Tax Reforms and Global Redistribution

Situating the Global South

SAKSHI RAI

The current international financial system needs an urgent overhaul as it continues to undermine workers' rights. The recent agreement on the "Two-Pillar Approach" that aims to tackle global corporate tax avoidance and taxing the digital economy falls short of addressing the priorities of the global South, and threatens their sovereignty.

Sakshi Rai (*srai@cesr.org*) is based in New Delhi and is with the Centre for Economic and Social Rights, New York.

Designed by rich and powerful countries and their institutions, the current global economic system is broken and systematically works against the interests of the global South and the rights of their people. With inequality levels soaring, there is an increasing outcry for the need to reform the international tax system to ensure it is inclusive and fair.

The emergence of the digital economy and rapidly changing business models have disrupted the system which was conceived in the early 20th century. Tax revenue losses from global corporate tax avoidance range between $200 billion and $300 billion, with low-income countries losing out the most (Garcia-Bernado and Jansky 2021). Thus, taxation, a sovereign policy tool, has become increasingly multilateral and requires cooperation to arrive at solutions that lead to healthy policymaking. How revenues are raised directly affect marginalised groups who largely depend on public services for their health, well-being, education and livelihoods.

In this context, the Organisation for Economic Co-operation and Development's (OECD) "inclusive framework" platform—which has more than 130 members—issued a statement on 1 July 2021 regarding the "Two-Pillar Approach" (henceforth, Approach) on the challenges arising from taxing businesses (OECD 2021). The 2007–08 global financial crisis catapulted the OECD and the Group of 20 (G20) to self-appoint themselves with the responsibility of reforming international tax affairs with the base erosion and profit shifting (BEPS) project. Due to the inherent bias towards "residence jurisdictions" (where the company's headquarters are located), generally the global North, and their over-representation in this process, these initiatives have fallen short of addressing the concerns and priorities of countries from the global South.

In 2015, the Group of 77 countries and China rallied for an intergovernmental tax governance body under the auspices of the United Nations (UN). This predictably was met with swift opposition from global North countries, who claimed that the OECD could manage the process fairly and effectively. Has the inclusive framework met this promise? Does this approach place global South governments on an equal footing with OECD countries? More importantly, does the new international tax regime secure the space of global South countries to raise resources effectively especially in the light of the pandemic while ensuring their sovereignty?

Understanding the Trade-offs

Approved by the members of the inclusive framework in July 2021, the Approach seeks to tackle two issues. First, "Pillar I" aims to build a multilateral consensus on how to bring companies without a physical presence within a jurisdiction, under the tax net. And, second, "Pillar II" directs attention towards the siphoning of profits to lower tax jurisdictions (commonly referred to as tax havens), thus aiming to put an end to the global "race to the bottom" on corporate income taxes. Countries often must compete with low or no tax jurisdictions and, therefore, indulge in slashing down their corporate income tax rates or provide large tax incentives

without any impact assessment, which ultimately limits their fiscal space.

The OECD's BEPS project's efforts have been to address the traditional understanding of businesses and appropriately tax tech businesses like Facebook, Uber, Zoom and others that can function in almost every country without having a local physical presence in terms of staff, offices, etc. This lack of a local presence has allowed these businesses to create economic value in what have been identified as "market jurisdictions" while escaping their tax obligations by booking profits in residence countries and tax havens.

Pillar I divides the "right to tax" back for market jurisdictions by revising profit allocation rules under three types of taxable profits, referred to as amount(s) A, B and C. Amount A "reflects profits associated with the active and sustained participation of a business in the economy of a market jurisdiction, through activities in, or remotely directed at that jurisdiction" (OECD 2020), and constitutes the largest chunk. Such a complicated policy design will be difficult to administer for most countries. It will prove to be especially detrimental for low-income countries who already have smaller sized tax administrations (South Centre Tax Initiative 2021). Instead of simplifying the distribution of taxing rights for low-income countries, the revenue-sourcing principle (a principle that decides how profits will be allocated between countries) introduced under amount A is complicated and draining. Depending upon how multinational companies (MNCs) collect and report information, the revenue sourcing principle uses a hierarchy of indicators to categorise companies into Automated Digital Services (ADS) and Consumer Facing Businesses (CFB) (OECD 2021). The indicators, however, that identify a business either as an ADS or a CFB under the scope of amount A are confusing and could be manipulated. For example, the nature of a business may be providing goods or services remotely (including marketing, distribution activities, etc) but are not covered by the Approach due to a difficulty in determining the scope of that business. This could lead to further tax disputes if companies were to question the categorisation in the scope, proving the reallocation under amount A to be ineffectual.

The approach also leaves out multinational digital businesses that do not meet a gross revenue threshold of €750 million. The South Centre Tax Initiative's (2021) expert group instead recommended that local thresholds should exist that correspond to the size of the economy. The current global revenue threshold, which is indiscriminately applied to all markets, inevitably restricts the ability of low- and middle-income countries from taxing MNCs that have a lower threshold and yet have a sizeable economic presence. Taxing large regional digital businesses from the standpoint of global South serves as crucial sources of revenue, and regional thresholds for this reason must be considered. Zimbabwe, for example, introduced a 5% tax rate on non-resident e-commerce platforms with revenue exceeding a threshold of $5,00,000 per annum. Since the OECD solution leaves no room for this, domestic tax measures like digital service taxes adopted by countries should be allowed to tax this revenue.

Infringing on domestic prerogative: One of the commitments under the Approach also entails the removal of national digital taxes or levies imposed unilaterally by countries. Earlier, countries like India, due to the lack of a global consensus around taxing digital businesses, proactively introduced amendments to national tax law.[1] By expanding the scope of "permanent establishment"[2] to significant economic presence, India was able to introduce an equalisation levy of 6%, outside of taxing incomes, on digital services including advertisements, maintenance of digital space, etc (Committee on Taxation of E-Commerce 2016). The UN Committee of Experts on International Cooperation in Tax Matters in 2020 pointed out that "elements of the significant economic presence proposal" had not been reflected in the Approach, inhibiting developing countries from being able to introduce national measures in case a business fell out of the scope (United Nations 2020).

Jurisdiction and right to taxation: The inadequacy of the OECD compromise is all the more frustrating considering that a promising alternative approach has already been sketched out. Efforts led by the UN Committee of Experts on International Cooperation in Tax Matters earlier in the year ensured significant changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries. This included amendments to the definition of "royalties" under Article 12, insertion of Article 12B which permits "withholding tax" on gross income being derived from automated digital services (ADS) among other changes. This will allow the right of taxation to the jurisdiction where the actual economic activity takes place or services are performed and not the residence jurisdiction of the recipient of these services. Suppose a company headquartered in Ireland provides a service to an Indian entity owned by a Singaporean arm of that company to perform a service in Malaysia. This proposal would protect Malaysia's right to tax the income derived from this service despite the company not having a physical presence in Malaysia. Arguably, these changes are valuable for low- and middle-income countries which provide an alternative solution in being able to successfully tax ADS, software payments, etc, especially in cases where resident jurisdictions are tax havens.

Geopolitics of exemptions: It is important to note that the commitments under the Approach may potentially have implications on how these changes are incorporated in existing tax treaties. Further, sectors like extractives and financial services have been kept out of the scope of the Approach. United Kingdom (UK)—home to the City of London, one of the largest financial hubs that is at the centre of the offshore secrecy industry—lobbied hard for the financial services sector to be exempted including the global minimum tax deal agreed on by the Group of 7 (G7) (James and Thomas 2021). International financial services centres provide an optimal ground for facilitating illicit activities like money laundering, corruption, tax avoidance and evasion in how they are set up. With the rise of international financial service centres or disguised secrecy jurisdictions even in

the global South aimed at capturing onshore capital (Waris 2014), the justification to exempt the financial services sector is deeply questionable and merits interrogation. The loss of revenue via illicit financial flows to these centres would be damaging for developing countries, as they struggle to recover from the varying effects of the pandemic.

Dispute resolution: Although presented under the guise of upholding tax certainty, the mandatory and binding dispute prevention and resolution mechanism arising from any disputes under the Unified Approach are in particular a matter of concern for developing countries. This move especially has been opposed by various regional institutions and groups of the global South. The African Tax Administration Forum (ATAF) in response to the statement issued by the Inclusive Framework noted that

> there should be no form of Mandatory Binding Dispute Resolution mechanisms for transfer pricing and permanent establishment disputes included in the Pillar One rules for countries where there is little double taxation risk as this would impose a demanding and complex process on such countries. (ATAF 2021)

Structurally, dispute resolution mechanisms work against the interests of developing countries while protecting the superstructure of rich countries in the name of international cooperation. International dispute resolution mechanisms—with investor state dispute settlements (ISDs) being the prime example—are rarely ever aligned with human rights obligations and principles, including equality and non-discrimination, transparency, participation, accountability, redistribution among other relevant principles. A recent example of this is when an international arbitration tribunal overruled India's domestic decision to retrospectively impose a tax liability of $1.6 million on Cairn India for aggressive tax avoidance, after Cairn invoked the UK–India Bilateral Investment Treaty to challenge this decision. As of early 2021, Cairn has initiated several proceedings against India in the courts of US, UK, France and others. This international ruling, which is not representative of India's people, has infringed upon the existing sovereign and democratic mechanisms of India (Khetan 2021). Further, it is no surprise that by making the dispute resolution process as binding, the Approach encroaches upon the national and regional sovereign processes of countries in the global South.

Global Minimum Tax

This lack of fair redistribution in the Approach is problematic, especially considering how global South countries are still reeling with the debilitating effects of the second and third waves of the COVID-19 pandemic. Their immediate and substantial need for revenue cannot be ignored and yet this coopted multilateral process by the OECD lays down commitments where countries—barring a few—will have to relinquish their sovereign space. Intermediate and alternative proposals by developing countries that have surfaced in the UN Committee of Experts on International Tax Matters cater to the immediate demand for domestic resources in a more equitable manner (United Nations 2020).

One very publicised moment was when G7 countries—presenting themselves as vanguards of international tax cooperation—recently proposed a global minimum tax rate of 15% on a country-by-country basis. While this step was aimed at tackling profit-shifting by multinational corporations to lower-tax jurisdictions and curbing a race to the bottom, and has been hailed as "groundbreaking," in reality it is business-as-usual under a new guise. Further, the global minimum corporate tax rate is not comparable with the statutory corporate income tax rates of many developing countries. Corporate income tax rates are in fact much higher in developing countries. At the risk of the rate becoming a ceiling for domestic corporate taxes, the deal has a long way to go from aligning with human rights principles and true redistribution.

Taxation and Workers' Rights

Part of the arsenal of tools that tech giants like Uber have at their disposal is their ability to report routine profits as royalty payments or service fee by way of registering intellectual property rights (or non-routine profits)[3] in tax haven jurisdictions (Sonnemaker 2021). Thus, workers and end-users using the technology platform of Uber appear to be making "service payments" to the Netherlands from a country where Uber operates, that is, from where the actual activity took place (CICTAR 2021). This is an example of how a MNC shifts revenues arising out of a country where the economic activity took place to corporate tax haven countries[4] like the Netherlands to avoid paying their fair share of taxes. In a response to the Inclusive Framework statement, the South Centre (2021) also pointed out that the significant tax avoidance risks to developing countries are posed by incomes being reported as service payments.

Nevertheless, it must be noted that the zero-rate offered by the tax haven jurisdictions would be rendered ineffectual if MNCs were taxed as a single global entity and on a global tax rate ranging between 25% and 30%. Treating MNCs as a single global entity and not independent parties trading with each other is a crucial step towards offsetting the imbalance facilitated by harmful preferential regimes (like tax havens). As a proposal to reform the international tax architecture, governments in the global South, the UN High-level Panel on International Financial Accountability, Transparency and Integrity, and civil society coalitions too have advocated for a global minimum tax rate between 25% and 30% (Financial Integrity for Sustainable Development 2021).

More importantly, the formula apportionment proposed under Pillar 1 divides the "undertaxed" profits between market jurisdictions using only users and sales, not employment. Applicable on "residual profits" and not total global profits, the proposed formula has revenue implications for low-income countries. Low-income countries are likely to have higher number of employees in these companies, despite not being residence jurisdictions. The weight assigned to employment/employees in the formula used to allocate profits will prove to be beneficial for developing countries—a position that is also held by the Group of 24 countries. Employment, as a production factor, is a key link between allocation of taxing rights for the governments and workers in the global South which reflects the

economic value generated by these activities in the global supply chain.

However, what is often overlooked from a labour perspective for tech companies is how the nature of employment has changed. Only including employment or number of employees alone in the formula will not be enough. The fundamental problem is the categorisation of gig workers as "independent contractors" or "micro-entrepreneurs" and not employees. This gross mischaracterisation assumes that gig or app workers are in control of the conditions they work in and the profits made while abdicating any accountability on part of the platform businesses. Recognising "gig workers" as employees will have significant implications on how profits are allocated to developing countries. At present, various trade unions globally are challenging this very definition which informalises employment relations. This does not only mean that digital businesses are misrepresenting the number of employees they have but are actually undermining worker rights exposing them to exploitation and rewriting social contracts. This gradual process of "informalisation of labour," which threatens their social protection and security, as well as their bargaining power, parallels the changing ecosystem of how businesses operate. By indulging in abusive tax practices, MNCs are depriving countries of crucial revenue meant for public services which the workers depend on and impacting the progressive realisation of human rights of populations especially in developing countries. Thus, companies can have their cake and eat it while the populations of these countries suffer doubly—with insecure jobs and livelihoods, and diminished public resources.

Conclusions

Global tax reforms are important so that profits and revenues are distributed to jurisdictions where the real economic activity takes place. This will ensure the reversal of the practice of extraction from the global South that has meant starving their domestic public services of resources. The current process initiated by the OECD is historically tainted with neocolonial geopolitics, and its capture by private actors. For a start, the deal does not bring companies like Uber and Amazon under its ambit which are not only structured via tax havens but are widely known for their exploitative practices towards workers. These companies, however, may be subject to various other digital taxes on services, which would be foregone if and when the deal comes into play. To add to this, the underlying data reported by MNCs on a country-by-country basis remains largely opaque and outside public scrutiny. By pushing this approach, the countries in the driving seat of the OECD are narrowing the possibilities for human rights realisation in the global South and acting against their own human rights obligations under international statutory instruments (Center for Economic and Social Rights 2020).

Therefore, it cannot be stressed enough—a progressive global tax agenda ensures a fair and transparent allocation of taxing rights, bearing in mind the needs and rights of workers and communities that businesses truly rely on.

NOTES

1 This third option was introduced as it could be implemented under domestic tax laws without requiring too many tax treaty changes.

2 The international tax regime would operate in a way where foreign companies would be required to have a "physical presence" in a jurisdiction to have "Permanent Establishment." This meant developing countries would lose revenue since they would be unable to tax profits by multinational companies based out of a different residence jurisdiction (mostly developed countries) who could book their incomes in low-tax or residence jurisdictions. The evolution of the definition of "Permanent Establishment" to "significant economic presence" is indicative of how digital businesses work.

3 Routine profits are locally generated profits. Non-routine profits include royalties arising from the use of intellectual property.

4 See Corporate Tax Haven Index (2021), https://cthi.taxjustice.net/en/.

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