

Digitalisation of the Global Economy

Navigating the Tax Challenges

July 2019



Taxation and the Digitalisation of the Global Economy

On 31 May 2019, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) (the Inclusive Framework) published a much-anticipated update on its work on addressing the tax challenges of the digitalisation of the global economy. The document, [Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy](#) (the Programme of Work), plots an ambitious “road map” towards concluding a new global agreement for the taxation of multinational enterprises (MNEs).

Welcoming the progress, the G20 Finance Ministers officially endorsed the Programme of Work at their meeting in Fukuoka, Japan, on 9 June, committing themselves to “redouble [their] efforts for a consensus-based solution with a final report by 2020”.¹

Those redoubled efforts will be necessary, as the vast majority of work still needs to be undertaken. The final “design architecture” of the new agreement is yet to be decided. Progress along the path will, the Inclusive Framework readily acknowledges, depend on “political engagement and endorsement” over the next few months.

The quickening pace of the digitalisation of the economy has seen numerous jurisdictions begin to take matters into their own hands. The imperative to find consensus quickly is explicit in the Programme of Work: “if the Inclusive Framework does not deliver a comprehensive consensus-based solution . . . there is a risk that more jurisdictions will adopt uncoordinated unilateral tax measures [both to attract more tax base and to protect existing tax base] . . . that risk significantly increasing compliance burdens, double taxation and uncertainty.”

The Programme of Work is the latest refinement of the OECD’s analysis of the complex and far-reaching tax challenges arising from digitalisation. The project has progressed from a relatively narrow examination of the digital economy², through an assessment of the digitalisation of the global economy³ to what now (potentially, at least) represents a fundamental overhaul of the framework of international taxation. The significance of this evolution cannot be emphasised enough. The Programme of Work does not propose a simple update for that framework – that was the purpose and achievement of the original BEPS Project – but rather fundamental changes in some of the principles of the taxation of cross-border business income of MNEs.

In this alert, we examine the Programme of Work and consider the response from, and implications for, key jurisdictions around the world.



1 Ministry of Finance, Japan, [Communiqué: G20 Finance Ministers and Central bank Governors Meeting, Fukuoka](#), 8-9 June 2019.

2 OECD (2015), [Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report](#), OECD/G20 Base Erosion and Profit Shifting Project.

3 OECD (2018), [Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS](#), OECD/G20 Base Erosion and Profit Shifting Project.

OECD: Finding the Path

Despite the magnitude of the OECD's ambition, the Programme of Work does not itself reveal much in the way of detailed, technical progress. The Programme of Work draws heavily on the Policy Note⁴ released at the end of January 2019, and the more detailed Public Consultation Document⁵ released at the beginning of February 2019 (and [analysed by us](#)).

Obstacles

The problems encountered under the current system of international taxation are now familiar:

- **Scale without mass** – Current rules do not adequately address the ability of MNEs to participate in the economic life of a jurisdiction without a physical, taxable presence in the jurisdiction.
- **Intangible assets** – Digitalisation relies on intangible assets (including, for example, intellectual property), which have no physical location.
- **Data and user participation** – Digitalised business depends on the value and importance of data gathering and user participation, which do not always have income tax consequences in source jurisdictions.

The design parameters outlined by the Programme of Work for a comprehensive consensus-based solution are unchanged since January. The solution needs to meet several political imperatives, including:

- Balancing precision and simplicity
- Being based on sound economic principles and concepts
- Ensuring a “level playing field” between all jurisdictions, irrespective of size and the level of development
- Aligning taxation with economic activity (without triggering double taxation)

The Two Pillars

The Inclusive Framework will examine multiple proposals and possibilities under the same two pillars set out in the Policy Note:

1. Pillar One: New Taxing Rights

Pillar One will redraw the international rules for the allocation of profits and nexus (i.e. taxable presence). It will determine how different countries will share the right to tax cross-border income. The new rules will allocate more taxing rights to the jurisdiction of the customer (i.e. the market jurisdiction) and, for the first time, will recognise nexus in circumstances absent any physical presence.

However, exactly what the new taxing right will look like and how it will work has not been determined. A number of different options remain for both the profit allocation and the nexus component parts of the rules.

• Revised Profit Allocation Rules

The new rules will prescribe a new method for determining the amount of profit (or, significantly, loss) subject to the new taxing right and for allocating those profits or losses among different jurisdictions.

The methods considered in the Programme of Work include:

- I. **Modified Residual Profit Split (MRPS)** – That is, identifying “non-routine” profits (in essence, the excess return that results from an MNE's engagement with the economy of the market jurisdiction) and allocating them to the market jurisdictions using, broadly speaking, existing transfer pricing rules.
- II. **Fractional Apportionment** – That is, “formulary apportionment”. Fractional apportionment avoids the complexity of MPRS by eliminating the need to identify routine and non-routine profits. It would apply to an MNE's consolidated global profits and allocate them between jurisdictions according to a set “allocation key” or formula.

Traditionally eschewed by the OECD as overly simplistic and inconsistent with the arm's length principle of transfer pricing, fractional apportionment would represent a momentous transformation of the principles upon which the international tax system is built.
- III. **Distribution-based “simplified methods”** – That is, methods that contemplate using fixed baseline profit margins for activities taking place in market jurisdictions, and amending traditional transfer pricing principles to allocate a higher return to such activities.

In any case, it seems likely that some sort of formulaic allocation method will be adopted. Therefore, there must be a risk that the use of some sort of arbitrary allocation key for multiple different scenarios will lead to some odd consequences. It remains to be seen who the resulting winners and losers will be.

4 OECD (2019), [Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note](#), as approved by the Inclusive Framework on BEPS on 23 January 2019.

5 OECD (2019), [Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy](#), 13 February 2019.

• Nexus

The new rules for establishing taxing rights will also include a new concept in international taxation: that of a remote, non-physical, taxable presence.

The Programme of Work contemplates the recognition of a non-physical, taxable presence through either:

- I. The expansion of the current definition of what constitutes a “permanent establishment” (PE) by deeming a PE to exist where an MNE has “a remote yet sustained and significant involvement in the economy”
- II. The creation of an entirely new and separate rule for a non-physical nexus that would operate in addition to the concept of PE

In either case, the key consideration in determining nexus will be determining the indicators that demonstrate an MNE is operating in the economy of a jurisdiction (beyond mere sales to customers located there from a remote location) and generating local revenue at or above a certain threshold.

The Programme of Work also recognises the need to ensure the new taxing right does not lead to double taxation, adversely impact existing tax treaties, or cause administrative complications. Of course, this is easily said but is much more difficult to design and implement.



2. Pillar Two: Global Anti-Base Erosion Rules

Pillar Two is intended to plug any gaps left by the original BEPS Project. While recognising that taxation remains a sovereign matter, Pillar Two envisages the introduction of a global minimum tax: the global anti-base erosion (GloBE) proposal.

This proposal is not limited to highly digitalised businesses. As the Programme of Work states, “it proposes a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax [and] helps to address the remaining BEPS challenges linked to the digitalising economy.”

The GloBE proposal is comprised of two rules:

• Income Inclusion Rule

The first part of GloBE is an income inclusion rule. This essentially represents an extension of existing controlled foreign corporation (CFC) principles. The new rule would allow a jurisdiction to tax a resident owner of an overseas subsidiary (or, via a “switchover” rule, a foreign branch) on the income of that overseas entity if that income is subject to tax at an effective rate below a minimum rate (as yet unspecified). The aim is simply to reduce the incentive to shift profits to low-tax jurisdictions.

The income inclusion rule could impose:

- I. An internationally agreed minimum rate (setting a floor for global tax competition) on an MNE’s global income. The Inclusive Framework countries consider this the simplest, most transparent and, therefore, most attractive option (although there is no current agreement on what the minimum rate should actually be).
- II. A minimum tax tied to the parent jurisdiction’s main rate of corporation income tax (CIT). The Inclusive Framework’s view is that this alternative would “result in a more complex and opaque international framework, given the significant variance in CIT rates”.
- III. A minimum rate within an acceptable range, which would depend on other design features of the GloBE proposal.

In all cases, the efficacy of the new rule will depend on accurately, and consistently, calculating the taxable income of entities. CFC rules calculate taxable income by applying the domestic rules applicable to the parent. However, adopting this approach on a global level would inevitably result in discrepancies, compliance complications, and double taxation. One solution the Inclusive Framework members are considering (which is not without its own challenges) is aligning the tax calculations more closely with international standards for financial accounting and reporting, but achieving consensus on the precise design will be problematic.

• Tax on Base Eroding Payments

The second part of the GloBE proposal deals with how source jurisdictions can protect themselves from base eroding payments.

Again, the Inclusive Framework members are considering multiple options. The tax on base eroding payments could take the form of either (or both):

- I. **An undertaxed payments rule** – This would deny deductions for (or impose a form of withholding tax on) payments to related non-residents if such payments were taxed in the hands of the related party at less than a minimum rate.
- II. **A “subject to tax” rule in tax treaties** – This proposal, necessitating significant modifications to bilateral double tax treaties, would impose a form of withholding tax on an outbound item of income (most likely interest and royalties in the first instance) and deny the availability of certain treaty benefits unless that income was subject to tax at a minimum rate.

Further technically complex work is required on a number of issues raised on the GloBE proposal, including (among others) rule coordination, targeting and proportionality, simplification measures, thresholds, carve-outs, avoiding the risk of double taxation, minimising administration costs, interaction with other parts of the BEPS Project, and compatibility with other international obligations.

Economics and Impacts

The policy choices are extensive and difficult. To help narrow down the options, and ultimately form a consensus around a comprehensive solution, the OECD is also committed to conducting detailed economic analysis and impact assessments of each component of each proposal “to support members of the Inclusive Framework to take decisions in relation to the future direction of the overall programme of work”. The impact analysis, looking at revenue, economic and behavioural implications for different sectors, industries and business models, will be critical in helping inform the political negotiations that will inevitably dictate the final shape of any comprehensive consensus-based solution. The Programme of Work states, “in addition to the important technical work that must be carried out, [a solution will] require political engagement and endorsement as the interests at stake for members go beyond technical issues and will have an impact on revenues and the overall balance of taxing rights.”

The Way Ahead

The Inclusive Framework will work on the proposals during the summer, operating through a number of Working Parties. The first priority will be to reduce the number of different options under Pillar One. The Working Parties will inform a Steering Group working on developing a unified approach. The Steering Group will recommend “the core elements” of a comprehensive consensus-based solution at the beginning of 2020. Assuming all proceeds as planned, next year will see the technical detail added, with a final report and recommendation expected to drop before the end of 2020.



United States – Digital Tax Politics Makes Bipartisan Bedfellows

Turning to the US political perspective, the increased chatter on a World-Order-Imposed digital tax has allowed for something rarely seen in the current US political climate: bipartisanship. In fact, digital tax proposals have brought together the Trump Administration and Capitol Hill's top tax writers – Republicans and Democrats alike – to call on other countries to abandon unilateral digital tax measures. For US lawmakers, the logic behind the show of unity is relatively straightforward – protect the US taxing authority and prevent other countries from using American companies to boost their tax revenues.

On 10 April 2019, the four leaders of the tax-writing committees released a joint statement on OECD negotiations to address the tax challenges of the digitalisation of the economy. Senate Finance Committee Chairman Chuck Grassley (R-IA) and Ranking Member Ron Wyden (D-OR), and House Ways and Means Committee Chairman Richard Neal (D-MA) and Ranking Member Kevin Brady (R-TX), all expressed their support for US involvement in the OECD negotiations. They urged other countries “to focus on and engage productively in the OECD dialogue in order to reach measured and comprehensive solutions”. Further, the top tax writers affirmed that even on an interim basis, “unilateral actions, such as digital services taxes [DST] proposed by some countries, can adversely affect U.S. MNEs and have negative economic and diplomatic effects.” The current proposals of the French government to introduce a DST, with retroactive effect from 1 January 2019, have come under particular attack. In a recent release, the Senate Finance Committee urged US Treasury Secretary Steven Mnuchin “to consider using all tools available under U.S. law, including the application of Section 891 of the U.S. Internal Revenue Code⁶, to convince the French government to rethink its decision”. The letter is illustrative of the irritation felt in Washington DC, describing the French plans as “short-sighted” and “a new transatlantic trade barrier” that could even jeopardise the Inclusive Framework’s effort to find global consensus.

Ways and Means Committee Ranking Member Brady has gone even further in his public statements, and has certainly not minced words on his opposition to digital tax proposals. In fact, he has referred to himself as a leader in “fighting for U.S. companies to not be subject to double taxation from this blatant revenue grab”. Strong words from these powerful lawmakers of both parties suggest that digital tax proposals will face stiff resistance from Capitol Hill in the weeks and months ahead.

Bipartisanship on this issue, however, is not limited to US lawmakers. On 25 October 2018, Treasury Secretary Steven Mnuchin made similar comments to those noted above in a public statement. Specifically, Secretary Mnuchin highlighted “strong concern with countries’ consideration of a unilateral and unfair gross sales tax that targets our technology and internet companies”. He added that a “tax should be based on income, not sales, and should not single out a specific industry for taxation under a different standard.” Moreover, he urged US economic partners to finish the OECD process working with the US, rather than “taking unilateral action in this area”.

As always, the devil is in the details – and as the details of the OECD’s work materialise, it will be important to monitor reactions from Treasury Department officials and US lawmakers. We are closely tracking these issues from several vantage points across the globe, and our expert team of practitioners in policy and process welcomes any comments or questions on the future of digital taxation.



⁶ Under Section 891, the President can proclaim that a law of a foreign country imposes discriminatory or extraterritorial taxes on US citizens or corporations. In such cases, the US is entitled to retaliate by doubling the rate of US taxes imposed on the citizens and corporations of that foreign country.

European Union – Digital Manoeuvres in the Dark

The EU has been actively promoting measures towards the fairer taxation of the digitalised economy for some time. The European Commission (Commission) issued two legislative proposals in March 2018, an interim and long-term proposal (analysed in our [client alert](#)). The Commission released its proposals shortly after the OECD's commitment to pursue a consensus on a global solution, but long before the OECD could actually commence serious work on finding an agreement on the parameters of such a solution.

By way of a reminder, the only proposal negotiated at EU level was the interim measure that proposed the implementation of an EU DST. Even though many EU member states are in favour of introducing an EU DST prior to a global and consensus-based solution, it was not possible to reach the unanimous agreement required by the EU decision-making process. Through lengthy negotiations, the scope for the EU's interim DST solution has narrowed to an advertisement tax only, but even that has failed to obtain the backing of all member states. Ultimately, this lack of consensus led to a halt of the negotiations until there is clarity of the OECD's work on a consensus-based solution in 2020.

Failure to progress matters at the EU level has not prevented some member states (most notably France, Italy, Spain, Austria and the UK) from deciding to pursue unilateral solutions at national level despite such actions running the additional risk of provoking the ire of Washington DC. The following sections of this alert discuss some of these actions in more detail.

The Commission, in an attempt to pursue further progress on the OECD level, informally suggested that member states act on its behalf to advocate the EU's interests at the OECD level. Nevertheless, taking into account that the EU does not yet have a unified approach, not all member states were enthusiastic with the idea.

The recent OECD Programme of Work will certainly lead to further debate at the EU level. A technical meeting took place at the end of last month to consider what the EU's preferred outcome from the Programme of Work should be. Although details have not been made public, we believe a few member states expressed resistance to any re-opening of the EU-level negotiations prior to the completion of the OECD's efforts to find a consensus-based solution.

The European elections in May 2019 and the change of the European Commission political leadership in November 2019 make further EU progress on these matters this year unlikely.

The European elections have indicated that the two largest political party groups, the centre right European People's Party (EPP) and the left-leaning Socialist and Democrats Party (SDP), came in first and second place respectively. Despite this, the two parties lost their joint majority in the European Parliament. As a result, both the EPP and the SDP are likely to seek political alliances with one or more other political parties. The most likely partners are the Alliance for Liberals and Democrats (ALDE – to be renamed Renew Europe) or the Green Party. The precise make-up of such alliances will have significant implications for future policy and regulatory decisions in Europe. While the European Parliament does not have a direct negotiating role on tax legislative matters, it has consistently put serious political pressure to member states to advance on legislative issues.

The outcome of the European elections also drives the process for determining the main candidates for key and hugely influential EU leadership roles in the coming months. These include:

- President of the Commission
- President of the European Council
- President of the European Central Bank



The next leader of the EU's executive body, the Commission, will be of critical importance in advancing the policy priorities of the EU, including in relation to taxation. Since the last Commission mandate, the President roles have been filled by lead candidates (the Spitzenkandidaten) championed by the largest political parties in the new European Parliament. However, due to the changes in the balance of political power in Brussels, resulting from the May elections, the European Council (made up of the leaders of the individual EU member states) failed to agree to nominate any of the Spitzenkandidaten for the Commission President position at an EU Summit on 20 June.

The European Council reconvened on 30 June 2019 in a further attempt to find an agreement. Negotiations were protracted but eventually concluded on 2 July 2019, with the nomination of the following, compromise, candidates:

- President of the European Commission: Ursula von der Leyen (German), current Federal Minister for Defence and affiliated with the EPP
- President of the European Council: Charles Michel (Belgian), currently interim Prime Minister and affiliated with the ALDE/Renew Europe group
- President of the European Central Bank: Christine Lagarde (French), currently the Managing Director of the International Monetary Fund (IMF) (although she has temporarily suspended her role with the organisation), also affiliated with the EPP

The nominations from the European Council will need to be signed off by the European Parliament. That vote is expected to be held during the second plenary session of the new parliamentary term, commencing on the week of 15 July. There is currently no guarantee that the European Parliament will approve the appointments. Given the degree of disagreement and the length of the negotiations at the level of the European Council, we expect that the parliamentary vote will be close.

It is important to appreciate that the taxation of the digitalised economy remains a core strategic priority for the EU and is likely to remain so, whoever is ultimately appointed in the three key roles. However, it is (perhaps) noteworthy that the nominee for the role of President of the Commission is a current member of the German government (which has been generally reluctant to support the EU's effort to impose an interim DST – see the section on Germany overleaf) and the nominee for the role of President of the European Central Bank is Christine Lagarde, the Managing Director of the IMF, an organisation that has been supportive of the Inclusive Framework's efforts to find a consensus-based solution.

The precise evolution of EU policy in the area will require particularly close attention in the coming months. We remain confident that digital taxation will remain a high political priority for the European Commission and across the EU.



Fraying at the Seams – Uncoordinated Unilateralism

The great fear, identified by the OECD, is that if the Inclusive Framework does not deliver a comprehensive consensus-based solution, more and more jurisdictions will grow impatient with progress.

The risk, the OECD says, is that in such circumstances a patchwork of uncoordinated unilateral measures will emerge. That, in turn, threatens to undermine the coherence of the international tax framework, leading to increased compliance and administrative burdens on taxpayers, greater uncertainty and double taxation. The concerns (and anger) expressed in the US (outlined above) reflect these fears.

The problem is that this patchwork of uncoordinated unilateral measures is no longer a risk; it is already a reality. Patience is showing signs of fraying at the edge.

Although some countries (Germany and Australia in particular) have shown a degree of forbearance, the actions of the UK, whatever its rationale, and others, serve as a stark illustration of what individual states are considering. Most notably, many of the unilateral measures suggest imposing the DST on revenue, rather than profit, resulting in loss companies paying tax. This is a fundamental shift in the approach to income taxation and could have a significant impact.

Outlined below, by way of illustration (but by no means a comprehensive list), are some of the various positions adopted by different jurisdictions.

Europe

Germany

Germany supports action against aggressive tax planning by MNEs and has had a particular focus on the tech industry. Its primary focus is on helping to find a consensus-based, long-term solution. It is noteworthy that Germany's strong preference is to prioritise the GloBE proposal outlined in Pillar Two of the Programme of Work.

GloBE, Germany argues, reduces the incentive for aggressive tax planning and controls global tax competition effectively because an MNE cannot reduce its tax burden below the minimum tax level, not even by means of tax shifting to low-tax countries. In addition, Germany believes the concepts that underpin GloBE are already familiar to some countries, including, for example:

- The US – There are strong links between GloBE and the new US tax rules that reserve the right to tax foreign-sourced Global Intangible Low-Tax Income (GILTI).
- Germany – Unsurprisingly, since GloBE is similar to the German *Zinsschranke* rules.

Germany introduced the *Zinsschranke* law to limit the domestic tax-deductibility of intercompany royalty payments if the corresponding income abroad was subject to a preferential low rate of taxation. Some jurisdictions contribute to harmful tax competition by offering preferential taxation for royalty income without linking this advantage to active development or research activities in the preferred country.

BEPS Action 5 recommends that such preferential taxation regimes should be abolished (or suitably amended), at the OECD level, by 30 June 2021. The *Zinsschranke* law is a defensive measure that protects the German tax base until the end of the transition period.

In contrast, Germany considers the proposals under Pillar One to be more ambiguous. It argues that Pillar One requires fundamental changes to the current international taxation system, including amendments to the definition of the permanent establishment in Article 5 of the OECD Model Convention and the possible development of a new, standalone, non-physical presence nexus rule.

Interestingly, however, despite recognising that the Programme of Work will need time for development and negotiations in order to achieve consensus (and uncertainty over whether consensus can be found at all), Germany is reluctant to implement unilaterally a DST. It has been a major block to the EU's own interim DST proposals. From Germany's perspective, expected DST revenues appear to be low when compared to the complexity and the consequential costs of implementation. In addition, there is a plausible risk to transatlantic relations (e.g. punitive tariffs in the US) because a DST effectively primarily targets US tech companies. Finally, Germany specifically introduced the *Zinsschranke* law instead of a DST. For these various reasons, Germany does not plan to introduce a DST in the immediate future (although it has not definitively excluded the option).

France

France has acted as the lead driver behind the EU's (ultimately unsuccessful) efforts to introduce an interim DST. Frustrated by a lack of multilateral progress, at both OECD and EU levels, the French Finance Minister, Bruno Le Maire, has forged a separate path for France. The French are probably the largest economy to take a broad-based DST (broadly modelled on the original EU proposal for an interim measure) through to the point of actual implementation. It is, therefore, unsurprising that the French proposals have been a source of particular concern, and the target of calls for robust retaliatory action, in the US (as discussed in the US section above).

On 9 April 2019, the French National Assembly passed a bill introducing a French DST. When applied, subject to thresholds for global and French revenues, the proposed DST rate is 3% on the revenue derived from digital marketplaces where users are in France. The French Senate approved a slightly amended version of the proposed French DST on 21 May 2019. The Senate introduced a three-year "sunset" clause that would automatically see the French DST abolished at the end of December 2021.

A *Commission Mixte Paritaire* (a committee constituted by an equal number of members from the Senate and the National Assembly) considered the revised bill on 26 June 2019. We understand that the *Commission Mixte Paritaire* was able to agree on a common position on the proposal at that meeting. However, the text of the final bill has not been published. Therefore, it remains unclear whether the "sunset" clause has been retained. The status of the "sunset" clause is important because it will help to illustrate how the French government is likely to respond to a successful conclusion to the Programme of Work and an agreement on a global, consensus-based solution.

Interestingly, in light of the US objections, the *Commission Mixte Paritaire* has also insisted that the French government should justify its decision not to notify its DST plans to the European Commission as a form of State aid. The French government has always been of the view that the new tax is not State aid.

Both houses of the French Parliament need to approve and adopt the final version of the DST bill. The bill was approved by the National Assembly on 4 July 2019. Voting in the Senate will take place on 11 July 2019.

Crucially, however, when formally approved, the French DST will take effect from 1 January 2019 (i.e. backdated to the beginning of the current financial year). The first payments in France will be due later this year in October.

Spain

Spain, alongside France, was one of the leading proponents arguing for the unilateral introduction of a domestic DST as a temporary measure pending multilateral agreement by the OECD.

In October 2018, the Spanish government originally published a draft bill to introduce a DST. The government sent a final version of the bill (published on 25 January 2019) to the Spanish Parliament for approval alongside the State Budget. Again, the key features are remarkably similar to the EU proposals released in March 2018: a rate of 3% on gross revenue from digital services including online advertising, intermediation services and the sale of user data. Revenue thresholds (worldwide revenues of €750 million and Spanish revenues in excess of €3 million) restrict its scope.

On 13 February 2019, the Spanish Parliament rejected the government's budget, a vote that precipitated a "snap" general election on 28 April 2019 and has meant the proposal for a Spanish DST, although unchanged, is currently on hold. The governing Spanish Socialist Workers' Party (PSOE), under the leadership of Prime Minister Pedro Sánchez, won the election, but it did not secure an outright majority and is currently in talks to lead a coalition government.

The hiatus will likely be brief. Once the new government is in place, the (unchanged) Spanish DST is expected to be reintroduced as part of a new State Budget package, which the new Parliament is likely to approve. The Spanish DST will take effect from January 2020.



United Kingdom

The engagement of the UK with the OECD's BEPS Project has always contained elements of contradiction.

On the one hand, the UK has been at pains to present itself as a leading proponent of the need for multilateral global reform of the international corporate tax framework, working hard towards securing consensus-based solutions and combatting the tax avoidance activities of MNEs that must, it says, contribute their fair share of tax. On the other hand, the UK has displayed both ambivalence to, and impatience with, the work of the Inclusive Framework. The introduction of its Diverted Profits Tax (DPT) in 2015, pre-dating the conclusions and recommendations from the main BEPS Project, illustrated the UK's willingness to act unilaterally. At the same time, the UK is often criticised for its continued support for (and alleged reluctance to adequately control) its Crown Dependencies (Jersey, Guernsey and the Isle of Man) and British Overseas Territories (including the British Virgin Islands, Cayman Islands and Gibraltar). These CDOTs are often used as offshore finance centres and (whether fairly or not) labelled as "tax havens".

Expect that contradictory pattern to continue to characterise the UK government's reaction to the Programme of Work. The current Chancellor of the Exchequer, Philip Hammond, is keen to portray the UK as continuing to lead the global effort against base erosion and profit shifting. The UK is clear that a comprehensive, international consensus-based agreement is the best solution for ensuring MNEs generating substantial value in the UK pay their fair share of tax. The UK was also one of the first jurisdictions to confirm its intention to implement a DST. It has introduced the necessary legislation and the UK DST is set to take effect in 2020. The introduction of a DST (analysed in more detail in our alert, [International Tax Poker: The United Kingdom's Digital Services Tax Proposal](#)) was always a political move by the UK. Displaying neither French unwillingness, nor German patience, to wait for the Inclusive Framework to complete its work, the UK's plan was primarily to pressurise the G20/OECD into speedier action. It is a plan that appears to have been successful.

As a highly developed consumption-based economy, the UK is seeking the evolution of existing principles, not a revolution that replaces them. It hopes to ensure that the recommended architecture of the future of international tax emerging at the beginning of 2020 will ensure the UK is able to tax global profits realised from UK-based users and consumers. It is looking for rules that will substantially broaden its tax base. From that perspective, the UK views the work of the Inclusive Framework as an enormous opportunity and considers it will be a "winner" from the overhaul. It will also consider that any radical fundamental reform, including, for example, some form of overly simplistic global formulary apportionment rule, is a risk that could leave it severely disadvantaged. From that perspective, it probably hopes that its insistence on faster change does not lead to overly simplistic and crude solutions. The UK will be following, and contributing as much as possible to, the Inclusive Framework's economic analysis and impact assessment work. Like so many other countries, it will be reluctant to reveal its precise position until it has greater clarity on the effect of any given rule.

All of that said there is much in the Programme of Work the UK will recognise. Under Pillar One, the UK is likely to encourage updating current transfer pricing rules and oppose a more drastic overhaul for profit allocation rules. For the proposed new non-physical nexus rule, the UK is likely to support a change that, in essence, will allow it to extend its tax base. Although it will not be its primary focus, the UK is likely unconcerned by some of the apparently radical principles being considered under Pillar Two that afford jurisdictions supra-national taxing rights. Indeed, the elements of the income inclusion and tax on base eroding payments rules that combine to form GloBE already underpin parts of the UK's tax code. They are, for example, evident in both the anti-hybrid mismatch rules (in place since 2016, closely following the recommendations of Action 2 of the BEPS Project) and provisions for taxing offshore receipts in respect of intangible property (introduced, unilaterally, by Finance Act 2019).

The potentially significant variable in all of this is, of course, Brexit and the future direction of British economic and fiscal policy once the UK has left the EU. The chance (or, perhaps, need) to embrace the digitalisation of the global economy and exploit the opportunities afforded by the so-called Fourth Industrial Revolution arises at a time when the UK's future is less certain than it has been in decades. It is, therefore, no coincidence that the UK government has published an [Industrial Strategy](#) (incorporating a [Digital Strategy](#)), intended to ensure the intangible assets that the OECD correctly identify as being a core characteristic of the digitalised economy are designed, owned, exploited and, therefore, taxed in the UK.

For the UK, there is more than just tax revenue, and international tax fairness, at stake. While the UK will continue to promote and support efforts to agree a global, consensus-based solution to the tax challenges arising from the digitalisation of the economy, it will undoubtedly pursue unilateral tax policy (both punitive and incentive) to protect its economic, and political, self-interest and position in the world.



Asia Pacific

Australia

Australia was actively considering introducing a DST. The government published a broad consultation on the tax challenges of the digital economy in October 2018. That consultation included consideration of the unilateral introduction of a DST on the basis that, despite the benefits they bring to society, digitalised business operations are able to have a significant economic presence in Australia but in a way that is difficult to tax under current rules – the scale without mass problem.

The Australian government has since pulled back from any current intention to introduce an interim DST. In an announcement published on 20 March 2019 (a little over a month after the OECD published its Public Consultation), it committed itself to helping the Inclusive Framework find a consensus-based, multilateral solution.

It is interesting to note that among the reasons given by the government for its change of tack was a concern that a unilateral DST would adversely affect businesses and consumers in Australia and dampen innovation and competition. Specifically, the Australian government seems to recognise the potential for double taxation that results from the imposition of unilateral taxes, and was perceptive in realising the possibility that larger, global economic consequences could result from unilateral, domestic tax policy.

New Zealand

On 4 June 2019, just four days after the OECD Inclusive Framework published the Programme of Work, the New Zealand Inland Revenue launched a discussion paper on the possibility of introducing a DST in New Zealand. The timing of the publication is notable.

The New Zealand proposal is remarkably similar to plans issued in other jurisdictions, including, in particular, the UK and the EU proposals. The target will be “digital platforms whose value is dependent on the size and active contribution of their user base”. The proposed rate is 3% of gross global turnover that is attributable to the New Zealand market. There are de minimis thresholds for both global and New Zealand revenues.

Much depends on the progress made by the Inclusive Framework towards a global solution, but, interestingly, the Inland Revenue will also consider the action (and reaction) of other countries. In this respect, the New Zealand stance is illustrative of jurisdictions’ willingness to protect their self-interest. However, to balance that, another consideration is “the risk of any reputational damage of New Zealand adopting a DST”, suggesting that momentum towards a critical mass of jurisdictions either adopting, or repudiating, a DST could be crucial.

If approved, the New Zealand DST would likely take effect in 2020-21.

Others

Other jurisdictions that have adopted, or are actively considering adopting, some form of DST (or alternative measures that widen their domestic tax base to catch profits specifically related to highly digitalised business) include:

- Austria
- Chile
- Colombia
- Czech Republic
- India
- Israel
- Italy
- Malaysia
- Slovakia
- Uruguay



The Road to Nowhere?

Assuming that a political agreement is reached before the end of 2019 with respect to the core elements of Pillar One (i.e. allocation of profits to market jurisdictions and the granting of taxing rights in particular circumstances even though the taxpayer has no physical presence in the taxing jurisdiction), the efforts described in the OECD's Programme of Work are likely to result in significant changes in the international tax framework as we know it.

The existing structure of international business taxation is premised on separate-entity accounting and taxation, including transfer pricing rules that deal with transactions between related parties. The existing regime is also based on traditional concepts of jurisdiction, which require that a country has power over either a person or a thing located in the country in order to impose income tax on profits arising from business operations involving the person or thing in question.

The proposals in Pillar One are not consistent with these longstanding principles. The profit allocation proposals relate to the profits of an MNE's corporate group or business line, rather than the profits of a single business entity. In addition, the nexus proposal would allow a country to impose tax on the net profits of an MNE despite the absence within the country of any person or thing belonging to that business. Thus, we are looking at a real possibility of revolutionary change, which will affect many elements of the current legal framework, including tax treaties. Domestic legislation will be required in all of the Inclusive Framework countries, and new multilateral approaches to tax administration will be needed. It will undoubtedly be a lengthy process, taking at least several years for the implementation of the new rules and procedures.

The chance that such a change will not happen is becoming slimmer, particularly in light of the G20's blessing of the Programme of Work. Therefore, multinational corporate tax executives and their advisers should keep a close eye on this process for the rest of 2019 and beyond.





We Can Help

We have a dedicated team of leading tax experts to help you with issues arising in the taxation of the digital economy. Jeff VanderWolk, who has extensive experience in private practice and government and agency work, leads our digital tax team. Most recently, Jeff was head of the Tax Treaty, Transfer Pricing and Financial Transactions Division at the Centre for Tax Policy at the OECD. He has also served as International Tax Counsel to the US Senate Committee on Finance and as a Special Counsel in the Office of the Chief Counsel at the Internal Revenue Service.

We can strategise and support your engagement with the OECD's Inclusive Framework on BEPS. We can help you understand the possible business and technical tax impacts of the proposals set out in the Programme of Work. We are also ready to assist with the implementation of strategies to ensure you are positioned to respond efficiently and effectively when change comes.

As a full-service global law firm, we are connected both locally and globally on the tax challenges arising from digitalisation. We can provide unique insight at the point where law, business and government meet. We place our clients at the core of everything we do, giving them a voice, supporting their ambitions and achieving successful outcomes.

We look forward to engaging with you as your trusted adviser, as national and international tax law continues to evolve and respond to the digitalisation of the economy.



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