

The FfD Chronicle



**CIVIL SOCIETY
FINANCING FOR
DEVELOPMENT**
Mechanism

The CS FfD Mechanism is an open civil society platform including several hundreds of organizations and networks from diverse regions and constituencies around the world. CS FfD Mechanism's core principle is ensuring that civil society can speak with one collective voice.

RETURN OF THE SOURCE COUNTRY PERSPECTIVE

In the early 1950s, before the UN intergovernmental tax negotiations were brutally shut down, source country taxation was top of the agenda. But as the OECD stepped in and snatched the role of global standard setter on tax, we didn't just get a tax system that strongly favored a minority of residence countries, but in fact one that mainly rewards tax havens. The failure of source and residence countries to work together to promote a fair and effective tax international system left everyone at a loss, as profits were siphoned off to whichever country offered the most harmful tax practices.

Today, as Workstream 2 begins its work, marks a historic comeback for the source country perspective. And it is more needed than ever. With the rise of the digitalized economy, the source/residence country picture has become much blurrier, and the number of countries that find themselves to be a market jurisdiction for companies with no physical presence has exploded.

With its focus on promoting taxation of services in the digitalized economy, Protocol 1 has the potential to generate much needed extra resources for a broad range of countries in the short run. In a world hampered by the failed transfer pricing system, digital services taxes and withholding taxes have important roles to play as taxes that are relatively simple to administer and can generate important additional revenue. With Protocol 1, governments need to seize this opportunity, including by replacing the deeply outdated idea of permanent establishment with the concept of significant economic presence.

But at the same time, Protocol 1 must also foresee a world where the global tax system is fundamentally reformed. As Workstream 1 – the Convention – embarks on the mission to ensure equitable taxation of multinational enterprises, it is clear that the transfer pricing system will have to go. The obvious alternative is a system whereby corporations are taxed on their global profits, and taxing rights are distributed to the different jurisdictions where they operate, virtually or otherwise, based on an agreed formulary apportionment under a unitary tax regime.

Where did all the profits go?

According to the EU Tax Observatory, the largest profit-shifting destinations in 2020 were:

1. Netherlands
2. Ireland
3. Switzerland
4. British Virgin Islands
5. Luxembourg

(Source: EUTO, Global Tax Evasion Report 2024)

DISPUTE-AVERSE? REPLACE THE OUTDATED TRANSFER PRICING SYSTEM

As we prepare to discuss Workstream 3 of the UN Tax Convention negotiations, on the prevention and resolution of tax disputes, it is essential to look beyond ineffective sticky-plaster “solutions” and address the structural flaws that generate these disputes in the first place.

The real barrier to effective dispute prevention and resolution lies in the current corporate tax system, which operates under transfer pricing rules and the arm’s length principle. This system is convoluted and unfit for purpose. It prevents countries from taxing corporate income effectively and generates an excessive number of disputes that are costly and time-consuming to resolve.

The issue of “comparable transactions” is a symptom of this problem. The system assumes that transactions within multinational corporations can be compared to similar transactions between unrelated companies. In reality, for many internal transactions, especially those involving intangible assets, intra-group financing or services, there are simply no genuine comparables. This is not an information-sharing gap: it is a false assumption built into the system. It leads to uncertainty, manipulation, and an increasing stream of disputes.

The logical solution is to replace the transfer pricing system with a unitary taxation approach, where multinational corporations are treated as single, coherent entities and taxed on their global profits, apportioned between countries according to real economic activity. Unitary taxation with formulary apportionment is a simpler, fairer approach that would prevent many disputes before they occur.

With this in mind, we argue that Workstream 3 should not invest resources in trying to add more layers of false solutions to resolve transfer pricing disputes. We would particularly warn negotiators against adopting “solutions” that risk deepening problems:

- Advance Pricing Agreements (APAs) have been presented as a way to provide certainty, but their track-record tells a different story. The 2014 LuxLeaks scandal, for example, exposed how APAs, quickly dubbed “Sweetheart Deals”, were used by tax havens to offer preferential arrangements to multinationals corporations. Beyond these scandalous schemes, APAs raise systemic concerns. They are agreed in “advance” and binding for the tax administrations, even if later evidence of tax avoidance emerges. Because they are requested and tailored for individual corporations, APAs risk giving special treatment to the most influential economic actors. The uncertainties of the corporate tax system should be addressed through comprehensive reform, not secret deals.
- Mandatory arbitration is a very dangerous path that should be rejected early on. Experiences with investor-state arbitration have shown how such mechanisms can undermine public interest. This should serve as a clear warning against using similar approaches in tax matters.

Finally, we stress that the UN Tax Convention must aim to create a coherent and consistent international tax system. While opt-in or opt-out provisions are common in OECD tax agreements, they are not the norm for UN treaties, and should not be introduced here.

Workstream III should enable these crucial discussions, to design a dispute system that tackles the real causes of disputes, not just the system’s effects.

“TRANSFER PRICING IS A SIMPLE SYSTEM THAT WORKS”

TRANSFER PRICING:



JOIN OUR SIDE EVENT!

Stocktaking the UN Tax Convention Negotiations

Civil Society Views on State of Play and Next Steps

13:15 - 14:45 NY Time

Tuesday, 12 August

Conference Room 6, UN Headquarters