Executive summary

On 16 March 2018, the Organisation for Economic Co-operation and Development (OECD) released Tax Challenges Arising from Digitalisation - Interim Report 2018 (the Interim Report). The Interim Report is a follow-up to the work delivered by the OECD in October 2015 under Action 1 of the Base Erosion and Profit Shifting (BEPS) Project, which was focused on addressing the tax challenges of the digital economy.

The Interim Report provides an in-depth analysis of the main features commonly found in certain highly-digitalized business models and value creation in the digitalized age, but does not make any specific recommendations to countries. It reports that the [BEPS Inclusive Framework (BEPS IF)] members agreed to undertake a coherent and concurrent review of the nexus and profit allocation rules and that “They will work towards a consensus-based solution.” The report is explicit that “there are divergent views on how the issue should be approached” and that “there is no consensus on the need for, or merits of, interim measures, with a number of countries opposed to such measures.”

The Interim Report considers the implementation and impact of the BEPS package, in particular of those BEPS Actions Points that are most relevant to digitalization. It also provides an overview of unilateral measures that have been
introduced by countries in this area. Further, the Interim Report includes a framework that can be considered when designing interim measures to address the tax challenges of digitalization, as well as an outline of the possible long-term approaches to address these challenges.

The Interim Report notes that further work will need to be carried out to understand the various business models operated by enterprises offering digital goods and services, as well as digitalization more broadly. An update on this work will be provided in 2019, as the BEPS IF works towards a consensus-based solution by 2020.

Detailed discussion

Background

On 5 October 2015, the OECD released the final report on Action 1, addressing the Tax Challenges of the Digital Economy. The Action 1 final report considered the direct and indirect tax challenges created by increased digitalization and provided an evaluation of the options to address these challenges. The report suggested that, together, the other BEPS Actions Points would effectively address the challenges posed by the digital economy. In the report, the OECD also discussed a number of potential interim measures that countries may consider, but did not ultimately recommend any of them.

The report indicated that there would be follow-up work carried out in this area and that a supplementary report reflecting the outcomes of continued work on the overall taxation of the digitalization economy would be released by 2020.

On 22 September 2017, the OECD released a public consultation document seeking input with respect to the tax challenges raised by digitalization and the potential options to address these challenges. The request invited stakeholders to submit their comments on: (i) the impact of digitalization on business models and value creation; (ii) challenges and opportunities for tax systems; (iii) the implementation of the measures outlined in the BEPS package; and (iv) potential options to address the direct tax challenges of digitalization. Following this request for input, on 1 November 2017, the OECD held a public consultation on the tax challenges of digitalization at the University of California, Berkeley.

The Interim Report

On 16 March 2018, the OECD released its Interim Report on the tax challenges arising from digitalization. The Interim Report is organized into eight different chapters:

- Introduction to the Interim Report on the tax challenges arising from digitalization (Chapter 1)
- Digitalization, business models and value creation (Chapter 2)
- Implementation and impact of the BEPS package (Chapter 3)
- Relevant tax policy developments (Chapter 4)
- Adapting the international tax system to the digitalization of the economy (Chapter 5)
- Interim measures to address the tax challenges arising from digitalization (Chapter 6)
- Beyond the international tax rules: The impact of digitalization on other aspects of the tax system (Chapter 7)
- Conclusion to the Interim Report on the tax challenges arising from digitalization (Chapter 8)

The Interim Report commences by providing an overview of the impact of digitalization on society and the global economy and outlines the work carried out in this area to date. In Chapter 2, the Interim Report provides an in-depth analysis of the main features of certain highly digitalized business models and value creation. It further describes the main features of digital markets and how these shape value creation, and identifies three characteristics that are frequently observed in certain highly digitalized businesses, namely:

(i) Scale without mass
(ii) Heavy reliance on intangible assets
(iii) The role of data and user participation

In Chapter 3, the Interim Report considers the implementation and impact of the package of BEPS Action Points, in particular of those BEPS Action Points that are most relevant to digitalization. Chapter 4 outlines some of the unilateral measures introduced by countries in this area, grouped in four categories:
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(i) Alternative permanent establishment thresholds
(ii) Withholding taxes
(iii) Turnover taxes
(iv) Specific regimes for large multinational enterprise groups

Chapter 5 considers the long-term solutions to addressing the tax challenges arising from digitalization, with particular focus on revisions required to the existing profit allocation and nexus rules. Additionally, this chapter describes the next steps to take forward the work of the BEPS IF towards a consensus-based solution by 2020.

Chapter 6 of the Interim Report emphasizes that there is no consensus on the merits of, or need for, interim measures. A number of countries are explicitly against the adoption of such measures, noting that there is lack of conceptual basis and potential for adverse consequences. Thus, the Interim Report does not recommend the introduction of interim measures. In contrast, the Interim Report sets forth design considerations for countries in favor of introducing interim measures.

Chapter 7 discusses the implications of digitalization on other parts of the tax system beyond the international tax rules. The implications range from changes to the taxable status of economic actors arising as a result of a shift from standard to non-standard work, to new tools available to tax administrations that deliver improved taxpayer services, more effective data matching, and greater capabilities to detect and investigate tax evasion and fraud. With respect to this issue, the Interim Report considers the new features and new risks for policymakers and tax administrations, while it identifies areas where further work will assist governments to leverage from the latest technological developments.

The last Chapter describes the areas of further work that have been described in the Interim Report, and the directions for the future work of the BEPS IF. It is pointed out that there is consensus among the BEPS IF members on work towards a coherent solution by 2020 with an update in 2019.

Next steps

The Interim Report will be presented to the G20 during their meeting in Buenos Aires, Argentina on 19-20 March. The next meeting of the Task Force on the Digital Economy (the subsidiary body of the OECD addressing this issue) will take place in July 2018.

Despite the technical complexity and the diverse positions, it is agreed among the BEPS IF members to undertake a coherent and concurrent review of the rules and achieve a consensus-based solution. Following an update on progress in 2019, the BEPS IF will work towards a final solution by 2020.

Implications

While countries have different positions regarding the tax challenges arising from digitalization and possible solutions, the Interim Report notes that members agreed to undertake a coherent and concurrent review of the nexus and profit allocation rules and that they will work towards a consensus-based solution. The Interim Report also notes that at present, there are divergent views on how the issue should be approached, with the European Commission potentially issuing its own set of related proposals as early as 21 March 2018.

Additionally, the Interim Report discusses interim measures that both the European Commission and some individual countries have indicated they may implement, believing that there is a strong imperative to act quickly.

Although an update on this work will be provided in 2019 and the BEPS IF working towards a consensus-based solution by 2020, countries are already taking national action with respect to the tax treatment of activity in the digital economy. It also remains to be seen how the European Commission may incorporate the findings of the Interim Report when releasing its proposal for a new legislative framework addressing tax challenges arising from digitalization. Companies should therefore consider putting in place or increasing their efforts to monitor change at both multilateral and national levels.

A more detailed Alert on this development will be published next week.
Endnotes

1. The Inclusive Framework on BEPS brings together over 100 countries and jurisdictions to collaborate on the implementation of the OECD/G20 BEPS Package.


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