Trade Union
Advisory Committee
to the OECD
*Commission
syndicale consultative
auprès de l'OCDE*

OECD proposal to reform tax rules in the context of digitalisation
Heading in the right direction, but not ambitious enough
Paris, 9 October 2019

On 9 October 2019, the OECD Secretariat published a "unified approach" to reform international tax rules to address the tax challenges of digitalisation. The OECD Secretariat proposal was discussed behind closed doors by OECD Member States participating in the OECD Task Force on the Digital Economy last 1 October. It follows the G20 request to the OECD to find consensus-based solutions to tackle the under-taxation of multinationals in an increasingly digitalised economy. This initiative is welcome, because aggressive tax avoidance has dire impacts on employment. The proposed solution does acknowledge that the current rules, with their excessive reliance on the "arms-length principle", are not adequate. However, the extent of the proposed reform is too timid to bring about real change.

About the OECD Proposals

Following several options for reform discussed throughout 2019 (TUAC response to OECD consultation), the OECD is now putting forward a proposal for a "unified approach". The starting point is to modernise the rules triggering taxation rights ('nexus'). Today, there is little chance of a company being taxed without a physical presence in the country. This is far from suitable for a digital economy where many businesses can remotely conduct economic activities. The OECD proposes that taxing rights can be asserted whenever revenues arising from sales exceed a certain level (to be determined).

The proposal is based on a three-tiered approach:

- A portion of MNE-residual profits would be allocated to market jurisdictions (where sales are made) in proportion to the volume of sales. This is a form of unitary taxation, whereby profits of a multinational would be identified globally, on the basis of consolidated accounts. The rest of the profits would continue to be taxed entity-by-entity, applying the arm's length principle.

- A minimum amount of returns would be assigned to market jurisdictions, to be taxed in accordance with the current transfer-pricing rules, applying the arm's length principle. Reading between the lines, the justification for this new rule might be that certain market jurisdictions need to be compensated for limited tax collection under the current rules.

- Market jurisdictions would be able to claim more taxing rights, to the extent that they agree in advance to a mandatory dispute resolution mechanism.

In parallel, discussions are continuing on the establishment of a global minimum tax rate. Concrete proposals should be expected before the end of the 2019.

TUAC Comments

This proposal heads in the right direction because it recognises that introducing unitary taxation is unavoidable in an increasingly digitalised economy. However, the scope of the changes that are foreseen is too timid and, in practice, falls short of what is required to achieve fair and sustainable taxation. In particular, the impact of international tax rules on employment is insufficiently taken into account in the current debates. There are four avenues for ensuring the OECD process meets public expectations:

- Greater tax transparency is needed for informed discussions on reforms;
- Transfer pricing and profit allocation rules should move more clearly towards unitary taxation;
- A global minimum tax rate is necessary to curb profit shifting; and
- Public accountability should prevail in dispute resolutions.

Greater tax transparency for informed discussions on reforms

In 2015, the OECD BEPS agreement failed to deliver a public country-by-country reporting system for multinationals. These reporting obligations will need to be adjusted in light of the revised rules. Transparency has not been raised so far in the current discussions. Data on tax reporting is either retained by each tax national administration, or it is treated as proprietary information by private businesses themselves – in both cases it makes impact assessment far more difficult to achieve.

Making data on country-by-country reporting publicly available and accessible to all would ensure that all governments, OECD and developing countries, and all stakeholders can access the same level of information and make an informed assessment of the different proposals for reform. More transparency on tax practices is the best way to ensure trust and evidence-based decisions.

Furthermore, the information that companies are required to share with tax administrations is indispensable for labour relations at all levels of a company group. Workers' representatives need to have access to information on the financial and economic situation of their company.

Transfer pricing rules and profit allocation – more decisive shift toward unitary taxation

The OECD "arm's length" principle for allocating profits within multinationals has failed to achieve fair taxation, treating the different units in a company group as distinct entities, leaving too many opportunities for aggressive tax planning. The current rules are a strong incentive for multinationals to fragment their corporate structures. Empty shells and letterbox-type practices do not merely impact profit-shifting; they also obscure employment relationships and by-pass national laws and deplete national treasuries. Furthermore, profit levels of otherwise healthy companies are artificially affected, hampering investment in productive capacities and wages. For this reason, the trade union movement has long been taking a position in favour of unitary taxation, whereby the profits of multinationals would be identified at group level and profits would be allocated according to a formula-apportionment method.

The proposed "unified approach" would require companies to make greater use of unitary taxation, but this would apply to a small and in fact unclear part of profits. The reform could also encourage further manipulations by introducing a new distinction between the moving concepts of "routine" and "non-routine" profits ("non routine" are also referred to as "residual" or "above average"). In practice, this means that, far from addressing the problem of corporate fragmentation and its adverse impact on workers' rights, the reform would actually worsen it.

In this context, the OECD should enhance current impact-assessment processes to include economic analysis of greater shifts towards unitary taxation. As far as scope is concerned, thresholds and carve-outs are too important to be left to last-minute negotiations. Any such provision should be incorporated and addressed early on.

Global minimum tax rate – higher rate is necessary to curb profit-shifting

Whilst the OECD proposal for a "unified approach" covers only profit-allocation rules (known as "pillar 1"), the OECD process also entails discussion on the introduction of a global minimum tax rate ("pillar 2"). Agreement on a minimum tax-floor principle – including a right to "tax back" under-taxed foreign entities – would be much welcome, provided that it meets expectations. The concern remains that the right to "tax back" would not be set at a level close to domestic effective tax rates, but well below the OECD average. Whilst offshoring to very low-tax jurisdictions and tax havens may become less attractive for multinationals, profit-shifting and its impact on employment would not be curbed.

The design of pillar 2 will be very important to ensure its efficiency. In particular, a number of questions concerning the determination of the effective tax rate (blending, tax holidays) need to be solved.

Public accountability in dispute resolutions

The OECD also plans to introduce new and stronger rules on legally binding and effective dispute-prevention and -resolution mechanisms. The parallel discussions around investment treaties and dispute settlements mechanisms call for extreme caution in the tax debate. Such mechanisms should not grant privileges to companies over any other stakeholders and governments.

A public consultation is now open until 12 November. TUAC will actively contribute to the debate.