OECD outlines work on future of international tax rules

**Background**

On 29 January 2019, the OECD Centre for Tax Policy and Administration (CTPA) hosted an OECD Tax Talk, and released a Policy Note, setting out significant new detail on work plans to address the tax challenges arising from the digitalisation of the economy (DoE), and to resolve remaining Base Erosion and Profit Shifting (BEPS) issues, still outstanding from earlier OECD work. A March 2019 public consultation was announced, feedback from which will inform a detailed work plan to be agreed by the G20 Finance Ministers in June 2019.

The proposals being put forward could have an impact on all businesses, going well beyond the highly digitalised ‘platform’ business models on which so much attention has focused in recent years. New rules would apply in place of well-worn international tax rules, from physical presence permanent establishment (PE) to the traditional transfer pricing (TP) arm’s length principle (ALP), for in-scope enterprises. In view of the 18 months set between the June 2019 G20 meeting and the end-2020 completion date the OECD CTPA Director, Pascal Saint-Amans, observed that the task is bigger than the BEPS project, and with less time. Businesses operating in China, both outbound and inbound, would be well advised to monitor these developments and consider participation in the upcoming consultation.

**Addressing digitalisation and remaining BEPS issues**

Work at G20/OECD level on DoE tax issues has been ongoing since 2013, resulting in the 2015 BEPS Action 1 report and the March 2018 TFDE Interim Report; see China Tax Alert Issue 8 of 2018. That report saw no consensus on a solution, but countries committed to explore changing nexus and profit allocation rules; this has now produced several proposals.
Four proposals have been put forward, and are grouped under two “pillars”. The three proposals under the first pillar look at changing the fundamental balance of international tax rules, allocating more of multinational enterprise (MNE) profits to the countries of markets or online users. These were described on the Tax Talk as being:

- User value creation approach: Originally put forward by the UK, this asserts that active user data and participation makes a significant contribution to profits for online advertising and gig economy businesses. Foreign enterprises could be treated as having a taxable presence in the user country, even without having a physical PE or subsidiary. A special new profit split, going beyond the TP ALP, could be used to attribute part of the MNE’s global residual profits (i.e. after remunerating the routine functions of MNE group entities) to the user country.

- Marketing intangibles approach: Proposed by the US, this would go broader than the above. Foreign enterprises whose businesses are highly reliant on marketing intangibles could be treated as having a taxable presence in a market country, on the basis of a new assertion that their marketing intangibles are “located there”. A new, non-ALP residual profits split would then allocate the part of global residual profits, attributable to marketing intangibles, into the market.

- Significant economic presence (SEP) approach: Advocated by India and Colombia, this would develop the BEPS Action 1 Report SEP (i.e. ‘virtual PE’) idea with a simplified profit allocation rule that would be easier for emerging economy tax authorities to apply.

Pillar 2 sets out a minimum tax rule, put forward by Germany and France, which would allow countries to ‘tax back’ profits of an MNE which have been ‘shifted’ into low tax countries. This would involve a special residence country CFC-style rule, drawing on the new US Global Intangible Low Taxed Income (GILTI) rule, as well as a source country base erosion rule, which could deny tax deductions on payments to countries where ‘low’ tax would apply. The coordination mechanism, the ‘minimum rate’, and other detail would need to be agreed.

**KPMG observations**

Work would proceed on these rules on a ‘without prejudice’ basis, meaning that countries would not be committed to particular outcomes. Nonetheless, it is clear that major changes are on the horizon. For businesses operating in China, whether with outbound or inbound operations, and whether being highly digitalised or more traditional, the rules emerging could have a profound impact on their global effective tax rates, their internal record keeping and tax risk management systems, their corporate structures, and their market competitiveness. A full consultation paper is set to be released by 12 February allowing three weeks for comments before the 13 March public consultation. Given the profound changes under consideration, businesses with a China connection are urged to study the document in detail, and raise concerns and issues for factoring into the work to 2020. Further KPMG updates will be released, and you can also read our recent DoE and tax article in *China Looking Ahead 2018*. 
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