Wednesday, September 11

Seminar F: IFA/OECD

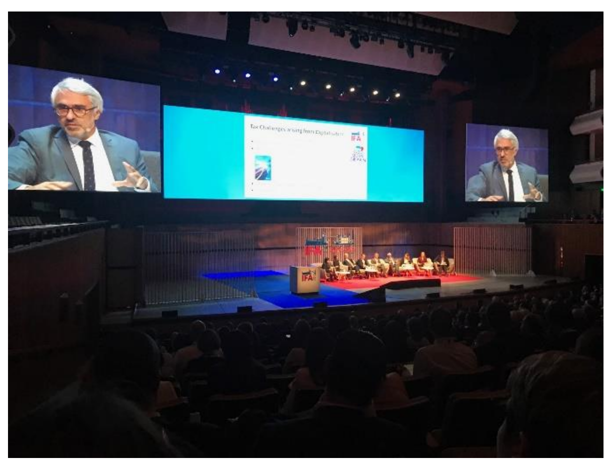
Chair: Stef van Weeghel (Professor of International Tax Law, University of Amsterdam & Global Tax Policy Leader, PwC)

Panel Speakers: Pascal Saint-Amans (Director, OECD, Centre for Tax Policy and Administration), Richard Collier (Senior Tax Adviser, OECD), Achim Pross (Head of the International Co-operation and Tax Administration Division, OECD), Lafayette G.(Chip) Harter (Deputy Assistant Secretary (International Tax Affairs), U.S. Treasury), Natalia Quinones Cruz, (Head of the Office for International Affairs, Colombian Tax and Customs Administration), Chia-Tern Huey Min (Deputy Commissioner (International, Investigation & Indirect Taxes Group), Singapore Inland Revenue Authority), Amy Roberti, (Director, Global Tax Policy, Procter & Gamble and Vice – Chair, BIAC), Wolfgang Schon (Director, Max Planck Institute for Tax Law)

Secretary: Erisa Nuku (Associate, Freshfields Bruckhaus Deringer)

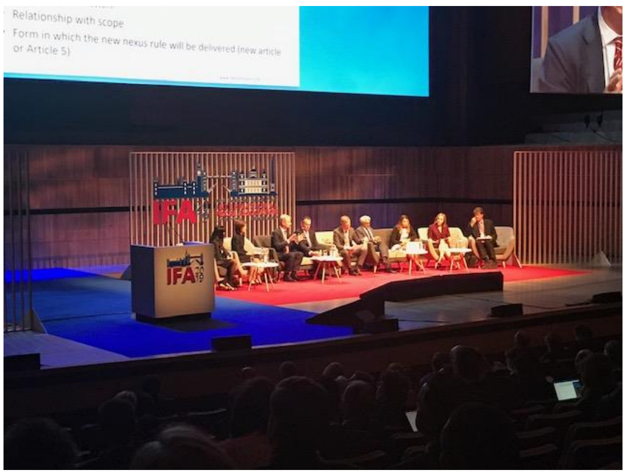
"These are exciting...and dangerous times..." remarked the great American politician Mr. Robert F Kennedy over 50 years ago... the IFA/OECD panel chair **Mr. Stef Van Weegel** kicked off the most eagerly awaited panel at the London Congress with Mr. Kennedy's quote, which according to him just about summed up the volatile international tax policy landscape.

OECD Tax Policy Director **Mr. Pascal Saint-Amans** then took the delegates through the latest on BEPS project, remarking that BEPS is well and truly "on its way..." He termed the MLI signing by 89 countries as a big success of the project and also an answer to the doubting Thomasses... He also stated that there are many more elements to BEPS than just the 4 minimum standards. Without wasting time, Mr. Amans acknowledged the 2 areas of frustration for stakeholders - i.e. Transfer Pricing (which has become more complex & difficult) and the 800 pound gorilla in the room - Digital Economy taxation!



Mr. Amans then drove straight into the debate on the tax challenges of 'digitalisation', terming the US tax reforms with a minimum tax, GILTI, BEAT provisions etc. at its core, as a 'fundamental change' that has facilitated a constructive conversation. Identifying 'highly digitalised business models' as the real challenge, Mr. Amans told the delegates that the group of countries thinking that nothing is needed, has shrunk. He then outlined the "two pillar" approach being worked on by the OECD, with the first pillar being the "Profit allocation and nexus" and the second pillar being "GloBE" (Global anti-base erosion proposal). He opined that

the solution would have to be based on these 2 pillars. Stating that the OECD was striving to unveil the first draft of a ‘Unified Approach' within a month, Mr. Amans conceded that they wouldn't be able to deliver a solution by 2020 in the absence of a Unified Approach on Pillar 1.



OECD's **Richard Collier** then shared the 3 pronged approach of developing a Unified Approach, namely - Identify a direction to solve the Digital Services Tax (DST), making it as less complex as possible, have it address digitalisation and must be one that goes beyond the Arm's Length Principle. He then talked of the possible overlap between the new approach and ALP and managing the overlap by ensuring it falls in the weakest part of ALP. In this context Mr. Collier mentioned the 'Residual Profit Split' approach as one possible solution. He went on to elaborate that the new approach could lead to a partial overwriting of ALP but at the same time, it ought to reconcile well with ALP. Later in the panel, he explained the 'Residual Profit Split' approach as follows:

1. Deem a certain level of a corporate's profits as 'normal' profits, that shall be out of bounds.

2. The excess over normal profits shall be the 'deemed residual' profit.

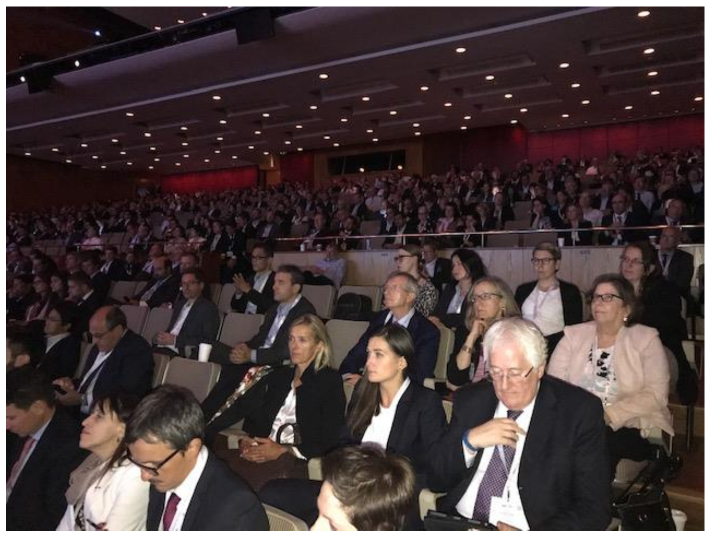
3. Identify the portion of the deemed residual profit to be allocated among market/user jurisdictions.

Mr. Collier summed up this approach as essentially taking a percentage of profits from the accounts of a company and allocating it to market/user jurisdictions. He did however add that this 'business-line' approach must be 'policeable' and 'practical.'

Mr. Lafayette Harter (Dy. Assistant Secy (International Tax) at US Treasury) chipped in with his 'personal' views, asserting that while the OECD embarks on this solution hunt, the 'scoping' decisions are critical and that an acceptable solution could be one that attracts both, broad support and capability of being implemented politically. Opining that the existing international tax consensus has served the world well for 100 years, he quipped that the current 'strain' was over digital models. He then framed the moot questions in this debate as - *"What are we trying to achieve? What needs to change?"*

He then went on to zero in on what he thought was the real problem, namely - Global lines of business that use intangibles to earn extra-ordinary profits. He called the focus on taxation of search engines and social media platforms as 'way too narrow' and saw the challenges facing international tax policy landscape as far larger. He remarked that the challenge is to find the right scope and felt that appropriate outcomes could be achieved by focusing on the core problem and if one did so, then the taxation of large international MNEs won't need much change.

Mr. Harter then gave his take on the 'residual profit split' approach, stating that allocation of residual profits above certain thresholds will isolate cases where extremely valuable intangibles are exploited. He sought to narrow down the applicability of this approach by 'isolating' the cases where current rules are breaking down and helping the MNEs to achieve tax results which are politically unacceptable. In this context he once again termed the scoping exercise as 'critical.'



Mr. Harter quickly added that a "full allocation (of profits) is off the table" and some incremental approach could be considered.. he once again referred to a well scoped regime that may allocate "somewhat more..." (profits) based on residual profits so that market countries can receive some share. He advocated a "high profit" threshold as part of the scoping exercise and a 'conservatively' higher threshold for departure from the Arm's Length Standard and Nexus... **Ms. Natalia Cruz** (Columbian Tax Administration) wondered as to how to allocate the residual profits to market jurisdictions? She opined that this may need a 'formula' approach... **Ms. Chia-Tern Huey Min** (Singapore Tax Administration) however had a note of caution for everyone, stating that one shouldn't 'oversimplify' to an extent that ignores the economic reality. She also stated that useful functions are performed in Global & Regional Head Quarters by way of strategic management, procurement function, etc. that creates a synergistic value for a MNE group. She therefore batted for setting of a level of profit that would be sufficiently high. She also suggested a potential new MLI for taxing rights allocation and called for a robust dispute resolution framework.

Ms. Amy Roberti (Director, Global Tax Policy, Proctor & Gamble) chipped in with the Industry view point, sharing that Businesses are looking for 'certainty' in the digital tax project and worried about a real possibility of escalation in tensions with USA's reaction to the unilateral levy of DST by several countries. She also felt that the lines are blurring between what is digital and non-digital. Ms. Amy then enlightened the delegates on the 5 aspects that contribute to the success of a manufacturing company:

1. Product

2. Packaging

3. Marketing/Advertising

4. Retail Execution

5. Users

Pointing to these factors, she then said that not all of them are equal contributors and went on to remark that *"If you don't get the product right, no matter what Roger Federer says (in the advertisement) you won't buy it."* She therefore took the point to its logical conclusion, opining that marketing is the least valuable thing while product is the most important and ought to occupy the pride of place in the value creation hierarchy.

Mr. Wolfgang Schon made a stirring intervention that received a loud applause from the delegates. His opening remarks - *" I haven't seen anything like this in international tax policy over the last 30 years... there is a paradigm change."* He opined that international tax is about 2 things - Principles and Money. He told the audience that we are witnessing a new form of revenue sharing - between production and marketing countries and between exporting and importing countries. He then quipped that the world is struggling to find a solution to fit the problem. He then drew the attention of panelists to the fact that the concept of Value Creation has been lost somewhere in the way ... Mr. Wolfgang then commented on the journey from 'digital' to 'digitalised' economy, which can't be ringfenced anymore. He alluded to the growing chatter about marketing intangibles and Significant Economic Presence (SEP) and said *" It is not digital anymore. "* Talking of an unlikely alliance that is shaping up between the United States and Emerging Market Economies, he stated that the traditional industrialised countries, i.e. Old Europe, better watch out. Looking forward, Mr. Wolfgang predicted that the solution won't be a destination based tax since VAT is not in the realm of Corporate Income Tax. While seeming to support the anchor principle that businesses ought to be taxed where value is created, he cautioned that while finding a unified solution one must be mindful that market size is not rewarded over 'effort', explaining that it disincentivizes Govt. effort to create infrastructure, education, promote R&D etc.

Ms. Natalia tried to do a fine balancing act on behalf of developing countries, arguing that it is in their interest to reach a co-ordinated multilateral solution and warned that a unilateral solution comes with the risk of companies making services costlier.

Mr. Richard Collier, speaking about the thinking on a 'new nexus' rule, shared that the countries are leaning towards a new article on the same. Ms. Amy, while stating that nexus is an important concept for businesses, expressed concern that it should not open up legal issues beyond tax. Carrying on in the same breath, she remarked that there are many reasons why a global company won't want to have a legal presence in 200 countries, drawing attention to the fact that tax in many countries has criminal liabilities.

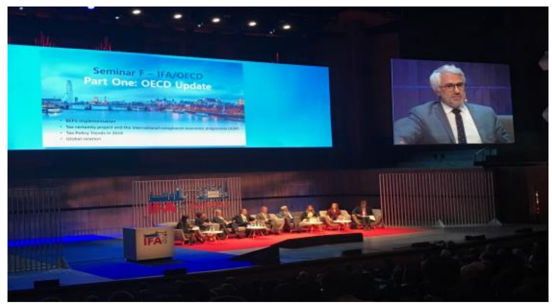
Mr. Achim Pross then quickly took the delegates through Pillar 2 approach of the OECD, i.e GLoBE (Global anti-base erosion proposal) and explained its underlying philosophy, stating that politicians feel that rationally operating businesses must pay a minimum amount of tax. Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation. He added that low tax is a key driver of discussions and in this context, referred to the concept of 'tax back' which GLoBE is premised on. He then shared the quandary being faced by the OECD in these words - "Whatever we do , will it create double taxation? " He said the emphasis would have to be on simplification, avoidance of double taxation and minimising compliance and administration costs. He acknowledged the 'real technical challenges' to make it workable, and also recognised the fact that any approach has to be EU compatible. Ms. Natalia argued in favour of 'carve outs', justifying it by citing examples of how developing countries attract investments by giving tax incentives.

Mr. Harter expressed some skepticism, remarking that implementing a per country measure is technically difficult to do and added that tax planning and incentives will still operate at the margins but will be countered by a lower international effective tax rate. He then played with a straight bat, making it clear that it would be politically difficult for the United States to support 'undertaxed payments' rule for US CFCs especially when GILTI is only 2 years old. Mr. Harter then warned of the consequences of then unilateral levy of DST by a few countries, quipping that " Such gross bases of taxes are not just bad taxes but a threat to the international system , unrestrained by OECD taxing principles. There is no reason to believe they will be restrained to Social Media. It is difficult to see a limit to gross base of taxes. "

Calling the targeting of US tech giants as an action against their 'National Champions', Mr. Harter minced no words when he said that political pressure runs both ways, that the big US companies are innovative and respected and USA intends to respond to countries who specifically target American companies. He reminded everyone that trade barriers give the US powers to respond and said that America feels it is important to defer proliferation of these unilateral actions. Mr. Harter held out hope that the OECD would succeed in its efforts because the alternative would mean 'broader trade disruption." Mr. Harter's final words on the panel said it all and captured the enormity of the issue...he said *"the international tax system is at a critical and perilous moment."*

Mr. Wolfgang opined that any approach requiring major international corporate groups to comply simultaneously with different CFC rules, might be overdoing the whole thing.

OECD Tax Policy Director **Pascal-Saint Amans** wrapped up the panel discussions, opining that status quo is not an option and that it is a chance for 'multilateralism', which one doesn't see too often nowadays. His parting words for the tax world - the Unified Approach to be unveiled by OECD within a month, could be a basis for negotiations.



The panel was moderated by tax luminary **Mr. Stef Van Weegel.**

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DTS & Associates Take:

OECD is proposing to scrap Arm's Length Principle (ALP), which they themselves have advocated and adopt modified residual profit method, which is net surplus over normal profit. Now, the places where goods are actually sold (the place of market) are asking for profit so what they are proposing is that the excess profit (i.e. super profit) be allocated. Of course there are many challenges with this and OECD is coming up with a report by October this year.

Developing countries like China and India made a big point that market places should be given due importance. So now FAR (Function, Asset and Risk) Analysis is not relevant but FARM (Function, Asset, Risk and Market) analysis has become relevant. However, USA is largely claiming that OECD is targeting only one country i.e. USA and therefore further delay might take place in finding solution for digital economy taxation while balancing developing countries concerns and taking care of big daddy's interest. The business even in U.S. will have to accept a proposition that there will be some tax payable by them in the countries in which the place of market exists. They cannot go away without paying any tax.