OECD public consultation on:

Addressing the tax challenges of the digitalisation of the economy

**Contribution by the TUAC**

Paris, 5 March 2019

On 13 February 2019, the OECD published a consultation document outlining four proposals to address the tax challenges of the digitalisation of the economy[[1]](#endnote-1): three proposals related to a revision of international rules on transfer pricing and permanent establishment status and one proposal to insert a new global right to tax back undertaxed foreign entities.

The following includes the responses by the TUAC following an internal consultation of its members. TUAC agrees to the publication of this response.

# General remarks

Tackling tax avoidance is highly relevant for the labour movement for two reasons: (i) ensuring fairer and more inclusive tax systems and (ii) ensuring corporate accountability to other stakeholders than the tax collector.

Regarding the latter, when a business avoids its obligations to the tax collector, its obligations to other stakeholders, including workers, are also often at risk. Trade union first-hand experience with corporate tax schemes strongly suggests that tax liability issues are intertwined with employer responsibility issues. The artificial constructions used by multinationals to diminish their tax accountability are indeed very similar, if not the same ones, than those built to obscure employment relationships, bypass national labour laws and social security contributions.

The 2015 BEPS Action Plan was a historical achievement in terms of multilateral tax cooperation. At the time, TUAC highlighted a number of shortcomings however, including the prevalence of the arm’s length principle in measuring intra-group transfer pricing and accordingly the failure to account for the unitary dimension of multinational enterprises[[2]](#endnote-2).

**TUAC welcomes the proposal to address the tax challenges of the digital economy. Their very existence is an implicit acknowledgement that the 2015 BEPS Action Plan was incomplete and needed further improvements. All three proposals have in common to increase taxing rights in market jurisdictions. Considering the current trade imbalances, they would shift part of the distribution of taxing rights between countries, in particular between trade “surplus” countries and “deficit” countries. They would also affect countries depending on their respective exposure to global value chains. Against this background,** governments should reach a consensus on the basis of long-term principles for fair taxation of businesses, as opposed to short term trade-related considerations.

**TUAC believes that the reform of international tax rule should follow the four following objectives:**

1. **Unitary taxation of multinational enterprises.** The international tax framework should treat multinationals for what they are: unitary entities. The current transfer pricing rules and its related arm’s length principle are based on the fiction that subsidiaries are independent from each other. International tax rules must move more clearly towards “unitary taxation”, whereby profits at global level are divided between countries.
2. **Simple and standardized rules**. The efforts should be on keeping the rules simple and, as far as possible, the same for everyone. The more complex the rules, and their exemptions, the bigger the risk for regulatory arbitrage and accounting manipulation.
3. **Fairness.** To be sustainable and recognized world-wide, the system should promote progressive taxation, ensuring long term funding of public administration, social rights and public services, especially in emerging countries which are comparatively more dependent on corporate tax.
4. **The tax race to the bottom must be stopped.** In an attempt to attract multinationals, jurisdictions have been engaging in a tax competition that impoverishes the general public, and fosters an environment that is conducive to corporate tax avoidance.

# REVISED PROFIT ALLOCATION AND NEXUS RULES

## Question 1. What is your general view on those proposals? In answering this question please consider the objectives, policy rationale, and economic and behavioural implications.

### General view on the three proposals

The three proposals exposed in the public consultation document all seek to trigger a positive review of the existing transfer pricing rules, shifting away from the arms’ length principle. In the long-run debate on source versus residence taxing rights, the three proposals would to some extent shift taxation from “production” source jurisdictions toward market destination jurisdictions. Overall, these developments should be welcome. However, TUAC has questions and reserves about the scope and design of some of the proposals. Further discussion on the design of the new rules is therefore indispensable.

### The “user participation” proposal

This proposal has the great merit of recognising the co-production theory of the firm whereby users may themselves generate value for the firm and hence contribute to production and profits. It also offers scope for a clear application of the formulary apportionment method, which is favoured by trade unions.

However, it would be limited to the business-to-consumers activities of online platforms. Furthermore, likewise the other two proposals, it is making a distinction between routine profits and residual profits, which may lead to manipulation by businesses.

The user participation proposal can be envisaged as an intermediary solution to generate immediate revenue. The user participation proposal conceptually could provide some elements of response as far as transfer pricing and permanent establishment rules are concerned. But the limited application to online platforms suggests that it would only amount to a partial solution to the need of a fundamental rethinking of the international tax rules.

### The “marketing intangibles” proposal

The scope of this approach would be wider than the “user participation” approach, as it would apply to all business-to-consumer activities for which “marketing intangibles” play a key role in generating income and profits.

However, the notion of “marketing intangibles” (as opposed to more traditional intangibles, such as patent rights) is fairly problematic in as far as it is difficult to stabilise and hence could lead to various interpretations and accounting manipulation by businesses.

The proposal is also insufficiently assertive on the need to shift to a formulary apportionment method, as only “residual profits” arising from “marketing intangibles” would be concerned. In addition, one of the options offered to distinguish marketing intangibles from other intangibles, would be to stay within the realm of the arm’s length principle, and hence entirely dependent on the existence of “comparables” (i.e. similar transactions outside the firm for which a price can be observed), which might prove to be illusory to obtain with digital intangible assets.

Another offered option is to refer to a “pre-agreed percentage” which in turn could lead to arbitrary decisions. It is therefore uneasy to verify whether such solution would lead to a fair application of the rules.

The wide scope of business of the marketing intangibles proposal should be explored further but the design and mechanics of this approach require crucial improvements.

### The “significant economic presence” proposal

This proposal is the least explained in the public consultation document and has not been included in the section comparing the different proposals. At face value it appears to be the most promising one as it offers a blanket application of the unitary taxation principle. Unlike the other two proposals, no distinction is made between intangible assets, nor between routine and residual profits. Concerning the allocation method, this approach is explicit on factors such as sales, assets, employees and, in certain cases, users. This proposal clearly would benefit from more technical discussions with a view to clarify possible design and mechanics. For instance, as far as allocation factors are concerned due consideration should be given to appropriate weighting with a view to guarantee a fair distribution of taxing rights between production and marketing jurisdictions.

Concerning nexus, the significant economic presence approach proposes a reform of the notion of taxable presence. TUAC considers that the rules on profit allocation are crucial for a meaningful reform of the current taxation system. The nexus rules should indeed be revised not as an end in itself, but rather in a way that supports the desired result of the new profit allocation rules. That said, because of the fast changing nature of the business world, it is imperative to avoid a rigid application of the rules on permanent establishment. The proposed notion of taxable presence should be welcome as it is based on a flexible range of criteria, including but not only the presence of users.

## 2. To what extent do you think that businesses are able, as a result of the digitalisation of the economy, to have an active presence or participation in that jurisdiction that is not recognised by the current profit allocation and nexus rules? In answering this question, please consider:

## i. To what types of businesses do you think this is applicable, and how might that assessment change over time?

The need to revise taxation rules is clearly needed for any business relying on digitalised assets. And the evidence is there: the European Commission estimates that in the EU, digitalised businesses face an effective tax rate of only 9.5%, compared to 23.2% for traditional business models[[3]](#endnote-3).

The OECD interim report in 2018 rightly identifies, among other challenges, the heavy reliance on intangible assets. Cloud computing, software and algorithms etc. are all central to increasingly digital business models. These intangible assets are by definition hard to value as there is no available comparator in the traditional economy. As a result, their considerable contribution to profits is not taken into account.

Yet, the digital economy cannot be ring-fenced. Multinationals are increasingly reliant on digital intangibles to generate revenues and profits. For this reason, taxation rules must be designed in a technologically-neutral perspective.

## ii. What are the merits of using a residual profit split method, a fractional apportionment method, or other method to allocate income in respect of such activities?

Under the current transfer pricing rules, and despite a timid opening of the 2015 BEPS Action Plan with the profit split method, multinationals are primarily treated as an aggregation of separate entities, rather than as a single group. This is particularly problematic from a workers’ perspective. Subsidiaries are treated as independent whilst they are in fact controlled and supervised by the same parent company.

Redesigning transfer pricing rules according to a unitary principle would be the long-term solution. Given the ambition of such proposal, various transitory measures could be applied, with indeed a formula apportionment being applied to intangible assets only. Tangible assets are less difficult to shift and to value. They could, for a period of transition, continue to be treated under the current transfer pricing rules.

## 3. What would be the most important design considerations in developing new profit allocation and nexus rules consistent with the proposals described above, including with respect to scope, thresholds, the treatment of losses, and the factors to be used in connection with profit allocation methods?

The tax base should be as large as possible and cover all profits arising from intangible assets. The more uniform the calculation rules, the easier it will be to navigate through multinational activities.

The user participation and the market intangible proposals make a distinctions between “residual” and “routine” profits and between “marketing intangibles” and (traditional) “trade intangibles”. These distinctions could be due to the desire to balance respect for the current rules with the need to adapt to digital challenges. Part of the profits would indeed continue to be taxed according to the current transfer pricing rules, whilst intangible assets supposedly specific to highly digitalised companies would be taxed under a more efficient formula apportionment method.

Yet such distinction is questionable. Routine profits are usually determined by reference to market returns achieved for similar types of transactions. Any calculation method akin to an arm’s length principle is complex to apply in particular in the context of highly digitalised activities because of the lack of comparables, and is therefore subject to manipulation and tax avoidance by multinationals.

For the same reason, the proposed methods to distinguish between “marketing intangibles” and (traditional) “trade intangibles” appear complex to establish in practice, and accordingly could also lead businesses to practices all sorts of regulatory arbitrage.

Such distinction could therefore be counterproductive if the intent is to redress the under taxation of digital businesses. Effective tax rates for digital activities are significantly lower under transfer pricing rules. There would be a clear incentive for multinationals to be even more “creative” in their accounting practices in order to artificially shift profit from one category to another. Considering the increasing complexity and diversity of business activities in large multinationals, tax administrations may struggle to keep up.

The consultation document also raises the prospect of a reduced scope through the use some “materiality thresholds” (e.g. cost ratios, size of customer and user base, or other metrics) and exclusions (e.g. de minimis rules, exemptions of certain industry sectors, exclusion of commodities). As a matter of principle, the rules should apply as uniformly as possible. If it is considered appropriate to establish thresholds, this should be done for clearly defined cases and on the basis of impact assessment. As an illustration, the proposed CCCTB – the EU version of formula apportionment – would apply to multinationals with a consolidated group revenue exceeding EUR 750 million. Such threshold is highly questionable from a tax fairness point of view. Also, the level is so high that a significant number of European groups would not be covered by the formula apportionment method, thereby raising issues of indirect discrimination on the basis of nationality. The European Trade Union Confederation therefore recommends a de minimis rule of maximum EUR 40 million of net turnover, which corresponds to the applicable thresholds to EU accounting rules (Directive 2016/34/EU)[[4]](#endnote-4).

In designing and weighting allocation factors, the current BEPS 13 Action on Country-by-country reporting, and equivalent C-B-C reporting requirements in the EU offer a good basis to move toward defining allocation keys. Employment, assets, sales and, where appropriate, the presence of a “user” base, should all be considered as factors. In discussing their design and respective weighting, due consideration should be given to the need to guarantee a fair distribution of taxing rights between production and market jurisdictions. None of these factors should therefore be considered in isolation, and attention should be paid to how innovation can be recognised in a proportionate manner.

## 4. What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?

The primary approach to ensure tax certainty and reducing disputes, is to reduce complexity. It means devising rules that are as uniform as possible, and that leave limited room for divergent interpretations. This would be the case of a formula apportionment method on global profits, without distinguishing between different types of intangibles.

Sufficient attention should also be paid to coherence between tax and accounting rules. If differing accounting practices allow different understandings of the tax base, there is room for legal uncertainty and accounting arbitrage. Any dispute resolution mechanism should operate in the greatest transparency, including the publication of reasoned decisions.

Concerning enforcement and collection, withholding taxes could become a key tool against tax avoidance, in particular with regard to highly volatile intangibles.

# GLOBAL ANTI-BASE EROSION PROPOSAL

## Q1. What is your general view on this proposal?

The global anti-base erosion proposal is much welcome as it seeks to introduce a floor in tax competition. It would allow a stable and internationally recognised right to tax back and to redress under-taxation of foreign entities. An appropriate minimum tax rate is therefore an indispensable complement to the rethinking of international tax rules.

The global anti-base erosion proposal should be considered as a complementary measure, not a substitute of new and more effective transfer pricing and permanent establishment rules.

## Q2. What would be the most important design considerations in developing an inclusion rule and a tax on base eroding payments?

An important consideration is the very process that would lead toward internationally agreed tax levels. Without questioning the sovereign right of countries to fix their rates of taxation, a floor set too low would not deter businesses from seeking to distort their distribution of profits. As an illustration, it is questionable whether the US GILTI reform setting a new “global” rate of 10.5 % will prove fully dissuasive whilst the US corporate income tax is 21%.

Action 3 of the BEPS already suggests a “top-up tax”, which builds closely on the concept of a minimum tax, of 12%. Such a tax rate would be grossly insufficient considering that in the OECD the average corporate income tax rate is 23.9%. Action 3 also suggests that this top-up tax should not exceed the minimum rate.

A minimum tax rate cannot be fixed at a level substantially lower than the global average for corporate income tax. Furthermore, the right to “tax back” should apply at the full domestic rate, and not be limited to the global minimum rate.

## Q3. What, if any, scope limitations should be considered in connection with the proposal set out above?

Considering that the minimum tax rate is a fundamental aspect of the fight against tax competition, the introduction of de minimis rules and/ or exemptions should be avoided.

The global anti-base erosion proposal should be treated as a complementary measure, not a substitute for “pillar I” proposals and be adapted accordingly.

Where profits are considered globally and apportioned according to an objective set of factors, the global anti-base erosion mechanisms on the identification and attribution of income would become relatively straightforward to devise. Conversely, to define relevant income in the context of the current transfer pricing rules would be of limited use, especially for assets which are difficult to value due to the lack of comparables.

## Q4. How would you suggest that the rules should best be co-ordinated?

To be effective, the global anti-base erosion rule should have vocation to apply widely. The OECD should therefore take the necessary steps to ensure that this rule is adopted by the greatest number of jurisdictions.

Q5. What could be the best approaches to reduce complexity ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?

Different accounting rules may also constitute an encouragement for manipulation. To foster legal certainty, TUAC encourages the OECD to engage in an in-depth reflection on consistent accounting standards.

As already highlighted above, TUAC warns against encouraging secret, unaccountable and overly complex dispute settlements, which could be considered as encouraging private rulings between countries and individual businesses. Any dispute resolution mechanism should operate in the greatest transparency, including the publication of reasoned decisions.

1. <http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf> [↑](#endnote-ref-1)
2. https://tuac.org/news/tuac-releases-trade-union-assessment-and-guidance-papers-on-the-oecd-beps-package-to-counter-corporate-tax-avoidance-practices/ [↑](#endnote-ref-2)
3. https://ec.europa.eu/taxation\_customs/sites/taxation/files/factsheet\_digital\_taxation\_21032018\_en.pdf [↑](#endnote-ref-3)
4. https://www.etuc.org/en/document/etuc-position-common-consolidated-corporate-tax-base-ccctb [↑](#endnote-ref-4)