UNITED NATIONS ESCAP
Recent Developments in International Tax and Implications for Developing Countries

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Background

- Under the existing international tax system, source countries cannot tax non-resident companies on their business income derived from those countries unless they have a permanent establishment (PE) or subsidiary there.
- Profits are allocated among the members of an MNE through transfer pricing rules using the arm’s-length standard.
- MNEs are able to avoid paying tax in source and residence countries in various ways, including providing digital goods and services remotely.
Unilateral Responses

- Digital services taxes (DSTs) – withholding tax on payments for digital services
- Expanded definition of PE – “significant economic presence”
- Withholding taxes on payments for digital goods and services
- Anti-avoidance rules
Multilateral Responses

- 2015 – OECD BEPS Project Action 1
- 2019-2021 – Pillar One and Pillar Two proposals developed by Inclusive Framework
- UN work – 2015-2021: responses to BEPS project and base erosion issues of concern to developing countries
- Article 12B dealing with “Automated Digital Services” added to UN Model in 2021
PILLAR ONE

• Applies to MNEs with global turnover of EUR 20 billion or more and profit ratio of 10% or more other than extractive industries and regulated financial businesses
• Not limited to digital goods and services
• Source (market) countries get new right to tax profits derived by these large MNEs from sales of goods and services to consumers
• Domestic revenues must exceed EUR 1 million (EUR 250,000 for countries with GDP less than EUR 40 billion)
PILLAR ONE

• Source country entitled to tax its share of residual profits (Amount A) (25% of global profits in excess of 10% of revenue)
• Residual profits allocated to source countries based on sales revenue derived from each country
  – Formula apportionment, not transfer pricing
• Mandatory dispute-prevention and -resolution mechanism
IMPLICATIONS OF PILLAR ONE

- DSTs and similar measures must be eliminated
- Revenue implications are difficult to estimate and depend on each country’s situation
- Very complex – domestic law, treaties, multilateral agreement
PILLAR TWO: MINIMUM TAX

• Minimum tax on MNEs with global revenue of more than EUR 750 million
• Minimum tax applies to income earned in other countries in excess of 5% of carrying value of tangible assets and payroll if taxed at less than 15%
• Applies only if MNE has revenue of at least EUR 20 million and profits of at least EUR 1 million from a country
• Supplemented by an “undertaxed-payments rule” and a treaty-based “subject-to-tax rule”
IMPLICATIONS OF PILLAR TWO

• Developing countries tax incentives that reduce tax to less than 15% will be effectively nullified by minimum tax
  – Tax havens and preferential tax regimes will be effectively eliminated
• Same effect on non-participating countries
• Developing countries should increase tax on foreign companies to 15%
TENTATIVE CONCLUSIONS

- New rules will be very, very complex
- Will developing countries be forced to rely on developed countries for the administration of the rules?
- Revenue implications for each country are difficult to estimate
- Inevitable loss of sovereignty over tax policy
THANK YOU