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Digital taxation

Congressional tax writers concerned over unilateral digital taxation proposals

Unilateral digital taxation proposals being floated against the backdrop of ongoing OECD global digital discussions are causing some anxiety in Congress and in the Trump Administration.

A group of bipartisan Congressional tax leaders on 10 April 2019 issued a joint release urging countries to abandon unilateral measures to adopt digital tax measures, and instead “focus on and engage productively in the OECD dialogue in order to reach measured and comprehensive solutions.”

The statement by Senate Finance Committee Chairman Chuck Grassley (R-IA) and Committee ranking member Ron Wyden (D-OR), and House Ways and Means Committee Chairman Richard Neal (D-MA) and Committee ranking member Kevin Brady (R-TX) came as G-20 Finance Ministers were meeting in Washington, DC.

Discussions surrounding digital taxation were also expected at the margins of the World Bank/International Monetary Fund spring meetings being held on 12-14 April.

Separately, Republican House Ways and Means Committee members on 3 April wrote to President Trump to voice their concerns over France’s proposed digital services tax (DST) which is intended to apply from 1 January 2019.

The 16 committee members characterized the French proposal as “designed and explicitly intended to target US companies.” The letter, which also referenced the United Kingdom’s proposed DST, argued that such taxes act as “a ‘de facto’ tariff on US exports” and threaten the US

tax base. The group urged the Administration to “engage forcefully on these issues, including addressing them as a trade barrier.”

Later in the month, US government officials offered their insights on the ongoing global digital taxation debate.

A senior Treasury official was quoted as saying that certain exporting and headquarters jurisdictions may need to accept a modest reallocation of taxing rights to market jurisdictions in order to achieve global consensus. He indicated that a certain loss of revenue by some countries may be the price for reaching a coordinated, coherent solution to the digital taxation conundrum.

The official cautioned that absent an agreed-upon global solution, unilateral measures will lead to more complexity and “enormous risks of double taxation.” He also said that he expected the arm’s-length standard would continue to apply in the great majority of transfer pricing cases, but that some other approaches may be necessary in some instances.

Another US Treasury official in April touched on the OECD’s ongoing pillar 2 consultation work on finding a common global anti-base erosion and profit-shifting approach. The official suggested that while it is too early to say how the global framework may be crafted, a future OECD standard may lean towards a “looser consensus and not being highly prescriptive about how you implement the basic goal of achieving a minimum tax rate.”

He reiterated earlier cautionary comments by US government officials that there are significant design complexities and technical challenges associated with a minimum tax regime.

Treasury and IRS news

IRS publishes revised 2019 Tax Treaty Table 1 with numerous updates and footnote clarifications

The IRS published a [revised version](#) of its “Tax Treaty Table 1” on the IRS website. Tax Treaty Table 1 lists the income tax and withholding rates on income other than personal service income, including rates for interest, dividends, royalties, pensions and annuities, and social security payments.

IRS names new IRS Associate Chief Counsel (International)

On 25 April 2019, the IRS’s Chief Counsel announced the appointment of Peter Blessing to the position of Associate Chief Counsel (International), which was previously held by Marjorie Rollinson, who left the IRS recently to join EY as Deputy National Tax Leader.

The table is referenced by but no longer included in IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*.

In general, the revised table contains updates and clarifications that can be categorized as follows:

- ▶ Footnote revisions clarifying treaty rate eligibility requirements
- ▶ Corrections to footnote references to withholding tax rates
- ▶ Removal of certain footnotes and marking them as “reserved” for future updates
- ▶ Update of treaty article citation references
- ▶ Change or correction of certain treaty rates on interest income

Withholding agents whose systems rely on Tax Treaty Table 1 should carefully review the numerous changes and related treaty articles and update their systems as needed.

The IRS also included cautionary notes in the revised table to remind users that, although Table 1 is a convenient reference tool used by many withholding agents for withholding rates, it should not be viewed as a substitute for the greater details provided in the relevant treaty provisions.

Rather, withholding agents should review the text of each applicable treaty, the Treasury Department Technical Explanation accompanying the treaty, IRS rulings and relevant competent authority agreements to determine whether a reduced rate of tax or an exemption is available.

No delay in Section 965 final regulations effective date

The IRS issued a correction to the final Section 965 regulations on 9 April, amending the preamble to dispense with a 60-day delay in the effective date of the regulations. The *Congressional Review Act* generally requires a 60-day delayed effective date for “major” rules, unless Treasury and the IRS determine that the 60-day delay is “unnecessary and contrary to the public interest.”

The Office of Management and Budget’s Office of Information and Regulatory Affairs had determined that the regulation was a major rule, but Treasury and the IRS deemed the delay not necessary. The final Section 965 regulations ([T.D. 9846](#)) were published on 5 February 2019, and were effective on that date.

IRS may use APMA FCD Model in some exams

The IRS may use the new Advance Pricing and Mutual Agreement Program (APMA) Functional Cost Diagnostic (FCD) Model released last February in examinations in appropriate cases, according to an IRS official. The IRS earlier had indicated that the excel-based financial model was developed for use when reviewing certain Advance Pricing Agreement (APA) requests and was not intended as an examination tool. The official noted, however, that there is no link between the APMA diagnostic tool and recent IRS interim guidance requiring transfer pricing issue teams to consult with APMA before making adjustments involving a related party in a treaty country.

Latest additions to LB&I compliance campaigns focus on transfer pricing and information reporting

On 16 April 2019, the IRS announced three new Large Business and International (LB&I) compliance campaigns, bringing to 53 the total number of LB&I compliance campaigns announced since enactment of the *Tax Cuts and Jobs Act* (TCJA). The new campaigns concern: (1) transfer pricing between US multinational companies and their foreign captive service providers; (2) income tax and information reporting requirements for offshore bank accounts; and (3) correctly filing Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*.

Campaigns are designed to select returns with identified potential compliance risks. According to the announcement, LB&I identified the campaigns through its data analysis and suggestions from IRS compliance employees. LB&I’s stated goal for its campaigns is to “improve return selection, identify issues representing a risk of non-compliance and make the greatest use of limited resources.”

In the announcement, LB&I briefly explains each issue, describes the planned treatment streams, and names the lead LB&I executive and practice area.

The IRS continues to analyze tax return and other information to identify campaigns for audit. The addition of these three new campaigns demonstrates LB&I’s continued efforts to move toward an issue-based examination program in which selection of tax returns for audits will be based on identified campaign issues.

Taxpayers that may be affected by a campaign should consider developing strategies to effectively respond to any formal or informal inquiries from the IRS (i.e., issue-based examinations or soft letters). In addition, the entire [list of 53 campaign issues](#) can be used as a source for assessing potential tax controversy risks and in the preparation of IRS audit-ready files.

GAO issues report on FATCA implementation

The US Government Accountability Office (GAO) in early April released a critical report on implementation of the *Foreign Account Tax Compliance Act* (FATCA), concluding that FATCA data limitations and a lack of a comprehensive strategy have hampered IRS efforts to increase compliance. The GAO recommended specific actions that should be taken to enhance compliance efforts, eliminate overlapping requirements, and mitigate the burdens on US persons abroad.

Among its recommendations, the GAO urged the IRS to develop a “comprehensive plan for managing efforts to leverage FATCA data in agency compliance efforts.” The IRS responded that the resources needed to develop such a plan “would be better spent on enforcement activities.”

OECD and UN developments

OECD's FTA publishes 7 reports on tax administration

The OECD Forum on Tax Administration (FTA) held its 12th plenary meeting in Santiago, Chile, on 26-28 March 2019. At this year's plenary, the FTA focused on four priorities:

1. Delivering on base erosion and profit shifting (BEPS) and tax certainty
2. Improving tax cooperation
3. Supporting the continued digitalization of tax administrations
4. Building capacity for developing countries

FTA members also welcomed publication of seven reports that provide tax administrations direct, practical assistance on the four priorities.

OECD's FTA releases Joint Audit 2019 report on enhancing tax cooperation and improving tax certainty

On 28 March 2019, the OECD's Forum on Tax Administration (FTA) published a report titled “Joint Audit 2019 - enhancing tax co-operation and improving tax certainty.” The report identifies both the benefits that may arise from the greater use of joint audits, as well as the challenges that must be overcome to ensure that those benefits can be realized as effectively and efficiently as possible, for both tax administrations and taxpayers.

The report is divided into seven chapters. The first chapter outlines the approach of the FTA Joint Audits Project, the second chapter illustrates the role that joint audits can play in enhancing tax certainty, and the third chapter provides an overview of the key benefits and the cost associated with the conduct of joint audits. The fourth chapter describes the current international landscape from the perspective of the exchange of taxpayer information in connection with joint audits, and the fifth chapter addresses the role of the taxpayer during the joint audit. The sixth Chapter deals with building capacity, relationships and trust in a dedicated network for international cooperation in joint audits.

The report concludes with a summary of the joint audit process and includes practical guidance and best practices for conducting joint audits.

OECD FTA announces ICAP 2.0

The OECD's Forum on Tax Administration (FTA) announced a second pilot of the International Compliance Assurance Program (ICAP 2.0). A new handbook that will guide the second pilot was also endorsed and published by the FTA. ICAP is a voluntary risk assessment and assurance program

OECD publishes full version of Model Tax Treaty

The OECD on 25 April 2019 published the 10th edition of the full version of the OECD Model Tax Treaty. The full version includes the full text of the Model Treaty as it read on 21 November 2017. It further includes articles, commentaries, non-OECD member positions, recommendations of the OECD Council and historical notes and background reports.

designed to facilitate open and cooperative multilateral engagement between multinational enterprise (MNE) groups willing to engage actively and transparently and tax administrations in jurisdictions where the MNEs have business activities.

The first ICAP pilot program was launched in January 2018, with the participation of eight FTA member jurisdictions (Australia, Canada, Italy, Japan, the Netherlands, Spain, the UK and the US). ICAP 2.0 includes nine additional participating tax administrations: Austria, Belgium, Denmark, Finland, Germany, Ireland, Luxembourg, Norway, and Poland.

UN subcommittee issues paper on digital taxation

The United Nations Subcommittee on Tax Challenges Related to the Digitalization of the Economy recently prepared a paper for the Committee of Experts on International Cooperation in Tax Matters for its 18th Session on 23-26 April. The Subcommittee noted that its work is independent of ongoing work in other forums, most notably the OECD. The report, which proposes a general workplan and guiding principles, addresses tax treaty issues, domestic law, and value added tax issues.

UN releases draft update to TP manual for developing countries

The United Nations Committee of Experts on International Cooperation in Tax Matters recently released a draft update to the “Practical Manual on Transfer Pricing for Developing Countries.” The updated release includes a new chapter on financial transactions and revised profit split guidance, among other changes.

The Subcommittee identified the tax challenges of the digitalization of the global economy as fundamentally about the inability of the “source jurisdiction” under the physical presence criteria of tax treaties “to tax business profits of certain *new* business models not requiring a *physical* presence in the market to derive such profits.” The paper describes possible approaches for addressing these challenges, particularly in respect of developing countries.

The paper was guided by the following principles: avoiding both double taxation and non-taxation; a preference for taxing income on a net basis where practicable; and simplicity and administrability.

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