How to appropriately tax a highly digitalized and globalized economy?

Addressing tax challenges arising from digitalization and trying to prevent Base Erosion and Profit Shifting (BEPS)

Mag. Martin Riedler
Central Specialized Unit for Legal Affairs
Joint Vienna Institute (JVI), 16 September 2022
Tax challenges arising from the digitalization of MNE groups

• Digitalization together with ongoing globalization of the economy complicates even more an appropriate taxation of multinational enterprise (MNE) groups
  – E.g., where should the profits of an MNE group that has branches all over the world and is gaining most of its profits by e-commerce be taxed?
  – Is there even something like a „digital economy“ that should be treated differently compared to the traditional economy? Or have we already arrived at a point where (almost) all kind of businesses can be part of the digital economy?

• Ongoing digitalization makes shifting of profits even easier (BEPS risks)
  – Highly „mobile“ profits
  – Challenging for policy makers to keep up with the pace of change
  – Agreeing on very targeted rules against BEPS gets more and more difficult
Multilateral Responses: OECD/G20 and European Union

• **OECD/G20 Inclusive Framework: Action Items against BEPS**
  – Anti Tax Avoidance Directive (ATAD) and ATAD II were agreed on an EU-level

• **OECD/G20 two-pillar solution to address the tax challenges arising from the digitalization of the economy**
  – EU Directive (for a coherent and coordinated implementation of the GloBE rules [Pillar Two] in the EU) agreed on a working party level, but no political agreement
    • Political agreement on a directive still possible?
    • Enhanced Cooperation (Art. 20 Treaty on European Union) as a way forward?
OECD/G20 two-pillar solution: Pillar One in a nutshell

- Expansion of taxing rights of market/user jurisdictions where there is an „active and sustained participation“

  - New Nexus (without physical presence)
  - Revised profit allocation
  - Removal of unilateral digital services taxes

  - Amount A
    - 25% of residual profits (> 10%)
    - Simplified tax base determination

  - Amount B
    - Simplified application of arm’s length principle on in-country „baseline“ marketing and distribution

  - Remainder
    - Profit allocation following standard transfer pricing rules

  - Tax Certainty (dispute prevention and resolution)
OECD/G20 two-pillar solution: Pillar Two in a nutshell

GloBE rules
(Global anti-Base Erosion rules)

Income Inclusion Rule (IIR)

UTPR

Subject to tax rule (STTR)

Minimum Taxation

15%
Effective tax rate (Jurisdictional blending)

9%
Nominal tax rate
Take-aways from the OECD/G20 projects

• Ring-fencing the digital economy has turned out to be impossible
  – Therefore, most recent rules are applicable to all parts of the economy

• Ongoing trend to focus only on the very biggest MNE groups
  – Implicit risk of complicating tax systems even more as there are different rules depending on the size of the tax payers

• There seems to be a trend to move on from very targeted rules to rules with a much wider scope, that work more mechanical
  – E.g. compare the scope of very targeted rules like the CFC-rules (first OECD/G20 anti-BEPS initiative) to the very wide scope of the Income Inclusion Rule of Pillar Two (part of the OECD/G20 two-pillar solution)
Future developments?

• Discussion