WORKING PAPER

Half Measures: Global Digital Tax Proposals Fall Short of Realizing Human Rights

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Recent global tax reform proposals take aim at the inadequacy of the existing international corporate tax regime. In theory, they aim to end aggressive tax avoidance by multinational enterprises. Do they actually achieve this? How will real people, their lives and rights be affected? This working paper analyzes the recent OECD global tax reform proposals from a human rights lens. It includes a special focus on the impact on Global South countries, those most negatively by the current system. It explores how the proposals' objectives are not currently achieved, and calls civil society organizations from all issue areas to push for a truly transformative reform.

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Introduction

In April 2008, newly-appointed Facebook COO Sheryl Sandberg wrote an email to the company's executives advocating an alteration to its tax strategy, noting, "my experience is that by not having a European center…it is very costly in terms of taxes." She advised that the company should locate in "a low-taxed jurisdiction to park profits" (Kiel, 2020). Just a few months later, Facebook shifted its international headquarters to Dublin, Ireland, whose 12.5% corporate tax rate is among the lowest in the world and is used by numerous multinational corporations to dodge tax liabilities. Over the next several years, Facebook also established subsidiary companies based in the Cayman Islands, funneling an estimated $645 million to the tax haven in 2012 (Garside, 2013).

Facebook's activity is emblematic of the challenges related to international tax in an increasingly digitalized economy. Under current international tax law, multi-national enterprises (MNEs) utilize their wealth and influence to exploit digital taxation loopholes and differing national tax rates to avoid paying their fair share of taxes. The International Monetary Fund (IMF) estimates that $600 billion (USD) in revenue is lost each year due to tax avoidance, and low-income countries in the Global South suffer disproportionate revenue losses. The IMF estimates that low-income economies alone account for $200 billion of that lost revenue, eclipsing the $150 billion they receive each year in foreign assistance (Shaxson, 2019).

Multinational enterprises (MNEs) are able to engage in abusive tax practices because existing international tax law requires companies to have a "physical presence" in a country in order to be classified as having permanent establishment in that jurisdiction, and thus to have its profits taxed there (Ovonji-Odida *et al*., 2020). Highly digitalized businesses, such as Uber, Facebook, Amazon, etc., have continued to lobby international economic governance spaces, arguing their online services in developing countries do not meet the criteria under the physical presence test (despite being used by many residents in those countries and creating economic value).

The inadequacy of the existing international digital tax regime has not gone unnoticed. Recent proposals to address the tax challenges arising from the digitalization and globalization of the world economy include a G7 proposal to establish a global minimum tax on corporate incomes, under the Organization for Economic Cooperation and Development's (OECD)

"Inclusive Framework on BEPS (base erosion and profit shifting)." This framework aims to eliminate aggressive tax avoidance used by MNEs that exploit gaps in international tax rules and incorporates various UN Tax Committee proposals aimed at increasing taxation of the global economy.

This working paper looks at the recent OECD global tax reform proposals in the context of the realization of human rights. The paper examines the relevant details of the tax reforms particularly from the perspective of Global South countries which disproportionately suffer the brunt of inadequate resource collection as a result of the current international financial architecture. Further, the paper analyzes how human rights law and principles can be followed and incorporated into the proposals to ensure greater equity and support for human rights enjoyment. It also explores critiques made by various actors and Global South countries which expose the gaps in the OECD's Pillar One and Two Framework. Finally, the paper offers a review of the current state of the international taxation regime and explores alternatives that could benefit Global South countries that are put at a disadvantage under the current international tax system.

G7-led Minimum Tax Proposal

The Details

On June 5th, 2021, following the G7 summit in London, finance ministers from the world's seven wealthiest nations unveiled an agreement on global corporate tax reform—heralded by various media organizations and top officials as "groundbreaking" and "seismic" (Starling, 2021). The plan articulated the G7's intention to set a global minimum tax rate of 15% for corporations on a country-by-country basis. US Secretary of Treasury Janet Yellen released a statement praising the plan, asserting that it would "end the race-to-the-bottom in corporate taxation, and ensure fairness for the middle class and working people in the U.S. and around the world" (Yellen, 2021). Other finance ministers indicated that the plan signals an effort to end tax avoidance practices such as profit shifting and tax havens, ensuring a more level international playing field.

Human Rights Analysis and Recommendations

From a human rights perspective, the G7 Minimum Tax Proposal was inadequate and illegitimate for several reasons. First, it failed to give a voice to the vast majority of the world's sovereign nations while concentrating the decision-making powers concerning international corporate taxation amongst seven of the wealthiest and most powerful countries in the world. It is important to note that the International Covenant on Economic, Social and Cultural Rights (ICESCR), to which the majority of G7 countries are a party, compels states to utilize "maximum available resources" to realize human rights (ICESR, 1976). Additionally, the UN Universal Declaration of Human Rights guarantees everyone a "social and international order favorable to realizing their human rights" (United Nations, 1948). These and other human rights treaties combine to impose extraterritorial obligations on nations to respect, protect, and fulfill human rights.

Several of these wealthy countries have been held accountable by international human rights bodies for violating these extraterritorial human rights obligations by serving as tax havens. For example, the UN Committee on Economic, Social, and Cultural Rights found that the UK's financial secrecy and corporate tax policies were "affecting the ability of the State party, as well other States, to meet their obligation to mobilize the maximum available resources for the implementation of economic, social and cultural rights" (UN Committee on Economic, Social and Cultural Rights, 2016). Financial secrecy allows wealthy individuals and companies to pay lawyers and accountants to utilize trusts, foundations, and shell companies to hide ownership of their assets from tax authorities. As noted by the Tax Justice Network, "this creates one rule for the wealthy and powerful (who can afford to pay…) and another set of rules for everyone else" (Knobel, 2020).

Forcing nations that offer these tax loopholes to be answerable to unambiguous and specific human rights treaties is a superior accountability process than binding dispute resolution mechanisms that favor wealthier parties that can afford to engage in lengthy and expensive legal battles. For example, in 2016, the UN Committee assigned to oversee compliance with the Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW) criticized Switzerland for the impact its financial secrecy and corporate tax policies have had on women's rights. As a party to CEDAW, Switzerland is legally obliged to avoid fiscal policies that are

detrimental to the rights of women, both domestically and abroad. However, Switzerland's cross-border tax abuse clearly had damaging consequences to women in countries in the Global South, such as India and Zambia. According to the Center for Economic and Social Rights (CESR), "reasonable estimates suggest that the Indian government lost out on between US $492 million and $1.2 billion in direct tax revenue from the funds held in just one bank branch in Switzerland—comparable to as much as 44% of the country's expenditure on women's rights….in the country in 2016." Similarly, in Zambia, copper mining companies' ability to shift their profits from Zambia to Switzerland led to losses of $326 million annually, which is equivalent to approximately 60% of Zambia's annual healthcare budget (CESR, 2016). Analyzing Switzerland's fiscal actions from a human rights perspective makes clear the destructive impact of these policies. When government resources are drained due to financial secrecy and tax avoidance, women and other historically marginalized groups suffer most critically because they rely on government-funded programs.

If the very countries that currently offer multinational enterprises digital taxation loopholes are the sole architects of the new minimum corporate tax, it is impossible for the proposal to be legitimate or address the inequalities that exist within the current system. The Principles for Human Rights in Fiscal Policy (a distillation of fiscal human rights principles created by human rights and fiscal policy experts from Latin America) affirm that "no State…should be subject to a regulatory regime…that has been built without offering opportunities for participating in its creation, according to the right of self-determination" (CESR, 2021). Taxation, as a policy instrument that has increasingly become multilateral, requires a democratic process with equal participation and redistribution at its heart, which the Inclusive Framework process clearly violates.

Beyond process and legitimacy concerns, the actual outcome of the G7 Minimum Tax Proposal is inadequate. The 15% rate is well below that of most nations, meaning that the "minimum" rule as currently proposed actually incentivizes countries to treat the 15% number as a ceiling rather than a floor. The "race to the bottom" that Yellen posits will be avoided through the G7 Minimum Tax could actually be accelerated because countries with higher rates would be forced to competitively lower corporate tax rates to the 15% minimum. The EU Tax Observatory recently released a study indicating that a global minimum corporate tax rate of 15% would provide minimal (if any) fiscal gains for developing countries: $1.1 billion annually for Brazil, $0.6 billion for India,

and $0.7 billion for South Africa. In contrast, the study found raising the global corporate minimum tax rate to 25 percent increased those gains to $9 billion for Brazil, $1.83 billion for India, and $3.65 billion for South Africa (Financial Transparency Coalition, 2021).

This minimum tax proposal later became Pillar Two of the OECD's proposed solution. The proposal will disproportionately benefit wealthier nations by giving resident jurisdictions first priority in taxing the undertaxed profits of MNEs (Ovonji-Odida et al., 2020). Global North countries normally serve as the resident jurisdiction for the vast majority of corporations, which means they collect an unfair and oversized share of benefits from corporate taxation. The current international tax regime expressly violates the rights of populations of low and middle-income countries to equitable development and taxation. Article 3 of the 1986 UN Declaration on the Right to Development compels all states to ensure "developing countries have the appropriate means and facilities to foster their comprehensive development," and Article 4 of the same document requires that states "fulfill their duties in such a manner as to promote a new international economic order based on sovereign equality…and cooperation" (United Nations, 1948).

This sovereign equality and cooperation cannot be achieved by continuing to allow wealthier and more powerful countries to have first priority in taxation rights.

One way to alter this is by changing the distribution of taxing rights between Global South countries (where economic activities often take place) and wealthier Global North countries (where companies are often based). As noted by the South Centre, developing countries are the worst affected by tax avoidance and illicit financial flows and thus should receive the first claim on taxable revenues (Ovonji-Odida et al., 2020). Tax experts from the EU Tax Observatory estimate that implementation of a proposal which combines a rate of 25% with a more equitable distribution could lead to Brazil annually gaining $18.1 billion, India $21.9 billion, and South Africa $6.05 billion (FTC, 2021). This loss of revenue undermines the redistribution of resources towards public services that are crucial for vulnerable populations. Allowing this unequal distribution of taxing rights to continue unabated will only widen the already large gap between the world's wealthiest and poorest populations.

[1] "Resident jurisdiction" refers to the jurisdiction in which a corporation is treated as a resident for tax purposes (usually the place of incorporation or headquarters).

The OECD's "Inclusive Framework": How Inclusive is it?

In January 2019, the Organization for Economic Cooperation and Development (OECD) released a four-page policy document advocating for a "two-pillar" approach for addressing the challenges of the digitalized global economy. As the first substantive re-examination of global taxation rules since the League of Nations in the 1920s, the OECD's "Inclusive Framework" proposal has missed a historic opportunity to establish a fairer and more equitable global tax system that works for all and not a few.

The Inclusive Framework is an international taxation proposal which 137 member jurisdictions have endorsed, and which essentially has two pillars. Pillar One seeks to alter the "physical presence" nexus for taxation, referenced above, to instead create taxing rights even in the absence of a company's physical presence in a jurisdiction. Pillar Two seeks to establish a global minimum corporate tax rate similar to the one proposed by the G7 above. The OECD estimates this two-pillar solution would result in an annual increase in revenue collection of $125 billion (OECD, 2021). However, it should be noted that this figure is dwarfed by the estimated $500-600 billion lost annually due to tax avoidance (Shaxson, 2019). Additionally, according to the OECD's own calculations, high-income countries are set to receive higher tax revenue gains than both middle and low-income countries under the two-pillar framework.

Human Rights Analysis and Recommendations

In a human rights context, the OECD Inclusive Framework (IF) shares many of the procedural inadequacies of the G7 minimum tax proposal. Membership in the IF is open to jurisdictions rather than sovereign nations, meaning many powerful nations have an overrepresented voice. For example, the South Centre notes "the United Kingdom has an astounding eight jurisdictions in the IF which are a mix of crown dependencies and overseas territories" (Ovonji-Odida et al., 2020). Investigative leaks like Pandora Papers too offer insight into how the City of London is at the center of the global financial offshore industry. Therefore, the involvement of 137 jurisdictions is only inclusive on paper. Many low-income countries that suffer from unfair digital taxation in reality lack a voice in the IF process. Specifically, a large number of African countries are not a part of the IF, including Algeria, Ghana, Uganda, and

and Zimbabwe. This process once again violates the Principles for Human Rights in Fiscal Policy's expression that sovereign nations have a right to make decisions regarding their own fiscal policy. As India's representative stated at a special meeting of the UN Economic and Social Council on tax affairs, "calling a process inclusive does not make it so" (United Nations, 2019).

Another human rights issue in the Inclusive Framework is the lack of transparency in decision-making. The Maastricht Principles on the Extraterritorial Obligations of States in the Area of Economic, Social, and Cultural Rights (a distillation of states' extraterritorial obligations in the fiscal arena) clarify that states must "observe international human rights standards, including… the right to participate in decision-making… as well as the principles of… transparency and accountability" (Maastricht Principles, 2011). The IF violates these principles by its near-total absence of formal rules regarding decision-making and procedure. OECD documents describe in vague terms a decision-making process for tax purposes that has a "two-layer structure." The first level includes working groups of member jurisdictions (which have limited developing country participation) and the second level, the Committee on Fiscal Affairs, reaches decisions on an unclear basis of "consensus" (Ovonji-Odida et al., 2020). This lack of transparency inhibits criticism and input from less influential and less represented developing countries. Despite this, 136 jurisdictions endorsed the global tax agreement by October2021, with the exceptions of Kenya, Nigeria, Pakistan and Sri Lanka (OECD 2021).

Brief Explanation on the Pillars

Pillar One outlines a new tax design that allows jurisdictions the right to tax irrespective of a company's physical presence within the region. The new taxing right ostensibly allows for multinational enterprises to be taxed according to their participation in local economies. However, as noted by the South Centre, the current number of thresholds that a company must overcome to qualify to be taxed for their economic presence in a region is much too high (Ovonji-Odida et al., 2020). Under the current mass of thresholds, hardly any but the largest companies in the world will qualify for the tax, and even those companies will likely pursue litigation strategies to avoid taxation under the rules.

OECD released Model Rules on Pillar Two in December 2021. These rules have been criticized not only for being overly complex, but for prioritizing taxing rights according to the residency of a top

parent entity, which is likely going to be located in a tax haven, over the taxing rights of source countries (most likely a Global South country). This means that tax havens like Ireland and other such conduit countries will receive the first right to tax the MNE's undertaxed profits, rather than the jurisdiction where the real economic activity of the MNE actually takes place, i.e., where the employees, users and assets are. Moreover, it is unrealistic to expect countries to implement these rules without ensuring that they undergo appropriate parliamentary and public scrutiny. The EU draft directive, for example, is said to have adopted its own modifications to the OECD Model Rules on Pillar Two andthe UK has reserved its right to tax diverted profits. Low and middle-income countries who have signed on to the agreement are encouraged to and adopt tax measures that work for them.

Additionally, it should be noted that developing countries have a sovereign right under international law to undertake national measures to tax the digitalized economy. As noted in George Melo's critique of the OECD, "[t]he decision to tax or not to tax and the manner in which to tax within domestic borders is one that has always been within the absolute discretion of each sovereign" (Ring, 2008). Even the OECD's own literature affirms this sovereign right. Its 2015 memo, 'Addressing the Challenges of the Digital Economy', notes that countries could "introduce any of… [the] options [including the imposition of equalization levies and of withholding taxes on digital transactions] in their laws as additional safeguards against bilateral erosion and profit-sharing, provided they respect existing treaty obligations" (OECD, 2015). However, the OECD Inclusive Framework aims to take away this right to engage in unilateral taxation under the two-pillar solution which does not cater to the concerns of Global South countries.

In 2016, the Indian government had imposed an equalization levy of 6% on digital advertising services. A 2% levy on non-resident e-commerce players was imposed in 2021. This levy raised over $204 million in the fiscal year (Seth, 2021). According to a report by the Financial Transparency Coalition (FTC), under the G7 proposal India would be forced to forego that revenue, with the United States already threatening trade sanctions on India if it continues to impose the equalization levy (FTC, 2021). Indeed, within weeks of the announcement of the Inclusive Framework, both France and the EU indicated their intent to repeal or halt negotiations on their own national digital taxes in favor of the OECD's international approach, under pressure from top US fiscal policy officials including US Treasury Secretary Janet Yellen. This infringement on states' sovereign right

to tax is not only a violation of international law, but it particularly harms Global South countries because it prevents them from taxing in a way that maximizes their resource allocation.

Finally, the current Inclusive Framework proposal lacks an organized structure for dispute prevention and resolution. Given the complicated nature of the new taxation regime under Pillar One, disputes will inevitably arise between countries, which will impose high arbitration costs. The OECD has appeared to indicate that recourse would be to mandatory and binding arbitration mechanisms, stating in its proposal, "Multinational enterprises will benefit from dispute prevention and resolution mechanisms…solved in a mandatory and binding manner" (OECD, 2020). This approach disadvantages poorer countries with fewer resources to dedicate towards litigation. The Financial Integrity for Sustainable Development (FACTI) panel recently published a report which publicized a litany of negative issues that have arisen from mandatory binding arbitration in an investor-state context. These issues include tensions between arbitration processes and the sovereign right of states to enforce tax rules, the possibility of unfair outcomes and biased arbitrators, the lack of transparency in the arbitration process, and concerns about the cost of arbitration and lack of resources.

As suggested by the FACTI Panel, less costly alternatives to arbitration, such as mediation and conciliation, should be considered (FACTI, 2021). Ultimately, the Inclusive Framework should strive to create clearer and more equitable rules towards global taxation so as to prevent disputes, and it should offer impartial and transparent dispute resolution mechanisms in its proposal.

Conclusion

The Current Landscape

As things currently stand, these major international reforms will be implemented in law by 2023 by countries that have agreed to the Two-Pillar solution, despite the refusal of Kenya, Nigeria, Pakistan and Sri Lanka – coincidentally all countries from the Global South – to agree to the Solution. Their reservations are not unfounded. The recent release of the OECD Model Rules on Pillar Two reveals how the objectives of what the BEPS project originally set out to do remain unachieved and, in many cases, unresolved.

Certain countries and several human rights organizations have issued statements either rejecting the Inclusive Framework or calling for further deliberation. Shortly after the G7 announcement, a trio of African civil

society organizations released a statement calling for a rejection of the tax deal. Their statement criticized both the exclusion of developing countries as well as the inadequacy of the 15% tax rate in resource collection, particularly with regard to African countries' debt servicing abilities (Tax Justice Network Africa, 2021).

The African Tax Administration Forum (ATAF) has expressed similar concerns, advocating that the minimum rate be raised to at least 20%. The ATAF also emphasized the importance of corporate taxation revenue for Global South nations, noting that "corporate income tax represents a higher share of tax revenues and GDP in developing countries than in rich countries." Similarly, India's Finance Ministry released a statement stressing that "some significant issues [in the Inclusive Framework], including share of profit allocation and scope of subject to tax rules, remain open and need to be addressed" (Indian Finance Ministry, 2021). These statements make it clear that many members of the international community believe that significant issues lie ahead despite the so-called "agreement".

Alternative Measure and Improvements

As demonstrated above, the international digital tax landscape is still a long way from being fair and equitable for all countries. It is important that any international policy enacted in this field be exhaustively and democratically critiqued and discussed (particularly since the current OECD agreement does not allow for any review of its terms until at least 7 years after the agreement comes into force). The Independent Commission for the Reform of International Corporate Taxation (ICRICT) describes the Inclusive Framework as "a missed opportunity", and argues that it "falls short of the comprehensive reform the world needs and does not reflect the demands that developing countries have made…for a bigger and fairer reallocation of taxing rights" (ICRICT, 2021). Thus, it is vital that both alternative measures and improvements to the Inclusive Framework be analyzed and discussed.

One alternative measure to the OECD Inclusive Framework is the United Nations' proposal on taxing automated digital services. Numerous human rights organizations have called for the establishment of a UN tax body to overhaul the international tax framework, and international tax work within the UN is ongoing.

In April 2021, the UN Committee of Experts on Tax Matters approved a recommendation to add Article 12B to the existing UN Model Tax Convention. Article 12B seeks to tax "automated digital services" through bilaterally negotiated tax treaties (Bansal, 2021). Essentially, Article 12B serves as a model for source countries and residence countries to negotiate taxes on automated digital services. The 12B method allows source countries to institute a withholding tax at a rate agreed to through bilateral negotiation. Alternatively, if this approach is too burdensome on a multinational enterprise, a tax can be levied based on the domestic tax rate of the source country.

Having the tax proposal formed under the auspices of the UN, a more inclusive multilateral body, allows for greater representation for developing countries. In 2018, the UN Group of 77 (a group of developing countries within the UN) released a statement demanding the UN Committee of Experts on International Cooperation in Tax Matters to be upgraded into an intergovernmental body under the auspices of the United Nations. As noted by the Financial Integrity for Sustainable Development (FACTI) Panel, "[i]nternational tax norms, particularly tax-transparency standards, should be established through an open and inclusive legal instrument with universal interpretation", and the Panel recommended that the international community initiate a process for a UN Tax Convention (FACTI, 2021). Ultimately, as urged by African civil society organizations in their statement critiquing the Framework, the reforms ought to be "inclusive, democratic, just, and transparent", which would be achieved by placing the process of global tax reform under the auspices of the UN (Ngeugan, 2021).

To begin with, there is a need to ensure that the global minimum tax of 15% should not be treated as a tax ceiling by countries. Countries must push to raise the global minimum tax (ideally to 25%, but at least to the 21% as proposed by the United States and Argentina), while prioritizing developing countries in the allocation of revenue (the G24, an intergovernmental group of emerging economies, has requested that developing countries have priority in taxing those profits shifted to tax havens). Global South countries also ought to be allowed a greater voice in the process, particularly with regard to dispute resolution mechanisms and ability to impose their own domestic digital taxes. Additionally, countries should adopt unilateral tax measures to raise more revenue in an equitable way where the Model Rules do not work for them. Ultimately, any international tax reform proposed in place of the Inclusive

Framework should aim to lessen the existing gaps in distribution of taxation rights and should be based on a fundamental respect for human rights.

In March 2022, the OECD is expected to release Commentary relating to the Model Rules on Pillar Two and the model provision for the Subject to Tax Rule, which is of particular importance to Global South countries. Human rights and economic justice organizations must continue to keep a close eye on the process, and amplify the call for a truly transformative reform of the global tax rules which would really allow the Global South the fiscal space they need to realize rights.

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