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BETTER POLICIES FOR BETTER LIVES

TAX CHALLENGES ARISING FROM DIGITALISATION

Top 10 Frequently Asked Questions

1. What are the tax challenges that the OECD/G20 Inclusive Framework on BEPS is working on addressing?

Due to digitalisation, globalisation and new business models, many Multinational Enterprises (MNEs) are able to make large profits in countries without necessarily booking these profits in these countries. This is partly due to the fact that they may operate business without establishing any physical presence (no premises, no employees, etc.). It is also due to the fact that rules to allocate profits are no longer fit in a globalised, highly digitalised economy where value is concentrated on intangibles. The current international tax rules, which date back to the 1920s, need to be updated with a new "nexus" concept and new profit allocation rules.

2. Why is a global solution to the tax challenges raised by digitalisation necessary?

There is now widespread agreement that the current rules must be adapted to the 21st century economy, ensuring that all businesses – and not just those in the digital sector - pay their fair share of tax where they have activities and where they earn their profits. In the absence of a full-fledged multilateral solution, countries have started tabling unilateral measures, which may further jeopardise the integrity of the international tax system.

3. What has been achieved so far?

The OECD/ G20 BEPS Project analysed the tax challenges arising from digitalisation in its 2015 report BEPS Action 1 Report, but a lack of consensus prevented countries from taking action. In light of increasing public pressure, the G20 delivered a mandate in 2017 to the OECD/G20 to renew work on this issue. Since early 2019, the OECD/G20 Inclusive Framework has been developing a Two-Pillar approach:

- **Pillar One** would establish new rules on where tax should be paid ("nexus" rules) and a fundamentally new way of sharing taxing rights between countries. The aim is ensure that digitally-intensive or consumer-facing MNEs pay taxes where they conduct sustained and significant business, even when they do not have a physical presence.
- **Pillar Two** would introduce a global minimum tax that would help countries around the world address remaining issues linked to Base Erosion and Profit Shifting by MNEs.

Despite the COVID 19 crisis, which has complicated the negotiating process involving 137 countries and jurisdictions, both Pillars have been developed technically. Though a number of issues remain to be solved, the architecture of each pillar is now well established.

4. What was agreed by the Inclusive Framework on 8-9 October?

Despite the COVID-19 pandemic slowing discussions, the Inclusive Framework released its blueprints for Pillar One and for Pillar Two which, members agreed, provide a solid foundation for developing a global, consensus-based solution to the tax challenges of the digitalisation of the economy. Members also agreed to hold a new public consultation, and to bring the process to a successful conclusion by mid-2021 (see Q10 "'What's next").

5. What is the main objective of the Blueprint under Pillar One on the reallocation of multinational business profits?

The Blueprint under Pillar One seeks to adapt the international income tax system to new business models through changes to the profit allocation and nexus rules applicable to business profits. Within this context, it expands the taxing rights of market jurisdictions under conditions of active and sustained participation in that market (Amount A); and also seeks to identify a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the Arm's Length Principle (Amount B) It also aims to significantly improve tax certainty by introducing effective dispute prevention and resolution mechanisms. Eleven building blocks constitute the bedrock of this Blueprint.

6. What is the main objective of the Blueprint under Pillar Two on the global minimum tax proposal?

The blueprint on Pillar Two lays down the features of a systemic solution - known as the global anti-base erosion proposal (GloBE proposal) - to address remaining BEPS challenges. Simply stated, it seeks to ensure that all large and internationally operating businesses pay at least a minimum level of tax. It includes the design of four rules set out in the Programme of Work: a) the income inclusion rule (IRR); b) the switch-over rule; c) the undertaxed payment rule (UTPR); and d) the subject to tax rule (STTR).

7. What are the main remaining issues under both Pillars where divergences must be bridged?

Key political decisions must still be made, and some further technical issues need to be resolved. On Pillar One, this includes: issues around which business activities would be covered; the elements of the formula which would allocate a portion of residual, i.e. "above normal", profits to the market jurisdictions for companies that are considered to be above an agreed profitability threshold; the choice between mandatory and safe harbour implementation; and aspects of the new tax certainty procedures aimed at dispute prevention and improved dispute resolution procedures. On Pillar Two, there are the remaining technical implementation issues identified in the Report on the Blueprint, as well as, among other issues, whether the co-existence of the United States' Global Intangible Low Taxed Income Regime (GILTI) would be treated as being compliant under Pillar Two.

8. What are the tax revenue implications of the Pillar 1 and Pillar 2 proposals?

A full agreement on Pillar One would lead to reallocation of about USD 100 billion annually to market jurisdictions, i.e. the countries where activity actually takes place. Agreement on Pillar Two could increase global corporate income tax (CIT) revenues by USD 60-100 billion per year, or up to around 4% of global CIT revenues, taking into account the combined effect of these reforms and the US GILTI regime. A consensus-based multilateral solution involving Pillar One and Pillar Two would lead to a more favourable environment for investment and growth than would likely be the case without international agreement.

9. What could happen if there is no long-term international agreement?

Without a global, consensus-based solution, the risk of further uncoordinated, unilateral measures increases. This would exacerbate trade tensions and likely prompt retaliatory tariffs on goods exported by countries implementing Digital Services Taxes. New OECD analysis suggests that the overall impact of a global tax and trade war could be a 1% drop of global GDP, at a time when the global economy is already suffering enormously. Before COVID-19, the world GDP growth was expected to be 2.9% in 2020. It is now projected to fall by 4.5% in 2020. In this context, the global economy needs greater tax certainty, via revamped international tax rules, not tax chaos. The Blueprints demonstrate that a viable solution is within reach.

10. What next?

Mindful of the urgency, the G20/OECD Inclusive Framework decided on 9 October 2020 to release the Pillar One and Pillar Two blueprints for public consultation, inviting comments from concerned stakeholders. These stakeholder inputs will contributed to forthcoming negotiations by the G20/OECD Inclusive Framework to further fine-tune and simplify the proposed solution under Pillar One and Pillar Two. The G20/OECD Inclusive Framework agreed "to swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021, and to resolve technical issues, develop model draft legislation, guidelines and international rules and processes as necessary to enable jurisdictions to implement a consensus based solution". The package will be presented to and discussed by the G20 Finance Ministers at their meeting on 14 October.

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