OECD releases Work Plan for the Digitalizing Economy Project

May 31, 2019

In brief

The OECD's Inclusive Framework (IF) on May 28 approved an ambitious Work Plan for the Digitalizing Economy Project covering the next 18 months. Released May 31, the 40-page Work Plan notes the IF's aim of finding a consensus-based long-term solution for a new international tax architecture that addresses both the allocation of taxing rights and nexus as well as unresolved base-erosion/profit shifting (BEPS) issues.

While acknowledging the many gaps that might exist between how jurisdictions approach these issues, the Work Plan establishes an aggressive timeline for considering the development of rules and design standards to feed into delivering a unified framework acceptable to the IF. Important anticipated milestones include a progress report in December 2019 (in which a unified approach may be announced), ongoing Working Party discussions throughout 2019 and 2020, and a final report delivered to the G20 by the end of 2020.

In detail

Pillar 1

Regarding the current Pillar 1 profit allocation and nexus proposals – user participation, marketing intangibles, and significant economic presence – the Work Plan notes several common features, including existence of non-physical presence nexus, use of total business profits, and simplifying conventions to reduce compliance costs and disputes (which may depart from the arm's-length standard). In devising a new taxing right method to allocate some measure of profits among market jurisdictions, the Work Plan refers to certain options as key considerations: conceptually underpinned methods to determine profit/loss that avoid double taxation; simplification measures to limit burdens on taxpayers and tax authorities; and actual administrability of any solution.

The Work Plan indicates possible approaches and features for exploration, including a modified residual profit split (MRPS) method, a fractional apportionment method, distribution-based approaches, use of business line and regional segmentation, design scope limitations, and treatment of losses. The MRPS method would allocate a portion of a multinational entity (MNE) group's non-routine profit to market jurisdictions to reflect value creation not currently recognized; various alternatives will be investigated, including possible simplifications.

Observation: The MRPS method is envisioned to co-exist with existing transfer pricing rules, with necessary coordination rules implemented to minimize disputes and provide certainty.

The fractional apportionment method avoids breaking profits into routine/non-routine buckets and would allocate on the basis of another approach, such as overall profitability.

Regarding consideration of a distribution-based approach, the Work Plan offers exploring a simplified approach with the twin aims of more profit allocation to market jurisdictions while reducing ongoing controversies surrounding proper pricing of marketing/distribution activities. This might include specifying a baseline profit in the market jurisdiction, which could be increased based on a group's overall profitability, or relying on variables to accommodate industry and market differences.

The market allocation possibly would be a final allocation (i.e., not reviewable under current transfer pricing rules). Technical issues to be considered include whether the baseline could function as a minimum/maximum return, how to handle a group with no established tax presence in the market jurisdiction, and coordination with the existing transfer pricing system.

Numerous technical issues with all of the proposed plans and the surrounding design issues will be analyzed by the Working Parties (particularly WP1, 6, 10 and 11) and FTA MAP Forum, with reporting back to the Steering Group.

Development of a new nexus rule may be necessary, such as one based on the concept of remote taxable presence. Potential features could include amendments to the existing definition of permanent establishment in the OECD Model Convention (Articles 5, 7, and 9), or a stand-alone rule that looks to an MNE group's sustained and significant involvement in a market jurisdiction's economy.

Observation: In thinking about how any new taxing right will be implemented, important design goals will include elimination of double taxation, the ease of administration, and changes to existing tax treaties.

Pillar 2

This approach – dubbed the global anti-base erosion (GLOBE) proposal – considers the right of other jurisdictions to apply rules where income is taxed at an effective rate below a minimum rate; the intent is to ensure that all internationally operating businesses pay a minimum level of tax. The two inter-related rules under consideration involve an income inclusion component (such as a top-up or fixed percentage approach), and an anti-base erosion payment rule (such as an undertaxed payment rule or subject to tax rule).

Important design features to be explored include rule coordination, simplification, thresholds, and compatibility with international obligations. The potential role of a withholding tax is referenced as a design option.

Observation: The Work Plan makes clear that any new rule under this Pillar should not result in taxation where there is no economic profit, nor result in double taxation. The GLOBE is envisioned as a means to stop any 'race to the bottom' on tax rates and help developing jurisdictions better mobilize domestic resources.

Impact assessments

The Secretariat will be convening a multidisciplinary team to carry out economic analysis and impact assessments of the various proposals to understand the potential effect on levels and distribution of tax revenues, including effects on investment, innovation, and growth (including across different kinds of MNEs, sectors, and economies).

OECD remarks

In remarks to tax reporters regarding the released Work Plan, Pascal Saint-Amans, the OECD's tax chief, noted that: "the goal would be to have a political agreement on a unified approach by year-end. We have appetite from countries…but what I think matters most is by the end of 2019, in advance of that schedule, we have a political agreement on a clear architecture which will be the result of grand bargaining between countries. If we have that, then the implementation hopefully will be by the end of 2020."

The takeaway

The Work Plan sets out an ambitious timeline: agreement of a unified approach to Pillars 1 and 2 by the end of 2019 (with a progress report in December); simultaneous parallel work by various Working Parties on embedded technical issues; and a final report by the end of 2020. Any number of obstacles to finding consensus could arise in this process, especially in achieving a unified approach.

With the depth of issues confronting the IF to possibly radically change the international taxing rights framework, it is uncertain whether the Working Parties can work through the voluminous technical questions delegated for consideration in a manner to meet political timing constraints.

The Secretariat's commitment to carrying out economic analyses and impact assessments on various proposals and issues will need to be supported by external feedback; companies should mobilize to ensure that relevant data points and operational models are considered for thorough analysis.

See also:

April 17 Tax readiness webcast: The OECD project formerly known as digital

Let's talk

For a deeper discussion of how the issues reflected in the OECD Work Plan might affect your business, please contact:

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