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

# OECD-hosted G20 Forum delivers a watered down proposal on the taxation of digitalised businesses

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## Key messages

On 31 January 2020, the OECD-hosted G20 Inclusive Framework, composed of over hundred countries, made progress to devise new rules for the taxation of multinationals' profits[i].

- Considering the number of national interests around the table, the complexity of the process, and the current state of multilateralism the agreement on a more precise roadmap for reform is welcome.
- The agreement covers new rules, known as "pillar one", for fully digitalised services, including online platforms and cloud services, but also to B2C and other consumer-related activities, and a progress report on a separate proposal to "tax back" undertaxed overseas profits (known as "pillar two").
- Pillar one agreement introduces a new unitary taxation rule reallocating a portion of profits to market jurisdictions irrespective of whether the company has a physical presence in the country or not.

On substance however, the proposed rules fall short of expectations.

- The proposed design for pillar one is excessively cautious, ensuring that most corporate profits would continue to be taxed according to the existing transfer pricing rules.
- Pillar one would also be the source of considerable complexity and arbitrary rules. Far from discouraging aggressive tax planning practices, the complexity of the proposed rules could in fact increase accounting tricks and regulatory arbitrage.
- The proposed scope is based on unclear and untested concepts ("residual profits", "consumer-facing activities").


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- Uncertainty remains with regard to implementation. The reference to an "alternative safe harbour" system is counter-productive and does not offer assurance that all countries wish to go ahead with tax reform
- No agreement was reached for the introduction of a minimum tax rate ("pillar two"). Yet, such roadmap would have offered the most positive prospects in terms of tax competition and increased tax revenues.

**The agreement**

On 31 January 2020[ii], the OECD-hosted Inclusive Framework on BEPS, comprising over 100 countries, agreed to principles on a reform of international rules for the taxation of multinational enterprises ('MNEs') to better account for new digital business models. The proposals are part of a G20 roadmap aiming at a definitive package by November 2020.

On substance, there are two "pillars" to the on-going discussions.

- Pillar one reviews the rules applying to the taxation of corporate profits of MNEs and how such profits should be allocated among countries.
- Pillar two consists in the introduction of a minimum effective tax rate, granting governments a right to "tax back" undertaxed overseas profits.

The agreement endorses broad principles for pillar one. It is on the other hand far more evasive on the prospects of agreement on pillar two, that section being marked as "work in progress".

The fact that the Inclusive Framework was unable to endorse the latter is of concern. According to first estimates, and in contrast with pillar one, the impact of pillar two on tax revenues could be quite substantial. The technical work of the OECD Secretariat continues but the fate of pillar two is uncertain at this stage.

*New taxing rights*

The agreement under pillar one would both come on top of, and reform existing rules on "transfer pricing" for the determination of taxable corporate profits. The agreement introduces a new unitary taxation rule for fully digital businesses and for B2C and other consumer-related activities by reallocating a portion of the consolidated group-wide profits to market jurisdictions in proportion of the volume of sales. The new rule would apply irrespective of whether the company has a physical presence in the country or not. This new taxing right (also known as "Amount A") would not apply to all corporate profits, but to "residual profits" only and above a given threshold.

The tax would apply to MNEs in excess of EUR750m turnover regarding the following activities:

- all automated digital services;
- business-to-consumer (B2C) activities and other forms of "consumer-facing" activities.

Automated digital services encompass: online search engines; social media platforms; online intermediation platforms, including the operation of online marketplaces, irrespective of whether used by businesses or consumers; digital content streaming; online gaming; cloud computing services; and online advertising services.

“Consumer-facing businesses” is a new concept, based on an enlarged understanding of business-to-consumer B2C activities. It encompasses traditional B2C activities but also the sale of consumer products through third parties, or intermediaries that perform routine tasks such as assembly and packaging. Thus would be included: personal computing products (e.g. software, home appliances, mobile phones); clothes, toiletries, cosmetics, luxury goods; branded foods and refreshments; franchise models, such as licensing arrangements involving the restaurant and hotel sector; and automobiles.

In addition, the new unitary taxation system would apply to businesses to the extent that they:

- exceed a certain level of profitability (yet to be determined); and
- exceed a certain level of extraordinary profits, (i.e. residual profits).This level also remains to be determined.

*Exemptions and implementation*

The new taxing right would exclude most business to business (B2B) transactions. According to the agreement, the proposal would hence require businesses to report on “sector segmentation” (in order to distinguish ”consumer-facing activities from others). The proposal also suggests an even more controversial “regional segmentation”, without elaborating on the justification for such segmentation.

In addition, three specific sectors are explicitly excluded from the scope:

- The extractive industry;
- The financial sector, except for “un-regulated” and fully digitalised activities, such as digital peer-to-peer lending;
- Ships or aircraft in international traffic.

In an attempt at addressing the complexity of existing transfer pricing rules (between the headquarter and the local subsidiary), additional rules are proposed. “Amount B” seeks in particular to fix an assumed level of remuneration for certain activities that take place in market jurisdictions. This is an effort to simplify the practical application of the arm length’s principle. “Amount C” covers any additional profit that would exceed Amount B. Under Amount C, the agreement puts considerable emphasis on the risks of double taxation, and the need for improved dispute resolution processes.

Logically enough, the proposal comes with the need for a new multilateral instrument (i.e. a convention) and new state-to-state dispute resolution mechanisms to give a legal ground for the creation of new taxing rights. And yet, despite the commitment by the Inclusive Framework to implement the proposal fully, the agreement leaves option open to an “alternative global safe harbour system”, at the request of the US Administration. It is not clear at all what the meaning of a “safe harbour” is. It would possibly allow for an opt-out system whereby individual MNEs could choose an alternative tax system with their jurisdictions of origin. In other words, corporations would be invited to choose the tax regime which suits them best.

**TUAC comments**

The on-going process began at the G20 level in 2017 – an acknowledgement that, despite the BEPS agreement in 2015, much remained to be done to address the taxation of digital economy. On the more technical aspects, the OECD was accepting the failures of the current transfer pricing rules (treating MNEs as an aggregation of single entities), which are particularly exacerbated in a digitalising economy. Steps towards unitary taxation (treating MNE as single entities) as seen in the proposal under pillar one is a long-standing trade union demand.

Considering the number of national and stakeholder interests around the table, the complexity of the process and the current state of multilateralism, the agreement on a more precise roadmap for reform is also welcome.

Yet, the inability to agree on pillar two is of major concern. Pillar two would indeed offer better guarantees in terms of addressing under-taxation of digital businesses and tax competition. The principle of a minimum tax rate is much needed because such reform could lead to an increase of tax revenues globally, not just for a chosen few. It could also limit profit shifting to tax havens to some extent.

On substance, the proposed design for pillar one is excessively cautious, ensuring that most corporate profits would continue to be taxed according to the existing transfer pricing rules. Indeed, the new taxing right (ie. "Amount A") would be effective after applying no less than five successive thresholds. These hurdles range from gross revenues thresholds, most likely EUR 750 M, to assessing what business profitability may justify the imposition of a new tax. Each of these thresholds would not only exclude the vast majority of MNEs from the tax reform, it would also be the source of considerable complexity and arbitrary decisions.

The reluctance to move too far away from the current transfer pricing system comes at the cost of increased complexity. Far from discouraging aggressive tax planning practices, the complexity of the proposed rules could in fact increase corporate manipulations.

More broadly, the proposed scope is based on unclear and untested concepts. This is all the more true for the concept of residual profits. It is also for the proposed rules to distinguish between within-scope "consumer-facing activities" from out-of-scope Business to business operations.

As part of the definition of scope, sector and "regional" segmentations are being considered. This means that businesses may rearrange the organisation of their business lines in order to avoid one or the other threshold. This will have a direct and unpredictable impact on the workforce. Regional segmentation may also mean that profits would have to be determined nationally, as opposed to the global level. The entire purpose of unitary taxation, the very essence of the reform, would thereby be defeated.

Uncertainty also remains with regard to implementation. The reference to an "alternative safe harbour" system is counter-productive and does not offer assurance that all countries wish to go ahead with tax reform, especially if such safe harbour would benefit US-based MNEs, where many fully digitalised businesses are headquartered (see as an illustration the [top 10 technology companies] by revenues).

The Inclusive Framework emphasises the importance of dispute prevention and dispute resolution mechanisms. This is logical considering the extreme complexity and arbitrary nature of the new rules. Bodies of experts are being evoked. This rings alarm bells in terms of independence and procedural safeguards.

Finally, most of these reforms involve a readjustment of country-by-country reporting rules. Unfortunately, transparency on business' tax practices do not appear to be part of the negotiations. The trade union movement has long expressed concerns about the confidential nature of tax strategies. Workers' representatives do need to have access to information on the financial and economic situation of their company, as well as the scale of investment into low tax jurisdictions.

### **Messages clés** *(traduction française)*

Le 31 janvier 2020, le Cadre inclusif du G20 animé par l'OCDE et composé de plus de cent pays, a progressé dans l'élaboration de nouvelles règles d'imposition des bénéfices des multinationales.

- Compte tenu du nombre d'intérêts nationaux autour de la table, de la complexité du processus et de l'état actuel du multilatéralisme, un accord sur une feuille de route plus précise pour la réforme est le bienvenu.
- Certaines des nouvelles règles, connues sous le nom de «premier pilier», s'appliqueraient aux activités entièrement numérisées, y compris les plateformes en ligne et les services Cloud, mais également aux activités « B2C » (prestation des entreprises aux particuliers) et à d'autres activités en « relation étroite » avec les consommateurs. L'accord contient aussi un rapport d'étape sur le projet séparé d'un droit d'imposition sur des profits sous-taxés à l'étranger ("pilier deux").
- Concernant le pilier un, l'accord introduit une nouvelle forme de taxation unitaire, réaffectant une partie des bénéfices aux pays de destination, que l'entreprise soit ou non présente physiquement sur ce marché.

Sur le fond cependant, les règles proposées ne répondent pas aux attentes.

- La conception du premier pilier est excessivement prudente, dans la mesure où la plupart des bénéfices des entreprises continueront d'être imposés conformément aux règles existantes en matière de prix de transfert.
- Le premier pilier pourrait également aboutir à plus de complexité et à de règles arbitraires. Loin de décourager les pratiques d'optimisation fiscale agressives, la complexité des règles proposées pourrait en fait accroître les manipulations comptables et les pratiques d'arbitrage réglementaire.

- Le champ d'application proposé est fondé sur des concepts peu clairs et non testés («bénéfices résiduels», «entreprises en relation étroite avec les consommateurs»).
- L'incertitude demeure aussi quant à la mise en œuvre. La référence à un «régime de protection alternatif» est contre-productif et n'offre pas l'assurance que tous les pays mettront en œuvre les mesures fiscales.
- Aucun accord n'a été trouvé pour l'introduction d'un taux d'imposition minimum («deuxième pilier»). Pourtant, une telle feuille de route aurait offert des perspectives les plus positives en termes de concurrence fiscale et d'augmentation des recettes fiscales.

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[i] http://www.oecd.org/tax/beps/international-community-renews-commitment-to-multilateral-efforts-to-address-tax-challenges-from-digitalisation-of-the-economy.htm
[ii] http://www.oecd.org/tax/beps/international-community-renews-commitment-to-multilateral-efforts-to-address-tax-challenges-from-digitalisation-of-the-economy.htm