Fifth Session, UN Tax Convention Negotiations
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Protocol 1 - Article 9

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Dear Madam Co-Lead,

Congratulations on this first draft and thank you for giving us the floor. I'd like to make two brief remarks touching on the issue of the method of taxation.

The first is that we want to highlight risks regarding giving taxpayers discretion to choose the method they prefer. Although data is scarce, a recently published IMF paper indicates that a large share of cross-border services takes place within multinational groups, with country figures indicating that such is the case for around half of digitally delivered services. Countries are logically afraid that taxpayers will choose a net method that may end up eroding the local tax base, as is currently the case for several countries which have adopted transfer pricing rules. Not coincidentally, the same IMF paper indicates that withholding taxes on services are adopted both as an anti-base-erosion mechanism and as a tool to retain taxing rights.

Still, while taxation on a gross basis may be easy to administer through a withholding tax in situations where there is a payment, the same does not apply in non-payment situations, which are also the object of the protocol in Article 6. It is still hard to understand how gross taxation would function in such cases. The fact that gross taxation is not related to actual profitability is also a valid criticism.

Therefore, we consider that net taxation is crucial for this protocol. The inclusion of a net method, however, requires tackling upfront the limitations of existing transfer pricing rules. Otherwise, Multinationals will continue to report profits where they want, instead of where they were actually generated. Ultimately, the only way to really address this is by treating Multinationals as unitary entities and attributing profits through formulary or fractional apportionment. The research from my colleagues at Tax Justice Network and Public Services International shows that countries could gain 500 billion dollars a year with such a move. The UN Tax Committee, too, believed fractional apportionment is the appropriate way for net profit allocation in the case of automated digital services.

This brings us to our second point. We agree with [ADD COUNTRIES] that the concept of a "reasonable allocation of profits" is a concept which is far too vague. The principles of the Convention prescribe new rules to be simple and easy to administer. For these reasons, we believe it should be strengthened to explicitly tie the net mechanism to a formulaic or fractionary approach. We understand the second sentence of Art. 9 (para 1) hints at fractional approaches, but these need to be made more explicit and the protocol could elaborate a process for establishing such methodologies.

Thank you, Madam Co-Lead.