



27-28 November '23, Geneva

# Conference on South-South Cooperation in International Tax Matters

## **TAXATION OF THE DIGITALIZED ECONOMY: Article 12B of the UN Model**

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## **Rationale:**

# **Article 12B (Income from Automated Digital Services) of UN MTC**

- PE provisions in UN MTC do not cover in their ambit a provision to tax any income arising in market jurisdictions from automated digital services (ADS).
- With Article 12B, a tax treaty provision under the UN MTC in place, it would enable jurisdictions to apply their domestic legislation levying taxes on income derived from digital business models.

## Features of Article 12B

- Ability to derive income from ADS from a country with little or no physical presence there justifies **source taxation**.
- Article 12B provides the developing countries with a simpler solution with a **share in entire profits** derived from the market economies and not just a share in the non-routine profits.
- The provisions have been carefully designed keeping in mind that many developing countries have limited **administrative capacity** and need a simple, reliable and efficient method to enforce tax imposed on income from ADS derived by non-residents.
- Article 12B allows a State to tax income from certain digital services paid to a resident of the other State on a **gross basis (under para 2)** at a bilaterally negotiated rate with an **option** to the taxpayer to pay tax on a **net profit basis (under para 3)** for the whole year.

## Features of Article 12B cont...

- Article 12B is deemed to automatically apply once the ADS (having **minimal human intervention** and administered through electronic network, internet) has been provided.
- The term '**automated digital services**' includes especially:
  - Online advertising services;
  - Supply of user data;
  - Online search engines;
  - Online intermediation platform services;
  - Social media platforms;
  - Digital content services;
  - Online gaming;
  - Cloud computing services; and
  - Standardized online teaching services.



## Features of Article 12B cont...

- Allows **State of source to tax** the underlying payments in accordance with the provisions of its domestic law (para 2)
  - However, if the beneficial owner of the income is a resident of the other Contracting State, the amount of tax imposed by the State of source (in which the income from ADS arises) may not exceed a maximum percentage of the **gross** amount of the underlying payments, as may be negotiated by the Contracting States.
  - Although, the rate is to be bilaterally negotiated, the Commentary has recommended that the rate may be set at a modest value, i.e. **three or four per cent**.
- Has **no thresholds** in terms of its application
  - The Commentary has provided an **alternative** for Contracting States to consider and **provide thresholds**, based on the worldwide revenue and based on the revenue from ADS derived from the source State, for the purpose of protecting taxpayers that have just entered a particular market, since they would more often be operating at a loss during the start-up stage.

## Features of Article 12B cont...

- Para 3 gives the beneficial owner an option to be taxed on a **net basis** for the whole year in the other (source) State where the income arises, as under:

Segmental Accounts	Qualified Profits of beneficial owner	Qualified Profits of beneficial owner belonging to an MNE group
<ul style="list-style-type: none"> <li>maintained</li> </ul>	30% * <b>Profitability Ratio of the beneficial owner's ADS business segment</b> * Gross Annual Revenue in Source State	30% * <b>profitability ratio of MNE group's ADS segment</b> * Gross Annual Revenue in source State
<ul style="list-style-type: none"> <li>not maintained</li> </ul>	30% * <b>Overall profitability ratio of the beneficial owner</b> * Gross Annual Revenue in Source State	30% * <b>MNE group's profitability ratio</b> * Gross Annual Revenue in Source State

- MNE group's profitability ratio applies provided MNE group's profitability ratio > beneficial owner's profitability ratio

## Features of Article 12B cont...

- **Objective of net basis taxation under para 3:** This option allows relief to taxpayer when:
  - ☐ it may have a lower tax liability as in para 2, and
  - ☐ it has a global business loss or a loss in the relevant business segment during the taxable year.
- Where the segmental profitability ratio or the overall profitability ratio of the MNE group to which the beneficial owner belongs is not available to the Contracting State in which the income from ADS arises, the provisions of this **para 3 shall not apply & the provisions of para 2 shall apply.**
- Any taxation at source that may have been levied pursuant to para 2 should be taken into account against the tax liability determined at a later stage pursuant to para 3.



## Features of Article 12B cont...

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- **Gross Annual Revenue in Source State** = sum total of payments underlying income from ADS arising in that Contracting State during the fiscal year, in accordance with the **sourcing rules in paras 9 and 10 of Article 12B**.
- Qualified profits shall be taxable at the **tax rate** provided in the **source State's** domestic law.
- The possibility that payments in consideration for ADS may be subject to **double or excessive taxation** is also reduced or eliminated under Article 23 (Methods for the Elimination of Double Taxation) of UN Model DTC.

## Features of Article 12B cont...

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- Article 12B does not apply curbs on **DSTs**.
- Article 12B also applies to **ADS provided to individuals** for their personal use. The commentary provides an alternative to exclude ADS provided to individuals.
- Article 12B shall not apply if the payments underlying the income from ADS qualify as “royalties” or “fees for technical services” under Article 12 or Article 12A of the UN Model DTC, as the case may be.
- A **State is entitled to tax payments for ADS** if paid by a resident of that State or by a non-resident with a PE or fixed base in that State and the payments are borne by the PE or fixed base.

## Implementation of Article 12B of UN MTC

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- Jurisdictions may **bilaterally** implement Article 12B.
- The UN Committee of Tax Experts is working on a **Multilateral Instrument** that will enable speedier implementation of Article 12B into the tax treaties.
- Developing countries in the UN Committee of Tax Experts must come together for early formulation of the Multilateral Instrument that will allow faster adoption of Article 12B by a number of countries simultaneously.

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