



**THE INTERGOVERNMENTAL
ORGANISATION
OF THE SOUTH**





Policy Options and Revenue Estimates

Kuldeep Sharma

Research Consultant – Tax

sharma@southcentre.int

Prisca Eleanor Musibi

Research Consultant – Tax

elliemusibi@gmail.com

South Centre Tax Initiative

<https://taxinitiative.southcentre.int/>

Taxcooperation@southcentre.int

PRESENTATION OUTLINE

Introduction

Treaty-based options:

- OECD Amount A
- UN Article 12B
- Revenue estimate comparison

Domestic Law Measures

- Digital Services Taxes (DST)/ Equalisation Levy (EL)
- Significant Economic Presence (SEP)
- Withholding tax (WHT)

Conclusion

INTRODUCTION

- Technology has enabled unprecedented global connectivity and, with it, a reimagination of the traditional ways of doing business.
- Profits can and have been derived from South and Southeast Asia in light of these new ways of doing business that do not depend on physical presence.
- Administrative challenges such as identification of sellers and customers, determination of the extent of activities and the collection and verification of information, identified as the main administrative challenges in the taxation of the digital economy under Action 1 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action Plan).
- The region's tax systems need to ensure the fair share of tax due to the respective jurisdictions from which profits are derived is collected.
- What policy options exist to address these challenges?

TREATY – BASED OPTIONS

OECD INCLUSIVE FRAMEWORK TWO PILLAR SOLUTION (AMOUNT A)

- Amount A of Pillar One of the Two Pillar Solution addresses the tax challenges arising from the digitalisation of the economy.
- Creates new taxing right for market jurisdictions on formulary computed residual profits from in-scope MNEs.
- Applies to MNEs that:
 - ✓ Have a global turnover of EUR 20 billion; and
 - ✓ Profitability > 10%
- Jurisdictions qualify to tax Amount A if an MNE derives revenue of at least EUR 1 million from that jurisdiction. (Lower threshold of EUR 250,000 for countries with GDP <EUR 40 billion)
- Currently expected to apply to less than 100 MNEs
- To be implemented via a Multilateral Convention (MLC) requiring at least 30 jurisdictions accounting for at least 60 percent of the Ultimate Parent Entities (UPEs) of in-scope MNEs sign.

TREATY – BASED OPTIONS

UN ARTICLE 12B OF MODEL TAX CONVENTION (MTC)

- Covers Automated Digital Services (ADS) defined as “any service provided on the Internet or another electronic network, in either case, requiring minimal human involvement from the service provider” (UN MTC 2021)
- Services especially (meaning at minimum) included:
 - ✓ online advertising services;
 - ✓ supply of user data;
 - ✓ online search engines;
 - ✓ online intermediation platform services;
 - ✓ social media platforms;
 - ✓ digital content services;
 - ✓ online gaming;
 - ✓ cloud computing services; and
 - ✓ standardised online teaching services.
- May apply on either gross or net basis, and the rate is open to bilateral negotiation, but 3-4% is proposed in Commentary.
- To be implemented either through bilateral negotiation/renegotiation or a future UN Multilateral Instrument (MLI).

COMPARISON OF TREATY – BASED OPTIONS

UN ARTICLE 12B VS OECD AMOUNT A

S.N	Feature	Article 12B	Amount A
1	Services covered	Applies only on ADS.	Applies to all types of businesses that are in scope.
2	Scope	No threshold in terms of its application.*	In-scope companies re the MNEs with global turnover above EUR 20 billion and profitability above 10%, with the exception of extractives and regulated financial services companies.
3	Nexus	No threshold.	Applies when the in-scope MNE derives at least EUR 1 million in revenue from the market jurisdiction.
4	Allocation of income to State of source	Gross basis or fractional apportionment (net basis).	Formulary apportionment.
5	Tax rate	For gross basis of taxation: To be mutually decided by contracting jurisdictions. For net basis of taxation: The CIT rate of a particular jurisdiction shall apply.	Reallocates 25% of residual profit to market jurisdictions in proportion to sales derived from that jurisdiction. To this amount, the CIT rate of a particular jurisdiction shall apply.
7	Implementation	Bilateral tax treaty/ UN multilateral instrument (MLI)**	Multilateral Convention

*The Commentary has provided an alternative for Contracting States to consider and provide thresholds based on the worldwide revenue and revenue from ADS derived from the source State

**The option of the UN MLI is under discussion within the UN Tax Committee

ADS VS HYBRID ADS

- The South Centre and CODA published a paper on 1st June 2022 containing potential revenue estimates deriving from the different revenue thresholds proposed for Amount A (EUR 20B v 10B) and variations of Article 12B where the option of hybrid ADS was also explored.
- In the paper, the term "hybrid ADS" included companies that provide services over the internet with minimal human involvement but whose types of activities are not among those listed in paragraph 6 of Article 12B.
- Para 6 contains the 'minimum' list of services covered under 12B.
- These hybrid ADS companies include:
 - ✓ businesses engaged in B2B services,
 - ✓ companies that sell software in connection with hardware, products, or services,
 - ✓ e-commerce companies that have traditional retail activities,
 - ✓ companies offering telecommunication services,
 - ✓ finance companies such as traditional and investment banks, asset management firms and insurance companies, etc that provide services online through ADS mode

Potential tax revenues Amount A vs Article 12B – South and Southeast Asian countries

S.N	Jurisdiction	Amt in USD Million (2020)			
		Amount A EUR 20 B threshold	Article 12B Gross Method @ 3% Tax ADS Only	Article 12B Gross Method @ 4% Tax ADS Only	Article 12B Net Method ADS Only
1	Cambodia	7.6	6.6	8.8	4.3
2	India	604	462.5	616.7	342.4
3	Indonesia	238.6	239	318.7	161.4
4	Malaysia	82.9	85.8	114.4	57.3
5	Pakistan	49.3	47.2	63	34.8
6	Philippines	111.6	89.6	119.5	74.8
7	Sri Lanka	29.5	22.8	30.4	19.2
8	Vietnam	68.4	80.5	107.3	44.7

Source: [South Centre](#) (2022)

Potential tax revenues Amount A vs Article 12B – South and Southeast Asian countries

Amt in USD Million 2020									
S.N	Jurisdiction	Amount A		Article 12B Gross Method @ 3% Tax		Article 12B Gross Method @ 4% Tax		Article 12B Net Method	
		EUR 20B threshold	EUR 10B threshold	ADS Only	ADS and Hybrid ADS	ADS Only	ADS and Hybrid ADS	ADS Only	ADS and Hybrid ADS
1	Cambodia	7.6	8.6	6.6	27.3	8.8	36.3	4.3	7.5
2	India	604	273	462.5	747.2	616.7	996.3	342.4	407.2
3	Indonesia	238.6	278.2	239	734.2	318.7	978.9	161.4	295.8
4	Malaysia	82.9	105.2	85.8	141.9	114.4	189.2	57.3	105.8
5	Pakistan	49.3	68.1	47.2	136.9	63	182.5	34.8	71.9
6	Philippines	111.6	127.1	89.6	273	119.5	364	74.8	134.5
7	Sri Lanka	29.5	34.1	22.8	78.4	30.4	104.5	19.2	32.7
8	Vietnam	68.4	77.3	80.5	204.4	107.3	272.5	44.7	75.6

Source: [South Centre](#) (2022)

Example: 12B for ADS and Hybrid ADS

- Google has over 100 product offerings targeted at both businesses and consumers.

- ✓ Google Pay
- ✓ Google Wallet

- Examples that would fall under the category of ADS include:

- ✓ Google Cloud
- ✓ Google Podcasts
- ✓ Google Ads

- Examples that would fall under the category of hybrid ADS include:

Alphabet



Google Ad Manager



Google Ads



Google Pay

Example: 12B for ADS and Hybrid ADS

- Another example of an MNE that has services that could fall within both categories is Alibaba Group.

❑ The following activities would fall under ADS:

- ✓ **Cloud services** - Alibaba Cloud and Dingtalk;
- ✓ **Digital media and entertainment** – Youku

❑ Those that would fall under hybrid ADS include:

- ✓ **Cainiao** – Provision of domestic and international logistics services

and supply chain management solutions

- ✓ **Alipay** (through ownership stake in Ant Group)



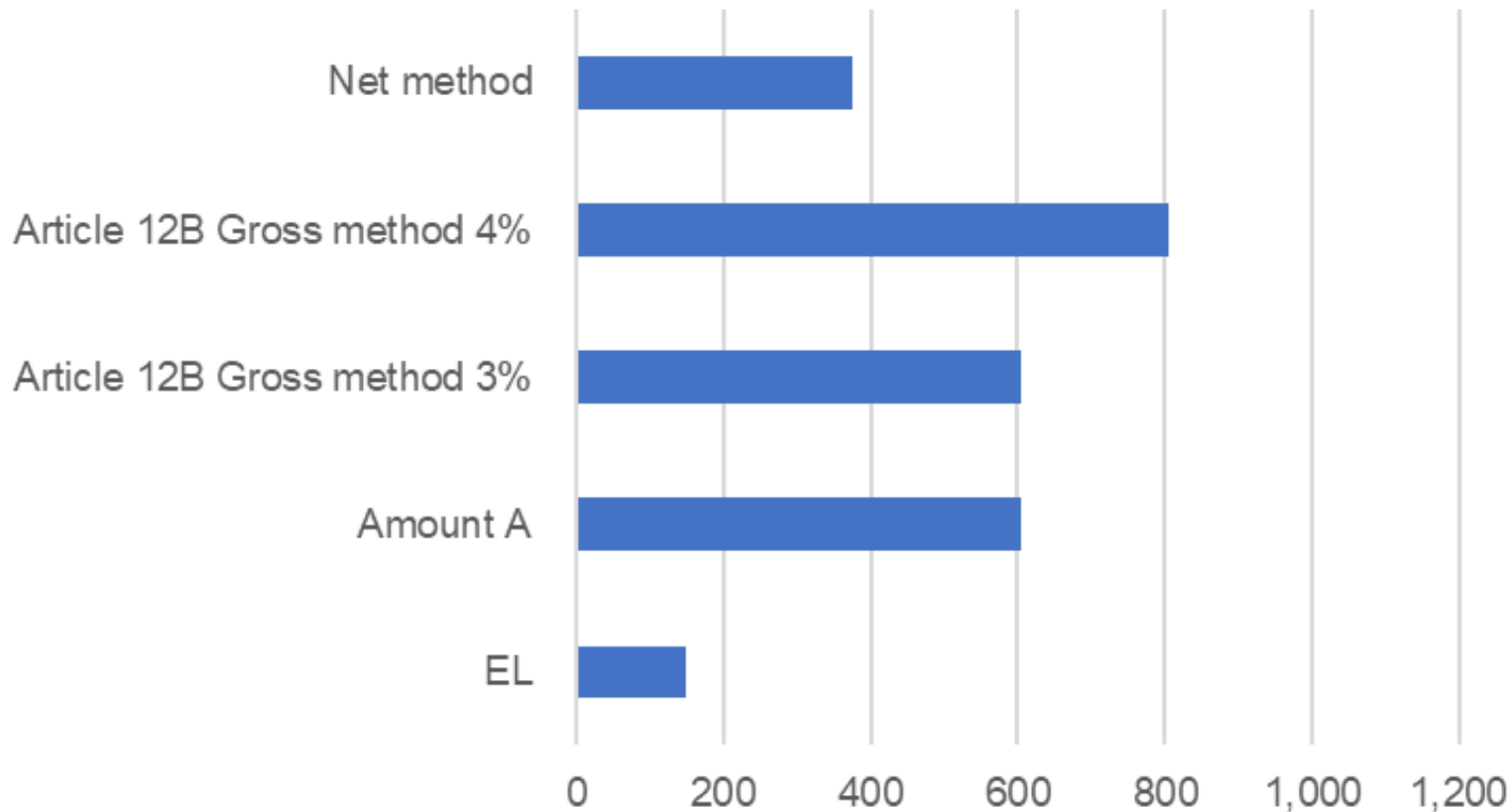
DOMESTIC LAW MEASURES

DIGITAL SERVICES TAXES(DST)/EQUALISATION LEVY(EL)

- One of the measures proposed in the 2015 Action 1 Final Report.
 - ✓ Pakistan – Fee for Offshore Digital Services – initially 5% increased to 10%
- Applies on a gross basis at a certain percentage on specified digital services provided by non-residents.
 - Countries considering the implementation of similar measures:
 - ✓ Indonesia- Electronic Transaction Tax
 - Should Amount A come into force, such measures must be withdrawn where a country has signed onto the agreement.
- May or may not include a threshold for application.
- Countries implementing such measures:
 - ✓ India – EL -6%&2%
 - ✓ Nepal – DST – 2%

REVENUE ESTIMATES OF DST/EL REVENUE VS TREATY-BASED OPTIONS

India: Comparative revenue generation under various options in USD millions (2020)



*Article 12B figures are inclusive of hybrid ADS

**India's EL revenue has reportedly increased to about USD 475 million in 2022

DOMESTIC LAW MEASURES

SIGNIFICANT ECONOMIC PRESENCE (SEP)

- Measure also proposed under Action 1 Final Report.
- Creates a business connection for a non-resident person that is not linked to physical presence.
- SEP may be established on a threshold of either revenue derived from, and/or users reached in a specific jurisdiction.
- SEP provisions can only apply in the absence of a DTA or where in the presence of a DTA, the PE provisions are amended to bring them in line with SEP provisions.
- India introduced SEP provisions in 2018 Finance Act which came into effect in 2021 with both revenue and user linked thresholds:

Particulars	Threshold
Revenue Linked Condition	Exceeds INR 20 million (approx. USD 243,900)
User Linked Condition	Exceeds 300,000 users

DOMESTIC LAW MEASURES

WITHHOLDING TAXES (WHT)

- The Action 1 Final Reports also included the proposal to extend the current scope of a jurisdiction's domestic WHT regime to cover gross payments on specific kinds of digital transactions.
- Countries implementing such measures include:
 - ✓ India – Introduced WHT at 1% of gross amounts paid to e-commerce participants (Indian residents) for using e-commerce platforms to sell goods or provide services.
 - ✓ Malaysia - Introduced WHT on income from digital advertising provided by a non-resident.
 - ✓ Vietnam - Introduced WHT at variable rates (0.1%-10%) on income derived by non-residents from digital and e-commerce operations in Vietnam.

Conclusion

Amount A provides roughly equivalent revenues when contrasted with Article 12B gross method/DST with a narrow scope of services and 3% rate

12B gross method/DST with a broad scope & 4% rate provides highest revenues

12B Net Method provides least revenues

Amount A contingent upon re-allocation of taxing rights from developed countries

UN's Article 12B bilateral solution holds greater promise for developing countries due to the flexibility in expanding services but is dependent on challenging bilateral negotiations.

Domestic law measures such as DSTs or WHT currently under implementation provide a starting point for countries that are yet to take any steps in ensuring they tap their fair share of tax revenue arising from the digital economy, especially non-IF Members...

...assessing their potential impact on FDI and digitalization of firms which could impact efficiency gains

THE SOUTH CENTRE

International Environment House 2
Chemin de Balexert 7-9
POB 228, 1211 Geneva 19
Switzerland
Tel.: +41 22 791 8050
south@southcentre.int

» FIND OUT MORE:

<https://www.southcentre.int>
<https://taxinitiative.southcentre.int>

» THE SOUTH CENTRE IN SOCIAL MEDIA:



[@South_Centre](https://twitter.com/South_Centre)



[SouthCentre GVA](https://www.youtube.com/SouthCentreGVA)



[South Centre, Geneva](https://www.linkedin.com/company/south-centre-geneva)