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Tatiana Falcão is a Policy Leader Fellow at the School of Transnational Governance at the European University Institute, specializing in international taxation and policy development. She was formerly at the Secretariat of the United Nations,

overseeing the work of the Committee of Experts on International Cooperation in Tax Matters, and is now a member of the Subcommittee on Environmental Taxation.

The views expressed are solely those of the author and do not necessarily reflect the views of the European University Institute.

In this article, the author reviews the major international tax policy developments of 2018 and assesses the progress of initiatives to tackle base erosion and profit shifting in both the developed and developing worlds.

If I had to enumerate the items that are dominating the international tax agenda, I would, of course, start with the taxation of the digital economy followed closely by the automation of tax assessment systems and the digitalization of processes. Next, there is the emphasis of transparency, and its relationship with corrupt practices and illicit financial flows. Transfer pricing is something of a supporting cast member — an important secondary issue in other debates, including policies on digital transactions and the transparency of cross-border relations. Another issue that is gaining traction amid automation and an increase in unilateral action by single states is environmental taxation — in particular, carbon

taxation — which could potentially address harmful emissions while also helping countries fund efforts in accordance with the U.N.'s 2030 Agenda for Sustainable Development.

I will explore each of these topics independently, but first I will consider the larger institutional picture, specifically looking at the role that the U.N. and the OECD play in international tax policy development.

The U.N., the OECD, and International Tax

The U.N. Inter-Agency Task Force on Financing for Development's (IATF) 2017 report¹ provides a substantive assessment of the progress toward the IATF's stated outcomes and the 2030 sustainable development goals. It is also a helpful tool for clarifying the different roles that international organizations play in international tax policy development.

The U.N. and the OECD are the only international organizations with policymaking competence or, to borrow the IATF's terminology, norm-setting competence. The other institutional stakeholders — namely, the IMF and World Bank — are active in the tax field, but generally offer policy analysis and advice at the national and regional levels. For example, they provide capacity-building programs, develop toolkits, and make objective recommendations to countries upon request.

Converging Interests and Membership Rosters

Historically, these institutions catered to different publics, with the OECD focusing on its membership of developed (or industrialized) economies while the U.N. served a larger,

¹U.N., "Financing for Development: Progress and Prospects — Report of the Inter-Agency Task Force on Financing for Development 2017" (May 22, 2017).

universal membership with a mandate to focus on developing country issues. However, recent developments have begun to change both the target audiences that the OECD and U.N. intend to reach and the appeal of international tax policies they formulate. This is the main reason for a degree of competition between the OECD and the U.N. in the tax arena.

In fact, one of the most intriguing side effects of the BEPS program was the OECD's increasing consideration of developing country approaches, interests, and practices. This can be seen in the interaction of the G-20 countries, the Global Forum on Transparency and Exchange of Information for Tax Purposes, and the Inclusive Framework on BEPS.

The OECD's increasing attention to developing countries — and particularly to middle-income, or emerging, economies — has intensified the competition between the OECD and the U.N. for resources, media coverage, and even for the leadership role in policy development. The BEPS program did not resolve the lingering question: Which international agency will take the lead in fostering the interests of developing countries? And the divide is likely to become even blurrier as the OECD expands the membership of the indirect framework on BEPS and increases its engagement with regional tax organizations. On October 25, 2012, the OECD and African Tax Administration Forum signed a memorandum of cooperation, agreeing to work together to improve tax systems in Africa.² Nearly six years later, on October 23, 2018, the OECD and the Inter-American Center of Tax Administrations (Centro Interamericano de Administraciones Tributarias, or CIAT) signed a memorandum of understanding documenting their intent “to continue their co-operation towards promoting fair and efficient tax systems and administrations to strengthen and modernise the international taxation administrative structures.”³

There seems to be competition for the leadership role at all levels of international engagement, but the two groups may still differ in

the level of participation afforded to countries at different stages of development.

Non-OECD countries that are members of the BEPS inclusive framework can influence the application of the BEPS program's policies — even if they were not invited to participate in making the underlying policies. The level of globalization in business relations means that the BEPS policies would have failed to have any impact on commerce or global norms if not for the admittance of non-OECD states. However, engaging these states in the implementation phase does not necessarily mean that there has been — or that there will be — a fair and level playing field in norm-setting.

On the other hand, the U.N. has always included all nations. It is (and always has been) the international organization with the largest number of member countries. It has not, however, taken the lead in tax policymaking and has, instead, followed in the footsteps of the OECD in most of the workflows related to BEPS. The result is quite surprising: We are seeing a convergence of policies toward a global common approach in many different arenas. Nowhere is this convergence of doctrines more apparent than in the application of the mutual agreement procedure articles of the OECD and U.N. model treaties, as I discuss in the following section.

Illustrating the Convergence: The MAP

The main difference between article 25 of the OECD model treaty and the U.N. model is that the former suggests including a compulsory arbitration clause to the MAP provisions, whereas the latter has historically put forward an optional arbitration provision. As such, the U.N. model contains two versions of article 25. States following the U.N. model can choose between alternative A (MAP without arbitration) or alternative B (MAP with mandatory arbitration) of article 25, meaning they can choose whether to adopt binding arbitration to resolve disputes arising with their tax treaty partner under the context of a bilateral tax treaty.

Following the conclusion of the OECD multilateral instrument, the distinction between the OECD view and the U.N. view on MAP and arbitration is no longer clear-cut. The enlarged reach of the policies administered by the OECD,

² See OECD, “OECD and ATAF Strengthen Tax Co-Operation With Africa” (Oct. 25, 2012).

³ See OECD, “OECD and CIAT Join Forces in Promoting Stronger Tax Systems” (Oct. 23, 2018).

and the need to cater to the particular needs of developing countries through the Inclusive Framework on BEPS, influenced the design of the MLI, making the application of the mandatory arbitration clause within the context of a mutual agreement procedure optional. This is the result even if the clause is not presented as optional in the OECD model.

It follows from the above that a country opting to follow article 25 alternative A of the U.N. model in its bilateral tax treaty negotiations could continue doing so while at the same time being a signatory of the MLI, simply by opting out of Part VI of the MLI.⁴

Although the OECD has not formally changed the language of its model treaty via the MLI, this concession exemplifies a step toward a more democratic, bottom-up approach to norm-setting in international tax policy, and it is in line with the solution proposed by the U.N. model.

Because the MLI only modifies bilateral tax treaties if both contracting states identify the treaty as covered by the MLI and both subscribe to the same provision proposed in the MLI, a mismatch in developed and developing country approaches — that is, if one party objects to Part VI of the MLI — means that the provision in the original treaty remains unchanged.

What does this signify? It means that every international organization that decides to cater to the needs of countries beyond simply a tight group of like-minded nations within the same levels of interest and economic development will experience the same problems that the U.N. has been delving into since the inception of the U.N. model in 1980.

With membership diversity comes greater complexity in the handling of tax issues and the drafting of tax policies: One-size-fits-all solutions become less feasible. That was the experience with the MLI, which had to foresee a range of different alternatives to cater to the needs of countries at different levels of commitment and economic development.

This changing reality also affected the revision of the transfer pricing guidelines to introduce the

commodities price method, a simplified method that emerged from developing country practices. The latest OECD transfer pricing guidelines make a concession to developing countries with the inclusion of the commodities price method — more commonly called the sixth method — as one variation of the comparable uncontrolled price method. By doing so, the OECD recognized this approach as one of the “authorized” transfer pricing methodologies. With this endorsement, the sixth method became mainstream: This is a positive outcome for the developing and emerging economies that were already applying it, as well as for other countries that are looking to adopt more streamlined, objective approaches to transfer pricing. The U.N. transfer pricing manual recognizes the sixth method as an independent method, raising it to the same level as all other — some would say more traditional — methodologies.

Ultimately, the assimilation of non-traditional practices and recognition of alternative approaches is likely to become a standard experience if the OECD continues to expand its membership to include emerging economies like:

- Chile, which became the first South American country to accede to the OECD in May 2010;
- Colombia, the 37th country to join the OECD in accordance with an accession agreement signed on May 30, 2018;
- Costa Rica, which has been undergoing the accession process with the OECD since 2015; and
- Brazil, which requested accession to the OECD in February 2018, although the OECD’s website does not list it as a country undergoing the formal accession program.

Further, the changing face of the OECD can be seen in — and will continue to influence — the debate on the digital economy. Originally, the OECD did not intend for BEPS action 1 to create a new international tax order to address digital activity. However, the debate has moved in that direction. What role will the G-20, the newest (and potential future) OECD members, and the members of the inclusive framework have in that debate? How can developing countries, for the first time since the creation of the inclusive framework, effectively influence the digital

⁴Tatiana Falcão, “Granting Juridical Autonomy to Article 25(5) of the Tax Treaty Model,” 4 *British Tax Review* 453 (Nov. 2017).

debate to ensure any potential new rules — rules that will no longer be designed by OECD countries for OECD countries — consider their unique needs? These questions are unresolved, but will be up for debate in 2019. It is the responsibility of international organizations, nongovernmental organizations, and the larger institutional stakeholders to make sure they get addressed.

The Digital Economy

The existing international tax framework requires some form of physical presence to give a country the right to tax an entity's income. This is the underlying premise behind article 7 of most double tax treaties and the source allocation rules, as well as the concept of a permanent establishment, whether the PE arises from the provision of a service, an agent's signing of contracts, or a physical establishment. Physical presence in a country is the key to establishing the country's right to tax corporate profits.⁵

The digital economy challenges this long-standing concept because the use of digital and non-physical networks allows multinational enterprises to be economically active in a particular country or region despite having little or no substantive physical presence therein. This new reality circumvents the rules that determine taxable presence and threatens to erode the tax base of source countries.

In this context, a source country is any country with a consumer market; the market does not need to be large or substantial. It simply requires an economically relevant consumer market that an entity can target remotely, through the internet, or through a mix of virtual and physical engagement. In this era of globalization, it is fair to say that all markets are subject to digital economic exploration.

Under the existing international tax framework, allocating taxing rights to a source or resident state is almost always synonymous with conferring taxing rights on a developing or developed country, respectively. The digital economy debate is changing that. For the first

time, the source-versus-residence split is not synonymous with the split between developing and developed countries, or between industrialized and emerging economies.⁶

Being able to capture rent from digital activity in a consumer market on a source basis is in the interest of every state. Thus, all countries have an interest in behaving like source states. The digitalization of the economy has spurred new debates on the establishment of nexus and economic substance in source states.

Nexus is essentially the criteria that connects a multinational enterprise's business profits to a location. There are numerous proposals for what should qualify as a nexus in the digital age. It could simply be the presence of a large consumer market in which the MNE operates. It could refer to an MNE's efforts to engage systemically in the economy of a country, use of local infrastructure, or delivery of goods or services to that country. Other suggested nexus criteria include the presence of a user base — notably, user base is not necessarily synonymous with consumer base because it may not be capable of generating value — or marketing intangibles.

Substance refers to the level of engagement in a particular economy. Basically, substance determines whether the interaction with a given economy is only incidental to the business — meaning it should not be subject to tax — or whether the interaction is intentional and directed toward a specific consumer market.

Some, myself included, have suggested that the digitalization of the traditional ways of doing business calls for a revision of the traditional ways in which we allocate income to source and residence states. I have argued in favor of creating a digital permanent establishment test, which would rely on the concepts of nexus and substance.⁷ Notably, however, taxing some digital business models might not require a total reformulation of existing international tax rules. For example, the existing international tax rules could be sufficient to allow the source state to

⁵ Falcão, "Taxing the Digital Economy — Policy Considerations and How to Advance the Debate," *Tax Notes Int'l*, Feb. 12, 2018, p. 623.

⁶ Falcão, "Taxing Online Advertising Services: Driving Policy Approaches From Case Law Analysis," *Tax Notes Int'l* (forthcoming 2019).

⁷ Falcão, "Taxing the Digital Economy," *supra* note 5.

capture the income that online advertisers generate.⁸

International bodies have yet to reach consensus on these matters. While the institutional stakeholders try to find a global solution, developed countries with large consumer markets are unilaterally taking steps to ensure that they can tax any profits that offshore digital enterprises derive from their domestic consumer base.

Recently, both the United Kingdom and Spain initiated formal consultations to assess the market impact of a unilateral digital services tax. In the United Kingdom, HM Treasury is considering the suitability of an interim 2 percent tax on digital services pending international agreement on a long-term solution.⁹ Likewise, the Spanish government issued a consultation exploring a 3 percent digital services tax on companies with an annual turnover above €750 million and Spanish sales in excess of €3 million. Meanwhile, the EU has proposed a draft council directive as part of a package of measures aimed at tackling businesses engaged in digital activities. Under the proposed directive, “on the common system of a digital services tax on revenues resulting from the provision of certain digital services” (COM(2018) 148 final), the EU would impose a digital services tax of 3 percent on companies with worldwide revenue over €750 million annually and annual revenue from EU digital activity over €50 million.

Many other countries are considering how they might address digital business activities using unilateral withholding taxes, turnover taxes, or the VAT system.

India — a leader among the middle-income countries when it comes to the development of novel approaches — has gone so far as to insert a “significant economic presence” test into its domestic tax legislation.¹⁰ This change enables India to negotiate for the inclusion of a new nexus rule based on a significant economic presence in double tax agreements moving forward.

The pieces of the digital economy puzzle were laid in 2018. Time will tell whether 2019 will be the year in which the international community will resolve the puzzle.

Unilateral Taxes: Fees for Technical Services

2018 also saw the release of the new U.N. model, which included a brand new article 12A on “fees for technical services.” If included in a bilateral treaty, article 12A — numbered to avoid disrupting the traditional numbering of articles in the model convention(s) — allows a contracting state to tax fees for specific technical services paid to a resident of the other contracting state on a gross basis at a rate negotiated by the contracting states. The relevant services are those of a managerial, technical, or consultancy nature.¹¹

The introduction of article 12A was among the most controversial agenda items that the U.N. Tax Committee of Experts has considered in recent years. Introduced at the request of developing nations, it creates a significant distinction between the U.N. and the OECD models. Under the OECD model — and under the U.N. model before the introduction of article 12A — income from services was taxable exclusively by the residence state unless the enterprise carried on business through a PE or fixed base in the source state.

Article 12A does not include any threshold — such as PE, fixed base, or minimum period of presence in a contracting state — as a condition for the taxation of fees for technical services. Therefore, from a policy perspective, it provides an incentive for an enterprise engaged in business in the source state to incorporate in that state to qualify for net income taxation on the technical services provided in or to that state. In that sense, it is an efficient tool to curb tax avoidance and evasion.¹²

Article 12A attempts to answer long-standing concerns raised by developing countries. But it does not fully answer all those concerns because it only allocates gross taxing rights on technical services — not services in general — although the

⁸ Falcão, “Taxing Online Advertising Services,” *supra* note 6.

⁹ HMRC, “Digital Service Tax: Budget 2018” (Oct. 29, 2018).

¹⁰ Indian Ministry of Finance, “The Finance Bill, 2018,” Chapter 3 (Direct Taxes), clause 4 (amendment of section 9), explanation 2A (Feb. 1, 2018); and Indian Ministry of Finance, “Provisions Relating to Direct Taxes, Finance Bill 2018,” (Feb. 2, 2018) (see explanation to clause 4, “‘Business Connection’ to Include ‘Significant Economic Presence’”).

¹¹ Falcão and Bob Michel, “Scope and Interpretation of Article 12A: Assessing the Impact of the New Fees for Technical Services Article,” 4 *Brit. Tax Rev.* 336 (Oct. 2018).

¹² Falcão, “The U.N. Model’s New Fees for Technical Services Provision,” *Tax Notes Int’l*, July 23, 2018, p. 367.

commentaries concede that some countries might want to expand the article to include all services by eliminating the word “technical.”

Regardless, article 12A is a first step toward more assertive source-country taxation that should help avoid the erosion of the source country’s tax base while also simplifying the administration of taxes at the source-country level.

A brief review of its application in the tax treaty context is sufficient to conclude that article 12A is extremely effective. An astounding number of treaties now in force or awaiting ratification contain an article like the U.N. model’s 12A, a development that occurred within a relatively short time frame. This demonstrates that developed countries have been willing to agree to a policy that developing countries sought out.¹³

Could a unilaterally devised withholding tax system — one that is effective in capturing rent on a recurrent basis and easy to administer — be the new normal?

Automation in Tax Collection

The digitalization of businesses and business transactions has also affected the way governments issue and assess taxes. This phenomenon can help relieve some of the pressures that tax administrations, particularly in developing countries, face in training and retaining personnel to assess and collect taxes.

The topic of automation of tax collection is related to several other movements in the international tax arena, including the emphasis on transparency in tax collection and enforcement, the increased exchange of information, and the overall goal of simplifying the process of charging and assessing taxes.

Climate Change

The U.N.’s 2030 agenda and the 15 sustainable development goals link together many of the topics discussed in this article, including automation in the collection of taxes, digitalization, and environmental taxation. These

three seemingly unconnected topics are now united by a common goal of mobilizing resources for sustainable development.

The economic impact of climate change is a topic that has already captured the attention of policymakers, and it is likely to become an increasingly important part of the international policy agenda reflected in the sustainable development goals. Although there is a specific goal for climate change, at least nine of the other sustainable development goals involve environmental protection. Many policymakers are now considering how to mobilize resources to protect against the harmful effects of climate change while also investing in new technologies that will help eliminate carbon dioxide emissions — the root cause of climate change.

The most objective — and direct — approach is simply to put a price on carbon. That can be achieved through a market-based approach. Emissions trading systems have been introduced in the EU (Directive 2003/87/EC), Canada (in Ontario and Quebec), and China (in 2018). Likewise, carbon taxes have been implemented in British Columbia, Denmark, Finland, Norway, and Sweden.

In 2017 the U.N. created the Subcommittee on Environmental Taxation under the framework of the U.N. Tax Committee and, in doing so, put the topic on its agenda for the next three years.¹⁴ The subcommittee began its work by looking at carbon taxes because they are recognizably one of the most effective instruments in changing consumer behavior.¹⁵ To the extent one can impose a higher tax on the more carbon-intensive product and a lower tax on the least carbon-intensive product, the tax alone provides a price incentive for consumers to shift to buying the least carbon-intensive fuels and products.

Further, carbon taxes are easy to administer, assess, and collect. Their imposition does not require auditing because the chemical properties of a fuel are enough to determine the carbon content of that fuel even before combustion.

¹⁴ Falcão, “Taking the Environmental Tax Agenda Forward: How the U.N. Committee of Experts Can Lead the Way,” *Tax Notes Int’l*, Mar. 5, 2018, p. 949.

¹⁵ U.N., Seventeenth Session of the Subcommittee on Environmental Taxation, “Environmental Tax Issues,” E/C.18/2018/CRP.14 (Oct. 2, 2018).

¹³ Falcão and Michel, *supra* note 11.

Therefore, as long as the tax is imposed at the uppermost level of the production chain, it can address all of the fuel's potential for pollution from the outset in an almost automated fashion.¹⁶ Not only is a carbon tax simple and capable of being applied with little oversight from the tax administration, it can generate revenues that can be used to advance the climate change cause — or address other items on the U.N.'s list of sustainable development goals, such as helping to eradicate poverty or improve education.

Several countries have introduced carbon taxes, and some have years of experience administering them. For example, many Nordic countries (Denmark, Finland, Norway, and Sweden) have relied on them for many years for many purposes, including revenue mobilization. Here, the U.N.'s role will be to bridge the gap between developed and developing countries and share success stories so that other countries can follow suit. This is especially important because, despite their many advantages, there are no examples of carbon taxes in the developing world.

The U.N. is taking the lead in developing a larger legal framework for the widespread application of carbon taxes. The OECD has monitored the application of environmentally related taxes for many years, but does not delve into policymaking in this field. The IMF is involved in environmental taxation as well, but it takes an economic approach to the topic.

In the wake of creating “new” taxes that can help meet goals set by the international community, raise revenue for development, and provide for the self-determination of nations by allowing them to keep sovereign rights over their tax basis, questions arise: What overarching principles should be observed? What is a fair allocation of taxing rights? Quotation marks are used to denote novelty because these are not new taxes, rather a tax basis that a particular policymaker has not yet addressed.

Before exploring this topic further, I will comment briefly on two other “new” taxes — cryptocurrency taxation and robot taxation — and discuss their potential effects.

Cryptocurrency Taxation

Arguably, the cryptocurrency market — along with other markets based on a virtual financial product including initial coin offering systems — is the product of several different yet interrelated phenomena, some of which are tax-related and others are not. If one had to locate the cryptocurrency market, it could arguably be placed at the intersection of the digitalization of services and markets, globalization of financial services, increased regulatory standards for the traditional financial services industry, and growing transparency measures.

Trading in cryptocurrency is, in part, a response to the tightening regulatory standards and higher transparency thresholds in the traditional financial and capital markets that have made it harder to disguise illegitimate capital flows and to hold previously untaxed income in a foreign jurisdiction. These more stringent standards may have inspired the development of a parallel deregulated financial market — a market that many now believe demands greater regulatory scrutiny itself as part of the BEPS project and related efforts.¹⁷

The characterization, taxation, and regulation of cryptocurrencies and cryptocurrency markets are policy issues that require urgent consideration. New measures should ensure parity between the taxation of digital and non-digital financial markets, hence increasing countries' ability to control these markets and collect revenue related to digital transactions. Failing to do so could result in substantial setbacks in the many achievements that policymakers have obtained to date, particularly through the various frameworks for increased transparency. A lack of regulation could increase the potential for illicit financial flows, tax evasion, and tax avoidance using blockchain technologies.

Also, the anonymity of the parties involved in blockchain transactions may make it difficult for tax authorities to identify the effective beneficiary of income or even simply trace the transaction back to one person or country, thus increasing illicit and criminal activities involving

¹⁶ Falcão, *A Proposition for a Multilateral Carbon Tax Treaty*, IBFD Doctoral Series (forthcoming).

¹⁷ Falcão, “A Token of Elucidation in the Taxation of Initial Coin Offerings,” *Tax Notes Int'l*, Aug. 20, 2018, p. 791.

cryptocurrency, including the untapped flow of financial resources arising from corruption and money laundering.¹⁸

Achievements like country-by-country reporting, the common reporting standard, the U.S. Foreign Account Tax Compliance Act, beneficial ownership registries, and heightened standards for exchange of information might all be rendered ineffective if the new digital financial market is not regulated.

Robot Taxation

Another question that repeatedly arose in international fora in 2018 was whether one should apply a tax to the mechanization of activities. The question is whether an automation tax — or a “robot tax” as it is popularly called — is a suitable solution to the impending (at least in theory) loss of jobs and funding for social security welfare systems if companies use robots as workers, substituting automated labor for human labor.

This discussion involves the concern that the development of artificial intelligence and further automation could lead to a loss of jobs and, as a result, the loss of personal income tax revenues and social security contributions.

To cut this subject short, I have always believed that if the objective of a robot tax is to make up revenue lost because of job destruction, there are other measures that could offset this loss without impairing technological progress. One familiar option: a carbon tax, discussed earlier in this column. A carbon tax would compensate for the lost revenue as a result of automation, while

also conferring a positive impact on the environment — a double positive and thus a much better solution to this impending problem, which is merely one of revenue generation.

Conclusion

The digital tax and trade revolution are happening at the same time as nations call for greater sovereignty and independence in the allocation and administration of taxes. This can be seen in Brexit, an increased allocation of territorial taxing rights in the United States, and the plea for greater allocation of source taxing rights in developing countries. Even as they fight for opposing interests, these movements all involve the will to keep the tax base domestic.

Policymakers will have to respond to these claims as they draft new normative approaches that can address all the issues brought about by a globalized, digital world.

Tax base allocation can stop the next major wave of immigration by preventing displacement due to climate change; it can increase nationally derived sources of revenue; and, to the extent formal employment increases, it should decrease the need for overseas development assistance. This will make nations more independent, increase economic self-determination, and enforce the sovereignty of nations¹⁹ — all while reinforcing the universality of tax regimes and the need for international tax coordination. ■

¹⁸ Falcão, “Coining Legal Terms for the Taxation of Virtual Currencies,” *Tax Notes Int’l*, Oct. 15, 2018, p. 289.

¹⁹ Falcão, “Linking Policies: Inter-Nation Equity, Overseas Development Assistance, and Taxation,” *Tax Notes Int’l*, Sept. 17, 2018, p. 1211.