Towards a United Nations Tax Convention: Prospects and Challenges for Developing Economies

By:

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Introduction

On 22 November 2023, the United Nations ("UN") General Assembly adopted by a landslide majority of 125 to 48 (with 9 abstentions) a resolution to begin the process of establishing a framework tax convention. This historic development is expected to completely change how global tax rules are decided. It is also expected that the UN framework tax convention, when established, could shift decision-making in global tax policy formulation from the Organisation for Economic Cooperation and Development ("OECD") to the UN.

The UN tax resolution was championed by the Africa Group and led by Nigeria to start an inter-governmental process to negotiate a new UN framework convention on international tax cooperation. Its adoption by the UN is believed to be a major win for developing countries and the global fight for tax justice. It is noteworthy that in the 78 years' existence of the UN, there has never been a universal or broadly inclusive forum for global coordination on international tax matters. International tax law and policy formulation has been largely led by the OECD and the G20 countries for the past 60 years. This situation was considered inequitable by developing countries who seek greater control over their economic destiny.

The OECD is a small club of 38 (mostly developed) countries where power and influence are primarily held by wealthy nations and where low-income countries are traditionally excluded from decision-making. The OECD Inclusive Framework on Base Erosion and Profit Shifting – a collaboration of about 140 countries established to address the tax challenges of the digital economy – did not provide satisfactory participation for developing countries. The two-pillar approach to resolving the tax challenges of the digital economy – proposed by the OECD – left much to be desired. Both solutions – especially the Pillar 1 approach – are believed to not be in the best interest of developing countries. Hence the Africa Group's agitation for a UN tax convention that will shift global tax policy formulation rights away from the OECD to the UN.

It is believed that the UN will be more representative of developing countries than the OECD. This sentiment seems to be supported by the remarkable results of the UN tax resolution vote. The resolution was opposed by 48 countries (mostly OECD countries) including Canada, Australia, United States of America ("US"), United Kingdom ("UK"), and all the European Union ("EU") member countries. Nine countries abstained from voting on the UN tax resolution, including OECD members like Iceland, Mexico, Norway, and Turkey. Notwithstanding this powerful opposition, the UN tax resolution was adopted by a majority of 125 countries including Nigeria, China, Russia, South Africa, and other developing countries.

This commentary highlights the prospects and challenges of a UN framework tax convention for developing economies and makes recommendations for mitigating risks. It argues that while the proposed UN framework tax

convention may provide a broader forum for increased conversations between developed and developing countries on international cooperation in tax matters, it may not be the magic wand of equal participation in global tax policy formulation hoped for by developing countries. Nevertheless, the adoption of the UN tax resolution is indeed a very significant development in the international tax law and policy space that will form the basis of very engaging conversations in the coming years.

Pitfalls of the OECD two-pillar approach to resolving the tax challenges of the digital economy

The rise of globalisation and digitalisation of financial systems has widened the economic divide between developed and developing countries. Prior to the rise of globalisation and digitalisation, allocation of taxing rights in international tax law and policy was hinged on physical presence. Accordingly, for a non-resident entity to be taxable within a foreign country, it must have a degree of physical presence in that country. The measure of physical presence necessary for the exercise of taxing rights over a non-resident entity by the source country was generally defined in the permanent establishment rules set out in various model international tax treaties and conventions. Most of these instruments were midwifed by the OECD.

The reliance on physical presence as basis for allocation of taxing rights in international tax law and policy was initially not a problem. In fact, it made logical sense at the time of its inception. It was practically impossible for non-resident entities to do business and earn income from foreign countries without having some degree of physical presence within those countries. However, globalisation and digitalisation of the economy has made it possible for non-resident entities to do business and earn millions of dollars from foreign countries without having any form of physical presence within those countries. This has led to global tax injustice. Non-resident entities participate in the digital economy of developing countries without paying any taxes to such countries, while repatriating their profits and paying taxes to developed countries.

Indeed, many African developing countries have reported difficulty in taxing highly digitalized business models. Their economies are becoming more and

more digitalised. This development enables multinationals to do business in African developing countries without any form of physical presence in those countries. This makes it difficult for African developing countries to establish taxing rights over the profits made by such multinationals from digital business activities conducted within their countries. It further erodes the tax base of low-income countries by allowing multinationals to shift (tax-free) profits digitally sourced from such countries to so-called tax havens where they pay little or no taxes on such profits. It has accordingly become necessary to review the current international tax rules which allocate taxing rights to source countries only where a degree of physical is established.

The OECD Inclusive Framework on Base Erosion and Profit Shifting (**"BEPS**") attempted to solve this problem by proposing a two-pillar approach to addressing the tax challenges of the digital economy. However, the effort was criticized on the basis that it was dominated by the G20 countries, especially the US and EU member countries, and that despite its expansion to an "inclusive framework" of over 140 countries, it continued to represent primarily the interests of the developed world. This is mostly true of the OECD Pillar 1 BEPS rule, because it is very limited in scope. The total amount that could be raised by applying the Pillar 1 rule is only about US$15 billion annually, which is a small fraction of the profit of a single large multinational entity. Also, most of the revenue goes to the richest countries – especially the US. In addition, the US gets a veto, which makes highly unlikely the success of the OECD Pillar 1 BEPS rule. For further reading on this, see Reuven Avi-Yonah, "Toward a More Inclusive International Tax Regime? Reflections on a UN Framework Convention", unpublished draft commentary posted on the author's LinkedIn page on 24 November 2023.

It has been observed that the result of Pillar 1 may be a proliferation of unilateral Digital Services Taxes ("**DSTs**") adopted by different countries in an uncoordinated fashion. (See Reuven Avi-Yonah, ibid.) This could lead to avoidable trade disputes amongst otherwise friendly countries. Indeed, the US Senate Committee on Finance had on 10 October 2023, issued a statement to the United States Trade Representative in which it criticized Canada's proposed unilateral DST measure which it described as a "*discriminatory" tax policy "that targets American businesses". It further issued a subtle warning stating that "the strong economic relationship between the United States and Canada… will*

become immensely challenging… if Canada subjects innovative American companies to arbitrary discrimination without facing any consequences".

OECD's Pillar 2 BEPS rule is believed to be a bit better than Pillar 1. (See Reuven Avi-Yonah, ibid.) This belief is hinged on the analysis that the combination of the Income Inclusion Rule and the Undertaxed Profits Rule means that for most developing countries, the rational response would be to adopt a Qualified Domestic Minimum Top-Up Tax. This would raise revenue while constraining the ability of multinationals to pit developing countries against one another. The drawback to Pillar 2, however, is that the rate is too low and the inclusion of the Substance Based Income Exclusion rule, and of refundable credits thereunder, means that unhealthy tax competition amongst developing countries could continue. (See Reuven Avi-Yonah, ibid.)

Overall, the OECD two-pillar BEPS rules do not effectively resolve the tax challenges of the digital economy for developing countries. This has led to calls for looking beyond the OECD two-pillar approach.

Prospects and challenges of the proposed UN framework tax convention

It goes without saying that OECD's leadership on global tax coordination came under threat following the successful UN tax resolution vote where an overwhelming majority of UN members (mostly developing countries) backed the African-led initiative to bring international tax cooperation to the UN. The UN tax resolution has the potential of marking the beginning of a truly inclusive international tax regime. (See Reuven Avi-Yonah, ibid.) It is also possible that the proposed UN framework tax convention may improve on the inadequacies of OECD's two-pillar BEPS rules. (See Reuven Avi-Yonah, ibid.) African Union is reported to have welcomed the vote as a "a beacon of hope" that would "facilitate the access of much needed financial resources". This reaction is not surprising. Developing (mostly African) countries had lamented for years that they were unable to influence discussions on global tax cooperation at the OECD, where the rules for cross-border taxation are generally considered and formulated. The UN tax resolution proposed by Nigeria had been backed by mostly developing countries due to their frustration at not being heard at the OECD level.

KPMG global tax policy leader, Grant Wardell Johnson, is reported to have said that although the OECD two-pillar BEPS approach was backed by the G20 group of economic powers and had aimed for a global consensus, the UN tax resolution is likely to result in increased cooperation on tax matters between the UN and the OECD. The extent to which this prediction will prove true remains open to question.

Recent reports of the International Monetary Fund show that developing (mostly African) countries are in huge debt. These debts are owed mostly to developed countries. Low-income countries have also struggled to recover from the financial crisis occasioned by the COVID-19 pandemic. The situation is worsened by the climate crisis and the increasing number of armed conflicts across the globe. The UN tax resolution vote is timely in that it has the potential to facilitate sustained international tax cooperation through inclusive, inter-governmental negotiations at the UN. International tax reforms designed to protect the tax base of source countries from the BEPS activities of multinationals may provide the much-needed financial freedom required for developing countries to break free of neocolonialism. It goes without saying that economic freedom comes with political and social freedom.

These prospects are, however, not without challenges. While the UN tax resolution may have succeeded, the proposed UN framework tax convention may be unable to overcome the united opposition of the OECD – most of whose members voted against it. (See Reuven Avi-Yonah, ibid.) Accordingly, the UN framework tax convention may not be the magic wand of equal participation in international tax law and policy formulation hoped for by developing countries. This is more so because many developing (mostly African) countries are indebted to developed countries and powerful multinationals. They sometimes rely on developed countries and multinationals for humanitarian aid. This economic reliance on the developed world may be exploited by developing countries (who are mostly OECD members) and powerful multinationals (most of whom benefit from the existing international tax regime) to influence the votes of some developing countries at the UN.

In addition, assuming the UN framework tax convention overcomes the united opposition of the OECD, there remains the question of expertise. Whereas the UN is a much larger organisation focused on several projects with human rights,

world peace, and climate action at the forefront; the OECD is a relatively smaller entity with international tax law policy formulation as its primary purpose for the past 60 years. In other words, while the UN may be the proverbial Jack of many trades and master of none – at least not of international taxation; the OECD is the proverbial Jack of a single trade – international taxation – and an arguable master of that trade. There is thus a legitimate concern that the quality of international tax law and policy rules may suffer if the reins of global tax policy formulation are shifted from the OECD to the UN.

Conclusion and Recommendation

The UN tax resolution may provide a wider forum for increased conversations on international tax cooperation amongst developed and developing countries. However, the proposed framework UN tax convention may not achieve the equal participation in global tax policy formulation hoped for by developing countries. Ultimately, it may only serve the purpose of giving developing countries a sense of increased participation in global tax policy formulation – without providing any real participation in actual decision-making. The economic reliance of most developing countries on the developed world and powerful multinationals may be exploited to defeat any true democratization of international tax law and policy formulation at the UN. There is also the risk of compromising the quality of international tax law and policy rules because the OECD may arguably have more expertise on the subject than the UN.

To mitigate these risks, developing countries may have to diversify their economic expansion measures to include strategies other than taxation of multinationals. Anti-corruption and anti-neocolonialism must be taken very seriously. This way, the developing world may be able to stave off the economic dependence that keeps it politically and economically subservient to multinationals and the developed world. Also, in negotiating the framework UN tax convention, developing countries can move for the UN to approve the work of the OECD with appropriate modifications to suit the peculiarities of the developing world. This could simultaneously address the international tax expertise concerns highlighted above while taking account of the inclusion concerns of developing countries that necessitated the UN tax resolution in the first place.

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