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## Session 7A: Taxation in the Digital Age

### Digitalisation presents challenges for international tax rules

The digital transformation of the economy calls into question whether the international tax rules, which have largely been in place for most of the past 100 years, remain fit for purpose in the modern global economy. While good progress has been made in tackling base erosion and profit shifting (BEPS) since 2015 as the result of the implementation of the 15 measures developed through the OECD/G20 BEPS Project, some of the more fundamental tax challenges posed by digitalisation have remained unaddressed. Developing a global, consensus-based solution to these issues is now the top priority for the more than 125 members of the OECD's Inclusive Framework on BEPS.<sup>1</sup>

The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the BEPS Action Plan, leading to the 2015 BEPS Action 1 Report. The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy. The Report also noted that, beyond BEPS, the digitalisation of the economy raised a number of broader direct tax challenges chiefly relating to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries. Many of these challenges relate to the fact that the existing international tax framework still largely relies upon firms having a physical presence in a jurisdiction before a taxing right can arise.

Following a mandate by G20 Finance Ministers in March 2017, the Inclusive Framework, working through its Task Force on the Digital Economy, delivered an Interim Report in March 2018, *Tax Challenges Arising from Digitalisation – Interim Report 2018*. The Interim Report provided an in-depth analysis of value creation across new and changing business models in the context of digitalisation and the tax challenges they presented. These challenges included the issues of nexus and profit allocation and the risks remaining after the BEPS project that highly mobile income producing factors can, in some instances, still be shifted into low-tax environments.

Against this backdrop, the members of the Inclusive Framework have committed to work towards delivering a multilateral solution to these challenges to the G20 by the end of 2020.

### Recent proposals offer a way forward to address these challenges

Recent international efforts to address these issues have highlighted the divergent positions of many jurisdictions. While the introduction of unilateral measures in a number of countries has underscored the urgency of the issue and the need to re-assess some of the key international tax principles, these divergent positions have made a consensus-based solution difficult to achieve. In a significant advance, the 128 members of the Inclusive Framework have recently agreed a policy note<sup>2</sup> – Addressing the Tax Challenges Arising

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<sup>1</sup> The Inclusive Framework on BEPS was created in 2016 to foster collaboration on the implementation of BEPS measures.

<sup>2</sup> <http://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf>.

from Digitalisation – that identifies concrete proposals in two pillars to explore and which could form the basis of a global, consensus-based solution. These pillars involve the re-allocation of taxing rights among jurisdictions and the need to address remaining BEPS issues.

The first pillar includes several proposals that would allocate more taxing rights to market or user jurisdictions in situations where value is created by a business activity through participation in the user or market jurisdiction. While these proposals would affect highly digitalised businesses, they would also potentially affect a much wider group of enterprises.

The second pillar would help resolve remaining BEPS risks by helping jurisdictions address cases where income is subject to no or only very low taxation. These proposals are important progress in updating fundamental tax principles for a twenty-first century economy.

### Next steps in advancing the international dialogue towards a consensus based solution by 2020

In agreeing to explore the two pillars on a without prejudice basis, members of the Inclusive Framework are cognisant that taking on these challenges, together, and on a co-ordinated, multilateral basis could ease the growing tension within the international tax architecture, with a growing number of countries having taken unilateral measures over recent years.

The Inclusive Framework has mandated its Steering Group to elaborate a detailed programme of work to be discussed at the Inclusive Framework's May meeting, with a view to reporting progress to the G20 Finance Ministers in June 2019 and delivering a long-term consensus-based solution in 2020.

**Q1:** What are the key challenges that need to be addressed in the existing international tax rules?

**Q2:** Do you think the different proposals outlined by the Inclusive Framework for exploration on a without prejudice basis are likely to be effective in addressing these challenges?

**Q3:** How do you see these proposals interacting with each other and what are the prospects of the Inclusive Framework achieving a consensus-based solution by 2020?