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- OECD releases proposal to rewrite international profit allocation rules

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The OECD has published a proposal to fundamentally alter the international profit allocation rules. There has been global concern around the ability of the current international tax rules to effectively tax digital multinationals as those rules were established against a backdrop of a much less mobile and more "tangible" economy. This proposal, now open to a public consultation process, has been driven by the OECD's efforts to date in addressing these challenges.

This proposal, if implemented, will significantly change the international tax system and is not ring fenced to the so called "digital economy". **Most international "consumer-facing" businesses will be impacted (not only the "tech" or online platform businesses).** We expect significant work will be required to get consensus on key definitions and exclusions.

The proposal seeks to allocate a greater share of taxing rights to market countries where consumers are located/where a company has substantial economic presence – regardless of a business' physical or taxable presence there under current tax treaty rules.

The proposal will generally mean a reallocation of more profit to market countries by determining (1) where tax should be paid ("nexus" rules) and (2) what portion of profits should be taxed – in certain circumstances this will be significantly different from the "arm's length principle" which is currently the cornerstone principle of transfer pricing analysis ("profit allocation" rules).

Further proposals are expected later this year on a global minimum tax. The expected timeline for implementation is sooner than expected (see timeline below), albeit from recent experience the implementation of OECD measures will take some time.

Earlier this year, the New Zealand Government released a discussion document outlining unilateral options to tax digital multinationals (see our June Tax Tips Alert). The Government indicated that if the OECD could not make sufficient process in progressing an international solution to taxing the digital economy, it would "seriously consider" a unilateral digital services tax.

It is promising to see the OECD progressing toward a consensus based solution. Whilst the Government has not defined what "sufficient progress" means, the latest OECD proposal announced should be seen as a significant step towards meeting this criteria. Our view remains that New Zealand should devote its policy resources to continue to work with the OECD towards a global consensus approach rather than diverting policy resources into further work on ideas for introducing a unilateral digital services tax in New Zealand. We understand that countries are expecting to decide whether to adopt the OECD's final proposals by the end of 2020.

Our UK colleagues provide further detail on the proposal to rewrite the international profit allocation rules in this Tax Policy Alert.

Please get in touch if you'd like to discuss what the changes proposed by the OECD mean for your business!

Timeline
Various OECD officials have repeated that we may see.

December 2019 / January 2020: Possible announcement of an agreement on a general technical framework.

Mid 2020 / End 2020: Possible announcement of a political agreement.

2021 / 2022: Implementation.

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