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Osler submission to OECD on Public Consultation Document Addressing the Tax Challenges of the Digitalisation of the Economy

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Authors: Patrick Marley, Kaitlin Gray, <p>Amanda Heale</p>

Osler made a submission [PDF] to the OECD in response to its February 13, 2019 public consultation document on the possible solutions to the tax challenges of digitalization (the 2019 Public Consultation Document). Digitalization has been at the centre of OECD discussions about international tax and the curtailment of tax planning strategies that shift profits to low or no-tax jurisdictions. Our comments on the 2019 Public Consultation Document are principally directed to the impact of the proposals on the international tax framework, including fundamental changes to the existing profit allocation (transfer pricing) and nexus (permanent establishment) rules. In particular, we noted that the OECD's proposals go well beyond simply taxing the digital economy – and have numerous issues that may not be possible for the OECD to address.

The OECD proposed three alternative proposals for taxing the digital economy in the 2019 Public Consultation Document:

1. The "user contribution" proposal, which would require revisions to the existing profit allocation and nexus rules based on active user participation. This proposal focuses on the value created by highly digitalized businesses through developing an active and engaged user base and would target social media platforms, search engines and businesses operating in the gig economy.
2. The "marketing intangibles" proposal, which allocates intangibles to market jurisdictions, together with a proportionate share of income. This proposal would require changes to the existing nexus rules that go beyond the requirement of having a physical presence in the jurisdiction, would have a broader scope of application than the user contribution model, and would target all industries and not only highly digitalized business models.
3. "Significant economic presence," which we understand to establish a taxable presence or a virtual permanent establishment where revenues are generated in a jurisdiction combined with other factors such as a large user base and billing and collection in local currency, among others. The significant economic presence proposal is premised on the idea that the existing international tax framework is not fit for purpose.

The 2019 Public Consultation Document also includes proposals to curb continued profit shifting to entities subject to no or very low taxation through an income inclusion rule (including consideration of global minimum tax rates) and a tax on base eroding payments.

In our submission, Osler notes that by incorporating proposals addressing unresolved BEPS issues under the banner of digitalization, and providing a relatively short timeline to comment, the OECD has effectively hamstrung the process, potentially pushing through major proposals without meaningful public consultation.

We also provide comments on a number of practical issues under the proposals for taxing the digital economy in the 2019 Public Consultation Document. The OECD should not move forward with the proposals without addressing these issues, providing clear guidance and examples along with meaningful opportunities for public consultation to ensure that there are no anomalous results. In order for the proposals in the 2019 Public Consultation Document to work effectively, countries must, as a minimum standard, agree to (i) abandon any unilateral measures targeting similar activities that may have been adopted prior to adopting a consensus approach, and (ii) share losses (either prospectively or retrospectively) resulting from similar activities. The OECD should ensure that countries take into account aggregate taxation levels (including taxes arising under the proposals and all other forms of taxation including VAT and other indirect taxes) when assessing the negative impact that the proposals will have on investment and the economy. In addition, countries should not be allowed to cherry pick when extending their nexus to tax digital activities, and must provide relief for resulting losses (including start-up losses) rather than simply taxing resulting income.

For further information see the full text of Osler's submission [PDF] or contact any member of our Tax Department.