

Comments on

Workstream B Article XX on the taxation of cross-border services

UN Tax Committee of Experts

ICC

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Introduction

The International Chamber of Commerce (ICC), as the institutional representative of 45 million companies in more than 170 countries, appreciates the opportunity to provide written comment on the published proposal on Draft Article XX on Dealing with Cross-Border Business Services.

We appreciate the international tax challenges brought about by the globalised economy and we welcome the possibility to constructively engage with the UN Subcommittee on the Digitalized and Globalized Economy and the UN Committee of Experts on this very important workstream. In the comments below we would like to outline industry concerns and comments in relation to this proposal and we stay available to answer any related questions and provide further information as needed.

As we expressed in our previous comments and during the 28th session of the Committee, the complexity of this proposal requires undertaking an economic analysis on the proposal's implications for all stakeholders and the global economy. We would also like to highlight that this submission has been drafted based on input and concerns received from ICC national committees in developing countries as well as member companies from emerging and developing countries.

Moreover, while the proposal is further discussed at the subcommittee level, we strongly recommend a structured and continued dialogue with the business community. As further indicated below, this measure will impact all companies, irrespective of industry sector, size of company, or geographic location. Please see the appendices which provide global examples from companies headquartered in Africa, Asia-Pacific, Europe, Latin America, and North America.

The proposed Article XX represents a fundamental shift and requires careful consideration to avoid rushing into an unworkable measure.

General comments

- The ICC business community would like to express its deep concerns on the proposed Article XX which will impact the rendering of services across a variety of industries, and not just the digital sector, as evidenced through our case examples in Appendix 1. The proposal in its current form is **extraordinarily broad, covering virtually all cross-border services** and will affect all industries and fundamentally shift the international tax system. Please refer to Appendix 1 which demonstrates nine case examples from a variety of business sectors that will be impacted.
- **Physical presence remains a key factor for the direct taxation of business profits**. Hence, taxing businesses that provide any service in a state where that business lacks any form of physical presence in that state would not be a successful approach. We would like to highlight the comments made by ICC Bolivia in Appendix 5, which summarise the challenges faced by Bolivia when it attempted to implement an approach similar to Article XX. It soon had to redefine the 'service' to encompass only a limited number of services due to the conflicts faced.
- We appreciate there are tax challenges from the digitalisation of the global economy, and acknowledge the concerns for developing countries. However, these particular concerns have been dealt with through the introduction of Article 12B (Income from Automated Digital Services) in the UN Model Double Tax Convention (UN MTC). While ICC members have expressed concerns also on Article 12B this will not be the topic of this paper.

- The suggested broadening of the taxation of services in the proposed Article XX goes way beyond updating the tax system for digital services. Article XX proposes to tax fees for *any* services regardless of where the service is performed and irrespective of the service itself. **The scope and breath of cross-border provisions of services that Article XX would capture is enormous.** This significant shift in the current treatment of services in the UN MTC requires careful consideration and an opportunity for stakeholders and impacted businesses to provide input.
- We are also deeply concerned that **these changes are being made prematurely, without any robust economic impact analysis** including on tax collections, trade and investment, and most importantly, implications to the global macroeconomy. The erosion of the standard for a permanent establishment (PE) will affect all businesses -- digital and non-digital, and could slow or inhibit business activities into certain jurisdictions. This could pose a huge compliance burden and tax cost for even just one day of service. This will also create tax uncertainty. **It will make the relevant jurisdiction adopting this article/changing their local tax laws less attractive for foreign investment**. Please refer to Example 2 within Appendix 1 demonstrating how business expansion may be inhibited through Article XX.
- We believe that the Committee should not take further action with respect to Article XX. Instead, the Committee should commission a well-researched discussion paper that considers the economic consequences to the market state of broad application of withholding taxes on services. In particular, we strongly recommend that such paper consider the effects on local economic development, the expected increase in prices charged, and the potential decrease of services provided to market state customers and the impact on tax revenue collection. Please refer to Examples 3 and 4 within Appendix 1 which demonstrate the potential adverse impacts of Article XX to likely unexpected industries and countries.
- When considering the content and placement of Article XX, we remind the Committee to be mindful of the role and purpose of a model treaty. The purpose of a model convention is to express a position on allocation of taxing rights that enjoys an appropriate degree of international acceptance. The fact that a model convention expresses accepted norms is essential for that model to carry legitimacy as the foundation for negotiations between contracting states. As a practical matter, there should be sufficient willingness of both developed and developing countries to consider and agree to a provision before it is included in the UN MTC. Including provisions that have little chance of acceptance raises questions of whether the UN MTC can continue to be used as a foundation for negotiation between countries.
- We consider Article XX should, at most, be included in the Commentary to the UN MTC as a potential alternative to consider in treaty negotiations. Articles 5(3)(b), 12A and 14 produce specific and tailored results for items of income described in those Articles. It is more likely that contracting states would desire to use as a starting point the more refined and specific provisions. A blunt provision like Article XX is appropriate only as an alternative described in the Commentary. In this context, there may be scope to further amend Draft Article XX wording to be more aligned to an acceptable standard of international tax framework that is appropriate for both developing and developed nations. For instance, incorporating a 'make available' condition which plays a vital role in safeguarding the interests of developed countries and indirectly of developing countries as well, by encouraging foreign direct investment flows from developed nations.

Specific comments

Physical presence

- We disagree with the statement in Annex B which states that '*These threshold and physical presence requirements are inappropriate conditions for source country taxation of cross-border services in light of new business models for delivering services.*' We still strongly believe that **physical presence remains a key factor for the direct taxation of business profits.**
- Removing the need to have physical presence and 183-day rule in relation to a services PE is a huge shift in international taxation with no sound basis or rationale for the change. Widely accepted international tax principles ensure that PE should have a degree of permanence before it gives rise to local taxation (i.e. temporary physical presence does not generally trigger a PE).
- We also disagree with the statement in Annex B which states that '*Article XX is an extension of the rationale for adopting Article 12B*'. The proposed Article XX is a fundamental shift for all types of businesses. This **new provision impacts traditional non-digital businesses** where physical presence is a value driver (e.g. professional services, retail etc.). The 183-day rule has many other practical benefits for non-digital income streams, e.g. for temporary relocations (which, since COVID-19, is a common business fact pattern), initial entering/testing of markets etc. This could be a huge compliance burden and potential taxation, even if just one day of service is required. Please refer to Example 2 within Appendix 1 in this regard.
- The erosion of the standard for a PE, means that **even activities occurring over a short period of time (e.g. brief meetings over several days) could potentially trigger withholding tax**. Not only will this subject companies to double taxation (depending on the ability to credit the additional tax suffered in the recipient jurisdiction), but the incremental risk could also slow or inhibit business activities into certain jurisdictions. This is a clear attempt to create a virtual PE (converting business profits into a new stream of withholdable payments).

Impact on developing countries and foreign direct investment

- Changes to physical presence tests and the proposed amendments to taxation of cross-border business services risk having **unintended consequences to developing countries' economies, in particular those that are exporters of services**. Please refer to Example 7 within Appendix 1 in relation to call service centres in developing countries which could be adversely impacted. Assumptions have been made that developing countries are net importers of services. However, international trade data shows that large amounts of service exports are now from developing countries, and the amount is increasing quickly.[1] Service exports from middle-income countries increased three-fold between 2005 and 2019, compared with a two-fold increase for high-income countries. Several developing countries were among the top 25 exporters of services in the world by 2019, including India and Thailand.

[1] World integrated Trade Solutions (WITS) and OECD-WTO Balanced Trade in Services dataset (BaTIS). See https://blogs.worldbank.org/psd/promise-export-led-services-growth-real

- While transportation and tourism have historically been the primary service export-led sector in developing countries, exports of other business services have grown discernibly fast for developing countries over the past 15 years. **Exports of telecommunications, computer, and information services quadrupled between 2005 and 2019, while those of other business services, such as legal, accounting, consulting, and engineering services more than doubled.** About one quarter of the global growth in the export of business services over the past 15 years was accounted for by developing economies. For example, ICT, finance, and other business services—which are all typically offshored and delivered remotely— accounted for more than 20% of the total exports of goods and services in Lebanon, Costa Rica, the Philippines, Ghana, and India.[2] As comments from Asian and African companies in Appendices 2 and 4 demonstrate, transforming and upgrading of the service sector is one of the key drivers of the overall economic development in developing countries.
- **Our global business community has concerns that such changes to physical presence tests or the expansion of taxation of cross-border business services will only stifle the growth of export-led services in developing economies.** The World Bank argues that export opportunities for developing countries will widen, but '*due to fewer restrictions on services trade, technology diffusion from digital platforms', and* an expanding list of multinational enterprises (MNEs) from developing countries that are exploiting export opportunities through outward foreign direct investment (which is the most dominant mode of services trade).
- Gross basis taxes like withholding taxes are a significant barrier to trade and do not distinguish between high- and low-margin/loss-making businesses, meaning that the rate (even a reduced rate under a treaty) could exceed the profit margin and make provision of the service uneconomic. Please refer to Example 1 within Appendix 1. This increases the cost of capital for businesses seeking to invest in the source country in question, and puts domestic and foreign owned local businesses at a competitive disadvantage with international peers when trying to procure services. While this trade barrier may in some ways be positive for some domestic service providers trying to compete internationally, it must also be considered that if it impacts foreign direct investments (FDI). It will give them a smaller pool of local businesses to source revenues from, and in our experience, there may not be burgeoning domestic markets across the broad spectrum of services that businesses may need to procure.

Scope and rationale

- In relation to passive and/or digital income streams – **applicable UN MTC** already exist. ICC members would welcome clarifications on which other types of payments would raise the Committee's concerns. A better understanding of the concerning transactions would enable us to provide more meaningful comments about appropriately scoped provisions to address those concerns.
- Annex B references base erosion and profit shifting as a motive for Article XX. In practice, **base erosion/profit shifting is rarely a motive for payments for services.** These types of payments generally follow genuine economic activity and are at less risk of abuse than other types of payments. And in any case, the Committee is not proposing the new article only applies to intercompany transactions. This should be updated if that is the intention. If this is the primary concern for developing countries, we believe it would be best dealt with through domestic anti-avoidance rules to capture artificial arrangements that are aimed

[2] OECD-WTO Balanced Trade in Services dataset (BaTIS)

at shifting profits. Please refer to Examples 3 to 9 within Appendix 1 which all show examples of third-party commercial payments which could be within scope of Draft Article XX, potentially unintentionally.

- In fact, many MNEs centralise certain routine activities in order to reduce their overheads. In other words, the objective is not tax planning but business efficiency. Securing a tax deduction for a business expense is then the natural consequence of centralising the function. These services are often low value services upon which a small profit is generated. Please refer to Example 1 in Appendix 1 which demonstrates the potential impact of Draft Article XX on such services and which is applicable to a wide range of businesses in different industries. If useful for the Committee to take an informed decision, we would remain available to provide some aggregate business data around the types of services that are charged cross border and the main countries in which the service activity takes place.
- Annex B also talks about an unlevel playing field whereby non-residents may have benefit over domestic service providers as they may be subject to no/low rates of tax on the payment in their country. If that is the concern here, **the wording of Article XX should be updated to target those non-residents that are not subject to tax (e.g. tax havens/low tax jurisdictions).** Otherwise, the risk of double taxation arises and the point around domestic providers being at a disadvantage to non-residents is moot. In fact, most of the time non-residents are at a disadvantage because withholding tax does not generally apply to in country payments. In all of the examples provided at Appendix 1, the recipient could be subject to headline rates of tax in its country of jurisdiction and the payment would still be within the scope of Article XX.
- Another key concern of ours in relation to the proposed amendment is that **no distinction is made between low- and high-value services or low-margin/loss-making and high-margin services**. If all types of services attract withholding taxes on gross receipts, without taking into account the costs or expenses incurred by a business in generating those receipts, this will have varying levels of impact to business' profitability and the global economy. A seemingly low withholding tax rate can translate into high effective tax burdens (please see Example 2 within Appendix 1). The corresponding effective tax rates will vary by profitability—the less profitable a company is, the higher their effective tax rate. This puts immense pressure on businesses, particularly those that are not yet profitable or with low profit margins. As mentioned, this could require them to pass on the cost of the tax onto ultimate consumers. Businesses that cannot do so could suffer serious financial distress or may be left with no choice but to exit the market or not to enter the market in the first place, to the detriment of consumer choice and investment in local ecosystems. If discussions on this topic do move forward, we recommend that there be more robust consideration with respect to the appropriate rate of withholding with respect to different categories of services that earn different profit margins. The establishment of any rate(s) should be left to bilateral negotiations.
- We understand that the Committee may consider including an election to be taxed on a net basis. While we appreciate the effort to provide a method of taxation that would take into account the profitability of taxpayers, if the intention is to model this after Article 12B, we note that the effectiveness of such an approach would depend on the specific terms negotiated between treaty partners. We also note that a net-basis option would need a streamlined administrative procedure. The administrative burden of filing in a particular jurisdiction and obtaining a refund can be significant and disproportionate to the tax collected. The Committee should also ensure that the net-basis election is available as a taxpayer right, rather than at the discretion of the local taxing authority.

- As noted by French business organisations (please refer to Appendix 3), currently Article XX could apply to flows between a branch and its head-office located in another jurisdiction, which would be undesirable. This possibility should be excluded within the Commentary. The Commentary should also make clear that 'fees for services' excludes payments such as interest payments (i.e. in addition to salaries, digital services and insurance payments that are explicitly excluded within Draft Article XX).
- As outlined by Asian ICC national committees in Appendix 4, another important issue to be addressed in the Commentary is in relation to the cost of equipment/parts used in relation to services provided by a service provider. Existing international tax principles support that the cost for equipment/parts should be excluded from the scope of 'fees for services', and it would be helpful for this to be clarified (covering also after-sales services).
- Also, there remain open items, as noted by the Committee (e.g. in relation to the interaction of Article XX with Article 8 and in relation to insurance services payments). These should be considered and clarified prior to any finalisation of the updated tax model.

Administrability

- The mark up on more routine centralised services is typically low and could not absorb a withholding tax levied on the gross payment, which would increase the pressure to contractually gross up for the withholding tax. This risks distorting the market price. If local corporate income tax filing is to be a genuine alternative to counteract 'over-withholding', this must allow for refund of the excess withholding tax which requires establishing efficient procedures allowing for a timely resolution of refund requests and prompt remittance in hard currency. Please refer to Example 1 within Appendix 1.
- Where companies currently bundle royalties and services it may be necessary in the future to unbundle and withhold separately for royalties and services if different withholding tax rates apply.
- For centralised services/cost recovery models there will be a potentially challenging issue if reimbursements of expenses are not specifically addressed, as there is generally little to no mark up on third-party expenses. It is already challenging with some large global service providers to insist on local to local country billing. If there are centralised billing arrangements this changes the incidence of withholding tax for these third party services.
- For countries that would impose very high withholding taxes on services with no effective economic relief from double taxation this could materially change the business case for centralised services. The likely consequence would be a review of the business operating model – potentially localisation of services, or in the alternative restructure of MNE presence in country (move to third-party distributor etc).
- In certain countries, the payment of withholding tax is a prerequisite for bank transfer authorisation. Banks become tax controllers and only validate currency transfers after payment of the tax. In such situations, withholding taxes become a new way to apply foreign exchange controls and implementing a further withholding tax to apply to all services will only make this administrative burden for businesses, worse. Please refer to the comments from French business organisations, at Appendix 3, in this regard.
- The inclusion of payments by an individual for services for personal use gives rise to administrability concerns (see, e.g., Example 5 in Appendix 1).

Double taxation, tax uncertainty, and a rise in tax disputes

- We believe the change will lead to a significant **increased double taxation and higher cost to doing business in countries** that adopt the new Article XX, particularly as one day of service in a country could trigger withholding tax and associated filing requirements. This means higher costs for non-residents doing businesses in the countries that adopt the UN MTC, especially given the proposal leads to local tax on *all* service payments (i.e. it is broadening the tax base). This will lead to higher consumer prices in those jurisdictions as businesses will not be able to take on this double taxation cost. It will make the relevant jurisdiction adopting this article/changing their local tax laws less attractive for foreign investment.
- Consideration also needs to be given to the interaction between the impact of Article XX with customs and taxes for services rendered in addition to a sale of goods, where services can also be subject to customs duties. If a withholding tax were to apply to the customs value involving services, that would also create double taxation. Please refer to Appendix 3 which shows comments from the French business organisations.
- We also **foresee a rise in tax uncertainty and tax disputes** with the proposed changes. We note that the reason for introducing Article XX is said to be *'simplification and increased coherence.'* Annex B states that the treatment of fees for services under existing provisions of UN MTC creates uncertainty in relation to characterising different types of payments and that the existing model may have resulted in difficult disputes. However, we find the new provision would actually increase administrative complexity for taxpayers and only bring about more tax uncertainty in an already increasingly complex international tax system.
- We believe the proposed amendment will actually make it more complicated for service providers and for customers of service providers. Aggregating clauses covering differing services into one clause is actually likely to lead to more uncertainty and tax disputes because it will mean a much wider payment base to review from a withholding tax perspective. In addition, there will be different interpretations taken by different countries in relation to what 'fees for services' encompasses.
- As noted in Appendix 6 (comments from Mining Company), the local tax administrations in the payor jurisdictions will become incentivised to argue that, on the one hand, services are of low value (to minimise corporate income tax deductions) but on the one hand high value (to maximise withholding tax). This brings unwelcome complexity and uncertainty. In fact, it is difficult to agree with source countries that intragroup services should attract high margins and therefore even a low level of withholding tax would not achieve a reasonable result, due to the interaction of gross vs net taxation as mentioned above (please refer to Example 1 of Appendix 1 which demonstrates this).
- If the Subcommittee moves forward regardless, we would welcome further engagement and strongly suggest that 'fees for services' is better and more narrowly defined to focus on the area of concern if this approach is taken.
- The proposed article also means countries have to agree on one withholding tax rate for all services covered by Article XX. So there is no longer the ability to have different withholding tax rates for professional services, technical fees, personal services, business services etc.
- The proposal also poses challenges for both service providers and service recipients who sign global services contracts. This model introduces complexity in cases with single contracts and dispersed resources and consumers – questions arise about who should withhold, how to withhold, and how to allocate income.

We note that many of the above points were raised by committee members during UN meetings that took place in October 2023.

We thank you for the opportunity to provide written comments and ICC remains committed to providing knowledge and expertise on behalf of the global business community as further needed.

Appendices

Appendix 1: Case examples

Example 1: Routine centralised services

Company A is a multinational business headquartered in Country A1. Company A centralises much of its governance, finance, human resource, IT and other services in Country A1. This means that these services are all provided in Country A1 on behalf of its subsidiaries that are located in different countries around the world (i.e. including a variety of developing jurisdictions where local presence has been established, which could cover jurisdictions from those in North/Central America such as Honduras and Mexico to those in East Asia such as Thailand and Vietnam).

The subsidiaries will therefore pay a services fee to Company A for undertaking this activity on its behalf. This is done for control and efficiency reasons, in particular since the head office of the company and its head office staff are located in Country A1. Company A itself does not have any physical presence outside of Country A1.

The services are considered low value and are charged at cost +5% margin.

Under existing Article 12A of the UN MTC, some of these services may not constitute 'managerial, technical or consultancy' services such that no withholding tax is due on the payment from the overseas subsidiary to Company A. For example, routine IT services, such as maintenance/training may not constitute services that involve the application of the service provider of specialised knowledge, skill or expertise on behalf of the service recipient.

However, under Draft Article XX, all of these centralised service payments will become subject to withholding tax in the payor jurisdiction.

The mark up on these routine centralised services is often low and therefore levying an additional tax based on the gross, intercompany service payment between the subsidiaries and its parent, Company A, makes it more costly and more administratively burdensome for Company A to do business in these local subsidiary jurisdictions. For example:

- Assume costs for a particular service of 100 generated by Company A. This is invoiced out to subsidiaries as 105 (per the 5% margin applied). This leaves taxable income of 5 in Company A which results in 1.25 tax in Country A1 (assuming a 25% tax rate).
- Assume Article XX imposes a 10% withholding tax on the payment of the invoice of 105 by the subsidiary of Company A. Withholding tax (WHT) of 10.5 is due. The net amount received by Company A is 94.5.
- In the event the WHT of 10.5 is creditable in Company A against its Country A1 tax liability of 1.25, the overall tax suffered by Company A is 10.5. **This represents a 210% tax rate on the profit of 5 generated by providing the service.**
- In the event the WHT is not creditable by Company A against its Country A1 tax liability (e.g. because there is no treaty between the countries and/or because the subsidiary country has introduced a unilateral measure based on Article XX which is not consistent with an existing treaty), the total tax cost is 11.75, **which represents a 235% tax rate on the profit of 5 generated by providing the service.**

A likely outcome is that the local subsidiaries of Company A will increase their prices charged to local consumers in the subsidiary jurisdictions to make up for the additional withholding tax suffered.

Example 2: Testing of the market

Company B is in the retail industry and resident in Country B2. It operates a retail and consumer services business, and after having undertaken some market research, it has decided to expand its services into Country C2 due to the opportunities in that market (for example, jurisdictions such as Sri Lanka, Maldives, Jamaica where tourism opportunities can be high).

In order to test the market further, Company B would like to establish a short term 'pop-up' services shop in Country C2 to determine consumer demand and local customer preferences. The short-term pop-up shop would be open and operating in Country C2 for a period of three months by employees of Company B who would temporarily travel from Country B2 to Country C2. After this initial period, Company B will make a decision as to whether it should permanently set up operations in Country C2 the following year.

Under the existing UN MTC, the short-term pop-up services shop should not constitute a services PE in Country C2 as no services are provided in Country C2 for a period of 183 days in a 12-month period. It is also assumed that no other permanent establishment is created (e.g. through a fixed place of business or dependent agency PE).

However, through the removal of Article 5(3)(b), Company B may not be able to undertake the above plans to test the market in Country C2 without onerous taxation and additional compliance, even if the ultimate decision was made not to permanently expand into Country C2.

This would lead to:

- Burdensome administrative costs for Company B (including legal and advisory fees incurred to ensure compliance with withholding tax requirements in Country C2). This may deter Company B from permanent expansion into Company B for fear of dealing with a tax administration that is overly burdensome, inconsistent with taxation policies in developed economies, and difficult to navigate compared to other jurisdictions.
- Burdensome administrative costs for the tax administration in Country C2 who would need to administer the additional tax compliance for Company B noted above, (likely relating to small/nil amounts of taxes) and potentially shortly after de-register the company (if it decided not to permanently expand into the country).

Services payments from local customers to Company B would also be subject to withholding tax under Article XX. This would either lead to (i) high costs for local consumers of Country C2 if they were to bear the withholding tax cost or (ii) lower/nil profit margins for Company B if they were to bear the withholding tax cost. If Company B already generates low operating margins on its services provided, then bearing another cost in the form of withholding tax may not be a viable option if they are to expand into Country C2.

In addition, if Company B already pays tax in Country B2 on the service fees generated by customers in Country C2, Company B will suffer double taxation. Double tax relief may be unavailable depending on the double tax relief rules in Country B2. This again may provide a reason for Company B not to invest in Country C2.

Example 3: Third-party contracting

A global chemicals company (Company D) is resident in Country D1 and manufactures and distributes certain chemical products to customers worldwide. Country D1 could be South Africa in this instance where some of the country's largest businesses are global chemicals companies.

As part of its operations, Company D subcontracts certain activities to third parties in Country E (e.g. routine marketing services), which are assumed not to be subject to withholding tax under existing Article 12A of the UN MTC. Third parties in Country E are subject to tax on the service payments received from Company D, in Country E.

Company D considers Country E to have excellent resource to efficiently and cost effectively carry out the services provided, making it economical for Company D to outsource these activities.

Under the new proposed Article XX, payments made from Company D to third parties in Country E, for the routine marketing services will be subject to withholding tax. Such payments are genuine commercial, third-party payments where tax/profit shifting is not the driver of the payment.

The imposition of withholding tax on the services payment from Company D to third parties in Country E means that:

- Company D and its third-party service providers will need to decide which party should bear the withholding tax cost.
- Service providers in Country E may increase their service fees charged to Company D to either compensate for the additional withholding tax charged, or for the additional costs involved in engaging advisors to assess the tax credit position in Country E and for dealing with additional compliance.
- This could lead either to Company D increasing the cost it charges end users in Country D for its chemical products or for Company D to consider alternative business options (e.g. different service providers) which could disrupt business operations and potentially lead to other unexpected costs.

Example 4: Treasury transactions

Company E is a tax resident of Country E1 and undertakes mining operations. This example could be relevant for jurisdictions such as Brazil or China that house large multinational mining corporations.

To manage its treasury activities, Company E enters into hedging transactions with a number of counterparties, including financial institutions such as banks, tax resident in overseas jurisdictions.

Under existing tax treaties, only payments akin to interest are currently subject to withholding tax. However, under Article XX, other fees such as broker fees, transaction fees and hedging fees would also be taxed. This could impact discounting fees which are common strategy to increase cash in-flow from customer receivables. Additional taxes on these types of fees would make these strategies less appealing.

Example 5: Hotel bookings

An individual tax resident in Country F intends to visit Country G (e.g. a country that attracts and relies on tourism such as Dominican Republic, Cuba, Morocco, Maldives). In preparation of the visit, the individual books a hotel room in Country G. The individual makes a payment to the hotel, which is owned by a company resident in Country G, to reserve a hotel room.

Because the individual is resident in Country F, pursuant to Article XX (5), the fees paid to the Country G hotel would be considered to arise in Country F. Because the hotel is owned by a company resident in Country G, the fees would be considered paid to a resident of Country G.

Because the exemption for payments made by an individual for services for personal use of an individual was removed in the latest draft of Article XX, the fee paid by the Country F individual would be subject to tax in Country F under Article XX.

This would be a highly impractical result, especially from an administrative perspective, for individuals making such payments. This result could also significantly increase costs for market state individuals to travel abroad, making those travel jurisdictions less attractive.

Example 6: Guarantee fees

A company in Country H engages a financial institution resident in Country I to provide a guarantee. The company in Country H makes guarantee fee payments to the financial institution in Country I.

Because the company is resident in Country H, pursuant to Article XX (5), the fees paid to the Country I financial institution would be considered to arise in Country H. Because the financial institution is resident in Country I, fees paid by the Country H company would be considered paid to a resident of Country I.

Thus, the fees paid by the Country H resident to the Country I financial institution for the provision of services (for the guarantee) would be subject to tax in Country H under Article XX.

Imposition of withholding tax on these types of fees would increase the cost of financing for local projects in the market jurisdiction.

Example 7: Call centre services

A company resident in Country J has engaged a third party in Country K to provide call centre services. Country K could be representative of various developing economies such as Costa Rica, the Philippines, or India which are all primary locations for call centre services.

The Country J company compensates the Country K third party on a cost-plus basis and makes payments on a monthly basis.

Because the company is resident in Country J, pursuant to Article XX (5), the fees paid to the Country K third party would be considered to arise in Country J. Because the third party is resident in Country K, the fees would be considered paid to a resident of Country K.

Thus, the fees paid by the Country J resident to the Country K third party for the provision of call center services would be subject to tax in Country J under Article XX.

This additional layer of tax would affect the economic viability of outsourcing certain services.

Example 8: Engineering services

A company resident in Country L provides engineering services relating to the construction of a new renewable energy site being built in Country M. The site is being constructed by an investor that is resident in Country M. The investor compensates the Country L service provider on percentage completion basis.

Because the investor is resident in Country M, pursuant to Article XX(5), the fees paid to the Country L engineering services provider would be considered to arise in Country M.

Because the engineering services provider is resident in Country L, the fees would be considered paid to a resident of Country L.

Thus, the fees paid by the Country M resident to the Country L resident for the provision of engineering services would be subject to tax in Country M under Article XX.

The tax imposed on the fees will likely increase the cost of this type of project in Country M as many service providers will require their fees to be grossed up to account for the applicable taxes. This will adversely impact Country M and the source country taxpayer who is receiving the service due to increased prices. In countries such as Ethiopia, Mexico and Kazakhstan there is a strong demand for engineers (e.g. in renewable energy in Ethiopia)[3] and therefore the consequences of Article XX to engineering services involving these types of jurisdictions should be properly considered.

Example 9: Agricultural activity

An agricultural company resident in Country N is required to perform in-country Research & Development (R&D) and testing with respect to certain products to obtain approval to sell the products in certain non-Country N territories. The agricultural company has therefore engaged R&D and testing providers that are resident in several non-Country N countries, including Country O, Country P and Country Q.

The agricultural company compensates these third-party providers on a cost-plus basis.

Because the agricultural company is resident in Country N, pursuant to Article XX(5), the fees paid to the third parties would be considered to arise in Country N. The third-party R&D and testing suppliers are resident in Country O, Country P and Country Q. Thus, the fees paid by the agricultural company would be considered paid to a resident of Country O, Country P and Country Q.

Thus, the fees paid by the Country N resident to the Country O, Country P and Country Q third parties for the provision of R&D and testing services would be subject to tax in Country N under Article XX.

This additional layer of tax would increase the cost of bringing the relevant agricultural products to market in Countries O, P, and Q.

Leading countries in agriculture such as Brazil, Thailand, and India could be adversely impacted as well as other developing economies where they are importing agricultural products to local markets.

[3] Please see page 18: final-cebr-report-12-09.pdf (raeng.org.uk)

Appendix 2: Comments from an African multinational company

There are different examples of how the proposed provision could be concerning in relation to cross-border services within our group. Prominent ones relate to the provision of management, technical, and know-how services to various African countries. Upon examining the operational models within the industry, concerns have arisen regarding the extensive implications of Article XX. Many multinational corporations (MNCs) operating in Africa already face significant challenges due to high withholding tax (WHT) rates and corporate income tax (CIT). The proposed broadening of the tax base, coupled with the limited double taxation agreement (DTA) network, presents considerable obstacles for African MNCs.

Furthermore, it is important to note that digital services taxes (DST) and levies on mobile money transactions contribute to the overall cost of doing business in Africa. The implementation of additional taxes under Article XX may exacerbate these challenges and potentially lead to higher costs for consumers as MNCs may transfer the burden of these taxes to end users.

Another area of concern is the impact on the outsourced model in other countries (e.g. India). While this model may not be directly applicable to all organisations, the implications of third-party payments under Article XX raise questions about the broader reach of the proposal.

Appendix 3: Comments from French business organisations

The definition of the term "service" is much too broad. Article XX is likely to impact significantly all MNE groups engaged in cross-border flows (not only the digital ones), and even smaller companies such as mid-caps which have international operations. Article XX would in fact entail a major shift in international taxation.

Given this, we advise the Committee not to move forward without having carried out a thorough economic impact assessment in order to document and make estimations of the overall economics of such change, including for developing countries which are exporters of services (e.g. India), and including the costs for companies as well as for countries which would have to provide tax credits (if Article XX is implemented in a tax treaty). There is a need to see the bigger picture, the process is too rushed.

Preliminary observation: Withholding tax (WHT) on services already exist to a certain extent due to the practice of certain developing countries (we have notably seen cases with African countries) in contravention of the tax convention. This has created a number of issues because there is then no tax credit that can be used in the country of the recipient, who therefore suffers double taxation.

Below are some additional comments, notably about the nature and value of services that may be impacted:

- Companies are increasingly using shared services across groups, with low added value (e.g. cost + 5%) in order to reorganise accounting, IT, digital, etc. (e.g. shared service centres, centres of excellence, etc.). If these services were to be subject to a withholding tax of 15%, that would clearly exceed the margin, which will systematically make these services loss-making. Please refer to Appendix 1, Example 1.
- More and more employees want to work remotely, sometimes from another country. For reasons of legal protection and labour law, they may be hosted in existing subsidiaries, and their cost is re-invoiced to the original subsidiary, sometimes "at cost" in order to avoid illegal subcontracting, or sometimes with only a small margin to cover administrative costs. Again, if these services were to be subject to a withholding tax of 15%, they would be loss-making.
- The treatment of these WHTs in countries which provide for "basket" taxation for the imputation of the WHT (e.g. basket for financial income, for royalties, etc): there would be another basket for services, with the WHT on services not being offsetable against other baskets.
- There is also a subject of interaction between customs and taxes for services rendered in addition to a sale of goods: Goods are subject to customs duties, but sometimes services are too. Their cost must be added to the customs value. If a WHT were to apply to them, that would create a "double penalty" (even more so if the WHT is not recoverable).
- In certain countries, the payment of the WHT is a prerequisite for bank transfer authorisation. Banks become tax controllers and only validate currency transfers after payment of the WHT. In such situations, WHTs in fact become a new way to apply foreign exchange controls. Implementing a WHT on all services will only make this worse.

Avoiding double taxation is of critical importance.

The existence of a tax credit in respect of the envisaged WHT on services is not mentioned: would Article 23 B of the UN Model Tax Convention be applicable? This should be clarified.

The consequences for the recipient should be taken into account: What about the loss of the tax credit during a deficit period? Would there be any refund?

If the WHT on services is implemented outside a double tax treaty, then there is a clear risk of double taxation as the country of the recipient is most likely not to grant a tax credit.

We are very concerned that certain countries may use Article XX as a domestic measure.

Additional points:

- As currently drafted, the Article XX WHT could apply to flows between a branch and its head office located in another jurisdiction, which would of course not be favourable. This possibility should be excluded.
- As regards the notion of "fees for service", it would be useful to specify that it excludes not only digital services, salaries, digital services and insurance as is already the case, but also interests and the like.
- If this provision were to apply to IT services, this would significantly increase the cost of these services for which banking establishments are large "consumers".
- Finally, with regard to paragraph 7, we understand that it is an anti-abuse clause whose terms are very imprecise, thus creating legal uncertainty. For example, what is meant by '*special relationship'* and '*exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship*'? These terms should be clarified within the commentary of the UN MTC.

Appendix 4: Comments from Asian ICC national committees

Part 1: Barrier on transformation and upgrading of the service sector of developing countries.

- Transformation and upgrading of the service sector are one of the key drivers of the overall economic development in many developing countries. This is also reflected in the increase of service exports as indicated in ICC's comments above. Some business models under such effort are determined by the stage and key areas of the country's economic development or the market situation, rather than leveraging the convenience of digital and communication technologies.
- For example, in biomedical and pharmaceutical industry, companies of developing countries are usually in the position to provide contracted R&D services to intellectual property (IP) owners in developed countries. The contracted service providers rarely have substantial involvement in subsequent profit-generating operations based on such IP in other countries. Additional tax burden on such cross-border services, even if priced-in, will undermine the competitiveness of enterprises in developing countries as well economies' efforts to upgrade the service sector.
- For developing countries with a big market and relatively complete supply chain, a business model has been developed under which domestic companies provide one-stop supply chain management services to the overseas companies. Taking the brand apparel industry as an example, the overseas brand owner is responsible for designing and modelling. The domestic service provider handles the end-to-end supply chain management for the brand owner from procurement of materials and manufacturers through logistics for terminal sales. Although it will fall into the cross-border services under the proposed Article XX, the services are performed in the country of the service provider and the cost will be passed on to the consumers in the same country. It is not in line with the intention of the proposed Article XX if such service fee is taxed by the country of the brand owner based on payment only.

Part 2: Low profit margin services rendered by developing countries will be adversely impacted.

As indicated in ICC's comments above, developing countries have increasingly become exporters of services. There are many types of services that are currently priced at a low margin. A tax on a gross basis as proposed under Article XX may lead to a loss position for the service provider, as evidenced through Example 1 in Appendix 1. The increment of pricing may affect the competitiveness of these service providers. Examples include but are not limited to:

1) After-sales services: after-sales services are usually priced at a low margin across all industries (usually under a cost-plus method, a model that applies a markup after a part's cost is determined);
2) Intra-group services: intra-group services are usually priced based on a cost-plus method;
3) More and more companies from developing countries have become contractors for other developing countries especially in the field of infrastructure (e.g. port, railway and train, canal, 4G/5G network, public facilities, etc.) in light of their competitive pricing and quality services. Under the existing UN MTC, the service provider may carry out certain types of services in its home country (e.g. design, project management, etc.) without being taxed in the country of the contract-issuing party. If a tax is levied on the gross amount as proposed in Article XX, the service provider will have to increase the contract price, the cost of which will ultimately be passed onto the contract issuing party.

Part 3: Separating the amount of service fee and the amount for equipment/parts

Paragraph 69 to 77 in the draft commentary to Article XX address the issue of whether reimbursement should be included in the definition of "fees for services".

Another similar important issue to be addressed in the commentary (if Article XX is ultimately adopted in the UN MTC) is the cost for equipment/parts used in a project provided by the service provider. The current international tax principles support the argument that the cost for equipment/parts used in a project should be excluded from the scope of "fees for services". This principle should cover all types of projects and should ideally also cover after-sales services.

Appendix 5: Comments from ICC Bolivia

We share the concerns raised by several countries regarding the scope of proposed Article XX. However, we do find merit in the current formulation of Article 12A, as it reflects a longstanding tradition among Andean countries. Specifically, Bolivia, Colombia, Ecuador, and Peru reached a multilateral agreement (Decision 578) to grant exclusive taxing rights to the country where the payment originates, albeit with a broader interpretation akin to Article 12A.

From the perspective of Bolivia, it is worth noting that Law 2493 of 2003 initially embraced a similar broad approach as Article XX, encompassing **all types of services** provided from or in foreign countries. As you can expect, this measure faced practical challenges and conflicts within the corporate sector and treaty network (i.e under such text even hotel services would be subject to WHT, which is obviously an absurd outcome as evidenced in Example 5 of Appendix 1). The solution came up just one month later, with Supreme Decree 27190. It refined the definition of "any service" to encompass **only** specific and ***numerus clausus*** **categories** such as professional, advisory, consultancy, technical services, and expert opinions.

Given this context, we believe that further expanding the taxing rights by broadening the scope of services subject to withholding tax at the source of payment would trigger **significant challenges**. **This is true even for Bolivia, which traditionally upholds the principle of taxation at the source.**

On the economic impact

Foreign trade has strategic importance for development in Bolivia. **Bolivia is a country with a high dependence on the export of commodities, low diversification of production, and high vulnerability to changes in international commodity prices.** In 2023, traditional exports (minerals and hydrocarbons) represented 72% of total exports, while non-traditional exports (agricultural, forestry, timber, and handicraft products) represented 28%.

In 2023, **Bolivia recorded a trade deficit after three consecutive years of trade surpluses.** The value of exports fell by 21% compared to 2022. **Hydrocarbon exports, in which natural gas is the main product, fell by 31%, and mineral exports fell by 15%. This deepened the current crisis of the net foreign reserves (NFR) of the Central Bank of Bolivia (BCB),** which have reached historic lows, prompting a devaluation of the domestic currency and the development of a parallel market for the US dollar.

Hydrocarbons have suffered a drastic reduction in their participation in Bolivian gross domestic product (GDP) and external trade over the last decade. **Between 2013 and 2023, hydrocarbon exports went from representing 55% of the total value of Bolivian exports to only 20%.** Mineral exports have partially compensated for this decline, increasing from 25% to 52% of the total exported between 2013 and 2023 due to the surprising increase in gold exports, but at a very high cost of environmental degradation in the country, including high imports of mercury and river pollution.

The decline in trade balance highlights the need to diversify the economy and promote sectors with higher added value and growth potential such as tourism, telecommunications, transportation, and computer and information services. Many developing countries have used hospitality, food, and transportation services related to tourism to diversify their exports and reduce their dependence on primary sectors. **Between 2018 and 2021, Bolivia's exports of services fell by 69%, from US$1.459 billion to US$452 million due to the impact of the pandemic.** Revenues from travel service exports decreased by 77%, and revenues from transportation services decreased by 60% during that period. As of the third quarter (Q3) of 2023, on an annual basis, service exports have recorded a recovery of 151% (US$1.137 billion) compared to 2021, which is essential to boost with

commercial and tax incentive policies. Travel services accounted for 65% of total service exports in Q3-2023 and transportation services accounted for 26%.

Bolivia also faces excessive logistical problems largely derived from its landlocked condition. In 2023, there was a three-month blockade on the border with Peru. Likewise, there were logistical problems with barges at the head of the Paraguay-Paraná Waterway. Similarly, there were recurrent roadblocks on the central axis roads of the country (Santa Cruz, La Paz, Cochabamba) due to internal social and political conflicts. **The sale of cross-border services related to the digital economy, for example, has the potential to overcome the landlocked condition of the country.**

Additionally, **Bolivia needs to make efforts to attract and retain foreign direct investment (FDI) to support its development process and contribute to job creation, technology transfer, and diversification of the production matrix.** According to the Economic Commission for Latin America and the Caribbean (ECLAC) in its report "Foreign Direct Investment in Latin America and the Caribbean 2023," Bolivia's share of total regional FDI in 2022 was 0.01%, below the shares of Paraguay (0.2%) or Ecuador (0.4%), compared to the 74% share of South America in Latin America and the Caribbean. Brazil (40.7%), Chile (9.3%), and Colombia (7.5%) had some of the largest contributions.

Sources:

- Avances de cifras del reporte de balanza de pagos | Banco Central de Bolivia
- Cifras del Comercio Exterior Boliviano 2023 - Boletín IBCE Cifras
- La Inversión Extranjera Directa en América Latina y el Caribe 2023 | CEPAL

Appendix 6: Comments from a mining company

The UN MTC introduced provisions for technical service (12A) in 2017 and automated digital services (12B) in 2021. Therefore, the introduction of this new rule may not have a significant impact because many services may already be under the scope of those provisions. Some argue that any service qualifies as 'technical'. The new article seems to contemplate the existence and interaction with 12B but not 12A. It is not clear why this is the case. It appears as though there could be confusion as to which article applies in this case. The wording in the new article also assumes that 12B is implemented by the Treaty country. However we understand that a country can choose to just impose new Article XX to catch all service payments. This should be clarified.

Singapore does allow taxpayers to rely on treaties to mitigate withholding taxes on services applied under domestic (territorial) law. Some of Singapore's treaties are such that if the service provider does not have a PE in Singapore under Article 5, then the withholding tax rate goes to nil, but a certificate of residence must be presented to justify that claim. However, some treaties such as those with Australia, Pakistan, Korea, Sweden and Taiwan exclude specific service payments from the Business Profit Article, in which case the technical services article (and the rate indicated) would apply. To the extent that these countries adopt the UN Article XX convention then it would need to be considered how this article will be introduced taken into consideration the treaty framework described above.

Brazil already has a 15% (25% in case of black listed countries) WHT applicable to most remittances out of the country, plus a host of other taxes in the "importation of services". There remains some ambiguity in the Brazilian Courts' view on whether or not treaties should supersede the domestic legislation. As such, it is questionable whether Article XX achieves anything if local tax administrations/courts continue to apply domestic WHT in priority to treaty provisions.

In terms of industry specific impact (for the extractive industries), a few additional points of note:

- It is often challenging for source countries to agree to sufficiently high margins on any intragroup service to make even a low level of WHT fully creditable (because of the difference between gross and net taxation) – all services are regarded as 'low margin' (range between cost + 7.5% and 10%). A few problems arise for businesses with hub and spoke models like our industry typically does:
    - The tax administration becomes incentivised to both argue that the services are of low value (to minimise CT deductions) and high value (to maximise WHT charges). This brings unwelcome complexity and uncertainty.
    - There is no realistic opportunity to receive equivalent services locally to head office services, but under corporate governance and residence country tax law we are required to charge for it when it is provided by the head office. So in practice you either have a business that is cut off from such services or is paying significantly more than a free market rate for them due to the impact of the increased tax costs. This is not good for investment (particularly marginal investment). Please refer to Example 1 in Appendix 1.
    - Typically, a head office cannot recharge all of its costs, and it may therefore have losses against which to offset the income of the fees it does charge. Thus, the gross basis WHT may not be creditable against CIT at all.
- This has the potential to impact discovery/geoscience services. Source countries have to make payments to suppliers from satellite operations for a variety of services from operation through to rental of equipment. Those payment and contracting structures are often convoluted given the local and international supply chain, i.e. availability of equipment and expertise (drilling,

assaying, lab testing etc.). This WHT position coupled with lower PE and employment tax thresholds **adds significant frictional costs to discovery operations which are already severely underinvested in (not only from a tax paid perspective, but also in terms of administration, process, system, accounting – which is not insignificant).** Given the nature of exploration spend and time to realise any revenue/ profit on an actual discovery those frictional costs are likely to be real costs for a long period of time, if not forever. This will make operating in some jurisdictions unpalatable (particularly in an already strong US dollar/high inflation environment), leaving what would otherwise be economically sound resource in the ground (ironically, leaving developing nations worse off).

- In marketing functions it is not uncommon to have tolling arrangements to process refined product – it can be structured as either a buy or sell or a service fee. If a withholding tax is indeed imposed, this could change the economics greatly or push the team to adopt the buy-sell approach. There are also a lot of marketing sales agency arrangements and buyers/helper agreements in place which would fall under the proposed provisions. To the extent WHT applies on these payments, this could possibly impact the economics of the Comparable Uncontrolled Prices used for benchmarking purposes which could have a knock on impact on intercompany pricing.

Appendix 7: Comments from a multinational enterprise based in Europe

Like many other multinational enterprises, our company provides low risk support services to the rest of its worldwide group primarily from the UK and Germany. These services include IT and cyber security support, data warehousing and security, standardised technology, commercial product design and services, financial operational and administrative support services.

Customer call centres and business support services are also provided from **India, Egypt, Central and Eastern Europe**. All such services are charged out on a cost-plus (between 3% and 5%) basis, have been subject to rigorous audit and/or bilateral APA agreements, and are subject to tax in the residence countries at the standard rates. **The gross total of the service charges is over €1billion, with the most significant proportion of the costs borne by developed economies in Western and Central Europe**, whilst charges commensurate with the size of the local markets are also borne by subsidiaries in India and across Africa. **Three emerging market countries currently impose withholding taxes beyond the scope of existing double taxation conventions, either declining to refund the excess amounts or doing so only after years of administrative process and litigation**.

Any additional taxes under the proposed wide-ranging Article XX would only serve to increase the costs of doing business and to the end consumer and have nothing to do either with the challenges of the digital economy or with tax avoidance. Please also refer to Example 1 in Appendix 1 for insight into how Article XX can adversely apply to centralised service costs.

Appendix 8: Comments from a multinational enterprise based in Europe

Our multinational company has operations in more than 50 countries worldwide including many developing countries. We have concerns that Article XX could entail a disproportionate taxation of cross-border services, even when the foreign provider has no fixed place of business or agent locally.

This is likely to discourage investment and will significantly increase the price of the services as the provider will have no choice but to pass the tax on to the customer.

The rendering of cross-border services is not limited to the digital sector: It covers all kinds of industries, with respect to consultancy, advisory, accounting, management, IT services, etc. Many of these services are not high-value services, but rather are invoiced on the basis of costs incurred + a limited mark-up. For instance, for routine, low-value-added services, the mark-up is frequently 5%. Applying a taxation on the gross income earned by the provider in this circumstance will often lead to a disproportionate level of taxation. Please refer to Example 1 in Appendix 1.

Additionally, we would like to draw the attention of the Committee to the fact that many non-OECD countries are actually **exporters of such kind of services** in today's globalised world, and could be severely hit by the new provision, as outlined in the letter and through the examples at Appendix 1.

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