CHAPTER 9

TRADE IN DIGITAL SERVICES AND INTERNATIONAL TAXATION: IMPLICATIONS FOR DEVELOPING ASIA

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The rise of the digital economy has offered opportunities to expand trade in digital services in Asia and the Pacific. Technology firms and digital intermediation platforms from the region are leading the expansion by delivering traditional services through digital tools and providing a range of new digitally intensive services. As digital service providers do not need physical retail presence to operate, their expansion has created scope for firms to lower taxable income artificially, with potential losses of revenue in the jurisdiction where profits are generated. The rapid emergence of technology firms in Asia means that these taxation losses could be more significant than in other developing regions.

Reforms of international tax rules endorsed by 137 jurisdictions will be important for Asia's prospects on digital services trade. Proposals for new nexus and profit allocation rules for taxing rights beyond physical presence directly target automated digital service providers. As the region hosts some of the largest providers of digital services, a global minimum tax may impact the sector. In parallel, Asian economies have gradually introduced measures to levy indirect taxes on imported digitally delivered services. Some economies have also adopted unilateral tax measures on digital services. Understanding their impact and ensuring consistency with trade rules and regional agreements are essential.

9.1 Digital Services Tax Models in Asia and the Pacific

Concerns over multinationals tax avoidance practices have been raised in the context of the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting initiative since 2013, with the increasing role of digitalization underscoring the need to adapt the international tax framework. Digital services are part of the discussion because they rely on features bringing challenges to national tax systems: reduced need for physical presence, reliance on data and other intangible assets, and growing mobility of business processes and users. In response to these challenges, several economies

have adopted unilateral measures targeting digital services to enhance tax revenues (Noonan and Plekhanova 2020). Most unilateral measures taken by Asian economies in the area of digital services can be classified into four main categories:

Digital permanent establishment. Measures to introduce amendments to domestic nexus rules to accommodate the concept of permanent establishment (PE) have been adopted in the region. These measures aim to expand the definition of nexus by accounting for significant economic presence and allowing for the taxation of profits of a nonresident corporation regardless of its physical presence in the taxing jurisdiction. Changes to the PE model include, for example, steps that base economic presence on local revenue or the number of users.

Indirect taxes on imported digital services. Economies can impose a value-added tax (VAT) or goods and services tax (GST) on goods and services that are supplied in their territory, impacting the services sectors such as internet advertising and digital intermediation services. Several Asian economies have made progress in adopting nondiscriminatory VAT or GST rules in relation to cross-border transactions.[1]

Withholding taxes. Some economies have expanded the scope of withholding taxes and the use of sector turnover taxes. A state can use a withholding tax by classifying business profits as royalties, or by introducing a fee for online digital services. The Philippines and Malaysia, for example, have included payments for the right to use software, visual images, or sound transmissions under the scope of royalties. Nonresidents providing digital services in the local market can be required to establish a local office and be subject to income tax. This often falls outside trade agreements and double taxation agreements.

Digital services taxes. These are taxes levied on the supply of a category of e-services, charged at a fixed rate, and generally applied at the place where the services are supplied. They have gained traction among economies as they are not covered by double taxation agreements. Digital services taxes (DSTs) can vary in scope of activities, revenue thresholds, and tax rates.

Table 9.1 provides a summary of recent unilateral measures covering digital services taken by Asian economies. Measures diverge in scope, mechanism, and sector, with some targeting e-commerce as well as a variety of digital services.

[1] International guidelines have been developed for making digital platforms liable for assessing, collecting, and remitting the VAT or GST due on the online sales they facilitate (OECD 2020).

Table 9.1: Recent Digital Services Tax Measures in Selected Asian Economies

Economy	Status	Effectivity Date	Type	Description
India	Enacted	1 April 2022	Digital PE	Revenue related to the digital PE
	Enacted	1 October 2020	WHT	Gross amount of sale of goods or provision of service facilitated through digital or electronic facility or platform
	Enacted	1 June 2016	Equalization levy	Gross amount of online advertising payments
	Enacted	1 April 2020	Equalization levy	Online sale of goods, provision of services or services facilitation (when operatory provides platform for others to supply service)
Indonesia	Enacted	31 March 2020	Digital PE	Revenue related to the digital PE
	Enacted	31 March 2020	Electronic transaction tax	Imposed on e-commerce sales when the digital PE cannot be applied due to the provision of a tax treaty
Japan	Announced	8 March 2021		Currently in discussion. Tax measures the allocation of tax rights to market economies (Pillar 1) for digital companies and the like, and evaluation of a DST based on case studies in other economies
Malaysia	Enacted	13 May 2019	WHT	
Pakistan	Enacted	1 July 2018	WHT	Payments for offshore digital services (online advertising, designing, creating, hosting or maintenance of websites, uploading, storing or distributing digital content, etc.) performed by nonresident persons
Singapore	Waiting for global solution	7 Dec 2020		To be based on international consensus on issues relating to the taxation of the digital economy
Taipei,China	Enacted	24 July 2019		Payments for online advertisement for e-services (online games, videos, audio broadcast, movies, music platform services, etc.) supplied to Taipei,China customers by foreign service providers without fixed place of business or business agent in Taipei,China (ESS providers)

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Table 9.1 *continued*

Economy	Status	Effectivity Date	Type	Description
Thailand	Proposed	To be determined	WHT	Income from e-commerce supplies of goods and services, including online advertising, gaming, shopping, and others
Türkiye	Enacted	1 March 2020	DST	Gross revenue derived from in-scope services (i.e., digital advertising services; sales of any audible, visual, or digital content services for the provision and operation of a digital platform)
Viet Nam	Enacted	1 January 2021	WHT	Income derived by nonresidents from digital and e-commerce operations in Viet Nam

DST = digital services trade, PE = permanent establishment, WHT = withholding tax.

Sources: International Monetary Fund (2021); KPMG (2021); and national tax administrations.

9.2. International Tax Reforms: Implications for Digital Services Trade

9.2.1. A New Right to Tax without Physical Presence

An important component of the agreement reached by members of the OECD/G20 Inclusive Framework in October 2021 is the creation a new taxing right to market economies which is independent from physical presence. The new taxing right allows to overcome the limitations of the PE concept (either the fixed base or dependent agent as provided in Article 5 of Double Tax Treaties) and to prevent double taxation.

Pillar One in the multilateral solution brings together three previously competing proposals into one solution.

Amount A: Setting a New Taxing Right Based on the Residual Profit of Multinationals

Amount A provides for a new taxing right on the residual profit of multinational enterprises (MNEs) when they meet a threshold in size and profitability. It refers to a certain percentage of the deemed "residual profit" of an MNE. Amount A is based on global financial accounts of profit before taxes where part of the income is allocated to jurisdictions based on a pro rata revenue allocation. The new taxing right allows for market jurisdictions (those where goods and services

are consumed) to tax part of the MNE's profits even in the absence of physical taxable presence. Amount A is applicable to all MNEs that meet two quantitative thresholds: a global turnover exceeding €20 billion (which may be reduced to €10 billion after 7 years of its implementation), and a profitability threshold above 10%. These MNEs will be subject to Amount A liability irrespective of the type of activity developed.

In addition, a significant part of that global revenue needs to be derived from foreign sources (the "*de minimis* foreign source in-scope revenue test"). Therefore, in-scope MNEs will be the ones deriving at least €1 million in revenue from a particular jurisdiction. For smaller jurisdictions with GDP lower than €40 billion, the nexus will be set at €250,000. This nexus rule will apply solely to determine whether a jurisdiction qualifies for the Amount A allocation. However, extractives and regulated financial services will be excluded.

Amount B: A Fixed Return for Marketing and Distribution Activities

Amount B proposes a fixed return for standard ("baseline") marketing and distribution activities taking place physically in a market jurisdiction. It is based on the arm's length principle. It tries to create a simplified approach to deal with market distributors. Contrarily to Amount A, it could be applicable to all MNE groups. The genesis behind Amount B is the perception that a significant number of disputes under the Mutual Agreement Procedure have dealt with determining the appropriate remuneration for marketing and distribution functions and that developing economies experienced particular difficulties in dealing with these transfer pricing disputes. Therefore, Amount B seeks to simplify the administrative burden put on tax administrations, lower the compliance costs for taxpayers, enhance tax certainty, and reduce tax disputes. For that purpose, it sets a fixed return—that is deemed to be in accordance with the existing arm's length principle—for marketing and distribution functions.

Tax Certainty

The third fundamental component of Pillar One is an overall enforcement of tax certainty through innovative and effective dispute prevention and resolution mechanisms. While aspects of the agreement need to be completed, multinationals headquartered in Asia and the Pacific will likely generate a significant share of the residual profit to be reallocated among jurisdictions, with a disproportional contribution from information and communication technology and technology firms (IMF 2021).

Pillar One also aims to improve tax certainty through innovative and effective dispute prevention and resolution mechanisms (Box 9.1).

Box 9.1. A Dispute Prevention and Resolution Mechanism for Taxing Rights

The Organisation for Economic Co-operation and Development Pillar One Blueprint proposes a mandatory binding dispute prevention procedure to provide early certainty on the application of the new taxing right. For the assessment of the filed Amount A self-assessment return and dispute resolution, a similar procedure would apply. The multinational enterprise (MNE) group would submit a request to apply the early certainty procedure to the "lead" tax administration (which should correspond to the country where the ultimate parent entity is located). The lead tax administration would conduct an initial review of the request to assess whether a review panel is needed.

For the assessment of a filed Amount A self-assessment return or a dispute resolution request, this would also first be reviewed by the lead tax administration to make such an assessment. If the lead tax administration concludes that a panel review is needed, a panel comprising representatives of six to eight affected tax administrations would be set up. Besides the lead tax authority, this panel would consist of jurisdictions from which relief is sought and recipient market jurisdictions under Amount A. The conclusion reached by the panel could be accepted or rejected by the MNE group. If the review panel is unable to reach a conclusion, a "determination panel" would be constituted with the obligation to reach a decision.

The outcome of this process would be binding for the MNE group and the tax administrations involved. If the MNE group does not accept the review or determination panel's decision, it may withdraw its request and use domestic administrative and judicial review procedures in the respective jurisdictions. For issues beyond Amount A, the Pillar One Blueprint proposes to improve existing dispute prevention mechanisms and develop new ones.

Source: OECD (2021).

Implementation

To ensure proper implementation of Pillar One, model rules have been developed within the OECD Inclusive Framework, with three main spheres for implementation:

- **Domestic legislation to create taxing rights consistent with the design of Amount A.** Each jurisdiction part of the agreement on Pillar One should adopt rules like identifying taxpayers, tax base, taxable period, tax rates, all consistent with Amount A design.
- **Public international law to overcome obstacles in tax treaties as regards Amount A.** This should be achieved with the development of a new multilateral convention. This new self-standing multilateral treaty would rule the implementation of Amount A. It is required as to overcome

existing treaty barriers such as Article 7 (Business Profits) of Double Tax Treaties. The Multilateral Convention will supersede bilateral tax treaties in force. It will also ensure a coordinated and consistent approach, for dealing with identifying paying entities and who bears the double tax relief. The same applies as regards the new tax certainty process.

- **Guidance to supplement the domestic and international legislation.** Its role will be to support and supplement domestic legislation and provisions of public international law. The Multilateral Convention and domestic law will be the primary means of applying Pillar One and will contain detailed rules.

9.2.2 A Global Minimum Corporate Tax for Multinational Enterprises

A second key component of the multilateral agreement endorsed by 137 jurisdictions is that multinationals, regardless of their sector and country of operation, will pay a minimum 15% of corporate income tax. This Pillar Two gives economies the right to "tax back" profit that is currently taxed below the minimum agreed rate. It essentially operates as a "top-up" tax, up to the minimum rate.

Together with achieving a minimum taxation on income, Pillar Two aims to considerably reduce incentives of MNEs to shift profits to low-tax jurisdictions and strengthen the transparency and predictability for tax administrations and firms.

These goals are achieved with two sets of interrelated rules that protect source economies against base-eroding payments and ensure that all international businesses pay a minimum level of tax on the income in each jurisdiction in which they operate. The two sets of rules are discussed in the succeeding paragraphs.

The Subject to Tax Rule

The subject to tax rule (STTR) is a treaty-based provision that applies for certain payments (at least interest and royalties and also a list of other covered payments) between connected persons. The rule is applicable where payments are subject to a nominal rate below 9% at the level of the recipient. The nominal rate adjusted for reductions in the tax base directly related to the income or entity receiving it. It allows the source jurisdiction to impose a tax on the gross amount of the payment only up to the difference between the agreed minimum rate and the adjusted nominal tax rate on the payment. The amount is creditable under the effective tax rate (ETR) of the second set of rules, the GloBe rules. In other words, the amount charged through the application of the STTR will be accounted for

when calculating the ETR in the context of the application of the GloBE rules described below.

GloBE Rules

GloBE rules involve the income inclusion rule (IIR) and the undertaxed payments rule (UTPR) that operate through domestic legislation.[2]

The IIR is the primary rule, while the UTPR works as a backstop. Both apply under the same €750 million threshold as the country-by-country reporting and exclude the same entities as under Pillar One. The mechanism for applying these rules is by reference to the effective tax rate by jurisdiction. Whenever the ETR in a jurisdiction is below the minimum agreed rate there will be a top-up tax percentage to bring the ETR in that jurisdiction up to the minimum rate of 15%. The calculation of the effective tax rate corresponds to the ratio of adjusted covered taxes paid over the net GloBE income obtained in the jurisdiction. A substance-based income exclusion allows to reduce the amount of GloBE income (Box 9.2). The substance-based income exclusion is based on a fixed return of payroll expenses in a jurisdiction and a fixed percentage of the carrying value of tangible assets in a jurisdiction. The IIR operates like a controlled foreign company rule. The UTPR is applicable when the IIR cannot be applied—i.e., when the top-up tax has not been caught under the IIR.

There is, however, a *de minimis* exclusion for jurisdictions where the MNE has aggregated revenues of less than €10 million and profits of less than €1 million. These conditions are cumulative and when met, the MNE does not have to compute the ETR—and consequently potentially apply to GloBE rules—in the respective jurisdiction. This *de minimis* exclusion is justified by the fact that the top-up tax that could be collected under GloBE rules would not be as significant as the compliance and administrative burden related to the calculation of the ETR and application of the GloBE rules.

An important element for jurisdictions is the option to adopt a qualified domestic minimum top-up tax (QDMTT). In applying the GloBE rules in a jurisdiction, it is relevant to analyze whether a constituent entity that is otherwise low taxed is subject to a QDMTT. The QMDTT reduces the jurisdictional top-up tax (eventually to 0). The QMDTT may be of relevance to prevent the tax base of otherwise low-taxed income from moving to another jurisdiction due to being caught by the application of the GloBE rules. In other words, the QMDTT offers the possibility for jurisdictions with the ETR below the minimum rate to collect the additional tax up to the minimum rate, preventing such tax difference from

[2] The IIR may be complemented by the switch over rule (SoR), which is also a treaty-based rule and aims to facilitate the application of the IIR whenever a country applies the exemption method in tax treaties to relief double taxation of business profits.

moving to another jurisdiction via the application of the IIR or the UTPR. In order to meet the condition of being "qualified," a QMDTT must have the following characteristics: (i) it determines the excess profits of the constituent entity in a manner equivalent to the GloBE rules; (ii) it increases domestic tax liability with respect to domestic excess profits to the minimum rate; and (iii) it is implemented and administered in a way that is consistent with the outcomes provided by the GloBE rules and commentary, and provided that the jurisdiction provides no benefits in relation to such rules.

Box 9.2: Substance-Based Income Exclusion

The substance-based income exclusion is relevant to determine the excess profit, which corresponds to the amount of profits to which the top-up tax percentage is applied (i.e., the excess points between the agreed minimum tax rate of 15% and the effective tax rate in a jurisdiction). The substance-based income exclusion is calculated using payroll expenses and the carrying value (original cost minus depreciation) of tangible assets, and allows for exclusion of a fixed return, which is subtracted from the Net GloBE income as regards payroll expenses and tangible assets developed in a jurisdiction. These two activities are chosen because they are less mobile factors and therefore less likely to lead to tax induced behavior. The fixed return is 5%, but there is a transition period of 10 years in which the fixed return starts at 10% for payroll expenses and 8% for tangible assets. The initial percentage will be declining annually by 0.2 percentage points for the first 5 years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last 5 years.

Source: Regional consultation on international tax matters for Asia and the Pacific (June 2022).

Implementation

As regards to implementation, Pillar Two will require amendments to domestic and international laws. The GloBE implementation entails domestic law amendments, while the STTR requires changes as to existing bilateral tax treaties. Importantly, Pillar Two will be based on a common approach: economies will not be required to implement the rules but if they opt to do so, they should follow the agreed framework and rules order.

To ensure proper implementation and effective coordination of these rules, model legislation and guidance are being developed and combined with a multilateral review process for the implemented rules. It is expected that a process will identify what are considered low-tax jurisdictions for the purposes of STTR application, i.e., jurisdictions that apply a nominal tax of less than 9%. Furthermore, the development of a multilateral convention is also being considered. While

a multilateral convention is not a prerequisite for the GloBE, it may be relevant for the coordinated implementation of the STTR. For the purposes of effective administration, an important design tool for Pillar Two would be a shared filing mechanism to ensure smooth exchange of MNEs' information and an appropriate mechanism for dispute prevention and resolution.

9.2.3 A New Provision for Double Taxation Treaties

In parallel to the multilateral solution, a new article in double tax treaties was approved in April 2021 under the United Nations (UN) Model Tax Convention as a solution to tax income from digital services. The approach takes into account concerns of feasibility, administrability, and distribution of taxing rights expressed by developing economies.[3] The new Article 12B entitles the source country to levy tax on gross income—typically through a withholding tax mechanism—on payments from automated digital services.[4] The right to tax income from digital services is granted to a contracting state where payment originates even if the service is provided in another jurisdiction.

The obligation to levy a tax is placed on the payer of the service, which should apply the provided double tax treaty rate whenever the recipient is the beneficial owner of that income. In contrast to the OECD/G20 Inclusive Framework Agreement, it does not require a new nexus rule or an alternative to the permanent establishment definition.[5]

Economies may introduce the new provision in the renegotiation of or signature of future double taxation treaties, which will need to be complemented by domestic legislation. They may also consider including some thresholds to limit the administrative burden for small-sized or new taxpayers. However, the renegotiation or conclusion of new double tax treaties is a burdensome process, also dependent on the relative bargaining power of developing economies and contracting partners as for the inclusion of this provision. The potential of this instrument will depend on the widespread inclusion of the provision in existing double taxation treaties.

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[3] The UN Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee) started this process in 2017, with the formation of the Subcommittee on Tax Challenges related to the Taxation of Digitalized Economy. The subcommittee considered several approaches to tax digitalized transactions from the perspective of developing countries.

[4] Examples of automated digital services include online advertising, supply of user data, social media platforms, cloud computing, online search engines, and online gaming.

[5] The new provision does not introduce any quantitative thresholds and applies to business-to-consumer services. While the applicable tax rate on digital services is to be negotiated bilaterally by the contracting parties in their respective double taxation treaties, a modest rate of 3%–4% is recommended.

In April 2022, Article 12B was included in the UN Model Tax Convention, and some developing economies may be considering its adoption given that double taxation treaties are intended to be simpler and easier to administer when compared with the complexities surrounding Amount A under Pillar One.

9.2.4 Extending Value-Added Tax to Digital Services

While developing a multilateral solution, economies have made efforts toward implementation of a framework to introduce VAT on imports of digitally delivered services and goods. An advantage of this approach is the consensus that rules establishing the allocation of VAT taxing rights are determined by the destination principle. Under this principle, the taxing right is located at the place of consumption. Tax administrations in Asia and the Pacific have made progress in this direction, allowing for compliance and revenue collection. Governments have also recognized that the VAT challenges of the digital economy require a globally coordinated response to ensure minimal cost and effective cooperation. International guidelines have been developed for making digital platforms liable for assessing, collecting, and remitting the VAT or GST due on the online sales they facilitate. Firm survey data also suggest VAT or GST rules for digital goods and services as their preferred alternative (WEF 2021).

As of 2021, more than 60 economies have adopted domestic legislation and undertaken reforms to capture VAT tax in digital services and low-value imported goods (Box 9.3). Most of these have implemented the vendor collection model, in which liability for tax payment rests with the nonresident services provider.

9.3 Policy Considerations for International Tax Reforms

Gains from increasing tax revenues may be modest. With implementation of the multilateral agreement starting in 2023, estimations suggest that the proposed reforms could increase global corporate income tax revenues by 6% or about $150 billion a year (OECD 2021).[6] Estimated gains from profit reallocation would be relatively modest (0.5% of global corporate income tax revenues) and larger among low- and middle-income economies. Revenues from a global minimum tax are estimated around 2%–4% of global corporate income tax, with larger gains for high-income economies. Recent estimates by the International Monetary Fund (2021) for Asia and the Pacific suggest a modest gain for economies in the region,

[6] These results assume that the US global intangible low-taxed income (GILTI) regime is replaced with a per-country minimum tax at a higher rate, leading to a considerably higher increase in revenues.

Box 9.3: VAT Digital Toolkit for Asia-Pacific

Introduced in March 2022, the VAT Digital Toolkit for Asia-Pacific aims to assist tax authorities in the region with the design and implementation of reforms to ensure the effective collection of value-added taxes (VAT) on e-commerce activities. VAT is a crucial source of tax revenue for several Asian economies, and challenges exist for tax collection on online services and digital products, and on online sales of low-value imported goods. Where no reforms have been implemented in response to digitalization, VAT revenue losses have increased, together with increasing competition for domestic firms with foreign suppliers.

The toolkit is based on core standards and principles reflected in a policy framework around four pillars: (i) creating the appropriate legal basis for jurisdictions to assert the right to impose VAT, (ii) ensuring VAT collection from nonresident suppliers through simplified registration and collection mechanisms, (iii) improving efficiency by requiring digital platforms to collect and remit VAT on sales carried through their platforms, and (iv) enhancing VAT compliance by nonresident suppliers and digital platforms.

The standards and recommendations have been implemented in over 70 jurisdictions with encouraging results, including improved VAT revenue collected and higher compliance. Efforts for improving VAT standards and recommendations aim to support economies' wider strategies to address the tax challenges from digitalization.

Source: OECD, World Bank Group, and ADB (2022).

with investment hubs and some economies potentially losing some tax revenue. Considering the heterogenous type of jurisdictions in Asia and the Pacific, the revenue impact of the multilateral solution may be wide-ranging.

Unilateral tax measures find favor but prompt retaliation and impact trade rules. While a multilateral solution is adopted, unilateral tax measures involving digital services are on the rise. These measures, however legitimate for raising tax revenue, have shown to be costly and potentially trigger retaliatory trade measures. From the perspective of businesses, they can also increase prices for consumers or result in suppliers not serving markets where measures are implemented. Estimations on the effects of trade retaliation measures to digital services taxes (DSTs) suggest a possible fall of global trade by 1% (OECD 2021). The most notable example of trade retaliation to unilateral tax measures probably comes from the United States (US). Following the adoption of DSTs by some economies, the US started a Section 301 of Trade Act investigations, considering that such measures could be discriminatory and inconsistent. As a result, the US imposed tariffs on goods imports from these economies. The measure

was suspended while multilateral negotiations on international taxation at the OECD/G20 level were being finalized.[7]

The surge in unilateral measures stresses the importance of consistency between World Trade Organization (WTO) trade rules and the new international tax framework. While key provisions in the General Agreement on Trade in Services (GATS) relate to nondiscrimination, international trade rules do not comprehensively encompass taxation issues (Low 2020). From the WTO perspective, most concerns about DSTs are associated with ensuring nondiscrimination, which is based on most favored nation (MFN) and national treatment principles (Mavroidis 2020). As for goods, MFN rules under the GATS require that all WTO members receive the same treatment. The national treatment principle requires that service suppliers of other members be treated no less favorably than domestic suppliers. However, in contrast to goods, national treatment in services is negotiated sector by sector, and not all obligations apply for all services (Low 2020). The GATS also includes provisions allowing exceptions to the MFN and national treatment principles.[8] While DSTs differ in their mechanism, they will need to be analyzed under the GATS framework to establish whether they can lead to legal or actual discriminatory treatment.

As regional trade agreements gradually include more elaborate provisions for digital services trade, they will require further alignment with current proposals for international tax policy.[9]

A global minimum tax brings investment and competition challenges. While the adoption of a global minimum tax may improve tax revenue, it could also bring challenges for existing investment policy frameworks in the region. The global minimum tax may impact policies in developing Asia for attracting foreign direct investment through special investment regimes as the tax advantage provided to MNEs for investing may be neutralized—at least up to the minimum agreed tax rate—in the country where the ultimate parent of the multinational is based. Policy makers will need to consider in the coming years to what extent tax incentives for attracting investment can be implementable or effective under the new international tax framework.

Reforms in the international tax framework may also have implications for competition in digital services sectors. As cross-border digital services expand, the compliance of foreign digital service providers to register and remit VATs or

[7] US authorities found the introduction of a DST to be discriminatory in intent and effect. As a result, the US could levy duties of up to 25% on imports from France. This measure could probably lead to more retaliatory measures.

[8] These are related to the existence of a double taxation agreement, in the case of MFN, or to ensure “the equitable or effective” imposition of direct taxes.

[9] As of 2017, nearly 9% of the 275 existing regional trade agreements notified to the WTO specified a right to impose an internal tax or charge on digital products.

GSTs on their operations is increasingly important. A tax framework including foreign suppliers of digital services may be a mechanism to ensure they have the same opportunities as domestic suppliers.

Compliance and implementation measures will need to be developed. From the perspective of both governments and firms, implementation of the OECD/G20 Inclusive Framework multilateral solution will increase compliance costs while at the same time provide tax certainty. To ensure proper implementation, efforts to upgrade the current tax framework and tax practices will be needed. Jurisdictions will need to develop domestic legislation implemented in association with a multilateral review of the implemented rules. International law will need to be developed to overcome obstacles in tax treaties, in particular the development of a new multilateral convention that addresses existing treaty barriers such as Article 7 (Business Profits) of double taxation treaties. For tax administrations, an important design tool for the appropriate application of the agreement relies on the existence of a shared filing mechanism as to ensure an effective exchange of information on MNEs and appropriate mechanism for dispute prevention and resolution.

9.4 Conclusion

The benefits and risks of digital services taxes and other unilateral measures should be weighed carefully. While these measures can moderately increase tax revenue, economies need to consider the possible effects of their implementation. Evidence suggests that DSTs could lead to trade disputes with partner economies, trigger compensatory measures, and prompt MNEs to reconsider their investment in some sectors. Under the OECD/G20 Inclusive Framework, participating members have also agreed to refrain from imposing DSTs in the future. Looking forward, consistency between existing WTO rules and the international tax framework will be important. While WTO rules are not fully adaptable to the tax challenges of digital services, future negotiations on market access and national treatment commitments under the GATS could contribute to a more structured approach to the taxation of digital services.

Consensus has emerged on the adequacy and feasibility of alternative measures, in particular the implementation of rules to ensure effective VAT or GST collection on imported digital services. Developing Asia should continue to use VAT as a mechanism to capture cross-border digital transaction as a source of revenue. As a tax imposed on a destination principle, the taxing right under VAT is allocated to the jurisdiction in which consumption occurs, which encourages its applicability for digital services. Economies in the region can build on these examples to reduce administrative costs and improve compliance. While awaiting

the implementation of the OECD/G20 Inclusive Framework Agreement, double tax treaties may provide another mechanism for granting taxing rights to digital services through the recently introduced Article 12B of the Model Tax Convention.

Although a multilateral agreement has been reached, regional and international cooperation will be essential to ensure its implementation. Notwithstanding the agreement, in developing Asia, consistent efforts will be needed to adapt and design new domestic legislation, upgrade double tax treaties, and account for other international law amendments. Regional cooperation can also contribute to ensuring effective exchange of information for tax purposes, developing appropriate mechanisms for dispute prevention and resolution on taxation, and technical assistance for modernization of tax administrations.

Jurisdictions in the region should consider assessing and eventually revising their preferential tax regimes so as to determine whether additional substance requirements are needed (to meet the substance-based income exclusion) and whether to introduce a qualified minimum domestic top-up tax.

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