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On the Need for a more Analytical Latam's Position on the Global tax Deal(*)

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Abridged comments for a regional appraisal and possible outcomes to implementation

1. **2010-2020: A Decade of Profound Changes in International Taxation**

Following the world financial crisis, the industrialized countries were deeply dissatisfied with revenue collection levels.

In that context, which extended to the first years of the last decade, the political dialectic of the time left aside the traditional frontiers between tax planning and tax avoidance, and the world leaders resorted to the new concept of "fair taxation" –a sort of moral, enhanced dimension of the tax obligation—in an attempt to overpass the strict legal limits of the tax obligation coached within the wording and spirit of the tax statute, and, hence, to cure in practice the inconsistencies of the international tax system that affect revenue collection.[1]

At that time, the pendulum hit hard the global entity which, availing itself of the many loopholes provided by the international tax system was perceived as paying taxes nowhere. OECD was then entrusted the gigantic task of changing the international corporate tax framework and to that end, designed the BEPS Action Plan which consisted of 15 concrete actions, to be developed within a very short time span (two years) with full support from G-20 (countries counting for roughly 80% of global GDP).[2]

The most significant technical achievement of the BEPS Plan was to turn the tax discussion back to the legal channels and away from the ethical dilemma which might have mistakenly driven discussions and prevented from reaching reasonable outcomes.[3]

On the contrary, The Final Report on Action 1 was, by far, the greatest failure of the BEPS Plan; it fell short and did not conclusively respond to the direct taxation issues posed by the digital economy. The report suggested various options but recommended none, so that the issues remained open and countries free to proceed unilaterally, which they did widely.[4]

The optionality (come and take as you like) approach postulated by the Final Report to Action 1 opened the door to diverging unilateral responses in the years to come, including: (i) The UK-type diverted profit tax or DPT; (ii) the Indian equalization tax; (iii) the Digital Service Tax utilized all

over Europe; (iv) the significant economic presence or digital PE test used in a variety of jurisdictions, including, among others, Malaysia, Israel, Slovak republic, and India; and (v) withholding taxes (WHT) with in conjunction with innovative source rules were adopted in Latin America (LATAM).[5]

In what has been identified as the BEPS 2.0 project, OECD efforts to arrive at a uniform solution for the taxation of the digitalized economy was kept going ahead and, indeed, invigorated after 2015 with a strong support from G-20, and the companion of an immense group of peripheral nations (approx. 140) pooled in the Inclusive framework.

The creation of the inclusive framework in 2016, in what I consider was the most surprising political success of OECD in the last decade, allowed OECD to bring into the Project and aligned with the global objectives pursued by the leading nations, a meaningful group of peripheral economies (including BRICS) gathered to that end, more or less unconditionally, and, at instances, even against their own particular interest.

All of the above mentioned unilateral experiments (DST, WHT, and the like) are now to be dismantled altogether as a condition for the application of Pillar I of the global tax deal on targeted multinational companies (MNCs).

Some query whether WHT are actually caught by the ban, though I definitively believe they should be. If Amount A were to be applied on top of existing WHT without crediting them against the Amount A attributed to given jurisdictions, the tax burden at market States would increase beyond what might have been expected by targeted digital service MNCs, creating multiple layers of tax on the same item of income, an inter-nation inequities among market jurisdictions with or without existing digital service WHT at the time of implementation of Pillar I.

2. Pillar I Transvestism: From the Significant Economic Presence Test to Pillar I of the Global Deal (2018-2021)[6]

The OECD Interim Report of March 16, 2018, emphasized the need to work towards a definitive solution on the taxation of the digitalized economy. Immediately after, the proposed EU Directive of March 21, 2018, called for an interim (DST) and a definitive solution; the latter to be based on a substance economic presence test with an attribution of profits on the basis of the profit-split method.

The significant economic presence test was kept as an alternate global nexus In OECD until the Public Consultation Document released a year later (6 March 2019). Concerning the attribution of income to where a significant economic presence was verified, this Document applied a formulary approach based on sales, assets and personnel, complemented by a withholding tax as a collecting tool.

The subsequent OECD consultations document also released in March 2019 presented two alternatives to measure value, and hence income, attributable to market jurisdictions which to some extent functioned as proxies to the significant economic presence test: (I) the user participation proposal, for highly digitalized businesses, and (ii) the marketing intangibles proposal, for highly digitalized and consumer-facing businesses.

However, a new document released on May 29, 2019, abandoned the prior line of work and gave birth to the current Pillar I and Pillar II solution, later developed in the OECD Unified Approach.

The OECD Secretariat Proposal for a “Unified Approach” under Pillar One, released in November 2019, was aimed at reaching a viable solution that avoided complexities and increases certainty. To this end, a three-tier mechanism was developed, consisting of Amount A, and Amount B, as defined, as well as a binding dispute resolution mechanism.

Amount A in its current version (after the final shaping of the Blueprints, as later refined and agreed by G20 in October 2021) is equal to 25% of residual profits, defined as profits in excess of 10%; amount A is allocated to market jurisdictions to which targeted MNCs are deemed to meet a certain sales threshold, based on an allocation key and source rules.

Targeted MNCs are now groups with a global turnover of at least Euros (€) twenty (20) billion and a profit margin which exceeds10%.

Pillar I is to be implemented through a multilateral convention and domestic legislation changes as well.

Are peripheral countries better off with Pillar I as finally designed in terms of revenue collection or otherwise?

As predicated, Pillar I entails the following advantage which benefits central and peripheral countries as well: It is a global unified response which materializes the pro-business objective of worldwide harmonization which would prevent/minimize the double or multiple taxation situation that would have arisen from the co-existence of diverging and conflicting unilateral systems of taxation.

Disadvantages, instead, particularly for LATAM countries, focus on (i) the excessive complexity for both taxpayers and tax administration, coming from complex, formulary rules on the allocation of income to markets, which apply throughout the chain of entities belonging to targeted MNCs. This entirely new allocation system might be far beyond LATAM tax administrations’ current human and technical capacities; (ii) the highly improbable acceptance of binding conflict resolution procedures, bearing in mind that no LATAM country adopted similar procedures (tax arbitration) under MLI. As designed, these binding procedures would be pivotal for the resolution of expected allocation conflict in connection with the application of Amount A; and (iii) revenue dissatisfaction: A wide perception among LATAM tax administrations that under Pillar I, OECD has been excessively pegged to a theoretical economic approach, lacking the political flexibility required to arrive at a satisfactory outcome that genuinely contemplates their interest. In other words, that compared with competing alternatives (WHT, DST) Pillar I would not change much in terms of an actual, meaningful allocation of taxing powers to the region.[7]

3. **Pillar II: A disruption in the International System affecting Peripheral Countries and favoring The Coffers of Central Economies**

Starting with the mandate of a global minimum tax rate equal to an effective 15% computed on a state-by-state basis, Pillar II, provides a disruptive, innovative income inclusion rule (IIR) which allows the jurisdiction of the ultimate parent to tax controlled entities down in the chain, up to the

minimum effective 15% rate. Targeted MNCs are those with sales in excess of € 750 MM.

The implementation of Pillar II would require domestic statutory changes, and if a State does not implement it, must at least allow other countries to apply the Globe Rules of which IIR is the core.

Predicated advantages of Pillar II center on the elimination of harmful tax competition (race to the bottom), an objective mainly associated with common practices among industrialized countries. It is worth mentioning, however, that among peripheral countries, the granting of tax incentives are more a pivotal tool associated with macroeconomic and tax policy design and the need to attract FDI.

Pillar II, meanwhile, imposed a severe limitation on jurisdictional power to tax or exempt; and a transfer of public revenues to foreign countries (MNCs' home country) through the top up taxation (IIR), which do not appear to be entirely justified under current principles of international law.

The international relationships among states, as we know them today, were developed as far back as the seventeenth century (Peace of Westphalia), where two fundamental pillars were set forth: (i) the reciprocal respect of each other State's sovereignty (juridical equality of States), (ii) based on a set of harmonized principles shared by all (coordination system).[8] In turn, the principles of international law become such when they are widely shared by the international community, giving rise to what is called an *opinion iuris*, and thus, creating a customary rule of international law.

So far, beyond the particular case of passive and other easily allocable income to foreign sources, under certain statutory conditions which are similar among nations, there is no *opinion iuris* in international tax law allowing one country to tax income that another country (not a tainted offshore jurisdiction) having a primary right to tax decide to exempt or otherwise privileged following its own criterion for tax policy design.[9]

Besides, one may wonder whether this was the adequate, proportional response to fight tax havens' proliferation:[10] I am afraid there might have been others less detrimental to peripheral countries that are not (and may not be) labeled as tax havens. Unless substantive business carve outs are finally contemplated, Pillar II interference with the market/source countries' right to design its tax policy on legitimate businesses operating within their border is unguaranteed under international law and disproportionate with the objectives pursued.

Of course the topic is highly debatable and I am sure the LATAM regional perspective does not coincide with that of an observer from central (industrialized) countries, where most headquarters of targeted MNCs are based. In any case, I find those critics strongly supportable from the peripheral countries' view point.[11]

4. How Costly to LATAM would be Adhering to the Two Pillars OECD solution?

Adhering to Pillar I would not be revenue neutral in LATAM. In the years following the 2015 Final Report on BEPS Action 1, WHT on digital services spread over LATAM. Peru enhanced old rules on technical services to that effect, while Uruguay aimed at enhancing its jurisdictional reach on foreign digital services, adopted source rules which confer tax jurisdiction to the country where the customer or client is situated, regardless of the place where the digital service or good provider performs its activities.

A similar rule for B2B services was proposed in Argentina in 2017, but not finally approved. The following rule was included in previous versions the tax bill sent by the Executive Branch to Congress on November 15, 2017:

(First article added after article 13, ITL)

"Article … (I). – *It is presumed, without admitting proof to the contrary, that FIFTY PER CENT (50%) of the price paid for digital services provided through the Internet or any adaptation or modification of the protocols platforms or technology used by the Internet or another network through which equivalent services are provided, constitutes net gain of Argentine source, when the service is economically used in the country. The regulations will establish the scope of the referred supplies."*

Since this proposal was deemed highly inconvenient at the time for policy, legal and technical reasons, The Ministry of finance decided to abort it before sending the bill to Congress.[12]

Although the Argentine income tax law (ITL) has not been changed on point since then, the National Tax Directorate, a technical body within the Treasury which is also the competent authority for treaty purposes, have issued a couple of opinions which collide with the Argentine domestic and treaty rules (Uber and Facebook cases).[13]

In Uber, based on an extravagant assimilation between the digital intermediation activity deployed from the Netherlands, and the underlying private transport business carried out locally by resident third parties which offer services through the digital platform, the National Tax Directorate found that Uber was engaged in transport business in Argentina; and, on that basis, built the argument that Uber had a Service PE in Argentina under the Argentina-Netherlands Treaty.[14]

In Facebook, reverting a binding opinion previously given by the tax authorities less than 2 years before, The National Tax Directorate sustained that advertising services rendered from abroad should be characterized as telecommunication services covered by article 14, ITL, thus mixing up, mistakenly, the nature of the digital service provided by Facebook (advertising through a foreign digital platform without an actual transmission to Argentina) with the technological means through which the service is receipted by local users (the Internet), i.e., a different service usually provided by a third-party ISP to the end user.

Brazil traditionally applies WHT on payment remittances for technical services rendered from abroad at a 15% rate (or 25% for black-listed jurisdictions), though specific treaties may contemplate lower rates, i.e.10%; technical services is a concept which might be construed to include digital services as well.[15]

Most Brazilian treaties establish in their Protocol that technical services should be treated as royalties under article 12. Exceptions to this rule are treaties with Austria, Finland, France, Japan and Sweden where technical services should be treated as business profits under article 7 as per the Brazilian Federal Revenue Interpretative Act 5/14. More recent treaties provide for technical services in specific treaty articles.

Chile, Colombia and Mexico have been, instead, more OECD-aligned concerning the direct taxation of digital services, though proposals have existed in Colombia and Mexico to proceed otherwise.

Moreover, DST-type levies at the subnational Level exit in Argentina (Gross turnover tax), in Brazil at the state and municipal levels (ICMS and ISS), and Mexico, mostly at the municipal level.[16]

The issue here is that beyond the data published by the OECD Economic Assessment on the potential revenues to be derived by the application of Pillar I, there is no other readily-available data in LATAM comparing the revenue yield under Pillar I and that coming from alternative solutions such as current WHT or DST.

Pillar II may also be costly to the region because of the wide use of the tax systems as a tool to attract FDI, including but not limited to free-trade zones which are significant in Brazil (Manaos), Uruguay (Montevideo, Nueva Palmira), Costa Rica, Argentina (Tierra del Fuego), and sectorial incentives to targeted industries. Query also whether corporate territorial regimes in the region (such as those in Bolivia, Costa Rica, El Salvador, Guatemala, Nicaragua, Panama, Paraguay, Uruguay) might be impacted by the minimum taxation under Pillar II.

As in the case of Pillar I, there is no readily available data in LATAM on the effect of eliminating current tax incentives to avoid IIR under Pillar II. Costa Rica is currently the only LATAM country which is addressing and evaluating this issue at the official level, with private stakeholders' participation.

If we observe the countries in the region, we find that (i) the domestic discussion on the internalization of the Pillars has not yet commenced;[17] and (ii) they currently behave (whether keeping or increasing corporate tax incentives) as if Pillar II's top up tax would never become a reality. As the most recent example, the extraordinary sessions of the Argentine Congress which are taking place this month were called to discuss among other bills, new initiatives for the granting of preferential corporate tax treatments to certain sectors of the economy.[18]

One possible development one might envision within the region, unless business carve-out under Pillar II becomes meaningful, is the appearance of soak-up taxes to neutralize top up taxation. These might either take the form of a minimal 15% taxation on targeted MNCs (i.e., € 750 MM or higher) or a provision similar to that existing under Argentine law pursuant to which tax benefits afforded should not be effective whenever they result in a transfer of revenues to foreign treasuries as it would happen with IIR.

Section 28, ITL, expresses:

"The total or partial exemptions or deductions that affect the assessment of this law included or not in it, will not produce effects to the extent that this could result in a transfer of income to foreign treasuries. The foregoing provisions shall not apply with respect to … (certain identified exceptions) nor when it affects international agreements signed by the Nation in matters of double taxation. The extent of the transfer will be determined in accordance with the records that taxpayers may provide. In the event that said contribution is not made, a full transfer of the exemptions or deductions will be presumed, and the respective amounts should be granted the treatment established by this law according to the type of income concerned."

Section 28, initially conceived to avoid the transfer of revenues in the case of foreign taxpayers from credit-country jurisdictions that did not allow a matching credit for the tax payable in Argentina but for the exemption granted, would be equally applicable to neutralize top up taxation under Pillar II. If so, targeted MNCs may be faced with double taxation since credit-countries have

been traditionally reluctant to recognize a foreign tax credit in this type of situation.

5. **Implementation issues: A Primer**

As regards the chances of a fast Internalization of the Pillar I multilateral instrument in LATAM, it is worthy to mention that although MLI was first signed in Paris in June 2017, a number of countries in the region (Argentina, Colombia, Mexico, and Peru) have not yet ratified MLI (or deposited the instrument of ratification with OECD).[19] Brazil was not even a signatory of MLI. This precedent may give some clues on what can be expected to happen with the Pillar I multilateral instrument's internalization process, so that expectations of a prompt ratification are rather low.

Internalization of both Pillars in LATAM countries (including the approval of domestic amendments) might be a troublesome and slow process, not only because of the technical complexity and innovation that they entail, but also because of political reasons that Congressional leaders might have to oppose or make observations on them.

Besides, pursuant to the division of powers inherent to the Republican form of government, the consent within the inclusive framework has been expressed by delegates of the Executive branch, in most cases even without participation of the pertinent Congress' technical Committees (e.g., The Ways and Means Committee of the House of Representatives or the Finance Committee of the Senate) which, at the time, will need to start discussing the very nuances of Pillar I and II from scratch, with an uncertain outcome.

* This contribution is based on the comments made by the author as panelist on "Tax Policy & Simplification Part 2 The New Global Tax Pacts: A Primer & Policy Perspectives on the OECD's Landmark Pillar I and II Profits' Pie Agreements" ABA Tax Committee, Mid-year Tax Meeting, February 4, 2022

[1] See Teijeiro, BEPS Project at half way – Entering the implementation stage, Kluwer International Tax Blog, November 30, 2015

[2] Id. note 1

[3] Se Teijeiro. International Taxation and the Moral Debate.Kluwer International Tax Blog, May 23, 2016

[4] Teijeiro, The BEPS Project Lacks Comprehensive Definition on the Taxation of Digital Economy in Market Jurisdictions, Kluwer International Tax Blog, October 24, 2015

[5] Teijeiro, A call for a Sustainable Response to the taxation of Digital Economy within the International Income Tax System, Kluwer International Tax Blog, October 5, 2017. See also Teijeiro, Is income taxation of foreign digital goods and services in the market state compatible with current international principles on the attribution of tax jurisdiction?, Kluwer International Tax Blog, November 222, 2017; Teijeiro, Are We Finally Coming into Terms on the Taxation of the Digitalized Economy? A View from a LATAM Perspective, Kluwer International Tax Blog, June 28, 2019; and Riccardi et.al.,Swimming against the Current? Taxation of the Digitalized Economy in Latin America, Bulletin for International Taxation, IBFD, 2019 (Volume 73), No. 10

[6] See on the various steps of this evolution, Essays in Honor of H. David Rosenbloom, Kofler, Mason, Rust, Eds., IBFD, 2021, Chapter 46, Teijeiro, Direct Taxation of the Digitalized Economy: Towars a Simplified Income Tax Model for Market Economies, p. 589

[7] Id. note 6

[8] Jimenez de Arèchaga, Derecho Internacional Pùblico, Fundaciòn de Cultura Universitaria, 2nd edition, II, p. 106

[9] Similarly, there was no *opinion iuris* back in 1962 when the Kennedy administration's tax reform was proposed and passed by the US Congress, adding subpart F to the IRC; later on, however, the international community accepted the practice through the generalized adoption of some form of CFC legislation.

This might happen once again with the top up taxation as provided under Pillar II, depending on its level of acceptance through internal legislative changes, but the concept itself is highly disruptive today and clearly affect the taxing powers (including the right to exempt) of peripheral countries.

[10] Back in 2015, I expressed a similar critic on the Brazilian full inclusion CFC regime, see BEPS Action 3: Public Discussion Draft on Strengthening CFC Rules: A Legal Critique to the Possible Implementation of a Full-income CFC System, Kluwer International Tax Blog, April 9, 2015

[11] Through BEPS and the new Global Tax Deal OECD has become the Pied Piper of international taxation: Remember the old fairy tale? In effect, called to charm away the "rats" of the international tax system, including the many loopholes BEPS was aimed to close, and the lack of suitable tools to fairly apprehend income from the digittalized economy under Pillar I, it also took away some of the basic paradigms with Pillar II, such as the full respect to the tax sovereignty of the peripheral countries under international general law, and the associated inter-nation equity

[12] Teijeiro, Is income taxation of foreign digital goods and services in the market state compatible with current international principles on the attribution of tax jurisdiction? Kluwer International Tax Blog, November 22, 2017

[13] See Teijeiro, id. note 6, at p, 594, footnote 12.

[14] For a critical analysis of this decisión see Teijeiro and Vazquez, Argentina / OECD / International Taxation of the Ride-Sharing Economy: Source Taxation through Service Permanent Establishment Provisions Revisited -The Case under the Argentine Treaty Network, Bulletin for International Taxation, IBFD, 2019 (Volume 73, 12)

[15] Id. note 5. Riccardi et. al.

[16] Id. note 5 Riccardi et. al.; see also Teijeiro and Vazquez, DIGITAL ECONOMY´S SUBNATIONAL TAXATION IN ARGENTINA, in 30 anos da Constituicao Federal de 1988, Uma Nova Era na Tributacao, Estudos em Homenagem ao Professor Sacha Calmon, Frattari and Lobato eds, ABRADT/ARRAES,2018, p. 269

[17] As recently as January 27, 2022, CIAT, OECD and IDB organized a meeting where the progress related to Pillars 1 and 2, which aim to address the challenges of the digitalization of the

economy, was presented.

https://www.ciat.org/ciat-oecd-and-idb-meet-with-latin-american-and-caribbean-countries-to-discuss-progress-related-to-pillars-1-and-2-and-evaluate-cooperation-actions/?lang=en

[18] Presidential Decree 51/22

[19] https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf The information is updated as of February 9, 2022

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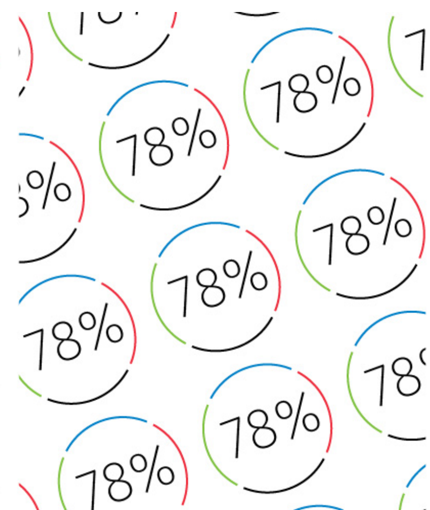

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