BRIEF ON THE TAX CHALLENGES ARISING FROM DIGITALISATION: INTERIM REPORT 2018

1. The challenges of the digitalisation of the economy were identified as one of the main focuses of the Base Erosion and Profit Shifting (BEPS) Action Plan leading to the 2015 BEPS Action 1 Report. In March 2017, the G20 Finance Ministers mandated the OECD, through the Inclusive Framework on BEPS, to deliver an interim report on the implications of digitalisation for taxation by April 2018. This report, Tax Challenges Arising from Digitalisation – Interim Report 2018 (the Interim Report) has now been agreed by the more than 110 members of the Inclusive Framework.

2. The Interim Report provides an in-depth analysis of the main features frequently observed in certain highly digitalised business models and value creation in the digitalised age, as well as the potential implications for the existing international tax framework. It describes the complexities of the issues involved, the positions that different countries have in regard to these features and their implications, and which drive their approach to possible solutions. These different approaches towards a long term solution range from those countries that consider no action is needed, to those that consider there is a need for action that would take into account user contributions, through to others who consider that any changes should apply to the economy more broadly.

3. Members agreed to undertake a coherent and concurrent review of the “nexus” and “profit allocation” rules - fundamental concepts relating to the allocation of taxing rights between jurisdictions and the determination of the relevant share of the multinational enterprise’s profits that will be subject to taxation in a given jurisdiction. They will work towards a consensus-based solution, noting that at present, there are divergent views on how the issue should be approached. It was agreed that the Inclusive Framework would carry out this work with the goal of producing a final report in 2020, with an update to the G20 in 2019. The Inclusive Framework’s Task Force on the Digital Economy will meet next in July 2018.

4. In addition, the Interim Report discusses interim measures that some countries have indicated they would implement, believing that there is a strong imperative to act quickly. In particular, the Interim Report considers an interim measure in the form of an excise tax on the supply of certain e-services within their jurisdiction that would apply to the gross consideration paid for the supply of such e-services. There is no consensus on the need for, or merits of, interim measures, with a number of countries opposed to such measures on the basis that they will give rise to risks and adverse consequences. The Interim Report describes, however, the framework of design considerations, identified by countries in favour of introducing interim measures, which should be taken into account when considering introducing such measures.

5. The Interim Report also takes stock of progress made in the implementation of the BEPS package, which is curtailing opportunities for double non-taxation. Country-level implementation of the wide-ranging BEPS package is already having an impact, with evidence emerging that some multinationals have already changed their tax arrangements to better align with their business operations. The measures are already delivering increased revenues for governments, for example over 3 billion euros in the European Union alone as a result of the implementation of the new International VAT/GST Guidelines. Also, the impact of widespread implementation of the BEPS package, including recent EU directives as well as some aspects of the US tax reform should result in neutralising the very low effective tax rates of some companies. Nonetheless, BEPS measures do not necessarily resolve the question of how rights to tax are shared between jurisdictions, which is part of the long term issue.

6. Finally, the Interim Report identifies new areas of work that will be undertaken without delay. Given the availability of big data, international cooperation among tax administrations should be enhanced, in particular, as regards the information on the users of online platforms as part of the gig and sharing economies, to ensure taxes are paid when they are due. The Forum on Tax Administration, working with the Inclusive Framework, will develop practical tools and cooperation in the area of tax administration and will also examine the tax consequences of new technologies (e.g., crypto-currencies and blockchain distributed ledger technology).

7. An update on this work will be provided in 2019, as the Inclusive Framework works towards a consensus-based solution by 2020.

Background

8. As part of the OECD/G20 BEPS Project, and in the context of Action 1, the Task Force on the Digital Economy (TFDE) considered the tax challenges raised by the digital economy. The 2015 BEPS Action 1 report[1] noted that the digital economy is characterised by an unparalleled reliance on intangibles, the massive use of data (notably personal data), and the widespread adoption of multi-sided business models. Further, it found that it would be difficult, if not impossible, to ring-fence the digital economy. The report went on to highlight the ways in which digitalisation had exacerbated BEPS issues, but also noted that the measures proposed under the other BEPS Actions were likely to have a significant impact in this regard.

9. The report also noted that beyond BEPS, digitalisation raised a series of broader tax challenges, which it identified as data, nexus and characterisation. These challenges chiefly relate to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries. While identifying a number of options to address these concerns, none were ultimately recommended. After the release of the OECD/G20 BEPS package it was agreed by countries to renew the mandate of the TFDE and continue to monitor developments in respect of digitalisation with a further report to be delivered by 2020 and with an interim report to be produced by the end of 2018.

10. In March 2017, the G20 Finance Ministers called on the TFDE to bring forward the delivery of its interim report, so that it would be finalised by no later than April 2018 – a request that was reiterated by the G20 Leaders at their July 2017 Hamburg Summit.

Digitalisation, Business Models and Value Creation

11. A robust understanding of how digitalisation is changing the way businesses operate and how they create value is fundamental to ensuring that the tax system responds to these challenges. In particular, looking at new and changing business models in the context of digitalisation, the report describes the main features of digital markets and how these shape value creation. The Interim Report also identifies three characteristics that are frequently observed in certain highly digitalised business models: scale without mass, heavy reliance on intangible assets, and the role of data and user participation, including network effects. It was noted, however, that countries have different views on whether, and to what extent, these features represent a contribution to value creation by the enterprise.

[1] OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241046-en

BEPS Implementation and relevant tax policy developments

12. Implementation of the BEPS measures is well underway in most countries. This is having an impact. As mentioned, over 3 billion euros in the EU alone has been collected as a result of the implementation of the new International VAT/GST Guidelines. On the corporate income tax front, significant recent reforms have been passed to implement the BEPS package. For instance several EU directives have been enacted. One measure of the US tax reform in particular (known as GILTI) is likely to raise the overall effective tax rate of US MNEs on their offshore income above a single digit.

13. Also, a significant number of multinational enterprises (MNEs) have taken pro-active measures to realign their tax arrangements with their real economic activity, either by reconsidering their transfer pricing positions or by relocating and on-shoring valuable assets, such as intangibles. With the exchange of Country-by-Country reports beginning in 2018 for the 2016 tax year, further evidence of the impact of the BEPS measures is anticipated in the coming years.

14. In recent years, we have also seen the introduction by some countries of a range of uncoordinated and unilateral measures, which appear to reflect a discontent among some countries with the outcomes produced by certain aspects of the current international tax system.

Towards a Global, Consensus-Based Solution

15. There is general acknowledgement that the digital transformation continues to be an ongoing process and that there is a need to monitor how these changes may be impacting value creation. The broader tax challenges of digitalisation raise very complex technical questions. Members of the Inclusive Framework have different views on the question of whether, and to what extent, the features identified as being frequently observed in certain highly digitalised business models should result in changes to the international tax rules. In particular, with respect to data and user participation, there are different views on whether, and to what extent, they should be considered as contributing to a firm's value creation, and therefore, what impact they may have on the international tax rules.

16. The different perspectives on these issues among the 113 members of the Inclusive Framework can generally be described as falling into three groups. The first group considers that the reliance on data and user participation may lead to misalignments between the location in which profits are taxed and the location in which value is created. However, the view of this group of countries is that these challenges are confined to certain business models and they do not believe that these factors undermine the principles underpinning the existing international tax framework. Consequently, they do not see the case for wide-ranging change.

17. A second group of countries take the view that the ongoing digital transformation of the economy, and more generally trends associated with globalisation, present challenges to the continued effectiveness of the existing international tax framework for business profits. Importantly, for this group of countries, these challenges are not exclusive or specific to highly digitalised business models.

18. Finally, there is a third group of countries that consider that the BEPS package has largely addressed the concerns of double non-taxation, although these countries also highlight that it is still too early to fully assess the impact of all the BEPS measures. These countries are generally satisfied with the existing tax system and do not currently see the need for any significant reform of the international tax rules.

19. Acknowledging these divergences, members agreed to undertake a coherent and concurrent review of the "nexus" and "profit allocation" rules - two fundamental concepts relating to how taxing rights are allocated between jurisdictions and how profits are allocated to the different activities carried out by multinational enterprises, and seek a consensus-based solution. While it is a challenging objective, the Inclusive Framework will work towards a consensus-based solution by 2020.

Interim Measures to Address the Tax Challenges Arising from Digitalisation

20. Developing, agreeing and implementing a global, consensus-based solution will take time, and, in some countries, there are pressing calls for governments to take more immediate action to address the tax challenges arising from digitalisation. There is no consensus on the need for, or the merit of, interim measures with some countries opposing them. The risks and adverse consequences that these countries believe would arise as a result of such measures include negative impacts on investment, innovation and growth, the possibility of over-taxation, distortive impacts on production and increasing the economic incidence of tax on consumers and businesses, and increased compliance and administration costs.

21. The countries considering interim measures recognise these challenges, but consider there is a fiscal and political imperative to act, pending a global solution which may take time to develop, agree and implement. They take the view that there is a sound conceptual basis for an interim measure, that value is being generated within their jurisdiction that would otherwise go untaxed challenging the fairness, sustainability and public acceptability of the system. They think the challenges need to be weighed against the policy challenges of not acting in the interim and consider that at least some of the possible adverse consequences can be mitigated through the design of the measure.

22. The report therefore reflects the framework of design considerations, identified by countries in favour of introducing interim measures, which should be taken into account when considering introducing such measures. This framework takes into account some constraints, including that any such measures should be in compliance with existing international obligations, temporary, targeted and balanced, minimise over-taxation, as well as designed to limit the compliance costs and not to inhibit innovation. The Interim Report considers an interim measure in the form of an excise tax on the supply of certain e-services within their jurisdiction that would apply to the gross consideration paid for the supply of such e-services.

Beyond the International Tax Rules: the impact of digitalisation on tax policy and tax administration

23. Digitalisation is offering new opportunities as well as some challenges to tax policy and administration beyond the international tax system. These include the growth of the gig and sharing economy and how this is affecting tax compliance and revenues as a result of the rise of non-standard work. At the same time, technologies like blockchain give rise to both new, secure methods of record-keeping while also facilitating crypto-currencies which pose risks to the gains made on tax transparency in the last decade. Some work is already underway to better understand and address these developments, but further work is required to ensure that governments can harness the opportunities these changes bring while ensuring the ongoing effectiveness of the tax system. It will also be important to give specific consideration to how advances can be implemented in developing countries to take into account their particular circumstances.

Next Steps

24. The interim report is a key milestone to developing a durable, long-term solution to the tax challenges posed by the digitalisation of the economy. To accomplish this, further work will need to be carried out on the analysis of the value contribution of certain characteristics of highly digitalised business models as well as digitalisation more broadly. To inform that debate, technical solutions would also be explored to test the feasibility of different options with respect to the profit allocation and nexus rules. This process will include gathering input from a broader group of stakeholders including business, civil society and academia.

25. An update on this work will be provided in 2019, as members work towards a consensus-based solution by 2020. Throughout, it will be important to continue to monitor the latest developments: from the evolution of new technologies and rapidly-evolving business models, to the adoption and impact of countries' legislative proposals that aim to address these challenges. Ongoing political support is essential to building consensus and achieving progress on these complex issues. The TFDE will hold its next meeting in July 2018.