Article

Impact of the New International Tax Principles on International Investment Agreements (IIA) and Geographical Strategies of Multinational Companies: New Tax Rules for The New Economic Scenario

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KEYWORDS:

International Taxation, OECD, BEPS, Pillar 1, Pillar 2, Source jurisdiction, GloBE, IIA, UN Model, UN, Multilateral Convention Framework, International Cooperation.

ABSTRACT:

The international taxation based on physical presence is obsolete. Since 2015, the OECD and the G20 have worked toward fairer tax rules. Countries have adopted Pillars 1 and 2 of the Inclusive Framework, aiming to tax companies at the source and establish a global minimum tax rate of 15%. While Pillar 1 remains on hold, Pillar 2 is already in effect in several countries. Significant advances have also been made in tax transparency and information exchange (mainly by the Global Forum), aiming to reduce illicit financial flows and gradually eliminate tax havens. The UN resolution of November 22, 2023, establishes an Ad Hoc Committee to develop the Draft Terms of Reference for a Multilateral Framework Convention (UN General Assembly A/AC.295/2024/L.4, 2024), thereby encouraging more inclusive and effective international cooperation on tax matters. This new scenario influences investment agreement negotiations and the geographic structure of transnational companies.

PALABRAS CLAVES:

Fiscalidad Internacional, OCDE, BEPS, Pilar 1, Pilar 2, Jurisdicción de la Fuente, GloBE, AII, Modelo de la ONU, ONU, Marco de Convención Multilateral, Cooperación Internacional.

RESUMEN:

La tributación internacional basada en la presencia física está obsoleta. Desde 2015, la OCDE y el G20 han trabajado para establecer reglas fiscales más justas. Los países han adoptado los Pilares 1 y 2 del Marco Inclusivo, con el objetivo de gravar a las empresas en la fuente y establecer una tasa mínima global de impuesto del 15%. Aunque el Pilar 1 sigue en espera, el Pilar 2 ya está en vigor en varios países. También se han logrado avances significativos en la transparencia fiscal y el intercambio de información, con el objetivo de reducir los flujos financieros ilícitos y eliminar gradualmente los paraísos fiscales. La resolución de la ONU del 22 de noviembre de 2023 establece un Comité Ad Hoc para desarrollar el Borrador de los Términos de Referencia de una Convención Marco Multilateral (UN General Assembly A/AC.295/2024/L.4, 2024), fomentando así una cooperación internacional más inclusiva y efectiva en cuestiones tributarias. Este nuevo escenario influye en las negociaciones de acuerdos de inversión y en la estructura geográfica de las empresas transnacionales.

MOTS CLES :

Fiscalité Internationale, OCDE, BEPS, Pilier 1, Pilier 2, Juridiction de la Source, GloBE, AII, Modèle des Nations Unies, ONU, Cadre de Convention Multilatérale, Coopération Internationale.

RESUME :

Le schéma de fiscalité internationale fondé sur la présence physique est obsolète. Depuis 2015, l'OCDE et le G20 ont œuvré pour des règles fiscales plus équitables. Des pays ont adopté les Piliers 1 et 2 du Cadre Inclusif, visant à taxer les entreprises à la source et à établir un taux minimum mondial de 15 %. Pendant que le Pilier 1 reste en suspens, le Pilier 2 est déjà en vigueur dans plusieurs pays. Des avancées importantes ont aussi été réalisées dans la transparence fiscale et l'échange d'informations, visant à réduire les flux financiers illicites et éliminer progressivement les paradis fiscaux. La résolution de l'ONU du 22 novembre 2023 établit un Comité Ad Hoc pour développer des Terms of Reference d'un Convention Cadre multilatérale (UN General Assembly A/AC.295/2024/L.4, 2024), encourageant ainsi une coopération internationale plus inclusive et efficace en matière de fiscalité. Ce nouveau scénario influence les négociations des accords d'investissement et la structure géographique des entreprises transnationales.

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1 INTRODUCTION: NEW FISCAL RULES FOR A NEW ECONOMIC SCENARIO

The economic structure of states is in constant evolution. Currently, digital economic activities dominate the global commercial landscape. Digital giants such as Google, Amazon, Facebook, and Apple (GAFA) operate on a global scale, generating profits in an international, non-territorial environment, which challenges conventional tax systems.

There is a pressing need to redefine tax rules. Otherwise, these "tech giants" will continue to legally avoid their fair share of taxes on the profits generated.

These companies are not constrained by national borders; their market spans the entire globe, and their business model does not depend on a physical presence in a specific territory to generate profits. The leading companies in this virtual business model share the following characteristics:

a) They operate at a multinational level.
b) They operate virtually in all countries.
c) They lack a tangible physical presence.
d) Under the traditional scheme, the parent company can only be considered a resident in countries where taxation is non-existent or very low.
e) Their most valuable assets are intangible, namely algorithms or databases, which cannot be located or linked to a specific territory.

As Professor García Novoa (Garcia Novoa, 2022) points out, "With digitalization, the feeling that international groups do not pay taxes adequately, and, above all, that they do not do so where they create value, increases considerably."

In the traditional scheme, the taxation of large multinationals was based on the principles of residence, worldwide or territorial taxation, and bilateral international treaties to avoid double taxation. However, these rules are no longer effective. Assessing the profits of these companies requires a different approach, leading to a reinvention of international taxation mechanisms. This has resulted in significant changes in both international taxation and national tax systems (as seen with the introduction of domestic taxes on digital services).

Among the new considerations are the principle of source jurisdiction, which, for taxation, prioritizes the location where wealth is generated. Additionally, since physical presence is no longer a requirement for conducting economic activities, current debates on taxation suggest the need to revisit concepts such as residence and permanent establishment.

In conjunction with the above, new concepts have been introduced, such as the Subject to Tax Rule (STTR) and the Global Anti-Base Erosion (GloBE) initiative. However, it is important to note that these new rules, although quite advanced, are not yet fully operational. Furthermore, their impact extends beyond the digital economy (which has merely been the starting point), affecting all economic activities, including those with an intrinsic physical presence (as illustrated extractive and energy industries).

1.1 THE PRINCIPLE OF TAXATION IN THE SOURCE JURISDICTION

This principle represents a new allocation rule of taxing rights for the states. Tax collection rule moves beyond the principles of residence or physical presence through permanent establishments. Now, it suffices that income is generated within a state's territory for that state to have the right to tax such wealth.

In 2021, as part of the development of the various actions (17 in total) under the Base Erosion and Profit Shifting Inclusive Framework (BEPS) of the OECD and the G20, particularly concerning action 1 on the digitalization of the economy, a statement was issued establishing a two pillars solution (Pillar 1 and Pillar 2) that transforms the traditional scheme of international taxation, especially for large transnational companies (Multinational Enterprises, MNEs).

Pillar One of the OECD and G20 Inclusive Framework introduces a new criterion for the allocation of taxing rights. It shifts from the principle of residence to the principle of source or the jurisdiction origin of the income. This will alter international tax rules by providing market jurisdictions with new taxing rights over MNEs, regardless of whether they have a physical presence in the country. Twenty-five percent of the residual profits[1] of the largest MNEs will be reassigned to market jurisdictions where the company's users and customers are located (Amount A)[2]. Additionally, Pillar One simplifies the application of the arm's length principle[3] to marketing and distribution activities in the country (Amount B)[4], ensuring dispute prevention and resolution while avoiding double taxation. A preliminary text of the Multilateral Convention (MLC) was published in 2023[5] with clarifications regarding Amount A. On February 19, 2024, the final version of Amount B of Pillar 1 was published, aimed at simplifying the application of the arm's length principle for group entities performing distribution activities. This document is incorporated into the 2022 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations as an annex to Chapter IV (OECD, 2023d). Through this action, the OECD intends for Amount B to come into effect starting in 2025, allowing jurisdictions to adopt it either as a safe harbour or as a mandatory rule.

The latest updated forecast for OECD's Pillar 1 continues to work toward reaffirming the commitment of Inclusive Framework members to achieve a consensus-based solution and finalize the MLC text by the end of March 2024, aiming for a signing ceremony by the end of June 2024, with the goal of enabling it to come into effect in 2025, allowing time for applicable national consultation, legislative, and administrative processes in each jurisdiction (OECD, 2024b).

Similarly, Article 12A of the United Nations Convention Model establishes the taxation of fees for technical digital services (FTS) in the source state, where the service is provided to the customer. The 2021 revision of the Convention Model adds Article 12B, extending the application of the principle of taxation in the source jurisdiction to automated digital services (ADS)[6].

In the European Union, proposals have also been presented for fair and effective taxation of the digital economy, but a directive on this matter has not been yet approved. However, progress is being made, recognizing the importance of addressing the tax challenges posed

[1] For the purpose of Amount A, the group's residual profit is identified as that which exceeds a profitability threshold of 10% Return on Sales for the Group.

[2] The Multilateral Convention (Multilateral Instrument, MLI) through which Amount A is implemented will be drafted and ready for signature in 2022, so that Amount A comes into effect in 2023

[3] The arm's length principle is the international standard that OECD member countries have agreed upon to determine transfer pricing.

[4] On February 19, 2024, the final document for Amount B of Pillar 1 was published to simplify the application of the arm's length principle for Group entities engaged in distribution activities. This document is incorporated into the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 as an annex to Chapter IV. With this, the OECD intends for Amount B to come into effect starting in 2025, allowing jurisdictions to opt for Amount B either as a safe harbor or as a mandatory rule.

However, since it is not a binding guideline and the OECD itself states that countries not adopting it will not be required to accept the results from jurisdictions that do, this OECD document could significantly increase disputes.

[5] The Inclusive Framework has drafted a text for a Multilateral Convention (MLC) that will enable the Parties to the said convention to exercise their domestic tax sovereignty (Amount A of Pillar One) over a defined portion of the residual profits of multinational enterprises that meet the income and profitability thresholds and have a specific nexus with the markets of these Parties.

[6] This necessitates revisiting the traditional requirement of physical presence in a territory, concepts of residence, and Permanent Establishment.

by the digitalization of the economy. The Council Directive 2022/2523 introduces Article 57, which focuses specifically on implementing the source jurisdiction rule. Meanwhile, some member states, including Spain, have adopted or are in the process of adopting unilateral transitional measures in this regard. Notwithstanding, as mentioned, the OECD reports on the digital economy, remind these unilateral measures are provisional and intended to be replaced by new legislation incorporating the internationally adopted solution.

Therefore, the urgency of increasing tax revenues forces states to implement their own digital services taxes, aiming to tax the profits of digital economic activities generated within their territory, regardless of the location of the entity conducting such activities.

Spanish Law 4/2020, on the Tax on Certain Digital Services (LDSDs), is a clear example of this. This state tax is our adaptation of Pillar I of Action 1 of the OECD's Inclusive BEPS Framework dedicated to the digitalized and globalized economy, it changes the connection point that justifies the exercise of the state's taxing rights. It has shifted from the principle of physical presence, such as residence or the existence of a Permanent Establishment (PE) in our territory, to the principle of source, meaning that taxation happens in the jurisdiction from which the income is generated. The regulation of this tax sets the localization of users' IP addresses of digital services as the connection determining the state's taxing rights. In other words, it dispenses the physical presence and considers the virtual presence of the taxpayer, demonstrated by the existence of digital services requested from our territory, which can be evidenced through the IP address of the device accessing the service.

1.2 THE GLOBAL MINIMUM TAX

Pillar Two (Global Anti-Base Erosion Rules) proposes a Global Minimum Tax for certain multinational enterprises (those with revenues exceeding 750 million euros), ensuring a minimum tax rate of 15% for entities within large multinational groups established in jurisdictions with lower tax rates[7].

The GloBE (Global Anti-Base Erosion) initiative has been widely endorsed by states[8], and its mechanism ensures the operation of the global minimum tax even for countries that have not adopted it.

Three possible taxation scenarios are foreseen:

1. The Minimum Domestic Tax or Qualified Minimum Top-Up Tax Rate (QMTTR) would be applied by jurisdictions adhering to this OECD model. It consists of a domestic tax that would complement the entity's Effective Tax Rate (ETR) to ensure that parent or subsidiary entities are taxed at a minimum of 15%.
2. The Inclusive Income Rate (IIR) would come into play if the parent entity has subsidiaries established in jurisdictions with an Effective Tax Rate (ETR) below 15%.
3. The Under Taxed Profit Rule (UTPR) would apply if the parent entity is located in a jurisdiction with an ETR below the 15% minimum.

[7] Please note that average income tax rates rarely fall below 20% in OECD, EU, or G7 countries. Jurisdictions with no taxation or more favorable rates are limited to territories classified as tax havens or non-cooperative jurisdictions (Echenache, 2022). In Spain, the Bill Establishing a Complementary Tax to Ensure a Global Minimum Level of Taxation for Multinational Groups and Large National Groups (IC) 1 , June 11, 2024, (BOE June 14).

[8] In December 2021, 136 OECD countries committed to implementing the Global Minimum Tax in their domestic legislation before 2024. Now, 137 countries and jurisdictions, representing over 90% of the world's GDP, have joined the two-pillar approach, which establishes a new international tax framework, and have agreed on a Detailed Implementation Plan that anticipates the application of the new rules by 2023. Currently, only a few of the 140 members of the Inclusive Framework have yet to join the two-pillar approach (OECD , 2022).

The combination of these three mechanisms ensures the operation of the minimum tax, creating an incentive for countries to adopt the new system to avoid being disadvantaged:

1. Countries integrating the new model into their tax systems will receive this supplementary tax, which would add to the existing corporate income tax.
2. Since corporate groups will be taxed at a minimum of 15%, it would no longer make sense to seek more favorable tax locations.
3. States no longer have the tool of lower taxes incentives for companies establishing in their territories. Doing so would merely result in the parent (IIR) or subsidiary (UTPR) jurisdiction collecting the forgone taxes due to domestic benevolent tax rates.

Following the Pillar 2 rules, the effective tax rate (ETR) would be compared to the 15% minimum to determine the applicability of the supplementary tax. However, the ETR calculation under the GloBE framework is noteworthy. Generally, the effective tax rate is understood as the amount of tax a subject pays relative to the income earned. This calculation is typically individualized even when dealing with related entities within a group.

The GloBE model rules, however, challenge this basic assumption by introducing the concept of “adjustment for covered taxes” (Article 4)[9], which includes taxes that would correspond to partners or participants. This could result in a group entity avoiding GloBE’s applicability by achieving an ETR of 15%, albeit fictitiously.

Another peculiarity of the minimum tax is the formula established for quantifying the base. For calculating the supplementary tax (starting by determining the ETR), the base is derived from the accounting result, not the taxable base of the domestic corporate tax. The accounting result is adjusted according to the model rules (Article 3). Using the international accounting standard facilitates a more harmonized or harmonizable tax base calculation compared to the diversity of internal corporate income tax regulations of each state (Eberhartinger, 2023).

It is precisely in the determination of the base where Pillar 2 contains provisions designed to preserve certain investments. Furthermore, this is especially interesting for the less favored territories: for example, the rejection of international shipping income (Article 3.3 of the model rules) and certain income associated with the value of tangible assets and personnel costs under the "substantive activities exclusion"[10] (Article 5.3). The purpose of this exclusion is to allow developing countries (DC) to continue offering effective tax incentives to attract genuine and substantial foreign direct investments. Certainly, excluding from the GloBE tax certain investments and commercial expenses associated with property, plant, equipment, natural resources, and employees, the additional burden to reach the 15% minimum is reduced. Thereby, developing countries (DCs) can maintain certain tax attractions for businesses and investments.

On the same path, Pillar 2 also includes a Subject to Tax Rule (STTR) with a rate of 9%. Members of the Inclusive Framework (IF) recognize that the STTR is essential for achieving consensus on the Second Pillar for developing countries. IF members would apply the nominal STTR rates in their bilateral agreements with developing countries when requested. Under the STTR, the taxing right is limited to the difference between the 9% and the existing tax rate. The STTR would be incorporated into the wording of Double Taxation Conventions

[9] Treating the taxes paid by the shareholders of controlled foreign corporations as if they were paid by the foreign corporation itself helps the low-tax constituent entity meet the minimum tax requirement of 15% and avoid additional taxes.

[10] The GloBE rules establish a "substance-based carveout" for substantial activities. This excludes 5% of the depreciation expenses of tangible assets and payroll costs from income. During a transitional period of 10 years, the excluded income will be 8% of the depreciation expenses of tangible assets and 10% of payroll costs, decreasing annually by 0.2 percentage points for the first five years and by 0.4 percentage points for tangible assets and 0.8 percentage points for payroll costs for the last five years.

with developing countries. For weaker and more needy economies, the STTR provides an anti-abuse guarantee as for foreign investments as well.

Additionally, a "de minimis rule" was introduced to exclude from GloBE jurisdictions hosting small groups with less than 10 million euros in revenues and less than 1 million euros in profits (Article 5.5 of the model rules).

Despite all of this, the initiative of the Minimum Tax has faced significant criticism, particularly from developing countries: "the alleged benefits of global minimum effective corporate income taxation in developing countries seem to be exclusively based upon three unconvincing premises, namely the idea that all corporate income tax incentives offered by developing countries are equally inefficient; the fact that all developing countries can easily switch from corporate income tax competition to other forms of competition; and most notably, the presumption that whilst an active endorsement of a global effective minimum corporate income tax may increase developing countries' tax revenue collection, their inaction on these matters may reflect an important revenue loss." (Parada, 2024).

On the other hand, countries that have adopted this second pillar have implemented corresponding normative measures to integrate it into their internal legislations. The year 2023 has been pivotal.

To summarize, all these changes aim for a more equitable tax system, ensuring that large companies contribute to the territories where they truly generate their profits.

2 THE ADVANCEMENT OF TAX TRANSPARENCY: TAX INFORMATION EXCHANGE AND COOPERATION AMONG JURISDICTIONS

The global movement towards tax international information exchange and the pursuit of greater transparency has been accelerating since 2008. The implementation of the new digital and global economic model, successive financial crises, scandals over hidden accounts, and the budgetary repercussions following the COVID-19 pandemic have driven states to reactivate and perfect data exchange mechanisms.

Recognizing Double Taxation Conventions (DTCs) have been a key tool and the starting point for tax information exchange between states[11], this model has evolved significantly in recent years. The Tax Information Exchange Agreements (TIEAs) promoted by the Global Forum, the OECD's Multilateral Convention on Mutual Administrative Assistance[12], European Directives, and the FATCA have been major steps towards achieving the standard of automatic information exchange and the Common Report Standard (CRS).

The OECD has consistently highlighted harmful tax practices that distort fair competition between states[13]. The key to curbing these practices lies in effective information exchange[14]. The emergence of the Global Forum on Transparency and Exchange of Information for Tax

[11] Article 26 of the OECD Model and the United Nations Model regulates the exchange of information between the Contracting Parties.

[12] The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (CMAAT) of 1988 was amended in 2011. Article 27 of the OECD Model already contains regulations on mutual assistance in tax collection between states. Similarly, in the European context, the directive addressing mutual assistance in the recovery of taxes (EU, 2010).

[13] The latest report published, (OECD, 2023).

[14] The beginnings were not easy. The first OECD report on this matter (from 1998) did not receive the approval of either Switzerland or Luxembourg, for example. Switzerland, which also did not agree to the introduction of Article 26 in the Model Convention, has adopted its own model of bilateral information exchange agreement. The Swiss Rubik Agreements (SRAs) are a model of bilateral agreement that, under the premises of preserving confidentiality and complying with tax obligations in the state of residence, requires withholding as an advance payment to guarantee the possible future tax. (Oberson, 2023).

Purposes (Global Forum, GF) has been crucial[15]. As a result of the Global Forum's work, the OECD published (OECD, 2002) the Model Tax Information Exchange Agreement[16]. TIEAs aim to promote information exchange with countries that do not have double tax treaties (DTCs)[17], primarily tax havens. The OECD's Model TIEA thus represents the new standard for effective information exchange against harmful tax competition practices. Although initially met with limited acceptance, there are now over 1,700 TIEAs worldwide. Naturally, as information exchange expands, there is a progressive reduction in territories classified as tax havens and non-cooperative jurisdictions[18].

In the European context, the information exchange system has been refined and expanded due to the increasing intra-community integration of states and in parallel with the evolution of international transparency. Directives have been issued over the years, including the Mutual Information Exchange Directive (UE, 1977), the Savings Taxation Directive, the Directive on Administrative Cooperation in Tax Matters (Council of the European Union, 2011)[19], the Mutual Assistance in Recovery Directive (EU, 2010), and the Directive on Administrative Cooperation in Indirect Taxation[20] (one-stop shop). Consequently, today, European countries enjoy an advanced, comprehensive, and secure model for the provision and exchange of tax-relevant data.

Meanwhile, in 2010, the United States introduced the Foreign Account Tax Compliance Act (FATCA)[21]. The purpose of FATCA is to ensure that all U.S. owners of foreign accounts report annually to the Internal Revenue Service (IRS) the value and income of those accounts. The system subjects to tax deposits in foreign accounts and is designed to declare the foreign income of U.S. persons. FATCA applies to both direct and indirect U.S. owners of accounts, i.e., U.S. account holders and foreign entities owned by U.S. persons. However, this is an internal measure. The Intergovernmental Agreement (IGA) was subsequently added (US Treasury, 2012) as a bilateral information exchange model[22].

The developments in Europe, particularly with the DAC, and in the United States with FATCA, and the announced intention to develop a multilateral automatic information exchange mechanism (US Treasury, 2012), prompted further steps. In 2014, the OECD introduced the

[15] The Forum was established in the year 2000 and included both OECD and non-OECD countries. Its objective was to promote the OECD standard for transparency and information exchange through meetings with tax officials and experts from around the world. It is, in fact, the leading authority on international tax transparency.

[16] Model TIEA. See also 2015 Protocol Model (OECD, 2015).

[17] TIEAs are distinct from DTCs as they are primarily concerned with the exchange of information.

[18] The following jurisdictions, which have not yet made commitments to transparency and effective information exchange, have been identified by the OECD Committee on Fiscal Affairs as uncooperative tax havens: Andorra, The Principality of Liechtenstein, Liberia, The Principality of Monaco, The Republic of the Marshall Islands, The Republic of Nauru, The Republic of Vanuatu. See more at OECD (2024c).

[19] This regulation expands on various directives over the period 2011-2024. It establishes country-by-country reporting obligations to be fulfilled by various operators, such as the obligation to report on the ultimate ownership of entities, the obligation for advisors to report on the international tax planning of their clients, and the obligation for digital platforms to report on users who meet certain thresholds, among others (DAC 1, 2, 3, 4, 5, 6, and 7). DAC 8 refers to crypto assets information report and there is a DAC 9 project which would facilitate the implementation of Global Minimum Tax for EU Member States.

[20] Directives on the common system of VAT (EU Directive, 1991, 1992, 2006). Regulations on administrative cooperation in the field of indirect taxation (Council of the European Union, 1992, 2018) amending subsequent regulations to the first mentioned regarding measures to strengthen administrative cooperation in the field of Value Added Tax (VAT).

[21] On March 18, 2010, Congress passed the FATCA. This provision introduced Sections 1471 to 1474 of Chapter 4 of the Internal Revenue Code (IRC). The IRC implemented the final FATCA regulations in 2013.

[22] The United States currently has more than 113 signed IGAs. The use of the CRS is expanding to new economic realities. For example, the application of AEOI rules to crypto-asset holders and providers is already being considered. See Oberson (2023).

Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI) and the Common Reporting Standard (CRS)[23].

3 THE LEADERSHIP OF THE UNITED NATIONS IN REGULATING INTERNATIONAL TAX COOPERATION: FROM THE MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPING AND DEVELOPED COUNTRIES TO THE MULTILATERAL FRAMEWORK CONVENTION FOR INTERNATIONAL TAX COOPERATION.

On November 22nd, 2023, a historic milestone occurred[24]: the UN General Assembly approved by a wide majority (125 in favor, 48 against, 9 abstentions)[25] the resolution (UN, General Assembly, Resolution A/C.2/78/L.18/Rev.1, 2023) "Promotion of inclusive and effective international tax cooperation at the United Nations".

Notwithstanding, previous resolutions (UN, Resolution A/RES/77/154, 2022; UN, 2022) had already anticipated these ideas: the need to centralize efforts made by various international organizations to make international tax cooperation more inclusive and effective.

Yet furthermore, November´s resolution marks a significant shift in the perspective on international taxation:

1. The United Nations becomes the central body for decisions in international taxation field.
2. A United Nations Framework Convention on International Tax Cooperation will preside tax relations between states.
3. An Ad Hoc Intergovernmental Committee (Ad Hoc Committee, AHC) of 20 geographically representative members will be responsible for drafting the Terms of Reference of the Framework Convention.

The AHC was established in February 2024[26] and has already held two substantive meetings, one in April and May 2024[27], and another in July and August 2024[28]. After extensive and sometimes difficult debates during the 22 meetings of its second session, a draft of the Terms of Reference (TOR) for the Framework Convention on International Tax Cooperation was approved on August 16th (UN, General Assembly A/AC.295/2024/L.4, 2024). While not all that glitters is gold[29], the process for a UN Framework Convention on International Tax Cooperation is now a reality, and we can affirm that it is progressing.

The key points of this document can be summarized as follows:

[23] The Finance Ministers and Central Bank Governors of the G20 endorsed the Automatic Exchange of Information (AEOI) as the future new standard for information provision (OECD/G20/GF, 2014). Today, more than 120 jurisdictions have endorsed the CRS.

[24] This resolution is preceded by resolutions that highlight the primary role of the United Nations and the potential frameworks for organizing international tax cooperation: 1. Multilateral Convention, 2. Framework Convention, 3. Framework Agreement. Ultimately, the decision was made to proceed with the Framework Convention.

[25] The resolution was proposed by Nigeria on behalf of the Group of African States. In summary, it was supported by developing countries. However, it did not receive backing from the EU, Switzerland, or the United States, among others, and several countries, such as Norway, Mexico, Turkey, and the UAE, remained neutral.

[26] The constitutive session of the AHC took place from February 20 to 22, 2024.

[27] The first substantive session of the AHC took place from April 27 to May 8, 2024, in New York.

[28] The second session took place from July 29 to August 16, 2024.

[29] 110 votes were cast in favor, reflecting the stance of the vast majority of African nations, South Central countries, Central Asia, and small island states. Eight key countries opposed the proposal of the Draft Terms of Reference: the USA, Canada, Japan, South Korea, Israel, the UK, New Zealand, and Australia. Additionally, many countries expressed reservations about certain aspects of the proposal and abstained from voting, totaling 44. These included EU member states, Switzerland, Luxembourg, Liechtenstein, the UAE, Ukraine, Estonia, Georgia, Latvia, Lithuania, Monaco, Montenegro, Moldova, San Marino, Singapore, Slovakia, Slovenia, Trinidad and Tobago, and Liberia.

1. **Protocol**: The Framework Convention (IFC) needs to reflect the main resolutions on Promotion of inclusive and effective international tax cooperation at the United Nations and the Sustainable Development agendas[30].
2. **Objectives**: The IFC should establish fully inclusive and effective international tax cooperation in terms of substance and process; Establish a system of governance for international tax cooperation capable of responding to existing and future tax and tax-related challenges on an ongoing basis; Establish an inclusive, fair, transparent, efficient, equitable, and effective international tax system for sustainable development, with a view to enhancing the legitimacy, certainty, resilience, and fairness of international tax rules, while addressing challenges to strengthening domestic resource mobilization.
3. **Principles**: As guidance to achieve the objectives the IFC should a. be universal[31]; b. respect the sovereignty of each country; c. be aligned with States' obligations under international human rights law; c. take a holistic[32] perspective; d. contribute to achieving sustainable development by ensuring fairness in allocation of taxing rights under the international tax system; e. provide simple and easy rules; f. ensure certainty for taxpayers and governments; g. require transparency and accountability of all taxpayers.
4. **Commitments to achieve the objectives**: a. fair allocation of taxing rights, including equitable taxation of multinational enterprises; b. addressing tax evasion and avoidance by high-net worth individuals and ensuring their effective taxation in relevant Member States; c. international tax cooperation approaches that will contribute to the achievement of sustainable development in its three dimensions, economic, social and environmental, in a balanced and integrated manner; d. effective mutual administrative assistance in tax matters, including with respect to transparency and exchange of information for tax purposes; e. addressing tax-related illicit financial flows, tax avoidance, tax evasion and harmful tax practices; f. effective prevention and resolution of tax disputes.
5. **Capacity building**: The framework convention therefore should include provisions regarding institutional mechanisms to support Member States, especially developing countries, in their efforts to build capacity on relevant international tax practice and related issues to ensure that they have adequate capacity to participate effectively in international tax cooperation and to implement the framework convention.
6. **Other elements**: inter alia, the following additional substantive and procedural elements should be included in the IFC: definitions; relationship with other agreements, instruments and domestic law; review and verification; exchange of information (for implementation of the framework convention); data collection and analysis; financial resources; Conference of the Parties; Secretariat;

[30] Paragraph 6 of the draft TOR, mentions resolutions 78/230 on "Promotion of inclusive and effective international tax cooperation at the United Nations"; 77/244 of 30 December 2022 on "Promotion of inclusive and effective international tax cooperation at the United Nations"; 70/1 of 25 September 2015 on "Transforming our world: the 2030 Agenda for Sustainable Development"; and 69/313 of 27 July 2015 on the Addis Ababa Action Agenda of the Third International Conference on Financing for Development.

[31] This principle of universality could encompass all aspects involved in the International Framework Convention (IFC), such as fostering state consensus to ensure effective international tax cooperation, ensuring participation and transparency, guaranteeing inclusivity in decision-making processes, and adapting to varying state capacities. This includes accommodating the rules for different states' capacities and creating capacity-building mechanisms for developing countries. Additionally, it involves understanding the IFC through a holistic approach that integrates all aspects of international tax cooperation. Indeed, from our perspective, the Framework Convention should strive to provide a universal and comprehensive tax solution that aligns with the realities of the Sustainable Development Goals (SDGs). In pursuit of this objective, the additional protocols will serve as crucial instruments.

[32] This holistic version of the Framework Convention is acclaimed by scholars. See Saucejo E. d. (2023). Professor de Andrés further advocates for an International Cooperation Organization within the UN in her work (Saucejo J. O., 2023)

subsidiary bodies; dispute settlement mechanisms; and procedures for amendments to the framework convention and adoption of protocols; and final provisions.

7. **Protocols**: Two early protocols should be developed simultaneously with the framework convention. One of the early protocols should address taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy. The subject of the second early protocol should be decided at the organizational session of the intergovernmental negotiating committee among the designed specific priority areas namely a. taxation of the digitalized economy; b. measures against tax-related illicit financial flows; c. prevention and resolution of tax disputes; and d. addressing tax evasion and avoidance by high-net worth individuals and ensuring their effective taxation in relevant Member States.

   Following protocols in other areas should be negotiated as illustrated a. tax cooperation on environmental challenges; b. exchange of information for tax purposes; c. mutual administrative assistance on tax matters; and d. harmful tax practices.

8. **Timeframe for the negotiation of the IFC**: Once the report containing the draft Terms of Reference (TOR) is approved by the General Assembly during its 79th session in September 2024, a three-year timeframe has been set for negotiating the International Framework Convention (IFC) and the two initial protocols. Consequently, the Framework Convention on International Tax Cooperation is expected to be presented to the General Assembly for approval during its 82nd session in 2027.

The scope of the matters covered by the Terms of Reference also encompasses the issue we are addressing, the debates underscored the necessity for the explicit inclusion in the Terms of Reference of the Framework Convention regarding the preservation and promotion of foreign investment in countries, particularly developing nations. This is crucial for enhancing revenue collection and mobilizing resources to effectively achieve sustainable development. Indeed, the approved draft of the Terms of Reference for the International Framework Convention includes a commitment to 'international tax cooperation approaches that will contribute to the achievement of sustainable development in its three dimensions—economic, social, and environmental—in a balanced and integrated manner."[33]

4 FOREIGN DIRECT INVESTMENT (FDI) AND THE NEW PRINCIPLES OF INTERNATIONAL TAXATION

Foreign Direct Investment (FDI) is significantly impacted by the emergence of new principles of international taxation. Pillars 1 and 2, the new dimension brought by the United Nations and the Framework Convention, and the increasingly refined tax information exchanges affect investors who must rethink their location strategies.

This new scenario also influences International Investment Agreements (IIAs)[34]. IIAs are agreements that states enter to attract investments to their territories. These agreements, which primarily encompass commercial or business aspects, often include tax measures, particularly in the form of investment tax incentives.

[33] Paragraph 10 c) of the Draft TOR (UN, General Assembly A/AC.295/2024/L.4, 2024).

[34] The most recent IIAs signed (UN, 2024).

The development of international taxation, as outlined above, raises questions about the compatibility of these incentives and other tax benefits with the new fiscal rules. This opens a new road for Investor-State Dispute Settlement (ISDS)[35].

One could argue that developing economies have gained a significant tool in Pillar II rules, which theoretically allows them to apply additional taxes before the home countries of the investors do. However, some developing countries, with weaker tax collection capacities or constraints imposed by older IIAs, may be unable to leverage this benefit. In such cases, developed countries of origin could consider pooling the revenues obtained through the IIR and converting them into development aid.

Recognizing that IIAs may pose limitations on the implementation of IF rules, a multilateral solution might be a more effective option to avoid disputes as host countries could eliminate or reduce preferential tax treatment for investors.

And, undoubtedly, on the other hand, in developing countries, these tax reforms will need to be combined with their necessary demand for investment. Specially for them, international support and technical assistance in both areas will be crucial to ensure that the potential benefits of the reforms are realized while minimizing negative effects on international investment, thereby advancing the achievement of the Sustainable Development Goals (SDGs) (UNCTAD, 2022).

Among the most relevant observations made by United Nations Trade and Development (UNCTAD) regarding the investment situation in developing countries (DCs) are the following (UNCTAD, 2023):

A geometric decline in investment in DCs.

A 12% decrease in Foreign Direct Investment (FDI) in 2022.

The urgent need for foreign investment in renewable energy in DCs.

Additionally, in terms of trade agreements (UNCTAD, 2024), it was noted that:

Global merchandise trade decreased by 1%[36].

High energy prices increasingly benefit exporters but pose a significant burden for DCs that are net importers of commodities.

DCs are grappling with growing debt payment obligations.

Given this data, it is logical that the critical importance of investment promotion and protection, particularly for developing countries, had been emphasized during the second session of the Ad Hoc Committee (AHC) in the meetings to draft the Terms of Reference (TOR) for the Framework Convention (FC) on International Tax Cooperation.

Indeed, among the objectives of the FC in paragraph 7b is "Establish a system of governance for international tax cooperation capable of responding to existing and future tax and tax-related challenges on an ongoing basis;".

[35] The Investor-State Dispute Settlement (ISDS) is the primary mechanism for enforcing obligations under International Investment Agreements (IIAs). Most disputes involve the application of the most-favored-nation clause. Tax incentives often become contentious, raising issues of tribunal jurisdiction. Some IIAs explicitly exclude tax matters or limit coverage to specific provisions, a trend more common in recent agreements. Without such exclusions, tax matters fall under IIAs, leading to non-specialized tribunals handling tax issues. A procedural improvement could involve referring tax-related claims to the competent tax authorities of the contracting parties, with a typical review period of six months.

[36] Even more, the latest highlight ids that Global GDP growth slows to 2.6% in 2024, continuing post-pandemic slowdown, (UNCTAD, 2024).

Regarding the principles in paragraph 9b we find that the FC should "recognize that every Member State has the sovereign right to decide its tax policies and practices, while also respecting the sovereignty of other Member States in such matters;"

And finally, we can clearly see the need for balance between international tax cooperation and the preservation and promotion of investment agreements is reflected in the wording of paragraph 13, titled "Other Elements. The framework convention should also include, inter alia, the following additional substantive and procedural elements: definitions; relationship with other agreements, instruments and domestic law; review and verification; exchange of information (for implementation of the framework convention); data collection and analysis; financial resources; Conference of the Parties; Secretariat; subsidiary bodies; dispute settlement mechanisms; and procedures for amendments to the framework convention and adoption of protocols; and final provisions."

5 CONCLUSION

There is no question that all these changes in international taxation principles, advances in transparency, and efforts to develop a multilateral tax regulatory framework aim to create a more secure, fair, and equitable international tax system, ensuring that large companies contribute to the territories where they truly generate their profits.

However, it is essential to remember the balance between tax justice and sovereignty as the legitimate pursuit of resources by states[37]. Justice for all may be a difficult theory to implement without generating consequences, such as disincentivizing foreign investment or reducing the estimated revenue for states.

On the other hand, tax regulations with aggressive tax competition provisions among states in the quest to attract investment result in an inequitable and unsupportive tax system, and ultimately, an unfair international tax landscape.

All these changes in international taxation pursuit neutrality in business decisions regarding the location of investments. Should tax competition between states be mitigated through the implementation of the two pillars and the automated exchange of information between countries, investment decisions would be influenced by factors other than tax motivations.

Yet caution is necessary, as states are sovereign and will always strive to attract investment to their territories. Double Taxation Conventions, tax incentives, stabilization clauses, and Investment Agreements will need to coexist with the new tax rules for revenue allocation.

The implementation of tax compliance by companies and the mechanisms for conflict avoidance and resolution will become increasingly important. Moreover, a framework convention on international tax cooperation that holistically addresses all related aspects can provide legal certainty to businesses and contribute to the balance of the system.

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[37] In this regard, we recommend listening to the podcast (Feria, 2023) by Professor Rita de la Feria from the University of Leeds.

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