

NEWSFLASH

February, 2019 – Volume 110

**Public consultation
paper released by
OECD to address tax
challenges of
digitalized economy**



Public consultation paper released by OECD to address tax challenges of digitalized economy

Public consultation paper ponders over the proposals discussed by the Inclusive Framework at a high level and seek comments from the public on a number of policy issues and technical aspects. Public comments are sought to assist members of the Inclusive Framework for developing a solution for its final report to be issued to the G20 in 2020. Comments on this consultation document should be sent by 1 March 2019.

The consultation paper talks about proposals to address the two major issues identified by the BEPS Action Plan -1 i.e. “Broader tax challenges” and “remaining BEPS issues”. It sets out proposals that could become part of the long-term solutions for taxation of digitalized economy.

❖ BROADER TAX CHALLENGES (REVISED PROFIT ALLOCATION AND NEXUS RULES)

The Inclusive Framework is currently examining the following three proposals for revising the profit allocation and nexus rules in response to the challenges posed by digitalization of the economy:

A. User participation proposal

- ❑ The proposal seeks to modify current profit allocation rules for certain businesses to provide that profits should be allocated to jurisdictions in which those businesses’ active and participatory user bases are located, irrespective of local physical presence.
- ❑ It acknowledges the difficulties in using traditional transfer pricing methods for determining the amount of profit that should be allocated to a user jurisdiction.

- ❑ It is proposed that the profit allocated to a user jurisdiction in respect of the activities/participation of users should be calculated through a non-routine or residual profit split approach. This proposal is most significant to the highly digitized business models such as social media platforms, search engines and online market place

B. Marketing intangibles proposal

- ❑ This proposal has been designed to address a situation where a multinational group can essentially reach into a jurisdiction, either remotely or through a limited local presence for developing a user/customer base and other marketing intangibles.
- ❑ It sees an intrinsic functional link between marketing intangibles and the market jurisdiction.
- ❑ The proposal would modify current transfer pricing and treaty rules to require marketing intangibles and risks associated with such intangibles to be allocated to the market jurisdiction.
- ❑ The proposal considers that the market jurisdiction would be entitled to tax some or all of the non-routine income properly associated with such intangibles and their attendant risks, while all other (routine) income would be allocated among members of the group based on existing transfer pricing principles
- ❑ The proposal would modify current profit allocation and nexus rules to require that the non-routine or residual income of the multinational group attributable to marketing intangibles and their attendant risks be allocated to the market jurisdiction.

- ❑ The special allocation of some or all non-routine returns from marketing intangibles, and the related expansion of the market country's taxation rights, would apply with no exceptions
- ❑ The allocation of non-routine or residual income between marketing intangibles and other income producing factors could be determined through different methods.

C. Significant Economic Proposal

- ❑ As per this proposal, a non-resident enterprise would have a taxable presence in a jurisdiction if it has a significant economic presence determined on the basis of a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means.
- ❑ It is based on the view that the digitalization of the economy and other technological advances have involved business enterprises heavily in the economic life of a jurisdiction without a significant physical presence.
- ❑ Revenue generation combined with other factors would be used to establish nexus in the form of a significant economic presence in the country concerned.
- ❑ Under this approach, profits would be allocated based on a fractional apportionment method, as discussed in the Action 1 Report. Also, Other simplified methods such as the modified deemed profits methods described in Action 1 Report would be considered.
- ❑ Also, imposition of a withholding tax as a collection mechanism and enforcement tool would be considered

Questions for public comments

- General view on the proposal to address remaining BEPS issues have been sought from the public in consideration of the objectives, policy rationales, and economic and behavioral implications of the proposal.
- The extent to which businesses, as a result of the digitalization of the economy, have an active presence or participation in a jurisdiction that is not recognized by the current profit allocation and nexus rules has been asked. Further, in answering above, it has been requested to consider the following points:
 - Which businesses have this type of applicability, and how the assessment may change over time?
 - What are the merits of using a residual profit split method, a fractional apportionment method, or other method to allocate income in respect of such activities?
- Suggestions are requested on the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes
- Comments have been requested on the design considerations in developing new profit allocation and nexus rules consistent with the proposals described above, including with respect to scope, thresholds, the treatment of losses, and the factors to be used in connection with profit allocation methods

❖ GLOBAL ANTI-BASE EROSION PROPOSAL

The BEPS issues are being considered to be addressed through the development of the following two inter-related rules:

A. Income inclusion rule

- ❑ The rule will seek to tax the income of a foreign branch or a controlled entity if that income was subject to a low effective tax rate in the jurisdiction of establishment or residence.
- ❑ The income inclusion rule would operate as a minimum tax by requiring a shareholder in a corporation to bring into account a proportionate share of the income of that corporation if that income was not subject to tax at a minimum rate.
- ❑ The rule would apply to any shareholder with a significant direct or indirect ownership interest in that company and would be applied on a per jurisdiction basis.
- ❑ The amount of income to be included would be calculated under domestic law rules and shareholders would be entitled to claim a credit for any underlying tax paid on the attributed income, with such credits also being calculated on a jurisdiction-by-jurisdiction basis.
- ❑ This rule would supplement rather than replace a jurisdiction's CFC rules.
- ❑ In the case of exempt foreign branches, the income inclusion rule would operate by way of switch-over rule that would turn off the benefit of an exemption for income of a branch and replace it with the credit method where that income was subject to a low effective rate of tax in the foreign jurisdiction.

❖ Tax on base eroding payments

This measure would deny a deduction or treaty relief for certain payments unless that payment was subject to an effective tax rate at or above a minimum rate. It further includes:

1. Undertaxed payments rule

- ❑ The undertaxed payments rule would deny a deduction for certain defined categories of payments made to a related party unless those payments were subject to a minimum effective rate of tax.
- ❑ The effective tax rate test would take into account any withholding tax imposed on the payment. The test for whether a payment was to a related party could be based on a 25% common ownership test
- ❑ The rule should apply to a broad range of payments and should cover “conduit” or “imported” arrangements, where the effect of an undertaxed payment is “imported” into the payer jurisdiction through a payment that is otherwise outside the scope of the rule

2. Subject to tax rule

This rule would apply to undertaxed payments that would otherwise be eligible for relief under a double tax treaty. Tax treaty benefits provided by the following Articles shall be denied by this rule:

- Article 7 (Business profits);
- Article 9 (Associated enterprises);
- Article 10 (Dividends)
- Article 11 - 13 (Interest, Royalties and Capital Gains)
- Article 21 (Other income)

Other considerations

Though, a rule-based approach is being considered to develop, the members of task force on digital economy are exploring the technical issues that may arise in between the designing of the rule.

These rules would be implemented by way of changes to domestic law and double tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of economic double taxation.

Questions for public comment

1. General view on the proposal to address remaining BEPS issues have been sought from the public in consideration of the objectives, policy rationales, and economic and behavioral implications of the proposal.
2. Design considerations have been sought for the both the rules from the public. Further, separate view has been requested on undertaxed payments and subject to tax proposals along with practical, administrative and compliance issues.
3. Suggestions are requested on the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes
4. Also, comments on scope limitations of the proposals and best way to coordinate the rule have also been asked.

ABOUT US

Nangia Advisors LLP is a premier professional services organization offering a diverse range of Taxation, Transaction Advisory and Business Consulting services. Nangia Advisors LLP has presence currently in Noida, Delhi, Gurugram, Mumbai, Dehradun, Bengaluru and Pune. Nangia Advisors LLP has been in existence for more than 38 years and has been consistently rated as one of the best advisory firms in India for entry strategy, taxation, accounting & compliances over the past many years. Nangia Advisors LLP had announced a strategic collaboration agreement with Andersen Global last year in May. Andersen Global is an international association of legally separate, independent member firms comprised of tax and legal professionals around the world. Established in 2013 by US member firm Andersen Tax LLC, Andersen Global now has over 4,000 professionals worldwide and a presence in over 129 locations through its member and collaborating firms.

Quality of our people is the cornerstone of our ability to serve our clients. For this reason, we invest tremendous resources in identifying exceptional people, developing their skills, and creating an environment that fosters their growth as leaders. From our newest staff members through senior partners, exceptional client service represents a dedication to going above and beyond expectations in every working relationship.

We strive to develop a detailed understanding of our clients' business and industry sector to offer insights on market developments and assist our clients develop effective strategies and business models. We have the resources and experience necessary to anticipate and competently serve our clients on issues pertaining to all facets of Tax and Transaction Advisory. We take pride in our ability to provide definite advice to our clients with the shortest turnaround time. The business and tax landscapes have changed dramatically, and the pace and complexity of change continues to increase. We can assist you navigate this shifting landscape.

OUR OFFICES

NOIDA

A-109, Sector-136,
Noida (Delhi- NCR)
201304,
INDIA

DELHI

B-27, Soami Nagar,
New Delhi – 110017,
INDIA

GURUGRAM

812-814, Tower B,
Emaar Digital Greens
Sector 61,
Gurugram,
Haryana- 122102

MUMBAI

11th Floor, B Wing, Peninsula
Business Park, Ganpatrao
Kadam Marg, Lower Parel,
Mumbai – 400 013. INDIA

DEHRADUN

First Floor, "IDA"
46 E. C. Road,
Dehradun – 248001,
Uttarakhand.
INDIA

BENGALURU

150/1 Infantry Road,
Bengaluru – 560001
Karnataka
INDIA

PUNE

Office number 3, 1st
floor, Aditya,
Centeegra, Fergusson
College
Road, Next to Mantri
House,
Pune - 411004