



Tax in a digital world: Why new international rules matter for everyone

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Tax in a digital world: Why new international rules matter for everyone

Robin Davis [00:00:06] Welcome to OECD Podcasts, where policy meets people.

Rory Clarke [00:00:11] Globalisation has been beneficial for many business people around the world, but one group of people it has made life more complicated for is tax officials. With so many companies doing business across borders, how can government tax authorities work out how much tax those companies owe or which countries they owe it to? Could multinational companies end up paying too much tax or too little or no tax at all? Such questions are not just technical. Policymakers also want answers, especially when public finances are under severe strain, as is currently the case with the COVID-19 pandemic. Now, the OECD has been leading international efforts to address these issues and aims to reach an agreement on some new tax rules this year. I'm Rory Clarke, and to help us understand the issues, I'm delighted to welcome Grace Perez- Navarro, who is deputy director of the OECD Centre for Tax Policy and Administration. Grace, thanks for joining us.

Grace Perez-Navarro [00:01:10] My pleasure, Rory.

Rory Clarke [00:01:12] Perhaps you could start by explaining how these tax challenges have come about and why people should care about them.

Grace Perez-Navarro [00:01:19] Sure. Happy to do that. Yes. Globalisation has had many positive impacts on people, businesses and economies around the world, but it has produced some serious tax challenges. Many of the tax challenges arise from the simple fact that every country has the sovereign right to establish its own tax system as it sees fit.

Grace Perez-Navarro [00:01:42] And so without some level of coordination among countries, this can produce gaps and mismatches between countries, different tax laws that enable multinationals to exploit those differences to artificially shift their profits to places with very low or no corporate income taxes. And so without some sort of coordination, you end up with this, this system that provides, in most cases, legal ways to escape taxation.

Grace Perez-Navarro [00:02:15] The other thing that has changed over time is the fact that increasingly more and more companies are deriving their profits not from selling goods, cars and detergent and whatever, but increasingly from what we call intangibles. So things like brands, think of luxury goods. They derive the bulk of their profits from the brand, not so much the actual thing.

Rory Clarke [00:02:45] By shifting, what do you mean? You mean shifting the accounts for tax purposes so they record the profit in countries that it might not necessarily have been earned, is that what you mean?

Grace Perez-Navarro [00:02:55] What essentially happens is that they can legally transfer just on a piece of paper and say, well, this brand is now going to be located in Ireland, for example, or the Netherlands or some other place. And so the brand has been transferred and then the profits the brand generates will be booked in that other country that may have lower taxation or a preferential regime or something. And so that is a way to transfer profits.

Grace Perez-Navarro [00:03:30] Another way that this is done is through the use of interest deductions. You'll book interest deductions in a high tax country and the loan or whatever it is you're paying for, will be in the low tax country. So the income will be booked in the low tax country and the deduction in the high tax country. So these are the kinds of things that a company can play with to reduce its taxes.

Rory Clarke [00:03:58] So this profit shifting leads to an erosion of the tax base in particular countries. And these countries are not getting the tax they rightfully deserve, is that it?

Grace Perez-Navarro [00:04:09] They are not getting the tax on the basis of where value has been created.

And this is precisely why in 2013 we launched the project with the G20 countries to tackle what we call "base erosion and profit shifting" [BEPS], to realign taxation where value has been created. We came up with 15 measures to try to address this, to restore the connection between real substantive activities and not mere paper profits, but where things really happen. We also try to bring about greater coherence in the tax laws of different countries, which was something fairly new for us: countries realised that while yes, that's a sovereign right of theirs, but there was greater value in coordinating positions across countries to avoid this exploitation of loopholes.

Rory Clarke [00:05:17] Are you saying that some countries were losing out? Are you talking about developing countries or even some OECD countries?

Grace Perez-Navarro [00:05:24] I think there were a lot of countries across the globe that felt they were losing out, whether they were large or small, developed or developing, because the objective of companies was to shift profits and minimise tax to the maximum extent possible. And because we're talking about large multinationals, they would have the legal advice to do this in a way that was technically legal. But what we may have called aggressive tax planning. So that was really the objective.

Rory Clarke [00:05:57] Now, you mentioned brands and new forms of business, which are harder to calculate in terms of where the revenues are earned and where the activity is. But for a few years now, the OECD has been helping to lead very important international talks on how tax rules should apply to digital firms such as Google, Facebook, Amazon, giants like that. Why would digital firms be different?

Grace Perez-Navarro [00:06:19] Well, actually, this was an outgrowth of the BEPS project. Action 1 of the 15 actions that I mentioned before was to address the tax challenges arising from the digital economy. And one of the key things that was included in that work was that there isn't something you can ring fence to talk about as the digital economy, but in fact, the whole economy is digitalising. And so you may say, well, no cars, but yes, cars increasingly have so much technology built into them, so much artificial intelligence that you can't say there's one thing that is called the digital economy. Our current rules are based on whether or not a company has a physical presence in a country in order for that country to be able to tax the profits derived in that jurisdiction.

Grace Perez-Navarro [00:07:18] And of course, now with highly digitalised activities where there is no longer a need to have a physical presence in order to engage very substantially in the economic life of another country, without having a physical presence these rules don't make sense anymore, because the physical presence rule really is what defines the connection to the country—what we call “the nexus” to the country—to justify that country having a taxing right. And so that's something that has changed in the digitalised world.

Rory Clarke [00:08:02] So what are governments hoping to achieve from the talks which are ongoing now? Is it more revenue, more fairness?

Grace Perez-Navarro [00:08:11] Well, it's really both of those things. It is definitely about fairness. If you take the situation of buying books online versus buying them at the local bookshop, there needs to be a level playing field. And it's also about revenues because countries do feel that they are losing a revenues that they should rightfully be able to tax.

Rory Clarke [00:08:36] I don't suppose there any estimates of what countries are foregoing, I presume that's too difficult to work out?

Grace Perez-Navarro [00:08:41] Well, actually, we have developed a proposal which consists of two pillars, one which creates a new nexus, as I just mentioned, and a new taxing right for the countries where these profits are being generated.

Grace Perez-Navarro [00:08:58] And then we also have another pillar, which is basically a backstop to all of the other BEPS measures, which is to ensure that all multinationals pay an agreed minimum level of tax. And so we have done some simulations and have estimated that our proposal would increase global corporate income tax revenues by about US\$50 to 80 billion US dollars per year. So we're talking about around 4% of global corporate income tax revenues in total.

Rory Clarke [00:09:36] And what about the firms themselves? How are they responding to this? What are the businesses telling you.

Grace Perez-Navarro [00:09:43] Well, what we hear and different businesses are in different situations. So what we hear is that they would like to see a global, multilateral, consensus based solution. They would like to see the unilateral digital services taxes go away because those are gross basis taxes, not on profits, but on revenues. And they would like to see a common approach. So that is what we hear. Business has provided a lot of input on the technical aspects of the design of these pillars.

Grace Perez-Navarro [00:10:21] But I suppose what we're not necessarily seeing is 100% endorsement of what we have proposed and lobbying for our solution. I suppose a lot of businesses would just like to see both the digital services taxes go away and our proposal go away. But recognising that that is not a reality, I think most businesses are trying to engage constructively in a design that would work.

Rory Clarke [00:11:01] Large firms like Google are often at pains to say that they fully comply with the law, that they're only doing what shareholders expect in keeping the tax bill down and maximising returns. Are we seeing a shift in this thinking in the business sector? And are the laws themselves perhaps also a little bit out of sync with the global economy?

Grace Perez-Navarro [00:11:22] Yeah, well, and I'm not speaking about any specific company, but I would say in general that we are seeing a bit of a shift in perspectives on this issue of maximising shareholder value, for example. And this relates a lot to the work that we have been doing on tax morale, which essentially is what is the willingness of companies to pay tax in a responsible manner.

Grace Perez-Navarro [00:11:54] And so we've seen principles for how companies should look at their tax responsibilities and engage with tax authorities. We've seen The B Team, which was originally launched by Richard Branson as a responsible business conduct group of companies, and they have come out with tax principles and what companies should do to pay tax responsibly. We've also seen institutional investors, big pension funds coming out with the statement saying they will not invest in companies that don't engage in responsible tax behaviour. And so I think there is a bit of a shift in perceptions here. I think businesses do understand that they need to comply with both the letter and the spirit of the law. And of course, this was a big part of what our BEPS project was about, trying to get companies to pay tax responsibly.

Rory Clarke [00:12:58] Now back to countries. One of the traditional things governments have is that if you overtax firms, they may up and leave to another jurisdiction. Now, countries are on board with this, as you say, but are there any niggling fears?

Grace Perez-Navarro [00:13:15] Well, different countries are in different positions, although I think the vast majority of the inclusive framework members—and we have 139 members—are interested in finding a global solution, because while they, of course, are interested in ensuring that their tax system remains competitive and that they have an overall attractive business environment, which includes what the tax system is, at the same time, they need to collect revenues in order to finance essential public services, like hospitals, roads, schools. And so, there's always that tension. And at the end of the day, in order to avoid a complete race to the bottom, countries have come together in order to get global international rules of the game.

Rory Clarke [00:14:10] Yes. At your recent Inclusive Framework Conference, the mood seemed quite positive, actually. "Let's get it done", I heard some countries saying: when are we aiming for exactly? Maybe you could explain the timeline a little bit, that lies ahead.

Grace Perez-Navarro [00:14:24] Yes. Well, we have a very tight timeline to come to a solution by mid-2021. So that is a very ambitious timeline. Now, having said that, we did publish in October two very detailed blueprints: one for Pillar 1, the nexus and profit allocation rules, and two, the minimum tax blueprint. And so we have a lot of agreement on a lot of issues.

Grace Perez-Navarro [00:14:52] There are still some outstanding political issues that need to be addressed. One of the key questions there is this question of the scope of these new nexus and profit

allocation rules. Another layer of the whole scope question is the size of companies. And so we're looking at targeting large multinationals in this project. And so that is another issue. Where will the thresholds be set?

Grace Perez-Navarro [00:15:22] But if we're able to resolve the scope questions, we think we will be able to come to agreement in June.

Rory Clarke [00:15:36] Of course, you work at the OECD with countries all around the world, not just OECD and G20; what are developing countries and emerging countries saying they have a different perspective or any concerns about this new setting of international rules on taxation?

Grace Perez-Navarro [00:15:54] Well, I think a lot of developing countries have an interest in ensuring that there is a change in the current international rules where they are not getting anything at the moment. I think they're also very interested in the minimum tax. And one of the key concerns is about the complexity of the current rules. And so we will be over the coming months looking to try to simplify the proposals so that they're easier to administer. But we have to remember that we're talking about the operations of large multinationals and so their activities are not simple.

Grace Perez-Navarro [00:16:37] One of the other things that is very important in the context of the project is providing tax certainty both to taxpayers but also to tax administrations. Taxpayers will want to ensure that there is no double taxation resulting from the overlay of these new rules. And tax administrations will want to ensure that there is certainty within a specific timeframe. Otherwise this will become unmanageable.

Rory Clarke [00:17:11] You mentioned the public consultation. Maybe tell us a little bit about that, because I'm sure a lot of listeners must think that these negotiations take place in little dark corners away from the public eye. How do the consultation go? Was there any interesting or surprising feedback?

Grace Perez-Navarro [00:17:28] Well, we have had several public consultations on this project over the last few years. And with the most recent one was on the 14th and 15th of January, we received over thirty-five hundred pages of comments from over 200 stakeholders, from business, civil society, academia and NGOs from around the world. And so that input is very useful in helping us to further refine and shape the proposals.

Grace Perez-Navarro [00:17:59] The comments showed a strong interest in the OECD delivering an international consensus based solution to prevent the proliferation of these uncoordinated unilateral measures. I'm sure you have seen that the reaction of the United States to these unilateral measures targeting its digital companies has been to impose sanctions. And so what we are potentially being faced with is a tax war, becoming a trade war, and businesses don't want that. Governments don't want that. And so it was very reassuring to see that interest in a multilateral solution being reflected in the comments.

Rory Clarke [00:18:48] Turning to the OECD role in all of this, the organisation marks its sixth anniversary this year, and it has a long history in international tax governance and rule-making, going way back; there

was the fight against tax evasion and tax havens in the 1990s and then, of course, the financial crisis in 2008 when the focus turned to transparency and profit shifting. How do you see progress? Are we in a better place now? And how much has that history helped?

Grace Perez-Navarro [00:19:19] Yes, I think there's definitely been tremendous progress. And I would say, yes, that it's because of the foundations that we laid early on that we were able to make this progress. A lot of times that it looks to people as though the changes that they've seen in recent years have been quite a revolution. But really, these changes have been evolutionary. If you think about the work that we were doing in the 90s and after that, the work that we did to address harmful tax practices, the work that we launched back then on getting rid of bank secrecy, if we had not done that core or work, then we would not have been able to make the progress we have made.

Grace Perez-Navarro [00:20:05] Why do I say that? What was important when we hit the financial crisis was the creation of political momentum to address these issues. And so prior to that, we didn't really have a G20 focusing on tax evasion and avoidance. The G20 wasn't there. There was no political grouping that could really push these issues forward.

Grace Perez-Navarro [00:20:31] And so we were working on those issues at a technical level. The financial crisis, for better or for worse, did give us that impetus and we were ready with solutions, and so we were able to take the things that we had done and really build upon those. And now, of course, with all of this political attention, with yet another crisis upon us right now, we're going to continue to be able to move these issues forward. I.

Grace Perez-Navarro [00:21:02] I think we have come a long way. And so I'm very proud of what the OECD has done to address a lot of the key issues. There's still much more to do. And it's important to keep addressing the issues because once you close one loophole, there's always something else. And so, it is important to continue the discussions. What I think has been a big breakthrough in our work is that we have so many more countries around the table helping to develop these rules. And though that may sometimes be harder to get agreement, at the end of the day, you have a much better system in place to try to tackle these issues.

Rory Clarke [00:21:47] Of course, the world has changed enormously in the last year with a COVID-19 pandemic. How has this changed your work? And presumably this has given your work extra urgency?

Grace Perez-Navarro [00:21:58] Yes, it has given extra urgency on a number of levels. One, it's more important than ever to fight tax evasion and tax avoidance. Two, one of the things that has happened during this pandemic, when people who have been confined or in lockdown and unable to go out to go shopping as they've done online shopping. And so a lot of these digital companies have profited tremendously well at the same time, more traditional companies may have suffered. And so it just highlights the need to resolve this issue and ensure that all companies are paying their fair share.

Rory Clarke [00:22:41] Grace Perez Navarro, you have been at the heart of efforts to improve international tax for many years and have witnessed more than one crisis, more than one challenge. As a tax expert,

but also as a human being, what is it like to work in such an extremely sensitive, yet critical area for all? And what advice would you give to a younger you, someone starting out in your field today?

Grace Perez-Navarro [00:23:05] Well, I know that a lot of people think tax is very boring, but I can assure you that it's been incredibly exciting working on all of these issues here at the OECD. And I can't think of a better place to work on these issues and build global consensus on some of the most important issues of the day. So what I would say to people entering this field is that it is not just about helping people file tax returns. There's so much that can be done through the tax system because governments are not collecting taxes for tax sake. They are collecting these taxes in order to provide hospitals, schools, roads. But not only that, but to pursue different social objectives, to address inequality, to address poverty. And so there are so many things that can be done through the tax system.

Grace Perez-Navarro [00:24:02] One of the things we're working on right now, which is so exciting, is dealing with climate change, and taxes have a key role to play in changing the behaviour of companies and what they invest in. So our work is incredibly important for the planet.

Rory Clarke [00:24:20] Grace Perez Navarro, thank you for enlightening us on the world of international taxation and making it fairer for everyone. Thank you for all you've been doing and good luck in the important work in the months ahead.

Grace Perez-Navarro [00:24:32] Thank you.

Rory Clarke [00:24:36] If you'd like to find out more about the issues discussed in this podcast, go to www.OECD.org/tax. Thank you for listening.

Robin Davis [00:24:56] To listen to other OECD podcast, find us on iTunes, Spotify, Google podcast and SoundCloud.com/OECD.