Addressing the tax challenges of the digitalisation of the economy

International Tax | Large Corporate

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The CIOT has responded to a consultation published by the Organisation for Economic Co-operation and Development (OECD) on addressing the tax challenges arising from the digitalisation of the economy, focusing on key points arising from the 'Unified Approach' suggested by the OECD's Secretariat.

The tax challenges arising from the digitalisation of the economy were identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan, becoming known as BEPS Action 1, in 2015. Since then policy discussion on those challenges has remained an important part of the international agenda. Following a mandate by G20 finance ministers in March 2017, the OECD/G20 Inclusive Framework has been working towards a consensus based global solution to these challenges. The OECD/G20 Inclusive Framework is a group of countries, coming together under the auspices of the OECD, and working together on an equal footing to implement the BEPS measures agreed in 2015; and, beyond that, considering new international tax rules as part of the fundamental discussions on how to address the tax challenges arising from digitalisation of the economy. The Inclusive Framework now has over 130 countries as members, including over 70% of non-OECD and non-G20 countries and jurisdictions from all geographic regions.

In January 2019, the Inclusive Framework issued a short Policy Note, which grouped the proposals under consideration in relation to the digitalisation of the economy into two pillars. Pillar One focused on the allocation of taxing rights and sought to undertake a coherent and concurrent review of the profit allocation and nexus rules. The Policy Note considered three proposals under Pillar One: the 'user participation', 'marketing intangibles', and 'significant economic presence' proposals. The Policy Note stated that the Pillar One proposals would entail solutions that go beyond the arm's length principle. Pillar Two is concerned with the remaining BEPS issues.

In May 2019, the Inclusive Framework adopted a Programme of Work to develop the consensus solution to the tax challenges raised by the digitalisation of the economy. The Programme of Work highlighted the commonalities of the three proposals under Pillar One, summarised in the January 2019 Policy Note, to facilitate a consensus solution on Pillar One. It also identified various technical issues that need to be addressed.

In October 2019, the OECD's Secretariat published a consultation document on the 'Secretariat Proposal for a "Unified Approach" under Pillar One'. The Secretariat's proposal builds on the Pillar One proposals in accordance with the Programme of Work. In our response to this consultation, the CIOT welcomed it as progress in the conversation around the impact of the digitalisation of the economy and acknowledged that it was a continuation of the work towards a consensus-based, long term solution to the tax challenges raised.

In our response, we commented on the key points arising from the proposed Unified Approach, whilst noting that there is still much outstanding regarding how the work under Pillar One might coalesce around a political and policy consensus that addresses the various challenges that concern policy makers, which are a result of the impact of the digitalisation of the economy and globalisation of businesses generally on tax bases. We said that because there is so much outstanding, it is very difficult to comment on the technical and/or practical implications of the Unified Approach at the detailed level of some of the questions in the consultation document.

Whilst we did address the questions for public comments that were asked in the consultation document, the key points that we focused on in our response were that:

- the principles underlying the Unified Approach must be articulated;
- the practical challenges arising will require a bold solution;
- mandatory, multilateral, binding arbitration is paramount; and
- resourcing these changes by the OECD and national tax authorities will be key.

Principles underlying the Unified Approach must be articulated.

The Unified Approach to Pillar One presented in the consultation document (the proposal) contains some profound ideas which challenge the existing principles that underpin the current international fiscal philosophy and which, if adopted, would

result in considerable upheaval within the international tax system. However, we said that the proposal does not set out a coherent vision of the principles underpinning the solution to address the challenges that have been identified. Before substantive progress can be made, we suggested that there must be clarity and consensus at a political level as to the how the challenges should be addressed, rather than seeking to address the impact of several different challenges simultaneously that are not underpinned by a unifying principle (and may not be pulling in the same direction). We also said that the temptation to move to a formulary (or partially formulary) system is understandable given the different challenges being addressed at the same time, but without a single underlying principle, a partial move will be inherently unstable.

The practical challenges arising will require a bold solution.

Notwithstanding these broader concerns regarding what it seeks to achieve, we welcomed the opportunity to comment on the actual proposal made by the Secretariat, as there are a number of design choices available with different trade-offs. The challenges involved in working through the proposal should not be underestimated: firstly, in order to achieve political agreement as to what is within scope, and agreeing the scale or amount of profits reallocation; and then translating the concepts into something that is practicable. Although the proposal seems in some respects conceptually simple, it is legally and technically complex, and a significant departure from the current international tax framework. Our response emphasised the very real technical and practical difficulties that will arise from implementing the proposal.

The CIOT said that in order to address the practical challenges, it may be necessary for the proposed solution to include administrative systems and multilateral cooperation that are even bolder than currently envisaged. A fresh approach should be considered to solve the issues that have been identified, and we said that a radical change may be preferable to an attempt to shoe-horn a solution into existing concepts. We suggested several ways to meet the policy objectives and recognised the trade-offs of each that will need to be considered.

Mandatory, multilateral, binding arbitration is paramount.

We welcomed the focus on dispute prevention as, while dispute resolution is necessary, it is not the best solution for business because of the time it takes; businesses need certainty from the outset. To achieve this, we said that the rules and definitions should be agreed and set out in an OECD publication, with limited room for states to adopt different, and potentially inconsistent, interpretations. It is inevitable that the fundamental changes proposed to the international tax system will give rise to disputes. It is our strong view that countries which sign up to the new taxing right that is proposed must also sign up to a new mandatory, multilateral and binding arbitration process.

Resourcing these changes by the OECD and national tax authorities will be key.

Our response noted that it is also clear that the implementation of a proposal delivering these aims will require significant resource from the OECD and national tax authorities, as well, of course, from taxpayers. We said that countries should be encouraged to commit to providing the additional resource that will be required.

Our response can be found on the CIOT website.

Pillar Two is the subject of a second consultation published by the OECD in November 2019. At the time of writing, the CIOT is preparing its response to this, which will be reported on in February’s Technical Newsdesk.