Submission on Workstream II: Taxation of Income Derived from the Provision of Services in an Increasingly Digitalised and Globalised Economy

Submitted to the

Intergovernmental Negotiating Committee
UN Framework Convention on International Tax Cooperation

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ABSTRACT

This submission, building on a prior contribution and supporting research, addresses the complexities of taxing income from cross-border services in a digitalised economy. It critiques the Co-Lead's Draft Options Paper, arguing that digitalisation has fundamentally altered the traditional basis for service taxation, shifting from physical performance at the customer's location to virtual delivery with minimal local presence. This raises difficult questions regarding the allocation of taxing rights, as both the provider's and customer's jurisdictions have legitimate claims. The submission highlights the rapid growth of business-to-business and automated digital services, the limitations of current withholding tax (WT) arrangements, and the narrow application of digital services taxes (DSTs). It advocates for a fair allocation of taxing rights rooted in where economic value and revenues are genuinely generated, rather than just the formal residence of entities. The paper evaluates two main approaches: taxation on a gross revenue basis (e.g., WTs), which is administratively simple but risks economic distortions, and net income taxation, which offers a more equitable solution but is administratively complex. It suggests that a combination of both methods - offering a net income option alongside a gross-based minimum - could address administrative and fairness concerns. The submission concludes that a sustainable protocol should establish sourcing rules for attributing revenues and enable shared taxing rights to reflect the contributions of both supply and demand sides.

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Introduction

This submission on the Co-Lead's Draft Options Paper of 21 January 2026 follows up the initial submission we made to this workstream in July 2025, and is based on a research paper we commissioned, which includes more detailed data and analysis.[1]

Statement of the Problem

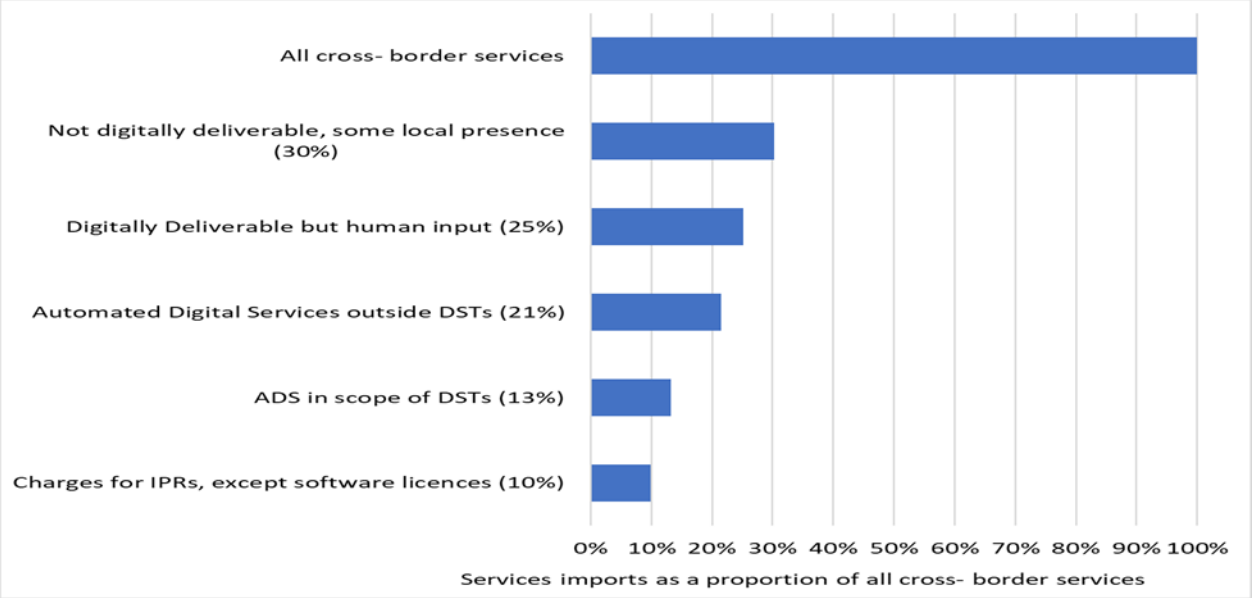
We respectfully suggest that the Options Paper misstates the nature of the problem. As we pointed out in our previous submission, all states tax income from activities where they are considered to take place. For services this has generally been the place of performance of the service. Services entail close and often continuous contact between the services provider and the customer, which traditionally involved direct physical contact, so performance was at the customer's location. This has been fundamentally disrupted by the impact of digitalisation, beginning with the information and communication technology revolution of the 1960s, and accelerating with the emergence of the internet and the world wide web in the 1990s. Digitalisation has facilitated the rapid expansion of cross-border services, enabling delivery with little or no local physical presence of the services provider.

While digitalisation has enabled the physical separation of services suppliers and customers, paradoxically it has also greatly strengthened the links between them, facilitating real-time and continuous contact, systematic collection of a wide range of data, and even contributions of content from users that enhance the services. Hence, the initial question is where are services performed? Legitimate rights to tax can be claimed by both the country where the customer is located and that from which the services are provided.

It is important to understand the dimensions of the key categories of cross-border services. Business-to-business (B2B) services have expanded most rapidly, facilitated by their digital deliverability. Payments to nonresidents for such services are deductible from the customer's business profits so directly reduce the source tax base, consequently they have been subject to withholding tax (WT) in many developing countries. However, as the Options Paper points out, a WT on fees for technical services is allowed in only around a quarter of tax treaties with developing countries. Furthermore, 'technical' services are considered to entail some human input, which excludes automated digital services (ADS), such as telecommunications, financial services and software licensing, as well as those which have been subject to digital services taxes (DSTs) in many countries, such as cloud computing, intermediation and streaming services. While payments for technical services are substantial, estimated at 25% of all cross-border services, the category of ADS has rapidly expanded to be even bigger, reaching an estimated 34% in 2023. However, only some 13% are within the scope of DSTs.

[1] Amaro and Picciotto (2026), *Options for a Protocol on Services under the UN Framework Convention on International Tax Cooperation*.

Graph: Cross-Border Services Imports by Mode of Delivery 2023



Source: Amaro and Picciotto (2026).

Taxing Rights and their Allocation

What is sometimes called 'taxable nexus' is simply the inherent jurisdiction and power of states to tax the income of their residents as well as the income deriving from activities within their territory. Although in principle states can tax their residents also on their income from abroad, as regards corporate profits most do not do so, and they exempt foreign income. Even states that historically to some extent taxed their corporate residents on worldwide income, including on 'controlled foreign corporations', have now designed these as anti-abuse measures, and their corporate tax systems are essentially territorial. International tax coordination should now focus on determining an appropriate and fair allocation of rights to tax income based on where real activities take place.

The basic approach is now stated in the draft article 5 of the Framework Convention Template of January 2026. This calls for a fair allocation of taxing rights among jurisdictions 'in which value is created, markets are located, revenues are generated or economic activities take place'. The Services Protocol should be rooted in this statement of principle.

It should be noted that this does not mention the country of residence. A key technique for base erosion and profit shifting is to route payments for services through entities treated as resident in countries where the income is taxed at low or zero rates. Consequently, the formal residence of the entity receiving payments is not relevant. The key factor is the location of the personnel and physical assets that enable the supply of the service. The location of the customer should also not be based on residence. Profits can only be realised through revenue from sales, so it is the country from which revenues derive that should have a right to tax a share of the income. This would usually be the country from which payments are made for the services.

However, digitalisation has complicated the attribution of revenue from sales. In particular, it has enabled the systematic collection of data about users, which can be sold or licensed,

often to a buyer in a third country. For example, data collected by a supplier of digital services based in country A from users in country B can be licensed to an entity in country C to display advertising to the country B users. In this case, although the payments derive from country C, their value can be said to derive from country B, where the users are located. Similarly, digital platforms provide intermediation services between customers and providers of other services, who may be located in different jurisdictions. In this case the country of location of the third-party services provider and that of the customer have equal claims to be considered the source of revenues from intermediation. Such cases can and should be dealt with by sourcing rules that attribute revenue from sales to the jurisdictions from which the income should be considered to derive.

Importantly, these rights to tax should not be exclusive. The protocol should not determine which country has the right to tax the whole of the income, but should formulate agreed rules or standards for *sharing* the taxing rights fairly. As draft article 5 suggests, such a fair allocation should take into account the contributions to generation of profits from both the supply side and the demand side, the location of the provider of the services as well as that of the customer or user.

Ensuring a fair allocation of taxing rights is difficult because services providers can derive substantial revenues from countries where their lack of physical presence means that they have few or no costs. Agreement would be needed on a method of attributing taxable income to market countries that would be acceptable to supplier states so that they would credit the tax paid. Early discussions in the workstream identified two possible approaches.

Gross basis vs net income taxation

Attribution based on a percentage of gross revenue, as with WTs, would be easy to administer. However, there is a wide disparity of marginal profitability of various kinds of services, for example between ADS and more labour-intensive services, such as engineering or consultancy. This could be dealt with by adopting different rates for specified categories: for example, a report for the government of India has proposed rates of 5% (equipment supply), 10% (engineering/infrastructure), 20% (general), and 30% (ADS).[2] Nevertheless, these would only produce rough approximations of the net profit, and would give rise to categorisation problems and disputes.

This approach is also open to the same criticisms from the economic perspective as a WT on gross payments, that it is equivalent to an excise tax or tariff, so is likely to raise costs for customers. A recent economic analysis for the International Chamber of Commerce has analysed the effects of adoption by global South countries of a broad WT based on article 12AA of the UN model, capped at a rate of 3% in treaties with the global North and 10% with other South countries. It estimates that this would result in tax revenue gains of some $7.0 billion. However, it claims that this would be offset by about the same amount because ‘weaker trade and investment [would] reduce aggregate output and corporate profitability’. This is based on assumptions that the increased costs would reduce imports of services that

[2] NITI Aayog (2025). *Enhancing Certainty, Transparency and Uniformity in Permanent Establishment and Profit Attribution for Foreign Investors in India*.

could not be supplied at competitive pricing or quality locally, creating a 'drag on economic performance' and fall in GDP, with consequent negative fiscal effects.[3] Conversely, a WT on payments to nonresidents may encourage foreign firms to create a local presence, or boost local providers by ensuring a level playing field.

In our view, as suggested in our previous submission, the more promising approach for a sustainable solution on sharing taxing rights would be net income taxation. This could be implemented through a simplified or a more comprehensive method. The simplified method, which is provided as an alternative in Article 12B of the UN model, involves applying the multinational enterprise's (MNE's) global profit rate to a share of the local sales revenue (30% in article 12B). A more comprehensive method was agreed for Amount A of Pillar One of the BEPS project. As the Options paper points out, the scope of Amount A was limited to a small number of very large and highly profitable MNEs, but the same methodology could be applied more widely. This would build on the achievements of the Inclusive Framework, particularly in the proposed rules for Amount A. These are particularly helpful in providing sourcing rules for attributing sales revenue for services, especially for revenues from licensing user data, and from intermediation.

Combining the two approaches

It would also be possible to combine the two approaches. This could be by offering a net income method as an alternative to attribution of income based on a percentage of revenues, as in article 12B, or by specifying a net income method based on apportionment subject to a minimum tax based on a revenue percentage, as recently enacted in Nigeria. However, the percentage rate would need to be high for the net option to be effective.

[3] Oxford Economics (2026), *Economic impact of Article 12AA New UN tax model provision on cross-border services.* ICC.