NANGIA ADVISORS LLP

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# NEWSFLASH

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## OECD issues programme of work to tax digitalised economy

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# OECD issues programme of work to tax digitalised economy

On 29 January 2019, the G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) released a short Policy Note to provide an update on their work undertaken to address the Tax Challenges of the Digitalisation of the Economy. Through such a note, it identified the two pillars based approach to work towards reaching a new consensus-based long-term solution in 2020, i.e. Revised Nexus and Profit Allocation Rules and Global Anti-base erosion proposal.

Recently, OECD on 29th May 2019 released a programme of work (PoW) which provides a path to delivering the long-term and consensus-based solution in 2020 to the G20 Finance Ministers and evaluate different issues and options that shall arise as the work progresses.

The PoW recognizes that new technical issues may emerge as the work progress. It identifies that there are cross-cutting issues which affects both Pillars, i.e. Revised Nexus and Profit Allocation Rules and Global Anti-base erosion proposal, identified in policy note issued in January 2019 and requires close coordination.

## ❑ Pillar 1: Allocation of taxing rights including both nexus and profit allocation rules

PoW would explore issues and options in connection with new profit allocation rules. It would include development of methods for determining the amount of profit and loss, which may be subject to the new taxing right. Consistency with the principle of avoiding double taxation, simplified methods and ease in administration have been identified as key considerations while devising such methods.

Analysis would be undertaken with respect to the complexity and uncertainty of the existing methods and the possible advantages of using other simplified approaches.

### A. Modified residual profit split method

This method would allocate a portion of the group's non-routine profit that reflects the value created to 'market jurisdictions' which is not recognized under the existing profit allocation rules.

It involves four steps: (i) determine total profit to be split; (ii) remove routine profit, using either current transfer pricing rules or simplified conventions; (iii) determine the portion of the non-routine profit that is within the scope of the new taxing right, using either current transfer pricing rules or simplified conventions; and (iv) allocate such in-scope non-routine profit to the relevant market jurisdictions, using an allocation key.

Issues and alternative options associated with each of the four steps, including possible simplifications would be explored in the PoW.

### B. Fractional apportionment method

Under this method, evaluation will be made with respect to development of the method to determine the profits of a non-resident entity or group that would be subject to the fractional apportionment mechanism and financial accounting regime upon which the profit determination would be based. Factors, such as employees, assets, sales, and users, for constructing the formula would be analyzed along with designing the rules for coordinating such method and the current transfer pricing system.

### C. Distribution-based approaches

This method would be explored under PoW as other possible simplified approach wherein in addition to non-routine profit, profit arising from routine activities associated with marketing and distribution would be taken into consideration.

This would undertake specification of rules providing a baseline amount of profit attributable to marketing, distribution, and user-related activities. Analysis for determining the proportion of routine and non-routine profits to market jurisdictions, application of such profits in case there is no tax presence in the market jurisdiction and coordinated with the current transfer pricing system would be undertaken.

### D. New Nexus Rules

PoW will also explore the development of a concept of remote taxable presence and a new set of standards for identifying when such a remote taxable presence exists. This may involve amendment to article 5 and 7 or introduction of a new standalone provision.

**Key Consideration under PoW with respect to Pillar 1, Revised Nexus and Profit Allocation Rules approach**

- In consideration of difference in profitability of multinational group across different business lines and regions, PoW will explore the possibility of determining the profits subject to the new taxing right on a business line and/or regional basis.

- Determination of design scoping limitations which would include development of rules to limit the scope of the new taxing right based on the size of a multinational group or business line and consideration whether they are constrained by other international obligations

- Evaluation of different options available for the treatment of losses under the new taxing right.

- POW would explore options and issues related to the elimination of double taxation and the avoidance and resolution of disputes in relation to the new nexus and profit allocation rules.

- Exploring the issues and options in connection with the administration of the new taxing right which would evaluate exploring collection mechanisms including a withholding tax, reporting obligations, mechanisms to disseminate that information to the tax authorities and technical and practical issues that may arise in determining and reporting the location of sales

- Modification of existing tax treaties, with the aim of ensuring that all parties committing to the changes can implement them at substantially the same time

## ❑ Pillar 2: Global Anti-base erosion proposal

Under Pillar 2**, GLoBE** proposal seeks to address the remaining BEPS challenges through the development of two inter-related rules namely, income inclusion rule and tax on base eroding payments.

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

### A. Income Inclusion Rule

The rule will ensure that the income of the multination group is subject to tax at a minimum rate thereby reducing the incentive to allocate returns for tax reasons to low taxed entities. This aims to protect the tax base of the parent jurisdiction as well as other jurisdictions where the group operates.

PoW would explore different methods under income inclusion rule such as top up approach, fixed percentage approach and switch over rule. Top up approach would impose a minimum tax rate and would operate as a top up to achieve the minimum rate of tax.

Under fixed approach, fixed percentage would be used rather than a percentage of the parent jurisdiction's tax rate. Switch over rule would turn off the benefit of an exemption for income of a branch, otherwise provided by a tax treaty and replace it with the credit method.

**B. Tax on base eroding payments**

It denies a deduction (or impose withholding tax) in the source country on payments subject to no or only very low taxation. PoW would evaluate undertaxed payments rule and subject to tax rule, in terms of design considerations, its balance with the factors such as objectives, design compatibility and co-ordination with other rules, avoidance of double taxation and taxation in excess of economic profit, and minimizing compliance and administration costs.

Further, subject to tax rule may subject a payment to withholding or other taxes at source and deny treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate. This rule contemplates possible modifications to the scope or operations of the different treaty benefits. Broad issues to be explored in connection with the subject to tax rule includes the degree of overlap with the undertaxed payments rule, and timing issues also considering the overall principle that any rule should include measures to avoid double taxation

**NANGIA'S TAKE**

***The document highlights the progress and the important issues which has come up for consideration with the progress in the work of finding the consensus-based solution for tax challenges in the digitalized economy. The document has also established the importance of evaluating the methods and proposals by carrying out economic analysis. The OECD is working at fast pace to meet the committed timeline. The results would not only lower the uncoordinated actions of various economies opting for unilateral measures of taxing the digital giants, but would also streamline the global tax environment.***

*Source: http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf*

# 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.

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