Working Group 3

International Tax Cooperation

POLICY PAPER

Working group led by José Antonio Ocampo, Co-Director of Economic and Political Development Concentration at School of International and Public Affairs, Columbia University, and Club de Madrid Advisor

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I. Context

The freedom of capital movement by multinational corporations (MNCs), financial firms and asset owners has become an increasingly relevant feature of the global economy. However, the free movement of capital and the opportunities for the geographical dispersion of firms has created fundamental challenges for tax authorities. Different national taxation norms and interstices between tax administrations create conflicts of interest among all actors, and double taxation arising from the concurrent exercise by two or more countries of their taxation rights may have an adverse effect on investments. Additionally, tax havens, ultra-low tax regimes and lack of administrative coordination between tax jurisdictions facilitate capital flight and loss of vital tax revenue, in particular due to profit shifting by MNCs and tax avoidance/evasion by high net-worth individuals. These trends deepen economic inequality and erode trust in the social contract.

A large network of bilateral tax treaties has historically managed international tax cooperation. These treaties follow two basic models, designed by the OECD and the UN. The first is generally viewed as favoring the countries where the headquarters of MNCs are located and the nations where they make their investments, respectively (1).

In recent decades, the tax reforms adopted by developed countries and the OECD's soft-law standards have created a landscape where MNCs take advantage of tax benefits, preferential regimes and tax havens to reduce their worldwide payments. This situation became evident as never before during the 2008-09 global financial crisis, which prompted the G20 to commission the OECD to study the causes and potential solutions to the low taxation levels of international firms.

1.The 2017 version of the UN model made an additional significant improvement by including standards for the taxation of technical services, which is crucial for adding tax revenues to developing countries and fighting against treaty shopping.

As a result of this, the Base Erosion and Profit Shifting (BEPS) negotiations were launched in 2013, leading to a report in 2015 and a multilateral convention signed in 2016, so far ratified by 65 countries (2). It was followed by the OECD Inclusive Framework, now encompassing more than 140 countries. The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, launched in 2000, opened up to non-OECD countries in 2009, and now includes 171 jurisdictions (3).

There is also the Committee of Experts on International Cooperation in Tax Matters, a subsidiary body of the UN Economic and Social Council, which became a regular committee in 2004 –after a long period as an ad hoc body— and was upgraded in the UN Conference on Financing for Development in 2015. Its main mandate is to help prevent double taxation and non-taxation and to assist countries to broaden their tax base, strengthen tax administration and curb international tax evasion and avoidance, supporting in particular developing countries. It is also in charge of updating the UN model for bilateral tax treaties, its traditional task.

A major problem of the global tax system is, indeed, that a large amount of profits is shifted to tax havens: $1 trillion in 2022. This is the equivalent of 35% of all the profits booked by MNCs outside of their headquarter country. This is also the case for the income and assets of high net- worth individuals. According to the analysis by the EU Tax Observatory (4), information exchange has been effective in reducing untaxed offshore individual financial wealth. However, despite this advance, the global tax revenues loss due to profit shifting from MNCs to tax havens continue to be high –close to 10%–. In turn, the effective tax rates for billionaires is very low –between 0 and 0.5% of their wealth, according to their estimates—. Further to the existence of a network of tax havens and ultra-low tax jurisdictions and the availability of tailored arrangements for high net-worth individuals, one of the main reasons for this is the lack of a global registry of beneficial owners, not just for financial assets, but also for non-financial assets and luxury assets such as yachts, private jets, real estate, art, and other property accessible particularly to the wealthy of the world.

II. Ongoing Negotiations and Opportunities

The outcome of the negotiations that took place under the OECD Inclusive Framework was the October 2021 agreement, aimed at curbing the negative consequences of the digitalization of the economy and profit shifting by large MNCs. It comprised two elements. Under Pillar I, a small share of the global profits of MNCs would be allocated to the countries where their customers are located, based on the countries' share of worldwide sales, even if they sell remotely. However, it only applies to very large and profitable firms –those with annual global turnover exceeding €20 billion and profit margins of at least 10% of revenue—, and only for 25% of their "residual" profit, defined as that exceeding a 10% profit margin. In turn, Pillar II established a minimum effective tax rate of 15% for MNCs with a turnover exceeding €750 million.

Although the agreement represented progress in tax cooperation, it has faced several criticisms. On Pillar I, developing countries consistently advocated for a meaningful reallocation of taxing rights to source countries –i.e., where these companies conduct their activities—. The African Tax Administration Forum (ATAF) demanded that a percentage of all global profits of MNCs –no only residual but routine—, should be apportioned to the countries where these companies do business.

2. https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf
3. www.oecd.org/tax/transparency/who-we-are/members/
4. EU Tax Observatory (2024), Global Tax Evasion Report 2024, available at: https://www.taxobservatory.eu//www-site/uploads/2023/10/global_tax_evasion_report_24.pdf

In turn, during the negotiations, the Group of developing countries in the Bretton Woods Institutions –the G24— put forward a proposal with four basic elements:

- The removal of the physical presence and its replacement with the principle of "Significant Economic Presence" as the rule for taxation of profits at the source.
- A formulaic approach to determine the taxable profits of the MNCs, called fractional apportionment –a system widely used by federal countries in their national taxation systems. Fractional Apportionment, like unitary taxation, would allocate a portion of the global profits of the enterprise to different jurisdictions where it has a significant economic presence based on a formula that contemplates some simple, objective criteria, giving balanced recognition to both supply and demand factors that contribute to profit-creation (sales, assets and employees).
- That source countries should have a priority in applying the minimum tax –including on MNCs' interest earnings, royalties, service payments, and capital gains.
- And administrative simplicity, which fractional apportionment would address.

Unfortunately, these proposals were not accepted.

In turn, the tax rate adopted under Pillar II has been deemed as too low by many analysts, and it is below the 21% proposed by the U.S. and well below the current statutory corporate tax rates of African. Latin American and most European countries (around 25%). Although it was intended as an effective rate, several carveouts imply that it will be below 15%.

Another problem of this two-pillar agreement is that signatories are required to remove unilateral measures like digital services taxes, a condition that is unsatisfactory for many developing economies as it would limit their ability to tax digital MNCs in the future. Additionally, although mandatory dispute resolution was ultimately included in Pillar I, developing countries continue to oppose a wider scope to include transfer pricing disputes. Despite all these weaknesses, most OECD Inclusive Framework members accepted the agreement –the exceptions were Nigeria, Kenya, Pakistan and Sri Lanka—. In any case, Pillar I still needs a Convention to be effective, and its approval by all parliaments may face significant obstacle, particularly by the US Congress. This is an additional uncertainty. A current draft text is being negotiated, but reservations remain from several countries –Brazil, India and Colombia, among them—.

Partially recognizing such drawbacks to developing countries, in 2023 the OECD Inclusive Framework developed a mechanism under Pilar II named Subject to Tax Rule (STTR) that modifies tax treaties and grants limited tax rights to source countries, as a top-up 9% tax on intragroup payments, including technical services. However, due to its narrow scope, as it applies only to specified categories of income, the associated revenue expectations are very low. Indeed, the IMF has estimated that it is unlikely to raise significant additional revenues for developing countries (5). Developing countries will be better off introducing the STTR developed by the United Nations Committee of Experts on International Tax Cooperation, which has a broader scope, as it applies to all income and capital gains arising in the source state, and it has higher revenue potential and simpler administrative requirements (6).

5. IMF, "International Corporate Tax Reform", January 2023, paragraph 15; available at: https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/02/06/International-Corporate-Tax-Reform-529240
6. See a comparative analysis in https://www.icrict.com/international-tax-reform/the-subject-to-tax-rule-a-comparison-of-the-oecd-and-un-versions/

According to all estimates, the greatest benefits of these tax reforms are expected to go to high-income countries, where the headquarters of the main MNCs are located. In response to the marginal benefits for the developing world, African countries proposed negotiating a UN tax convention. After the approval of a General Assembly resolution in December 2022 (7), it became the central issue in international tax debates in 2023. Based on the three alternatives proposed by the UN Secretariat, on November 2023 the UN approved, by a wide margin (8), the establishment of an intergovernmental committee to draft the terms of reference for a UN Framework Convention on International Tax Cooperation aiming at an effective and inclusive international tax cooperation system.

The Independent Commission for the Reform of International Corporate Taxation (ICRICT) has presented proposals that could be considered in these negotiations (9). They include the adoption of a global formulaic approach for MNCs, according to which they would have a global income tax return and pay taxes in the countries where they operate based on production, sales and employment. They also include a stronger minimum corporate tax rate –the group proposed an effective tax rate of 25% with no carveouts during the OECD negotiations—as well as the global asset registry and the possibility of adopting wealth taxes at the global level.

In turn, there is a growing recognition that today's tax systems tend to be sharply regressive at the top of the distribution, with high net-worth individuals who tend to pay proportionally less in taxes than other socio-economic groups. To face this issue, the EU Tax Observatory has proposed a global tax for billionaires (somewhat less than 3000 globally) equivalent annually to 2% of their wealth, which could include as part of its design an exit tax to avoid capital flight (10). Based on this recommendation, the Brazilian G20 presidency has committed to propose the creation of a coordinated global minimum tax on the super-rich following this proposal (11) . This innovative global framework could generate an annual revenue of $250 billion, also promoting income redistribution and reducing wealth concentration.

As a result of the work of the ad-hoc Intergovernmental Committee that met in 2024, the Chair's Proposal for the Terms of Reference of the UN Convention was approved in August 2024 (12), with much less negative votes than the November 2023 resolution (13). According to this Proposal, the objectives of the Convention should be to establish a fully inclusive and effective system of tax cooperation and an appropriate system of governance in this area of international collaboration.

To guarantee this, some of the guiding principles of the Convention should be that it:

- "be universal in approach and scope and should fully take into account the different needs, priorities, and capacities of all countries, including developing countries, in particular countries in special situations; (...)
- take a holistic, sustainable development perspective that covers in a balanced and integrated manner economic, social and environmental policy aspects;

7. UN General Assembly Resolution 77/2044 of December 30, 2022.
8. 125 votes in favor, 48 against and 9 abstentions.
9. https://www.icrict.com/
10. The US actually chargers an "expatriation Tax" on accrued capital for US for individuals who change their citizenship.
11. See in this regard the proposals presented by Gabriel Zucman to Brazil as president of the 2024 G20 Summit – "A blueprint for a coordinated minimum effective taxation standard for ultra-high net-worth individuals", available at:: http://gabriel-zucman.eu/files/report-g20.pdf
12. United Nations, "Chair's Proposal for Draft Terms of Reference for a United Nations Framework Convention on International Tax Cooperation, August 15 th https://financing.desa.un.org/sites/default/files/2024-08/Chair%27s%20proposal%20draft%20ToR_L.4_15%20Aug%202024____.pdf
13. 110 votes in favor, 44 abstentions and only 8 votes against.

- be sufficiently flexible, resilient and agile to ensure equitable and effective results as societies, technologies and business models and the international tax cooperation landscapes evolve; (...)

- provide for rules that are as simple and easy to administer as the subject matter allows; (...)

- require transparency and accountability of all taxpayers" (paragraph 9 of the August 2024 resolution).

Based on these principles, the Proposal indicates that the Convention should include commitments in several areas: "fair allocation of taxing rights, including equitable taxation of multinational enterprises; addressing tax evasion and avoidance by high net-worth individuals (...); effective mutual administrative assistance in tax matters, including with respect to transparency and exchange of information for tax purposes; addressing tax-related illicit financial flows, tax avoidance, tax evasion and harmful tax practices; and effective prevention and resolution of tax disputes" (paragraph 10). However, these suggested commitments are only formulated in general terms.

To achieve some of these commitments, it proposes two early protocols: one on taxation of income derived from the provision of cross-border services, and a second one to be chosen from a list of priority areas that includes taxation of the digitalized economy, measures against tax-related illicit financial flows, and tax evasion and avoidance by high net-worth individuals, among other issues (paragraphs 15 and 16). Finally, although, as already indicated, it also proposes that the Convention should establish a system of governance for international tax cooperation, it does not suggest any specific proposal in this area.

Beyond what has already achieved in the UN negotiations and the forthcoming G20 meeting in Brazil, the year 2025 offers a significant number of opportunities on global tax cooperation and what it can offer for the implementation of the SDGs, in which the world faces significant financing gaps. First, the negotiations of the UN Tax Convention will start. Second, the IV International Conference on Financing for Development that will take place in Spain in June-July will include tax cooperation as part of its agenda. Third, the G20 South African presidency can also generate a momentum to advance this agenda. In this regard, gaps in the outcome of the G20 Brazil meeting decisions could be filled out by Club de Madrid. Fourthly, the COP30 of the Climate Change convention that will take place in Brazil in November can also advance in the design of the tax issues associated with this global threat.

Ensuring developing countries fully participate in global tax dialogues is, of course, crucial. In this regard, the most important issue is pressure on developed and key developing countries and low-tax jurisdictions that are reluctant to collaborate on international tax cooperation. The G20 South African presidency and Club de Madrid should help bridge the gap between the different views, which are often linked to political/ideological and/or geopolitical considerations to advance this agenda.

III. Major Issues on the Agenda

Based on the principles and commitments agreed in the Terms of Reference for the UN Convention, the negotiations on international tax cooperation, including in the G20, should focus on both substantive and governance issues. The first group includes:

1. Fighting Harmful Tax Practices: combating tax evasion, money laundering and capital flight. This requires international cooperation to address transparency and challenging –and hopefully eliminating– tax havens. It also requires significant efforts to address the recovery and repatriation of assets from illicit financial flows, as they represent a significant loss of revenue worldwide.

2. Adequate taxation of the profits of MNCs, including but not limited to a fair reallocation of taxing rights between countries. This could be underpinned by the principle of unitary taxation and formulary apportionment of all large MNCs' profits across different jurisdictions. This would require the development of a nexus rule based on the principle of significant economic presence, whereby a taxable presence will be created in the country when a non-resident enterprise has significant revenue-raising business activities. And it should involve the coordinated taxation of windfall or excess profits, including strengthening anti-avoidance instruments, such as a 25% global effective minimum tax on the profits of MNCs.

3. Common principles and minimum standards for the taxation of the income of the world's super-rich and all countries' very rich individuals, including anti-avoidance instruments such as a global minimum tax on their income. Indeed, the proposal of a minimum tax on the super-rich and the very rich could also be negotiated as one of the early protocols of the UN Convention, hopefully after an agreement in the G20. This should be complemented by the commitment by all countries to adopt the taxation of wealth, inheritances and appropriate taxation of capital gains as complements to the taxation of income. These should be seen as leading policies to tackle world inequality.

4. Common principles and minimum standards for ensuring transparency of wealth ownership, including through the creation of a global asset register that identifies final beneficial owners of all assets, combining public data components and components held privately for tax authorities and other enforcement bodies. The associated information should be publicly available, researchable and machine readable. Ownership transparency is, of course, essential to tackle illicit financial flows and can facilitate the return of stolen assets –the first recommendation presented above.

5. The development of coordinated mechanisms for digital services taxes.

6. Clear criteria for taxing activities associated with the exploitation of natural resources. In particular, developing countries should avoid giving tax benefits for MNCs exploiting their natural resources. In fact, they should complement income taxes with royalty payments and strong regulations, and by creating additional green taxes on carbon emissions and contamination.

7. Bring tax policy issues into the negotiations on climate change. This could include earmarking green tax receipts to support the advancement of national climate goals, possibly through the integration into the tax regulations the Nationally Determined Contributions (NDCs) agenda. This should also include the establishment of global sectoral green taxes (e.g., on maritime shipping or the aviation sector), the widespread introduction of carbon taxes and/or regulated carbon markets, the definition of development-adjusted carbon price floors (14) and, as the previous issue implies, avoid subsidizing fossil fuels.

8. Public country-by-country reporting of MNCs' economic activities based on the robust Global Reporting Initiative for public reporting on taxes. The relevant information should be publicly available.

9. Guarantee effective exchange of information among tax authorities, not only among the Global North countries, but also with the Global South.

14. See in this regard https://www.imf.org/en/Blogs/Articles/2022/05/19/blog-why-countries-must-cooperate-on-carbon-prices

The challenges of the negotiations must not be underestimated, as a number of developed countries voted against the UN agreement and have refused so far to provide the necessary funding to ensure that all member states –particularly poorer and smaller developing countries— are able to effectively participate in the negotiations. The hope is that they will realize that it is in their own best interests to join and support inclusive processes.

There are three governance issues in international tax cooperation that must also be addressed. The first relates to the system of global governance for international tax cooperation. One of the alternatives is the transformation of the UN Committee of Experts on International Cooperation in Tax Matters into an intergovernmental organ. This proposal has been defeated twice: in 2004, when the Committee was nonetheless given a permanent character; and in 2015, when the Group of 77 presented a similar proposal at the Addis Ababa Financing for Development Summit. The alternative that some countries have suggested is to create a new UN organization to support international tax cooperation.

The second is strengthening the tax rules and administrative capacity of developing countries' national tax authorities –two elements that should be central to improved national governance—. Their tax revenues (not only through tax rate increase, but also tax base expansion) are essential for their domestic resource mobilization. Capacity building is crucial and could be supported by the Official Development Assistance (ODA). Developing countries also need to build greater capacity to deal with the international taxation challenges and to participate in multilateral negotiations. And it is essential to encourage a shift from informal to formal economy with governmental incentives, disseminating good experiences in that regard.

The third is creating a broad set of regional tax cooperation processes. In this regard, the OECD has its own cooperation system for its members, which has been in place for a long time. The African Tax Administration Forum is also one of those mechanisms, and the Latin American and Caribbean Taxation Platform (PTLAC) was created in 2023 under the leadership of Brazil, Chile and Colombia. Both the African and Latin American mechanisms must expand tax cooperation activities among all countries in their regions, so that we may build a fair, inclusive, and sustainable international tax system from the bottom-up. And similar mechanisms must be created in other regions of the South.

14. See in this regard https://www.imf.org/en/Blogs/Articles/2022/05/19/blog-why-countries-must-cooperate-on-carbon-prices

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