TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY

Pan African Conference
Nairobi, Kenya
1st October 2019
Background

- **2013**: BEPS Action Plan announced
- **2015**: Action 1 Report delivered
- **2017**: G20 agreement for delivery of interim report in 2018 and final report in 2020
- **2018**: Interim report delivered
  - Member proposals for a long-term solution
- **2019**: January - Policy paper
  - February/March - Public consultation
  - May - IF meeting
  - June - G20 FM meeting
- **2020**: 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).

Timeline (2019 & Early 2020)

- TFDE & SG (Oct/19)
- Public Consultations (Nov/19)
- IF (Jan/20)

Build viable consensus proposal addressing challenges
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

- Ensuring all internationally operating business pay a minimum level of tax
- Setting a floor for tax competition
- Addressing remaining BEPS concerns
- Need for an internationally agreed, uniform and coherent approach

Limits of “substance” as a mechanism for addressing harmful tax competition

Opportunity to revisit some of the outcomes under the hybrid rules
Overview of Pillar Two – GloBE proposal

- Income not subject to tax at a minimum rate
- Income inclusion rule
- Subject to tax rule
- Switch-over rule
- Undertaxed payments rule
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

- OCT/19
  - UA Presented to G20 FM

Next steps:

- NOV/19
  - Public Consultations
- JAN/20
  - IF Meeting
- JUL/20
  - G20 FM Meeting
- NOV/20
  - G20 Leaders’ Summit

Work on development of a global solution
ECONOMIC ANALYSIS & IMPACT ASSESSMENT
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**

**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

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

**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

**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

• **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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