

These questions of scope and interpretation are fundamental and will remain contested as digital technologies evolve and digital products substitute for traditional commodities. Other concerns aside, prior agreement on which products are implicated by electronic transmission at the level of HS system codes⁴³ should be a prerequisite for discussion of the future of the moratorium, with provision for renegotiating the list in the future. Without such clarity, developing countries would be surrendering tax policy in a very important part of the tax toolkit.

3.3.3 The accelerating rate of growth of this type of 'good'

Trade in digitalised goods is a major component of the rapidly expanding global digital economy. That dynamic is driven, in part, by the application of digital technologies to 'legacy' activities, such as telecommunications, banking and payments, and transportation; in part by the introduction of new mediums to enable transactions, such as digital platforms and market-places; and through the integration of digital technology with tangible goods, whether computer-readable products like books or films, or as smart products and the 'Internet of things'.

Recent estimates indicate a very high growth rate in the trade of digitisable goods, substituting for the equivalent physical goods. These estimates necessarily draw on historical data by analogy, because such goods have not previously been subject to tariffs. Both UNCTAD's 2019 paper and this paper apply historical data based on 49-HS categories over the period 1998-2010.⁴⁴ Both studies suggest a plateauing, if not a ratcheting down, of digital-equivalent physical goods imports after 2010.⁴⁵ The rapid penetration and substitution of these digitisable products can be attributed to lower transportation costs and possibly superior quality, alongside their lower cost due to exemption from tariffs applicable to physical imports.

The UNCTAD 2019 study uses the average annual growth rate of global imports of 49 digitisable products for the period 1998-2010 (8%) as a trend rate of growth, to estimate a figure for physical imports of these items in 2017 of \$255 billion. Compared to the actual imports of these physical goods of \$116 billion, this gives an estimate of the impact of substitution of \$139 billion, or 55% of the total imports of digitisable goods. Using the average annual growth rate underweights the higher growth rates in the middle years of the data and overweights the final year, which was an unusual year because of the global downturn subsequent to the 2007-08 financial crisis. Also, estimates using historical growth rates do not recognise the possibility of an acceleration of the growth rate in the future.

There are two main studies supporting a ban on customs duties for electronic transmissions, one by the European Centre for International Political Economy

⁴³ As in UNCTAD 2017, 12 and UNCTAD RP.29 2019

⁴⁴ See UNCTAD RP.29 2019, 10

⁴⁵ UNCTAD RP.29 2019, 12, figure 1

(ECIPE)⁴⁶ and one from the OECD,⁴⁷ both published in 2019. These studies doubt that this rapid rate of substitution will continue, and suggest that there is a limit to how much of this kind of trade can be digitised, and hence that the estimates of lost tariff revenues may be overstated. An additional consideration is that trade in the 49 HS-category products used in the UNCTAD methodology to estimate digitisable products represents only 1.2% of the total trade,⁴⁸ and thus the potential additional tariff potential is relatively small.

This report agrees that there is much uncertainty over the paths and the speed that technological development will take. As in the previous industrial revolutions, digital technology is rapidly being applied in many areas of the economy and human activities. Successful application in one area often migrates into others; little did the camera industry expect that telephones would become the dominant method for taking still pictures and, to an increasing degree, video recording. The 49-HS categories, which involve physical goods such as films, books, sound recordings, and computer software,⁴⁹ are rapidly growing areas of human activity that have many interconnections with other products. More importantly, because of the continued evolution of digital technology, it is highly likely that digitisable products will expand beyond these 49-HS categories. For example, the introduction of additive manufacturing (3D printing) allows for physical imports of equipment and components to be replaced by the transmission of the specifications for domestic assembly.

3.3.4 Estimates of and methodologies for tariff revenue and economic activity lost

Divergent estimates of the impact of the moratorium on developing countries reflect these ambiguities and uncertainties, as well as major differences in methodology. In making these estimates, the first step is to *estimate the potential losses in tariff revenue* from the moratorium. Estimating tariff revenues foregone requires assumptions about what might have been collected if the products had not been electronically transmitted, and about the future trends in digitisation of traded goods and services, as discussed above.

The second step requires *estimating the impact on the economy of lost tariffs*. The UNCTAD 2019 study confines itself to estimating tariff losses from 49-HS product groups. The estimate for value of online imports is calculated by subtracting the actually observed product-by-product physical imports after 2010 from an extrapolated estimate of the imports using growth rates before 2010.⁵⁰ The UNCTAD

⁴⁶ ECIPE 2019

⁴⁷ Andrea Andrenelli and Javier López González (2019), *Electronic transmissions and international trade – shedding new light on the moratorium debate*, OECD Trade Policy Papers, No. 233, OECD Publishing, Paris (hereafter ‘OECD 2019’). Available at: <http://dx.doi.org/10.1787/57b50a4b-en>

⁴⁸ OECD 2019, 5 and 17

⁴⁹ 49-HS 49119910

⁵⁰ UNCTAD RP.29 2019, 10

study estimates that by 2017 some 55% of global imports of the identified digitisable products are electronic transmissions, which escape customs duties, while 45% are physical imports, which do not.⁵¹ Importantly, UNCTAD assumes that if the moratorium continues, all physical imports will be digitised and thus free from tariffs.

This report uses the same methodology, but applies the slightly lower 7% annual growth rate for electronic transmissions.⁵² It also assumes that imports of electronically transmitted products now in physical form will effectively stay in physical form in the future and will *not* be replaced at any time in the future by their digitised counterparts. This contrasts with the UNCTAD study's assumption that, with a permanent moratorium, all physical imports of this type would be digitalised. The truth would be somewhere in between, but it is difficult to make a judgement where this would be.

Table 2 compares the UNCTAD and this study's estimated tariff losses: whereas UNCTAD finds that developing countries would lose \$4.46 billion in tariffs on electronically-transmitted goods based on bound tariff levels, this study finds, with the alternative estimated growth rate, the tariff losses to be about \$4.42 billion.

3.3.5 Methodological flaws in studies supporting the moratorium

The methodologies of the two most recent studies supporting the moratorium, from ECIPE and the OECD, differ slightly from each other. Both studies estimate the benefits and costs of not having a moratorium by simulating the impact of an increase in tariffs on products where none are collected now. Reasoning that tariffs increase the cost of imported goods to domestic consumers/users of the product and so reduce consumption, which reduces GDP growth with negative welfare effects, they suggest that the quantitative losses in welfare exceed the benefits to be gained from collecting tariffs. Both studies make problematic assumptions and have significant methodological flaws.

The **ECIPE study** (2019), which acknowledges the support of the Global Services Coalition, evaluates the economy-wide impact after the imposition of tariffs. Whereas the largest *tariff loss* estimate in the UNCTAD study was \$10 billion, the ECIPE study finds that developing countries would suffer *welfare losses* of \$13 billion.⁵³ That calculation in effect portrays welfare losses as exceeding any gains in tariffs collected if the moratorium was eliminated. The study contends that public finances are threatened by the *non-extension* of the moratorium, because the imposition of tariffs on this subgroup of products would reduce economic activity and thus inflict even more public finance losses. In the scenario where all trading countries impose tariffs in retaliation for others' tariffs on digitisable products, it

⁵¹ UNCTAD RP.29 2019, 11

⁵² The UNCTAD study finds an average annual growth rate of 8%, estimated by getting the straight average among the growth rates of the historical data. This study estimates the annual growth rate assuming a compounding process inside the historical data.

⁵³ ECIPE 2019, 3

Table 2

Moratorium: Estimated per annum tariff revenue loss on electronic transmissions for WTO developing countries				
	Physical Imports of Digitisable Products (\$Bn)	Estimated Online Imports or ET of Digitisable Products (\$Bn)	Potential Tariff Revenue Loss using Average Bound Duties (\$Bn)	Potential Tariff Revenue Loss using Average MFN Duties (\$Bn)
This study	36.85	35.1	4.42	2.28
UNCTAD (2019)	28.4	51.56	4.46	2.79

Source: ‘This study’ data are from author’s calculations: estimates for potential tariff losses are calculated by applying the average tariff estimates of 12.6% and 6.5% from Columns 5 and 6, respectively, in Row 2 in UNCTAD RP.29 2019 on estimated online imports from Column 3. All UNCTAD data derived from UNCTAD RP.29 2019: (1) For estimates of physical and estimated online imports see Columns 2 and 3 of Row 2 in Table 3; (2) For potential tariff losses, data are from totals over 58 countries of Columns 4 and 7 in Table 4.

Notes:

- Annual figures based on imports for the year 2017.
- Definition of ET follows UNCTAD RP.29 2019.
- This study’s estimate of tariff losses does not include possible losses from imports that are now occurring physically. For example, if lost tariffs on physical imports, on the assumption that these are later digitised, were included in this study’s estimates, the number in column 6, row 2, would be \$9.24 billion, close to UNCTAD RP.29 2019’s estimate of \$10.1 billion in its Table 3, page 18.

estimates a welfare loss of US\$13 billion for developing countries, representing ‘between 12 to 244 times more than the tariffs’ that could be collected.⁵⁴

There are important flaws in the ECIPE methodology and its implementation.⁵⁵ The study applies the method of computable general equilibrium modelling (CGE) to estimate the economic impact. It uses a data set common to CGE trade modelling known as GTAP,⁵⁶ which does not have the actual electronically transmitted products

⁵⁴ ECIPE 2019, 11

⁵⁵ Rashmi Banga (2019), ‘Modelling Impact of Moratorium on Electronic Transmissions Using CGE: A Critique’, *Advances in Social Sciences Research Journal* 6(8), August 2019, 391-400 (hereafter ‘Banga 2019’) DoI:10.14738/assrj.68.6966

⁵⁶ The GTAP data set is heavily used in the numerical evaluations of trade policies. GTAP contains bilateral trade data for each of the major product categories for all countries (with a few exceptions in the case of very small economies). It is a very large data set. It is prohibitively costly to create a different data set for products not already in the data, because the data set seeks to be consistent so that the export of a product of one country is equal to the import of the bilateral partner. Users of GTAP often seek to shoehorn the existing data set for their purposes. In this case, that appears to involve applying fractions on the four bilateral services trade categories in the data set, those fractions being based on some estimate of how much of the services can be related to electronically transmittable products. For example, applying such a fraction would seek to exclude services that would involve the retail sale of automotive fuel, which is part of the ‘retail and wholesale trade services’ sector in GTAP

broken out separately as specific products. As noted earlier, the WTO moratorium applies to *digital goods*. The WTO Secretariat conducted a study in 2016 on the impact on online deliveries of *digitisable goods*, which are physical goods with the potential to be digitalised and then transmitted digitally.⁵⁷

However, the GTAP model aggregates data that includes broad *services* sectors. The ECIPE study simply asserts that the term ‘electronic transmissions’ is ‘potentially very broad and may be used to justify tariffs on the online provision of goods and services’, with no attempt to relate that assertion to the moratorium itself.⁵⁸ From there, it focuses its assessment of the impacts of removing the moratorium in relation to *four services*: (a) wholesale and retail trading services, (b) recreational and other services, (c) communications services, and (d) business services not elsewhere classified. While these services are highly significant for e-commerce, they are outside the scope of the moratorium.⁵⁹ The ECIPE researchers then estimate the impact of potential tariffs that terminating the moratorium could unleash on these four service sectors – introducing another artifice, that of ‘tariffs’ on services. By treating electronic transmissions as services the study appears to be aligning its analysis with the novel position the EU has been promoting in its recent FTAs, noted above.⁶⁰

Furthermore, CGE models are restricted to a static set of product and service sectors for which a sector-by-sector data set has been created or is available. When applied to trade issues, that necessarily means the main impact of tariffs is to reduce welfare through losses in the ‘consumer surplus’ (benefits to consumers of lower prices), because tariffs raise the domestic prices on goods on which they are levied. It does not reflect the possibility that higher tariffs on imports could stimulate domestic production, which generates new employment opportunities and additional incomes. The typical CGE model considers such effects to be outside the model and treats them with scepticism.

Consistent with other applications of the CGE methodology, ECIPE’s concluding section appeals to the potential for greater trade liberalisation to stimulate growth and development, even though the methodology does not contain formal equations that embody these considerations. At its most basic, the study recites the familiar argument that removing obstacles to electronically transmitted imports will facilitate the rise of new internationally competitive enterprises and permit developing countries to participate more deeply in the digital economy.

⁵⁷ WTO, ‘Note by the Secretariat’, JOB/GC/114, 2016, cited in Banga 2019, 393

⁵⁸ ECIPE 2019, 7

⁵⁹ S/C/W/68, 16 November 1998, paras 34-35

⁶⁰ For example, Article X.3, EU Proposal to Indonesia; EU New Zealand Free Trade Agreement. Title [] Digital Trade, 25 September 2018, Article 7

In line with the position of developed countries, the *OECD study* (2019) released in November 2019 supports the effort to prohibit customs duties permanently.⁶¹ The study examines the direct revenue impact of an extension of the temporary moratorium (not a *permanent* moratorium) on tariffs on electronic transmissions, based on the product list used in UNCTAD's 2019 analysis.⁶²

The report finds the estimated potential foregone revenue for developing countries to be low (0.08% - 0.23% of overall government revenue), in large part because at the present time electronic transmissions represent only 1.2% of total trade. To generate its main numerical results the study relies on a sector-by-sector⁶³ calculation of the introduction of tariffs on the 49-HS product categories and tariff assumptions utilised by the UNCTAD study. The authors find that *welfare losses* exceed *gains in tariff revenue*, especially in developing countries, and concludes that 'customs duties on electronic transmissions will reduce the benefits associated to digitisation (lowering trade costs), prioritising government revenue over consumer welfare'.⁶⁴

The OECD's analysis draws on two recent studies that use US trade data to evaluate protectionism provoked by recent US policies to impose tariffs.⁶⁵ These studies find that the costs of these policies are borne by domestic consumers, with harmful impacts on productivity, employment, and balance of payments. That methodology and its related policy arguments may well be applicable to developed countries, although it is notable that they can be disregarded in relation to specific sectors whose expansion these countries are themselves prioritising.⁶⁶ They are much less applicable to developing countries, which might be more willing to accept the estimated welfare losses generated from higher prices for specific HS products with the aim of creating new domestic enterprises in these sectors.

⁶¹ OECD (2019), 'Trade in the Digital Era'. Available at: <https://www.oecd.org/going-digital/trade-in-the-digital-era.pdf>. This is a declassified version of Andrea Andrenelli and Javier Lopez Gonzalez, 'Electronic Transmissions and International Trade – Shedding new light on the Moratorium Debate', Working Party of the Trade Committee, TAD/TC/WP(2019)19/FINAL, 4 November 2019. This paper refers to the published form as OECD 2019

⁶² Inferred from OECD 2019, 6

⁶³ The study uses econometric techniques to estimate the demand and supply schedules for each of the 49 HS-product category markets (OECD 2019, Annex C, 46-49) on which the welfare analysis can be applied

⁶⁴ See OECD 2019, 44. The same and the following page report the main empirical results in Table A.3 'SMART Simulations – tariff reductions on digitisable goods, USD 1000'

⁶⁵ See Pablo Fajgelbaum et al (2019), 'The Return to Protectionism', *NBER Working Paper Series*, No. 25638, National Bureau of Economic Research, Cambridge, October 2019. Available at: <http://www.nber.org/papers/w25638>; and Alberto Cavallo et al (2019), 'Tariff Passthrough at the Border and at the Store: Evidence from US Trade Policy', *NBER Working Paper Series*, No. 26396, National Bureau of Economic Research, Cambridge, October 2019. Available at: <https://www.nber.org/papers/w26396>

⁶⁶ For example, the US undertakes extensive industrial policy measures, even while denying their existence. See Robert H Wade (2017), 'The American paradox: ideology of free markets and the hidden practice of directional thrust', *Cambridge Journal of Economics* 41(3), May 2017, 859–880. Available at: <https://doi.org/10.1093/cje/bew064>

The OECD study relies on a number of other unsubstantiated presumptions,⁶⁷ notably the reduction in transport costs (which would be welfare enhancing for consumers, but not necessarily for shippers) and the possibility that the increased use of imported inputs could stimulate ‘export diversification, productivity growth and rising domestic value added in exports’.⁶⁸

3.3.6 Non-tariff impacts on development

These proponents of a permanent moratorium support their arguments by appealing to economic factors that are not explicitly covered by their statistical modelling. The UNCTAD study and this report do not go beyond estimates of the impact on potential tariffs to be collected. While the ECIPE study’s CGE methodology and the OECD study’s partial equilibrium, product sector-by-sector methodology allow for a more complete evaluation of the proposals for a permanent moratorium, the crucial question is whether the outcomes reflect the totality of the development challenge to developing countries.

Both the studies rely on the assumption that there are a fixed number of product sectors in developing countries. That assumption ignores the main challenge that, in order to achieve structural transformation, developing countries must transit from being consumers of imported products to being producers. Historically, because new activities are not commercially profitable for domestic enterprises, successful efforts to introduce new economic activities require governments to subsidise investment and protect the activities from import competition until they can match their counterpart foreign products in cost and quality.⁶⁹

If a government finds it in its long-term strategic interest to enter an electronically transmitted sector, for example, to upgrade domestic software design capacity, it must have the tools to undertake these policies. A permanent moratorium will prohibit protection through tariffs. Moreover, these kinds of policies often require subsidies for the priority industry. For example, a government might want to subsidise the import of a 3D printer, a physical good, to assist a domestic start-up to debug software that embodies designs of equipment and parts not presently available locally. Other strategies might use duty drawbacks on the import of the 3D printer for those importers in the priority list, but not for others. While not directly related to tariffs, such measures may fall foul of other trade rules on subsidies.

⁶⁷ OECD 2019, 27

⁶⁸ OECD 2019, 29

⁶⁹ Manuel F Montes (2017), ‘Industrialization, Inequality, and Sustainability: What Kind of Industry Policy Do We Need?’ in Civil Society Reflection Group (eds) *Spotlight on Sustainable Development 2017: Reclaiming policies for the public*, 89-97. Available at: https://www.2030spotlight.org/sites/default/files/download/spotlight_170626_final_web.pdf

The requirements of industrial policy go beyond the question of raising tariffs on all electronically transmitted products. Effective industrial policies involve tariff increases (and decreases) on specific imports targeted to the development of new economic activities. Developing country governments could subsidise importation through electronic transmissions for industrial development purposes. During the period when they are not yet prioritising the local manufacture or design of a specific electronically transmitted product, they could apply zero tariffs on inputs if that policy would accelerate the upgrading of the competitiveness of their participating enterprises. At a later time, when the potential to produce an electronically transmissible product emerges, they could then raise the tariffs to protect domestic start-ups entering the market.

The question of whether VAT could substitute for tariffs foregone, as suggested in both the ECIPE⁷⁰ and the OECD⁷¹ studies, is emblematic of the problems when research focuses on tariffs without addressing the industrial development perspective. Suppose a country sought to break into producing 3D printers. A VAT on the physical ink of the printer, as those studies suggest, would be insufficient, irrelevant and contrary to the requirements of industrial development. At present, 3D printers are physically imported, and a tariff could be imposed on the physical import during the learning phase to stimulate domestic design and production of such printers. But if in the future the specifications and design of such printers can be electronically transmitted, the country must have the capacity to impose a tariff on this method of importing a foreign-designed 3D printer. A VAT on the ink of the printer might partially compensate for loss of tariff revenues, but it will not prevent the importation of the printer by electronic means.

3.3.7 Diversity of impacts among developing countries

When compared to developed countries, developing countries have a wider range of levels of development, colonial legacies, political and cultural traditions, geographical and population size and built-up capabilities, as well as different profiles of commodity exports and imports. They therefore have wide-ranging levels of interest and capability to export, and to absorb electronically transmitted imports, at present and potentially for the future.

Aggregate estimates of developing-country losses from imposing tariffs (such as the ECIPE study) ignore a wide range of losses from non-imposition of tariffs. Whether to cut tariffs on electronic transmissions, and if so by how much, depends not just on the size of revenue losses, but most importantly on the industrial strategy of individual countries with regard to electronically transmitted products. Does the country already have sectors that would benefit in terms of more rapid growth and domestic innovation by facilitating access to – and thus lower tariffs on –

⁷⁰ ECIPE 2019, 3

⁷¹ OECD 2019, 20

electronically transmitted products? Are there sectors whose expansion and upgrading it has decided to support by protecting them from competing imports through tariffs?

A particularly promising potential for developing countries' exports appears to be in specific areas of software products (such as web design, adaptation of software to local conditions, trouble-shooting), remote services (such as remote accounting and financial services and medical procedures), and the export of cultural products (such as movies and telenovelas).⁷² Some leading developing countries and some LDCs, such as Bangladesh, are participating significantly in these sectors and have a huge growth potential. Most of these are services, not digitisable goods, and not subject to the moratorium – although they may be subject to restraints under the GATS and other trade in services agreements.

The crucial longer-term consideration is that a permanent moratorium would vastly reduce the policy space of developing countries to address rapidly growing, and poorly defined, trade in digitised goods. Because there are currently no bound tariffs for digitisable products which move online, developing and developed countries could raise them for domestic policy reasons in the absence of a moratorium. This means the actual potential tariff revenue loss could be higher than projected by both the UNCTAD study and this report.

It can also be argued that the share of tariff revenue loss incurred by developing countries might be lower (since there is no reason to presume that developed countries would be constrained to have similar duties as developing countries). That is a distinct possibility and another unknown. At present, the temporary moratorium mainly benefits large digitalised companies, almost all of which are US companies, and provides these companies with first-mover advantages to the disadvantage of all other countries. Even European countries are aggrieved about their inability to obtain sufficient tax revenues from their operations. These same European companies would potentially be disadvantaged in the same way as developing countries if the moratorium is made permanent.

To reiterate, developing countries exhibit a wide range of industrial development. Not all will want to levy tariffs on many electronically transmitted products. Some, perhaps many, of these countries might find it in their interest to extend the tariff moratorium on electronic transmissions at the present time – but they could opt to apply tariffs unilaterally without a moratorium. Other developing countries who seek to develop their own digital enterprises for industrial development purposes or even security reasons would prefer to have the policy space to be able to levy tariffs. For both types of developing countries, a permanent moratorium is neither necessary nor prudent.

⁷² See Country Profiles 2005–2014 in UNCTAD (2019), *Creative Economy Outlook: Trends in international trade in creative industries, 2002-2015*, UNCTAD, Geneva, 24. China reports a surplus of \$29 billion in its creative trade in 2015, India, Thailand and Indonesia of around \$2 billion each.

Table 3 presents an estimate of electronically transmitted exports from developing countries for the year 2017, based on historical data (2002-2010, the same period used to estimate the imports for the year 2017). For developing-country exports to developed-country destinations, the movement to online transmission is particularly significant.

Table 3 indicates that the movement to transmission online since 2006 was particularly acute for the region it consolidates as 'Greater China', which includes China, Hong Kong-China, Macao-China, and Taipei-China; for the other developing countries the movement to online transmission has been less severe. The last four rows in Table 3 provide an estimate of the tariff values that can be collected from developing-country exports based on different tariff levels. The elasticity of demand for these products determines the distribution of incidence (which population finally absorbs the cost) of the tariff. The total duty which a developing country might avoid with a moratorium on the exports of electronically transmitted products appears to be significantly lower than the tariff revenue it would lose with such a moratorium. That includes China,⁷³ which is a big exporter as well as importer of electronically transmitted products, but the value of its imports exceeds its exports, which were estimated as in the order of \$37 billion in 2014. As such it is rational for the developing-country group not to support the continuation of the moratorium even at this present time.

3.3.8 Technical feasibility

The final argument to be addressed regarding the moratorium relates to the feasibility of levying customs duties on e-transmissions. ECIPE argues that it would be 'costly and technically complex' and 'impose undue administrative burden on not just producers and consumers but also tax authorities and carriers'.⁷⁴ South Africa and India expressly rebutted this argument in 2019, pointing to a number of countries, including Australia, New Zealand, the EU, Indonesia and India, that are now taxing intangible, including digital, products, which indicates that this should also be possible for electronic transmissions.⁷⁵ Likewise, some form of the mechanisms developed to impose VAT on the trade in services should also be suitable for the imposition of tariffs on electronic commerce, to the extent that a tariff can be analogised to a VAT.

Technical capacity is also not a valid argument in favour of a permanent moratorium on digital goods (or, perhaps, services or intellectual property payments) from a development perspective. It is an argument in favour of upgraded technology that not only gathers information on users, but also their origin of the transmissions.

⁷³ UNCTAD RP.29 2019, 8. China's export figure was based on a WTO note on Fiscal Implications of the Customs Moratorium on Electronic Transmissions, 2016-JOB/GC/114, 20 December 2016

⁷⁴ ECIPE 2019, 15

⁷⁵ WT/GC/W/774, 4 June 2019, para 4

Table 3. Estimated developing-country electronically transmitted exports (2018, \$billion)

	All Developing Countries		Developing Countries Except Greater China	
	To Developing Countries	To Developed Countries	To Developing Countries	To Developed Countries
		Total		Total
Total estimated exports of ET products	17.20	48.82	3.05	3.23
Actual recorded exports of physical ET products	12.40	17.57	2.89	1.97
Estimated exports of ET products moved online	4.80	31.25	0.16	1.26
Simple Average of Bound Duties in 2017 (%)	12.60	0.20	12.60	0.20
Simple Average of MFN Duties in 2017 (%)	6.50	0.20	6.50	0.20
Potential Tariffs on online ET exports using Average Bound Duties (\$bn)	0.60	0.06	0.02	0.00
Potential Tariffs on online ET exports using Average MFN Duties (\$bn)	0.31	0.06	0.01	0.00
		0.67		0.02
		0.37		0.01
				6.28
				4.85
				1.43

'Greater China' includes the applicable bilateral trade statistics of China, Hong Kong-China, Macao-China, and Taipei-China. The assumption is that the internal trade of these jurisdictions interacts with other developing countries and with developed countries as an integrated entity, which might not apply to certain products. Some of the sums in the table are subject to rounding adjustments.

Source: Calculations by co-author Manuel Montes

The increasing occurrence of Internet crime, such as the profitable demands for ransom payments for restoring access to data needed by public authorities,⁷⁶ is prompting changes to the Internet protocol to facilitate the identification of transmitting parties and their location.

The participation of countries from the Global South in any WTO or FTA negotiations needs to be based on a clear understanding of whether a permanent moratorium on tariffs on electronic transmissions is in their interest. There is a profound disagreement over the potential impact of such a prohibition on developing countries' public finances and the potential of their domestic enterprise sector to participate in the same activities. The resolve of certain members of the WTO to pursue this demand is unethical and antithetical to the development acquis that the multilateral trading system has long espoused.

⁷⁶ Renee Dudley and Jeff Kao, 'The secret trick by firms using cyberhacking victims: pay the ransom', *The Guardian*, 15 May 2019. Available at: <https://www.theguardian.com/technology/2019/may/15/ransomware-samsam-payments-bitcoin-scam>

4

TAXING DIGITALISED CORPORATIONS

ONE way for developing countries to improve their public finances, aside from tariffs, is to tax the increasingly powerful digital corporations that pay very little tax anywhere in the world, especially in source countries where they have no physical presence. That is easier said than done. In a global digitalised economy taxing the profits or income of MNEs creates a contest over the allocation of taxing rights on the earnings of companies across different jurisdictions. How that income is attributed will have profound development consequences. Statutory rates of corporate income tax have suffered a sharp race to the bottom since 1980.¹ Today, developing countries are twice as dependent on corporate income tax revenues as OECD countries.² Ineffective or inappropriate reforms could harm their public finances much more significantly.

This Part examines how trade in services and e-commerce rules enable tax avoidance strategies of digital MNEs and the arm's-length principle, and may frustrate initiatives at the multilateral, regional or national level to tax digitalised corporations where their activities take place and value is created.

4.1 International tax avoidance practices

Multinational enterprises have numerous techniques to reduce their effective tax rates on corporate income to very low levels. A key strategy is to establish subsidiaries in small jurisdictions that have no income tax, or in developed countries that have low tax rates, such as Ireland. Another is to create subsidiaries in countries whose tax laws shelter certain types of income, such as royalties paid on intellectual property like software. These strategies generally involve complex corporate structures that assign ownership of assets such as intellectual property rights, or functions such as corporate finance, to subsidiaries in countries applying no or low

¹ Ernesto Crivelli, Ruud de Mooij and Michael Keen (2016), 'Base Erosion, Profit Shifting and Developing Countries', *FinanzArchiv. Public Finance Analysis* 72(3), 268-301, Figure 2

² Crivelli, de Mooij, Keen 2016, Figure 1

tax to foreign income on royalties or interest, while such payments reduce the taxable business profits of operating entities in high-tax countries.³

Such strategies are not new. However, the development of the digital economy has made it increasingly possible to generate large revenues from countries anywhere in the world with little or no physical presence in those countries. This may involve the cross-border sale of goods, or most often the delivery of services into a country, while channelling the revenue to a low-taxed foreign jurisdiction. Highly digitalised MNEs increasingly operate a digital platform or an Internet marketplace from one or more global hubs that facilitate interactions between users, or users and service providers, again channelling the revenue they generate from fees, advertising and the trading of data to a low-tax jurisdiction. Where digital MNEs do have a legal presence in countries where they operate, those local affiliates generally conduct only low-value activities.

A common form of payment between related parties covers the rights to use intellectual property (IP). Typically, a low-taxed company acquires the IP in one of several ways: by funding its research and development, by buying it after it was developed, or by receiving the IP as a capital contribution. Once the low-taxed company owns the property, it licenses its use to various operating companies and receives royalties in return under the licence. The royalty payments are routed through countries that do not tax royalties on IP or that have tax treaties with the source jurisdictions that reduce or eliminate any withholding taxes that would otherwise be due on them.

A further technique uses a low-taxed treasury centre to make related party loans. Because the treasury centre is often funded largely with capital, it can charge high interest on related party loans and earn a wide spread because it is funding the loans out of interest-free capital. These high rates are often rationalised as those that the operating company would have to pay if it borrowed on a stand-alone basis. When high interest rates are successfully challenged by local tax authorities, the rate will usually be reduced, but remain significant. As with the case of royalties, the interest payments are routed through companies in countries that have the benefit of tax treaties or provide favourable tax treatment for them. Once the low-taxed income is accumulated offshore, the MNE may repatriate it to its parent company, in cases where the parent's resident jurisdiction exempts foreign-earned income from tax. Where there is no such exemption (as under the US tax law prior to the Tax Cuts and Jobs Tax Act 2017 (TCJA))⁴, it is reinvested offshore so the parent

³ Sol Picciotto (2018), 'International tax, regulatory arbitrage and the growth of transnational corporations', *Transnational Corporations* 25(3), 27-53, 40-43. Available at https://unctad.org/en/PublicationChapters/diaeia2018d5a3_en.pdf

⁴ US Pub. Law 115-97.

company can record the tax benefit attributable to the low-taxed earnings under established accounting principles.⁵

4.1.1 The 'Uber Model'

The following account of the model Uber was using in 2015 shows how it channelled income from the source country to the lowest-tax locations:⁶

- A fare paid in the source country through the Uber app would go directly to Uber BV Netherlands (BV), a subsidiary of Uber International CV Netherlands (CV). CV was in turn a subsidiary of Uber US.
- The drivers in the source country were paid by another Netherlands subsidiary Rasier BV with whom they had the contractual relationship.
- Uber's contracts with its drivers deemed them to be self-employed and responsible for tax payments on those earnings in the source country, as well as all the costs of providing the ride, including any licensing fees, insurance, etc.
- Uber's local entity in the source country did not receive any direct revenue from the fare but was paid by Uber BV to supply marketing and support services. After deduction of expenses, including interest payable to Uber's financing entity, this would leave very low levels of income.

Uber's revenue from the ride, channelled to BV and CV in the Netherlands, was beyond the control of the source country, and Uber's complex corporate structure enabled it to avoid paying almost any tax on its income anywhere:

- CV was considered a partnership under Dutch law, and its income was deemed to be passed through to its partners, a general partner located in the US and limited partners also located outside of the Netherlands. Consequently, this income was not taxable in the Netherlands.

⁵ In the US, low-taxed earnings reinvested indefinitely offshore did not suffer the US corporate ETR under APB 23 (codified as FASB ASC 740-10-25-3).

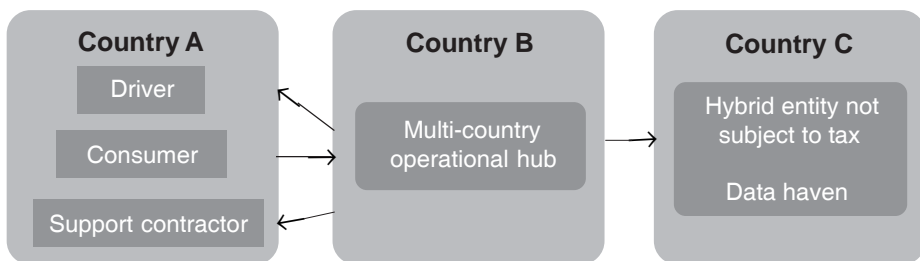
⁶ Nevia Cicin-Sain (2020), 'Taxing Uber', in Jasenko Marin, Sinisa Petrovic, Miso Mudric and Hrvoje Lisicar (eds), *Uber: Brave New Service or Unfair Competitor: Legal analysis of the Nature of Uber Services*, Springer, 183; Brian O'Keefe and Marty Jones (2015), 'Playing the Uber Tax Shell Game', *Fortune*, 22 October 2015. Available at: <http://fortune.com/2015/10/22/uber-tax-shell/>. Some of these tax avoidance structures have been affected by enactment of the US Tax Cuts and Jobs Act (TCJA) 2017, the EU Anti-Tax Avoidance Directive, and changes in Dutch tax law, but these do not affect the amount of income attributed to source countries.

- The US parent had sublicensed the software for the app to CV, and CV sublicensed the software to BV. Payments for fares to BV were in large part collected and paid by BV as royalty payments to CV for use of the app.
- Under US tax law, CV was treated not as a partnership but as a corporation. Accordingly, CV was not subject to direct tax in the US.
- Moreover, because its income was considered to be derived from an active business (licensing the app to third party users), it was not subject to indirect tax under the US tax law dealing with passive income.

Thus, most of Uber’s revenues from payments by customers were not taxed anywhere. The source country could tax only the payments to drivers (as their income) and the ‘routine’ remuneration paid by Uber to its local subsidiary for support services. Under the law prior to the TCJA, this so-called reverse hybrid arrangement, known as a CV/BV or ‘double Dutch’ structure, was used to shelter low-taxed income out of the US.⁷

Figure 2 provides a much-simplified version of how this kind of profit shifting might occur.

Figure 2: Profit shifting flow chart



⁷ Visa and Mastercard allegedly used a similar practice in New Zealand to avoid being classified as a ‘large’ company for tax purposes, despite New Zealand being one of their most profitable credit card markets. Gareth Vaughan (2018), ‘Google and Apple are under pressure over tax, Should Visa and Mastercard be too?’, *Spinoff*, 3 April 2018. Available at: <https://thespinoff.co.nz/business/03-04-2018/google-and-apple-are-under-pressure-over-tax-should-visa-and-mastercard-be-too/>

The hypothetical in Box 4.1 explains how existing and proposed trade rules on local presence, local servers, data transfer, source codes and algorithms, as well as prohibited performance requirements on foreign investments that cap royalty payments, would facilitate the adoption of such a structure and could prevent governments from adopting counteracting tax measures, unless they could be justified under the various limitations and exceptions.

Box 4.1 How trade rules facilitate Uber-style profit shifting and tax avoidance

Limo operates a ride-share business in Country A from across the border in Country B. Limo defines its business as a computer technology (not a transportation) service. Payments made by users of its app in Country A go to a subsidiary of Limo resident in Country B. That subsidiary has a licensing contract to pay most of the fare payment as a royalty to another Limo subsidiary in Country B, which in turn forwards most of those royalties to a further Limo entity resident in Country C. Limo has structured its corporate entities so its income is not taxed in Country B (where its entity is treated as a partnership) or in Country C (where it is treated as receiving active income from the royalties and not subject to tax). Limo's subsidiary that provides support services in Country A is treated as performing routine low-risk activities so declares little income.

Countries A and B have one or more trade agreements between them that contain the following **trade in services** and **e-commerce rules**.

Trade in services commitments (see Part 2: 2.4.2, 2.6): Country A has made full commitments to allow the supply of computer and related services across the border (mode 1) with no limitations, but no commitments on transportation services. The following rules would apply:

- **Local presence** (see Part 2: 2.4.6): Country A cannot require Limo to have a subsidiary, representative office or other form of enterprise, or be resident in the country, as a condition of being allowed to supply the service.
- **National treatment** (see Part 2: 2.4.4): Country A must apply the same tax rules to local ride-share providers as to Limo without any hidden discrimination, such as applying the tax at a threshold that does not capture local firms. Alternatively, the tax rules could treat Limo and local providers differently so long as that does not adversely affect competition between them.
- **Market access** (see Part 2: 2.4.5): If Limo does have some presence in Country A, such as a subsidiary, the government could not require it to take a particular legal form, for example that would meet the requirements for a permanent establishment under Country A's domestic law.

It might also be argued that deeming Limo to have a permanent establishment when it has no physical presence, so as to enable its revenue to be taxed at source, would be a 'measure affecting the supply' of the service across the border (in mode 1). That would depend in part on whether Limo's service is classified as a computer intermediary service or a transportation service, given the different commitments on each. Assuming it was considered a computer service for trade law purposes, there would still be debate over whether the measure breached the market access rule by limiting the total quantum or value of services that Limo could provide, or only the profitability of them.

- **E-commerce rules on transfer of information** (Part 2: 2.3.1) and **Local servers** (Part 2: 2.3.2) : Country A could not require the data collected by Limo to be stored within the country to facilitate effective monitoring of its activities and taxing of its revenue, even by requiring a copy to be retained,⁸ and to be accessible on a local server. The 'legitimate public policy' protection would be unreliable, as the legitimacy of these requirements might be challenged and there might arguably be a less-burdensome way to achieve the objectives.
- **Source code** (Part 2: 2.3.3) : Limo could keep secret the source code of the software app and the algorithm through which the software operates, so the nature and details of the transactions conducted through the app could remain undiscoverable. Provisos to this are very limited and, at best, would apply to the conduct of an individual investigation.

Country B and **Country C** have a trade agreement between them that includes **prohibited performance requirements** (Part 2: 2.5). Country B cannot cap the royalty payment in the licensing contract between the two Limo subsidiaries established in its territory, and which is then transferred to Limo's entity in Country C, where it would not have to pay tax on the royalty payment.

Exceptions (Part 2: 2.8.2): The GATS exception for tax measures applies to 'equitable' imposition of a direct tax, which might be contested, and only for national treatment, not for market access. The GATS tax treaty exception only covers double taxation provisions. Each FTA would need to be reviewed forensically, especially given the broader range of e-commerce, services and investment provisions that might apply. The CETA exception would provide the most flexibility, particularly for differential treatment of Limo and locally-owned providers.

⁸ Arguably permitted under the TPPA/CPTPP Article 14.11

4.2 Multilateral initiatives

Around the time the WTO began to explore e-commerce issues in 1998, developed countries began to seek multilateral solutions to address harmful tax practices that were diminishing global welfare and undermining taxpayer confidence in the integrity of tax systems. The OECD first formally addressed the issue with a report on *Harmful Tax Competition* in 1998.⁹ The OECD has continued to dominate international moves to reform corporate income tax, with some input from the UN.

That process has generated concerns that developing countries' context, specific needs and responses are being excluded or marginalised. Such concerns are not new. For years, the OECD tax standards have sought to facilitate the transfer of costs and revenues with the effect that the profits of MNEs land in company headquarters to become part of developed-country tax bases. Long-standing tensions over the development of the vast body of treaties, law, and practice that apply to taxing of MNEs are encapsulated in the distinctive approaches of the UN and OECD model double taxation treaties.¹⁰ A further point of tension has been the extent to which proposals for allocating taxing rights over MNE activities would reduce the application of the OECD's arm's-length treatment of transactions among related entities, which enables tax minimisation strategies.¹¹

An important guide to assessing the development sensitivity of approaches to harmful tax practices is the commitment made by UN Member States in the Addis Ababa Action Agenda 2015 to 'make sure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies'.¹² To do so requires an agreed methodology for attributing profits among the tax jurisdictions where an MNE operates. That becomes especially complicated

⁹ The OECD sought to understand how tax havens and harmful preferential tax regimes, or harmful tax practices, affected the location of financial and other service activities, eroded the tax bases of other countries, distorted trade and investment patterns and undermined the fairness, neutrality and broad social acceptance of tax systems generally. OECD, *Harmful Tax Competition. An Emerging Global Issue*, OECD, 1998. Available at: https://read.oecd-ilibrary.org/taxation/harmful-tax-competition_9789264162945-en#page8

¹⁰ Michael Lennard (2009), 'The UN Model Tax Convention Compared with the OECD Model Tax Convention: Current Points of Difference and Recent Developments', *Asia-Pacific Tax Bulletin* January/February 2009. Available at: https://www.taxjustice.net/cms/upload/pdf/Lennard_0902_UN_Vs_OECD.pdf. Sol Picciotto (2013), 'Is the International Tax System Fit for Purpose, Especially for Developing Countries?', ICTD Working Paper 13. Available at: <https://www.ictd.ac/publication/is-the-international-tax-system-fit-for-purpose-especially-for-developing-countries/>

¹¹ Michael Durst (2010), 'It's not just academic: The OECD should reevaluate transfer pricing laws', *Tax Notes International* 57, January 2010, 247. Available at: https://www.taxjustice.net/cms/upload/pdf/Durst_1001_OECD_-_not_just_academic.pdf

¹² United Nations, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development*, 15 July 2015, A/RES/69/313, para 23. Available at: <https://sustainabledevelopment.un.org/index.php?page=view&type=111&nr=7831&menu=35>

for digital activities where marketing, content creation, operating platforms, data processing and consumption may take place simultaneously in different jurisdictions.

4.2.1 The OECD Inclusive Framework

The OECD launched a process to reform international tax rules in 2013. Rather than address the global allocation of taxing rights in order to remedy the inadequacies of the international tax architecture, the Base Erosion and Profit Shifting (BEPS) project focused on reforming the existing rules, therefore retaining and adjusting the status quo. In particular the BEPS action plans have buttressed and made more complex the OECD approach to allocating the income of MNEs, which is based on the arm's-length presumption that focuses on transactions between related companies, or transfer pricing standards, and effectively legalised tax avoidance by MNEs.¹³

The BEPS project was supported by the G20 leaders, so tax officials from non-OECD G20 countries were also involved. In 2016, following its completion, participation was opened to all states willing to accept the commitments already agreed, by joining the *Inclusive Framework on Base Erosion and Profit Shifting*. The project also continued with the work on digital economy taxation, which had made little progress in the initial phase, even though it was the first of the 15 points in the BEPS Action Plan of 2013. While the Inclusive Framework on BEPS now has 137 participating governments from diverse tax jurisdictions,¹⁴ including many developing countries, it is served by the OECD Secretariat which is still staffed almost entirely by officials from OECD Member States. Developing country representatives had to weigh a familiar trade-off between being in the room during discussions and being associated with a secretariat-driven outcome over which they have structurally constricted influence.

The OECD BEPS process sought to constrain the ability of MNEs to engage in harmful tax practices in all countries, but in practice it tightened rules against *developing* country-based secrecy and low-tax or no-tax jurisdictions while treating some of those based in *developed* countries very lightly.¹⁵ It retained the bias in the existing system against taxation of business profits at source, which has always worked against developing countries, even though the mandate for the BEPS project from the G20 leaders was to tax MNEs 'where activities take place and value is

¹³ Durst 2010

¹⁴ Members of the OECD/G20 Inclusive Framework on BEPS. Available at: <https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>

¹⁵ Some developing countries have subsequently introduced systems for determining the tax classification of jurisdictions with specific benchmarks – such as tax rates on income – which are clearly less arbitrary than those the OECD and EU have used. See for example, Jahanzeb Akhtar and Veronica Grondona (2019), 'Tax Haven Listing in Multiple Hues: Blind, Winking or Conniving?', South Centre Research Paper 94, April 2019. The authors also discuss how developed countries in various groupings have politicised the creation of tax haven lists and undermined their credibility

created'. In particular, it made minimal changes to the taxable presence threshold (the concept of 'permanent establishment', or PE), and continued to apply the arm's-length principle and transfer pricing methods for allocation of MNE income. Yet it is these rules that encourage MNE tax avoidance by attributing only 'routine' profits to operating subsidiaries in high-tax countries, and channelling most MNE income offshore to subsidiaries in low-tax countries.¹⁶

Criticisms that the process effectively excluded the concerns and perspectives of developing nations were expressed during the consultations that led to the final BEPS outcomes.¹⁷ The United Nations Tax Committee in 2015 evaluated the responses of 13 developing countries to a questionnaire on what they saw as fair and appropriate means of responding to the challenges of BEPS. Whilst BEPS issues were affecting tax revenues and distorting competition between domestic (usually small) and foreign (generally large) enterprises, the survey also identified differences between developing countries that reinforced the need for tailored responses.¹⁸ The digital economy was identified as a priority, even then.

The BEPS project recommendations published in September 2015 showed that no progress had been made on the key issues raised particularly by the first point in the Action Plan, international tax implications of the digitalisation of the economy. The BEPS Action 1 report *Addressing the Tax Challenges of the Digital Economy* in 2015¹⁹ concluded that, although it had some specific new features, including the collection and usage of data, digitalisation had affected the whole economy and exacerbated the problems of avoidance, so that reforms needed to go beyond BEPS issues.²⁰ This shift indicates that OECD Members themselves were concerned that the permissive attitude of OECD standards to MNE profit shifting was seriously impacting on their own tax bases. Addressing that problem entailed a re-examination of the two main principles underlying international tax rules: (i) taxable presence (the PE rules), and (ii) the allocation of MNE income. The OECD would continue to work on these issues, whilst monitoring developments, and aimed to produce proposals by 2020.

¹⁶ For detailed analysis and critiques of all the BEPS project reports see the submissions by the BEPS Monitoring Group, a global network of international tax researchers concerned with the effects of MNE tax avoidance especially on development. Available at: <https://www.bepsmonitoringgroup.org>.

¹⁷ See for instance: ActionAid International (2015), 'Patching up a broken tax system', ActionAid. Available at: <https://actionaid.org/publications/2015/patching-broken-tax-system-why-beps-not-solution-poor-countries-tax-problems#downloads>; Krishen Mehta (2014), 'The OECD's BEPS process and developing countries – a Way Forward', Tax Justice Network, December 2014. Available at: <https://www.taxjustice.net/wp-content/uploads/2013/04/BEPS-and-Developing-Countries-draft-2.pdf>

¹⁸ Carmel Peters (2015), 'Developing countries' reactions to the G20/OECD Action Plan on Base Erosion and Profit Shifting', *IBFD Bulletin for International Taxation*, June/July 2015. Available at: https://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_G20OecdBeps.pdf

¹⁹ OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD, Paris. Available at: https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#page7

²⁰ OECD 2015, 11

The remainder of the proposals and recommendations in 2015 are generally considered to have made the rules more complicated than the previous already-complex practices based on the OECD Model Tax Convention on Income and on Capital.²¹ This complexity benefits only the large MNEs and their legions of tax advisers, who continue to exploit the defects in the rules. Tax authorities, especially in developing and least developed countries, have far fewer resources, so lack the capacity to attempt to counteract these strategies.

A further interim report in 2018 on *Tax Challenges Arising from Digitalisation* confirmed that MNEs are increasingly able to operate on a global scale, deriving enormous profits from many countries with a minimal physical presence.²² The requirement of physical presence for a ‘permanent establishment’ tax nexus is no longer relevant. That raises the fundamental challenge of establishing clear criteria for allocating MNE income that reflect its activities in each country. Digital companies have developed dynamic business models, based for example on data collection and exploitation, that can no longer be governed by old laws, and preferential tax regimes for the location of data and information storage are on the rise. Hence, the current rules on international tax are not fit for purpose.

There are two broad options to allocate corporate income tax revenues of MNEs: the historic arm’s-length principle, which provides a perverse incentive for MNEs to devise complex tax avoidance structures; or the unitary approach that taxes corporations as single entities and applies a formulary approach as a method of sharing tax revenues among jurisdictions.²³ In 2015, the Independent Commission to Reform International Corporate Taxation (ICRICT), a group of eminent policy experts and moral leaders supported by civil society organisations campaigning on tax justice, evaluated the three main unitary approaches, and recommended formulary apportionment as the best for allocating the global profits of MNEs.²⁴ Due to the impact of digitalisation, Action 1 of the BEPS project has itself begun to explore formulaic approaches, even though in the other 14 action plans the BEPS programme has buttressed (and made more complex) the OECD tax sharing method based on the arm’s-length principle.

²¹ The latest version was adopted in 2017. Available at: <http://www.oecd.org/ctp/model-tax-convention-on-income-and-on-capital-full-version-9a5b369e-en.htm>

²² OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018*, OECD, Paris

²³ At the national level, both the US and Canada use formulary apportionment systems to share tax revenues among their federated states that impose taxes on earnings.

²⁴ ICRICT (2018), *A Fairer Future for Global Taxation. A Roadmap to Improve Rules for Taxation of Multinationals*, ICRICT, February 2018. Available at: <https://www.icrict.com/icrict-documents-a-fairer-future-for-global-taxation>

4.2.2 The OECD's Unified Approach²⁵

Since 2019 the Inclusive Framework has been debating the way forward. In February 2019 a consultation document outlined three new proposals to address the tax challenges of the digitalised economy,²⁶ which included the Group of 24 proposal discussed below.

In October 2019, the OECD's Secretariat put forward a 'Unified Approach' combining these three proposals.²⁷ This outlined a 'new taxing right' (described as Amount A), based on a new nexus rule that does not depend on physical presence; it would start from the MNE's global profits, and allocate part of the global 'residual' profit²⁸ to market jurisdictions, in proportion to sales revenues. However, this would apply only to the very largest MNEs and to 'consumer facing' and 'automated digital service' businesses; its implementation would require revision of tax treaties.

A second formulaic method, 'Amount B', would attribute a fixed remuneration for distribution activities, again to market countries, but this would not require treaty changes. The remainder of the 'residual' profit would continue to be attributed by existing transfer pricing rules, which are ad hoc and subjective. Realising that this would generate conflicts, many developed countries insisted that there must be mandatory dispute resolution, especially if a market country claimed any additional profit (described as Amount C).

²⁵ In addition to the Unified Approach, the Inclusive Framework is also considering a second pillar on the taxation of MNEs. The second pillar is not focused exclusively on digital businesses and contains two parts. The first part would impose a worldwide minimum tax on large MNEs, and the second part would allow source countries to disallow tax deductions for payments for interest, royalties and similar items made to low- or not-taxed related parties located outside of their jurisdiction. The second element of pillar two, disallowing tax deductions for base reducing payments, may be of particular value to developing countries that often suffer from MNEs employing such tactics to reduce taxable income in their jurisdictions. OECD (2020), 'Statement by the OECD Inclusive Framework on BEPS', 27-30.

²⁶ See OECD (2019), 'Public Consultation Document: Addressing the Tax Challenges of the Digitalization of the Economy', 13 February 2019, OECD, Paris. Available at: <https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf> For all OECD documentation on this see: <http://www.oecd.org/tax/beps/beps-actions/action1/>. For a critical evaluation see BEPS Monitoring Group (2019), 'International Corporate Tax Reform and the "New Taxing Right"'. Available at: <https://www.bepsmonitoringgroup.org/news/2019/9/10/international-corporate-tax-reform-and-the-new-taxing-right-b4ajr>

²⁷ OECD, 'Public consultation document, Secretariat Proposal for a "Unified Approach" under Pillar One, 9 October 2019 – 12 November 2019', OECD, 4. See also OECD (2020), 'Statement by the OECD Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy', OECD, Paris, 8. Available at: <https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf>

²⁸ This is the amount left after attribution of profits for a routine return on capital, the residual amount often being referred to by economists as 'rents'.

In February 2020 the OECD shared its preliminary estimates of the impact of the Unified Approach.²⁹ The proportion of routine profits, as well as the percentage of residual profit allocated to markets under Amount A would be decided by the Inclusive Framework. The economic impact analyses assume that the routine profit would be either 10% or 20% of the ratio of profit-before-tax to turnover, and that Amount A would be 20% of the residual. On this basis, the assessment calculated that the amount of taxes raised overall from MNEs would not increase by a sizeable amount, but these taxes would be distributed differently across countries. In proportionate terms, low- and middle-income economies came out a little ahead in this redistribution, but most of the redistribution would be between developed countries.

Many developing countries participating in the Inclusive Framework were concerned that the OECD's Unified Approach would, once again, favour the residence countries of MNEs. Substantial submissions from developing countries included significant input from India, the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G24), who are the caucus group of developing countries in the resident boards of the World Bank and the IMF, and the African Tax Administration Forum (ATAF).

The ATAF has advanced a regional approach among African countries that is more relevant to their needs. For example, the size threshold for MNEs subject to a new taxing right would be inappropriate for less developed economies. There are also concerns that a multilateral agreement might preclude countries applying their own measures.³⁰

As a substitute for the physical presence used in current rules, the G24 proposed a taxable nexus based on 'significant economic presence' combined with a 'fractional apportionment' approach for allocation of MNE income.³¹ The test of a significant economic presence would be based on sales exceeding a threshold amount, combined with user-based factors such as active users, collection of data

²⁹ OECD, 'Tax challenges arising from the digitalisation of the economy: update on the economic analysis and impact assessment', Webcast, 13 February 2020. Available at: <https://www.oecd.org/tax/beps/presentation-economic-analysis-impact-assessment-webcast-february-2020.pdf>; see also <https://taxfoundation.org/summary-of-the-oecd-impact-assessment-on-pillar-1-and-pillar-2/>

³⁰ Martin Hearson (2019), 'Africa responds to the Inclusive Framework's digital tax agenda', International Centre for Tax and Development, 7 August 2019. Available at: <https://www.ictd.ac/blog/africa-responds-to-the-inclusive-frameworks-digital-tax-agenda/>

³¹ G-24 Working Group on tax policy and international tax cooperation (2019), 'Proposal for Addressing Tax Challenges Arising from Digitalization', 17 January 2019. Available at: https://www.g24.org/wp-content/uploads/2019/03/G-24_proposal_for_Taxation_of_Digital_Economy_Jan17_Special_Session_2.pdf.

and digital content.³² The attribution of profit should be based on a balance of supply-side factors (assets and employees) and demand-side factors (sales revenues), as it is in the US system of profit sharing among its states. Developing countries favour this approach because it would likely attribute more revenues to them and be easier to audit.

There are many possible variations on how profit could be attributed under the G24 model. One important factor is whether the distribution of the profits was based only on the proportion of sales from the territory versus one in which both the proportion of sales and employment were used. Analysis by Cobham, Faccio, and Fitzgerald indicates that using only sales as the attribution variable benefits OECD countries, most particularly the US, and hurts developing countries; using sales and employment improves benefits for developing countries considerably.³³ They find the OECD method is the least beneficial, and the global formulary apportionment affords the greatest benefits, to developing countries.³⁴ The impact of the profit reattribution on developing countries could be quite substantial, potentially exceeding 8% of current corporate tax revenue for the Group of 77 developing countries in the case of total formulary apportionment.

4.2.3 South responses to the Unified Approach

The Unified Approach was essentially a negotiation between developed countries that reflected concerns that the digital giants, mainly based in the US, are not paying an appropriate amount of taxes given the scale of their business in those jurisdictions. To succeed it would need to be adopted by a consensus of, at least,

³² Revenues will be attributed to the digital permanent establishment attributable to the local customers' digital usage of the business. The profit derived from these revenues will be determined by multiplying the revenues by the operating profit margin of the business segment. This profit will be allocated between the market jurisdiction and the other jurisdictions contributing factors of production to the business using an allocation formula that incorporates sales, assets and employees. A simple example will illustrate the operation of a FAM. Assume Country A has enacted a FAM of 3% and based it on operating income produced from advertising revenue generated from users and customers in a digital business in Country A. Company X, a tax resident of Country B, has a digital business which provides an Internet marketplace to users there. It has a sustained and substantial presence in Country A, and in year 1, it generated advertising revenue of \$10,000,000 from users located there. On a worldwide basis, its Internet marketplace business produced pre-tax income of 10% on its revenue. In this case, the tax to be apportioned between Countries A and B based on their respective allocation factors would be $(\$10,000,000 \times .10 \times .03)$ \$30,000

³³ Alex Cobham, Tommaso Faccio and Valpy Fitzgerald (2019), 'Global Inequalities in Taxing Rights: An early evaluation of the OECD tax reform proposals', 5 October 2019, Preliminary draft, SocArxiv. Available at: <https://osf.io/preprints/socarxiv/j3p48/>

³⁴ Quantitatively, a full comparison between the OECD estimate in 'Tax Challenges Arising from the Digitalisation of the Economy: Update on the Economic Analysis & Impact Assessment' 2020 and in Cobham, Faccio, and Fitzgerald (2019) is not possible unless both are calculated out of the same data set. The latter study relies only on US multinationals while OECD (2020) estimates are presumably based on all multinationals. See OECD (2020), 'Tax Challenges Arising from the Digitalisation of the Economy: Update on the Economic Analysis & Impact Assessment', Webcast, 13 February 2020. Available at <https://www.oecd.org/tax/beps/presentation-economic-analysis-impact-assessment-webcast-february-2020.pdf>

the developed countries, and would need to be administered by each resident jurisdiction of a digital business' parent company.

The OECD process has come under considerable pressure as some countries take unilateral action in response to the low or non-taxation of the digitalised economy.³⁵ When the OECD announced a deadline of 2020 for agreeing on BEPS-consistent digital tax rules it enjoined all jurisdictions – both OECD and non-OECD – to delay their unilateral digital-related reforms.³⁶ Some countries have ignored the OECD's injunction. India, Malaysia, South Africa, among others, have introduced measures that do not conform to the OECD approach; Sweden, Switzerland, the UK, and even the EU have taken similar actions.³⁷

India took the lead in the efforts to adopt laws unilaterally to overcome the lack of commercial presence by MNEs. An amendment to the income tax act provided that 'digital transactions relating to goods, services or property undertaken in India by a nonresident or systematic and continuous soliciting of business shall constitute "significant economic presence" (SEP) in India, irrespective of the situs of the nonresident or place of provision of service'.³⁸ However, the government agreed to suspend its work on the proposal pending the attempts by the Inclusive Framework to secure consensus on a form of a digital corporate income tax.³⁹

Nigeria was another early mover. In 2018 Nigeria's company law was amended to require any foreign company intending to do business in the country to incorporate a separate entity in Nigeria for that purpose, making it a tax resident.⁴⁰

³⁵ See for example, Tim Bradshaw (2019), 'Countries vow to press ahead with digital taxes despite US threat', 4 December 2019, *Financial Times*. Available at: <https://www.ft.com/content/6529014c-169a-11ea-9ee4-11f260415385>

³⁶ OECD, 'OECD leading multilateral efforts to address tax challenges from digitalisation of the economy', 9 October 2019. Available at: <https://www.oecd.org/tax/beeps/oecd-leading-multilateral-efforts-to-address-tax-challenges-from-digitalisation-of-the-economy.htm>

³⁷ See KPMG, 'Taxation of the Digitalized Economy, Direct Taxes' for a listing of these actions. Available at: <https://tax.kpmg.US/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf>

³⁸ Finance Act 2018, no. 13 of 2018, 28 March 2018, Clause 4 Amending the Income-tax Act, Section 9. See also India Department of Revenue, Central Board of Direct Taxes (2019), 'Public Consultation on the Proposal for Amendment of Rules for Profit Attribution to Permanent Establishment', F. No. 500/33/2017-FTD.I (India's proposal for a FAM), 18 April 2019

³⁹ Government of India, Budget Speech of the Minister of Finance 2020, para 6.10. Available at: <https://www.indiabudget.gov.in/>

⁴⁰ Government of Nigeria, Companies and Allied Matters Act 2004 (as amended 2018), S 54: 'Subject to sections 56 to 59 of this Act, every foreign company which before or after the commencement of this Act was incorporated outside Nigeria, and having the intention of carrying on business in Nigeria, shall take all steps necessary to obtain incorporation as a separate entity in Nigeria for that purpose, but until so incorporated, the foreign company shall not carry on business in Nigeria or exercise any of the powers of a registered company and shall not have a place of business or an address for service of documents or processes in Nigeria for any purpose other than the receipt of notices and other documents, as matters preliminary to incorporation under this Act.' See 'Deemed profit assessment on non-resident Companies', *Deloitte*, (undated). Available at: <https://www2.deloitte.com/ng/en/pages/tax/articles/inside-tax-articles/deemed-profit-assessment-on-non-resident-companies.html>

Failure to comply is an offence that attracts fines for the company and officials or the agents who permit that non-compliance, with a minimum but no maximum level of penalty.⁴¹ Non-resident companies are taxed on profits deemed to have been derived in Nigeria under one of four circumstances. One of those circumstances is profits adjusted by the Tax Authority to reflect arm's-length transactions in related party arrangements. Nigeria's Inland Revenue service has also treated offshore service suppliers (in the oil sector) as having a PE in Nigeria and taxed on income derived from Nigeria even if paid from outside.⁴²

4.2.4 US withdrawal from discussions

These developments signify an overall disagreement between countries regarding the most appropriate solution and the speed with which it should be realised. There is still no agreement on indicators that countries can use to peg their share of a digital company's profit that is derived from their territory. The prospects for consensus by the end of 2020 looked remote when the US Secretary of Treasury wrote to the OECD in December 2019 to say that the US could not agree to the proposal as written, but suggesting that it should become a voluntary 'safe harbour', at the election of companies.⁴³

In June 2020 the US withdrew temporarily from the Integrated Framework initiative to develop new rules for taxing the technology corporations.⁴⁴ In a letter directed to the finance ministers of Spain, Italy, France and the United Kingdom, the US Treasury Secretary Steven Mnuchin reiterated the US's objection to measures that focus solely on digital businesses and predominantly fall on US-based enterprises. The proposed approach would change 'the most fundamental principles of international taxation, including the taxable nexus threshold and the arm's-length

⁴¹ Under Section 55 failure of a foreign company to comply with those requirements may be convicted of an offence that carries a minimum fine of (N2500) and its officials or agents who wilfully permit the non-compliance face a minimum fine of N250 and N25 per day

⁴² Non-resident companies are also liable to tax on the profit or income derived from Nigeria. Where actual profits cannot be determined, the Federal Inland Revenue Service may apply a deemed profit rate on turnover derived from Nigeria. *Taxation of Companies*, s9(1), S 30

⁴³ Steven Mnuchin, US Treasury Secretary (2019), Letter to Jose Angel Gurría, Secretary-General of the OECD, on DSTs 3 December, 2019. Available at: <https://www.orbitax.com/news/archive.php/U.S.-Treasury-Secretary-Sends—40283>; Jose Angel Gurría, Secretary-General of the OECD, Response Letter to Steven Mnuchin, US Treasury Secretary, 4 December 2019. Available at: <https://www.oecd.org/newsroom/Letter-from-OECD-Secretary-General-Angel-Gurría-for-the-attention-of-The-Honorable-Steven-T-Mnuchin-Secretary-of-the-Treasury-United-States.pdf>

⁴⁴ Steven Mnuchin, US Treasury Secretary (2019), Letter to Jose Angel Gurría, Secretary-General of the OECD, on DSTs, 3 December 2019. Available at: <https://www.orbitax.com/news/archive.php/U.S.-Treasury-Secretary-Sends—40283>; Jose Angel Gurría, Secretary-General of the OECD, Response Letter to Steven Mnuchin, US Treasury Secretary, 4 December 2019. Available at: <https://www.oecd.org/newsroom/Letter-from-OECD-Secretary-General-Angel-Gurría-for-the-attention-of-The-Honorable-Steven-T-Mnuchin-Secretary-of-the-Treasury-United-States.pdf>.

principle'. US insistence that Pillar 1 was implemented on a safe harbour basis had been rejected, bringing discussions to an impasse. With the world facing 'the most serious health crisis in over a century and the most serious economic challenge in generations' the US said governments should not be distracted from those important matters by discussions that involved modest amounts compared to the size of the economic challenges. Secretary Mnuchin called for the OECD to pause discussions with a review to resuming later in 2020.

The four ministers jointly replied the same day, pointing to seven years of good faith negotiations to get to the current proposals, in which the positions and proposals of the US were 'now strongly reflected'. The COVID-19 crisis had confirmed the need for a fair and consistent allocation of profit by multinationals with little or no physical presence; indeed, the 'Digital Giants' were likely to emerge from the crisis more powerful and more profitable than ever. Postponing the work and not addressing those challenges 'would constitute a collective failure'.⁴⁵

The OECD Secretary-General subsequently called on all members of the Inclusive Framework to remain engaged in the negotiation. He warned that the absence of a multilateral solution would see more countries adopting unilateral measures, which would, in turn, trigger tax disputes and heighten the prospects for a trade war at a time of historic downturn. The schedule of meetings would continue as planned.⁴⁶

Without consensus participation of all parent countries of major MNEs, including the US, a multilateral approach would be unworkable, as well as inequitable for countries of the Global South. Box 4.2 shows that existing and proposed trade rules would pose a further impediment, even if the United Approach proceeded along the lines proposed.

⁴⁵ Letter from the Ministers of Finance of the French Republic, Spain and the Italian Republic and the Chancellor of the Exchequer of the United Kingdom to Steven Mnuchin, US Treasury Secretary, 12 June 2020. Available at: <https://www.politico.eu/wp-content/uploads/2020/06/Letter-Mnuchin-IT-FR-UK-SP-FINAL-SIGNED%E2%80%94CLEANED.pdf>

⁴⁶ 'OECD Secretary-General Angel Gurría has reacted to recent statements and exchanges regarding the ongoing negotiations to address the tax challenges of the digitalisation of the economy', OECD, 18 June 2020. Available at: <https://www.oecd.org/tax/oecd-secretary-general-angel-gurria-has-reacted-to-recent-statements-and-exchanges-regarding-the-ongoing-negotiations-to-address-the-tax-challenges-of-the-digitalisation-of-the-economy.htm>

Box 4.2 Some implications of the digital trade rules under the Unified Approach

The **trade in services rules on market access and local presence** are important enablers for the large digital players such as Google, Amazon, Uber, Facebook and Airbnb to minimise their tax liability under the arm's-length principle. Depending on the sectoral commitments or reservations the source country made at the time the trade in services agreement was negotiated (see Part 2: 2.4.2, 2.6), the digital MNEs:

- could not be required to have a presence in the country (see Part 2: 2.4.6), or
- take a particular legal form if they do (see Part 2: 2.4.5).

A 'substantial economic presence' test would be a '**measure that affects**' the cross-border (mode 1) supply of computer-related or another relevant sectoral service.⁴⁷ Most of the big tech MNEs insist they are merely supplying computer services, not substantive services. National-level litigation has challenged those self-designations, with variable effects.⁴⁸ However, the same designations may not apply for both tax and trade purposes (see Box 4.1). Because countries often have different commitments on different services, which classification is applied to the service would determine whether the source country has obligations under those rules (see Part 2: 2.4.2).

If a country has made a relevant commitment, the next question is whether the tax measure breaches one of the core rules. For example, application of a formulary approach that deems a 'substantial economic presence' above a certain threshold might be challenged if it:

- effectively exempts local competitors; whether they are like services and suppliers from the source country or a third country will be a complicated legal question (**national treatment** rule, see Part 2: 2.4.4);
- significantly restricts the size of a supplier's market or its growth above a certain value (**market access** rule, see Part 2: 2.4.5).

⁴⁷ The EU has a standard demand that developing countries adopt full commitments to Computer and Related Services in its FTAs and it has advocated the adoption of the 'Understanding on Computer and Related Services' in its WTO e-commerce proposals Joint Statement on Electronic Commerce, 'EU Proposal for WTO Disciplines and Commitments Relating to Electronic Commerce', 26 April 2019, INF/ECOM/22 para 4.2; see also Kelsey (2020).

⁴⁸ For example, 'Uber to face stricter EU regulation after ECJ rules it is a transport firm', *The Guardian*, 20 December 2017. Available at: <https://www.theguardian.com/technology/2017/dec/20/uber-european-court-of-justice-ruling-barcelona-taxi-drivers-ecj-eu>; but see 'Airbnb should be seen as a digital service provider, ECJ advised', *The Guardian*, 13 April 2019. Available at: <https://www.theguardian.com/technology/2019/apr/30/airbnb-should-be-seen-as-a-digital-service-provider-ecj-advised>

Apportionment under a formulary approach and determination of the elements that constitute a 'substantial economic presence', such as the number of employees, would also be measures affecting the supply of a service. How such a measure was applied to an MNE would be highly contested (for example, most of the major tech MNEs say they have few, if any, employees in most countries where they operate). There would be potential for challenges that the **administration of the measure of general application** was not 'reasonable, objective and impartial' (see Part 2: 2.4.7).

A formulary approach to allocation under a Unitary Approach assumes the ability to collect data on the earnings of a line of business generally and per country. Digital MNEs could not be required under e-commerce rules to hold the data relevant to their transactions within the source jurisdiction (see Part 2: 2.3.1-3.2.2). The **rules on transfer of data and local servers** allow data to be held in the company's country of choice, including a data and/or tax haven or non-participating country. These rules apply to data related to their activities, including data from users/customers, as well as the company's own accounting data that tax authorities may wish to access (see Part 6). The relevant information would not fall within the carve-out for information 'held by or on behalf of a Party' or measures relating to its collection. The defence that such measures were legitimate policy objectives might be challenged in terms of their legitimacy and whether there were less burdensome approaches available, such as a safe harbour.

Transparency provisions (see Part 2: 2.7) that require opportunities for other states and their 'interested persons' to comment on proposed rules would enable the US and its MNEs, in particular, to allege that formulary-based tax measures constitute unfair trade practices and threaten retaliation or a trade dispute if they were implemented.

Exceptions (see Part 2: 2.8.2 and Box 2.1) The GATS exception for tax measures applies to 'equitable' imposition of a direct tax for national treatment only. The GATS tax treaty exception only covers double taxation provisions; while these tax initiatives are connected to double taxation, their compliance with double taxation treaties and provisions is likely to be disputed. Each FTA has different flexibilities and restrictions, and would need to be reviewed individually.

5

TAXING DIGITAL TRANSACTIONS

A RANGE of other taxes are being developed as alternatives to taxing digital corporations directly. Many of these initiatives are experimental.

The rapid emergence of digital services taxes (DSTs) reflects the impatience or unhappiness of many countries with the inability to reach agreement on international corporate tax reforms through the OECD. These initiatives face strong and growing resistance from digital MNEs and the US government, especially.

Those conflicts are set to intensify following the US's temporary withdrawal from the Integrated Framework negotiations on digital tax. The USTR's investigation into France's digital services tax under Section 301 of the US Trade Act 1974 in 2019 paved the way for the US to announce in June 2020 that it was initiating similar proceedings against 10 countries that have adopted or are considering adopting a DST: Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey and the United Kingdom.¹ The report on France's DST therefore provides important insights into the legal arguments that these and other countries can expect the US to make under existing and proposed trade rules.

A less controversial option has been to extend value-added taxes (VATs) to cross-border digital transactions. A number of countries, including India and several African states, have introduced other innovative tax measures. South Africa, Rwanda and India have moved in different ways to cap royalty payments to stem a favoured tool for profit shifting.

All these ways of taxing the digital economy raise questions of compliance with the trade rules and the scope of the tax exceptions. Opposition to their adoption highlights the risks that digital MNEs and powerful states, particularly the US, will use the opaqueness and uncertainty of the trade rules, and the threat of sanctions, to have a chilling effect on governments, especially in developing countries.

¹ Office of the USTR, 'USTR Initiates Section 301 Investigations of Digital Services Taxes', 2 June 2020. Available at: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/june/ustr-initiates-section-301-investigations-digital-services-taxes>

5.1 Digital services tax

The DST is a transaction tax, not an income tax, but it can be viewed as a substitute for a digital economy corporate income tax. A large number of countries have enacted or are in the process of enacting such taxes.² They are mainly aimed at the large MNEs that operate in the digitalised economy, with US firms being the majority of companies affected. The tax takes the form of an excise tax on a percent of gross income, or of turnover, realised from designated aspects of e-commerce. Whether a DST is considered a direct or indirect tax depends to a large extent on how it is formulated. Countries may adopt a structure to avoid the DST being seen as a tax on income, which would be restricted under their tax treaties, but as Box 5.1 shows that may cause problems with the GATS.

Although the details vary quite widely, the taxes principally target revenues produced by one or more of four types of online businesses: (i) services delivered through the Internet, such as digital advertising; (ii) the provision of a digital platform or interface between two or more Internet users; (iii) the deployment of an Internet marketplace; or (iv) the collection and exploitation of data by an Internet provider. Financial services are often outside the scope of the tax. While they are commonly couched as a temporary alternative to a universally accepted corporate income tax, history has shown that ‘temporary’ taxes tend to become permanent once countries enjoy the benefits of the revenue they create.

5.1.1 The EU model of DST

A number of EU Member States began to explore the creation of DSTs as early as 2017. To head off a multiplicity of such taxes within the EU, the European Commission in 2018 proposed a Directive for adoption in the EU.³ This would complement the requirements for businesses to pay tax in a Member State where they have a substantial digital presence, even if they are not physically present there, as a means to facilitate the imposition of a traditional corporate income tax.⁴ The Commission’s proposal sought to address the new business model of digital services whose characteristics do not fit the existing tax rules ‘in terms of how value is created, due to their ability to conduct activities remotely, the contribution of end-users in their value creation, the importance of tangible assets, as well as a tendency towards winner-takes-most market structures rooted in the strong presence of network effects and the value of big data’.⁵

² For a list of the countries and the types of DSTs being imposed, see KPMG, ‘Taxation of the Digitalized Economy’. Available at: <https://tax.kpmg.US/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf>

³ European Commission (2018), ‘Time to establish a modern, fair and efficient taxation standard for the digital economy’, COM 2018/146, 21 March 2018

⁴ European Commission 2018, COM 2018/146, 6

⁵ European Commission (2018), ‘Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services’, COM/2018/0148 final - 2018/073 (CNS), 2

The Commission's proposed DST would target revenues resulting from the supply of digital services where participation of a user constituted an essential input for the business and from which it gained revenues, in other words revenue from the monetisation of the user input. The proposed tax would apply to three aspects of user participation: placement of advertising targeted to users of a digital interface; transmission of data collected about users that was generated from their activities on that interface; and making multi-sided digital interfaces, or intermediation services, available to users to interact with other users and which may facilitate the provision of user-to-user supply of goods and services in an online marketplace.⁶ The tax would apply for MNEs with total revenue of at least €750 million⁷ and EU revenue of at least €25 million. This common approach was not adopted by the EU, as it faced opposition from Sweden, Denmark and Ireland, in part out of concern about US retaliation.⁸ The European Commission revived the idea in May 2020 as part of its COVID-19 recovery strategy.⁹

The EU's initial failure to act left it to Member States to proceed with their own digital taxation.¹⁰ France is the leading example. In July 2019 France adopted a tax of 3% on two types of services in which French users are deemed to play a major role in creating value:¹¹ *digital interface* or *intermediary* services that connect users to buy and sell goods between themselves; and *targeted advertising* services that target digital advertising on the basis of user-generated data, and the *sale of that user data* to advertisers.¹² France used the same thresholds as the EU proposed

⁶ European Commission 2018, COM/2018/0148 final, 7, summarising Article 3

⁷ That is the threshold for the OECD's country-by-country reporting, discussed in Part 6

⁸ 'Countries vow to press ahead with digital taxes despite US trade threat', *Financial Times*, 4 December 2019. Available at: <https://www.ft.com/content/6529014c-169a-11ea-9ee4-11f260415385>

⁹ Hannah Monicken (2020), 'EU eyes digital tax for revenue in proposed bulked-up budget to address crisis', *Inside US Trade*, 27 May 2020. Available at: <https://insidetrade.com/daily-news/eu-eyes-digital-tax-revenue-proposed-bulked-budget-address-crisis>

¹⁰ Elke Asen (2020), 'Digital Services Taxes in Europe', *Tax Foundation*, 20 March 2020. Available at: <https://taxfoundation.org/digital-tax-europe-2020/>

¹¹ The following example illustrates how the formula would attribute revenue to France under the tax. Assume Company A provides a digital interface for the sale of goods and services. It provides this service in 25 countries, including Country X that has enacted a DST. Country X's DST is set at 3% of the revenue from this type of service. In the year in question, Country A's total revenue from this service is \$100,000,000 based on a 1.5% charge on the price of the goods and services provided. The customers of Company A located in Country X constitute 5% of Company A's total customers. Under the DST law, 5% of the revenue, or \$5,000,000, would be subject to the DST of 3% for a tax of \$150,000.

¹² The *targeted advertising* service applies to the placement and the monitoring of an advertisement that is targeted on the basis of data concerning the individual who viewed the advertisement, and the sale of user data in connection with Internet advertising. Article 299, II.2 reads: 'services marketed to advertisers, or their agents, for the purposes of placing on a digital interface advertising that is targeted based on user data collected or generated when such interfaces are visited These services may specifically include purchasing, storage, and placement of advertisements, advertising and performance monitoring, and user management and transmission services.' As translated in Office of the USTR, Ambassador Robert E Lighthizer, 'Section 301 Investigation. Report on France's Digital Services Tax', 2 December 2019, 15 (hereafter 'Section 301 Report'), 26-27. Available at: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

and the tax was to operate retroactively to revenue from 1 January 2019. It was projected to apply to about 27 companies, 17 or about two-thirds from the US, and only one from France.¹³

France and the US became locked in a pitched battle. The US launched an unfair trade practice investigation under Section 301 of the Trade Act, after which the USTR authorised retaliation through 100% tariffs on imports of French products, such as champagne, cheese and handbags.¹⁴ A truce was announced in January 2020, as France agreed to hold the tax in abeyance until the end of the year while the Inclusive Framework worked on a worldwide corporate income tax for the digital economy.¹⁵ However, while asking other countries to suspend plans for DSTs pending consensus at the OECD, the US back-pedalled on the existing proposals (see Part 4: 4.2.1).¹⁶ At the time of writing it is uncertain how France will respond.

5.1.2 Developing-country DSTs

Like tariffs, DSTs are a transaction tax that is relatively easy to apply, which has made them appealing to a number of developing countries. The following is a sample of them, most of which are now subject to USTR investigation:

- **India:** In June 2016, as part of Prime Minister Modi's *Digital India* strategy, India adopted a 6% 'equalisation' levy on the gross annual amount of payments for specific services above a threshold. It was initially applied only to digital advertising. The target was business-to-business transactions, with the recipient in India responsible for withholding and remitting the payment monthly.¹⁷ Dubbed the 'Google tax', it had returned US\$139 million by 2018.¹⁸ Its scope was extended by the Finance Act 2020 to all non-resident e-commerce operators, defined as providers of digital platforms making or facilitating sales

¹³ Section 301 Report, 26-27

¹⁴ Office of the USTR, Ambassador Robert E Lighthizer, 'Report on France's Digital Services Tax Prepared in the Investigation under Section 301 of the Trade Act of 1974', 2 December 2019. Available at: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/conclusion-ustr%E2%80%99s-investigation>

¹⁵ 'France agrees to delay new tax on tech giants', *BBC*, 21 January 2020. Available at: <https://www.bbc.com/news/business-51192369>

¹⁶ Steven Mnuchin, US Treasury Secretary (2019), Letter to Jose Angel Gurría, Secretary-General of the OECD, on DSTs, 3 December 2019. Available at: <https://www.orbitax.com/news/archive.php/U.S.-Treasury-Secretary-Sends-40283>; Jose Angel Gurría, Secretary-General of the OECD, Response Letter to Steven Mnuchin, US Treasury Secretary, 4 December 2019. Available at: <https://www.oecd.org/newsroom/Letter-from-OECD-Secretary-General-Angel-Gurría-for-the-attention-of-The-Honorable-Steven-T-Mnuchin-Secretary-of-the-Treasury-United-States.pdf>

¹⁷ 'Three years on, India's equalisation levy still impacts digital advertising', *TMF Group*, 6 June 2019, Available at: <https://www.tmf-group.com/en/news-insights/articles/2019/june/india-equalisation-levy/>

¹⁸ Rohan Seth (2019), 'India's Upcoming Digital Tax: how will big tech cope?', *The Diplomat*, August 2019. Available at <https://thediplomat.com/2019/08/indias-upcoming-digital-tax-how-will-big-tech-cope/>

of goods or provision of services, at the rate of 2%, with entry into force on 1 April 2020.¹⁹ This is payable by the operator, on a quarterly basis. The US was predicted to retaliate and it has, indeed, begun that process.²⁰

- **Pakistan** was another early mover in July 2018, introducing a 5% withholding tax on payments for offshore digital services performed by non-residents. The definition of digital services is extensive and detailed, including revenues from online advertising, webhosting, storing or distributing digital content, online collection and processing of data, and online marketplaces for trading goods and services.²¹
- **Turkey** enacted a 7.5% DST in December 2019 that entered into force on 1 March 2020.²² The tax applies to gross revenue from sales by MNEs that have consolidated group revenue basically equivalent to the EU's thresholds.²³ The President could reduce the tax rate to 1% or double it for some or all of the services. The scope was broader than the European Commission's 2018 proposal, covering providers of digital services such as advertisement services, in-app sales (such as games, music, videos), paid services through social media and websites who act as intermediaries for sales of goods and services.²⁴ Companies that failed to register for the tax could have access to their services blocked. Where the company had no local presence, the tax was to be declared by an intermediary. However, the law could require the MNE to establish a Turkish entity. Prior to the law entering into force, the US announced it was evaluating whether to launch an unfair trade practice investigation against Turkey,²⁵ and it has since done so.

¹⁹ Finance Act 2020, Part VI, available at <https://www.incometaxindia.gov.in/Documents/News/Finance-Act-2020.pdf>

²⁰ Seth 2019

²¹ Digital services is defined in the Finance Act 2018 as 'online advertising including digital advertising space, designing, creating, hosting or maintenance of websites, digital or cyber space for websites, advertising, e-mails, online computing, blogs, online content and online data, providing any facility or service for uploading, storing or distribution of digital content including digital text, digital audio or digital video, online collection or processing of data related to users in Pakistan, any facility for online sale of goods or services or any other online facility'. Quoted in Grondona et al 2020, 23

²² Law no. 7194, Digital Service Tax and Amendment of Certain Laws and the Decree Law numbered 375, Gazetted on 7 December 2019, number 30971. Ramazan Bicer (2019), 'Turkey enacts 7.5 percent digital services tax', *MNE Tax*, 22 December 2019. Available at: <https://mnetax.com/turkey-enacts-7-5-percent-digital-service-tax-37161>

²³ €750 million globally and revenue in Turkey of approximately €30 million

²⁴ Deloitte, Tax News, No: 2019/15, 11 December 2019. Available at: <https://www.verginet.net/dtt/11/tax-news-2019-15.aspx>

²⁵ Office of the USTR, 2019; Yusuf Mansur Ozer and Hande Pat (2020), 'Turkey: Digital services tax enters into force on 1 March 2020', *Mondaq*, 11 February 2020, <https://www.mondaq.com/turkey/Tax/892420/Digital-Service-Tax-Enters-Into-Force-On-1-March-2020>

- The **Indonesian** government had incorporated regulations for a DST in a tax bill, but the Parliament had not passed the Bill before it shut down over COVID-19. In its place, the government issued a regulation by decree that provided for income tax on e-commerce activities carried out by foreign individuals or digital companies with a ‘significant economic presence’, determined through the companies’ gross circulated products, sales and/or active users in Indonesia. Those companies would be declared to have permanent establishment in Indonesia and be subject to domestic tax regulations. If a tax treaty made that impossible, the government would charge an electronic transaction tax on sales in Indonesia. Netflix was reported to have supported the tax.²⁶
- **Zimbabwe** introduced a 5% tax on revenues from non-resident e-commerce platforms in January 2019 above a certain threshold. The tax applies to income from foreign domiciled broadcasting services and electronic operators in respect of delivering goods and services. Foreign entities providing digital services who are liable to the tax are required to appoint a local representative.²⁷

Numerous other developing countries have adopted some variation on DST.²⁸ **Vietnam, Malaysia** and **Kenya** do, or plan to, tax revenues derived by non-residents from online marketplaces.²⁹ If successfully imposed, these taxes may become a permanent fixture in developing countries as preferable to any revisions to international corporate income tax rules that result from the negotiations through the Inclusive Framework on BEPS, even if they were to secure consensus support among developed countries.

5.1.3 The USTR’s Section 301 investigation of the French DST

The Section 301 investigation into France’s DST provides important insights into the arguments the US is likely to raise against such taxes, including in the pending Section 301 inquiries into digital taxes adopted or proposed by several developing countries (currently Brazil, India, Indonesia and Turkey). The following summary has categorised the US’s arguments as empirical, normative and strategic.

²⁶ ‘Indonesia taxes tech companies through new regulation’, *Jakarta Post*, 1 April 2020. Available at: <https://www.thejakartapost.com/news/2020/04/01/indonesia-taxes-tech-companies-through-new-regulation.html>

²⁷ Grondona et al 2020, 25

²⁸ For a comprehensive account as of March 2020 see KPMG, ‘Taxation of the digitalized economy’, Developments summary, updated 25 March 2020. Available at: <https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf>

²⁹ Tim Bradshaw (2019), ‘Countries vow to press ahead with digital taxes despite US threats’, *Financial Times*, 5 December 2019, <https://www.ft.com/content/6529014c-169a-11ea-9ee4-11f260415385>

(i) The *empirical argument* lays the groundwork for asserting discrimination and competitive disadvantage. While the DST is not discriminatory on its face, the majority of corporations affected by the tax would be from the US: only one French firm would meet the criteria and threshold for the tax on Internet advertising, and none for digital interface services.³⁰ The report cited statements from French politicians and officials, for example referring to a ‘GAFA tax’, and their assurances that French companies would not be affected as evidence of a discriminatory intention.³¹ The French tax was described as a more egregious version of the EU’s proposal that had also targeted US companies, because France excluded categories the EU’s tax would have covered so as to provide greater protection for French companies.³² The report identified a progression of filters that ensured predominantly US firms were targeted:

- The *services to be taxed* targeted Internet advertising and digital interface services. The US considered the selection and definition of both to be arbitrary and discriminatory.³³ The *targeted advertising* tax does not apply to traditional advertising where French firms still hold half of the domestic market share,³⁴ or to Internet advertising that is not based on individual user-generated data (i.e. not targeted). The tax on data only targets data generated by users on interfaces, not data generated by users through the Internet of Things, for example data mined by the auto industry from motor vehicles.³⁵ The tax on *digital interface* services applies to those that connect users with other users to buy or sell services, but not to suppliers selling their own products, such as taxis, hotels, and retailers, which is what the major online French companies do.³⁶
- The *dual global and national thresholds* that must be met before the tax applies have no economic rationale,³⁷ and are intended to target US companies and exclude French competitors. The tax will not capture: small operators; large and successful French companies with limited global reach, even if they have a larger market share in France than the taxed digital companies; and large companies where these activities are a relatively small part of their business.³⁸

³⁰ Section 301 Report, 26-27

³¹ Section 301 Report, 31-35

³² Section 301 Report, 47

³³ Section 301 Report, 69-70

³⁴ Section 301 Report, 36

³⁵ Section 301 Report, 75

³⁶ Section 301 Report, 14, 38 and 68

³⁷ Section 301 Report, 29

³⁸ Section 301 Report, 36

- The grounds on which activities are *deemed to have taken place ‘in France’* during a calendar year are arbitrary and spurious. *Digital interface services* qualify when someone in France uses the interface to buy or sell products or services or the user has an account opened from France that allows them to access the services on the interface during the year.³⁹ The tax applies for *targeted advertising* when an individual is located in France either when they view a targeted ad or when the data connected to their interaction with a targeted ad is sold, whether or not any of the participants is French.⁴⁰
- The formula to determine the *quantum of tax payable* is arbitrarily based on attribution of revenues relative to the share of transactions, not based on a determination of actual value.⁴¹

The US argued that levying such a ‘discriminatory tax’ on US digital corporations would put them at a competitive disadvantage. Any French firms subjected to the tax would be able to deduct the DST payments from the profits on which they pay income tax, which may not be available for non-French companies paying corporate income tax in other countries.⁴² Further, because the tax applies to revenues and not to income, it would result in double taxation through payment of tax in other countries on the same revenue.⁴³

US digital companies would also face increased compliance costs. Introduction of the entirely new tax would involve new methodologies for calculating the tax and require new tax reporting and internal business, accounting and financial reporting systems. Compliance would require companies to generate multiple forms of data: the company’s global revenue, the number and location of advertising transactions, the use of targeted advertising, the amount of data collected from French users and the amount of that applied to targeted advertising to those users. Most of that information is not currently collected and it would cost US companies millions of dollars to re-engineer their systems. The proposed retroactivity of the tax would magnify that burden.⁴⁴

(ii) The normative argument seeks to entrench the *status quo ante*. The USTR’s report objects that the DST diverges from the norms of the international tax system through its extraterritoriality, by taxing revenue not income, and in ‘penalising particular technology companies for their commercial success’.⁴⁵ The argument treats the taxing of MNEs based on physical presence as an immutable principle,

³⁹ Section 301 Report, 18-19

⁴⁰ Section 301 Report, 19, 63

⁴¹ Section 301 Report, 20

⁴² Section 301 Report, 48-49

⁴³ Section 301 Report, 56-7

⁴⁴ Section 301 Report 53, 60

⁴⁵ Section 301 Report, 10

using arguments that align with the US's rejection of the current proposals for the OECD's Unified Approach.

In the US's view, the central tenet of international tax law is that companies should only be subject to a country's corporate tax regime on the basis of a territorial connection to the country.⁴⁶ That principle of permanent establishment was affirmed in bilateral tax treaties between the US and US-EU Member States, including the US-France tax treaty.⁴⁷ A company that has an office with limited functions and does not meet the definition of permanent establishment would not be subject to corporate tax in France.

Basing the tax on gross revenue was also out of line with international opinion, with revenue-based taxes criticised as 'inefficient', creating 'barriers to economic growth' and 'generally considered to be unfair tax policy'.⁴⁸ Under OECD and UN model treaties, revenue taxes like DSTs would amount to double taxation, by taxing companies once on DST and then by corporate tax in the country where the company pays tax on income related to those services.⁴⁹

(iii) The *strategic argument* justifies the global dominance of Big Tech and delegitimises moves to adjust national and international tax regimes to that altered reality. The report accuses France of 'retroactive and unilateral' introduction of the DST. The Bill had been introduced with inadequate consultation and opportunities for comment and the legislation was passed with undue haste.⁵⁰ France's action had undermined the prospects for consensus on a multilateral agreement, despite numerous approaches made by the US urging France to work through the OCED's process.⁵¹

The report also attacked the premise that digital service providers were legitimate targets for a special tax. Most of the covered US companies were founded as Internet companies and their business models reflect that.⁵² It is the nature of firms that deliver digital interface services that they do not have a physical presence in most countries and are not taxable under international tax law norms. They are now being penalised for the success of their model.

Further, discrimination between 'GAFA' (Google Apple Facebook and Amazon) and other digital companies and advertisers on the basis that they pay much less tax was not supported by studies. The report cited research by ECIPE (whose report on the moratorium, discussed in Part 3: 3.3.5, acknowledged the support of the Global Services Forum) to claim that digital companies pay an average effective tax

⁴⁶ Section 301 Report, 60

⁴⁷ Section 301 Report, 55-56

⁴⁸ Section 301 Report, 56

⁴⁹ Section 301 Report, 56

⁵⁰ The US complained that the proposal was published on 6 March 2019 and enacted on 24 July 2019, substantively unchanged: Section 301 Report, 1

⁵¹ Section 301 Report, 65

⁵² Section 301 Report, 45

rate comparable to or higher than the average tax rate for traditional companies. Facebook said in evidence that it pays all taxes it is required to by law. So did Google. Thus, the problem was not one of under-taxation, but of where the companies pay the corporate income tax.

On the targeting of data, the claim that digital companies uniquely benefit from the value of data obtained from users was said to misrepresent the nature of the transaction. The real value of tech companies is the software and the business model. The majority of users create little of value and get the service for free. Data is exchanged for the free services.⁵³

In sum, it is clear from the strategic and normative arguments in the report that the US intends to use its domestic law, backed by its unilateral interpretation of international trade treaties, to defend the outmoded orthodoxy and resist taxation measures that challenge its digital ascendancy. The subsequent US announcements, first of a tranche of new Section 301 inquiries into DSTs and the next week its temporary withdrawal from the OECD negotiations, signal the intention to write its own rules for both tax and trade law, irrespective of what transpires in multilateral or plurilateral negotiations.

Ironically, the US federal government was about to engage a similar battle internally. In January 2020 three states proposed legislation to tax the gross revenues of digital companies.⁵⁴ A Bill in the Maryland Senate sought to tax annual gross incomes from certain digital advertising services, with criminal sanctions for failure to comply. Nebraska proposed a sales and use tax on the retail sale of digital advertisement. New York State was considering a bill to impose an additional 5% tax on the gross income of 'every corporation which derives income from the data individuals of this state share with such corporations'. These initiatives draw support from a ruling of the US Supreme Court in 2018 that '*a business does not need a physical presence in a State to meet the requirements of due process which call for some definite link, some minimum connection, between a state and the person, property or transactions it seeks to tax*'.⁵⁵

The US strategy will be hard for countries to defeat alone, especially for the Global South. It will harness the available and proposed trade rules to support its case, albeit defined and interpreted unilaterally. Although the US does not frame its legal argument explicitly in trade terms, the investigation indicates the kinds of arguments the US would be likely to make using the available trade in services and e-commerce rules in the WTO and its FTAs. Few of these arguments are backed by independent research, and the report treats the assertions of partisan think-tanks

⁵³ Section 301 Report, 74-75

⁵⁴ Veronica Grondona, Abdul Muheet Chowdhary and Daniel Uribe (2020), *National Measures on Taxing the Digital economy*, Research Paper 111, South Centre, Geneva, May 2020, 6-7

⁵⁵ *South Dakota v Wayfair, Inc.* 138 S. Ct. 2080 (2018), quoted in Grondona et al 2020 footnote 21

and lobbyists, or the digital MNEs themselves, as unquestioned truth. Despite the lack of empirical evidence, the report provides a powerful precedent and warning to developing countries, which will need to develop collective strategies to resist.

Box 5.1 anticipate how the expensive reading of trade in services rules and commitments and the proposed e-commerce rules might be harnessed to oppose a DST and reinforces the need for developing countries to resist such approaches. Ironically, some developed countries that are pushing for these new rules might find them used to attack their own DSTs.

Box 5.1 How trade in services and e-commerce rules in FTAs/the WTO may affect DSTs

Trade in services rules

A digital services tax would constitute a ‘measure that affects the supply of a service’, such as advertising, data processing, a search engine or webhosting, which the country has agreed to subject to the relevant rules.

Classification is crucial to both the DST and the trade rules (see Part 2: 2.4.2). DSTs only apply to certain digital services activities. The tax is targeted by reference to the classification of service activities, such as advertising or a digital interface, location and other characteristics, such as user-generated or user-targeted activities. Tax authorities will develop their own criteria for determining whether an activity meets that classification. A service may not be classified the same way by tax authorities as it is for trade in services rules. For example, an Internet marketplace might be supplying a computer service or retail distribution; a digital advertiser that sells information to other online advertisers might be supplying a computer service or advertising service. At present, there is no clarity around these classifications.

Most of the digital MNEs that would be affected by a DST define themselves by the technology of delivery. Many WTO Members have made commitments to allow the cross-border supply of computer and related services,⁵⁶ including data storage and processing. Many countries also have commitments on substantive services that operate through digital platforms, such as hotel and tour agencies, education and retail distribution, or that are fully automated, such as derivatives trading, services related to mining, and even some maritime transportation.

Ambiguities about the scope and application of each classification, and inconsistencies across agreements, create uncertainty and potential overlaps. Tax authorities in many developing countries are likely to struggle to unravel these complexities – and may not even be aware of them.

If the tax is explicitly discriminatory and adversely affects the competitive position of the taxed company compared to its domestic counterparts, it could breach the **national treatment** rule (see Part 2: 2.4.4). The same would apply if the tax is de facto discriminatory in its scope, threshold or criteria. However, the legal test for deciding

⁵⁶ Usually defined according to the services classification of CPC84

which companies are alike is unclear. A requirement that the offshore digital entity holds data locally could also be a 'measure affecting the supply of services' and inconsistent with national treatment if it applied only to foreign firms and affected their competitive position.

Banning or blocking a service supplier, for example for non-compliance, might also constitute a breach of **market access** (see Part 2: 2.4.5).

The **local presence** rule (see Part 2: 2.4.6) would prevent governments from requiring cross-border suppliers of digital services to have a representative office or any form of enterprise as a condition of supplying the service, even if it considers that is essential to effective assessment and enforcement of a DST. The government might require the appointment of an agent, who would normally be an intermediary, such as an accountant, lawyer, financial adviser or other professional. However, the prohibition on requiring a local presence would apply to them too.

The **administration** of measures of general application that affect trade in services (which a DST would be and do) must be 'reasonable, objective and impartial' [see Part 2: 2.4.7). The meaning and scope of 'administration' is undefined and could be interpreted to include the manner in which offshore digital companies are required to meet the registration, reporting and compliance obligations under the DST law. Standards that could be considered vague, subjective, unpredictable, excessive or discriminatory could be challenged.

Administering disclosure requirements may also be problematic. It will be difficult to disentangle the taxed elements of digital activities from other aspects of the digital MNEs' operations within and outside the country, such as user-generated data from data generated from other sources.

The **GATS tax exception** applies only to direct taxes on income or capital, which DSTs are not, or to double taxation provisions (see Part 2: 2.8.2).

E-commerce rules

Access to data, and data about data, will be essential to the effective operation of DSTs. Revenue based on in-country customers is complicated for similar reasons. If data that is user-generated cannot easily be distinguished from synthetic or algorithmically-generated data, the taxed company may dispute its inclusion in assessments of revenue. Effective determination of those questions assumes the ability to access and analyse detailed data about the company's operations and, if necessary, the **source codes and algorithms** used to mine and utilise it, contrary to proposed new e-commerce rules (see Part 2: 2.3.3). So far, only the USMCA allows authorities to require disclosure, and even that is solely for individual cases and the software may not be made available to non-government analysts.

Requiring that the relevant data, or at least a copy, is retained in the country to enable effective implementation of the tax would be likely to violate the **transfer of information** and **local server** provisions in most recent e-commerce chapters and proposed for the WTO (see Part 2: 2.3.1, 2.3.2).

Governments may need to resort to the available **protections and exceptions**, which differ across agreements and between trade in services and e-commerce rules. Some countries may not have commitments to the relevant services sectors. The

legitimate public policy and legitimate public welfare exceptions for the national treatment and data transfer rules might be challenged on both ‘legitimacy’ and substantive grounds.

Proposed **transparency** rules in the plurilateral negotiations on Domestic Regulation of Services⁵⁷ and Investment Facilitation⁵⁸ would require prior consultation with foreign digital companies and their parent states on the introduction and design of a DST and consideration of those comments ‘to the extent practicable’ and implemented in the manner set out in a country’s law (see Part 2: 2.7). Some recent FTAs have stricter obligations.⁵⁹ This process would facilitate external intervention and provide a formal channel for the threats of retaliation by the US and others.

Regulatory coherence processes, such as impact assessments that mandate evidence-based proposals and prioritise the least-restrictive options, would add to the burden on policy-makers and increase potential for challenge and regulatory chill (see Part 2: 2.7 and Part 7).

5.2 Consumption tax on digital delivery and digitised goods and services

Consumption tax, usually called a value-added tax (VAT) or goods and services tax (GST), is collected in a staged process. Each intermediary business in the chain adds an element to the VAT charged, passing along the amount to the next business until it reaches the ultimate consumer. With cuts to tariffs and competitive pressure to reduce corporate and personal income taxes, VAT has become a major source of revenue for both developed and developing countries. As with other taxes, their experiences have often diverged. Many developing countries have faced significant implementation problems, reflecting their large informal economies and, in some cases, a lack of administrative capacity to implement the VAT. As a result, VAT revenue may come from only a small number of companies and may be small in amount.

Unlike its digital corporate income tax proposals, the OECD has managed to establish agreed mechanisms for applying VAT to the digital economy. There are difficulties applying VAT on cross-border digital transactions involving physical goods, where collection from non-resident suppliers relies on a reverse charge mechanism. Collecting VAT on intangibles and services can be even more difficult. Beginning in 2006, the OECD began work on creating guidelines for this, culminating in the publication of agreed guidelines in 2017.⁶⁰ The OECD also began work in 2016 to

⁵⁷ Services Domestic Regulation, ‘Note by the chairperson. Draft Reference Paper on Services Domestic Regulation’, 12 July 2019, paras 15-20, on file with Jane Kelsey

⁵⁸ ‘Investment Facilitation for Development, draft text’, INF/IFD/RD/39, September 2019, 9, para 3.4, on file with Jane Kelsey

⁵⁹ For example, USMCA Article 28.9

⁶⁰ OECD (2017), ‘International VAT/GST Guidelines’, 12 April 2017. Available at: <https://www.oecd.org/ctp/international-vat-gst-guidelines-9789264271401-en.htm>

develop implementation mechanisms for the collection of that VAT, again producing guidelines in 2017 (the Guidelines).⁶¹

The Guidelines establish mechanisms for two categories of transactions: business-to-business transactions (B2B) and business-to-consumer transactions (B2C). For B2C transactions, the Guidelines recommend a simplified registration process for remote suppliers: the supplier needs to register with the source jurisdiction in advance of doing business there and is then obligated to impose VAT on in-bound transactions. For B2B transactions, the Guidelines recommend a reverse charge (or self-assessment) mechanism. Here, the importing business imposes VAT on its own purchases.

The Guidelines also recommend employing withholding taxes or using intermediaries, such as digital platforms, to impose VAT. In the case of intermediaries, the impositions of VAT would be either pursuant to a contract between the supplier and the intermediary or by treating the intermediary as the deemed supplier. The use of intermediaries in the VAT process is expected to become increasingly important as the digital economy expands. Where the intermediary is registered to do business locally, tax authorities can readily deal with them. It can be much more problematic where they are not located in the country.⁶² If those options fail, tax authorities need to levy taxes on local customers until the intermediaries comply with the local law – an unhelpful option for developing countries.

The OECD's Guidelines have been broadly accepted in developed countries and many jurisdictions with VAT regimes have begun to apply them to cross-border e-commerce in recent years.⁶³ Box 5.2 briefly examines several examples from the Global North in terms of their compliance with national treatment obligations on trade in services. The review reveals the legal risks that politicians can unwittingly create when they claim to be protecting the national economy and the potential political risks they may face as digital MNEs retaliate.

⁶¹ OECD (2017), 'Mechanisms for the Effective Collection of VAT/GST where the supplier is not located in the jurisdiction of taxation', OECD 2017. Available at: <https://www.oecd.org/tax/tax-policy/mechanisms-for-the-effective-collection-of-VAT-GST.pdf>; Richard Bird and Pierre-Pascal Gendron (2007), *The VAT in Developing and Transitional Countries*, Cambridge University Press; see also citations to various EU materials at EU, 'Modernizing VAT for cross-border e-commerce'. Available at: https://ec.europa.eu/taxation_cUStoms/bUSiness/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en

⁶² OECD (2020), *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy*. Public consultation document, 19 February 2020 – 20 March 2020, Annex A, 38-39

⁶³ See, for example, Australia, A New Tax System (Goods and Services Tax) Act 1999, Division 9-25; New Zealand, Taxation (Residential Land Withholding Tax, GST on Online Services and Student Loans) Act 2016

Box 5.2 VAT on digital services and the National Treatment rule: lessons from developed countries

Australia: In accordance with the OECD Guidelines, since July 2017 Australia has applied its domestic GST to digital products and services bought in Australia through cross-border transactions, including smartphone apps, songs, podcasts, e-books and games.⁶⁴ The government described the move as closing a loophole, levelling the playing field, and removing an unfair advantage to offshore firms.⁶⁵

The Federal Government moved separately to levy GST on all purchases by consumers of physical goods from across the border, removing a A\$1000 minimum price per purchase (de minimis) where the business's annual turnover exceeded A\$75,000. The measure was deferred for 12 months until July 2018 following intensive political lobbying by Amazon, eBay and other overseas Internet retailers.⁶⁶ Amazon's response was to block Australians from buying goods from its offshore e-commerce sites and redirecting them to its more limited Australian website.⁶⁷ Local competitors objected that the deferral was a subsidy to offshore retailers.⁶⁸

Both measures prima facie comply with the national treatment rule. They apply GST equally to foreign and 'like' national suppliers. Even though compliance might be more difficult for offshore operators, the effect is unlikely to reach the threshold of 'modifying the conditions of competition' in favour of nationals. It should also satisfy the test in the TPPA/CPTPP of 'like circumstances' (see Part 2: 2.4.4) as GST applies to similar purchases from onshore and offshore.

If Australia needed to rely on an exception, the GATS tax exception would be unavailable as that only applies to a direct tax and the international tax treaty exception is only for double tax provisions. If necessary, the tax might be said to be a measure to implement an otherwise GATS-compliant law, being the GST, under the General Exceptions.

However, a government spokesperson's comment that the measure would protect Australian industries that were threatened by e-commerce were not helpful, as that suggests a disguised preference that could undermine the national treatment rule, and

⁶⁴ 'Aust "Netflix tax" to come into effect this week', *The New Daily*, 25 June 2017. Available at: <https://thenewdaily.com.au/entertainment/tv/2017/06/25/netflix-tax-july-1/>

⁶⁵ Government of Australia, 'Delivering a fairer playing field for Australian businesses', 21 June 2017, media release. Available at: <https://ministers.treasury.gov.au/ministers/scott-morrison-2015/media-releases/delivering-fairer-playing-field-australian-businesses>

⁶⁶ Government of Australia, 'GST on low value imported goods', 31 January 2018. Available at: <https://www.abf.gov.au/importing-exporting-and-manufacturing/importing/cost-of-importing-goods/gst-and-other-taxes/gst-on-low-value-goods>; Frank Chung (2017), 'Amazon, Alibaba, eBay and Etsy may block Australian users if controversial online GST changes go ahead', *news.com.au*, 23 April 2017. Available at: <http://www.news.com.au/finance/business/retail/amazon-alibaba-ebay-and-etsy-may-block-australian-users-if-controversial-online-gst-changes-go-ahead/news-story/3a2d62515b247fc79b927f1db0696ba4>

⁶⁷ 'Amazon will stop shipping to Australia from 1 July', *Australian Financial Review*, 31 May 2018. Available at: <https://www.afr.com/business/retail/amazoncom-will-stop-shipping-to-australia-from-july-1-20180531-h10rzv>

⁶⁸ 'Online shopping GST delayed for 12 months', 19 June 2017. Available at: <https://thenewdaily.com.au/money/your-budget/2017/06/19/online-shopping-gst-delayed/>

fail the test in the chapeau of the General Exceptions that disallows a ‘disguised barrier to trade’.⁶⁹

New Zealand: A tax on all online purchases of digital services in New Zealand from October 2016, dubbed the ‘Netflix tax’, requires offshore suppliers to register for GST, collect the same 15% tax on sales as local bricks-and-mortar retailers do, and pay that money to the Department of Inland Revenue. Academics questioned its enforceability, especially if there were heavy sanctions for non-compliance, given the reliance on offshore companies’ cooperation.⁷⁰ Two years later the government removed the \$400 de minimis that applied to the offshore online tax. New Zealand’s law appears to comply with national treatment under both GATS and TPPA.

Canada: The proposal from a parliamentary committee in Canada during 2017 to impose a 5% levy on high-speed Internet services explicitly to protect the domestic media industry would be much more problematic. While there could be legal arguments about whether Internet and traditional media were ‘like’ services, the explicit intent of the levy was to target predominantly foreign Internet suppliers of content and undermine their competitive position. Its adoption was blocked by the government anyway.⁷¹

While applying corporate income tax to non-resident digitalised companies can be problematic even for developing countries, VAT will become an increasingly important source of revenue as the digital economy expands. Some developing countries have successfully extended their laws to digital traders:

- South Africa has applied VAT to digital goods supplied via digital platforms since 2014; the tax had returned R3 billion (US\$510 million) in revenue to the government as at February 2019.⁷²
- Kenya introduced a tax on income accruing through a digital market-place and expanded the application of VAT to services supplied through a digital marketplace in November 2019.⁷³ That was accompanied by an amendment

⁶⁹ Hon Scott Morrison, ‘Delivering a fairer playing field for Australian businesses’, Media Release, 21 June 2017. Available at: <https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:%22media/pressrel/5351041%22>

⁷⁰ ‘University of Auckland: Online shopping tax unenforceable’, *New Zealand Herald*, 26 September 2016. Available at: https://www.nzherald.co.nz/university-of-auckland/news/article.cfm?c_id=1503679&objectid=11714815

⁷¹ “‘Netflix tax’ not in the cards, Finance Minister Bill Morneau says”, *The Star*, 25 June 2017. Available at: <https://www.thestar.com/news/canada/2017/12/10/netflix-tax-not-in-the-cards-finance-minister-bill-morneau-says.html>

⁷² ‘Here’s how much money government has made from taxing digital services in South Africa’, *BusinessTech*, 16 June 2019. Available at: <https://businesstech.co.za/news/finance/322985/heres-how-much-money-government-has-made-from-taxing-digital-services-in-south-africa/>

⁷³ Finance Act 2019, s.3. See Mercy Muendo (2019), ‘Kenya’s tax on digital trade and services: what’s known and not known’, *CNBC Africa*, 11 December 2019. Available at: <https://www.cnbcafrica.com/news/special-report/2019/12/11/what-you-need-to-know-about-kenyas-tax-on-digital-trade-and-services/>

extending the Income Tax Act to cover income accruing through a digital marketplace, defined as ‘a platform that enables direct interactions between buyers and sellers of goods and services through electronic means’.⁷⁴

- The Indonesian government moved in April 2020 to charge VAT on sales of intangible goods and/or services through electronic platforms.⁷⁵
- Other countries to introduce VAT on various kinds of online transactions include Albania, Angola, Cameroon, India, Malaysia, Nigeria and Uganda, in some cases without a threshold before cross-border firms have to register for VAT.⁷⁶

There are, however, distributive downsides to VAT as the burden ultimately falls on the consumer and not on the company providing the service, with flow-on effects for digital uptake. Many developing countries also lack the capacity to implement it effectively and the leverage to secure cooperation from the digital companies being taxed, especially in the absence of a local presence. At a meeting of the African Tax Administration Forum in 2019, a Ugandan official recounted the frustration when foreign companies simply ignored the instruction to register for VAT.⁷⁷

5.3 Restricting tax avoidance by royalty payments

Royalty payments are a favoured vehicle for profit shifting to low- or no-tax jurisdictions, as the ‘Uber model’ showed (see Part 4.2). This strategy is especially attractive to digital businesses where intellectual property in the form of software, algorithms and AI are core assets that can easily be held by a subsidiary within a jurisdiction that levies low or no tax on royalties.⁷⁸ Three tax policy decisions are in play: establishment of ‘patent box regimes’ by jurisdictions that treat royalties as a privileged low-tax category, which encourages a race to the bottom among such governments; limits on the deductions for royalties that the source jurisdiction allows; and licence arrangements between private entities, including related parties.

⁷⁴ Mercy Muendo 2019

⁷⁵ ‘Indonesia taxes tech companies through new regulation’, *Jakarta Post*, 1 April 2020. Available at: <https://www.thejakartapost.com/news/2020/04/01/indonesia-taxes-tech-companies-through-new-regulation.html>

⁷⁶ Annie Musgrove (2020), ‘Digital Tax Around the World: What to Know about New Tax Rules’, 9 June 2020. Available at: <https://quaderno.io/blog/digital-taxes-around-world-know-new-tax-rules/>

⁷⁷ Martin Hearson (2019), ‘Africa responds to the Inclusive Framework’s digital tax agenda’, ICTD, 7 August 2019. Available at: <https://www.ictd.ac/blog/africa-responds-to-the-inclusive-frameworks-digital-tax-agenda/>

⁷⁸ Commonly the actual R&D expenditure has already been tax deductible as an actual expenditure

A study by the Tax Justice Network points out how ‘preferential regimes for the tax treatment of intellectual property and the absence of rules limiting the deduction of royalty payments for intellectual property or intangibles between intra-group companies from the corporate income tax base put countries at risk.’⁷⁹ Action 5 of the OECD BEPS on harmful tax practices did not consider all patent box regimes harmful. Criteria included whether the regime was the main motivation for the location of the activity. One means of determining that was the existence of a nexus between the income benefitting from the intellectual property and the underlying research and development activities that generated it.

While Action 5 was seen as a step in the right direction, the Tax Justice Network considered it was insufficient to ‘prevent the abuse of patent boxes being used in profit shifting and base eroding tax wars’.⁸⁰ Potentially unlimited amounts of qualifying profits could still be taxed at a lower rate, and it was near impossible to police the nexus requirements.

Countries where the income is generated also need to decide how to treat royalties as deductible expenses, especially knowing they may be exported to a patent box jurisdiction. South Africa links the amount of deduction it allows for intra-group royalty payments to the withholding-tax rate.⁸¹ A number of other countries have limited deductions by intervening in arrangements between private parties:

- Rwanda caps deductions for royalties that a local company pays to a related non-resident company at 2% of turnover.⁸²
- Germany introduced limits on royalty payments between related parties as part of Action 5 of the OECD BEPS on ‘harmful tax practices’, in situations where companies failed to comply with the revised nexus approach under the BEPS.⁸³
- The Indian experience shows the policy sensitivities of restricting foreign investors’ use of royalties for profit shifting. After India liberalised its foreign investment rules in 2009 the Government amended the Foreign Exchange Management Rules of 2000 to remove the need for the Commerce Ministry

⁷⁹ Rachel Etter-Phoya, Shanna Lima and Markus Meinzer (2019), ‘Corporate income taxation in the digital age: Africa in the Corporate Tax Haven Index 2019’, 28 August 2019, Tax Justice Network, 17. Available at: <https://www.taxjustice.net/wp-content/uploads/2019/08/CORPOR1.pdf>

⁸⁰ Etter-Phoya 2019, 21

⁸¹ P J Hattingh, South Africa – Corporate Taxation, Country Analyses OBFD, 2019, cited in Etter-Phoya, 24

⁸² ‘Rwanda: Corporate – Deductions’, PWC. Available at: <https://taxsummaries.pwc.com/ID/Rwanda-Corporate-Deductions>

⁸³ Fried Frank Harris Schriver (2017), ‘Germany limits tax deduction for royalty payments’, *Lexology*, 2 June 2017. Available at: <https://www.lexology.com/library/detail.aspx?g=bdc8d58f-cc19-4d01-a1f7-001d6f7ad11a>

to approve royalty payments exceeding 5% of domestic sales and 8% of export sales. Capital outflows began to surge, so in 2017 the Government began exploring whether the royalty payments could be considered excessive. The Commerce Ministry's attempt to reintroduce restrictions in 2018 was stymied by the Ministry of Finance, which was concerned about sending negative signals to foreign investors. In November 2019 the Government circulated a proposal to reintroduce such restrictions in the case of technology transfer or collaboration involving foreign entities directly or indirectly through any local firm.⁸⁴ As of mid-2020, the proposal had once again fallen captive to a battle of competing priorities between the commerce and finance ministries.

Digital MNEs are clearly concerned at the potential for increased uptake of these kinds of restrictions. Several recent FTAs prohibit governments from restricting the amount or duration of royalty payments under private licence contracts between a foreign investor and another local entity, of any kind, whether or not they are related parties.⁸⁵ There is an exception for a legitimate public welfare objective, but it may be difficult to argue that a tax-related objective fits that criteria (see Part 2: 2.5).

Agreements that contain this rule allow parties to limit their exposure to these rules through positive or negative list schedules. However, governments must be alert to the risks at the time they are negotiating those schedules and be able to secure agreement from the other parties to protect the policy space for that measure. Box 5.3 uses the Indian example of a policy to-and-fro to illustrate how a government's regulatory options for capping royalty payments might be foreclosed by negative list annexes in FTAs.

⁸⁴ 'Govt considering to reintroduce restrictions on royalty payments', *Economic Times of India*, 17 November 2019. Available at: <https://economictimes.indiatimes.com/news/economy/policy/govt-considering-to-reintroduce-restrictions-on-royalty-payments/articleshow/72095797.cms?from=mdr>

⁸⁵ TPPA/CPTPP Article 9.10.1(i). This prevents a Party from setting the rate or amount of a royalty, or the duration of a term, under an existing or new licence contract that is freely entered into between the foreign investor and a person in the territory (including a subsidiary), if the requirement is imposed or enforced in a way that involves a non-judicial government body directly interfering with the licence contract.

Box 5.3 Caps on royalty payments, policy space and negative list schedules

India's prevarication over its policy to cap royalties provides a good illustration of the serious problems with negative list schedules. Imagine the Indian government had entered an agreement that prohibits it from imposing a performance requirement that caps the level of royalties in a licence contract between a foreign investor and is a related party (see Part 2: 2.5) and that agreement used negative list annexes to protect the government's policy space (see Part 2: 2.6).

If India's original regulation had been listed in **Annex 1** of a negative list, a **standstill** would apply that allowed India to maintain the measure after the trade agreement came into force. But once the restriction was removed, a **ratchet** would lock in the higher level of liberalisation and prevent India from reinstating the cap even to the previous level, let alone tightening it.

On the other hand, if India had reserved the right to adopt or maintain such a measure in **Annex 2** of the negative list, it could reinstate it or adopt an even more restrictive cap.

If India had no protection under either annex, it would have to rely on the taxation exception, the prudential exception or the general exceptions to justify reinstating any cap.

It is debatable whether any of those exceptions might apply. India's measure was an indirect means to address tax avoidance and it could be argued was designed for a prudential, rather than a tax reason. If accepted as a prudential measure, it must not be used as a means to circumvent India's GATS commitment to not apply such investment measures.

The **GATS tax exception** applies to the equitable and effective implementation and collection of **direct taxes** (see Part 2: 2.8.2). That defence would not apply as the royalty cap only seeks to achieve that objective indirectly.

The cap might be considered a measure to implement an otherwise GATS-compliant law, being the corporate tax under the **General Exceptions** (see Part 2: 2.9.2). However, it might be hard to show the measure was 'necessary' when few other countries considered it to be so. Even if it qualified as such, the cap might be challenged as arbitrary and unjustifiable discrimination or a disguised barrier to trade, especially in the context of President Modi's *Made in India* strategy.

6

REPORTING AND DISCLOSURE OF TAX-RELATED INFORMATION

TAXATION and compliance require multiple different forms of information and the rules that govern them are crucial.

Digital MNEs collect and store information, offshore and onshore, on their income and assets, commercial transactions, their supply and value chains, related-party relationships, financial records and debt obligations, interest spreads and royalties, and much more. Intermediaries, especially the legal and accounting professions and other financial institutions, financial investigation units and company registry offices also hold information that has tax implications. As with digital MNEs, they operate nationally, globally and virtually.

In the digital era, information relating to business activities is only one part of the picture. Collection of information itself has become a highly valued activity that generates taxable assets in the form of individualised data, aggregated data and meta-data, which governments are now seeking to tax. The practicalities and compliance issues relating to a DST are especially complicated and still largely untested. The global revenue relating to the targeted services may be relatively easy to define for tax purposes, but much more difficult to calculate precisely for a particular country.¹ The law establishing the DST may simply target payments made by residents in the country, or it may incorporate a more sophisticated formula designed to attribute revenue to the country, such as a proportion based on the percent of users located in the country compared to the worldwide users of that service. That requires access to highly specific data.

Tax authorities and other government agencies are entrusted with and can requisition information on people and companies, some of which may be sensitive. Until recently, that information was held by individual countries that keep the tax information on persons or companies which were subject to tax in their jurisdiction confidential. Information about the financial accounts of individual taxpayers and companies enjoyed similar confidentiality in the banking system. A government had limited means to secure this type of information from a foreign jurisdiction

¹ The practice is to base the revenue on sources tied to in-country users or customers. For this purpose, the Internet provider will usually use an IP address that indicates the location from which the user or customer is connected to the Internet.

because the reach of their country's law did not permit it to do so, unless the person in question had some kind of physical connection with the home jurisdiction.

Bank secrecy was protected around the world, with only limited rights for tax authorities to obtain information from local banks, and only to enforce their own taxes. Some countries such as Switzerland went further and enacted criminal laws to protect tax and financial information, providing a safe haven for many wealthy individuals. Countries such as Panama and British Virgin Islands were notorious for setting up shell companies to keep wealth information anonymous.

Some taxation treaties did provide for the exchange of tax-related information, but these were generally of limited value, because they allowed only provision of information on request, and usually only information already in the possession of the tax authority asked to supply it. This situation led to large-scale tax evasion by individuals and abetted aggressive tax avoidance by companies.² The lack of tax information had a particularly iniquitous effect on developing countries, as many of their tax administrations were already struggling to implement a corporate income tax effectively.

In the past decade, several information-sharing programmes have begun prising open that door. Some initiatives are directed more to information regarding high-worth individuals, while others focus on corporations. They are all mainly led by developed countries and reflect their needs and circumstances, leaving developing countries more at risk from the introduction or application of trade rules that may restrict their ability to access information.

The initiatives examined here demonstrate how trade rules on the digital economy might pose further barriers to transparency, particularly of the data value chains, and compound the difficulties that already confront the tax authorities in developing countries to access the information they require.

6.1 Reporting requirements

6.1.1 *The Foreign Account Tax Compliance Act (FATCA)*³

Enacted by the US in 2010, FATCA began to change the secrecy of tax and financial information. FATCA requires non-US financial institutions to report to the US Department of Treasury on the assets and liabilities of persons (principally individual, not corporate, taxpayers) with any indicia of a connection to the US.⁴

² Leonard Schniederman (2019), 'Hidden Wealth: The Global Campaign for Tax Transparency', *Tax Notes International*, 20 May 2019

³ US Public Law 111-147, Title V; US IRS, 'Summary of FATCA Reporting for U.S. Taxpayers'. Available at: <https://www.irs.gov/businesses/corporations/summary-of-fatca-reporting-for-us-taxpayers>

⁴ The US uses the following indicia: a US place of birth; identification of the account holder as a US citizen or resident; a current US residence or mailing address (including a US PO box); a current US telephone number; standing instructions to pay amounts from a foreign (meaning non-US) account to an account maintained in the US; a current power of attorney or signatory authority granted to a person with a US address; a US 'in-care-of' or 'hold mail' address that is the sole address with respect to the account holder.

The application of the Act was postponed several times, because this area is so complex.

While FATCA was a unilateral measure applied to foreign financial institutions, its provisions could be satisfied if a foreign government entered into an inter-governmental agreement with the US, whereby the foreign government would take the initiative to gather the pertinent information from its financial institutions and itself provide this information to the US. The US has entered into more than 110 such agreements. It also published regulations on how foreign financial institutions can comply directly with FATCA if their government does not do so. As leverage, the US imposes a 30% withholding tax on any US-sourced income paid to a foreign person or financial institution until it is satisfied there is compliance with the Act.

FATCA works for the US, which is the parent for most MNEs. But it is not designed to ensure information flows to other countries, developed or developing. Most of these intergovernmental agreements are asymmetrical, with either formal but limited reciprocity or no reciprocity at all – in other words, the US does not agree to provide equivalent information to the other government.⁵

6.1.2 Common Reporting Standard (CRS)

Following the enactment of FATCA, many of the barriers to the exchange of tax and financial information began to break down. The G8 and G20 leaders backed a multilateral information exchange programme initiated by the OECD, known as the Common Reporting Standard (CRS).⁶ This was launched in 2014, and is administered by the Global Forum on Transparency and Exchange of Information for Tax Purposes, open to all states to join but based at the OECD.⁷ The easiest way for countries to participate is by joining the Multilateral Convention for Mutual Administrative Assistance in Tax Matters, revised and open to all states in 2010, and its associated Multilateral Competent Authority Agreement.

Initially, one country had to specifically ask another jurisdiction for the information – a process known as the exchange of information on request (EOIR). That was cumbersome, particularly because many jurisdictions lacked sufficient information to specify which taxpayers they wanted information on. It was only after a sustained campaign by the Tax Justice Network, and following the financial crash and its ensuing fiscal crises, that political leaders finally agreed to establish a comprehensive global system for automatic exchange of tax information (AEOI).⁸ To

⁵ Andres Knobel (2016), 'The Role of the U.S. as a Tax Haven. Implications for Europe', Report Commissioned by Greens/EFA Group in the European Parliament, 10-15. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2943976

⁶ See: <https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/>

⁷ For information on the Global Forum see: <https://www.oecd.org/tax/transparency/>

⁸ See Sol Picciotto (2020), 'Technocracy in the Era of Twitter. Between Intergovernmentalism and Supranational Technocratic Politics in Global Tax Governance', 18 April 2020. Available at: <https://ssrn.com/abstract=3587542> or <http://dx.doi.org/10.2139/ssrn.3587542>

participate in the process, a country must have adequate systems to accommodate the automatic exchange of information and related procedures, while keeping the information being exchanged confidential – posing significant barriers to many developing countries’ participation.

The Global Forum has over 160 members and observers, including a large number from the Global South.⁹ Over 100 countries have signed on to the standards and more than 4,000 bilateral exchange arrangements are in force. The scheme has three drawbacks for developing countries. First, like FATCA, the Common Reporting Standard focuses on wealthy individuals and the trusts and private companies they use to hide their wealth, not on public corporations. Second, the US has refused to sign on, stating it is largely in compliance with the standard by adhering to FATCA and its often asymmetrical inter-governmental agreements. That leaves a major information gap for developing countries, especially as a majority of MNEs and data servers are located in the US. Third, many developing countries are members of the Global Forum, but not of the OECD where the standards were developed. Again, these standards were not designed to meet their needs. Many developing countries find it difficult to meet the technical requirements of the AEOL process, even though the OECD offers them assistance.

6.1.3 Compliance with tax transparency standards

The 1998 OECD Report on Harmful Tax Competition recognised that the lack of effective exchange of information perpetuated by strict secrecy rules and other protections from scrutiny, and no overall transparency in the operation of legislative, legal or administrative provisions, were key features of tax havens.¹⁰ In response to the increasing tax competition enabled by these two factors, the G20 and OECD called for the implementation of the standard on Exchange of Information on Request (EOIR).

In order to ensure rapid implementation, the Global Forum’s peer review mechanism was established to evaluate the ability of member countries to effectively exchange information in accordance with international transparency standards.¹¹ The methodology and terms of reference identify ten essential elements of the transparency and EOIR that ensure the availability, accessibility and effective exchange of information for tax purposes.¹² For EOIR to be considered effective, the information must be available, the tax authorities must have access to the information, and there must be a basis for exchange.¹³

⁹ See: <https://www.oecd.org/tax/transparency/about-the-global-forum/members/>

¹⁰ OECD (1998), *Harmful Tax Competition. An emerging global issue*, OECD, 22–23

¹¹ Global Forum (2018), *Exchange of Information on Request (EOIR): The Peer Review Mechanism Process*, OECD

¹² Global Forum (2016), *Methodology for Peer Reviews and Non-Member Reviews*, OECD, 1

¹³ Global Forum (2016), *Terms of Reference to Monitor and Review Progress Towards Transparency and Exchange of Information on Request for Tax Purposes*, OECD, 2-3

Some of the information that should be available includes adequate, accurate and up-to-date information on the identity of the legal and beneficial owners of legal entities and arrangements. This should be provided in a timely manner and requires enabling legislation and administrative practices at the national level.¹⁴ Accessibility entails the authority's ability to obtain information held by various institutions, including financial institutions, and designated non-financial businesses and professionals, including legal professionals, accountants and advisers, amongst others. Finally, a legal mechanism such as the Mutual Administrative Assistance in Tax Matters (MAATM)¹⁵ that enables authorities to engage in information exchange is necessary and should not provide an authority with the ability to decline a request or be restricted.

Based on these criteria, countries will be evaluated as compliant, largely compliant, partially compliant or non-compliant. The objective is to identify areas of improvement for countries. The first round of reviews under Phase I carried out by the Global Forum, completed in 2013, revealed that 14 jurisdictions had significant gaps in implementation that could not allow them to progress to the next phase, Phase II. These countries included Botswana, Panama, Trinidad and Tobago, Switzerland and United Arab Emirates.¹⁶ These ratings were also evaluated by the EU as part of its own list which aimed to improve tax good governance globally and to ensure that other countries were making efforts to comply with the same standards as EU Member States.¹⁷ As a result, countries that were found to be non-compliant with the implementation of EOIR were included in the EU list of non-cooperative tax jurisdictions; Panama and Trinidad and Tobago, in particular, were identified as having major transparency concerns.

As mentioned above, the lack of transparency and effective information exchange were and continue to be viewed as essential features of a tax haven. The EU listing was adopted as an effort to pressure countries to comply with international standards and 'secure a level playing field'.¹⁸ A number of the countries initially identified as non-compliant, including Panama, have since been reviewed by both the Global Forum and the EU, resulting in a revision of their compliance with international transparency standards. As of 2019 Panama was adjudged to be partially compliant.¹⁹

¹⁴ Global Forum (2016), *Terms of Reference to Monitor and Review*

¹⁵ See OECD *Convention on Mutual Assistance in Tax Matters*. Available at: <https://www.oecd.org/ctp/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm>

¹⁶ Global Forum (2013), *Annual Report – Tax Transparency Report on Progress*, OECD, 21

¹⁷ EC (2020), *Common EU list of third country jurisdictions for tax purposes*, EU, Brussels

¹⁸ European Parliament (2018), *Listing of Tax Havens by the EU*, European Parliament, Brussels, May 2018, 6

¹⁹ Global Forum (2019), *Peer Review Report on the Exchange of Information on Request: Panama (Second Round)*, OECD

6.2 The *Panama v Argentina* WTO dispute

The dispute Panama brought against Argentina in the WTO illustrates the legal minefield a government could face when it takes measures to secure access to information that is necessary to counter tax evasion or avoidance through offshore jurisdictions. Both Argentina and Panama are members of the Global Forum and therefore committed to implement its tax transparency and EOIR standards, and to participate in the peer review process. At the time Panama initiated this dispute in 2012, Argentina had completed both stages of the peer review process: the review of its legal framework against the standard and a review of its application in practice. Panama had not amended its regulatory framework in response to recommendations made in the phase 1 review in 2010.²⁰

Back in 2001 Panama had already placed its opinion on the record at the WTO that measures affecting transactions with countries that were considered to be tax havens, including measures proposed by the OECD and applied by some WTO Members, would violate those Members' obligations under the GATS. Mexico, Argentina and Venezuela were mentioned by name. Panama claimed it had a 'progressive, modern and transparent tax system' with tax rates consistent with those applied internationally and had 'an advanced system of mutual legal assistance for an exchange of information with other States and ... an excellent record of cooperation in that area'. It considered the real rationale for such measures was the superior competitiveness of Panama's tax collection system.²¹

The Argentine government set up an information sharing arrangement designed to comply, as far as possible, with the international standards on transparency adopted by the Global Forum. Panama was not part of that arrangement.²² Argentina put restrictions on financial service providers from some countries, including Panama, on the basis that they did not have an agreement with Argentina for exchange of information on taxation issues. At the WTO Panama challenged the following eight financial, taxation, foreign exchange and registration measures as breaching Argentina's GATS obligations: 1. Withholding tax on payments of interest or remuneration; 2. Presumption of unjustified increase in wealth; 3. Transaction valuation based on transfer prices; 4. Payment received rule for the allocation of expenditure; 5. Requirements relating to reinsurance services; 6. Requirements for access to the Argentine capital market; 7. Requirements for registration of branches; 8. A foreign exchange authorisation requirement.

²⁰ *Panama v Argentina*, Panel Report, paras 2.55-2.59. Available at: <https://www.oecd.org/countries/panama/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-panama-2019-second-round-5f2584a0-en.htm>

²¹ WTO, Council on Trade in Services, Report of Meeting held on 9 July 2001, S/C/M/54, 27 August 2001, paras 66-75

²² *Panama v Argentina*, Panel Report; *Panama v Argentina*, Appellate Body Report

Measures 1, 2 and 4 are most pertinent to cross-border activities of digital MNEs. The WTO Panel decided against Argentina, finding its measures breached the MFN rule but not the national treatment obligation, and that Argentina failed to satisfy all the elements of the relevant General Exceptions to excuse that breach. The Appellate Body said the Panel applied the wrong interpretations in relation to both the MFN and national treatment rules and, because of that, it was not proven that Argentina had breached either obligation. The Appellate Body did not substitute its own interpretation and decision for the Panel's. Irrespective of the legal outcome, the dispute had a chilling effect very early on: *Argentina conferred cooperative country status on Panama even before it lost at the Panel stage, although Panama had not agreed to exchange information.*

The legal arguments and reasoning in the dispute at the Panel and Appellate Body levels, and the available exceptions, are summarised below in two boxes. The first, Box 6.1, deals with the non-discrimination rules, which are most relevant for taxation of digital cross-border activities.

Box 6.1 *Panama v Argentina*: MFN and national treatment

Panama alleged that Argentina had breached its GATS obligations, *inter alia* by discriminating in favour of Panama's competitors from other countries (MFN) and domestically (national treatment).²³ Argentina had no relevant exclusions from the MFN rule²⁴ and had scheduled full national treatment commitments on the relevant sectors of financial services.

Most-Favoured-Nation Treatment (GATS Article II) (see Part 2: 2.4.2)

The **Panel** began by noting the dearth of jurisprudence on trade in services rules to help decide the case.²⁵ In considering the MFN obligation, the Panel examined whether Argentina's measures treated services and suppliers from Panama, as a non-cooperative country, less favourably than *like* services and suppliers from other countries with which they were in a competitive relationship, and if that treatment had adversely modified their conditions of competition. Having found they were alike and in a competitive relationship, the Panel considered whether the heavier additional requirements and stricter conditions on Panama as an uncooperative country impacted adversely on their competitive position. Argentina argued that its ability to access tax information from 'cooperative' countries counterbalanced any apparent competitive disadvantage for Panama. However, Argentina had designated as 'cooperative' some countries that had not yet concluded tax treaties or other disclosure arrangements with Argentina. The Panel concluded that Panama did receive less favourable treatment vis-a-vis those WTO Members and ***Argentina had breached its MFN obligation.***

²³ *Panama v Argentina*, Panel Report, para 2.9.

²⁴ Exclusions from the MFN rule had to be scheduled before the GATS was adopted in 1994.

²⁵ *Panama v Argentina*, Panel Report, para 7.155

The **Appellate Body** rejected the Panel’s legal interpretation on MFN.²⁶ It decided that the Panel applied the wrong test to decide whether Panama’s service suppliers were *like* those of other countries. Because ‘likeness’ is an essential element of MFN, and there was no valid finding of likeness by the Panel, **there was no proven breach of MFN**. However, the Appellate Body made it clear that it took no view on whether the services and suppliers were *actually* ‘like’.

National Treatment (GATS Article XVII) (see Part 2: 2.4.3)

Did Argentina breach its *National Treatment* obligations (non-discrimination between foreign and domestic services and suppliers) in relation to Panama’s services and suppliers of services across the border (through mode 1)?²⁷

The **Panel** reasoned that Panama’s services and suppliers were ‘like’ those from cooperative countries, which were in turn like those from Argentina. The key question was whether the three measures at issue here – those numbered 1. presumption of unjustified increase in wealth, 2. application of the payment received rule when allocating expenditure for transactions, and 4. valuing of transactions for the transfer pricing regime – modified the conditions of competition between Argentina and Panama to Panama’s detriment. The Panel said Argentina’s regulations were intended to neutralise the competitive advantage over its own service suppliers that Panama enjoyed by not having to exchange information with Argentinian authorities, and so the measures did not give preferential treatment to Argentina’s services and service suppliers. **There was therefore no breach of national treatment.**

Applying similar reasoning to the MFN issue, the **Appellate Body** disagreed with the Panel’s approach to considering whether Panama’s services and suppliers were ‘like’ those from Argentina. It also rejected the Panel’s approach to deciding whether Panama’s services and suppliers were treated less favourably. The Appellate Body said once the Panel decided the measures adversely modified the conditions of competition, it was not appropriate to go beyond the design, structure and expected operation of the measures to consider the regulatory justifications for them. Those considerations would more properly be argued in relation to an exception.²⁸ The Panel was therefore wrong in concluding there was no less favourable treatment. However, because the Appellate Body found the Panel’s finding of ‘likeness’ was flawed, and the threshold test for the national treatment obligation was therefore not satisfied, **no breach of national treatment had been proven.**

²⁶ *Panama v Argentina*, Appellate Body Report, para 7.1

²⁷ Identified, for example, at *Panama v Argentina*, Panel Report, para 7.463

²⁸ *Panama v Argentina*, Appellate Body Report, para 7.1

Box 6.2 considers how the Panel and Appellate Body dealt with the taxation and other aspects of the GATS General Exceptions.

Box 6.2 *Panama v Argentina*: The exceptions

GATS General Exceptions (Article XIV 2 (d)) (see Part 2: 2.7.2)

Argentina invoked **paragraph 2 (d)** of the GATS General Exceptions as a defence to the complaints against the three tax measures (presumption of unjustified increase in wealth; transaction valuation based on transfer prices; and the payment received rule for the allocation of expenditure).

Panama noted the lack of jurisprudence on the tax-specific exceptions and that they only cover two situations. Paragraph 2(e) was for measures that were the result of an agreement on the avoidance of double taxation. These measures were not. The only other permissible purpose could be paragraph 2 (d) *to ensure the equitable or effective imposition or collection of direct taxes in respect to services or service suppliers of other Members*. Panama said the burden was on Argentina to identify the direct taxes concerned, then establish what equitable or effective imposition or collection of those taxes meant in this context, and demonstrate that the measure sought to achieve that result.²⁹ Panama claimed that several of Argentina's three measures were not directed at the collection or imposition of direct taxes.³⁰ Further, Argentina had not shown the imposition of the tax was effective or equitable, even though it might increase the overall tax collection from Argentinian nationals, or that the measures would have the effect of collecting more tax from the services or service suppliers of *other Members* (rather than from Argentina's own taxpayers).

Argentina argued that the very objective of the three defensive tax measures in question was to ensure the equitable and effective imposition or collection of direct taxes from countries not cooperating on transparency. It was necessary to treat Panama's financial services and service suppliers differently because there was a greater risk of tax evasion, tax avoidance and fraud from non-cooperative countries. The lack of information from Panama made it impossible for the Argentine authorities to determine whether transactions had a legitimate commercial purpose or whether they were solely aimed at avoiding payment of tax in Argentina, the identity of the beneficial owners of foreign entities, and the real value of the transactions in question. The measures it had adopted were part of a global strategy and they were not 'excessively restrictive' of trade in financial services, because they did not prevent the supply of such services to Argentina.³¹

Unfortunately these issues were not resolved. Because the **Panel** found there was no breach of national treatment on those three measures, it exercised judicial economy

²⁹ *Panama v Argentina*, Panel Report, 187

³⁰ Panama defined direct taxes as 'taxes directly imposed on the person subject of the obligation', *Panama v Argentina*, Panel Report, 187

³¹ *Panama v Argentina*, Panel Report, para 7.768-769

and did not engage with these legal arguments.³² The **Appellate Body**, having determined that the ‘likeness’ threshold for MFN and National Treatment was not met, did not address this argument about the exception, either.

GATS General Exceptions (Article XIV.2(c)) [see Part 2: 2.7.2]

Argentina also relied on **paragraph 2(c)** of the General Exceptions to defend six of its measures.³³ This defence applies to measures that are ‘*necessary to secure compliance with laws or regulations which are not inconsistent with [the GATS] including those relating to ... preventing deceptive and fraudulent practices ... protection of privacy of individuals ... safety*’. Argentina argued that ‘including’ meant the listed objectives were only illustrative.³⁴

The **Panel** agreed. The first step was to show that each measure was designed to secure compliance with a GATS-compatible law by identifying the laws being implemented by the measures. Argentina pointed to its specific laws and regulations, including the law on Concealment and Laundering of Money of Criminal Origin. It then had to show the laws being implemented were not themselves contrary to the GATS, which would be assumed unless Panama showed otherwise, which it did not.³⁵ Thirdly, Argentina had to show a nexus between the laws and the impugned measures. The Panel took a broad approach to this, noting that the G20 and OECD both recognised the efficacy of defensive tax measures.³⁶

The Panel then had to consider whether the particular measures were ‘necessary’ to achieve compliance with those laws. Specifically, it considered the importance of the objective, the contribution of the measure to that objective, and the trade-restrictiveness of the measure. There was no question about its importance. The Panel remarked that ‘*protecting the national tax system is a question of primordial importance for any country and particularly a developing country*’ and that ‘*the need for measures to facilitate transparency and the exchange of information as a way of combatting tax evasion have been recognized as a priority at the international level for more than 15 years*’.³⁷ Likewise, ‘*protecting society against the threat of money laundering is an interest that is important in the highest degree*’.³⁸

The Panel also concluded that Argentina’s measures were not more trade restrictive than necessary to achieve its objectives. Panama had failed to identify alternatives that

³² *Panama v Argentina*, Panel Report, 188

³³ 1. Withholding tax on payments of interest or remuneration, 2. Presumption of unjustified increase in wealth, 3. Transaction valuation based on transfer prices, 4. Payment received rule for the allocation of expenditure, 7. Requirements for the registration of branches, and 8. Foreign exchange authorization requirement.

³⁴ *Panama v Argentina*, Panel Report, 148

³⁵ *Panama v Argentina*, Panel Report, p.155, citing *US – Carbon Steel* at para 157.

³⁶ *Panama v Argentina*, Panel Report, 162

³⁷ *Panama v Argentina*, Panel Report, 165

³⁸ *Panama v Argentina*, Panel Report, 167

were reasonably available to Argentina that would preserve its right to achieve the same level of protection.³⁹

However, Argentina fell at the final hurdle. Even if all the other requirements were met, the defence would fail if the measures were applied in a way that **constitutes 'arbitrary or unjustifiable discrimination'**. The Panel found that Argentina had not applied the same classification of a 'non-cooperative' jurisdiction, and the related penalties, to countries with which it was *negotiating* an information access arrangement but had not (yet) concluded one.⁴⁰ Neither party appealed the finding that Argentina's measures were discriminatory under the chapeau.

On considering whether a measure is to 'secure compliance' with laws or regulations, the **Appellate Body** said it was enough to show its design secures compliance with specific rules, obligations, or requirements under those laws or regulations, even if the measure cannot be guaranteed to achieve such result with absolute certainty.⁴¹

The *Panama v Argentina* case provides a number of notable take-aways for the purposes of this report:

- First, countries that facilitate aggressive tax planning regimes may be prepared to take lengthy and expensive WTO disputes. That will often be designed to have a chilling effect on the tax regulators. It is notable that six months after establishment of the Panel to hear this claim, and before its report was issued, Panama had been included in Argentina's list of cooperative countries.⁴²
- Second, this was the first GATS case dealing with taxation measures. The WTO dispute Panel and Appellate Body disagreed on the basic elements of the core national treatment and MFN rules. The lack of clear jurisprudence leaves future interpretations of the GATS rules in a state of uncertainty.
- Third, the most relevant exceptions were not fully examined by the Panel or addressed by the Appellate Body, which leaves the scope and extent of the protections they provide for tax-related measures uncertain.
- Fourth, while not addressing these exceptions, the Panel made a very strong statement on the importance of effective revenue regimes, and the risks from harmful tax practices, especially to developing countries:

³⁹ *Panama v Argentina*, Panel Report, para 7.764

⁴⁰ *Panama v Argentina*, Panel Report, 184. The panel also considered the prudential exception, but that is not analysed here

⁴¹ *Panama v Argentina*, Appellate Body Report, para 6.203

⁴² *Panama v Argentina*, Panel Report, para 2.7

In any country, tax collection is an indispensable source of revenue to ensure the functioning of the State and the various government services to citizens. Protection of the national tax base guarantees the viability of a country's public finances, and by extension, its economy and financial system. The risks posed by harmful tax practices are even more important for developing countries because they deprive their public finances of financial resources vital to promoting their economic development and implementing their domestic policies. Lastly, there can be no doubt that combating money laundering, which fits in with the fight against drug trafficking and terrorism, is a priority for the international community, and thus also for Argentina.⁴³

This strong observation will doubtless be cited in further arguments when a government invokes the taxation exception, albeit limited in the GATS to the category of direct taxes and double tax provisions of international tax agreements.

- Fifth, despite that statement, the Panel still found against Argentina because its implementation of the measures against an uncooperative country was legally flawed. That dispute showed that transitional arrangements, for example treating countries with which negotiations are underway but not concluded as cooperative, might seem sensible from the perspective of tax authorities, but may nevertheless fall foul of the discrimination rules, even when the governments have complied with all the other WTO obligations.
- Finally, this dispute dealt inconclusively with existing GATS rules. There is very little legal clarity that governments can draw from this case in relation to measures to address tax avoidance or evasion through offshore havens. The legal jeopardy this creates for governments is magnified by the complexities of FTAs and would be further exacerbated by expansive interpretations of trade in services obligations and the adoption of the novel 'electronic commerce' rules being promoted in FTAs and the WTO.

6.3 Disclosure of corporate information

Tax authorities need the power to obtain or access corporate information. A number of disclosure initiatives have been developed in recent years, including Mandatory Disclosure Rules, Country-by-Country Reporting and Beneficial Ownership Registers. Digital technologies have made it more difficult to implement these regimes and to secure compliance from offshore corporations and

⁴³ *Panama v Argentina*, Panel Report, para 7.681

intermediaries. The existing and proposed trade rules pose additional obstacles, especially for developing countries.

6.3.1 Mandatory disclosure rules

Action 12 of the BEPS project provides recommendations for the design of Mandatory Disclosure Rules to require taxpayers and intermediaries, such as financial institutions and third-party tax advisers, to disclose ‘aggressive tax planning arrangements’. In 2015, the OECD developed a modular framework for such a regime that countries could adapt to their needs.⁴⁴ Since then a number of jurisdictions have enacted their own tax disclosure schemes. Most are OECD countries, reflecting the particular importance of these aggressive tax planning regimes to the resident countries of MNEs.

In the Global South, South Africa has long required mandatory disclosure of some kinds of avoidance arrangements.⁴⁵ Since 2003 every company or trust deriving any tax benefit from a reportable arrangement has had to report that arrangement to the South African Revenue Service (SARS) within 60 days of accruing any benefit to enable its evaluation from an anti-avoidance perspective. Promoters of the arrangement should also be identified.⁴⁶ A subsequent amendment requires tax intermediaries to disclose certain schemes or arrangements to the revenue authority when they are being promoted.⁴⁷ Between 2009 and 2015, 629 arrangements were reported to SARS with the majority of disclosures being made by large companies.⁴⁸ More recently in December 2019 Mexico enacted a disclosure provision that requires registration of tax advisers and disclosure of certain general and personalised schemes designed for their clients.⁴⁹

The EU has one of the most extensive regimes.⁵⁰ It requires any person that designs, markets, makes available for implementation, or manages the implementation of a ‘reportable cross-border arrangement’ to report it to the government. If there is no such intermediary, the taxpayer is required to make the

⁴⁴ OECD, ‘Mandatory Disclosure Rules’. Available at: <https://www.oecd.org/tax/beps/beps-actions/action12/>

⁴⁵ OECD (2015), ‘Mandatory Disclosure Rules – Action 12: 2015 Final Report’, OECD, 25-28 (hereafter ‘OECD 2015’). Available at: <https://www.oecd-ilibrary.org/docserver/9789264241442-en.pdf?expires=1586253237&id=id&accname=guest&checksum=208EF13E3AF7F247B8B4FFCC8C3B4C02>

⁴⁶ Section 76A of the Income Tax Act 1962. See SARS, Reportable Arrangement Guide, SARS, 1. Available at: <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-TAdm-G13%20-%20Reportable%20Arrangement%20Guide.pdf>

⁴⁷ SARS Tax Administration Act No. 28 of 2011

⁴⁸ OECD 2015, 29

⁴⁹ Government of Mexico Federal Fiscal Code, Articles 197-202

⁵⁰ Council Directive 2018/822/ EU of 25 May 2018 (known as DAC 6); see also Patricia A Brown (2019), ‘Combating Aggressive Tax Planning Through Disclosure: A Comparison of U.S. and EU Rules Applicable Tax Advisers’, *ABA Tax Times* 38(3), 14 June 2019. Available at: https://www.americanbar.org/groups/taxation/publications/abataximes_home/19jun/19jun-pp-brown-et-al-combating-aggressive-tax-planning-through-disclosure/

disclosure directly to the government. Reportable transactions are those with generic hallmarks of certain abusive tax avoidance schemes or with specific hallmarks of less abusive schemes where tax avoidance is a 'main benefit' of the scheme. Once a transaction is reported in one EU Member, this state is required automatically to exchange the information it has received with other EU Member States through a centralised database. The information is kept confidential, although subsequent action to close down a tax planning scheme may be made public.

The disclosure regime has two main limitations. First, it relies on cooperation from the professional firms, which may resist obligations to report arrangements that fall within the 'hallmarks'. Second, the disclosure obligation is limited to intermediaries located in the jurisdiction of the country requiring disclosure; it does not apply to intermediaries located offshore. That adds to the incentives to conduct legal, financial, and accounting services from offshore data/tax havens. The responsibility for disclosure then falls onto the taxpayer.

6.3.2 Country-by-Country (CbC) reporting

BEPS Action 13 sets out a corporate reporting regime for MNEs as one of the four minimum standards that members of the Inclusive Framework must implement. The regime aims to provide tax authorities with sufficient information to conduct risk assessments on transfer pricing, and 'useful' (but not necessarily sufficient) information to help conduct risk assessments of whether MNEs are engaging in base erosion or profit shifting.⁵¹ The MNEs are required to create three repositories of information: a master file, a local file, and a CbC report (required only for those with gross revenue of €750 million or more).

- The **CbC report** requires detailed jurisdiction-by-jurisdiction and country-specific information on pre-tax income, taxes paid and accrued, stated capital, the number of employees, tangible assets, and lines of business. It is supplied to the tax authority in the jurisdiction of the headquarters company and is shared with other relevant jurisdictions participating in the scheme, subject to confidentiality.
- The **master file** contains five sections: (1) the organisational structure; (2) a description of the MNE's business(es) and their business strategies; (3) the MNE's intangibles and the strategies for their exploitation; (4) a list of the MNE's intercompany financial activities; and (5) the MNE's financial statements and tax positions.

⁵¹ BEPS Action 13 Country by Country Reporting portal, <http://www.oecd.org/tax/beps/beps-actions/action13>. 'BEPS Action 13: Re-examine Transfer Pricing Documentation', Roedl and Partner, undated. Available at: <https://www.roedl.com/insights/beps/beps-action-13-re-examine-transfer-pricing>

- The **local file** contains similar information but with a focus on local operations.

The master file and local file are to be filed or available upon request with each jurisdiction in which the MNE operates.

The effectiveness of this reporting regime depends on its adoption by sufficient states and compliance by the MNEs. Each participating country is to enact enabling legislation and then enter into information-exchange agreements under Action 13 of the BEPS programme. An OECD review released in September 2019 reported over 80 countries had a domestic legal framework that required CbC reporting by MNE groups; implementation among these countries was considered ‘largely consistent’ with the minimum standard.⁵²

However, the reports are delivered to the tax authority of the MNEs’ home countries, which are almost all OECD states. They can be exchanged with other participating countries, but only on strict conditions of confidentiality, as well as of ‘appropriate use’. By March 2020 reports had been exchanged for two years, but with very few developing countries: for example, in Africa only South Africa, Mauritius and Seychelles. There is also little information on corporate compliance, which is left to the MNE’s home country, and the degree of scrutiny is likely to vary widely. Only one country, the US, has so far published aggregate data. Some countries have used the information for analytical purposes, as has the OECD in trying to calculate the impact of its digital tax proposals. However, there is no robust evidence that this reporting regime has produced additional tax revenues for countries currently involved.

A review of the scheme was conducted in March to June 2020, five years after its establishment. This included some reconsideration of the scope of information required. A significant gap was identified of particular relevance to digital MNEs: the reports only include data on countries where the MNE has an entity which prepares separate accounts. This would not include countries where the MNE may have significant revenues, even if it has a branch which does not prepare separate accounts.⁵³

There are also serious limits on what information in the CbC can be used for. The handbook on effective implementation of CbC reporting stipulates that revenue authorities cannot use the information contained in a report as evidence from which to conclude that transfer prices are not appropriate or to effect adjustments to the income of a taxpayer.⁵⁴ Since the CbC report cannot be used to make an assessment,

⁵² OECD (2019), *Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 2): Inclusive Framework on BEPS Action 13*, September 2019, OECD. Available at: <https://www.oecd.org/publications/country-by-country-reporting-compilation-of-peer-review-reports-phase-2-f9bf1157-en.htm>

⁵³ See BEPS Monitoring Group (2020), ‘Review of Country-by-Country Reporting (BEPS Action 13)’, 7-8. Available at <https://www.bepsmonitoringgroup.org/news/2020/3/7/country-by-country-reporting>

⁵⁴ OECD (2017), *Handbook on Effective Implementation of Country-by-Country Reporting*, OECD, 17. Available at: <http://www.oecd.org/tax/beps/country-by-country-reporting-handbook-on-effective-implementation.pdf>

revenue authorities will need to initiate a full audit of the taxpayer. Developing countries are at a particular disadvantage, as they often face information asymmetries when evaluating the value chains of an MNE and may lack the capacity to evaluate and assess them. Limitations on the use of CbCs also mean their revenue authorities need greater transparency of information in other areas in order to effectively evaluate the tax position of an MNE, particularly where digitalised value chains are concerned.

A further obstacle to developing countries is the confidentiality among participating countries, which is vigorously protected. Under current rules, CbC reports can only be shared with qualified tax authorities – those whose protection of confidentiality meets OECD-determined benchmarks. Publication of CbC reports would greatly facilitate monitoring of MNE tax avoidance by all tax authorities, as well as stakeholders such as investors, trade unions, and the general public, and help to mobilise parliamentary and citizens’ support for such efforts.

6.3.3 Beneficial Ownership Registers

A third disclosure initiative is the development of Beneficial Ownership Registers. Tax reporting and exchange of information regimes can be largely undermined if opaque legal structures are created that shield the identity of their true owners. Closely held corporations and trusts with anonymous owners enable money laundering and corrupt practices that erode countries’ revenue base and undermine the perceived legitimacy of the tax system.

In an attempt to close this loophole, in 2014 the G20 issued general principles for countries to follow in enacting beneficial owner laws and regulations.⁵⁵ A number of countries and regional organisations have adopted rules that follow these principles and require the reporting of those individuals who are the ultimate beneficial owners of companies, trusts and other opaque structures. Other international organisations have issued guidelines, including the Global Forum, the Financial Action Task Force (FATF) and Transparency International.

Ghana and Kenya were early movers, alongside the UK. In 2016, during the UK Prime Minister’s Summit on Tackling Corruption, Ghana committed to preventing the misuse of corporate entities and legal arrangements to hide the proceeds of corruption by implementing requirements for a central register for beneficial ownership information. The Ghanaian government also pledged to ensure publicly accessible, accurate and timely beneficial ownership information.⁵⁶ Following a series of reforms to regulate the beneficial ownership register, Ghana passed legislation

⁵⁵ G20 High Level Principles on Beneficial Ownership Transparency. Available at: http://www.g20.utoronto.ca/2014/g20_high-level_principles_beneficial_ownership_transparency.pdf

⁵⁶ ‘UK Prime Minister’s Summit on Tackling Corruption in London 12 May 2016. Ghana Country Statement’, 2016. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/522707/Ghana.pdf

in 2019 that entered into force in February 2020 that requires every company to keep a registry of beneficial owners and submit it to the Registrar General.⁵⁷ The centralised register operates through manual and electronic databases. The Data Protection Act 2019 makes an exception to non-disclosure of information where requested by the Registrar of Companies.⁵⁸

Most often, a registration requirement applies to ultimate beneficial owners with a controlling interest in an entity, commonly defined as an ownership interest of 25% or more. In some cases, such as with the UK requirement covering companies,⁵⁹ the information is open to public inspection; in many cases, it is not. Indeed, the adoption of a beneficial owner registry may be met with fierce resistance from secretive jurisdictions and those who use them, as happened when the UK extended its requirement to its overseas territories (such as Bermuda) and its Crown dependencies (Jersey, Guernsey and the Isle of Man).

A similar reaction to disclosure requirements occurred in the US, which is considered to be a particularly lax jurisdiction about reporting ultimate beneficial owners. In the US, a person can set up a shell company with disguised beneficial owners in many states, Delaware being a favourite jurisdiction. When the US government moved to rectify this situation, major US financial institutions were strongly supportive, looking to make their anti-money laundering and counter-terrorist financial reporting responsibilities somewhat easier. The American Bar Association led the opposition to the effort, arguing that this would unduly burden practising attorneys (and presumably disadvantage their clients). The result has been a stalemate, with no federal legislation enacted.

Again, many of these moves are recent and there will be practical implementation problems as well as corporate resistance. Among the numerous challenges identified by an FATF review in late 2019 were the adequacy, accuracy and timeliness of information; access by the competent authorities to the information in the face of data protection and privacy laws; a lack of effective sanctions for non-compliance; and legal and practical complexities of securing information from other countries.⁶⁰

Overall, the many positive initiatives on reporting and disclosure of tax-related information that is essential to taxing the digitalised economy do little to improve access for developing countries to that information, especially when it is located in

⁵⁷ Government of Ghana, Companies Act 2019 (Act 992) and Companies (Beneficial Ownership Information) Regulations 2020

⁵⁸ Mahesh Acharya and Faith Chebet (2020), 'Kenya's New Companies (Beneficial Ownership Information) Regulations', March 2020. Available at: <https://www.mondaq.com/CorporateCommercial-Law/905304/Kenya39s-New-Companies-Beneficial-Ownership-Information-Regulations>

⁵⁹ See House of Commons Library, 'Registers of beneficial ownership', *Briefing Paper, Number 8259*, 7 August 2019. Available at: <https://commonslibrary.parliament.uk/research-briefings/cbp-8259/>

⁶⁰ Financial Action Task Force, 'Best Practices on Beneficial Ownership for Legal Persons', October 2019, 14-15. Available at: <https://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf>

an MNE's home jurisdiction. Box 6.3 suggests that expansive readings of trade in services obligations and proposed e-commerce trade rules are likely to increase the obstacles. The complexity, novelty and opaqueness of these trade rules and exceptions makes it impossible to predict how they should and would be interpreted. This uncertainty impacts most severely on developing countries that have the least direct access to the information that would enable them to tax digital MNEs and the digitalised economy, even if the tax rules themselves were made fit for purpose in the digital age.

Box 6.3 Trade rules as obstacles to developing countries' access to information

Access to information (See Part 2: 2.3.1-2.3.2) To audit the international transactions of digital (or any) MNEs operating in multiple jurisdictions requires access to information about their business activities. That, in particular, is necessary to help authorities select which taxpayers to audit and to formulate audit issues, and to do so in a timely manner, as well as to assess data generated through those activities that governments may want to tax. That may be very difficult to achieve in the face of uncooperative taxpayers, aided by the trade rules. New 'e-commerce' rules may prevent the government from requiring that information relating to activities within its territory is held in the country⁶¹ and protect the ability of digital corporations to hold such information in a jurisdiction that has lax rules or is a data/tax haven. While providing access for tax authorities may be considered a legitimate public policy objective that justifies departure from the rule, the measure may be considered an unnecessarily restrictive way to achieve the objective – for example, if other countries rely on voluntary compliance by corporations or intermediaries.

Local presence (see Part 2: 2.4.6) If neither the digital company nor its intermediaries has a local presence, this rule says they cannot be required to have one, unless the country has preserved the right to do so generally or specifically on tax matters. That would leave tax authorities in developing countries, especially, with no effective or affordable route to require disclosure and no leverage to secure compliance.

National treatment and MFN (see Part 2: 2.4.3, 2.4.4) It might be argued that regulations relating to disclosure of information are measures that affect the supply of a service and are subject to the trade in services disciplines, especially on national treatment. Disclosure requirements could potentially be problematic if the same requirements did not apply in law or practice to local firms, for example by applying a threshold or differential criteria that put the foreign supplier at a competitive disadvantage. The obligation would only apply where the government has committed that service in its schedule; however, uncertainties about classification of digital services suppliers (see Part 2: 2.4.2) and how to identify comparators for the purposes of the national treatment rule make it difficult to assess with any certainty whether a disclosure requirement would comply with a government's trade law obligations. Similar difficulties arise if different countries are treated differently.

⁶¹ Some versions of the data transfer rule may allow requirements to store a copy of data on a local server, such as TPPA/CPTPP Article 14.11.

Disciplines on Domestic Regulation of services (see Part 2: 2.4.6) require the *administration* of measures of general application to be reasonable, objective and impartial. In the GATS and some FTAs this rule applies to services sectors on which countries have scheduled commitments, such as computer and related services or a specific service such as advertising, retail distribution, transportation or tourist accommodation. Other FTAs, such as the TPPA/CPTPP, apply it across the board to all services.⁶² Some proposals for the plurilateral text on Investment Facilitation would also apply it for all investments.⁶³ That could open the way for challenges to the implementation of registration, reporting and disclosure requirements.

GATS tax exception (see Part 2: 2.8.2) This exception might apply where disclosure requirements are a means to enhance the imposition and collection of *direct* taxes on income or capital. Alternatively, they could be considered measures to implement a taxation law that is GATS-compliant. Only the latter would be subject to the ‘necessity’ test of whether (inter alia) a less burdensome means of achieving the objective was reasonably available, which the MNEs and their home countries such as the US will always claim there was. For either of these exceptions, the US might argue that disclosure obligations fall most heavily on certain kinds on foreign firms and constitute unreasonable or unjustified discrimination, including discrimination between different kinds of businesses. That would be a difficult argument if the obligations were based on international arrangements and guidelines, provided care is taken with their design (viz. *Panama v Argentina*). The strong statements in the *Panama* dispute about the sovereign right to tax would reinforce that view.

FTA tax exceptions (see Part 2: 2.8.3) The protections in FTAs vary. The TPPA/CPTPP explicitly protects the rights and obligations of the parties under a tax convention, which is defined as a double taxation treaty or ‘other international taxation agreement or arrangement’, and is broader than the GATS exception that applies only to double taxation measures. Reporting and disclosure rules that are developed in a multilateral context should qualify as an international taxation arrangement. That argument may become more difficult where there is limited uptake of an arrangement, and it is unclear whether regional regimes would be protected.

Where there is no international taxation arrangement or there is a dispute over its application, other tax exceptions would come into play. The complex exception in the TPPA/CPTPP applies to ‘taxation measures’, which only explicitly excludes customs duties.⁶⁴ Taxation measures would include those that directly relate to reporting for tax purposes. It is debatable whether that could extend to measures designed to facilitate effective disclosure, such as requirements to store data within the territory to enable assessment of taxable activities and liability.

⁶² TPPA/CPTPP Art 10.8.1

⁶³ For example, ‘WTO Structured Discussions on Investment Facilitation for Development. Communication from the European Union. EU proposal for WTO disciplines and commitments relating to investment facilitation for development’, 27 February 2020, INF/IFD/RD/46, para 2.3.1

⁶⁴ TPPA/CPTPP Article 24.4

7

EMPOWERING DIGITAL CORPORATIONS OR THE GLOBAL SOUTH?

THIS report is not about the right legal answer according to the trade agreements and what countries of the Global South should do as a matter of law. The previous Parts reveal a worrying degree of legal uncertainty and complexity for governments, legislators and tax authorities who want and need to develop effective and just ways of taxing the digital economy, but are confronted with current and proposed trade rules that seriously constrain their policy space.

That uncertainty creates serious risks that decision-makers may be chilled from taking measures they consider necessary to protect their revenue base and implement their development strategies, and for the world to achieve the SDGs. Even where there is a large degree of consensus on what needs to be done, especially among countries of the Global South, the power of the digital MNEs and their home governments, especially the United States, can be – and is intended to be – intimidating. The more of those rules there are, and the more frequent and potent the threats, the higher those risks will be.

The aim of this report is to alert developing countries, especially, to the legal arguments they may face as they adopt new rules to tax the digitalised economy, and the added legal and political risks attached to proposed new rules on digital trade and reinterpretations of existing trade in services rules and commitments.

The final issue for this report is the potential for the trade rules to deepen that power imbalance if digital companies and powerful states are guaranteed opportunities to comment on proposed new tax laws, regulations and procedures. There is a growing number of examples where states, principally the US, have exploited their dominance through threats of a trade dispute, conducted unilateral trade investigations, imposed sanctions, and retaliated through withdrawal of aid or other benefits, such as access for temporary migrant workers. Digital MNEs have threatened to withdraw technological and other services and investments on which countries and consumers have come to depend. The more dominant they become and the more difficult it is for local firms to compete, the greater that leverage will be.

There is a deep irony that trade rules aim to strengthen the lobbying power of digital corporations and their parent states in the name of ‘transparency’, while other trade rules assist the corporations to remain opaque and unaccountable.

Transparency provisions that are already found in the TPPA/CPTPP and USMCA have been proposed in all the WTO plurilaterals on E-commerce, Domestic Regulation and Investment Facilitation. If adopted, they would further empower the tech companies and their home governments to intervene, lobby and threaten sanctions against sovereign governments. Indeed, the US may use the rejection of these interventions as evidence of pre-determination and/or the failure of the other government to adequately assess the less burdensome alternatives that the US and the tech MNEs had proposed.

In a final paradox, the adoption of taxation measures the US dislikes may be used as an excuse to walk away from initiatives to develop new multilateral tax rules that it also dislikes.

7.1 US unilateralism

The US wields more influence than any other country over the rules for taxing the tech industry and the digital economy. It has now abandoned any pretence of collaboration in seeking a multilateral solution to the issue and revealed its intention to exert its influence unilaterally through mutually reinforcing mechanisms.

This reflects a well-honed US strategy to: dilute negotiating proposals and delay the process of negotiations, blame others for failure to reach consensus, insist that other countries defer their measures to enhance the prospects of concluding the negotiations, and then withdraw, in the meantime initiating unilateral challenges to punish other countries that address the failure of the multilateral process by adopting their own measures.

7.1.1 The US corporate lobby

Digital MNEs are the biggest spenders on 'government relations' and lobbying. From 2005 to 2018 Amazon, Apple, Google, Facebook and Microsoft spent half a billion dollars on lobbying to influence Washington DC alone,¹ ratcheting up their spending as they faced increasing scrutiny. Google is the top corporate spender in the US,² and outlaid €8 million on lobbying EU institutions in 2019 as it faced inquiries there into anti-competitive practices and other legal violations.³

¹ AJ Dellinger (2019), 'How The Biggest Tech Companies Spent Half A Billion Dollars Lobbying Congress', *Forbes*, 30 April 2019. Available at: <https://www.forbes.com/sites/ajdellinger/2019/04/30/how-the-biggest-tech-companies-spent-half-a-billion-dollars-lobbying-congress/#ffb3e6057c96>

² Ben Brody (2019), 'Google, Facebook, Amazon, spent records amount on lobbying', *Bloomberg News*, 22 January 2019. Available at: <https://www.bloomberg.com/news/articles/2019-01-22/google-set-2018-lobbying-record-as-washington-techlash-expands>

³ Elena Cavellone (2020), 'Tech giants are serious about Lobbying in Brussels', *EuroNews*, 14 January 2020. Available at: <https://www.euronews.com/2020/01/14/tech-giants-are-serious-about-lobbying-in-brussels>

Powerful corporations have powerful friends. Their success is evident in the USTR's 'Digital 2 Dozen' demands that set the template for US negotiations, starting with the TPPA. The Deputy USTR responsible for digital services and who oversaw the TPPA negotiations on e-commerce, Robert Holleyman, came to the job after 23 years as the President and chief executive of the US Business Software Alliance.⁴ The US's chief intellectual property negotiator in the TPPA left to head global trade and IP policy at Facebook.⁵

The state-corporate relationship extends to influencing other countries. In April 2020 six major lobby groups with overlapping membership called on the USTR to pressure India over the expansion of its equalisation tax from just online advertising companies to a 2% tax on the revenues of all e-commerce operators and suppliers that do not have a taxable presence in India.⁶ The tax was imposed at the end of March 2020 with collections to begin on 1 July 2020. The lobbyists' letter claimed the tax was more restrictive than the EU's DSTs, because it applied to all services and goods supplied over the Internet and had an extremely low threshold of around \$267,000. Moreover, they objected that it was incorporated into the national budget at the last minute, with no consultation – and reiterated the argument that India's actions would detract from work towards a consensus at the OECD.

The corporate presence of Big Tech is evident throughout the contemporary trade arena. Digital corporations made up around one-third of the membership of Team TiSA, the corporate lobby formed to promote the Trade in Services Agreement that included an e-commerce annex modelled on the TPPA.⁷ Most of the evidence cited in the USTR's Section 301 investigation into the French DST was from the tech corporations, supportive lobbies and researchers, or intermediaries.⁸ Industry-funded think-tanks and foundations also wield huge influence in the policy and regulatory processes of the US government and in Europe. ECIPE, whose study on the WTO moratorium on electronic transmissions was critiqued in Part 3.3.5, is a European example, and that study acknowledged support from the Global Services Coalition.

7.1.2 Section 301 investigations

The US government has multiple vehicles through which to exert its influence unilaterally. The USTR can initiate investigations under Section 301 of the Trade Act 1974, as it did in 2019 over France's Digital Services Tax (see Part 5: 5.1.3) and has

⁴ 'Ambassador Robert Holleyman'. Available at: <https://www.uschamber.com/ambassador-robert-holleyman>

⁵ 'Probir Mehta'. Available at: <https://www.weforum.org/people/probir-mehta>

⁶ 'US tech giants appeal to Trump administration to fight India's new digital tax', *Inside US Trade*, 7 April 2020. Available at: <https://insidetrade.com/daily-news/us-tech-giants-appeal-trump-administration-fight-india-s-new-digital-tax>

⁷ The negotiations for TiSA were suspended in late 2016 and have not resumed

⁸ Section 301 Report

more recently done for another ten countries.⁹ The Act offers a choice of taking action under Section 301, the WTO, or an FTA, or all of them. According to the WTO's Dispute Settlement Understanding, Members cannot unilaterally determine that there has been a violation of WTO rules. Yet that is *de facto* what Section 301 of the US Trade Act empowers a USTR to do. Opting for a Section 301 inquiry, at least as a first step, has multiple advantages. The US can bypass the normal prolonged dispute process in the WTO. More importantly, the investigation involves a domestic process in which the US is the accuser, prosecutor, judge and executioner, rather than an independent international dispute mechanism.

After consultations with the country whose actions it objects to (an opportunity for threats to proceed, with potential for sanctions) the USTR can pursue an investigation to decide whether the measure is 'actionable' under Section 301 and if so, what action to take. The inquiry considers whether the policy, law or practice violates trade agreements; is unjustifiable as inconsistent with US international law rights and burdens or restricts US commerce; and imposes an unreasonable or discriminatory burden or restriction on US commerce. The USTR invites public and other interested persons to make submissions within the Section 301 criteria. In the French tax investigation the 'vast majority' of written submissions and all oral submissions supported the allegations.¹⁰ Their views, including assertions by Facebook, Google and others about their tax compliance, were cited as uncontested evidence in support of the finding of unfair trade practices.

In conducting the investigation, the US applies its own interpretation of the relevant trade rules, as well as its domestic law, even when that view is largely rejected internationally. Following this biased process, the Act authorises the US to retaliate in a number of ways: through unilateral suspension of the benefits under a trade agreement; restricting imports of goods and services from that country; making binding agreements with the country concerned about phasing out or eliminating the measure or providing compensation; or by denying authorisations to supply certain services in the US. By arrogating this authority to itself as an exercise of its own sovereignty, the US gains a potent tool to challenge another sovereign government's decision to proceed with a measure that the US opposes. The consequences could be crippling, especially for developing countries.

The US's ultimate goal is to have a chilling effect on all governments that are considering similar measures. That strategy is already evident with the DST. The USTR investigated France's tax and authorised sanctions on its exports, and then suspended those tariffs as France also deferred implementing its tax, pending progress on new digital tax rules in the OECD by the end of 2020. Several other

⁹ Office of the USTR, 'USTR Initiates Section 301 Investigations of Digital Services Taxes', 2 June 2020. Available at: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/june/ustr-initiates-section-301-investigations-digital-services-taxes>.

¹⁰ Section 301 Report, 11

countries also agreed to suspend their measures pending an outcome under the Inclusive Framework. Then the US stepped back from that process. Almost simultaneously, the USTR announced it was launching Section 301 investigations into ten more trading partners for adopting or proposing a DST, including Brazil, India and Indonesia.¹¹ Submissions were called for, although a hearing date was not set due to uncertainties over COVID-19 restrictions. The target countries, and others, can expect the arguments, findings and consequences to mirror those for France (see Part 5: 5.1.3).

The Section 301 process was challenged by the EU back in 1998 as incompatible with the US's WTO obligations. The Panel found no breach after the USTR promised the US would only render Section 301 determinations in conformity with its WTO obligations.¹² The Panel warned that the US would no longer be considered as conforming to its obligations if it repudiated or in any way removed those undertakings. The US's practice is being put to the test again as a number of countries challenge the sanctions relating to steel and other products that the Trump administration imposed following recent Section 301 investigations. These cases may prove inconclusive, at least for some time. The US has paralysed the WTO dispute process by refusing to appoint Appellate Body members, which removes the ability of states targeted under Section 301 to resolve those matters legally and require the US to cease and desist.

Effectively, the US can have it all ways: impede the development of international tax rules so it can continue to operate under domestic law and outmoded international norms that suit its commercial and political settings; blame those who take unilateral action for the lack of progress on updating the international rules of undermining multilateral work towards a consensus; and threaten unilateral action if countries proceed with such measures.

In the investigation into France's DST, the US hailed the original OECD/G20 actions that built on the arm's-length principle, as a successful outcome that addressed the issues arising from MNEs' tax minimisation strategies.¹³ Some, including France, had considered these were insufficient to address taxation of digital companies. As a result, discussions had continued in the OECD with the G20 calling for a final report in 2020. The US then accused France of undermining that multilateral approach by its unilateral action and cited numerous occasions on which US officials had urged France not to proceed with the DST, but to work with the US to develop a multilateral solution.¹⁴ It noted the French legislation had no sunset clause that meant it would lapse when the OECD's work yielded an agreed approach.

¹¹ 'Office of the USTR, Initiation of Section 301 Investigations of Digital Services Taxes', Federal Register Notice, Docket No. USTR-2020-0022, 2 June 2020

¹² *United States – Sections 301-310 of the Trade Act 1974*, Panel Report, WT/DS152/14, 28 February 2000

¹³ Section 301 Report, 6

¹⁴ Section 301 Report, 7-8

Meanwhile, as noted previously, the US has dragged its heels in the OECD process.¹⁵ In June 2020, citing the priority of dealing with the health and economic crises generated by COVID-19, the US temporarily withdrew from the OECD Pillar 1 process.¹⁶ However, the US Treasury Secretary Steven Mnuchin did so in a letter directed to the finance ministers of Spain, Italy, France and the United Kingdom, threatening ‘appropriate commensurate measures’ if they proceeded with their digital services taxes. In response, those ministers observed that retaliation would not be in the economic interests of either the US or the EU and the US’s desire to ‘strengthen unity in the face of the unprecedented economic crisis ... cannot be achieved through threats and sanctions’.¹⁷

7.1.3 The US International Trade Commission (ITC)

The quasi-judicial ITC conducts separate investigations into alleged injury caused to US industry by imports and alleged violations of IP rights, which carry implicit threats of retaliation on trade and/or aid. It also provides analysis and reports. The terms of reference for its 2019 study on US trade and investment in Sub-Saharan Africa (SSA) included to ‘provide an overview of recent developments in the digital economy for key SSA markets including the role of U.S. products and services in those markets, regulatory policies and market conditions that affect the adoption of digital technologies, and how the adoption of these technologies affects other industry sectors such as manufacturing and other services’.¹⁸

In its submission, the pro-industry Information Technology and Innovation Foundation focused on digital policy developments.¹⁹ It criticised data protection and privacy provisions, requirements to use local servers, restrictions on payment services, and the imposition of high taxes and tariffs on ICT products by Sub-Saharan African countries that were outside the Information Technology Agreement. The

¹⁵ Steven Mnuchin, US Treasury Secretary (2019), Letter to Jose Angel Gurría, Secretary-General of the OECD, on DSTs, 3 December, 2019. Available at: <https://www.orbitax.com/news/archive.php/U.S.-Treasury-Secretary-Sends—40283>; Jose Angel Gurría, Secretary-General of the OECD, Response Letter to Steven Mnuchin, US Treasury Secretary, 4 December 2019. Available at: <https://www.oecd.org/newsroom/Letter-from-OECD-Secretary-General-Angel-Gurría-for-the-attention-of-The-Honorable-Steven-T-Mnuchin-Secretary-of-the-Treasury-United-States.pdf>

¹⁶ Steven Mnuchin, US Treasury Secretary (2020), Letter to the Ministers of Finance of the French Republic, Spain and the Italian Republic and the Chancellor of the Exchequer of the United Kingdom, 12 June 2020. Available at: <https://www.politico.eu/wp-content/uploads/2020/06/CLEAN-US-letter-DST-120620201.pdf>

¹⁷ Response Letter from the Ministers of Finance of the French Republic, Spain and the Italian Republic and the Chancellor of the Exchequer of the United Kingdom to Steven Mnuchin, US Treasury Secretary, 12 June 2020. Available at: <https://www.politico.eu/wp-content/uploads/2020/06/Letter-Mnuchin-IT-FR-UK-SP-FINAL-SIGNED%E2%80%94CLEANED.pdf>

¹⁸ ‘USITC to Study US Trade and Investment in Sub-Saharan Africa’, 14 June 2019. Available at: https://www.usitc.gov/press_room/news_release/2019/er06141115.htm

¹⁹ ‘ITIF Post-Hearing Written Submission Regarding Investigation No. 332-571: U.S. Trade and Investment with Sub-Saharan Africa: Recent Trends and New Developments’, 9 September 2019. Available at: <http://www2.itif.org/2019-submission-trade-investment-africa.pdf>

submission also launched a personalised attack on UNCTAD's research that had criticised the moratorium on customs duties on e-transmissions, saying it had misled African countries into opposing its permanence.²⁰

7.1.4 The USTR National Trade Estimates Report

Each year, the USTR issues a report on 'foreign trade barriers' on a country-by-country basis. Each year, the profile of digital issues has grown. The reports now have a separate heading for 'barriers to digital trade' – described as barriers to cross-border data flows, data localisation requirements, discriminatory practices affecting trade in digital products, restrictions on the provision of Internet-enabled services, and other restrictive technology requirements – alongside 'services barriers' and failure to protect intellectual property. The 2020 report identified as trade barriers the digital tax-related measures adopted by Argentina, Australia, Brazil, Canada, the EU (specifically Czech Republic, France, Italy, Spain and UK), India, Kenya, New Zealand and Turkey.²¹ The report provides an informal guide to which countries' actual or proposed laws, policies or other measures the US has most directly in its sights.

7.2 US corporate-led threats to retaliate

Patterns are emerging of direct pressure by the tech companies across the Global North and South, threatening retaliation themselves or by the US government. For example:

- Google's submission to the Kenyan Parliament in 2019 echoed the argument from the USTR's French DST investigation that introducing the tax on digital markets was contrary to the international tax system that requires companies to pay the bulk of their income tax in their country of residence. Google warned that proceeding with the tax risked a trade war with other countries, meaning the US. Uber said there was a risk of confusion under the law that would prompt litigation and proposed a clause that would allow the industries to work with the government authorities to develop the 'right definitions' for the regulations.²²
- When the Australian government announced it would require foreign firms to levy GST on international deliveries, Amazon announced it would block

²⁰ ITIF 2019, 14

²¹ USTR (2020), *2020 National Trade Estimate Report on Foreign Trade Barriers*, 31 March 2020. Available at: https://ustr.gov/sites/default/files/2020_National_Trade_Estimate_Report.pdf

²² 'Uber seeks clarity on taxing online firms', *Business Daily*, 1 September 2019. Available at <https://www.businessdailyafrica.com/corporate/companies/Uber-seeks-clarity-on-taxing-online-firms/4003102-5256592-kdrbuyz/index.html>

Australians from buying on the international site Amazon.com, rather than through the Australian domain name that supplies a smaller range of products locally. A submission released under New Zealand's official information law showed similar threats from Amazon to cut the range of products it made available to New Zealand customers if the government proceeded with GST on low-value imported goods.²³

- Urged on by tech lobby groups, the US government has made multiple threats against India, targeting the H-1B visas that many thousands of Indian tech workers rely on to enter the country each year. The US progressively reduced approvals, mainly to workers for Indian tech firms who were exporting from the US. In 2020 the US introduced a complex new registration and selection process for Indian workers entering under the scheme.²⁴ The measures were linked in the media to US complaints over India's 'equalisation' levy that included the 'Google tax' on digital advertising transactions,²⁵ and the requirement to store data locally.²⁶

7.3 Empowering the Global South

Old national laws are not catching up with new facts, and the facts that governments require to make tax policy decisions on the digital economy are neither clear nor predictable.²⁷ Tax justice demands a broad examination of policies and processes that impact on the ability of governments from the Global South to protect and enhance the fiscal social contract. Moves to develop new international tax norms currently offer little prospect that they will address those needs.

Developing countries need regional and national strategies that can enhance their domestic capacity, bridge the digital divide and reduce dependence on the

²³ Tom Pullar-Strecker (2018), 'Amazon warns New Zealand on internet shopping tax change', *Stuff*, 3 August 2018. Available at: <https://www.stuff.co.nz/business/105982965/amazon-warns-on-internet-shopping-tax-change-but-government-signals-no-uturn>

²⁴ Priyanka Sangani (2020), 'Indian IT's H1-B visa woes could worsen in 2020', *The Economic Times*, 3 January 2020. Available at: <https://economictimes.indiatimes.com/nri/visa-and-immigration/indian-its-h-1b-visa-woes-could-worsen-in-2020/articleshow/73077722.cms?from=mdr>

²⁵ Mercy Muendo (2019), 'Kenya's tax on digital trade and services: what's known and not known', *CNBC Africa*, 11 December 2019. Available at: <https://www.cnbc africa.com/news/special-report/2019/12/11/what-you-need-to-know-about-kenyas-tax-on-digital-trade-and-services/>; 'Trump administration to propose major changes to H1-B visas', *Economic Times*, 18 October 2018. Available at: <https://economictimes.indiatimes.com/nri/visa-and-immigration/trump-administration-to-propose-major-changes-in-h-1b-visas/articleshow/66269711.cms?from=mdr>

²⁶ Neha Dasgupta and Aditya Kalra (2019), 'U.S. tells India it is mulling caps on H1-B visas to deter data rules', *Reuters*, 20 June 2019. Available at: <https://www.reuters.com/article/us-usa-trade-india-exclusive/exclusive-us-tells-india-it-is-mulling-caps-on-h-1b-visas-to-deter-data-rules-sources-idUSKCN1TK2LG>

²⁷ Richard Westin (2007), *International Taxation and E-Commerce*, 2nd Edition, Kluwer Law International, 1

dominant corporations. That cannot be achieved in a data-driven global economy without moves to upgrade and reward their role in data value chains and enhance domestic capacities to refine the data.²⁸ A modern and equitable tax regime also needs to identify the new sources of value generated from within a jurisdiction and capture part of the benefits for sustainable development and the public good. The mismatch between where profits are taxed and where and how activities take place and value is created is now widely recognised.²⁹ The insistence of a number of OECD countries, especially those with preferential tax regimes, that taxation is based on residence, and their hostility to proposals to tax the value generated from digital activities in other countries, including data, confirms the significance of such initiatives.

Attempts to extend existing trade rules to previously unforeseen digital technologies and services, and proposals for more extensive trade rules on the digital economy, would impede these imperatives in two ways: by further eroding the revenue base that supports these strategies and funding for governments to fulfil their responsibilities to their citizens; and inhibiting the options for digital development, including access to and control over data that is sourced in their territory. The current e-commerce and digital trade proposals give precedence to the needs and demands of large digital MNEs, and limit the ability of policy-makers to establish new industries and identify and prioritise their contributions to value chains through accessing source codes and data.

The moratorium on customs duties on electronic transmissions is a specific and urgent problem. Despite recent studies by the proponents of making the moratorium permanent, the evidence weighs heavily against doing so for reasons of public revenue, tax policy space, digital development, the sheer uncertainty of the scope of the moratorium, and the pace and shape-shifting of future technological developments. Those who demand that developing countries accept a permanent ban on this tax policy option seek to lead them, handcuffed and blindfolded, into the fiscal unknown.

All countries, but especially those from the Global South, should refrain from participating in a process of trade negotiations that may limit their flexibility and ability to tackle inequality through sustainable financing of economic and social rights for their citizens. The African Group have rejected the process of plurilateral negotiations on 'electronic commerce' as premature, pushing the trade agenda too far without addressing the outstanding development issues in the Doha Round.

²⁸ UNCTAD (2019), *Digital Economy Report: Value Creation and Capture – Implications for Developing Countries*, 10. Available at: https://unctad.org/en/PublicationsLibrary/der2019_overview_en.pdf

²⁹ UNCTAD, *Digital Economy Report*, 11

The proponents' appeals to providing 'e-commerce for development' that will benefit small and medium enterprises are self-serving and cynical.³⁰

Those views were echoed by global civil society organisations when self-selecting members of the WTO initiated negotiations on e-commerce in early 2019, without a mandate. The collective statement from civil society urged countries to opt out of the process, because the proposed rules would severely constrain their policy space to develop their economies in the future and accelerate the global disadvantage of workers and small enterprises in all countries vis-à-vis large corporations that currently dominate the global economy.³¹

7.4 Achieving tax and trade justice

To be truly responsive to the challenges and opportunities that a transforming digital economy poses for development, all governments, but particularly in the Global South, will need trade policies that maintain their policy space to innovate and regularly re-evaluate their strategies on a national and regional basis.

There are different and genuinely pro-development options for addressing the growing cross-border trade in digital products. That trade could be subject to GATT negotiations that determine classifications and appropriate tariff bindings, subject to differential treatment that recognises the significant development asymmetries.

Some developing countries may prefer to re-define electronic transmissions as services so that they can exercise a greater degree of control over them under the GATS and develop appropriate means to tax them. However, that would require a careful review of their schedules, including those on cross-border trade (mode 1) and on computer and related services, financial services, and telecommunications. It would also require resistance to expansive interpretations of existing obligations and new rules, including on domestic regulation of services and investment facilitation. Outside the WTO, FTAs pose even greater risks to effective taxation and digital development by developing countries and to solidarity among countries of the Global South.

More fundamentally, global rules to govern digital technologies and the MNEs that control them should not be drawn up in a multilateral *trade* institution that is committed to market-based regulation and liberalisation, which assumes a non-existent level playing field, and which excludes the social actors whose lives and

³⁰ WTO (2017), 'The Work Programme on Electronic Commerce: Statement by the African Group', 6 December 2017, WTO, WT/MIN(17)/21 (African Group Statement). Available at: <https://www.tjm.org.uk/documents/briefings/mc11-work-programme-on-electronic-commerce-statement-by-the-african-group-6-december-2017.pdf>

³¹ 'Statement from Civil Society Organizations against E-commerce rules in the World Trade Organization', 25 January 2019. Available at: <http://www.ourworldisnotforsale.n>

development will be shaped by such rules. A single-minded pursuit of that free trade model is untenable in the current context, especially as countries plan their recovery strategies from COVID-19. The debate regarding the regulation or non-regulation of the digital economy has to move beyond a simplistic corporate-driven focus to balance states' obligations to their citizens via the fiscal social contract and facilitate trade policies that are equitable, sustainable and can be achieved. The WTO and FTAs are not the appropriate forums for that debate.

As the introduction observed, trade and tax officials tend to act in silos as they seek solutions to the novel challenges posed by a digitalised economy that is dominated by MNEs that have no local presence. Many OECD countries are pursuing contradictory courses in the trade and tax arenas. Most developing countries seem to be fighting a rear-guard action on both the tax and the trade fronts over proposals they desperately need to influence.

It is time for policy-makers and regulators to leave their silos and pursue synchronous international tax and trade strategies that are **both** based on tax and trade justice. WTO Members need to remember that they are also member states of the United Nations and have committed themselves to the Sustainable Development Goals. Especially in a post-COVID-19 environment, targeted trade and tax policies will need to prioritise economic and social rights and ensure that the powerful digital MNEs are genuinely contributing to achieving those goals.

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