Will the OECD reach a digital tax consensus?

By Erika Morphy
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The OECD's push to overhaul fiscal principles to account for the increasing digitalisation of the economy is worrying multinationals, as Erika Morphy reports.

As part of the OECD's ongoing work on base erosion and profit shifting (BEPS) – a project that seeks to prevent companies from using tax avoidance strategies that exploit gaps and mismatches in tax rules in order to artificially shift profits to low- or no-tax locations – the organisation has also been seeking public comment on a related subject: tax issues arising from the digitalisation of the global economy.

In recent months, proposals from various countries have been submitted that address not only the digitalisation of the economy but also the remaining BEPS issues.

From the OECD's viewpoint, this is a good thing. "The international community has taken a significant step forward towards resolving the tax challenges arising from digitalisation," says Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration. "Countries have agreed to explore potential solutions that would update fundamental tax principles for a 21st-century economy, when firms can be heavily involved in the economic life of different jurisdictions without any significant physical presence and where new and often intangible drivers of value becomes more and more important."

He adds: "The features of the digitalised economy exacerbate risks, enabling structures that shift profits to entities that escape taxation or are taxed at very low rates. We are now exploring this issue and possible solutions."

Double taxation warning

But from the multinationals' viewpoint, these proposals are worrying – not just because they will result in a revenue tax but also because, as things stand, there are multiple suggestions to be considered. Monica Loving, international tax services leader at accountancy and business advisory firm BDO, says: "There is significant concern that double taxation could happen if different countries were to adopt different approaches."

Germany and France, for example, want to set a minimum global rate for multinationals that would tax where these companies invest in their digital

operations. On the other hand, an approach backed by India and Colombia, among other countries, would allow them to tax companies if they have a significant digital presence in their jurisdictions. Meanwhile, outside of the OECD's framework, countries such as France and the UK have been looking at a digital services tax that would target digital advertising revenues and the sale of individual data.

The common theme among these proposals – and the overarching question with which the OECD is wrestling – is determining the value chain of an online operation or platform that generates revenue. Ms Loving says: "This will be an evolving space for some time. No one knows where it will go."

Alan White, managing principal at Analysis Group, says to understand the depth of the issue, three important characteristics that are part of any highly digitalised business must be considered. These are scale without mass, a heavy reliance on intangibles such as intellectual property and the role of data and user participation, including network effects. "Given these unique characteristics, countries dispute whether, and the extent to which, these features contribute to value creation by the enterprise, with implications for the tax burden," he says.

Hope for concessions

The OECD expects to issue a refined set of proposals in late 2019, which might provide some better clarity on these issues. By 2020, it is expected to come up

with a set of rules that would be applicable to countries that want to put them in place.

The greatest hope among multinationals is that a consensus is reached, notes Ms Loving. History, however, suggests that could be a long process. For instance, the EU has been unable to agree on a unified approach to a digital services tax, according to Andrew Cousins, a director in consultancy firm Duff & Phelps' transfer pricing practice. "The original proposal for a 3% tax on digital services revenues was watered down to a proposal by Germany and France to tax just digital advertising revenues, but even this failed to be carried," he says.

Indeed, there is little consensus at present, according to Jennifer Correa Riera, a partner at law firm Fuerst Ittleman David & Joseph. "Different countries have different rules on nexus and profit allocation and some companies are not getting taxed at all. For them it is a double no-tax regime," she says.

Those companies will get a shock when the OECD does arrive at a conclusion, according to Ms Riera, especially if they are not digital service giants such as Google or Facebook, which automatically watch for such events. "What has been happening with the OECD isn't resonating with companies that aren't traditional tech providers," says Ms Loving. "But ultimately this is about the global distribution of profits, no matter what line of business a company is in." Or, as Mr Cousin puts it: "As the global economy becomes increasingly

digitised, more and more companies are likely to fall into the net of digital taxes."

If anything, this will make the new rules that much harder to swallow. Already, just by their general nature, the revenue taxes are bound to be unpopular with multinational companies as the level of the tax paid is not tied to the company's profitability, according to Mr Cousins says. "A group can be loss-making and still be liable for taxes on revenues," he says. In addition, revenue taxes are not covered by double-tax treaties, in contrast to a corporation tax, he adds.

Unavoidable outcome

Ms Riera believes double taxation may be unavoidable for some companies, depending on how well received the final rules are, and for those companies the best they can do is structure a legal mechanism that would minimise the double taxation. Asked what that mechanism might be, she shrugs and says: "I can't give you a mechanism because the rules don't exist yet."

But while it is too early for actual tax planning, Ms Riera believes that companies can and should be monitoring the situation. She also advises companies to run forecasts to see what the tax effect will be from the various proposals.

More than likely, companies will change their behaviour as they adapt to the new tax regime – a change that will also affect site-selection decisions, according to Mr Cousins. The global minimum tax rate proposal, for instance, has the potential to change behaviour as there will be less incentive to put profit or operations into low-tax jurisdictions, and all of the proposals mark a move away from the arm's length principle, he says, which is "a standard that companies and tax administrations have used for a long time".