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INSIGHT: The OECD's Global Anti-Base Erosion Proposal Raises Many Questions

BY JEFFERSON VANDERWOLK

The OECD's February 13 public consultation document on ''Addressing the Tax Challenges of the Digitalisation of the Economy'' discusses policy proposals under two headings. The first heading is ''Revised profit allocation and nexus rules'' relating to the challenge, for market countries, of imposing income tax on the profits of non-resident companies selling to local customers through the Internet. Under the second heading, ''Global anti-base erosion proposal,'' the Organization for Economic Co-operation and Development (OECD) describes a combination of rules that were reportedly suggested in the latter half of 2018 by Germany and France as a means of implementing what is essentially a global minimum tax regime for all multinational enterprises, regardless of where the parent company resides. The link between the two parts of the consultation document is not readily apparent.

The consultation document is the latest in a stream of publications on the topic that began in September 2014 with the Interim Report on BEPS Action 1 (Addressing the Tax Challenges of the Digital Economy). Since that first report, we have had:

- the October 2015 Final Report on BEPS Action 1;
- a September 2017 paper titled ''Request for Input on Work Regarding the Tax Challenges of the Digitalised Economy'';
- a March 2018 report, ''Tax Challenges Arising From Digitalisation—Interim Report 2018'';
- an October 2018 policy note, ''Tax and Digitalisation''; and
- a January 2019 policy note, ''Addressing the Tax Challenges of the Digitalisation of the Economy—Policy Note.''

The first mention in those documents of ensuring that profits would be taxed somewhere at a certain minimum level was in the January 2019 policy note—the last of that series. This was quickly followed by the public consultation document just two weeks later. All of the other reports and papers dealt only with the nexus and profit allocation questions that arise from the ability of multinationals to conduct substantial business, via the internet, in countries where the seller has no taxable presence under current international tax norms.

The consultation document provides only a brief explanation of why the global anti-base erosion proposal was added into the mix. First, it says that certain countries are concerned that the recommendations from the BEPS Project are not adequate to prevent base erosion. Second, it says that ''in the absence of multilateral action there is a risk of un-coordinated, unilateral action, both to attract more tax base and to protect existing tax base'' (Paragraph 90), prompting a proposal for ''a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax.'' (Paragraph 91)

The quick responses to these points are:

(1) it is too early to judge the effectiveness of the BEPS Project's recommendations, which are still in the early stages of being implemented in domestic laws, in each case with prospective effect only;

(2) the risk of uncoordinated unilateral actions was a driver for the BEPS Project generally, and has no particular relevance to the idea of a global minimum tax; and

(3) one of the original, and arguably fundamental, premises of the BEPS Project was that each country has the right to set its own tax rates, including very low or even nil rates (a premise repeated in the consultation document itself).

Adding to the sense that further thought is needed is the assertion in the consultation document that the proposal allows countries ''to 'tax back' profits where other countries have not sufficiently exercised their primary taxing rights.'' What (and whose) is the standard for a ''sufficient'' exercise of a country's taxing rights? What if a country chooses to raise all of its revenue from taxes other than a tax on business profits? Do the countries of the Inclusive Framework really believe that every country should be required to impose a ''sufficient'' tax on business income?

Those who have followed the digital taxation debate closely will recall that the OECD's March 2018 Interim Report said that the Inclusive Framework countries were divided into roughly three groups: those who favored a targeted approach based on user contributions, those who favored a broader approach based on marketing intangibles, and those who thought no changes should be made in the international tax rules until the effect of the BEPS Project could be fully assessed. What happened to the third group?

Given that the Inclusive Framework already has a big job on its hands in trying to find a long-term solution by next year to the nexus and profit allocation issues arising from digitalization, it is hard to understand why it has added a global anti-base erosion proposal to the current work of the Task Force on the Digital Economy. If political considerations dictate that the proposal needs to be discussed, it should be discussed separately and deliberately. The stakes are too high for a rushed process.

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