Mandates of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights; the Special Rapporteur on the right to development; the Independent Expert on the promotion of a democratic and equitable international order and the Special Rapporteur on extreme poverty and human rights

Ref.: AL OTH 25/2022
(Please use this reference in your reply)

30 March 2022

Excellency,

We have the honour to address you in our capacities as Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights; Special Rapporteur on the right to development; Independent Expert on the promotion of a democratic and equitable international order and Special Rapporteur on extreme poverty and human rights, pursuant to Human Rights Council resolutions 43/10, 42/23, 45/4 and 44/13.

In this capacity we would like to bring to your attention information we have received concerning the statement on "Two-Pillar solution to address tax challenges arising from the digitalization of the economy" [hereafter- Two Pillar Solution], agreed upon on 8 October 2021[1], under the OECD/G20 Inclusive Framework Base Erosion and Profit Shifting Project (BEPS). The Two Pillar Solution marks a positive shift on the recognition that multinational enterprises (MNEs) are unitary entities and should be taxed accordingly; that a minimum tax should be paid; and that profit should be shared across jurisdictions. However, concerns have been raised about the scope and contents of the announced agreement. Among those concerns, several low and middle-income countries consider that the agreement does not respond to their needs, especially at a time when countries are seeking to recover from the crisis resulting from the Covid-19 pandemic. These countries have also noted that the Two Pillar Solution will negatively affect their ability to increase public revenues, in order to meet the needs of their populations and thus to realize human rights, particularly economic, social and cultural rights and the right to development. Concerns are particularly pronounced in relation to Pillar Two of the agreement, and the establishment of a low rate of 15 percent, which in many countries is lower than existing statutory corporate income tax rates, and even effective tax rates.[2]

General overview of the facts

As of 4 November 2021, 137 countries and jurisdictions of the 141 members of the OECD/G20 Inclusive Framework on Base erosion and profit shifting (BEPS) joined an agreement entitled "Two-pillar solution to address the tax challenges arising from the digitalisation of the economy".[3] The agreement aims at addressing the pressing and serious issue of tax avoidance strategies of

[1] https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

[2] https://www.southcentre.int/wp-content/uploads/2021/10/SC-Statement-on-IF-Two-Pillar-Solution-13-Oct-2021.pdf

https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

Delegation of the European Union

multinational enterprises (MNEs), which often shift profits to countries with low tax rates, eroding domestic tax bases. Digital corporations, in particular, have been highlighted as the type of corporations which most benefitted from international tax competition between countries by booking their income in low-tax jurisdictions, or by moving some parts of their business to these jurisdictions.

The Two Pillar Solution agreement on corporate taxation ostensibly aims at increasing government revenues by addressing the tax challenges arising from the digitalization of the economy. Under Pillar One, expected to come into effect in 2023, taxing rights on corporate profits are reallocated. Pillar Two introduces a global minimum corporate tax rate of 15 per cent.

Nevertheless, the Two-Pillar-Solution may mainly benefit some high-income countries while lower-income countries will lose important shares of their revenues. Lower levels of revenue collection in developing countries would weaken the States' capacity to fulfil their human rights obligations due to their inability to adequately fund social policies and public services essential for human rights [such as the adequate standard of living, health, education and social security], disproportionately affecting the poorest segments of the population. The socio-economic impact of the COVID-19 pandemic has brought to the fore the importance of public services for which revenue in low-income countries is essential.

In addition, the process and negotiation of the Two-Pillar Solution under the auspices of the OECD and the G20 are considered to have worsened already existing imbalances in taxing rights and in the effective participation of all States on equal footing. While the OECD may appear to have sought to provide an inclusive forum for these negotiations, it does not provide equal voice, access to information and participation to all States, which are not its members. Low and middle-income countries, despite having presented observations and raised concerns on a number of issues that directly affect their taxing rights, consider that their inputs and preoccupations have not been taken into account in the process, and that they did not always have the required information and time to consider the implications of the proposals.

This negotiation, moreover, has taken place against a backdrop of already high inequities between OECD countries and developing countries. The State of Tax Justice 2021 found that OECD countries and their dependencies are responsible for 70.6 per cent of global corporate tax abuse, amounting to an annual loss of corporate of US$220.5 billion. Moreover, "[w]hen including tax losses to offshore wealth tax evasion, OECD countries and their dependencies are responsible for 78.3 per cent of all tax losses suffered by countries around the world, costing countries over US$378 billion in lost tax every year." [4]

Pillar One

Pillar One was meant to address the concern that large MNEs, in particular those in the digital economy, were not paying fair taxes. It recognizes the value of taxing MNEs on the basis of their global consolidated profits and the necessity of taxing rights being allocated between jurisdictions based on an agreed formula, since the current rules generate systematic inequality in taxing

[4] https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf page 32

rights to the detriment of lower-income countries.[5]

According to the agreed rules under the Two Pillar Solution, the allocation of profits will be made on market jurisdictions based on where goods and services are used or consumed. The new rule would introduce an additional taxing right of profit components (Amount A), which will be reallocated within a process of three different steps. The residual profits of a limited number of multinational corporations will be subject to re-allocation. At the same time however, the existing transfer pricing system will be maintained and applied to all other profits.

This solution will bring about only minimal benefits to developing countries. According to OECD's own estimates, it will reallocate around USD 125 billion of profits to market jurisdictions. However, that amount represents only around USD 10 billion in tax revenue for the countries which as noted by the South Centre is "a minuscule amount, especially when the annual scale of corporate tax avoidance ranges from 100-307 billion."[6]

The proposed division of profits under Pillar One would also result in a segmentation of global profits of an integrated multinational corporation among different lines of business. This not only creates complexity, it will further enable multinational enterprises to allocate profits among different jurisdictions as though corporate affiliates were separate economic actors, transacting with each other at arm's length -- a practice which, in the past, has resulted in shifting profits to tax havens. The maintained transfer pricing rules would continue to be the basis for taxing a very substantial part of corporate profits.

In addition, the underlying complexity of the analysis needed to identify the residual profit subject to re-allocation for Amount A may create differing views for both businesses and the tax administrations of affected jurisdictions. It may also entail a disproportionately high administrative burden for countries with low or overly stressed capacities, and provide a fertile ground for tax avoidance, which would thwart the desired effect of the Two-Pillar-Solution. Complexity not only creates uncertainty for business and national tax institutions, whether double taxation or double non-taxation is applicable, but obstructs monitoring and accountability mechanisms to play their role in retracing whether multinationals pay their fair share of taxes and where.

Concerns have also been expressed about the lack of transparency with regard to the economic rationale and the empirical assumptions that were used for the establishment of this new rule, given that the relevant studies not published, thus further weakening the participatory decision-making process.[7]

We are also concerned that the reallocation of taxing rights towards "market jurisdictions" is likely to be of little benefit to non-OECD countries and may

[5] A. Cobham, T. Faccio, V. FitzGerald, Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals, October 2019, p. 3

[6] https://www.southcentre.int/wp-content/uploads/2021/10/SC-Statement-on-IF-Two-Pillar-Solution-13-Oct-2021.pdf

A. Cobham, T. Faccio, V. FitzGerald, Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals, October 2019, p. 6.

reduce revenues for a range of lower-income countries.[8] Some observers and Government officials have called for a formula that takes into account a number of variables, including sales but also employment and capital, for the apportionment.

The Two-Pillar Solution has a strong focus on mandatory binding dispute resolution mechanisms despite the strong concerns of several developing countries. Binding arbitration mechanisms empower a very limited group of non-state private adjudicators to overturn tax assessments by public authorities and to issue binding opinions on sensitive distributional questions about which countries are allowed to tax which component of the multinational profit by how much.[9] With regard to the exacerbated complexity and the unclear nature of the new tax rule, the binding rulings may have severe implications on future possibilities of countries to protect their tax base and ensure that MNE pay their fair share of tax. In order to enable an informed public debate and to hold governments and MNEs accountable, it is essential that the public have access to information about cases and their outcome.

Pillar Two

We welcome governments seeking to strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits. The Global Anti-Base Erosion Rule (GloBE) has provided a minimum level of tax on the income arising in each of the jurisdictions, which is a positive development. The setting of the minimum level of tax at 15 per cent of corporate profits, however, is much lower than what had been advocated for by a number of organizations and stakeholders, including the Independent Commission for the Reform of International Corporate Taxation (ICRICT), the High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda, the African Tax Administration Forum (ATAF), the African Union, the BEPS Monitoring Group, the Global Alliance for Tax Justice, some member states of G-20, and others. This 15 per cent minimum will drive several low and middle income States, notably in Africa, to lose considerable portions of their revenue since their average effective corporate tax is often significantly higher, varying between 20 and 30 per cent.[10] Furthermore, the economic rationale behind the minimum level of tax at 15 per cent is unknown and unclear, and given the fiscal competition between States, in practice it may turn into a ceiling rather than a floor.

Moreover, given that not all the declared income of MNEs in a particular jurisdiction will be included in the calculation of the 15 per cent, there are serious concerns that this would still allow for profit shifting. A potential race to the bottom, below the 15 per cent minimum, could ensue for other portions of the corporate income. In that respect also, Pillar Two appears insufficiently ambitious to put effectively an end to fiscal competition.

[8] Ibid, p. 22.

[9] M. Hearson, T. N. Tucker, An unacceptable surrender of fiscal sovereignty: the neoliberal turn to international tax arbitration", 20 May 2021.

South Center, Policy Brief N 23, 11 February 2022, page 3 refers, for illustration of the divergence, to the average effective tax rate for some countries [including Angola, Argentina, Brazil, India, China, India and South Africa, among others]. The average effective rate is 25 per cent, which is 10 percentage points above the minimum rate of 15 per cent.

While we acknowledge that this is a complex discussion involving different viewpoints and, at times, conflicting assessments, we would like to draw the attention of your Excellency and the members of the European Union to the relevant international norms and standards that are applicable to the issues brought forth by the situation described above. We wish to express our concern that the Two Pillar solution, as it stands, would significantly undermine the revenue collection and taxing rights of low and middle-income countries. This in turn will affect the availability of resources to ensure the progressive realization of all economic, social and cultural rights, as well as of the right to development, as expeditiously and effectively as possible. This is more worrisome during times of severe resource constraints caused by a cumulative negative impacts of the COVID-19 pandemic, previous fiscal adjustments due to high levels of indebtedness and additional need for public resources to respond to health and social protection requirements of the population.

Reduced tax base and revenue for the realization of human rights

We are concerned that the Two-Pillar-Solution will reduce the ability of low and middle-income countries to mobilize enough resources to invest in essential public services and the realization of human rights, including the right to health, the right to social security, and the right to food, all of which are guaranteed under the International Covenant on Economic, Social and Cultural Rights. Reallocating taxing rights based on revenue provided under Pillar One is likely to reduce the tax base and decreases tax revenues. We are further concerned that the implementation of the Two Pillar Solution may constitute a retrogressive step in the implementation of the International Covenant on Economic, Social and Cultural Rights, if its results in reducing the tax revenues for developing countries.

We are further concerned that other alternatives were not given serious analysis and consideration, such as the G-24-proposal on “Significant Economic Presence” [11], and other those revenue-raising alternatives that may not result in reduction of revenues and, thus, may have avoided potential retrogressive measures.

Tax evasion, illicit financial flows and realization of human rights

As already noted above, we are further concerned that the division in residual profits (subject to re-allocation) and other profits (subject to the existing transfer pricing system) provided under Pillar One results will facilitate aggressive tax optimisation strategies and tax evasion. Such forms of abuse will be especially difficult to combat, since the reduced tax base provided by Pillar One might further limit the resources necessary to strengthen the capacities of the tax administrations.

In connection to the above alleged facts and concerns, please refer to the Annex containing **References to International Law,** attached to this letter which cites relevant international human rights instruments and standards. It is our responsibility, under the mandate provided to us by the Human Rights Council, to seek to clarify all issues brought to our attention that fall within our mandates, we would be grateful for your observations on the following matters:

1. Are the facts summarized above accurate? Please provide any additional information and any comments you may have on the aforementioned information and concerns.

[11] https://www.g24.org/wp-content/uploads/2019/03/G-24_proposal_for_Taxation_of_Digital_Economy_Jan17_Special_Session_2.pdf

2. Please describe the mechanisms for overall tax planning that have been considered for this proposal and how the Two Pillar Solution would address tax optimization, and its negative impact on tax collection in some countries.

3. Could you describe if any compensation for the lost revenues is intended, for example through a supplementary tax? Have any safeguards been put in place to ensure that the reduced tax base will not negatively affect the realization of economic, social and cultural rights?

4. Please explain the procedure and grounds used to reject alternative proposals, including the G-24-proposals on "Significant Economic Presence".

5. Please explain how the formula used to establish a 15 per cent rate and how it would affect some low and middle-income countries with a corporate taxation rate higher than 15 per cent. What are the aggregated estimates that have been considered and which countries would most benefit/ most loose as a result? Please explain, whether they were made transparent during the negotiations.

6. Please clarify the next steps for the implementation of the agreement and how these would allow for participation of all countries on equal footing. In particular, please explain how the Model Rules on Pillar Two and the model provision for the Subject of Tax Rule and the steps under consideration for these documents.

7. Please explain if an assessment of the extraterritorial impact of the OECD/G20 tax deal on the resources necessary in developing countries in order to realize human rights in line with their obligations and commitments was conducted and known in the course of the negotiations.

8. Please explain how the Inclusive Framework puts the formally declared participation on equal footing and equal influence on the configuration into practice during the negotiations.

9. Please clarify the views of the European Union about the development of a UN Tax Convention and about the creation of a Global Tax Body under the auspices of the UN as an inclusive forum.

This communication and any response received will be made public via the communications reporting website within 60 days. They will also subsequently be made available in the usual report to be presented to the Human Rights Council.

We may publicly express our concerns in the near future as, in our view, the information upon which the press release will be based is sufficiently reliable to indicate a matter warranting immediate attention. We also believe that the wider public should be alerted to the potential implications of the above-mentioned concerns. The press release will indicate that we have been in contact with the European Union to clarify the issue/s in question.

Please note that other letters with similar information have been sent to the G20 Presidency, the Executive Secretariat of the Group of 77, the Director of the Intergovernmental Group of 24 and the OECD.

Please accept, Excellency, the assurances of our highest consideration.

Attiya Waris
Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights

Saad Alfarargi
Special Rapporteur on the right to development

Livingstone Sewanyana
Independent Expert on the promotion of a democratic and equitable international order

Olivier De Schutter
Special Rapporteur on extreme poverty and human rights

Annex
Reference to international human rights law

In connection with above alleged facts and concerns, we would like to draw the attention to the relevant international norms and standards that are applicable to the issues brought forward by the situation described above.

- **Committee on Economic, Social and Cultural Rights**

One of the pillars of the protection of economic, social and cultural rights under Article 2 of the International Covenant on Economic, Social and Cultural Rights is the obligation to progressively realize the rights set out in the Covenant, making use of the maximum of available resources.

In compliance with article 2.2 of the Covenant, and the provision on progressive realisation of these rights, States should not adopt impermissible retrogressive measure, unless strictly justifiable. As the Committee on economic, Social and Cultural Rights has clarified, retrogressive measures, meaning taking steps that would reduce the enjoyment of economic, social and cultural rights, are only permissible under certain strict circumstances. Furthermore, the onus is on the various Governments to demonstrate that their proposed measures will meet all their human rights obligations, notably by ensuring that measures are, among other characteristics, necessary, in that they must be justifiable after the most careful consideration of all other less restrictive alternatives; reasonable, in that the means chosen are the most suitable and capable of achieving the legitimate aim; not discriminatory, aimed at mitigating the inequalities that can emerge in times of crisis; and ensuring that the rights of disadvantaged and marginalized individuals and groups are not disproportionately affected; and subject to meaningful review and accountability procedures.

The Committee has also provided its authoritative interpretation on State obligations under the Covenant in the context of business activities in its General Comment No. 24 (2017). In paragraph 37, the Committee states, inter alia, that: "States should combat transfer pricing practices and deepen international tax cooperation, and explore the possibility to tax multinational groups of companies as single firms, with developed countries imposing a minimum corporate income tax rate during a period of transition. Lowering the rates of corporate tax solely with a view to attracting investors encourages a race to the bottom that ultimately undermines the ability of all States to mobilize resources domestically to realize Covenant rights. As such, this practice is inconsistent with the duties of the States parties to the Covenant."

- **Declaration on the right to development**

We recall that the UN Declaration on the right to development (A/RES/41/128) declares that States have the primary responsibility for the creation of national and international conditions favourable to the realization of the right to development; that they have the duty to co-operate with each other in ensuring development and eliminating obstacles to development, and that they should realize their rights and fulfil their duties in such a manner as to promote a new international economic order based on sovereign equality, interdependence, mutual interest and co-operation among all States, as well as to encourage the observance and realization of human rights (article 3.1 and 3.3).

The Declaration further sates that sustained action is required to promote more rapid development of developing countries and that effective international co-operation is essential in providing these countries with appropriate means and facilities to foster their comprehensive development (article 4.2). We are concerned at the information that, contrary to these commitments, the concerns of low- and middle-income countries in relation to the establishment of the new international taxation rules have not been taken into consideration in a meaningful manner.

We refer to the Guidelines and recommendations on the practical implementation of the right to development (A/HRC/42/38), which urge states to guarantee social protection floors and welfare, even in times of economic and financial crisis, in line with the Social Protection Floors Recommendation, 2012 (No. 202), of the International Labour Organization (para 60). The Guidelines also request States to enhance accountability in the private sector, by publishing the taxation rates and revenues generated by major economic actors (para 65); and recommend that Governments should develop a global and a regional taxation architecture with a view to countering the race to the bottom fueled by tax policies that are increasingly in favour of capital to the detriment of people's welfare (para 81).

- **Guiding Principles on human rights impact assessment of economic reform policies**

We also refer to report A/HRC/40/57 of the Independent Expert on foreign debt, international financial obligations and human rights, which contain the Guiding Principles on human rights impact assessment of economic reform policies. In particular, we highlight Principle 11 entitled Policy coherence, notably 11.b: "Fiscal policy should be used as a countercyclical tool to prevent and/or manage crises, as well as to equalize opportunities and maximize the realization of human rights". In the commentary, the Independent expert noted "[f]iscal policy can play a major role in achieving equality, tackling discrimination and strengthening governance and accountability, as well as combating poverty and funding development. Fiscal policy also has a clear and well documented effect on economic growth: while pro-cyclical contractionary fiscal policy reduces economic growth, expansionary fiscal policy during downturns increases growth."

- **Guiding Principles on Business and Human Rights**

We would like to highlight the Guiding Principles on Business and Human Rights (A/HRC/17/31), which were unanimously endorsed by the Human Rights Council in June 2011. These Guiding Principles are grounded in recognition of:

a) "States' existing obligations to respect, protect and fulfil human rights and fundamental freedoms;
b) The role of business enterprises as specialized organs or society performing specialized functions, required to comply with all applicable laws and to respect human rights;
c) The need for rights and obligations to be matched to appropriate and effective remedies when breached."

According to the Guiding Principles, States have a duty to protect against human rights abuses within their territory and/or jurisdiction by third parties, including business enterprises. The obligation to protect, respect, and fulfil human rights, recognized under treaty and customary law entails a duty on the part of the State not only to refrain from violating human rights, but to exercise due diligence to prevent and protect individuals from abuse committed by non-State actors (see for example Human Rights Committee, General Comment no. 31 para. 8).

It is a recognized principle that States must protect against human rights abuse by business enterprises within their territory, including by taking appropriate steps to "prevent, investigate, punish and redress such abuse through effective policies, legislation, regulations and adjudication" (Guiding Principle 1). This requires States to "state clearly that all companies domiciled within their territory and/or jurisdiction are expected to respect human rights in all their activities" (Guiding Principle 2). In addition, States should "enforce laws that are aimed at, or have the effect of, requiring business enterprises to respect human rights…" (Guiding Principle 3).

In particular, Principle 10 states that "when acting as members of multilateral institutions that deal with business-related issues, should: (a) seek to ensure that those institutions neither restrain the ability of their member States to meet their duty to protect nor hinder business enterprises from respecting human rights; (b) encourage those institutions, within their respective mandates and capacities, to promote business respect for human rights and, where requested, to help States meet their duty to protect against human rights abuse by business enterprises, including through technical assistance, capacity-building and awareness-raising; (c) draw on these Guiding Principles to promote shared understanding and advance international cooperation in the management of business and human rights challenges.

- **Guiding Principles on Extreme Poverty and Human Rights**

Furthermore, when adopting the UN Guiding Principles on Extreme Poverty and Human Rights, States agreed that adequate resources should be raised and used to ensure the realization of the human rights of persons living in poverty. In particular, "fiscal policies, including in relation to revenue collection, budget allocations and expenditure, must comply with human rights standards and principles, in particular equality and non-discrimination" (UN Guiding Principles on Extreme Poverty and Human Rights, para. 53).

States also agreed, in para. 63, to ensure policy coherence, by taking into account all international human rights obligations when designing and implementing policies and acknowledged that some international and national policies and decisions may result in conditions that create, sustain or increase poverty, domestically or extraterritorially. Therefore, they decided that "before adopting any international agreement, or implementing any policy measure, States should assess whether it is compatible with their international human rights obligations".

Moreover, paras. 96-98 indicate that:

“96. States must take deliberate, specific and targeted steps, individually and jointly, to create an international enabling environment conducive to poverty reduction, including in matters relating to bilateral and multilateral trade, investment, taxation, finance, environmental protection and development cooperation. This includes cooperating to mobilize the maximum of available resources for the universal fulfilment of human rights.

97. Even when a member of an international organization, a State remains responsible for its own conduct in relation to its human rights obligations within and outside its territory. This includes identifying the possible human rights impact, including on persons living in poverty, of measures agreed at the international level.

98. A State that transfers competences to or participates in an international organization must take all reasonable steps to ensure that the relevant organization acts in accordance with the international human rights obligations of that State and in a manner conducive to poverty reduction.”