TAX CHALLENGES OF THE DIGITALISATION OF THE ECONOMY: OECD UPDATE

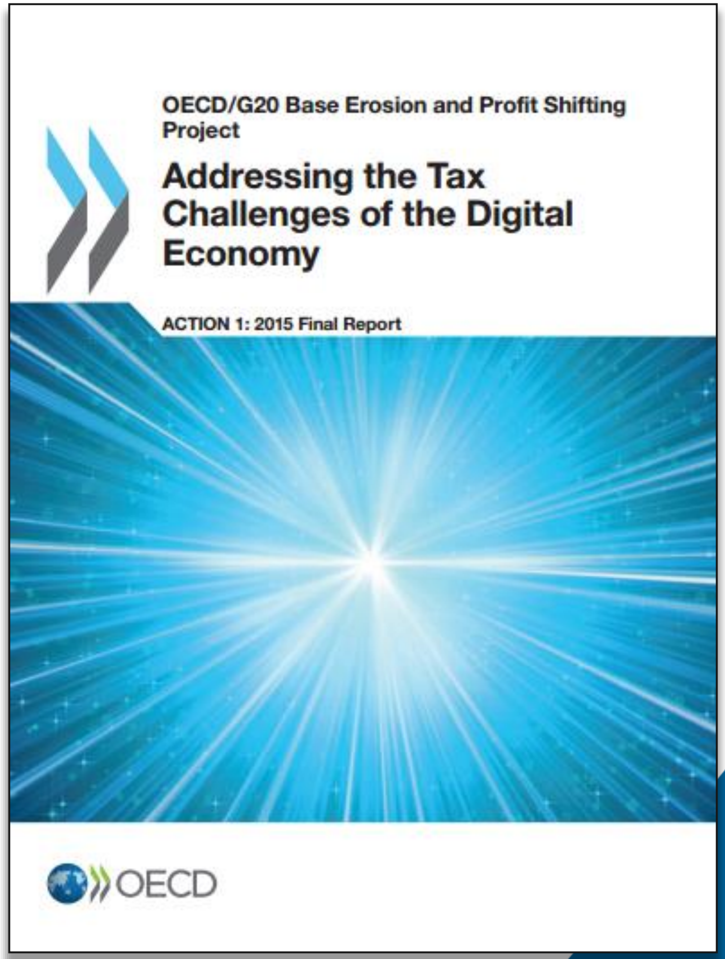
Sophie Chatel – Head of the OECD Tax Treaty Unit

9 November, 2018 – Sofia

BETTER POLICIES FOR BETTER LIVES

BEPS Action 1 Report - 2015
Addressing the Tax Challenges of the Digital Economy

- Delivered to G20 Finance Ministers in October 2015 as part of the BEPS Package
- Good progress on VAT in relation to cross border digital services
- Lack of consensus on direct tax questions
- More work to be done, especially on business models and value creation
- Unilateral measures expected



BEPS Action 1 Interim Report
Tax Challenges Arising from the Digitalisation - 2018

- Analysis of business models and value creation
- Implementation and impact of BEPS
- Stocktake of unilateral measures adopted by countries
- Long-term solutions
- Interim measures
- Impact of digitalisation on other aspects of the tax system
- Conclusion and next steps

Interim Measures

There is no consensus on the need for, or merit of, interim measures, and the report does not recommend their introduction

Countries considering the introduction of interim measures agreed on factors that need to be taken into account in designing such a measure:

- Temporary
- Targeted (with the focus on internet advertising and online intermediation services)
- Compliance with a country’s international obligations, including tax treaties, WTO & EU
- Minimising over-taxation
- Minimising impact on start-ups, business creation and small business more generally
- Minimising cost and complexity

Common features of highly digitalised business models, and their tax implications

Cross-jurisdictional scale without mass	Reliance on intangible assets	Data and user participation
Impacting the distribution of taxing rights over time by reducing the number of jurisdictions where a taxing right can be asserted over the business profits of an MNE	Significant progress under BEPS project, but often difficult to determine how to allocate income from intangibles among different parts of an MNE group	If considered a source of value creation, could pose challenges, as such a concept of value creation is currently not captured by the existing tax framework

Divergent perspectives

The views of countries can be generally described as falling within three groups:

First Group	Second Group	Third Group
User participation may lead to misalignments between where profits are taxed and where value is created. This does not undermine the principles of the existing international tax framework. Only targeted changes needed	Digitalisation and globalisation of the economy present challenges to the existing international tax framework, BUT these challenges are not exclusive or specific to highly digitalised business models	BEPS package has largely addressed double non-taxation, but still too early to fully assess the impact. Generally satisfied with the existing tax system and do not currently see the need for any significant reform

Review of the key concepts

Members of the Inclusive Framework have agreed to:

Review

Undertake a coherent and concurrent review of the profit allocation and nexus rules

that would consider the impacts of digitalisation on the economy, relating to the principle of aligning profits with underlying economic activities and value creation

Solution

Work towards a consensus-based solution by 2020

with an update to be provided in 2019

State of play

- Task Force on the Digital Economy (TFDE)
  - meeting in July: new proposals to develop technically
  - meeting in December to discuss path forward.

Country approaches

- Focus on data and user participation
  - Confined to certain highly digitalised business model
  - No need for wide-ranging change
- Broader approach of allocation of taxing rights
  - Not exclusive to highly digitalised business model
  - Taking market jurisdictions more into account
- Further work on anti-base erosion measures
  - Encourage a minimum level of taxation
  - Not specific for highly digitalised businesses model

Key concepts of Tax Treaties

Nexus

Rules that determine jurisdiction to tax a non-resident enterprise

Profit Allocation

Rules that determine the relevant share of the profits that will be subjected to taxation

1	8	9	9

1899 Austria-Hungary Tax Treaty

- One of the first comprehensive international tax treaties for the avoidance of double taxation.
- In the context of economic development and industrialization, tax treaties were introduced to reduce obstacles for trade and investments.
- The structure of the OECD and UN Model Conventions were already present in the 1899 treaty, distinguishing between various types of income.
- This structure allows for the allocation of taxing rights as a way to eliminate double taxation. It limits the taxation of non-residents carrying on a business and uses the concept of permanent establishment.

1	9	2	3

League of Nations – Economists' Report

- Proposed different methods to avoid the "evil of double taxation".
- Tax credits or reciprocal exemptions (e.g. shipping).
- The Convention could also provide for taxing rights to the state of origin for certain categories of income and provide relief in the state of residence, and exempt non residents from taxation on business income.

1933 Draft Multilateral Convention

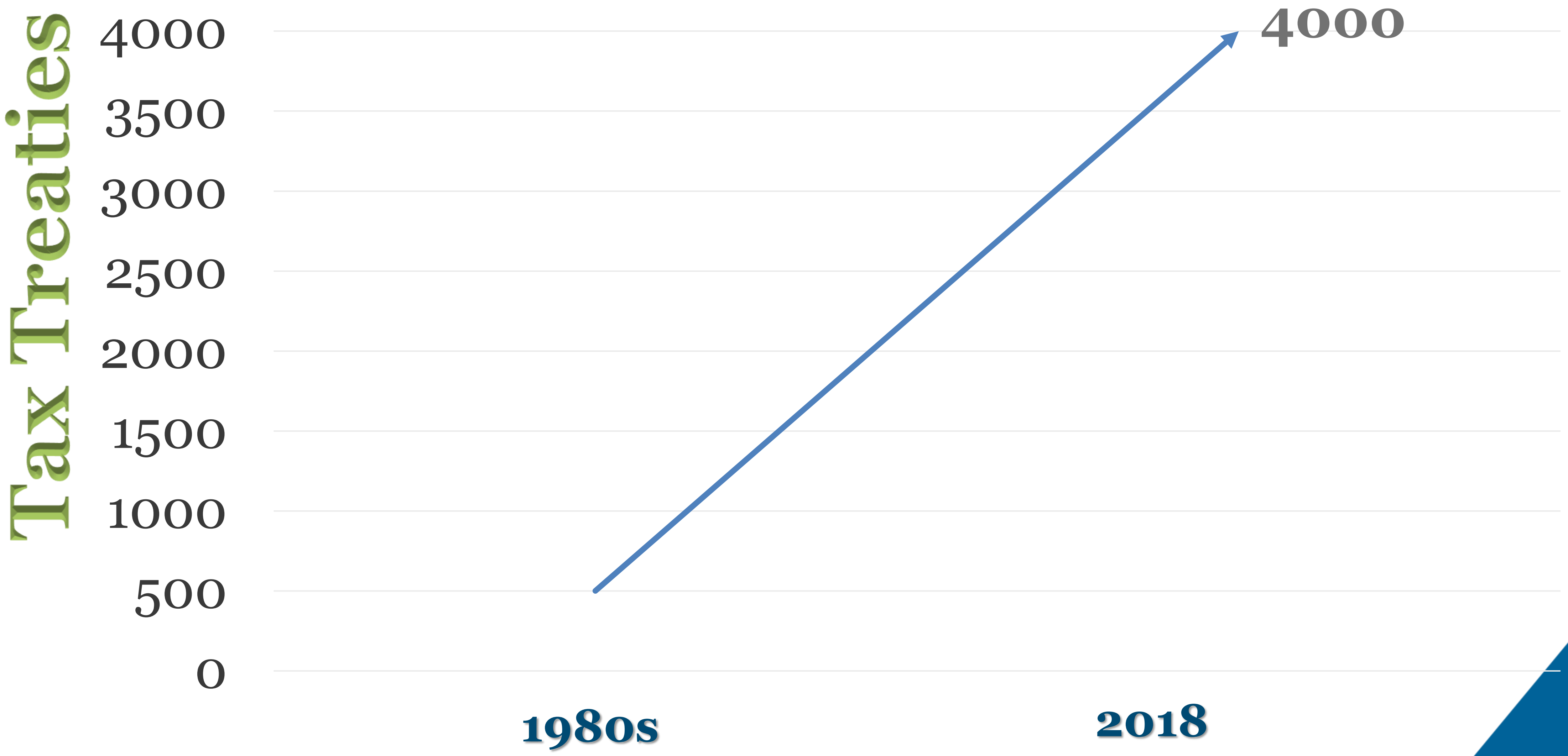
- Rejected the concept of viewing the MNE as a whole.
- Basic principle that a foreign enterprise should be taxable only if it has a permanent establishment.
- Income attribution based on the principle of independent enterprise and separate accounts.
- Subsidiaries are not considered to be PEs, but a provision in Article 6 permits a State to recapture profits which may have been diverted from it by transactions concluded with the foreign parent enterprise on a basis other than at arm’s length.

1	9	6	3

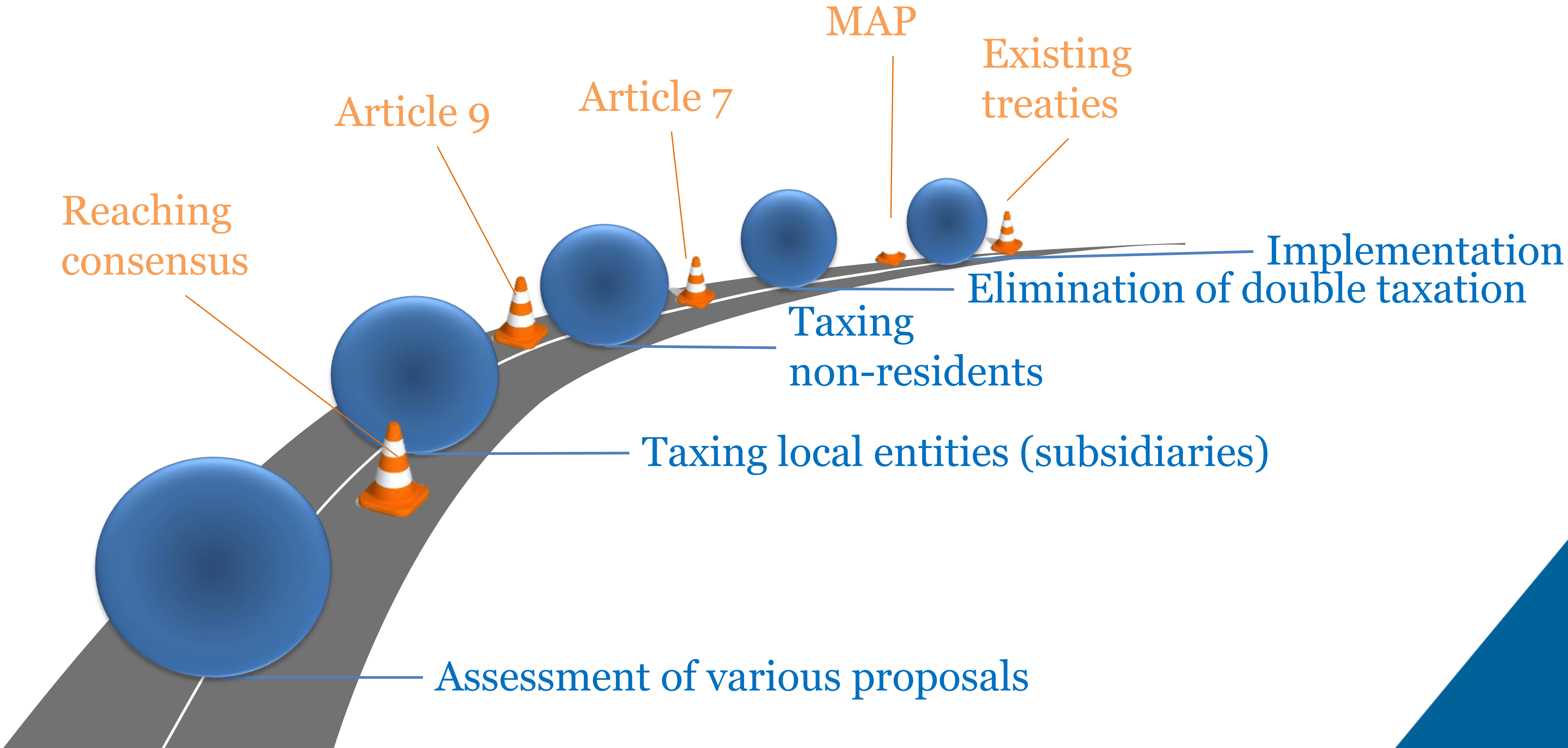
1963 OECD Model Convention

- In response to the need for extending the network of bilateral tax conventions to all member countries of the OEEC, and subsequently of the OECD.
- Harmonisation of conventions in accordance with uniform principles, definitions, rules, and methods, and agreement on a common interpretation.
- The Council of the OECD adopted, on 30 July 1963, a recommendation concerning the avoidance of double taxation, and called upon the Governments of member countries (when concluding or revising bilateral conventions between them) to conform to the OECD Model Convention.

Tax Treaty Network



Tax Treaty Considerations



Timetable for delivery

2018 — **TFDE Meetings**

2019 — **G20 Update**

2020 — **Final Report**

- OECD/TFDE to discuss path forward at its 4-5 December meeting
- G20 Inclusive Framework on BEPS meeting in January 2019 to set the sense of direction
- Update report for the 2019 G20 Japanese Presidency

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