

Taxing the digital Economy: A realistic goal for 2020?

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An ambitious project

New year. New resolutions.

From an international taxation perspective, the resolution to reach in 2020 is a clear and an urgent one: worldwide consensus on how to tax the digital economy. It is all but a new project, considering that the discussion started 5 years ago. But 2020 has been set as the landmark-deadline year to find a common solution. Indeed, there is no more margin and no excuse for extensions.

The business world knows well why. Uncertainty in taxation can be costly and is certainly risky. Since the rise of the international debate, in the context of the Base Erosion and Profit Shifting (BEPS) Project, many countries introduced local digital taxes, others are in the process of doing so and others wait for the international response. The burden is then on business to find its way through this complex puzzle, with many pieces missing and with further changes lying ahead.

On the one hand, there is wide agreement on the urgent need to reach international consensus on the matter. On the other, this is not reflected in the actual stance of many highly influential countries. It is therefore questionable if a consensus solution on digital taxation is a realistic goal for 2020. Yet this is still the plan, negotiations are at a peak and for the first time a unified proposal is on the table for discussion at the end of January 2020.

In this light, the present article provides an overview of the unified proposal suggested by the OECD secretariat to set the basis for a consensus solution by the end of the year.

OECD's Unified Approach: Background

As mentioned above, it was five years ago, in 2015, in the context of Action 1 of the Base Erosion and Profit Shifting (BEPS) Project, that taxation of digital business was officially identified as problem. It was also recognized that this problem merited to be studied independently from the BEPS project, because its implications go much beyond base erosion.

The tax revenue at stake is quite high and therefore countries' intention to compromise low; as a result, progress in the debate has been rather slow. 2018 saw, thus, an interim report by the Task Force on Digital Economy and then a number of country-initiated proposed solutions.

The Unified Approach suggested by the OECD in autumn 2019 seeks a compromise of these proposals to the extent they deal with allocation of taxing rights on digital business. To this end it underlines the points where minds worldwide seem to meet:

- First, it is recognized that in digital economy, some taxing rights should be granted to the market or user/consumer jurisdictions.
 - Second, digitalization renders unnecessary physical presence for a business to generate income in a jurisdiction. Hence, a new nexus should be identified, focusing on economic presence.
 - Third, the fact that physical presence has become irrelevant necessitates the identification of new transfer pricing rules beyond the arm's length principle.
- In forming its proposal, the OECD also sought to take into account the need for tax certainty. OECD's proposal shall be discussed at the end of January 2020 with the purpose to reach consensus on the main principles of the common solution for digital taxation. The details of such solution should then be worked on and finalized by the end of 2020.

1 OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

2 OECD (2018), *Tax Challenges Arising from Digitalization – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

The Unified Approach: Brief Overview

Considering that the Unified Approach shall be the base for the discussion on the taxation of the digital, it is worth summarizing its key features, keeping in mind that many practical issues (e.g. tax rates, remain open questions).

First, in terms of scope, the new tax rights are suggested to apply to consumer-facing businesses. This would include (i) business that exploits new technologies to remotely interact with users/consumers as well as (ii) any business that has a “consumer-facing element”, i.e. markets its products or provides services to consumers. The rationale of the approach is that user engagement is important for value creation in all these cases. Where this is not the case, the business may be considered out of scope (extractive industries, e.g. oil and gas).

Second, the relevant factor for a business in scope to be taxable in a jurisdiction (nexus) should be related to the income such business is generating from that jurisdiction. In other words, economic presence would substitute physical presence for the business in scope. This recognizes that income can be generated remotely. But this does not imply that the jurisdiction of the (potential) user/consumer has not contributed to its generation. It is the jurisdiction that ensures the infrastructure for users/consumers to be users/consumers and should be fairly remunerated for that.

Third, transfer pricing rules should be adopted to the new context, i.e. to the potential absence of physical presence. This means that they should be maintained to the extent they can apply to routine transactions and new rules should be agreed for transactions not reasonably covered by the existing rules. These new rules should require:

- (i) A certain part of the business profit that remains after calculation of the profit from routine transactions to be taxed in market jurisdictions;

- (ii) Market jurisdictions would also have taxing rights over the income generating activities of the business there.

To ensure tax certainty, targeted dispute resolution mechanisms should ensure smooth and effective resolution of any disputes between the taxpayer business and the market jurisdiction.

Recent developments and conclusion

To conclude, the Unified Approach is a remarkable work by the OECD, seeking to promote an acceptable response to the burning question of taxation of the digital. It is an important step and provides an opportunity that should not be missed.

In view of the upcoming discussion at the end of January, tensions have apparently risen worldwide. The harsh exchanges between the US, France and the OECD are telling in this respect.

Yet this should not lead to losing sight of the big picture. Missing the opportunity for a common solution would undoubtedly lead to a lose-lose situation for all parties to the debate. While a compromise cannot be ideal for no one, the lack of a compromise will harm everyone.

It is critical that political leaders around the world find the way to an agreement this time.



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3 OECD (2019), *Secretariat Proposal for a “Unified Approach” Under Pillar One*, Public Consultation Document, 9 October 2019 – 12 November 2019, OECD Publishing, Paris.

4 T. Franck, CNBC, *Treasury Secretary Mnuchin warns of new global taxes, opposes digital services duty*, 4 December 2019.