TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY

Pan African Conference

Nairobi, Kenya

1st October 2019

BETTER POLICIES FOR BETTER LIVES

Background

2013	2015	2017	2018	2019	2020
• BEPS Action Plan announced	• Action 1 Report delivered	• G20 agreement for delivery of interim report in 2018 and final report in 2020	• Interim report delivered • Member proposals for a long-term solution	• **Jan** - Policy paper • **Feb/Mar** - Public consultation • **May** - IF meeting • **June** - G20 FM meeting	• **Final Report**

Where are we today?

Tensions in the system

- Aggressive audits & tax disputes
- Unilateral measures
- Dissatisfaction focused on highly digitalized MNEs and allocation of taxing rights

Three proposals from IF members

- None of them has reached consensus in isolation

High level of political commitment

- G20 and G7 support
- IF commitment (2018 Interim Report, 2019 PoW)

Goals and Implications

- Develop unified approach merging 3 proposals for consensus;
- Start with the strong commonalities identified in the PoW;
- Meet strong demand for simplicity (e.g. public consultation).

PILLAR 1

Commonalities

- Envisage a new nexus rule independent of physical presence
- Reallocate taxing rights in favour of market/user jurisdiction
- Go beyond ALP in reallocating taxing rights, including departing from the separate-entity principle
- Simplicity, stabilisation of tax system and increased tax certainty in implementation

Guiding Principles

- Avoid complexity where possible
- Limit overlaps with existing ALP
- Restore stability and certainty in the system
- Robust dispute prevention/ resolution measures

…as Foundations of a Unified Approach

Introduce new nexus

- Deal with the digitalisation of the economy
- New nexus rule for remote activities

Revise profit allocation rules

- Increase profit allocated to market jurisdictions
- Avoid distortions

A – Portion (%) of deemed residual profit

B – Fixed return for baseline distribution functions

C – Additional return for activities exceeding those covered in Amount B based on TP analysis

PILLAR 2

Pillar Two – Rationale of the GloBE proposal

Limits of "substance" as a mechanism for addressing harmful tax competition

Opportunity to revisit some of the outcomes under the hybrid rules

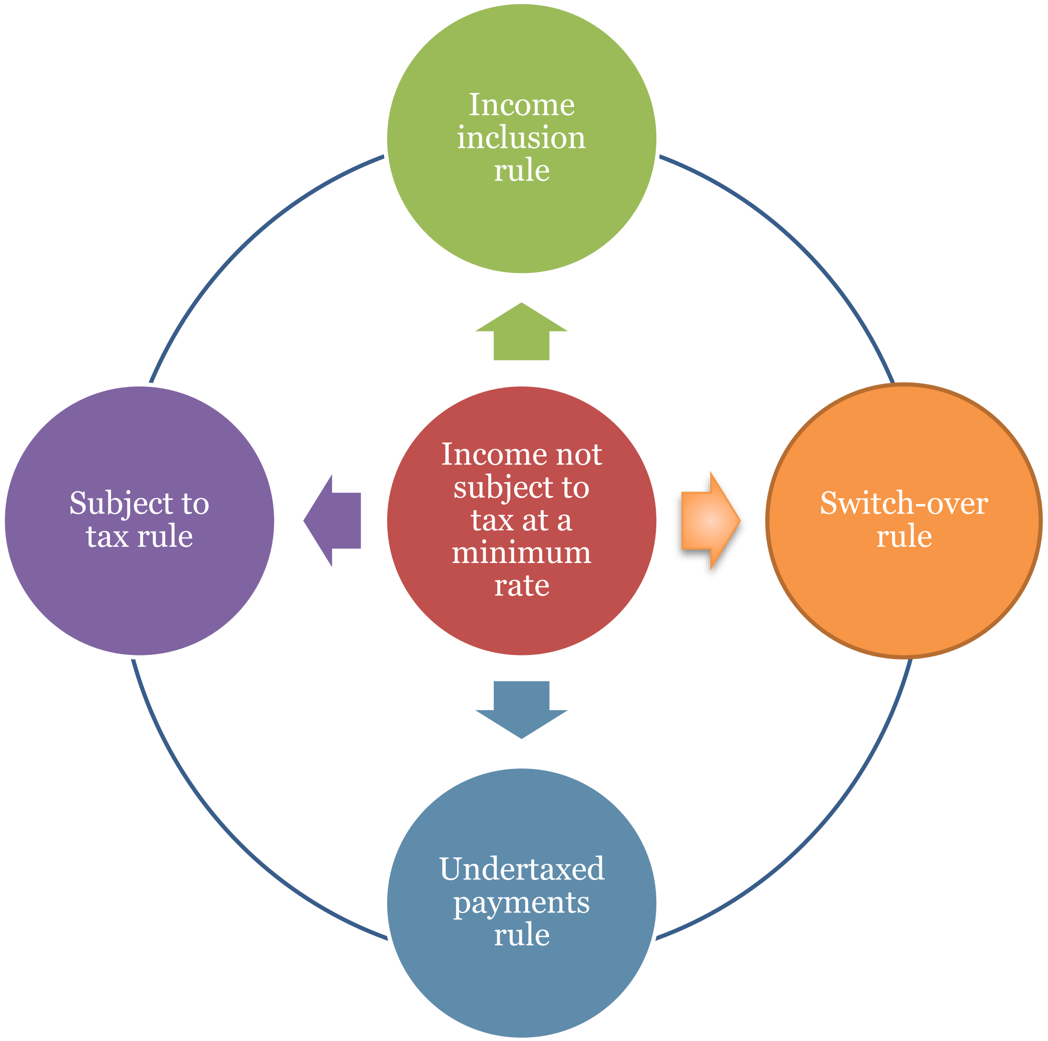
Setting a floor for tax competition

Ensuring all internationally operating business pay a minimum level of tax

Address remaining BEPS concerns

Need for an internationally agreed, uniform and coherent approach

Overview of Pillar Two – GloBE proposal



Next Steps & Key Dates

Objective of upcoming October TFDE meeting

- Discuss the model and whether it can be a basis for work going-forward
- Obtain input on open policy and technical issues

Next Steps

Refine and agree on UA

Work on development of a global solution

OCT/19
- UA Presented to G20 FMs

NOV/19
- Public Consultations

JAN/20
- IF Meeting

JUL/20
- G20 FM Meeting

NOV/20
- G20 Leaders' Summit

ECONOMIC ANALYSIS & IMPACT ASSESSMENT

Economic Analysis Outline

Part A: Background

- Reform assessment framework
- Counterfactual (i.e. unilateral measures and tax uncertainty)

Part B: Tax revenue implications

- Pillar 1: focussed on Amount A of the Secretariat’s “unified approach” proposal
- Pillar 2

Part C: Investment implications

- Effective Tax Rate modelling
- Broader investment implications (Further work ongoing)

Part A: Background

Reform assessment framework

Counterfactual

- **Proliferation of unilateral measures**
  - New anti-avoidance provisions (e.g. DPT in the UK and Australia, GILTI and BEAT in the US)
  - New digital taxes discussed, announced or implemented in about 20 jurisdictions (e.g. turnover taxes)
  - Around 10 jurisdictions have announced they would consider such taxes in the absence of a multilateral solution
- **Tax uncertainty has been increasing** according to various surveys among MNEs
- **The counterfactual scenario without reform represents the risk of increasing fragmentation of the international corporate tax system**
  - Greater tax uncertainty and greater distortions that would weigh on investment and its efficient allocation

Part B: Revenue Implications

Key Objective

- Initial results gauge the overall direction and magnitude of the impact of the proposals
- Secretariat has assessed the proposals under a range of different design and parameter scenarios
- All results preliminary and dependent on reform design
- Design and parameter choices are not intended to pre-judge decisions that are still to be taken by the IF

Flexible framework

- Secretariat can model proposals in more detail on ongoing basis
- Continued analysis on scope, thresholds, parameters and design

Broad geographic and company coverage

- More than 200 jurisdictions
- Based on firm-level data covering more than 25,000 MNE groups, including major digital MNEs, complemented with aggregate data

Summary of the Assessment Approach: Pillar 1

Revenue Change for Jurisdiction A = Global Allocated Residual Profit × (Jurisdiction A Share of Sales − Jurisdiction A Share of Residual Profit) × Jurisdiction A Corporate Tax Rate

Global Allocated Residual Profit: Estimate global residual profit, and assume that a fraction of it is reallocated
Key data sources: Consolidated firm-level microdata combining Orbis, Worldscope, Fortune 500 list

Jurisdiction A Share of Sales: Allocate residual profit on the basis of destination-based sales
Key data source: OECD Activities of Multinational Enterprises (AMNE) Database

Jurisdiction A Share of Residual Profit: Take away residual profit in proportion to the share of residual profit in each jurisdiction
Key data sources: CbCR data on profits combined with Orbis microdata, national accounts and FDI statistics

Jurisdiction A Corporate Tax Rate: Apply the combined statutory tax rate
Key data source: OECD Tax Statistics

Summary of the Assessment Approach: Pillar 2

Revenue Gain for Jurisdiction A = Global Low-Taxed Profit × (Minimum Tax Rate − Current effective rate of low-taxed profit) × Jurisdiction A Share of revenues from minimum tax

Estimate Global Low-Taxed Profit (LTP) assuming either global blending or jurisdiction blending

Key data sources: Consolidated firm-level microdata including combining Orbis and Worldscope (global blending), CbCR data on profits combined with Orbis microdata, national accounts and FDI statistics (jurisd. blending)

Estimate Effective Tax Rate on Low-Taxed Profit (LTP)

Key data sources: Same as previous box

Will depend on behavioural reactions of governments and MNEs

Not modelled at this stage

Part C: Overview of Main Investment Implications

- **The impacts of the proposals on overall investment in the economy are expected to be modest**,
  - Many MNEs would not face any changes to their investment incentives, and the overall impact on effective tax rates would be modest for the large majority of jurisdictions,
- **Pillar 2 may result in sharper increases in effective tax rates in zero-tax jurisdictions**, in the case of no behavioural responses
- **Pillars 1 and 2 should reduce the incentives for MNEs to engage in profit shifting**
- **Implementation of the proposals should reduce the importance of taxes** in attracting investment.
  - Real factors (e.g. infrastructure & education levels) will become relatively more important in attracting foreign investment
- In contrast, **inaction could lead to larger increases in overall tax rates on investment**, stemming from a proliferation of digital services taxes levied on turnover not profits.

Key Dates

Key dates

- **Task Force on the Digital Economy meeting**: 1 October 2019
- **November Meeting of Working Party No. 2 on Tax Policy and Tax Statistics**: 12-13 November 2019
- **TFDE Public Consultation:** 24 November 2019
- **Finalisation of Economic Analysis and Impact Assessment Report:** End of 2019
- **Ongoing analysis anticipated:** 2020

THANK YOU

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