



For the kind attention of:

Mr. Ramy Youssef, Chair of the Intergovernmental Negotiating Committee to draft a United Nations Framework Convention on International Tax Cooperation and two early protocols (INC) and Mr. Daniel Nuer, Co-Lead of Workstream I.

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Subject: ICRICT submission regarding the Draft Issue Note of Workstream I of the Intergovernmental Negotiating Committee on the UN Framework Convention on International Tax Cooperation.

The Independent Commission for the Reform of the International Corporate Taxation (ICRICT) appreciates the opportunity to provide input to the United Nations negotiating committee of the Framework Convention on International Tax Cooperation.

Abstract

This submission is presented to Workstream 1 of the Intergovernmental Negotiating Committee on the UN Framework Convention on International Tax Cooperation. It outlines the Commission's core recommendations on the scope and content of the Convention.

The negotiation of the Convention is a historic opportunity to reform an outdated international tax system and create a new framework that is inclusive, transparent, and equitable. The Commission calls for an international system that tackles tax avoidance by multinational enterprises and high-net-worth individuals, reallocates taxing rights fairly, and strengthens domestic resource mobilization for sustainable development.

To achieve this, we must replace the current transfer pricing rules and the arm's length principle with unitary taxation based on formulary or fractional apportionment. This shift would allocate MNEs' global profits according to real economic activity - employment, sales, assets - ensuring that value is taxed where it is created. The Commission also rejects mandatory arbitration and advocates for simpler, clearer rules that prioritize dispute prevention over resolution.

The Convention should commit to progressive taxation, effective taxation of natural resources, gender-responsive fiscal policy, and alignment with environmental and human rights obligations. These

elements are essential to a tax system that supports global development goals and reduces inequalities within and among countries.

Comments on the Draft Issue Note of Workstream I

Introduction

The negotiation of the UN Framework Convention on International Tax Cooperation is a landmark opportunity to reform an outdated global tax architecture and to build a more inclusive and equitable international tax system, enabling countries to cooperate more effectively to ensure equitable taxation and to participate on an equal footing under clear, transparent rules of negotiation.

It affords an opportunity to collectively address tax evasion and avoidance - by multinational enterprises (MNEs) and high-net worth individuals - and resolve gaps in global taxation arising from globalization and the digitalization of the world's economies. The efficiency and fairness of the international tax system has an important impact on the possibilities for raising domestic revenue for sustainable public financing, which, in turn, is necessary for sustainable and equitable development.

In addition, the past few decades have seen a rapid increase in the amount of double tax treaties signed between countries, from around 500 to more than 3,000. This network of bilateral tax treaties is skewed towards the needs of resident countries (home not only to the ultimate parent entities of multinational companies, but also their intermediaries) as such treaties limit the taxing rights of source jurisdictions (often developing countries) restricting their ability to raise revenues.

The combination of transfer pricing and the preference of residence over source taxation in double tax treaties provides the foundation for an embedded global system of tax avoidance and a global tax regime which is complex, inefficient, and unfair.

On the issue of fair allocation of taxing rights

A fair allocation of taxing rights entails a reform of the principles governing international taxation, i.e. the arm's length principle, and the pre-eminence of residence over source taxation in tax treaties.

The existing rules favour taxation in the countries of declared residence of capital, both because of the pre-eminence in tax treaties, but also due to the arm's length principle which often arbitrarily associates value to the location of assets, functions and risks. This system has allowed MNEs to erode the tax base both in developed and developing countries, by shifting profits to MNEs' affiliates located in low tax jurisdictions. As countries in the Global South rely on revenues from MNEs more than countries in the Global North, the resulting system contributes to north-south inequality and constrains the efforts of countries of the Global South to achieve sustainable development.

True reform would begin with recognising the reality that modern-day MNEs are unified and highly integrated groups of entities that are under single control and have a single set of owners. That means jettisoning separate entity taxation of MNEs and the use of transfer pricing rules to determine profit allocation in favour of taxing them as unitary firms.

The arm's length principle allows MNEs to exploit legal and regulatory gaps, assigning routine profits to high-tax jurisdictions while shifting excess profits in the form of intangible-related payments to tax havens.

The arm's length principle's fundamental flaw is its reliance on a fiction: that related entities operate as independent parties. This creates subjective, contested profit allocations that courts struggle to adjudicate, leaving tax administrations powerless against systematic base erosion and profit shifting.

A unitary approach should apportion the MNE's global income to the different jurisdictions based on objectively verifiable factors, rather than resort to the fiction of arm's-length transactions. These factors, such as employment, sales, resources used, fixed assets, etc., should be chosen to reflect the MNE's real economic activity in each jurisdiction.

Just as important, these factors cannot be easily moved around the group to avoid taxation. Relocating employees to a low-tax jurisdiction involves much more than transferring intangible assets to a letterbox company in such a jurisdiction. Firms have even less power over the location of their customers. Furthermore, these objective factors reflect actual economic activity, while the separate entity principle and transfer pricing rules enable profit shifting to MNE's entities lacking economic activities, for example, through the use of intellectual property rights held in low tax jurisdictions.

The outdated permanent establishment principle should also be abandoned and replaced by the development of a nexus rule based on the principle of Significant Economic Presence (SEP), whereby a taxable presence will be created in the country when a non-resident enterprise has a SEP, defined as purposeful and sustained interaction with the economy of that country, including sales of goods and services by any means, including digital.

In summary, it is our view that a fair allocation of taxing rights can only be achieved by moving away from the current dysfunctional transfer pricing system towards unitary taxation, to allow the allocation of taxing rights over the profits of multinationals in a balanced way (through formulary/fractional apportionment) using factors reflecting both supply (e.g., assets, employees, resources used) and demand (sales). Neither can create value without the other.

The Convention should therefore include:

- 1) a commitment to ensure equitable taxation of multinational enterprises so that their profits are allocated to all jurisdictions where real business activity takes place.
- 2) a commitment to move away from the current transfer pricing system towards unitary taxation based on formulary/fractional apportionment.

On the issue of effective prevention and resolution of tax disputes

Tax is central to state sovereignty, and it is inappropriate and unacceptable to expect states to submit disagreements over the interpretation of rules on their taxing rights to third party adjudication in any

form. As a Commission we strongly urge that this opportunity is used to develop new rules that are fairer, clearer and easier to administer, so that the risk of disputes is minimised. The focus should be on dispute prevention rather than resolution.

The level of judicialization in cases of international taxation has become very high, and has been growing due to the subjectivity of the rules on allocation of income, based on the arm's length principle in transfer pricing. These ineffective and dysfunctional rules have been exploited by multinationals to avoid taxes. This is the main source of uncertainty in the tax compliance process and the increasing number of tax disputes. As argued above, the best way to provide certainty for taxpayers and tax administrations alike is to develop a new approach to the allocation of income of multinationals for tax purposes, based on the economic reality that they operate as unitary enterprises under central ownership and control.

Dispute prevention does not necessarily require the existence of a double tax treaty. It can also be enabled by administrative cooperation through bilateral and multilateral exchange of information agreements. However, the arm's length principle is the most important constraint on dispute prevention in both developed and developing countries.

Advance pricing agreements (APAs) can also be a source of disputes and imbalance. Except in cases in which they seek to simplify rules, negotiations on advance pricing agreements can last several years, and as such are biased towards taxpayers with more resources. The information asymmetries that affect tax administrations mean that APAs in practice bind their hands.

Most international tax disputes stem from differing interpretations of transfer pricing. Tax treaties traditionally rely on the Mutual Agreement Procedure (MAP) allowing tax authorities to resolve disputes bilaterally. While MNEs have long pushed for binding arbitration to prevent double taxation, even OECD countries initially resisted.

The BEPS project introduced a system of mandatory arbitration, but this has been largely rejected by developing countries. It is unnecessary and inappropriate for this experiment to be duplicated at the UN.

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) included an optional arbitration mechanism, intended to incentivize settlements rather than frequent arbitration. This convention was meant to modify the existent network of treaties. The arbitration mechanism was the object of reservations by a [number of countries](#).

The OECD has since focused on strengthening MAP as part of BEPS Action 14, publishing member profiles and [datasets](#) on disputes - though arbitration cases remain undisclosed. Disputes continue to rise, from under 3,000 in 2016 to around 5,000 in 2022, mostly between OECD members and a few emerging economies (notably India). In this context, developing countries have been arguing that clear, simple rules and administrative cooperation, not arbitration, are key to preventing disputes.

Instead of focusing on a binding dispute resolution, the emphasis should be on efforts to resolve the underlying problems behind tax dispute prevention and resolution (the conflicting nature of the arm's length principle and the pre-eminence given to the residence principle in existent tax treaties).

Moreover, in other arenas, such as the resolution of disputes under investment agreements, the deficiencies of arbitration are well documented. There is, therefore, a growing consensus in both developed and developing countries against arbitration due to the associated costs, potential loss in revenues, a lack of confidence in the impartiality of the arbitrators and constitutional/sovereignty concerns.

For the above reasons, as a Commission we oppose the use of mandatory arbitration.

On the issue of sustainable development

The Framework Convention [ToR](#) specify the objective of establishing “an international tax system for sustainable development.” Furthermore, the recently adopted [Outcome Document of the Fourth Financing for Development Conference](#) - the *Compromiso de Sevilla* - also includes a number of decisions that are highly relevant to this issue, such as:

- *“We will promote progressivity and efficiency across fiscal systems to address inequality and increase revenue. We will promote progressive tax systems in countries, where applicable, and enhance efforts to address tax evasion and avoidance by high-net-worth individuals and ensure their effective taxation, supported by international cooperation, while respecting national sovereignty. We will also promote effective and equitable government spending.” (paragraph 27(e));*
- *“We encourage effective taxation of natural resources...”. (paragraph 27(f));*
- *“We will (...) advance discussions on gender responsive taxation.” (paragraph 27(g));*
- *“We will promote the consideration of the environment, biodiversity, climate (...) in fiscal programming in line with national circumstances, sustainable development priorities, and poverty eradication strategies.” (paragraph 27(h));*
- *“We encourage countries to integrate financing of social protection systems and policies, including floors...” (paragraph 27(i));*
- *“We further reaffirm that the pursuit and enjoyment of human rights and fundamental freedoms for all, encompassing civil, political, economic, social and cultural rights, which includes the right to development, must be respected, protected and promoted, without distinction or discrimination of any kind.” (paragraph 3)*

With this in mind, we believe the Convention should include a commitment to ensure that fiscal systems are fully in line with the progressive fulfilment of human rights and sustainable development, including the achievement of relevant UN goals, obligations and commitments. This should include specific mentions of the goal of reducing inequality within and among countries, environmental protection and gender equality, as well as the promotion of progressive tax systems.

Full and effective participation of observers

Paragraph 21 of the Framework Convention ToR states that “*civil society and other relevant stakeholders are encouraged to contribute to the work of the intergovernmental negotiating committee in accordance with established practices.*”

We are very committed and keen to respond to this invitation. However, our contribution can only be meaningful if it is well-informed and timely. With this in mind, we find it deeply concerning that observers have not been invited to participate in the online meetings of the Workstreams. The fact that we have been unable to even observe the numerous meetings that Member States have already had, leaves us with a very limited understanding of the specific discussions, and significantly reduces our ability to feed into and respond to the debate.

We would like to stress the importance of allowing for full and effective participation of civil society and trade unions in all meetings of the committee, including the online sessions of the Workstreams.