

The Current Global Tax Policy Process: 10 Questions and Answers

by Jefferson VanderWolk

Reprinted from *Tax Notes International*, December 17, 2018, p. 1207

A Multinational Prescription for Global Tax Policy

by Jefferson VanderWolk



Jefferson VanderWolk

Jefferson VanderWolk is a partner with Squire Patton Boggs (US) LLP and former head of the tax treaty, transfer pricing, and financial transactions division at the OECD Centre for Tax Policy and Administration (2016-2018).

In this article, the author discusses the influence of the OECD inclusive framework on tax policy and its importance for multinational business in all sectors.

Copyright 2018 Jefferson VanderWolk. All rights reserved.

Q1: What is the OECD doing now? I thought the BEPS project was over.

A1: The G-20/OECD base erosion and profit-shifting project has evolved into the Inclusive Framework on BEPS, a truly global tax policy body made up of more than 120 member countries, including the United States and all the other major national economies of the world.¹ This evolution was contemplated during the initial two years of the BEPS project. The BEPS inclusive framework's mission is described by the OECD as follows:

Countries and jurisdictions are now working together on implementing the BEPS package consistently on a global basis, and to develop further standards to

address remaining BEPS issues. To these ends, the decision-making body for the OECD's tax work — the OECD Committee on Fiscal Affairs (CFA) — has been opened up to interested countries and jurisdictions to put in place an Inclusive Framework on BEPS. The Inclusive Framework on BEPS held its first meeting on June 30 and July 1 of 2016 in Kyoto, Japan, and the second on January 26 and 27 of 2017 in Paris.²

Members of the framework work on an equal footing to tackle tax avoidance, to improve the coherence of international tax rules, and to ensure a more transparent tax environment. Specifically, the framework:

- develops standards regarding remaining BEPS issues;
- will review the implementation of agreed minimum standards through an effective monitoring system;
- monitors BEPS issues, including tax challenges raised by the digital economy;³ and
- facilitates the implementation processes of the members by providing further guidance and by supporting development of toolkits to support low-capacity developing countries.⁴

Q2: I've heard about BEPS implementation through peer reviews and the like, but what are the "remaining BEPS issues" for which the BEPS inclusive framework is developing standards?

² Further meetings of the BEPS inclusive framework were held in June 2017, January 2018, and June 2018. The next meeting will be in January 2019.

³ The digital economy work has evolved into much more than mere monitoring.

⁴ OECD, "Background Brief: Inclusive Framework on BEPS," at 8 (2017). It is not clear whether the framework will exist for a limited time or indefinitely, but it will exist at least until the end of 2020.

¹ The BEPS inclusive framework had 124 members as of November 2018; see OECD, "Members of the Inclusive Framework on BEPS" (Nov. 2018).

A2: Two major areas of unfinished business, in the view of many countries, are transfer pricing (which was covered by actions 8-10 of the BEPS action plan) and the tax challenges presented by the digitalization of the global economy (as outlined in action 1 of the BEPS action plan).

On transfer pricing, some countries believe the work under actions 8-10 made the OECD's transfer pricing guidelines more complex and difficult to apply in practice for tax administrations and taxpayers alike. Consequently, these countries suspect that well-advised multinationals will continue to shift profits to low-tax locations while arguing that their transfer pricing complies with the arm's-length standard as dictated by the OECD guidelines. Moreover, some countries believe the transfer pricing rules fail to allocate income appropriately to the demand side of the supply-and-demand chain of value creation. Specifically, the use of development, enhancement, maintenance, protection, and exploitation (DEMPE) analysis to allocate income related to intangibles is viewed by some delegates as a flawed approach.⁵

On the tax challenges posed by the increasing digitalization of the global economy, the BEPS inclusive framework restarted work on this issue in late 2016, after the OECD had deferred it in 2014 on the basis that the entire economy was becoming digital and so it would be impossible to ring-fence one sector defined as "the digital economy." Subsequent political developments in Europe and elsewhere have increased the pressure for a consensus-based solution and have thrust the OECD's work in this area into the spotlight.

Q3: Hasn't the OECD's work on digitalized business taxation been preempted by the digital services tax (DST) proposals of the United Kingdom, the European Commission, and others?

⁵ This is even though DEMPE analysis and all the other guidance developed under actions 8-10 were agreed on by all the countries involved in the process in 2015. The multinational business community has a very different perspective on the effects of the current transfer pricing rules. Moreover, U.S. multinationals now live in a world where the global intangible low-taxed income rules mean that a significant level of tax must be paid on all foreign-derived income other than routine returns on tangible property.

A3: No. On the contrary, those unilateral proposals have given added importance to the OECD's work. Not only have major players such as the United States and the Nordic countries urged the EU finance ministers to wait for the OECD process to play out, many of the DST proponents themselves, such as the United Kingdom, have designed their proposals to give the OECD time to reach agreement on a long-term solution by 2020.⁶ Similarly, countries such as Australia and New Zealand appear to be inclined to wait and see what emerges from the OECD process before making any decision about their own tax policy.⁷

Q4: If the focus is on taxing the tech giants — Google, Amazon, Facebook, Apple, Netflix, and the like — why should multinationals in other sectors care about the OECD's work on this issue?

A4: Others should care because the focus is broadening. The rapid digitalization of the economy has caused the OECD process to evolve to have a much wider scope. With the support of the OECD's Centre for Tax Policy and Administration, the BEPS inclusive framework is looking at options for a long-term solution to perceived tax challenges presented by the digitalization of business models in all industries, not only internet-based businesses. Therefore, all multinational corporations should be aware that the outcome of the current discussions at the OECD may have a significant impact on their businesses and should seriously consider what steps they might take to influence that outcome.

Q5: How is the policy work being done, as a practical matter? And how far has it progressed?

A5: The BEPS inclusive framework's work in this area has been delegated to a subsidiary body called the Task Force on the Digital Economy. This is a misnomer, given that the task force stated in its initial report that there is no digital economy that can be ring-fenced from the rest of the global

⁶ The latest proposal for an EU DST, at the time of writing, would defer implementation of the new tax to 2021, and then only if the OECD process fails to produce an agreement on a long-term solution. See European Council, "Franco-German Joint Declaration on the Taxation of Digital Companies and Minimum Taxation" (Dec. 4, 2018).

⁷ New Zealand Tax Working Group, "Future of Tax: Interim Report" (Sept. 2018); and Australian Treasury, "The Digital Economy and Australia's Corporate Tax System," Treasury Discussion Paper (Oct. 2018).

economy.⁸ Rather, the operating assumption now is that all types of businesses, of all sizes and in all sectors, are adopting digital tools and processes — in various ways — in their different business models. A more accurate name for the group would therefore be the Task Force on Multinational Corporate Income Taxation.

The tax policy challenges initially identified as the focus of the task force's work were twofold. First, the internet has enabled remote sellers of goods and services to compete effectively in markets where they have no physical presence and thus no taxable presence for income tax purposes (as opposed to VAT/consumption tax purposes). Second, the ever-increasing value of intangible assets such as computer algorithms and name brands arguably made it easier — at least before the BEPS project — for multinationals to allocate profits to low-tax locations where those intangibles were located for income tax purposes. One challenge that was identified regarding intangibles was the question of whether profits should be allocated to the value that may arise from user contributions (such as user reviews on Amazon, videos uploaded to YouTube by members of the public, or personal data gathered from users of Facebook or Google).

Following 18 months of research and discussion, the task force issued an interim report in March, with the approval of the BEPS inclusive framework.⁹ The interim report concluded that the task force needed to undertake further study of possible changes to the existing international standards regarding taxable nexus and the allocation of profits among countries. The report acknowledged that countries were divided about the right approach to finding a long-term solution. (The question of short-term solutions, such as the European Commission's DST proposal, was essentially set aside by the task force.) One group of countries, led by the United Kingdom, argued for a "user contribution" approach addressing only large internet-based businesses that derive significant value from user contributions.

Another group, led by the United States, preferred an approach that would apply to all industries and would modify (or clarify) current international standards of transfer pricing to ensure that a greater share of the value of marketing intangibles was taxed in the relevant market or destination jurisdictions. Countries advocating such an approach have stated that while it would allocate greater profit to the market jurisdiction, it should not be interpreted as a wholesale move to market- or destination-based taxation.

A third group, including Ireland, Sweden, and others, advocated doing nothing until enough time has passed to be able to assess the effectiveness of the various BEPS project measures, including changes to the transfer pricing rules and the threshold for taxable presence under the model tax convention. Although the third group's position is consistent with what was agreed in the final report on BEPS action 1, it seems to have been superseded by later events.

Q6: Are those three alternative approaches still the only options under discussion?

A6: No. More recently, a new approach has been put forward by Germany and France. These countries are suggesting that every country adopt (1) controlled foreign corporation rules that impose tax at the parent-company level, at a non-trivial rate, on global profits exceeding routine returns on tangible assets (like the U.S. global intangible low-taxed income rules); and (2) anti-base-erosion rules that would deny deductions or, alternatively, deny treaty benefits, such as a withholding tax exemption, for payments to low-taxed nonresident affiliates (somewhat like the U.S. base erosion and antiabuse tax rules). The German Finance Ministry has called this proposal the global anti-base erosion (GLOBE) approach.¹⁰

Although the GLOBE approach does not directly address the ability of remote sellers to compete in a market without having a taxable presence there, it does deal with the desire to do something about profit shifting via transfer pricing. Moreover, it would do so without the

⁸ OECD, "Addressing the Tax Challenges of the Digital Economy, Action 1 — 2015 Final Report," at 11-13 (2015).

⁹ OECD, "Tax Challenges Arising From Digitalisation — Interim Report 2018: Inclusive Framework on BEPS" (2018).

¹⁰ See, e.g., Stephanie Soong Johnston, "Germany, France Explore GLOBE Proposal to Tax Digital Economy," *Tax Notes Int'l*, Nov. 19, 2018, p. 782.

need to make radical changes to the transfer pricing guidelines or the model tax convention. And it would be politically attractive to policymakers by ensuring that (1) multinationals are taxed somewhere on all their profits at a meaningful rate, and (2) market countries can tax at least part of the profits of remote sellers from sales to local customers. It's worth noting that the United States is unlikely to oppose the GLOBE approach, as it is conceptually similar to the GILTI and BEAT regimes enacted in the United States last year. Also, the U.S. model treaty has a special-regimes provision that is conceptually like the contemplated treaty element of the GLOBE approach.¹¹

It's possible that the BEPS inclusive framework will pursue work on both the GLOBE approach and either the user participation approach or the marketing intangibles approach to income allocation and taxable presence. Given that the United States opposes the user participation approach, it appears more likely that the framework will opt to explore the viability of the marketing intangibles approach.

Q7: What will the task force and the BEPS inclusive framework do next?

A7: Following the task force's meeting of early December, it will report to the BEPS inclusive framework at the next meeting of the plenary body in late January 2019. If the framework can agree on pursuing one or more of the alternative approaches under discussion, the task force will proceed to work on the details of the chosen approach, with a view to submitting a second interim report to the G-20 finance ministers in mid-2019.

Depending on what is agreed on in January, the work on details during the first half of 2019 is likely to be delegated to one or more of the OECD's working parties, such as Working Party 6 (multinational enterprises), which deals with transfer pricing; Working Party 1 (tax conventions and related questions), which deals with treaties; or Working Party 11 (aggressive tax planning), which deals with CFC rules and base-eroding payments (among other things).

¹¹ See article 28(1) of the U.S. Model Income Tax Convention (2016).

The OECD is committed to delivering, on behalf of the BEPS inclusive framework, a final report to the G-20 in 2020, with details of the agreement (assuming there is an agreement) on a long-term solution.

Q8: Isn't the OECD (and the task force and the BEPS inclusive framework) just a talking shop? What makes people think that its conclusions — if an agreement is reached — will have any effect in the real world?

A8: All 124 BEPS framework countries are participating in the OECD-led process to find an agreed, multilateral, long-term solution to what is widely perceived to be an international tax policy issue that many countries would address unilaterally in the absence of a multilateral agreement. This work is fully supported at the highest political level: the G-20 leadership.¹² Moreover, all the framework countries have managed to reach agreement on the BEPS minimum standards and measures to monitor the implementation of those standards, and to "name and shame" through a peer review process any countries that fail to live up to their agreement. For treaty-based standards, the multilateral instrument is now available as a tool to update large numbers of bilateral tax treaties in a short period of time. For transfer pricing standards, the OECD's transfer pricing guidelines are already incorporated into the domestic laws of some countries and are relied on as persuasive authority by the courts in many more countries. Global tax policymaking at the OECD, at least regarding corporate income tax on multinational groups, appears to have become a reality.

Thus, it is possible — perhaps likely — that a new, globally harmonized approach to multinational corporate income taxation will be determined over the course of the next year or two, and then implemented over time by countries individually. As with the BEPS

¹² "We will continue our work for a globally fair, sustainable, and modern international tax system based particularly on tax treaties and transfer pricing rules, and welcome international cooperation to advance pro-growth tax policies. Worldwide implementation of the OECD/G20 Base Erosion and Profit Shifting package remains essential. We will continue to work together to seek a consensus-based solution to address the impacts of the digitalization of the economy on the international tax system with an update in 2019 and a final report by 2020." G-20, "G-20 Leaders' Declaration: Building Consensus for Fair and Sustainable Development," para. 26 (Dec. 1, 2018).

minimum standards, such as country-by-country reporting, a peer review system would probably be established to monitor compliance with the agreement.

Q9: What should multinational businesses be doing at this point?

A9: Companies with international operations should be monitoring developments closely so they can factor them into their long-term plans. They should also be thinking about which of the alternative approaches would be best (and worst) and preparing to act when the process reaches the point at which it is a strategic imperative for the company to try to influence the outcome of the OECD process, either individually or through industry associations or other groups. At that stage — which arguably has already arrived — multinationals will need to advocate their preferred approach directly to the policymakers who are participating in, and influencing, the process. This includes senior OECD officials based in Paris as well as country representatives from, for example, Treasury, European finance ministries, and the tax policy units of other G-20 countries such as Japan, China, India, Australia, and Canada. And given that tax policy is heavily influenced by political considerations, advocacy efforts directed at political players are advisable as well.

Q10: Doesn't the OECD normally ask the public to comment on discussion drafts before finalizing any recommendations on an issue?

Why shouldn't companies wait for that to happen?

A10: Although it's possible that at some point the task force will formally consult with the public, including the business community, it cannot be assumed that comments submitted in response to such consultation alone would be influential. By the time a discussion draft has been written and published, much of the debate among policymakers on the issues will already have occurred. To be effective, the business community will need to promote their views in this matter proactively, with detailed, practical suggestions, as U.S. business representatives do in the halls of Congress and Treasury in Washington. Written communications are of course one method of advocacy, but face-to-face meetings are advisable (at least by video conferencing, if not in person).

The stakes are too high for multinationals to allow the OECD/BEPS inclusive framework to proceed in the traditional way, without significant ongoing input from those who will be affected by the outcome of the process. Policymakers need to understand evolving business models and processes so that they can balance concerns about inappropriate allocations of income and taxing rights against the risk that undue tax burdens could stifle economically beneficial innovation using digital tools and processes. In a new world of global tax policymaking, there needs to be a new kind of global tax policy engagement and advocacy as well. ■