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WORKING PAPER

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MEETING DOCUMENT

From:	General Secretariat of the Council
To:	Working Party on Tax Questions (Digital Taxation)
Subject:	Update on the OECD Project "Tax Challenges Arising from the Digitalisation of the Economy"

Delegations will find attached a PowerPoint presentation made by the OECD at the Working Party on Tax Questions (Direct Taxation - Digital) on 13 February 2020.

Update on the OECD Project "Tax Challenges Arising from the Digitalisation of the Economy"

Mayra O. Lucas Mas Senior Transfer Pricing Advisor, OECD 13 February 2020



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Agenda

- Introduction
- Package agreed by the G20/OECD Inclusive Framework on BEPS (IF)
- Next steps





Plenary meeting of the Inclusive Framework on 29-30 January 2020

- 122 jurisdictions
- 360 delegates

State of Play

Tensions in the system

Political support for a consensus-based global solution

Increased tax audits & disputes

Proliferation of unilateral measures

Strong digitalisation of the economy 137 jurisdictions working together

G20/ G7 repeated support G20 mandate to arrive at a consensusbased solution by 2020



Two Pillars

Pillar One

Pillar Two

Allocation of profits and new nexus rule

GloBE

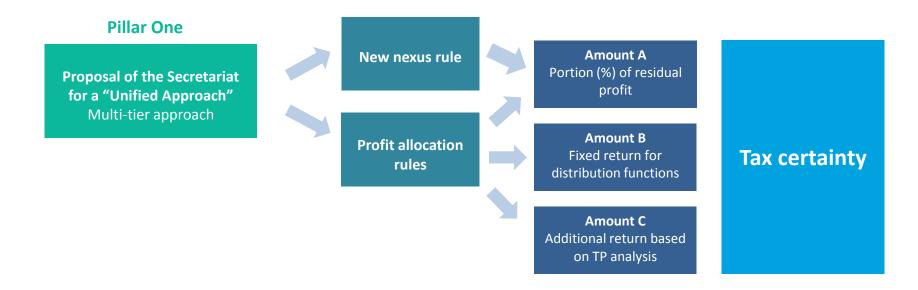
Economic analysis and impact assessment

Consensus-based long-term solution by the end of 2020

Need for political endorsement & spirit of compromise



Proposed "Unified Approach" under Pillar One – October 2019





Consultations

Public Consultation Pillar 1 - November 2019

- **300 submissions** of comments
- **3 000 pages** of comments
- 500 participants attended the public consultation meeting

Public Consultation Pillar 2 – December 2019

- 180 submissions of comments
- 1 300 pages of comments
- 200 participants attended the public consultation meeting

8 Regional outreach events since October 2019



PACKAGE AGREED BY THE INCLUSIVE FRAMEWORK

Outcomes IF Plenary

29-30 January 2020

Members approved

- Statement from the IF
- Outline of the architecture of the "Unified Approach" under Pillar One
 - Annex: Revised Programme of Work on Pillar One
- Progress Note on Pillar Two



- Strong support from IF members for reaching a multilateral agreement with respect to Pillar One and Pillar Two
- Recognising the concurrent work on a without prejudice basis on the two pillars, [they] affirm their commitment to reach an agreement on a consensus-based solution by the end of 2020
- Agreed upon an outline of the architecture of a Unified Approach on Pillar One as the basis for negotiations
- Welcomed the progress made on Pillar Two (which follows the outline of Pillar Two in the PoW)



- Pillar One: IF endorses the Unified Approach as the basis for the negotiations of a consensus-based solution to be agreed in 2020
- Proposed reallocation of taxing rights under Pillar One would require improved tax certainty, including effective and binding dispute prevention and resolution mechanisms
- In the design and implementation of the solution, IF acknowledges the need to minimise complexity



- IF members note
 - technical challenges to develop a workable solution
 - areas where critical policy differences remain to be resolved to reach an agreement
 - a December 3 letter from the US Treasury Secretary to OECD Secretary-General Gurría
 - reiterating the US political support for a multilateral solution and
 - including a proposal to implement Pillar One on a 'safe harbour' basis



Statement – paragraph 3 (continued)

- Many IF Members express concerns 'safe harbour' basis could
 - raise major difficulties, increase uncertainty and fail to meet all of the policy objectives of the overall process
- Note
 - although the final decision on the matter will be taken only after the other elements of the consensus-based solution have been agreed upon
 - resolution of this issue is crucial to reaching consensus



- Recognise number of other issues where significant divergences will have to be resolved; including:
 - 1. binding nature of dispute prevention and resolution mechanisms and scope of the dispute resolution mechanisms under Amount C
 - 2. Digital differentiation
 - 3. Regional segmentation
- Note concerns expressed by some jurisdictions and businesses about the continued application of Digital Service Taxes (DSTs)



Pillar Two

- IF welcomes the significant progress on the technical design of the Pillar
- Notes that more work needs to be done (as described in the progress report)



- The IF notes
 - the good progress on the economic analysis and impact assessment of Pillars One and Two
- The IF calls
 - for continued efforts to strengthen the analysis with caution due to data limitations and
 - for more detailed analysis on the investment and growth impacts of the proposals before the end of March 2020



- Reaffirm
 - commitment to bridge the remaining differences and
 - reach agreement on a consensus-based solution by the end of 2020
- Noting agreement will depend on the further concurrent work which will be carried out on the two pillars
- Important step: next meeting in early July
 - intended to reach agreement on key policy features of solution which would form the basis for a political agreement



OUTLINE OF THE ARCHITECTURE OF A UNIFIED APPROACH ON PILLAR ONE

The New Taxing Right (Amount A): Scope (section 3.1)

Automated digital services

 Provision of automated digital services that are provided on a standardised basis to a large population of customers or users (online search engines, social media platforms, cloud computing services, etc.)

Consumer facing business

- Businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers (e.g. personal computing products, clothes, branded foods, franchise models, automobiles)
- Intermediate products and components out of scope (with possible exception)

Specific considerations

Extractive industries, commodities, financial services sector, and international traffic



The New Taxing Right (Amount A): Scope (section 3.1)

Thresholds

- Limited to MNE Groups that meet a certain gross revenue threshold. This threshold could, for instance, be the same as for CbC reporting (i.e. MNE groups with gross revenue exceeding EUR750M)
- Consideration will be given to:
 - aggregate in-scope revenue threshold
 - de minimis threshold



The New Taxing Right (Amount A): Nexus (section 3.1)

Significant and sustained engagement with market

- Local in-scope revenue threshold over a period of years
- Commensurate with the size of a market (but with a minimum level)
- For **automated digitalised businesses**, the revenue threshold will be the *only* test (scale without mass)
- For **consumer facing business**: *additional* factors to be considered

Design and simplification option



- To be designed to eliminate (or limit to a bare minimum) any filing and other tax related obligations.
- Exploration of simplified reporting and registration-based mechanisms (such as a "one stop shop")



The New Taxing Right (Amount A): Quantum of Amount A (section 3.2)

A formula based allocation mechanism

- Based on a formula designed to identify the portion of residual profit allocated to market jurisdictions – consolidated group financial accounts
- Amount A only applies to the portion of profit exceeding a certain level of profitability – Profit Before Tax the preferred measure to assess this
- Allocation key of sales for allocation of Amount A to market jurisdictions

Further technical work

- Business line and regional segmentation to be explored
- The quantum of Amount A could be weighted for different degrees of digitalisation
- Specific revenue sourcing rules to be consider for different business models



The New Taxing Right (Amount A): Elimination of Double Taxation (section 3.3)

Identify the entity/entities liable

• Entities earning the relevant deemed residual profits

Apply the most effective double tax relief method

Exemption / credit / corresponding adjustment

Further work required

- Determining the relieving entity(ies)
- Methods for allocating Amount A liabilities



The New Taxing Right (Amount A):

Interactions and potential for double counting (section 3.4)

Interactions between A and B

No significant interaction between Amounts A and B

Interactions between Amounts A and C

- Identifies potential interactions between Amounts A and C
- Notes that no double counting should give rise to double taxation given the application of the mechanism to eliminate double taxation



Amount B: Fixed Return (section 4)

Fixed Return under the Arm's Length Principle

- Fixed return based on the ALP for "baseline" or routine marketing or distribution activities performed in a market jurisdiction
- The fixed return would consider differences in region and industry
- Treaty changes will not be required to implement Amount B

Further technical work

 Definition of baseline activities / profit level indicator / fixed % at an agreed profit / benchmarking studies / industry or region differentiation



Tax certainty (section 5)

Dispute prevention and resolution

 Tax certainty is an essential element of the unified approach and is a fundamental part of the design of Pillar One

Dispute prevention and resolution under Amount A

- Disputes will likely affect the taxation of Amount A in multiple jurisdictions
- Agreement that a new effective and binding dispute prevention and resolution mechanisms is required for amount A





Tax certainty (section 5)

Dispute prevention and resolution under Amounts B and C

- Core of the work on tax certainty and dispute prevention and resolution for Amounts B will be to limit disputes by using fixed rates of return on baseline distribution and marketing activities
- Amount C will involve:
 - exploring innovative approaches to dispute resolution
 - reaching agreement on the breadth of the application of new enhanced dispute resolution is critical and IF members agree to return to the matter as part of arriving at a consensus-based solution in 2020
 - also enhancing MAP and domestic measures



Implementation and administration (section 6)

General implementation aspects

- New multilateral convention for coordinated, consistent and effective implementation
- Compliance and administrative costs, novel compliance requirements, transition rules
- Commitment by members of the Inclusive Framework to implement this agreement and at the same time to withdraw relevant unilateral actions

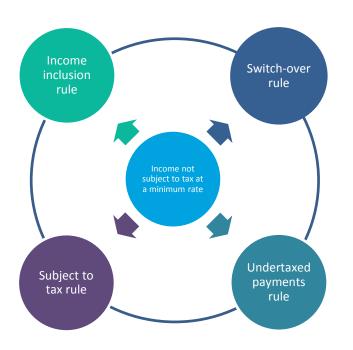
Alternative Global Safe Harbour Approach

Electing MNE group would agree, on a global basis, to be subject to Pillar One



PROGRESS REPORT ON PILLAR TWO

Pillar 2 - GloBE proposal



Income inclusion rule (IIR)

Switch-over rule

Undertaxed payments rule (UTP)

Subject to tax rule



Timeline

Inclusive Framework Programme of Work Policy Note May 2019 January 2019 Working Party and Focus Group Meetings from June onwards Consultation on P1 and P2 2nd Public Consultation **Progress Note** February / March 2019 December 2019 January 2020



Status of work

Good technical progress on many aspects of Pillar Two but significant work remains

- Ongoing constructive discussions on various policy and design options
- Close coordination between the relevant working parties drawing on:
 - Input from stakeholders in March and December Public consultation
 - Work of expert group on financial accounting on the determination of the GloBE tax base
- IF acknowledges the valuable input from stakeholders and the implications of the short time-line



IIR and UTP Rules

IIR draws on the design of CFC rules

- Top-up to an agreed minimum rate calculated as fixed percentage
- Protecting both the tax base of the parent jurisdiction as well as other jurisdictions where the group operates by reducing the incentive to allocate income for tax reasons to low taxed entities

UTP Rule

- Denial of deduction or equivalent adjustment in relation to intragroup payments
- Complements the IIR



Key design issues IIR & UTP

Tax base

- Use of financial accounts as a starting point
- Mechanisms to address temporary differences
- Adjustments for permanent differences

Blending

Options still being considered

Carve-outs

- FHTP
- Substance carve-outs

UTP Rule

A number of design options under consideration also designed to limit complexity, compliance and administration costs and the risk of overtaxation



Subject to Tax & Switch- Over Rules

Subject to tax rule (STT rule)

- Subjects a payment to withholding or other taxes at source and denies treaty benefits
- Options and issues being explored to design a simple and targeted rule
- Further consideration on scope of payments covered, the design of the minimum tax rate test and other key aspects
- Exploration of the application of the STT rule to unrelated parties on interest and royalties

Switch-over rule

 Design of a rule to ensure that the IIR applies to foreign branches that are exempt under tax treaties, turning-off the benefit of such exemption where that income is subject to a low ETR



Rule coordination, simplification, thresholds, international obligations

Co-ordination with other rules (including existing BEPS measures)

Simplifications to reduce compliance costs

Thresholds

 possible thresholds (such as the EUR 750 million revenue threshold used for CbC reporting) Compatibility with international obligations



ECONOMIC ANALYSIS

Main caveats

Results will ultimately depend on Pillar 1 and Pillar 2 design and to be decided by the Inclusive Framework

- Further revisions will be made to reflect future design decisions
- Current estimates assume that Pillar 1 is not a "safe harbour" regime

Underlying data have limitations

 Due to gaps in coverage and time lags and the methodology inevitably involves simplifying assumptions

Refinements are still ongoing to improve data quality, in cooperation with Inclusive Framework members

Potential strategic reactions of MNEs & governments

- For Pillar 2, some of these reactions have been modelled in the assessment
- These reactions are difficult to anticipate with certainty



Overall impact on global tax revenues would be significant

The combined effect of Pillars 1 & 2 would lead to a significant increase in global tax revenues

- The revenue gains are broadly similar across high, middle and low-income economies, as a share of corporate tax revenues
- The reforms are expected to lead to a significant reduction in profit shifting

Failure to reach a consensus-based solution would lead to further unilateral measures, more uncertainty and more trade disputes



In addition to reallocating taxing rights, Pillar 1 would slightly increase tax revenues

- Global tax revenues would slightly increase as some taxing rights shift from low-tax jurisdictions to higher-tax jurisdictions
- Most economies would experience a small tax revenue gain
- On average, low and middle-income economies would gain relatively more revenue than advanced economies
- Investment hubs would experience some loss in tax revenues
- More than half of the profit reallocated comes from 100 MNE groups



Pillar 2 would raise significant tax revenues and reduce profit shifting

Pillar 2 would raise a significant amount of additional tax revenues

The amount will depend on the rate and the design

The reform would reduce profit shifting

- Pillar 2 would reduce tax rate differentials between jurisdictions and reduce the incentives for MNEs to shift profit
- This will be important for developing economies as they tend to be more adversely affected by profit shifting than high-income economies



Investment impact

- The direct effect on investment costs is expected to be small in most countries
- The reforms would reduce the influence of corporate taxes on investment location
- The failure to achieve a consensus-based solution would lead to more unilateral measures, uncertainty and trade disputes



Stay tuned!

Upcoming OECD Tax Talks on 13 February (14.00-15.00 CET) on Economic Analysis and Impact Assessment

Ask questions and comment throughout the webcast via e-mail or Twitter:



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#OECDTaxTalks



NEXT STEPS

Ambitious schedule

2020

End of 2020

29-30 January

Inclusive Framework Meeting, Paris, France

22-23 February

G20 Finance
Ministers Meeting,
Riyadh,
Saudi Arabia
Endorsement of
progress made

1-2 July

Inclusive
Framework
Meeting, Berlin,
Germany
"agreement on the
key policy features
of a solution"

18-19 July

G20 Finance Ministers Meeting,
Jeddah, Saudi Arabia

21-22 November

G20 Leaders Summit, Riyadh, Saudi Arabia



THANK YOU! QUESTIONS?