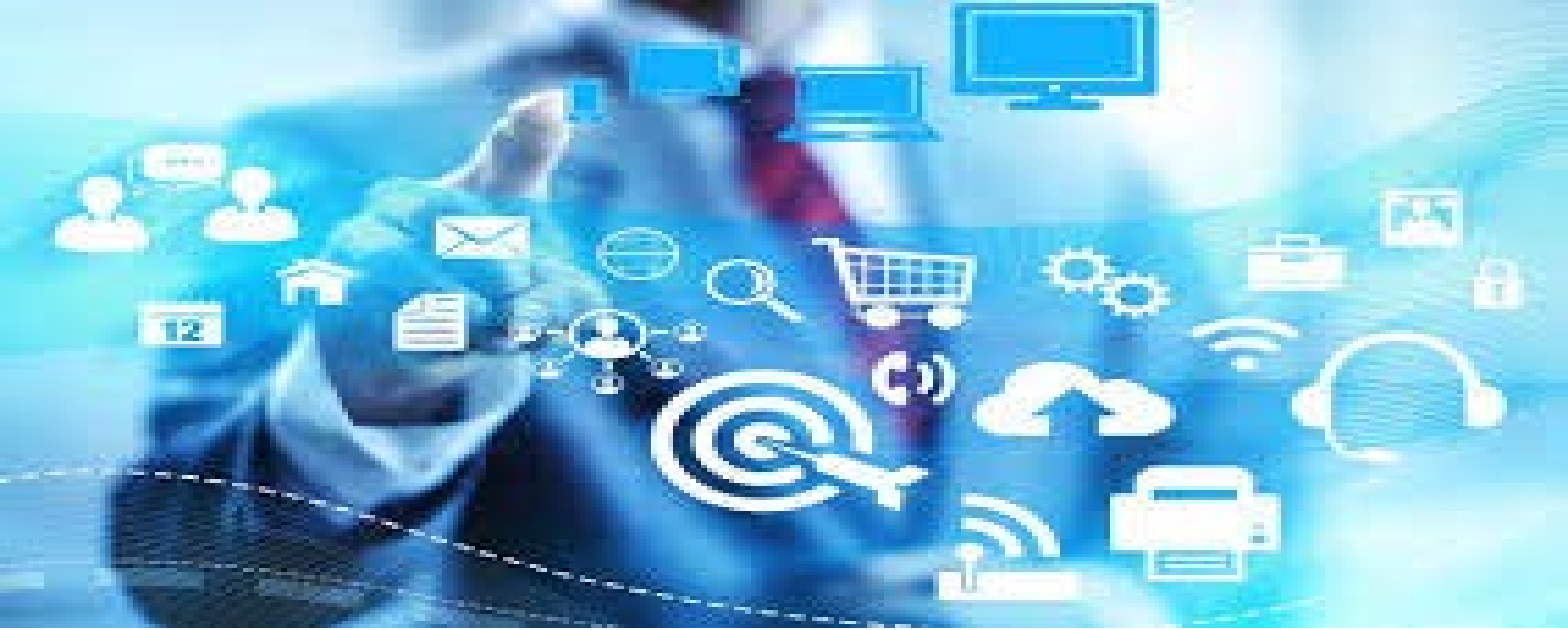

TAXATION CHALLENGES: A FOCUS ON THE DIGITAL ECONOMY

G-24 Technical Group Meeting
March 15th, 2019

BACKGROUND

2015

- Action 1 report by OECD in the context of BEPS- no consensus

March 2017

- Concern over unilateral measures- allowable only until 2020 (Interim Report)

July-December 2018

- Work by the TFDE at the OECD on Profit Split alternatives

January 2019

- 3 policy options for BEPS Inclusive Framework

March 2019

- Public consultation (200 responses, over 2000 pages)
- Public consultation meeting (March 13th-14th)

THE PROFIT SPLIT APPROACHES

	User Participation	Marketing intangibles
Scope of application	Ringfenced to only 3 types of companies: i) social networks; ii) search engines and iii) online marketplaces	No ringfencing
Allocation method	Residual profit split	Residual profit split
Nexus	Presence of sufficient active users (no threshhold agreed yet for user number or active period metrics- DAU or MAU)	Presence of a market intangible (no agreement on what constitutes a marketing intangible)

HOW RESIDUAL PROFIT SPLITS WORK

1. Profit (or loss) determination

- Combine financial statements for relevant related parties using IFRS
  - Business line segmentation, currency exchange problems
  - OECD Profit Split Guidance under BEPS Action 10 (June 2018)

2. Identification of routine and non-routine functions

- Routine functions must be identified, as they are to be remunerated first with other existing transfer pricing methods
- The non-routine functions must be identified in order to determine the factors for spliting the residue.

3. Remunerating routine functions

- Profits associated with routine functions will be allocated according to existing TP rules.

4. Splitting residual profits (or losses)

- The remainder after remunerating routine functions will be allocated to the jurisdictions where the non routine functions happen, including the market jurisdictions where the marketing intangible or user participation are producing profits.

Market jurisdictions get the smallest piece of the pie

TECHNICAL PROBLEMS ASSOCIATED WITH PROFIT SPLIT APPROACHES

ítem	User Participation	Marketing intangibles
Scope	Ringfenced against action 1 recommendations- will not address BEPS concerns	Same scope as SEP
Alignment with value creation	Risk is easily transferred, and thus it remains easy to separate profits from the jurisdictions where value is created.	
Allocation methods	Allocates minimum income and does so only when the company reports extraordinary profit. Most digital companies report net operating losses. Information is too limited, especially in the case of closed companies outside of a stock exchange market. Determination of routine and non routine functions (and profits/losses) will inevitably render different results for each auditor in each jurisdiction. High administration costs and legal uncertainty.	
Nexus	Transfer pricing guidelines are not mandatory in most countries. Uncertainty in the existence of a nexus.	Marketing intangibles include many things, including user interaction and other functions that could eventually be considered as "routine" for some business models
Revenue	Costs are too high- capacity buidling, information gathering. In many cases only losses will be attributed.	

SIGNIFICANT ECONOMIC PRESENCE (SEP)

Initially contemplated in the Action 1 report. Creation of a taxable nexus for a company operating in a digital environment if the following conditions are met:

A. Generates income from sales or transactions in the market jurisdiction AND
B. Develops a significant economic presence by developing at least one of these activities:

1. Data input by an existent user base
2. Significant volume of digital content derived from the jurisdiction
3. Billing and collection in local currency or with a local form of payment
4. Maintenance of a website in a local language
5. Responsibility for the final delivery of goods to customer or the provision of other support services such as after-sales services or repairs and maintenance
6. Sustained marketing and sales promotion activities

Each of the 6 additional activities will require a threshhold to trigger a SEP

SEP– PROFIT ALLOCATION

Two alternatives:

1. Small withholding tax (around 1%) applied to a proxy such as gross sales or transactions. The withholding can be performed by financial institutions responsible for issuing the forms of payment.

2. The enterprise may opt for fractional apportionment by providing all necessary information to the local tax authority. In such case, the enterprise may claim a refund for withholding applied in excess of the tax allocated under fractional apportionment.

SEP- ADVANTAGES

Taxable income	Nexus	Revenue
• A withholding tax on gross sales or transactions is broader and easier to administer • In the cases in which the taxpayer opts for fraction approtionment allocation, they will need to provide useful information to the tax administration.	• True alignment with value creation- a significant economic presence necessarily adds value from the market jurisdiction • Avoids uncertainty and complex methods to determine if a marketing intangible is present and if it can be associated with non-routine functions	• Our tax administrations are experienced in auditing withholding taxes • Income is certain and more appropriate to the economic presence in the jurisdiction.

DIGITALIZED BUSINESSES ARE NOT USUALLY POSTING EXTRAORDINARY PROFITS

Non-routine profits will most likely become losses that will be attributable to the market jurisdictions.

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NEXT STEPS

13-14th March 2019

- Public meeting where commentators will explain their positions

8-9 April 2019

- Inclusive Framework Steering group meeting

27-29 May 2019

- Inclusive framework meeting

2019-2020

- Technical work for proposal for consensus
- 2020 presentation of proposal, eliminarion of unilateral measures

DEVELOPING COUNTRIES MUST ACT TOGETHER

The G-24 proposal is the first instance of a susbtantive developing country option for the standard setting process