

Disservicing the South: ICC report on Article 12AA and its various flaws

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“[We] find little evidence that higher WHTs reduce aggregate service payments at the importer level, consistent with service rerouting. These results highlight the role of WHTs as a policy tool for limiting base-eroding payments in global services trade.”

— **IMF study by Liu, Klemm & Lal (2025)** which serves as ICC report’s main academic reference

The International Chamber of Commerce (ICC) has presented a report on the economic impact of the global implementation of a withholding tax (WHT) modelled to Article 12AA of the UN Model. The report provides a macroeconomic estimate of the revenue effects of implementing Article 12AA, relative to the status quo. It claims that the roughly USD 7 billion in additional revenue for the Global South from implementing Article 12AA would be entirely offset by indirect revenue losses, driven by lower GDP as a result of declining trade activity.

While clearly advancing the business lobby case against source-based WHTs, **the analysis does not stand up to even light scrutiny**.

Most strikingly, it contradicts the central conclusion of its own key academic reference: that WHTs are a relevant policy tool to limit base-eroding service payments, and that there is little evidence of a reduction in aggregate service payments at the importer level. In the following, we explain the most problematic elements of the model’s core assumptions and mechanisms.

The report’s core mechanism “with the implementation of WHT on cross-border services, services trade falls” is not supported by the academic literature. The report effectively assumes that cross-border services activity declines once it is taxed more heavily, and it uses this as the key channel to generate large negative macroeconomic effects. However, the empirical literature it relies on does not establish an aggregate contraction mechanism. In fact, even

where higher withholding taxes are shown to reduce *bilateral* service inflows, the same research finds no evidence of a decline in *total* service imports at the importer level. This means that import and export effects should be zero. Consequently, no “spillovers” should be expected, except for payments that were purely made to shift profits.

Evidence from digital services taxes points in a similar direction: While the taxes might change fee structures and prices, no reduced overall trade activity is found in the affected digital segments (HM Treasury 2025; National Audit Office 2022; Langenmayr & Muddasani 2025). Coefficients based on bilateral channels are particularly problematic given the fact that Protocol 1 discussions can lead to a multilateral treaty. For such a treaty, studies that look at re-routing make limited sense, considering similar conditions would be found in the different bilateral channels.

The projected losses are almost entirely driven by China and India, while most other Global South countries can benefit from the implicit trade barrier of a source-based WHT. Much of the modelled GDP loss comes from lower exports. This mechanism is mainly relevant for net exporters, countries that export more cross-border services than they import and therefore face larger costs from additional source-based taxes than they gain from the implicit barrier on imports. The report claims that the Global South is a net exporter of technical services and uses this to argue that Article 12AA would “mainly hurt the Global South.” We replicate the main figure used to support this claim in Figure 1 for the report sample based on data from BaTis.

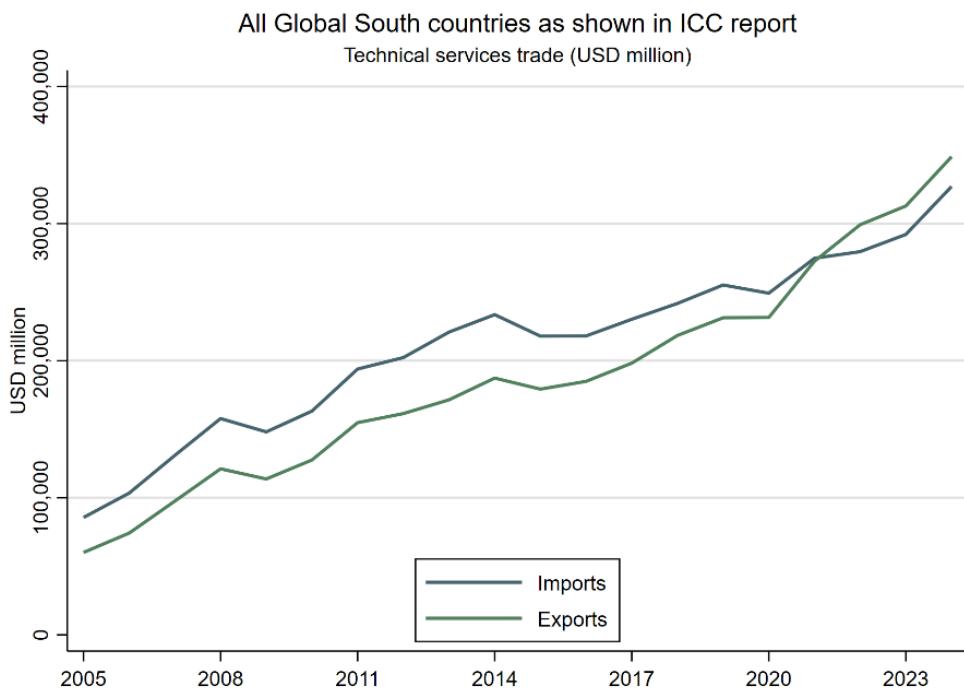


Figure 1: ICC includes India and China to suggest that the Global South has become a net exporter

However, this claim is an artefact of aggregation: it holds only because the report includes China and India and then adds up exports and imports across all countries into one combined total. That approach lets a few very large exporters dominate the headline picture, even if most other Global South countries are not net exporters. Yet the report does not present a single aggregate estimate excluding China and India. In Figure 2, we therefore show the export balance and implied exposure for all sample countries excluding China and India. This clearly illustrates that the majority of countries are importing considerably more technical services than they export.¹

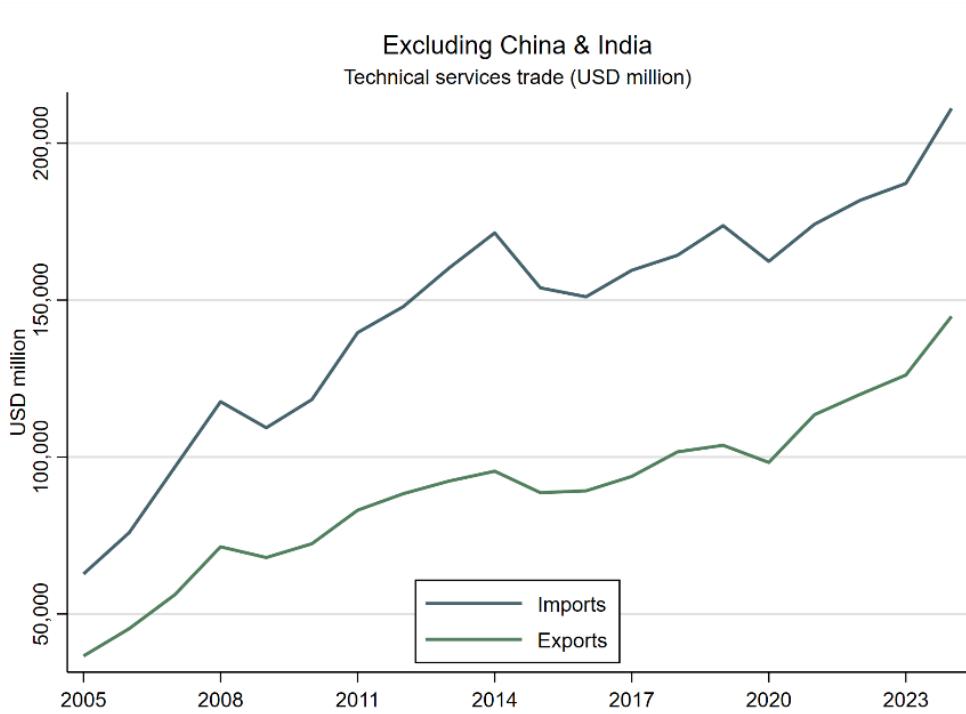


Figure 2: For most of the global South, services imports are far greater than exports

Figure 3 shows that, indeed, four out of five countries of the Global South are net importing technical services, rather than exporting them. Once this concentration is made transparent, the report's broad conclusion falls apart: for Global South countries that are net importers of cross-border services, the relevant margin is not "lost exports," but the scope to raise revenue and curb base-eroding payments with limited downside to domestic activity—consistent with the report's own country boxes, where several net importers (e.g. Nigeria) are projected to benefit.

¹ This does not mean that China and India would lose from the implementation of Article 12AA, as it remains unclear if trading activity would be adversely affected at all.

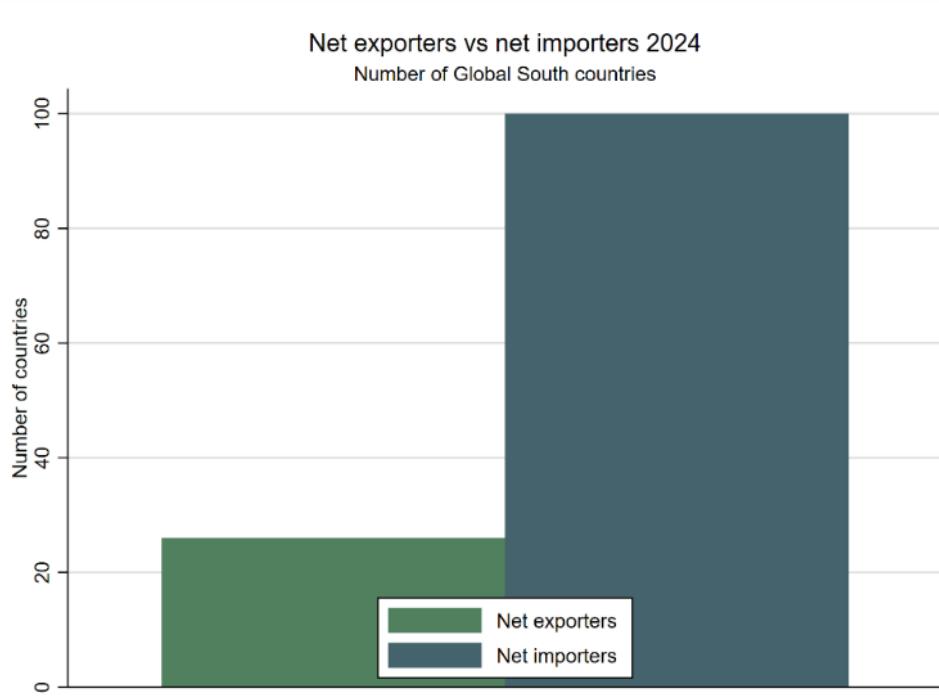


Figure 3: Four out of every five ICC sample countries are net importers of services

The bias in the sample is particularly misguiding given the context that led to current negotiations, which were prompted by the Africa Group - the great majority of which are not covered given the lack of data. But instead of recognizing the limitations of the sample, the report goes on to make “grand statements” regarding the Global South. The idea that the Global South could be adequately represented without including 42 of 54 countries that make up the Africa Group is at best misleading.

The report treats additional tax revenue as if it disappears from the economy: it models GDP losses from lower trade, but does not model the GDP gains from additional fiscal space. If Article 12AA raises revenue “in the short term,” that additional revenue does not sit in a vacuum—it can finance public spending or investment and, strengthen fiscal stability, or reduce other distortionary taxes. For instance, the ICC report ignores the fact that withholding taxes, which are levied within the income tax, might lead to a foreign tax credit on the service exporter; digital service taxes, on the other hand, normally do not, and in this regard are arguably *more* distortionary. Any of these channels – public spending and investment, fiscal stability and non-distortionary regimes – would support domestic demand and output, and would therefore reduce or even offset the negative GDP effects the report builds into its model.

The report’s discussion of Foreign Direct Investment (FDI) reflects a core misunderstanding of what Article 12AA is about. FDI typically takes the form of establishing or acquiring a local subsidiary or the setting up of a local permanent establishment (PE). The profits of this local subsidiary or PE are already taxed in the source

country under the current system. By contrast, in many digital and other remote service business models, FDI has become less relevant precisely because services can be sold cross-border without a local taxable presence. Article 12AA is an attempt to address this gap: it targets cross-border service payments that have, in practice, remained lightly taxed or untaxed at source for a long time.

It is therefore implausible that implementing Article 12AA would reduce FDI. If anything, it may make FDI more competitive relative to remote service provision without a local presence (and without a PE), because it narrows the tax advantage of serving a market purely from abroad.

Indeed, Article 12AA may also make outward profit shifting from countries receiving FDI – countries where actual business takes place – more difficult. This last aspect makes the IMF conclude that withholding taxes are a suitable policy instrument to avoid base erosion and profit shifting, unlike the ICC report which apparently is drafted in support of such shifting.

The purpose of this note is not to argue for gross withholding at source over any other alternative (net) methods of taxation. Withholding taxes have proven to be administrable and useful tools to retain taxing rights at source, but they also have downsides compared to net approaches. Gross taxation fits well with the payor nexus. As the negotiations have shown, the payor nexus is not equally desirable for all types of services.

We think a unitary approach with formulary or fractionary apportionment (like the net option in Article 12B) may be more generally suitable. This, however, does not mean the option gross taxation of services like under 12AA should be discarded based on misguided analysis and highly selective modelling.

References

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