



Corporate Tax Negotiations at the OECD: What's at Stake for Developing Countries in 2020?

Martin Hearson, February 2020¹

Introduction

We could be in the midst of the biggest change to the way multinational companies are taxed in decades. For the past year, over 130 developed and developing countries have been trying to agree on how to 'go beyond' some of the fundamental principles that have underpinned cooperation on corporate taxation for a century (OECD 2019a). In January 2019, they opened negotiations to redistribute 'taxing rights' over multinational businesses among themselves, a matter previously thought too complex to discuss in a multilateral setting. Their reason for doing so was the challenge of taxing digitalised business models effectively.

What makes these proposals potentially radical is not just that they transgress

decades-old taxation norms. It's also that they are being developed within an 'Inclusive Framework' (IF) in which many developing countries have a seat at the table. This is an institutional innovation by the Organisation for Economic Cooperation and Development (OECD), a cartel of 36 more developed countries that has historically been the *de facto* global standard-setter.

The IF proposals divide opinion. The Financial Times described them as 'a global shake-up of corporate taxation', while according to the International Tax Review, 'the OECD has stunned the tax world by signalling countries' willingness to consider radical steps to drag the global corporate tax system into the 21st century' (Giles 2019; Hartley 2019). In contrast, Joseph Stiglitz accused the OECD of 'canonizing

¹ Based on a talk given at the World Bank and IMF Tax Sunday event, 20 October 2019.

gradualism', while civil society groups such as Tax Justice Network Africa and ActionAid believe that the proposals 'will not adequately address underlying global issues surrounding tax evasion and IFFs [illicit financial flows]' (Stiglitz 2019; Tax Justice Network Africa and ActionAid Denmark 2019). The BEPS Monitoring Group considers them 'unnecessarily complex' and has called for a more comprehensive approach (BEPS Monitoring Group 2019).

At the time of writing, the OECD is struggling to hold together a coalition that includes powerful emerging markets such as India, impatient European countries such as France, and an increasingly belligerent United States. The challenge of brokering an agreement among these powerful states is one reason to lower expectations about what the evolving proposals can deliver for developing countries, even though many of them are at the table. Participation in whatever agreement emerges will entail real costs and risks, which must be evaluated against what appear limited potential gains. But there is also much to play for, in this process itself and in the precedents it sets. This paper describes the proposals as they stand, and highlights some of the issues for developing countries. It draws on discussions with developing country negotiators and other participants in the IF discussions between July 2019 and January 2020, as well as their published comments.

Developing country interests in international tax cooperation

What are we reforming when we say, 'international tax reform'? Until recently the

nature of international tax rules could be explained concisely: first, that soft law was developed by the OECD, and often adapted with developing countries in mind by a United Nations (UN) expert committee; second, that soft law became hard law through bilateral treaties based on the OECD and UN templates, or when countries based their domestic law on it. Today the institutional picture is more complicated: the OECD/UN division of labour has been disrupted by the creation of the IF and the emergence of regional model treaties in Africa; multilateral agreements are taking on an increasingly 'harder' character, for example through the minimum standards that IF members are expected to meet.

Developing countries face two difficulties with existing rules, both of which are hardwired in. First, the restrictions they impose on the ability to tax foreign multinationals at 'source' are too great. The premise of the system is that recipients of foreign investment should accept numerous restrictions on their ability to tax that investment. Second, they are too complex to administer effectively. ICTD research has considered at length the ways in which international tax rules could be simplified to reflect the reality of resource constraints in lower-income countries (Durst 2019; Ezenagu 2019; Picciotto 2018).

In spite of these problems, there is some flexibility in the system for lower-income countries. The terms of individual bilateral treaties, for example, can vary, although rarely beyond the parameters set by the model treaties. Research has shown that, although they have that room to manoeuvre, lower-

²As well as phone and email conversations, this included discussions at the ICTD/BEPS Monitoring Group workshop on Addressing the Tax Challenges of Digitalisation of the Economy (London, July 2019), the Third ATAF High-level Tax Policy Dialogue in (Victoria Falls, July-August 2019), the Nineteenth Session of the United Nations Committee of Experts on International Cooperation in Tax Matters (Geneva, October 2019) and annual meetings of the IMF and World Bank (Washington, DC, October 2019).

³The process was recursive, as soft law tools were updated in response to innovation in bilateral and domestic practice.

income countries have not generally managed to take full advantage of the possibility for greater 'taxing rights' provided for them by the UN model treaty (Hearson 2016; Mutava 2019). Perhaps more importantly, adherence to international tax rules is not mandatory. Countries aren't given taxing rights by the OECD or the UN. They choose to surrender them when they sign binding tax treaties, or when they follow soft law such as the OECD's transfer pricing guidelines. For countries that have not historically been international tax rule-makers, there is therefore a trade-off between the benefits of adhering to international consensus and the more parochial gains from unilateralism.

We are now seven years out from the first discussions about what is becoming known as 'BEPS 1'. This original 'Base Erosion and Profit Shifting' project was led by the OECD and G20 and focused on their priorities. With a few small exceptions, it neither reallocated taxing rights nor simplified existing rules (Oguttu 2017, 2016; Valderrama 2018). As a result, uptake from developing countries was muted. In Africa, for example, only 25 out of 54 countries have joined the IF, the Institutional Framework that emerged from BEPS 1. Only 13 have signed the Multilateral Instrument, the hard law instrument that accompanies it. Some of these have participated due to coercion by the European Union, rather than out of genuine enthusiasm (ATAF 2019a: 20).

These, then, are two initial questions we can ask when testing how beneficial any new reforms are from the perspective of lower-income countries: (1) do they make corporate tax easier to administer? and (2) do they give (proportionately) more taxing rights to developing countries? Two further questions will be addressed later in the paper.

Developing country interests in taxing the digitalising economy

On top of these historical issues, developing countries are considering how to respond to the opportunities and challenges created by digitalisation, just like other countries. Digitalised business models are having transformative effects in areas of economic life where developing countries had lagged behind, effectively leap-frogging analogue stages. For example, the widespread use of mobile banking has overcome the absence of retail banking penetration. Social media has taken off in an environment with less intense offline communication.

In most cases, developing countries are moving slower than developed countries in formulating policy responses, but we can observe some innovation here (Rukundo 2020). In corporate tax, for example, Kenya recently proposed to expand its definition of permanent establishment to include digital advertising platforms. African countries such as Uganda, Kenya and South Africa have revised their value added tax laws to cover imports, especially by digital means, including requirements for platforms or payment agents to help with enforcement. A number of countries have also introduced or are considering more specific taxes targeted at various kinds of payments for digitalised services or transactions. However, these fall on consumers and can be unpopular.

The current process, informally known as 'BEPS 2.0', emerged as a result of similar unilateral measures among OECD and G20 states, in particular the introduction of digital service taxes in Europe and Asia. It has three main drivers: to reallocate some tax base to these 'market countries' in which highly digitalised multinational companies make money, regardless of whether they have a physical presence; to prevent

unilateral actions and disputes arising from them; to internationalise some of the anti-tax avoidance measures introduced by the US government in its recent tax reform.

This leads to a third question against which to evaluate the proposed reforms: (3) how much overlap is there between measures designed to satisfy these priorities, and the (admittedly not yet clearly formulated) priorities of developing countries in this area?

Structural issues with developing country participation

In response to criticism of interim proposals, the OECD secretariat has leaned heavily on the inclusiveness of the IF, the 137-strong body through which the reform process is being conducted. 'We now serve all these countries and a compromise will have to be found among all of them', the Director of its Centre for Tax Policy and Administration has said (cited in Topham 2019).

The reality of any consensus-based decision-making process, however, is that not all countries are able to make use of their membership to the same extent. There are several reasons for this, as discussed in a 2019 report by ATAF, the African Tax Administration Forum (ATAF 2019a). Four stand out from this report and ICTD's own initial research. First, developing countries are at the early stages of policy development – not just on tax and digitalisation, but on digital strategies for their economies. The issue-framing stage of the BEPS 2.0 process took place at a point where these countries had not clearly identified their concerns and is likely to reach critical decision points before they are fully ready. Second, the process is operating at a pace that is demanding for many OECD members, but impossible for many lower-income countries to participate in fully. As ATAF commented after

“It is extremely challenging for many of our members to fully participate.”

– African Tax Administration Forum

the most recent IF plenary meeting, “we are very concerned that the political and technical complexities of the Inclusive Framework proposals and the timing of the process that aims for a global agreement by the end of 2020 means it is extremely challenging for many of our members to fully participate...some countries may commit to new rules without a full understanding of the revenue and investment implications for them” (ATAF 2020).

Third, lower-income countries are not well organised into caucuses, unlike the OECD, G7 and European Union, which all have a long tradition of working together to negotiate common positions. While ATAF and the Intergovernmental Group of 24 (G-24) have emerged as developing country blocs within the IF, it will take time and experience to build up a culture of effective caucusing. Fourth, lower-income countries often suffer from a disjuncture between technicians and their political counterparts. While developed countries are represented in the IF by senior finance ministry officials or others with a policy mandate, lower-income countries are generally represented by revenue authority officials. ATAF (2019a: 16) expresses concern that ‘the pace of change of international tax standards presents a major challenge to many African countries, particularly as much of the BEPS outcomes requires more than operational decisions; they also require policy changes that must be channelled through Ministries of Finance’.

The OECD secretariat is committed to helping developing country participants overcome these constraints, but it is also important to be realistic. It is unlikely that a process moving so quickly, with contours determined by big power politics, will produce an outcome over which lower-income countries feel ownership. According to one developing country negotiator, 'We are waiting for someone to tell us: "Here is your part of the leftovers".' On the other hand, African officials state that they are in discussions about implementing unilateral measures based on a pessimistic reading of the OECD process.

This brings us to a fourth and final question with which to evaluate the proposals: (4) will the institutional framework that emerges from BEPS 2.0 allow developing countries to continue to formulate solutions suited to their own circumstances in the medium term?

The current proposals: 'Pillar One'

The IF's work on BEPS 2.0 is divided into two pillars. The explicit purpose of Pillar One is to reallocate a share of multinational companies' taxable profits towards the 'market' countries in which they make sales. In January 2019, the IF published a document summarising three proposals to do this (OECD 2019a). Although they were not attributed to countries, the proposals were widely acknowledged to have originated with the US ('marketing intangibles'), the UK ('user participation') and the G-24 ('significant economic presence').

In October 2019 these proposals were superseded by the secretariat's proposal for a unified approach, as the basis for finding a consensus among all parties (OECD 2019b). The developing country negotiators spoken with by the author since its publication have largely described the secretariat proposal as closer to that of the

US, with little connection to the G-24's significant economic presence. As the UN Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee 2019: 2) states, 'elements in the significant economic presence proposal, which could be important for developing countries, are not included in the currently proposed Unified Approach'.

The secretariat proposal includes three 'amounts':

- **'Amount A'** has had the highest profile because it abandons certain red lines that have until now defined the parameters of what was possible in international tax reform. It would establish a 'new taxing right' under which companies would become taxable on their net profits in a country in whose economic life they have a critical mass of sales and possibly users. This would be the case even where they have no physical presence, which current rules require. Furthermore, it would allocate a portion of profits to countries where the new taxing right exists by means of a formula, which until recently was anathema to the OECD. Despite this excitement, there is a low expectation among participants in the IF negotiations that Amount A would deliver significant new tax revenue for lower-income countries. The United States also appeared to withdraw support from this proposal in December 2019 (Mnuchin 2019).
- **'Amount B'** would attribute profits to companies' marketing and distribution functions, with the proposal that 'the possibility of using fixed remunerations would be explored' (OECD 2019b: 9). This would only apply where there is a physical presence, and would be largely a simplification of existing rules. Depending on the formulae agreed it could attribute some additional profits towards the market country, but these are most likely profits that that country currently misses out

on due to the challenges of enforcing existing rules; it does not represent a change in the political settlement underlying those rules. Nonetheless, it is widely considered that Amount B is the principal part of the proposal from which lower-income countries could be expected to gain. They often complain that multinationals manipulate the profits of their distribution companies downwards as a tax planning technique, and that existing tax rules do not adequately capture the value creation of localised marketing functions. In the longer term, the endorsement of a simplified approach here – something that ICTD research has pointed towards – would set a precedent that could be as significant as the abandonment of physical presence and the use of a formula (Ezenagu 2019).

- **'Amount C'** would allow a country to challenge the amount received via amounts A and B, adjusting the total upwards using traditional transfer pricing methods if it considered that appropriate.

Importantly, this proposal is designed to be overlaid on top of the existing bilateral treaty regime, not replace it. The claim that it would nonetheless enhance certainty within the international tax regime comes from its use of simplifications, as well as from the secretariat's proposal that: 'Any dispute between the market jurisdiction and the taxpayer over any element of the proposal should be subject to legally binding and effective dispute prevention and resolution mechanisms' (OECD 2019b: 9).

There are three overriding issues for lower-income countries with the Pillar One proposal as it stands: scope, allocation and dispute resolution.

Issue 1: scope

Amount A of Pillar One would cover all consumer-facing businesses, not just the highly digitalised companies whose tax affairs

triggered discussions. Similarly, Amount B would apply to companies' marketing and distribution activities. The difficulty of arriving at clear definitions of these concepts is a common theme in many comments received by the OECD. The scope of Amount A in particular would be likely to be limited in several ways that would significantly affect its relevance to developing countries.

- **Identifying the companies within scope.** Amount A would only apply to companies with a turnover greater than a certain amount, possibly €750m. Only the world's largest companies would be affected. For example, Jumia, perhaps Africa's best-known e-commerce firm, turned over just €130m last year (Reuters 2019). The G-24 proposed a lower threshold of €500m, while the UN tax committee suggested a lower threshold for regional businesses (Intergovernmental Group of 24 2019; UN Tax Committee 2019). There would also be 'carve-outs' excluding certain sectors. The proposal states that the new approach is not suitable for 'the extractive industries'. It also suggests other possible exclusions, such as commodities and financial services. What does this mean for developing countries? They could benefit from the exclusion of sectors where their position is primarily near the beginning of value chains, and where they do not have large consumer markets. Other sectoral carve-outs, such as for financial services or shipping, could limit their gains from the 'new taxing right'.
- **Identifying the countries in which they are taxable.** The new taxing right for Amount A would only kick in once sales and/or users exceed a certain amount. This could work against less wealthy countries, where sales are naturally lower in absolute terms. The secretariat's proposal helpfully leaves open the

possibility of adapting this threshold to market size, a point made by all the submissions from developing country groups. It also suggested somehow including non-paying users, an important point given the popularity in Africa of services such as WhatsApp, which collect user data, but do not sell services to users or advertisers.

- **Identifying the profits to be redistributed.**

Amount A would only apply to a company's 'residual' profits, which the proposal suggests cannot be easily tied to particular parts of the business and are particularly high for digital companies. The residual profit would be any profit above a fixed percentage deemed to be the 'routine' profit rate, which would be negotiated within the IF. Once determined, the residual profits would again be subdivided by applying a fixed percentage, this time into those associated with the market (this is 'Amount A'), and those associated with other functions. Clearly, the amount of profits redistributed under Amount A would depend on these two fixed percentages. Equally clearly, agreeing them among over 130 countries is likely to be a key sticking point. It has been made clear that setting the rates will be a political decision.

In summary, the gains for lower-income countries from Amount A would be limited to companies' 'consumer-facing' business higher than a certain overall threshold, with sales in the market above a certain threshold, excluding certain sectors, and only a proportion of their profits. Those elements are still under negotiation.

Issue 2: allocation

Once the scope of the profits covered by the new taxing right is determined, the next question is where they would be allocated. Pillar One is premised on the motivation of moving the tax base towards the market country.

Amount A would thus allocate the profits in scope using a formula that incorporates sales as the basis of allocation. As noted above, including non-paying users in the calculation may be to the benefit of lower-income countries. Campaigners and commentators have seized on analysis from the IMF and elsewhere suggesting that a reallocation based on sales may not benefit lower-income countries, and argued that labour (staff costs and/or numbers) should be included as well (De Mooij, R.A., Liu, L., and Prihardini 2019, Cobham, Faccio and FitzGerald 2019).

Under Amount B, meanwhile, the level of any fixed rate of return on marketing and distribution activities would be important to the gains for lower-income countries. If it varied by sector, the value of the return in sectors of relevance to developing countries would be a critical matter for negotiation.

Issue 3: dispute resolution

Dispute resolution is already a subject of some controversy between developed and developing countries. Most lower-income countries have little experience of the Mutual Agreement Procedure, which is the non-binding form of dispute resolution in their bilateral tax treaties. Furthermore, the current form of binding dispute settlement – tax treaty arbitration – is eschewed not just by lower-income countries but also by larger emerging markets such as India and China. ATAF, the UN tax committee and the G-24 all state opposition to mandatory binding arbitration, and what the G-24 describes as 'the linkage of the solution to the dispute resolution measures' (Intergovernmental Group of 24 2019: 1). By January 2020 this had become ATAF's "primary concern" with Pillar One (ATAF 2020). Finding a form of dispute settlement that is acceptable to developing countries is likely to be challenging, but it is also a non-negotiable element of the proposals for the United States.

The current proposals: 'Pillar Two'

The second pillar of the IF agenda, referred to as the Global Anti-Base Erosion proposal, 'GloBE' (OECD 2019c) is not really about the digitalised economy at all. It aims to ensure a minimum global effective tax rate for multinational companies. It proposes four rules that would make it much harder for them to move taxable profits around in order to minimise their tax liabilities. These rules would allow countries to impose tax on multinational companies' income that would otherwise be taxed below a minimum effective tax rate. Some of them would be applied by the host countries in which a multinational company operates, and others in its home country.

- Under the **undertaxed payments rule**, the **host country** would identify payments within a multinational firm that reduce its local taxable profits and are not subject to a minimum rate of tax. Tax could be imposed through a withholding tax, already a commonplace tool in developing countries, or by including the payments in calculating the local company's taxable profits.
- The **subject to tax** rule would apply a similar principle to tax treaties. It would disallow reductions in the tax that a company pays in the **host country** because of its tax treaties, where the payment affected by the tax treaty is not subject to a minimum tax rate.
- The **income inclusion rule** is the corollary to the undertaxed payments rule, but would focus on multinational companies' branches and affiliates, rather than on payments between them. It would allow the **home country** to tax the income of the foreign branches and subsidiaries of a parent

“Pillar Two is potentially worth more than Pillar One in revenue terms, which means there is more at stake from design decisions.”

company if they do not pay the minimum effective rate. This rule would partially reverse the direction of travel in developed countries' tax systems, from 'worldwide' systems that taxed multinationals' foreign profits minus a credit for taxes already paid abroad, towards 'territorial' systems that exempt profits earned abroad from tax at home.

- The **switchover rule** is an accompanying tool to be included in the **home country's** tax treaties. It would allow it to tax the profits made by an overseas branch or from immovable property (e.g. land) on a worldwide basis, rather than through an exemption as the treaty might otherwise specify.

Pillar Two has attracted less attention, because the overall shape is less controversial.⁴ In part, this is because it is inspired by reforms already adopted in the US, which other countries are seeking to emulate. Nonetheless, Pillar Two is potentially worth more than Pillar One in revenue terms, which means there is more at stake from design decisions. There are many unresolved questions about how each rule would be designed and how they would interact. Three design elements would be particularly important in determining how much developing countries would gain from Pillar Two: rate, rule order and tax incentives.

⁴For example, the G-24 and the UN tax committee submitted comments to the OECD's October 2019 consultation on Pillar One, but not its November 2019 consultation on Pillar Two.

Issue 4: rate

The IF plans to specify agreed minimum effective rates, rather than leaving this decision to individual countries, as international tax negotiations usually do. Countries have different preferences for the minimum rate, determined by a number of elements. One of these is how strong they want these rules to be: whether they want them to deter only the most aggressive forms of tax avoidance that achieve very low rates, or whether they want to establish a relatively high floor on the effective tax rates paid by multinational firms. Another element is their own corporate tax rates: since developing countries tend to have higher rates than developed countries, a lower minimum rate “is unlikely to lead to a change in taxpayer behaviour.”

Issue 5: rule order

Because more than one of Pillar Two's four rules could apply in many cases, countries would need to agree on which rule prevails when they clash. The list of the four proposed rules above began with those most likely to give taxing rights to developing countries. Documents published by the OECD tend to begin with the income inclusion rule, and OECD member states want this to have priority. Nonetheless, it has been the subject of much disagreement within the IF steering group. ATAF argues that the undertaxed payments and subject to tax rules should be applied first, to ‘help address the current imbalance in allocating taxing rights between residence and source jurisdictions’ (ATAF 2019b). It has been suggested that the rule order would matter little when their function is to change behaviour and deter tax avoidance, not to raise revenue directly. It is hard to square this argument with strongly-held country positions on both sides of the debate.

Issue 6: tax incentives

The OECD's consultation document states that the GloBE proposal could reduce tax competition between states, not only in terms of the ‘harmful’ tax competition that enables tax avoidance, but also competition through lower rates and tax incentives. It points out that ‘the GloBE proposal may shield developing countries from pressure to offer inefficient tax incentives’ (OECD 2019c: 7). This is a very positive development in terms of tax policy, but makes the politics trickier, because it is an incursion on ‘policy space’. Tax incentives are widely used by African states, and many tax treaties have special ‘tax sparing’ clauses that prevent a multinational's home country from imposing extra taxes where the taxes were reduced as a result of tax incentives in the treaty partner. As African officials have explained, it would be difficult to sell the GloBE package to a finance minister if part of its effect would be to reduce his/her ability to use tax incentives for investment promotion. That said, if OECD and G20 countries move ahead with adopting the income inclusion rule, developing countries may have no choice in the matter. Two design choices could achieve a compromise. The first is an income inclusion rule that would allow firms to blend their profits, either at the jurisdiction level so that low taxes from an incentive would be offset by taxes paid in other parts of the business, or globally whereby companies could offset low tax in one country with high tax in another. ATAF, in its comments on the GloBE proposal, does not support blending beyond jurisdiction level. Alternatively, it has been suggested that income benefitting from tax incentives that are widely accepted as ‘not harmful’ could be carved out of the Pillar Two regime.

Conclusion: costs and benefits for developing countries: what we know so far

Each of the issues listed above is currently at least partly unresolved. The overall cost/benefit calculation is therefore very unclear at present. If we return to the four questions posed earlier, however, we can reach several initial conclusions.

1. Do the proposals make corporate tax easier to administer?

Amounts A and B of Pillar One are explicitly designed to simplify, by introducing formulary and mechanical approaches. Both would be limited in scope in the current negotiation round, but the precedent for further expansion of these simplified approaches may be significant. Pillar Two would be designed to change behaviour, reducing tax avoidance, taking some pressure off revenue authorities' enforcement efforts. Both the G-24 and UN tax committee urge the IF to consider a simplified application using withholding taxes, which have long been a simple frontline tool against tax avoidance in developing countries. All that said, the proposed new rules would be applied on top of existing ones, so there would be a significant implementation burden in terms of putting in place the right legal arrangements and training staff. The UN tax committee has stated that it is 'concerned about the complexity of the proposal' (UN Tax Committee 2019: 4). Strengthened dispute settlement would further intensify these demands on participating states. This burden needs to be considered against any potential gains.

The proposals under both pillars rely on revenue authorities having financial information about multinational companies to which current international agreements do not automatically give them access. This is especially so for developing countries, which in most cases

only have access to information about a multinational's local operations in their country. For example, for Pillar One, they would need to know the full picture of a company's global operations in order to claim an apportionment of residual profits. The first BEPS process introduced a country-by-country reporting requirement for multinational companies, but the reports are submitted to multinationals' home countries. Other countries can only obtain them by joining the exchange of information system, unless they introduce a requirement for local filing as Vietnam has done. For Pillar Two, governments would need information on foreign companies receiving payments from their country, which currently requires a resource-consuming exchange of information on request.

2. Do the proposals give a greater share of taxing rights to developing countries?

This is less clear. Any redistribution would be a political decision, the result of a negotiated outcome. Pillar One is explicitly designed to redistribute to 'market jurisdictions', but developing countries are not always in this category for every sector. For extractive industries and many commodities they are net producers, while in other sectors their market size is small if measured purely on the basis of sales. It is widely understood that the gains for developing countries from Pillar One would come from Amount B, which is a simplification of existing rules and does not represent a policy decision to redistribute between onshore jurisdictions, but rather revenue

“Any redistribution [of taxing rights] will be a political decision, the result of a negotiated outcome.”

gains resulting from easier implementation of existing rules. Any distributive impact of Pillar Two beyond its anti-avoidance element would depend on the rule order agreed. In all cases, however, estimating the revenue gains for developing countries is more challenging than for developed countries because of data limitations, as well as the analytical capabilities of revenue authorities and finance ministries.

3. Do the proposals adapt sufficiently to the challenges of digitalisation?

The proposed reforms would update international tax rules taking into account some of the major challenges presented by the digital economy: the ability to make profit in a country without a physical presence, the role of data in business models, and the ability to shift profits by manipulating intellectual property. These would inevitably be partial steps, since debates about rates, rule order and thresholds would all produce compromises that limit the gains to developing countries, as is the nature of any negotiation process. Furthermore, digitalised business models in developed and developing countries do not always look the same, as the popularity of mobile money in Africa illustrates.

Further adaptations of international tax rules to technological change will inevitably be needed in the medium term. As artificial intelligence expands throughout the value chain, the emphasis on sales without physical presence in the BEPS 2.0 process will become outmoded. Increasingly, the challenge for developing countries will be in commodity production and manufacturing processes, where value-added will be hollowed out, and with it the tax base.

4. Will the institutional framework provide space for medium-term innovation?

The key driver of this process, as made clear by OECD documents, is to halt the spread of

“The most sustainable outcome will ... be one that provides a framework for innovation.”

unilateral taxes on digital services, particularly the DSTs implemented or proposed across Europe. The final form of the package deal will not be clear for some time, but according to OECD officials it is likely to include a moratorium on such unilateral measures. Any moratorium could be enforced through a minimum standard within the IF; it might also filter through to any binding dispute mechanism. This would be a real cost/benefit dilemma for developing countries, many of which continue to debate the merits of joining the IF and Multilateral Instrument.

The outstanding question for developing countries considering the costs and benefits of adopting the IF consensus will be: is it preferable to adopt the consensus approach or to design a home-grown solution, if it is not possible to do both at once? Unilateral measures are undoubtedly second best: they may be levied on gross income rather than net, which has more distorting effects; they are more likely to create double taxation; when indirect taxes on digital services are used, they can be more regressive, and can have negative impacts on freedom of speech and financial inclusion. The most sustainable outcome will therefore be one that provides a framework for innovation in areas opened up by the OECD discussions, to help minimise these negative consequences. We must recognise that developing countries are at an inevitable structural disadvantage in global negotiations. They also need time to understand the impact on their economies and tax bases, and hence their needs from international tax reform.

Further reading

- ATAF (2019a) The Place of Africa in the Shift Towards Global Tax Governance: Can the Taxation of the Digitalised Economy be an Opportunity for More Inclusiveness, African Tax Administration Forum
- ATAF (2019b) ATAF's Opinion on the Inclusive Framework Pillar One (Including the Unified Approach) and Pillar Two Proposals to Address the Tax Challenges Arising from the Digitalisation of the Economy, African Tax Administration Forum
- ATAF (2020) 'Media Statement on the Outcomes of the Inclusive Framework Meeting 29 to 30 January 2020', 31 January, <https://www.ataftax.org/media-brief-inclusive-framework-jan-2020>
- BEPS Monitoring Group (2019) 'OECD Secretariat's Proposals for a "New Taxing Right"', 13 November, <https://www.bepsmonitoringgroup.org/news/2019/11/12/oecd-secretariat-proposals-for-a-new-taxing-right>
- Cobham, A., Faccio, T., and FitzGerald, V. (2019) Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals (preprint), SocArXiv, <https://doi.org/10.31235/osf.io/j3p48>
- De Mooij, R.A., Liu, L., and Prihardini, D. (2019) An Assessment of Global Formula Apportionment. IMF Working Paper 213. Washington, DC: International Monetary Fund.
- Durst, M.C. (2019) Taxing Multinational Business in Lower-Income Countries: Economics, Politics and Social Responsibility, Brighton: Institute of Development Studies
- Ezenagu, A. (2019) Safe Harbour Regimes in Transfer Pricing: An African Perspective, ICTD Working Paper 100, Brighton: Institute of Development Studies
- Giles, C. (2019) 'OECD Takes Aim at Tech Giants with Plan to Shake Up Global Tax', Financial Times, 9 October
- Hartley, A. (2019) 'OECD Announces Countries' Plans to Revolutionise International Tax System', International Tax Review, 30 January
- Hearson, M. (2016) Measuring Tax Treaty Negotiation Outcomes: The ActionAid Tax Treaties Dataset, ICTD Working Paper 47, Brighton: Institute of Development Studies
- Intergovernmental Group of 24 (2019) Comments of the G-24 on the OECD Secretariat Proposal for a Unified Approach to the Nexus and Profit Allocation Challenges Arising from the Digitalisation (Pillar 1), OECD, https://www.g24.org/wp-content/uploads/2019/12/G-24_Comments-on-OECD-Secretariat-Proposal-for-a-Unified-Approach.pdf
- Mnuchin, S.T. (2019) Letter to OECD Secretary-General José Ángel Gurría, <https://www.orbitax.com/news/archive.php/U.S.-Treasury-Secretary-Sends--40283>
- Mutava, C.N. (2019) Review of Tax Treaty Practices and Policy Framework in Africa, ICTD Working Paper 102, Brighton: Institute of Development Studies
- OECD (2019a) Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, <https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf>
- OECD (2019b) Secretariat Proposal for a "Unified Approach" under Pillar One: Public Consultation Document, Paris: OECD Publishing, <https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf>
- OECD (2019c) Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two: Public Consultation Document, Paris: OECD Publishing, <https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf>
- Oguttu, A.W. (2017) Tax Base Erosion and Profit Shifting in Africa – Part 2: A Critique of Some Priority OECD Actions from an African Perspective, ICTD Working Paper 64, Brighton: Institute of Development Studies
- Oguttu, A.W. (2016) Tax Base Erosion and Profit Shifting in Africa – Part 1: Africa's Response to the OECD BEPS Action Plan, ICTD Working Paper 54, Brighton: Institute of Development Studies
- Piccioletto, S. (2018) Problems of Transfer Pricing and Possibilities for Simplification, ICTD Working Paper 86, Brighton: Institute of Development Studies
- Reuters (2019) 'Shares of African E-commerce Company Jumia Jump 71 Percent in Debut', Reuters, 12 April
- Rukundo, S. (2020) Addressing the Challenges of Taxation of the Digital Economy: Lessons for African Countries, ICTD Working Paper 105, Brighton: Institute of Development Studies
- Stiglitz, J. (2019) 'Corporate Tax Avoidance: It's No Longer Enough to Take Half Measures', The Guardian, 7 October
- Tax Justice Network Africa, ActionAid Denmark (2019) Joint Submission to the OECD Public Consultation on the "Tax Challenges of Digitalisation", 6 March
- Topham, G. (2019) 'OECD Tax Reform Plans Could Make Inequality Worse, Analysis Finds', The Guardian, 6 October
- UN Tax Committee (2019) Comments Submitted to the OECD Secretariat on the "Unified Approach" as Proposed by the Secretariat in its Public Consultation Document of 9 October, OECD
- Valderrama, I.J.M. (2018) 'Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative', Bulletin for International Taxation 72.3: 160-170

Credits

Martin Hearson is a Research Fellow at the International Centre for Tax and Development at the Institute of Development Studies. He researches the politics of international business taxation, and in particular the relationship between developed and developing countries. He was previously a fellow in international political economy at the London School of Economics and worked in the charity sector for a decade.

The ICTD is funded with UK aid from the UK Government and by the Bill & Melinda Gates Foundation; however, the views expressed herein do not necessarily reflect the UK Government's official policies, nor those of the Bill & Melinda Gates Foundation. Readers are encouraged to quote and reproduce material from the series. In return, ICTD requests due acknowledgment and quotes to be referenced as above.



ICTD is based at the Institute of Development Studies, Brighton BN1 9RE UK.

First published by the Institute of Development Studies in January 2020 © Institute of Development Studies, 2020



International Centre for Tax and Development
at the Institute of Development Studies
Brighton BN1 9RE, UK

T +44 (0)1273 606261 F +44 (0)1273 621202 E info@ictd.ac W www.ictd.ac