

OECD hosts public consultation on document proposing significant changes to the international tax system

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Executive summary

The Organisation for Economic Co-operation and Development (OECD) hosted a day and a half-long public consultation on 13-14 March on its document entitled [Addressing the Tax Challenges of the Digitalisation of the Economy](#). The sessions were chaired by the French and US government representatives who serve as co-chairs of the OECD Task Force on the Digital Economy. Government representatives from about 60 countries attended the consultation. The OECD received over 200 comment submissions on the consultation document that was issued on 13 February. Representatives from business, labor groups, non-governmental organizations (NGOs), and academia participated in the consultation to discuss their perspectives on the proposals outlined in the OECD document. EY submitted a [comment letter](#) and a global team of EY representatives participated in the consultation.

The OECD laid out a timeline through 2020 for advancing work on the proposals and reaching consensus on a coordinated global approach. Dozens of stakeholders urged caution in the development of the details of what potentially are sweeping changes to long-standing rules for determining taxing jurisdiction over business profits and broad new anti-base erosion rules that go well beyond the 2015 Base Erosion and Profit Shifting (BEPS) project recommendations. Many stakeholders also expressed the view that some changes to the international tax system are inevitable to better align the taxing rules with the new global economy.

Because the consultation was intended as an opportunity to hear from stakeholders, the government representatives who attended were largely in listen mode and did not share their views during the sessions. Information regarding the consultation is to be shared with the Inclusive Framework on BEPS, which now has 129 countries participating.

Detailed discussion

The OECD consultation document includes two separate sets of proposals, referred to by OECD officials as pillar one and pillar two. Pillar one involves revised profit allocation and nexus rules aimed at expanding taxing rights of the user or market jurisdiction based on the existence of certain intangible assets, including so-called marketing intangibles. Pillar two involves two integrated global anti-base erosion rules: an income inclusion rule likened to a minimum tax on profits and rules for taxing so-called base-eroding payments (accomplished through the denial of tax deductions or treaty benefits for payments that are not subject to a minimum level of tax).

The first day of the consultation focused on the pillar one proposal for revising profit allocation and nexus rules to allocate more value to user or market jurisdictions. The discussion suggested that some change to traditional nexus and transfer pricing rules may be inevitable, with virtually all commentators seeming to agree that changes to these rules are needed while vigorously debating the scope and detail of such changes. The second half day of the consultation was devoted to pillar two and generated more diversity of view among participants, with many business representatives expressing caution or even opposition to the proposal for new global standards relating to minimum taxes.

Discussion on process and timeline

Brian Jenn, Deputy International Tax Counsel, U.S. Department of the Treasury and co-chair of the OECD Task Force on the Digital Economy, began the consultation, saying a work plan is being developed during this early stage. In comparison to the BEPS project, the current effort is at the same stage as when the OECD was developing the BEPS Action plan in 2013. Grace Perez-Navarro, Deputy Director of the OECD Centre for Tax Policy and Administration, described key steps that will be taken between now and the end of 2020. Following the consultation, there will be more thorough analysis of the comments received and meetings

of the steering group of the Inclusive Framework on BEPS in April and May. A work plan for the project will be developed and presented to the Inclusive Framework at the end of May for approval. It will then be presented to G20 Finance Ministers at the beginning of June and to G20 leaders at the end of June.

Once the work plan is adopted, the various OECD working parties will begin what was described as “the hard technical work.” OECD officials made clear that discussion drafts will be released for public comment and that they expect this process to begin in late 2019 or early 2020. The OECD objective is for the Inclusive Framework to agree on and make public the final consensus outcomes by the end of 2020.

Officials stressed that this public consultation would not be the only chance for stakeholders to have input into the process: a year-and-a-half more of work is yet to come, and there will be further opportunities for input, they said. Both Jenn and Pascal Saint-Amans, Director of the OECD Centre for Tax Policy and Administration, noted that there was no public consultation in advance of the development of the BEPS Action plan in 2013. Saint-Amans quipped that the 13-14 March public consultation drew a big crowd for a “tax party” – underscoring the high level of interest at this very early stage of the design of possible solutions.

Discussions on pillar one – revised profit allocation and nexus rules

The first day’s discussion on pillar one demonstrated a shared view among all participants that the economy has changed dramatically and will continue to change due to digitalization. There also was general recognition that nexus and transfer pricing rules need to change accordingly, including the need for some movement either within, or potentially even away from, the arm’s-length principle. There was a marked lack of consensus, however, around how significant the movement should be, with some from the business community arguing that adoption of a more multi-sided formulaic approach for allocating taxing rights to user or market jurisdictions should not be pursued or, if considered, should be as narrow and simple as possible, while NGOs and academics advocated more dramatic changes. As an alternative to a multi-sided formulaic approach, some discussed a potential one-sided mechanical profit allocation approach in which a minimum sales-based return to a market jurisdiction would be guaranteed.

Points of agreement during the discussion included the following:

- ▶ Attempts to “ring fence” certain types of businesses, including the most digitally driven business models, should be avoided.
- ▶ Company representatives said they generally are indifferent as to where they are taxed, provided they are not subject to multiple levels of taxation on the same dollar of profit.
- ▶ Business participants also noted that moving profit allocation away from the countries where assets and people are located to market jurisdictions, without regard to physical presence in such locations, would create a mismatch between the place where infrastructure investments must be made and the place where tax may be imposed.
- ▶ Representatives of digital companies and start-ups noted that any new approach should take into account losses as well as profits, an issue of particular importance for newer companies.
- ▶ Representatives of both business and organized labor agreed that simplicity is key to any new approach, with representatives from organized labor arguing that complex rules operate to the advantage of large corporations, which they view as more able to manipulate such rules. Some use of safe harbors and mechanical or formulaic approaches seemed to be supported by most of the commentators.
- ▶ Business representatives cautioned that transfer pricing rules must continue to respect and reward value creation and risk taking, so that transferring too much profit into user or market jurisdictions would be uneconomic. Some maintained that any new approach should identify and apportion to the user or market jurisdiction as modest an amount of profit as possible, thus doing as little damage as possible to existing transfer pricing approaches that align with the underlying economics.
- ▶ Broad agreement existed among stakeholders that countries that unilaterally adopted narrow digital sales taxes should immediately withdraw those taxes if consensus on a broader solution is achieved.
- ▶ Finally, the business representatives emphasized the importance of reaching consensus. As a change in the division of taxing rights would unavoidably create winners and losers, they stressed, consensus can only be reached if all jurisdictions agree to the solution. Without such agreement, businesses would pay the price through double taxation and increased administrative costs.

While the general recognition of the need to develop some new global standards seemed clear, conflicting views were expressed regarding both the process and the technical details of any new standards:

- ▶ Starting with the timeline, some urged the OECD to slow down the process because the changes being contemplated were too dramatic and monumental to develop in 18 months. Others argued that even the current timeline expressed by OECD officials at the outset of the public consultation was too long, and the need for action is urgent.
- ▶ The discussion focused mainly on the potentially new profit allocation rules, while the question of defining a new nexus standard was not a key topic of discussion.
- ▶ On the question of new profit allocation rules, a wide range of potential alternatives was brought forward: from simplifying and using the possibilities within the current arm’s-length principle, to mechanical and mandatory methods of pricing that would supplement the arm’s-length principle, to mechanisms that would respect the arm’s-length principle for remuneration of routine activities while prescribing some form of a profit split for the “residual profits,” to a fully formulaic approach to an aggregated measure of a company’s profits.
- ▶ While there seemed to be agreement that some form of mechanical or formulaic approach may be necessary to allocate profit to user or market jurisdictions, disagreement existed over the scope of such a change. Most commentators focused on the marketing intangibles proposal outlined in the consultation document, and several business representatives identified specific narrow approaches for allocating profit to user or market jurisdictions based on some definition of marketing intangibles. Representatives from organized labor, however, were uniform in their support for the so-called significant economic presence proposal, which would involve discarding the arm’s-length principle for a formulaic apportionment approach to transfer pricing. Participants expressed very little support for the so-called user participation proposal.

Discussion on pillar two – global anti-base erosion rules

The four-hour discussion of the global anti-base erosion proposals on day two lacked the general agreement around the need for some change that characterized the first day’s discussion of pillar one. In fact, many commentators questioned the need for further anti-base erosion measures after the 2015 BEPS recommendations, and business

representatives urged the OECD to do a better job of identifying the base erosion problems that are perceived as remaining to be solved prior to any further work developing minimum tax and other potential solutions. Moreover, the potential for distortive effects on real economic activities was considered a significant risk. At a minimum, these commentators suggested that the OECD should progress with its work on pillar one and should only come back to examining the pillar two proposals once that work is completed.

Organized labor representatives, however, disagreed. They maintained that a tax rate “race to the bottom” among developed countries continues even after the BEPS work was completed and BEPS measures are being implemented. They further argued that developing countries are paying the price as they lack adequate revenues to fund infrastructure investments, education, etc. Not all the NGOs agreed with that, however, with some NGOs stressing the importance of simplification and more robust minimum substance measures, while questioning the complexity of the proposals for minimum tax rules.

Participants also weighed in on the following issues:

- ▶ The potential link between pillars one and two. Some commentators argued that there was a clear link, while others saw no link whatsoever.
- ▶ Minimum tax design issues and complexity. Business representatives argued that: (i) a minimum tax should apply on a global basis rather than on the country-by-country basis that seems to be contemplated in the consultation document; (ii) any such tax should serve as a minimum tax and should not result in taxation at the maximum tax rate in the parent country; and (iii) most countries have controlled foreign company rules so the pillar two proposals would need to be integrated into those regimes.
- ▶ The level that should be set for a minimum tax rate. Some suggested that the OECD should identify a floor at which tax rates are viewed as being too low but refrain from specifying the tax rate for minimum tax rules, leaving that decision to individual countries.

- ▶ The complex design and administrative issues around the proposal to tax base-eroding payments. Commentators noted that applying such a tax on a payment-by-payment basis would be necessary but very difficult to achieve, particularly if the goal were to apply the deduction disallowance (or treaty benefit denial) only when a payment is not subject to a minimum level of tax by any jurisdiction. Several commentators noted that, while a jurisdiction may appear not to apply a minimum level of tax, the payment could ultimately be subject to significant tax by another jurisdiction that has controlled foreign company or anti-base erosion rules. One commentator noted that very detailed ordering rules would be needed to avoid double taxation, but questioned whether such an approach would be feasible.
- ▶ The new US base-erosion and anti-avoidance tax (BEAT). Several business representatives noted the base-eroding payment proposal’s similarity to the BEAT and urged the OECD not to use it as a model.

Implications

The proposals in the OECD document have implications well beyond digital businesses or digital business models and could lead to significant changes to the overall international tax rules under which multinational businesses operate. Implementation of major changes in the international tax architecture – whether through a global consensus reached in the OECD process or through unilateral measures adopted without coordination – is a current focus for many governments around the world. It is important for businesses to follow these developments closely as they unfold over the coming months. In addition, companies should consider taking the opportunity to share their perspectives both through the OECD comment process and directly with tax policy officials in the countries that are part of their global footprint.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, Washington, DC

- ▶ Barbara M. Angus barbara.angus@ey.com
- ▶ Jeff Levey jeff.levey@ey.com

Ernst & Young Belastingadviseurs LLP, Rotterdam

- ▶ Marlies de Rooter marlies.de.rooter@nl.ey.com

Ernst & Young Société d'Avocats, Paris

- ▶ Jean-Pierre Lieb jean.pierre.lieb@ey-avocats.com

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EYG no. 000826-19Gbl

1508-1600216 NY
ED None

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