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Sideshow: The UN Committee of Experts and Digital Services Taxes



BY JEFFERSON VANDERWOLK

In the world of international tax policy, for the past two or three years the spotlight has been on the OECD/G20 Inclusive Framework's two-pillar project on the tax challenges of digitalization, sometimes called BEPS 2.0. The project is aimed at finding a global consensus on how to tax corporate profits from the cross-border provision of digitalized services and products, and clarify the taxation of cross-border marketing and distribution functions (Pillar One) as well as consensus on a global minimum tax regime common to all countries (Pillar Two). The project has been delayed both by the global pandemic and by political differences among the participating countries on some of the main issues raised by the proposed tax changes. The Inclusive Framework is now working toward a mid-2021 deadline, primarily through behind-the-scenes negotiations between country representatives.

Outside of the spotlight, a small and fairly obscure body called the UN Committee of Experts on International Cooperation in Tax Matters has been working on some of the same issues. In October 2020, a sub-committee of the Committee of Experts advanced a proposal to add a new article (12B) to the UN Model Tax Convention that would allow a contracting state to impose withholding tax on payments arising in that country to a resident of the other state for "automated digital services" as defined in a yet-to-be agreed OECD report. Despite objections from some members, this proposal was approved by a majority vote in the 25-member Committee of Experts, subject to further work to be done by the sub-committee on the commentary

that would accompany the new treaty article. The final vote on including Article 12B and its revised commentary in the UN Model is expected in April 2021 at the next meeting of the Committee of Experts.

This development has not attracted as much attention as the OECD/G20 Inclusive Framework project, for several reasons. First, the change would only be in the UN Model Tax Convention, which is not as widely used as the OECD Model Tax Convention. Second, if included in any new treaties, Article 12B would apply only to the treaty parties who agreed to its inclusion; thus, it would not be imposed upon any country that did not want it. Third, Article 12B is unlikely ever to apply to payments to the large, global companies at whom digital services taxes are aimed. Most of those companies are based in the U.S., and the U.S., which opposes digital services taxes and uses its own model tax treaty in any case, would almost certainly never agree to a provision like Article 12B.

Yet the UN Committee's work on Article 12B could nevertheless be significant in the current circumstances. By explicitly acknowledging digital services taxes and permitting them to be imposed via withholding on the gross amount of outbound payments, the UN Committee, through the adoption of Article 12B, is sending a signal to developing countries that do not yet have a digital services tax in their law that they might do well to have one. This was noted in the World Bank Group Staff's recent comments on Article 12B, as follows:

"The development of a treaty article such as Article 12B will be in line with the policy rationale of jurisdictions wishing to use more straightforward domestic rules to exercise taxing rights over income generated in their economies. Moreover, a new treaty article provides an agreed international framework within which jurisdictions can adopt aligned approaches, leading to

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international consistency of treatment and a mechanism to mitigate double taxation. Although a new article 12B may take time for countries to implement through bilateral treaties, it has immediate signalling effects that will be welcomed by many developing economies.”

Giving a green light to developing countries worldwide regarding digital services taxes conflicts with the goal of the OECD/G20 Inclusive Framework project. The countries that have enacted digital services taxes so far have said that they will repeal them when the Inclusive Framework reaches agreement on a global approach. And it is not at all clear that the World Bank Group Staff is correct in saying that digital services taxes are supported by a policy rationale of “exercising taxing rights over income generated in their economies.”

Interestingly, the World Bank Group Staff notes that Article 12B will not be aligned with many digital services taxes if its scope is limited to “income arising” in a contracting state, since the taxes apply to income from transactions occurring outside that country, between non-residents of that country. In addition, their comments tellingly refer to consumption taxes such as VAT in discussing how Article 12B might best work in practice. Arguably, digital services taxes are really just specially targeted consumption taxes dressed up as corporate income tax.

Although the UN Committee of Experts’ work is currently a sideshow rather than the main event in the international tax arena, it deserves more scrutiny than it has received to date. The fact that Article 12B is a model treaty provision does not limit its significance to treaties; rather, the general lack of treaties between developing and developed countries will ensure that double taxation due to the increased use of digital services taxes goes unrelieved. The countries striving to strike a deal in the Inclusive Framework negotiations—including the U.S.—might well consider whether the UN Committee’s adoption of Article 12B risks undermining their efforts, and, if so, whether there is anything they can do about it.

Oddly, under the mandate establishing the UN Committee of Experts, the 25 individuals that form the committee as nominees of their respective countries do not

act in their official capacities (as government officials or otherwise) but rather as in their capacity as individuals with expertise in tax policy and administration. Of the current 25 committee members, only two are tax officials of a G7 country (Canada and Germany). The one other G7 country with a nominee on the committee, Japan, chose a law professor. Four of the BRICS have nominees (Brazil, Russia, India, and China). The rest are from smaller countries, mostly in the developing world.

In practice, it appears that, unlike the OECD/G20 Inclusive Framework, the committee makes decisions based on a majority vote rather than requiring consensus. Thus, as few as 13 individuals acting in their personal capacity can adopt a policy measure in the UN Committee of Experts, whereas any decision of the Inclusive Framework is significantly more robust as it would require consensus among the governments of 139 member jurisdictions.

It should be a matter of concern to the Inclusive Framework that the UN Committee of Experts is moving forward with a proposal that will encourage more countries to enact unilateral digital services taxes while the Inclusive Framework is trying to eliminate them. As the world gropes its way toward the creation of some form of effective global tax policy process, the implications of allowing the UN Committee of Tax Experts to operate as it has done up to now need to be considered carefully by all involved.

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