



**TAX AND**

**A PRACTICAL  
EXAMINATION OF  
CURRENT PROPOSALS  
FOR DIGITAL TAXATION  
AND INTERNATIONAL  
MINIMUM TAXATION FROM  
THE PERSPECTIVE OF  
SELECTED ECONOMIES –  
SOUTH AFRICA, GERMANY,  
SPAIN, KOREA, INDIA AND  
THE USA**

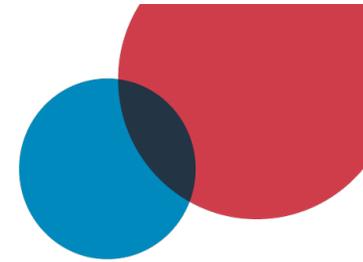
**IFA Congress,  
London**

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**September 11, 2019**

**Your global tax partner**

# PANELISTS



**JENS BRODBECK**  
**ENSAfrica, South Africa**  
T: +27 21 410 2500  
E: jbrodbeck@ensafrika.com



**XAVER DITZ**  
**Flick Gocke Schaumburg, Germany**  
T: +49 228 9594 226  
E: xaver.ditz@fgs.de



**RICARDO GOMEZ**  
**Garrigues, Spain**  
T: +34 91 514 52 00  
E: ricardo.gomez@garrigues.com



**KYU DONG KIM**  
**Yulchon, Korea**  
T: +82-2-528-5542  
E: kdkim@yulchon.com

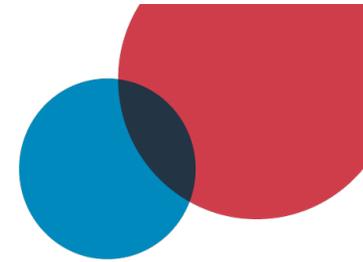


**SUHAIL NATHANI**  
**Economic Laws Practice, India**  
T: +91 22 6637 1993  
E: SuhailNathani@elp-in.com



**ERNESTO PEREZ**  
**Alvarez & Marsal, United States of America**  
T: +1 305 704 6720  
E: eperez@alvarezandmarsal.com

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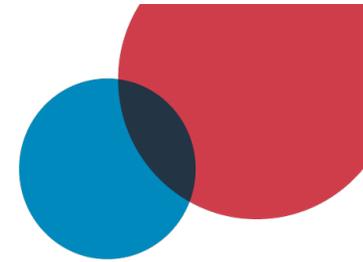


- I. Reform proposals of OECD / G20 / Inclusive Framework
- II. Reallocation of taxing rights – definition of a new nexus
- III. New profit allocation rules
- IV. Minimum taxation
- V. Conclusion



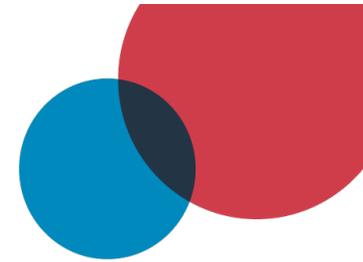
**REFORM  
PROPOSALS OF  
OECD / G20 /  
INCLUSIVE  
FRAMEWORK**

# REFORM PROPOSALS OF OECD / G20 / INCLUSIVE FRAMEWORK (1)



- ❖ The **tax challenges arising from the digitalisation** of the economy were identified as one of the main areas of focus of the OECD / G20 Base Erosion and Profit Shifting (BEPS) Project.
  - 2015 BEPS Action 1 Report: “Addressing the Tax Challenges of the Digital Economy”
  - Discussion of potential options, but no clear recommendations

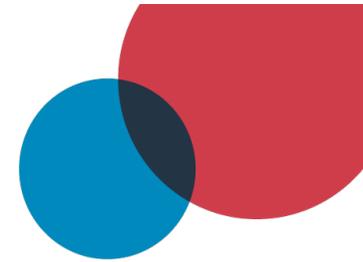
# REFORM PROPOSALS OF OECD / G20 / INCLUSIVE FRAMEWORK (2)



- ❖ In March 2018, the Inclusive Framework issued **Tax Challenges Arising from Digitalisation – Interim Report 2018**.
  - Detailed analysis of new and changing business models
  - Key aspect: Provision of services to customer without physical presence in the local market
  
- ❖ The **Inclusive Framework further intensified its work** after the delivery of the Interim Report.
  - Members made suggestions on the (new!) allocation of taxing rights and the rules on profit allocation.

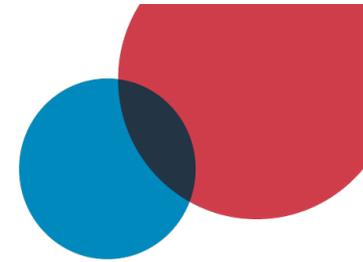
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# REFORM PROPOSALS OF OECD / G20 / INCLUSIVE FRAMEWORK (3)



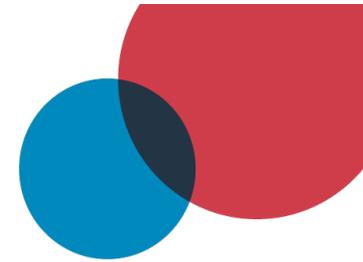
- ❖ In the Policy Note **Addressing the Tax Challenges of Digitalisation of the Economy**, approved on January 23, 2019, the Inclusive Framework agreed to examine and develop these proposals on a “without prejudice” basis.
  - **Pillar 1** focuses on the allocation of taxing rights (review of profit allocation and nexus rules).
  - **Pillar 2** focuses on the right to tax where other jurisdictions do not exercise taxation rights or tax “too low”.

# REFORM PROPOSALS OF OECD / G20 / INCLUSIVE FRAMEWORK (4)



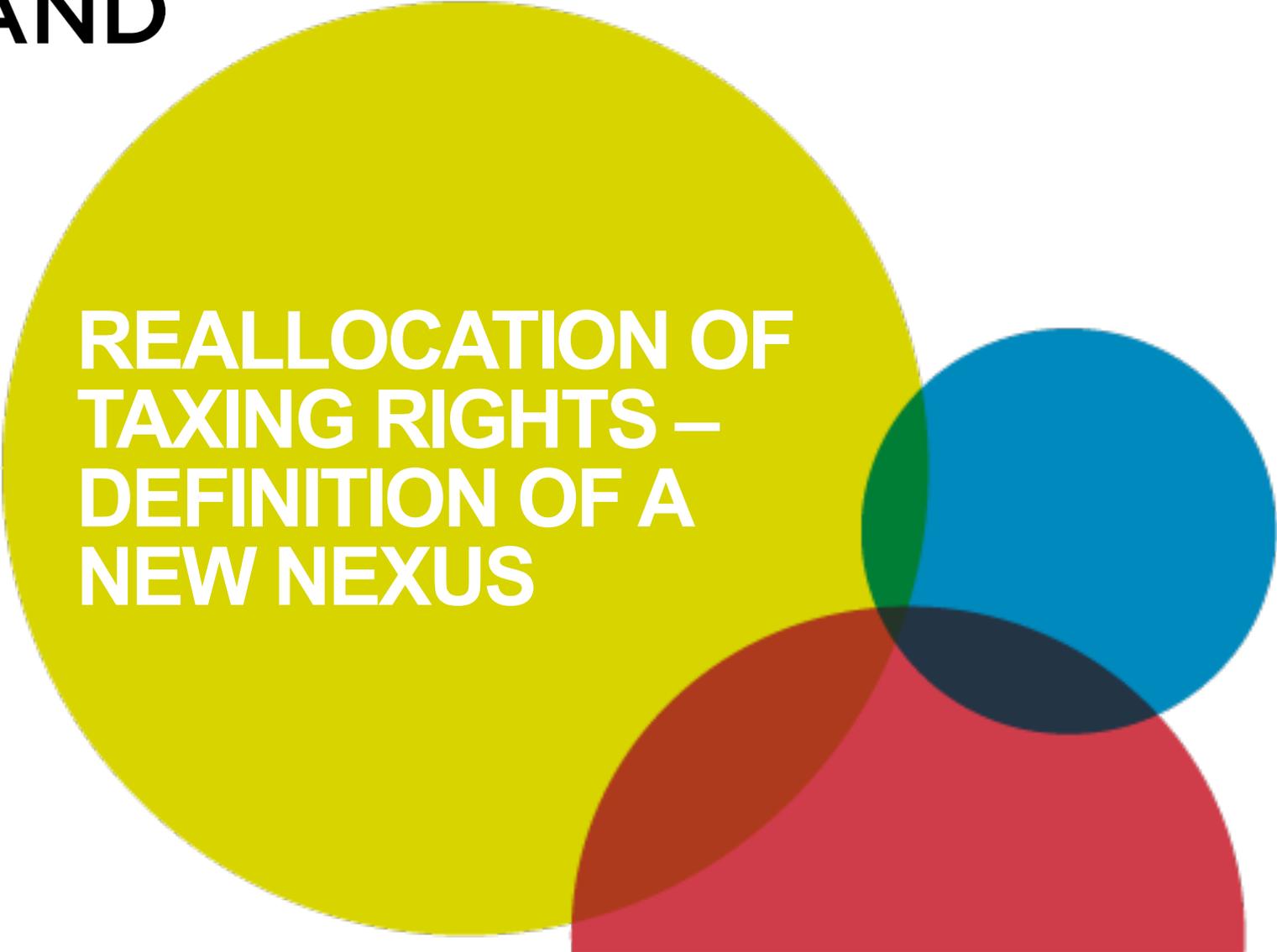
- ❖ **Public consultation meeting** at the OECD on March 13 and 14, 2019.
  - Dissatisfaction regarding taxing rights when there is no physical presence.
  - Risk that jurisdictions will adopt uncoordinated unilateral tax measures.
  - Dissatisfaction of many countries regarding lack of taxation rights without a physical presence.
  - Consideration of market presence for right to tax.

# REFORM PROPOSALS OF OECD / G20 / INCLUSIVE FRAMEWORK (5)



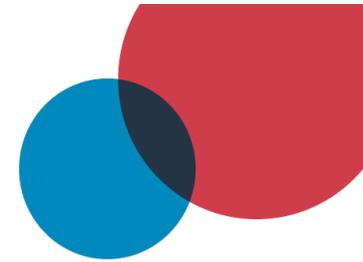
- ❖ On May 28 and 29, 2019 the **Program of Work** to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy was approved by the OECD / G20 Inclusive Framework on BEPS.
  - Analysis of **possible solutions** for pillar 1 and pillar 2.

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**REALLOCATION OF  
TAXING RIGHTS –  
DEFINITION OF A  
NEW NEXUS**

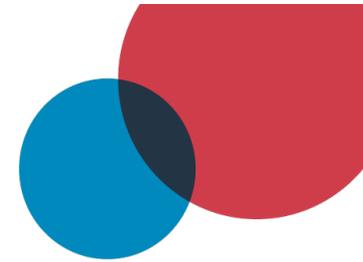
# REALLOCATION OF TAXING RIGHTS – DEFINITION OF A NEW NEXUS (1)



- ❖ Development of a new concept of taxing rights **when there is no physical presence.**
  - New concept of taxable income source
  - No physical presence requirements
  
- ❖ Development of a new non-physical presence nexus rule to allow market jurisdictions to **tax market / customer-orientated profits**
  - Amendment of p.e. definition in Art. 5 OECD-MC?
  - Amendment of Art. 7 OECD-MC regarding profit allocation?
  - Definition of a new concept of income taxable in the source country?

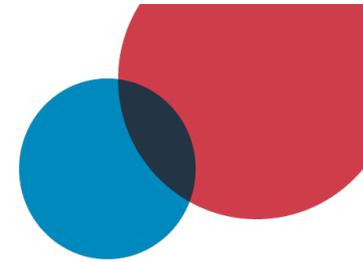
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# REALLOCATION OF TAXING RIGHTS – DEFINITION OF A NEW NEXUS (2)



- ❖ No reference to value creation as fundamental basis of definition of right to tax.
  - Existence of customer demand and buying power as argument for right to tax.
  - Justification by functions performed or risks assumed?

# FOR DISCUSSION



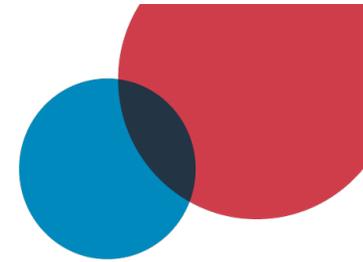
- ❖ What is your country's position on the redefinition of taxing rights?
- ❖ How can such a taxing right be defined?
- ❖ Do you see a risk that the new approach could be applied outside the digital economy as well?
- ❖ How can such an income-orientated taxing right be justified (without value added in the same country)?
- ❖ Can the new approach be practical?

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**NEW PROFIT  
ALLOCATION  
RULES**

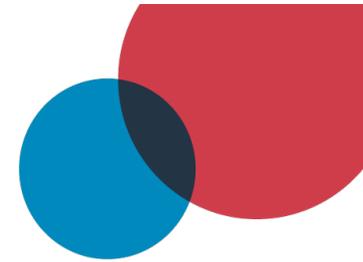
# NEW PROFIT ALLOCATION RULES (1)



## ❖ Concept:

1. Allocation of taxing rights and profits to **jurisdiction of customer** and/or of user (“market jurisdiction”).
2. Taxing right without a physical presence.
3. New profit allocation rules based on the total profit of the business.

# NEW PROFIT ALLOCATION RULES (2)



❖ **Three proposals** have been developed on how rights to tax income can be allocated among countries in the digital age:

**1. User participation proposal** (user nexus)

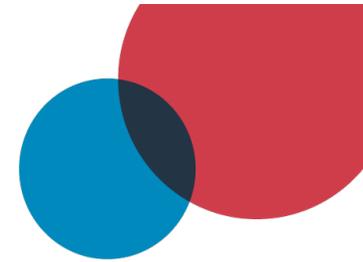
- Taxing right if user of source country uses a digital service
- User p.e.
- Focus on digital economy

**2. Marketing intangible proposal** (marketing IP nexus)

- Taxing right because of value created by intangibles in the same country
- Marketing p.e.
- No focus on digital economy

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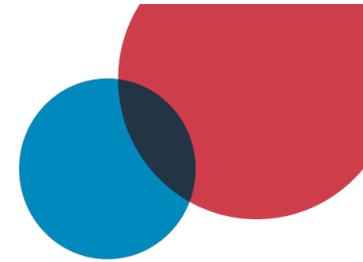
# NEW PROFIT ALLOCATION RULES (3)



## 3. Significant economic presence proposal

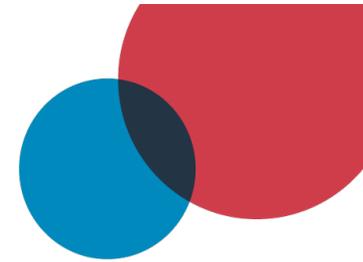
- Taxing right if non-resident company has a significant economic presence by interaction with the jurisdiction via digital technology and other automated means.
- Possible factors: (1) existence of a user base, (2) volume of digital content, (3) billing and collection in local currency, (4) the maintenance of a website in a local language, (5) responsibility for the final delivery to the customer or (6) sustained marketing and promotion activities.
- Discussed in BEPS action item 1.

# NEW PROFIT ALLOCATION RULES (4)



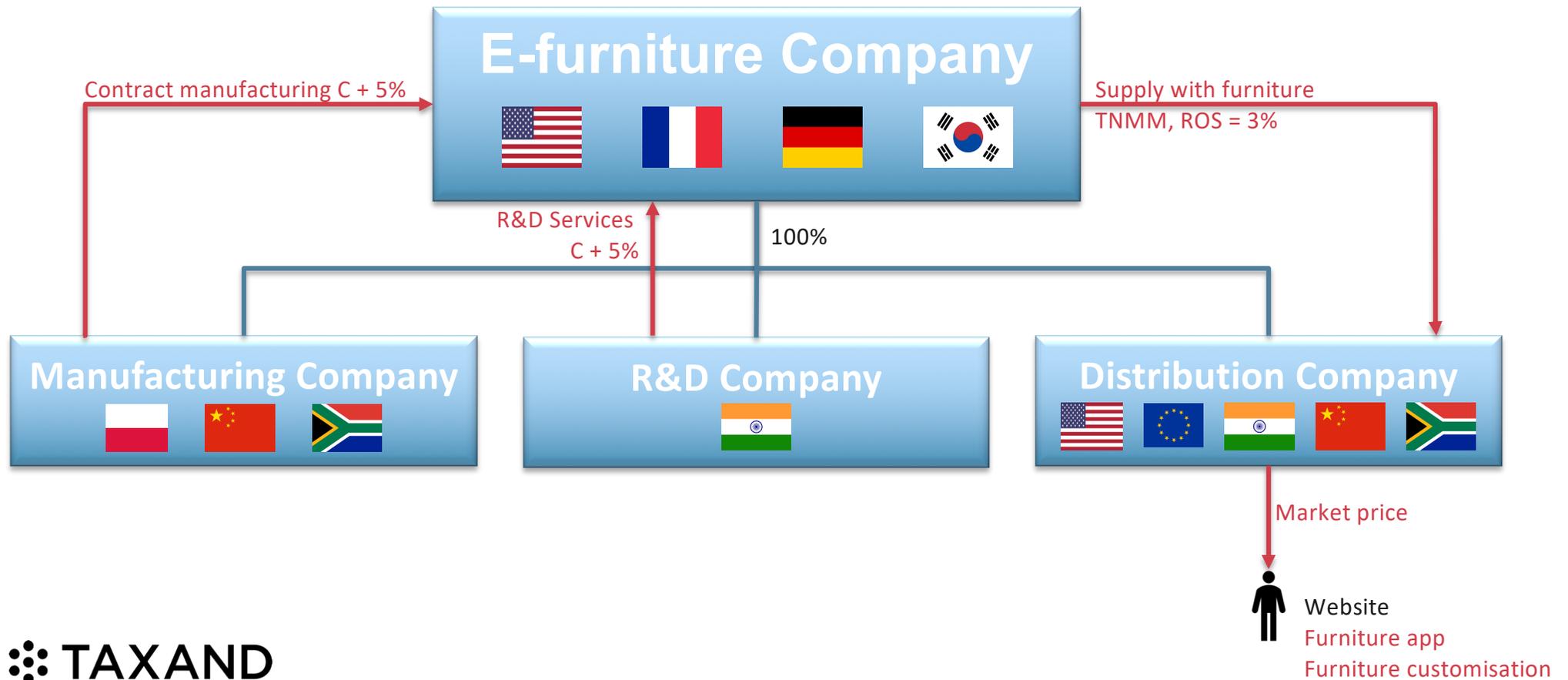
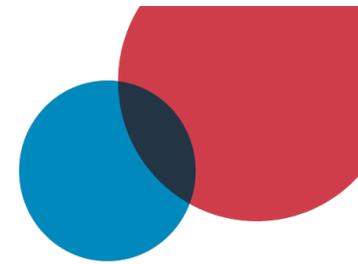
- ❖ Three proposals regarding methods of profit allocation to market jurisdiction:
  1. Modified residual profit split (MRPS) method
    - 4 steps:
      1. Determine total profit to be split
      2. Remove routine profit
      3. Determine residual profit that is within new taxing right
      4. Allocation key to allocate in-scope residual profit to relevant market jurisdictions
    - MRPS will coexist with tp rules

# NEW PROFIT ALLOCATION RULES (5)

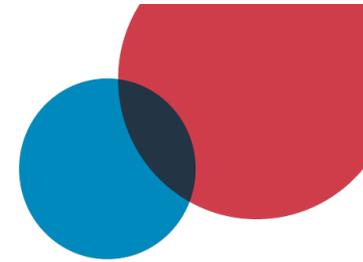


2. Fractional apportionment method
  - No distinction between routine and non-routine profit
  - 3 steps:
    1. Determine profit to be divided
    2. Select allocation key
    3. Allocate function of the profit to market jurisdictions
3. Distribution-based approach
  - Simplified approach
  - Allocation of baseline profit to market jurisdiction
  - Option: Increase of baseline profit on MNE overall profitability

# NEW PROFIT ALLOCATION RULES – CASE STUDY



# FOR DISCUSSION



- ❖ Is the discussion / implementation of the new profit allocation rules the end of the arm's length principle?
- ❖ Is the profit split approach accepted in your country?
- ❖ Will the jurisdictions with the manufacturing and R&D functions accept the new rules?
- ❖ What does the new approach mean for E-furniture Company's tax return?
- ❖ Are the measures to avoid international double taxation sufficient?

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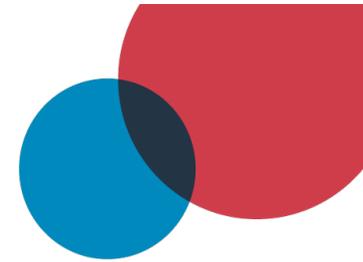
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**MINIMUM  
TAXATION**

The graphic features a large yellow circle on the left containing the text 'MINIMUM TAXATION'. To its right are three overlapping circles: a blue circle, a red circle, and a dark blue circle. The red circle overlaps the bottom of the yellow circle, the blue circle overlaps the top of the red circle, and the dark blue circle overlaps the bottom of the blue circle.

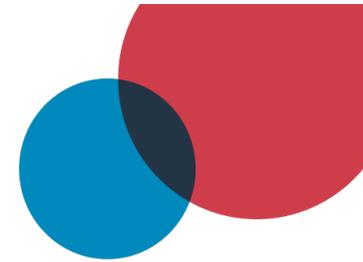
# MINIMUM TAXATION (1)



## ❖ Idea of pillar 2:

- **Each jurisdiction is free** to determine its own tax system (in particular CIT rate).
- However, other jurisdictions (in particular jurisdiction of parent company) have the right to apply a **specific tax regime** when income is taxed at an **effective rate below a minimum rate**.

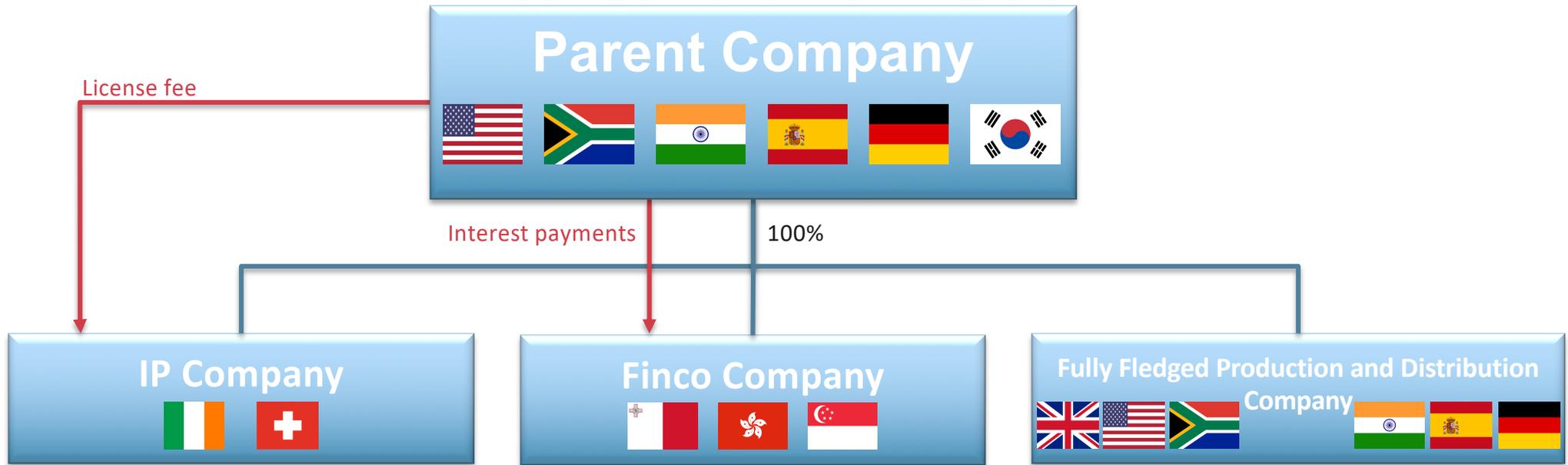
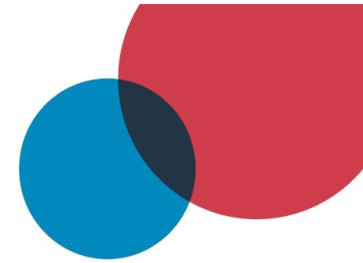
# MINIMUM TAXATION (2)



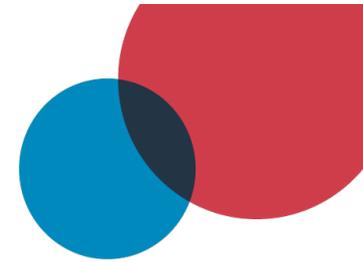
## ❖ Two proposals are being discussed:

1. An **income inclusion rate** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate
2. A **tax on base-eroding payments** that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless those payments were subject to tax at or above a minimum rate.

# MINIMUM TAXATION – CASE STUDY



# FOR DISCUSSION



- ❖ What is your country's position on the discussed proposals?
- ❖ What is low taxation?
- ❖ Is minimum taxation in line with CFC rules?
- ❖ If the minimum taxation is implemented, are tax avoidance rules still necessary?

Flick Gocke  
Schaumburg

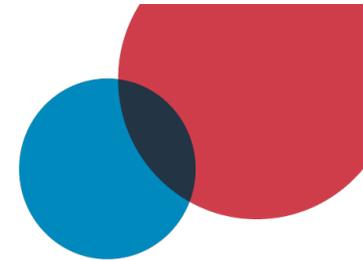
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ARSENE

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group.

YULCHON  
Attorneys at Law  
YULCHON

Kojima  
Law Offices

BARROS & ERRÁZURIZ

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