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OECD Centre for Tax Policy and Administration

OECD

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For attention: Ms Yanga Maputa
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Dear Sir/Madam

SAICA WORK ON THE UNIFIED APPROACH

We refer to the Organisation for Economic Cooperation and Development's (OECD) and the G20 Nations' Inclusive Framework reports entitled "Tax challenges arising from digitalisation – Report on the Pillar One Blueprint" ("Blueprint – Pillar One") and the "Tax challenges arising from digitalisation – Report on the Pillar Two Blueprint" ("Blueprint – Pillar Two"), published on 12 October 2020, which contain proposals that will change the global tax landscape once finalised.

The South African Institute of Chartered Accountants (SAICA), South Africa's pre-eminent accountancy body, is widely recognised as one of the world's leading accounting institutes. SAICA is a founding member of the International Federation of Accountants, Chartered Accountants Worldwide and the Global Accounting Alliance. The Institute provides a wide range of support services to more than 50 000 members and associates who are chartered accountants [CAs(SA)], as well as associate general accountants (AGAs(SA)) and accounting technicians (ATs(SA)), who hold positions as CEOs, MDs, board directors, business owners, chief financial officers, auditors and leaders in every sphere of commerce and industry, and who play a significant role in the nation's highly dynamic business sector and economic development. SAICA's main office is located in Johannesburg, but it also has three regional offices throughout South Africa. However, with more than 8500 members outside South Africa, SAICA maintains representative offices in both the United Kingdom and Australia.

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Member of the International Federation of Accountants (IFAC), Pan African Federation of Accountants (PAFA), Global Accounting Alliance (GAA), Chartered Accountants Worldwide (CAW) and Investors in People. Proudly South African.

The SAICA Transfer Pricing Committee, have reviewed the Blueprint reports and what this could mean for multinational groups operating in Africa. In this regard, we are also collaborating with our sister/similar organisations in Uganda and Zambia in respect of the Blueprint Pillar One Report.

We wish to comment on the following key areas:

The Blueprint – Pillar One Report:

1. The relevance of Amount B;
2. Amount B: What are possible in-scope activities, and how to define it;
3. Amount B: What should the economic analysis to determine Amount B look like;
4. Amount B: Confirming the operation of this practically;
5. Amount A: Commentary on scope, nexus and revenue sourcing;
6. Amount A: Confirming the likely operation of Amount A and alleviation of double tax, and the interaction with Digital Service Taxes; and
7. Thoughts of dispute prevention and resolution.

The Blueprint – Pillar Two Report:

1. Limitation of pre-GLOBE carry-forward losses; and
2. Potential coherence issues with the allocation of income and taxes.

Comments on the Blueprint – Pillar One Report:

1. <u>Focus on the relevance of Amount B</u>

At the outset we wish to state that we support simplicity (within reason), certainty, the arm's length principle, mitigation of double taxation and reduction of transfer pricing disputes. We are grateful for the work done to date to pursue these objectives.

From the constituency consulted, including for example MNEs in different industries operating across South Africa and other African countries, members of SAICA and African sister institutes and tax practitioners, there is a concern about the lack of certainty in Africa especially for baseline marketing and distribution activity. In most, if not all African countries, there are no successful Advance Pricing Agreement ("APA") programs to date to grant certainty and the Mutual Agreement Procedure ("MAP") programs have resulted in limited and more time consuming resolution of double taxation than would have been expected for a continent with such a large and increasing amount of transfer pricing disputes. Most African countries do not include a mandatory arbitration requirement in their treaties to expedite the MAP process. The Blueprint – Pillar One proposes the adoption of a representative panel to assist with double taxation disputes coupled with a mandatory binding dispute resolution process. In order to be effective, countries in Africa which adopt the blueprint should be encouraged to adopt such remedies into their treaties, or participate in a multilateral instrument that achieves this result in law. Absent this and coupled with the number of court cases rising (including the Nestle and Mopani cases in Zambia) and the lack of options to mitigate double taxation, the risk of double taxation and transfer pricing uncertainty of controlled transactions is high.

Our understanding is that Amount B aims to standardise the remuneration of "baseline marketing and distribution activities" (more specifically for distributors, regardless of industry), to increase simplification in the administration of transfer pricing and to enhance certainty and to limit the potential for disputes. In addition, it is understood that Amount B would constitute an arm's length return in terms of article 9 of the OECD Model Tax convention and/ or domestic legislation or guidance. A fixed return for in-scope activities based on the arm's length principle is proposed.

Amount B has the potential to simplify compliance, bring much needed certainty, reduce the amount of transfer pricing disputes, and consequent double taxation where disputes remain unresolved. Failing on Amount B would be failing on a key objective of Pillar One.

Should the Inclusive Framework not achieve consensus on Amount B, we would gladly engage to give input on a pilot project which includes African countries willing to participate in the project to achieve greater certainty, with respect to what constitutes arm's length remuneration for baseline marketing and distribution activities in Africa. For such a pilot to achieve the objective of increased tax certainty the key trading partners of the countries engaging in the pilot must commit to recognise Amount B as an arm's length outcome.

Regardless, the sections below elaborate broadly on our views of what the scope of Amount B could be, and how to determine it.

2. Amount B: In-scope activities

To determine whether a taxpayer performs "baseline marketing and distribution activities" for distributors, to which Amount B applies, we propose a dual test for distributors (i.e. taxpayers that buy and sell finished goods and/ or services):

- inclusion test; AND
- exclusion test.

Inclusion test:
To determine whether a tested party, and more specifically a distributor of goods and/ or services[1] would fall within an Amount B in-scope activity, we wish to propose that this should be determined by a formula to assess intensity of the distributor, e.g.:

- the use of operating or sales and general administrative ("SGA") expenses to sales for distributors. Operating expenses would be defined as the costs between the gross profit and operating profit level per local GAAP; or
- value adding expenses to sales threshold for distributors. Value adding expenses could simply be costs or expenses incurred by the in-market "distributor" which are

[1] This would only be applicable to associated enterprises who contractually sell to customers of the group and are purely re-sellers.

not external, e.g. employment costs, depreciation and other overheads, but excluding third party advertising and marketing costs, foreign exchange gains/ losses.

If the distributor's operating expenses or value adding expenses to sales ratio falls below a threshold relevant to its industry and region, it should achieve a margin, being "Amount B". This proposal is based on the assumption that reliable thresholds can be determined by industry (and even by region). The relevant ratios could be determined by either a) input from industry, or b) analysis of publicly available data in databases.

<u>Exclusion test:</u>

If the tested party met the inclusion test, the next step could be to apply an exclusion test to ensure that the distributor is functionally performing routine distribution activities. We propose that the distributor should be excluded from the application of Amount B if:

- There has been a significant year on year movement (e.g. 20% or more) in either its sales or uncontrolled costs, above the operating profit/ earnings before interest and tax ("EBIT") profit level (e.g. significant volatility caused by factors such as foreign exchange gains/ losses or as result of adverse or abnormal market conditions, such as depressed oil prices or COVID-19). The commercial reality is that such losses can arise (also in third party transactions) as a result of adverse market conditions. This formulaic exclusion test acknowledges this. In particular, entities suffering significant foreign exchange losses as result of dramatic currency depreciation against the US$ and Euro is a reality in the African region;

- The tested party is in its first [two to three] years of operation, to cater for volatility typically observed in "start-up" businesses. Consideration should be given whether distributors, which receive guaranteed margins, should qualify for this exemption;

- The tested party's revenue and/ or cash flow is regulated contra to the arm's length principle (e.g. competition law, pharmaceutical single exit price regulations, foreign exchange regulations). It has happened that some MNEs have been subject to exchange control restrictions, in especially Nigeria and Ghana, where arm's length payments could not be made from these countries; <u>**or**</u>

- If the negative functional factors (initial suggestions, which aligns with the content in the Blueprint – Pillar One at para 669) in the table below apply, the tested party would then fall out of the scope of Amount B.

	Functions to possibly exclude (negative factors) – not baseline marketing and distribution activity
Market	Sets, prescribes and controls market strategy, consumer value strategy for Region/ Global market; core demand creation strategy.

	Functions to possibly exclude (negative factors) – not baseline marketing and distribution activity
	Brand governance (determining brand visual, core brand messaging parameters, competitive positioning). Regional/ global strategic marketing/ brand roles. Strategic marketing: Setting overall core marketing strategy, developing key multi-territory campaigns, defining market research priorities and driving priority campaigns for Regional or global market. Controlling decisions regarding the defence and protection of IP.
Sell	Set and controls pricing strategy and maximum prices at which products can be sold in markets. No sales mandate parameters. Product development.
After-sales	Define the vision and strategy for customer service, segment customer base and define priority segments for Region/ Global market. Perform significant after sales support and advice.

Note that, if a distributor is excluded from Amount B, it does not necessarily imply the existence of an intangible or premium in excess of Amount B. It is just an indication that the arm's length nature of controlled transactions should be determined in accordance with the OECD Transfer Pricing Guidelines.

Applying the above criteria would likely exclude Regulated Businesses and multinational groups operating on a decentralised basis, e.g. banks, insurance companies, regulated fund managers, mobile and fibre telecommunications companies.

The Blueprint – Pillar One also proposes exclusions based on valuable marketing intangibles. In this regard we request that greater guidance is provided as to the interpretation of "valuable". To this end, customer lists and the right to distribute in certain markets or industries may be viewed as valuable intangibles. In addition, countries' domestic law may recognise these as intangibles creating conflict between the international position and the domestic law. We recognise that where such valuable market intangibles exist, the taxpayer should arguably not be in scope of Amount B given the functionality in-market that lead to the development, enhancement and maintenance of the intangible.

3. Determining Amount B

To arrive at Amount B, we recommend the following analysis to arrive at a reliable Amount B for baseline marketing and distribution activities, in Africa specifically, given the lack of comparable data for the region:

- Consider performing a global TNMM benchmarking search (at both the EBIT and profit before tax ("PBT") or Earnings before tax ("EBT") profit levels) and segment results by industry and region (at both country level, region and developing and developed market level). Operating expense, SGA expense and Value-adding expense data should also be observed, if available, to inform the inclusion test;

- Corroborate the above, for Africa, by considering a deductive approach, using an appropriate database, and/ or the additive approach to select MNEs, with publicly available data, who largely operate in Africa, to sense check the margins identified through the search above. The publicly available data for businesses in Africa is usually of listings on African stock exchanges. These businesses have of course a greater functional profile than one would expect of a distributor subject to Amount B. In the absence of reliable comparables in Africa, when stress testing an appropriate margin for distributors subject to Amount B, to evaluate the margins of "all in risk groups"[2] operating in Africa could be supportive of an arm's length margin for Amount B in Africa. Surely distributors would not earn more than all-in risk entities/ entrepreneurs. This data can frame broad profitability, i.e. be indicative of a ceiling of returns;

- Corroborate the above, for Africa, by considering alternative PLIs, for example return on working capital, return on operating expenses and/ or return on assets. Further work should be done to consider the impact of funding on distributors in Africa; and

- To the extent that reliable data can support it, consider comparability adjustments to account for unique factors impacting distributors operating in the Africa region such as the impact of foreign exchange risk, if this risk, or its impact, is not an exclusion criterion (see above).

We would welcome the opportunity to refine recommendations on:

- whether returns should be capped though with reference to group profitability. Should distributors in the industry have low profitability, this would reflect in the benchmarking study performed;

[2] Multinational Enterprises (MNEs) that carry on a consolidated basis all the functions, assets and risks of the value chain within that economic unit.

- the impact of fragmentation or of functions in separate distributors. Some groups could have longer supply chains or multiple subsidiaries in one country with shared functions, which could result in the “split” of functions and margins;

- whether the ultimate target margin should be Operating (EBIT) or Net (EBT/ PBT) profit. The benefits of PBT as a profit level indicator would be greater simplicity and certainty, given the variable interest rates, variable accounting of foreign exchange gains/ losses in Africa (above and below the EBIT level) and the relatively recent introduction of IFRS16, which caused the reclassification of certain parts of operating lease expenses as quasi- or notional interest;

- the economic impact to a market jurisdiction if the target margin for Amount B is too high; and

- whether there should be a rebuttable presumption that Amount B for baseline marketing and distribution activities shall prevail, unless it can be refuted by reliable internal comparables.

4. The Operation of Amount B

We wish to also confirm the operation of Amount B and highlight the implications of achieving a target margin at the end of the relevant year of assessment.

We would recommend that the target margin be achieved at the end of the year of assessment (as contained in the local statutory audited annual financial statements), to mitigate the exposure to secondary adjustments, withholding tax and customs duty, if applicable.

Should this not occur, we recommend harmonisation of other taxes with Amount B, for example, thought should be given to the knock-on impact of transfer pricing adjustments on customs duty, VAT and withholding taxes.

We recommend that the test for Amount B be in local GAAP (as opposed to group GAAP), regardless of tax accounting or specific tax rules.

For Amount B to achieve desired success, we believe that the above, in respect of Amount B, could be reconciled to the arm’s length principle and not necessitate changes in either local legislation or double taxation agreements.

We support the codification of Amount B in a multilateral competent authority agreement to give the required certainty in local law on what Amount B would be.

We further recommend that Amount B be reviewed every three years, and its success be evaluated through a peer review mechanism, akin to other peer review mechanisms.

5. Amount A: Commentary on scope, nexus, revenue sourcing

We commend the OECD for its extensive work on especially the activity test for ADS and CFB. We acknowledge that it is groundbreaking tax policy, with many political and commercial challenges, amidst a departure from traditional international tax principles.

Depending on the consensus of political positions among the Inclusive Framework, we would welcome simplification of the activity test.

To this end we would encourage the Inclusive Framework to consider:

- Whether it is possible to combine the key features of ADS and CFB, and also to clarify the purpose of the two sets of definitions. In this respect, we understand that:
    - The reason for the different activity tests is as a consequence of different governments' input, the possibility of different ratio's to be applied to the two activity tests, and possible phased implementation; and
    - The overlapping key elements of both activity tests are focused on business that generates profits because of its active, sustained, automated, digital, participation in the market, especially where the MNE has limited to no presence in the market, directly or via a third party;
- Whether a general definition could be defined first (with illustrative examples to be included, i.e. the current positive factors), and then apply negative tests for business that should not be in scope; and
- Clear allowance for segmentation for out of scope activity to apply turnover tests to, especially where MNEs engage in whole or in part in business-to-business arrangements, as opposed to activities which drive demand by the ultimate consumer.

Many MNEs function on a regional basis due to the heterogeneity of the regions, with regional management developing marketing, sales and after-sales strategies that are aimed at acquiring and retaining consumers in the respective regions (e.g. the marketing strategy applied across the MNE group is not a one strategy for all regions). In such situations, determining Amount A with reference to a Group's consolidated financial statements, which contains regional segmented financial information, could be more appropriate. Determining Amount A with reference to only the Group consolidated financial statements of the ultimate holding company (without regional segmentation) would not result in a fair allocation of taxing rights to market jurisdictions.

We further welcome the *de minimus* foreign in-scope revenue test. We suggest that consideration be given not to define the domestic market only with reference to the ultimate parent, but also to consider situations where the revenue is ultimately generated outside of the "domestic market" where the intangibles which generate that profit, vests. In other words, the "domestic market" could be defined as the market where intangibles vest or entrepreneurial activity largely take place, and more than [X]% of revenue as a result of that intangible or activity vests in that market or country. This could occur from time to time especially where the MNE made acquisitions, rely on cost sharing arrangements and/ or "ring fenced market participation", i.e. limited participation in a market outside the "domestic market".

Further, the Blueprint – Pillar One proposed a safe harbour for when an actual segmented approach should be taken for in-scope transactions to when a hypothesised approach should be taken. As many African jurisdictions will likely fall below any such safe harbour level, we would welcome input into the proposed approach of hypothesising segmentation based on the consolidated financials. Furthermore, even where the aggregated in-scope revenue falls within the proposed safe harbour, many African jurisdictions may still prefer segmented financials to be prepared on an actual basis. Taxpayers should have the opportunity to present the most reliable segmentation of its business, where in-part, in-scope of Amount A.

It is noted that the blueprint proposes the GAAP of the UPE be adopted and that there is unlikely to be significant variances from local accounting standards. We would welcome any findings on comparing variances between US GAAP, IFRS and local accounting standards, but appreciate the practicality of relying on the UPEs GAAP.

6. <u>Operation of Amount A</u>

We understand that what is proposed is that a designate group company of an MNE ("the paying entity"), would pay income tax in its country (i.e. the country of tax residency of the paying entity) on Amount A (if any), with allocations to relevant countries or markets' Revenue Authorities. The tax authority collecting the tax on Amount A would distribute the tax to the relevant countries or markets' Revenue Authorities. Consequently, Amount A is a <u>notional calculation</u>, and is not determined by actual inter-company transactions or tax registrations in market jurisdictions. Consequently, there is no need to consider customs, withholding tax or deductibility of charges for domestic corporate tax purposes.

Those countries which have already or will introduce a unilateral Digital Services Tax ("DST") may therefore need to withdraw the DST on adoption of the proposed approach. In some instances, transactions which fall outside the scope of amount A, as a result of the scope, or as a result of the safe harbours may still be subject to DSTs. Consequently, thought should be given on how to provide relief for such unilateral measures, or whether governments and taxpayers may elect to be subject to Amount A to ensure relief from double taxation – especially where MNEs are excluded based on turnover thresholds. To this end, the multilateral instrument and DST legislation should provide for the required relief.

It can happen, conceivably, that Amount A could be subject to tax already in the market jurisdiction by virtue of the residual profit being realised in the market where a multinational enterprise operates on a decentralised basis, or if for example Amount B has been exceeded for whatever reason. Notably, this can occur on highly decentralised consumer facing businesses, e.g. professional service firms and telecommunication service providers. In this case, we wanted to confirm and support that relief from double taxation should be considered either through credits or exemptions in the paying jurisdiction, or market jurisdiction. We propose that a credit (or exemption) in the paying jurisdiction be given (i.e. the country where the paying entity is tax resident) in the calculation of taxes to be paid on Amount A. This should be the most efficient, especially given that group accounts are often finalised before local statutory accounts.

It would be important that the "paying entity" be tax resident in a country that participates in the ensuing multilateral competent authority agreement.

We also wish to note our concern about the administrative burden that Amount A would cause on limited taxpayers in Africa which would be subject to Amount A. The tax functions of South African listed groups are often not as sizable as larger global MNEs. The extent of the administrative requirements to comply with Amount A is uncertain. We welcome further debate on the Amount A threshold to ensure that the compliance burden does not outweigh the Amount A objectives.

We welcome further debate on regional differentiation in the determination of Amount A, even within Africa. Profit profiles can differ widely from one market to another in Africa, e.g. while end-to-end system profit could be high in country A, it would not necessarily be so in country B.

While some MNEs may have reasonably homogenous profits, there will be many MNEs that have differing margins by business segment and market. Market profitability may differ substantially (i.e. achieve healthy profits in one region versus losses in another region) due to the impact of specific market conditions and cost infrastructures relevant only to that specific geographical region.

7. Dispute prevention and resolution mechanisms

For the unified approach to be successful in Africa, there should be a deliberate action on the part of the OECD/ inclusive framework to ensure that Revenue Authorities are not incentivised by assessment targets. This can hamper the successful implementation of the unified approach.

Lastly, we support binding mandatory arbitration.

Comments on Blueprint – Pillar Two

SAICA fully supports the objective of the GloBE rules under Blueprint - Pillar Two. We welcome a next step in the fight against base erosion and profit shifting by introducing a global minimum tax regime for MNEs. SAICA encourages decision makers to ensure its application is straightforward, transparent and allows for a pragmatic approach. This would imply that the OECD's ongoing work with respect to Pillar Two further strives to minimize additional compliance burdens for MNEs and develops robust mechanisms to prevent and resolve any disputes where an MNE is directly or indirectly, e.g. disputes between jurisdictions, implicated.

Such a minimum tax regime must assure that an agreed minimum tax is paid on the economic income that is earned in each jurisdiction where an MNE carries on its activities. At the same time, the GloBE rules must ensure that the 'ability to pay'-principle is respected in all circumstances, preventing taxation in excess of economic income and discrepancies in the allocation of income and covered taxes to the jurisdictions. In this light, SAICA takes the opportunity to single out two specific topics in the Blueprint – Pillar Two that may have a negative impact:

- **Limitation of pre-GloBE carry-forward losses –** such a limitation would impose a sanction on MNEs that have made important investments and acquisitions in past years to expand their existing activities; and

- **Potential coherence issues with the allocation of income and taxes –** any incoherence could lead to a jurisdiction being inadvertently qualified as a low-tax jurisdiction for the purposes of GloBE potentially leading to double taxation.

1. <u>Carry-forward of (pre-GloBE) losses</u>

Previous draft blueprints on Pillar Two provided that operational losses in a jurisdiction are carried forward as an allowed deduction in the computation of the GloBE tax base in the subsequent year. The carry- forward mechanism provides a solution for the temporary differences that may arise between financial accounting income and tax computation of income. SAICA underwrites the principle that MNEs should not be subject to GloBE tax because of the mere recovery of prior period losses.

The carry-forward mechanism for operating losses would also apply to the so-called 'pre-regime losses', i.e. losses the MNE Group suffered in the periods prior to becoming subject to the GloBE rules. Failure to take appropriate account of pre-regime losses would result in a GloBE tax on a distorted picture of the MNE Group's tax position, resulting in a taxation in excess of operating profit and an over taxation of economic investments. Disregarding pre-regime losses under the GloBE-rules would convert timing differences on the recognition of profit and loss into permanent differences based on the arbitrary fact that the MNE Group was not subject to GloBE when the investments were made and the operating losses were incurred[3].

Although the carry-forward of losses is, as a principle, unlimited in time, it was stated in previous draft blueprints that there would be an exception for pre-regime losses.

Such a limitation in time for pre-regime losses would impose a sanction on MNEs that have made important investments and acquisitions in past years to expand their existing activities, If the relevant jurisdiction applies a tax loss carry-forward that is unlimited in time, as is the case in most instances, this will automatically result in GloBE tax as the losses that relate to the pre-GloBE investments will continue to

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[3] Draft blueprint, para. 357.

reduce the covered taxes in that jurisdiction in relation to the GloBE income. In other words, the restriction of pre-regime losses would undermine the rationale of Pillar Two. That is to prevent taxation in excess of economic income, in accordance with the 'ability to pay'-principle.

Previous draft blueprint's justification to limit the use of historical losses is t*he alleged permanent nature of these losses because of a change in the entity's operations*. It is important to underline that only in very rare cases will the investments that resulted in 'historical' losses relate to *different* economic activities than the activities the MNE carries out when entering into the GloBE regime. The concern that MNEs would abuse the tax loss carry-forward must be adequately addressed through separate anti-avoidance rules targeting undesired changes of control or changes of activities, and not by introducing a limitation in time for the use of pre-regime losses. Such a specific anti-avoidance rule appears to be already incorporated in the Pillar Two blueprint.

A further justification for limiting the carry forward of pre-regime losses could be that that some simplification is required in the computation of the carry-forward and that it would be burdensome for each relevant entity to perform a re-calculation of prior year income and taxes to determine the pre- regime carry-forward. The valid concern for simplification and reduction of burdens for MNEs does not justify a limitation in time for the carry-forward of pre-regime losses. The losses resulting from pre-regime investments and acquisitions will in principle only be re-calculated and invoked in GloBE by those entities that are impacted by pre-regime losses. The result of unlimited carry-forward of pre-regime losses in GloBE would be a GloBE tax in accordance with the ability to pay-principle preventing taxation in excess of economic income. A GloBE tax respecting its underlying objectives outweighs any practical arguments regarding a –potentially complex- burden of proof for MNEs, requiring a GloBE computation for pre-regime years.

Furthermore, a limitation in time may have discriminatory effects as it potentially affects presumably more sectors that have large, historic investments.

2. <u>Coherent allocation of income and taxes</u>

An effective and fair GloBE tax includes rules that ensure that the GloBE tax base and the related taxes are correctly allocated to the same jurisdiction for the computation of that jurisdiction's effective tax rate. If there would be any discrepancy in the allocation of the covered tax and the related GloBE tax base, this will inevitably lead to unintended GloBE tax that is not in accordance with the underlying policy objectives of Pillar Two. The jurisdiction to which the GloBE tax base is allocated, without the related taxes, may inadvertently qualify as a low-tax jurisdiction for the purposes of GloBE.

SAICA believes that the principle of a coherent allocation of GloBE tax base and taxes is already reflected in the draft blueprint. However, it should be further considered whether additional correction mechanisms should be implemented to prevent and/or remedy potential discrepancies.

By way of example, ABI refers to the treatment of dividends within an MNE. Generally, a dividend results from (taxable) income of a subsidiary. Therefore, the jurisdiction of the subsidiary includes the (distributed) income in its GloBE tax base and, likewise, the related taxes on this income are included in the covered taxes of the subsidiary's jurisdiction. In the parent's jurisdiction, GloBE provides for an exclusion of the received dividend from the GloBE tax base, as in most cases, the dividend will be low or not taxed in the parent jurisdiction (for example, because the parent jurisdiction provides for an exemption to avoid economic double taxation). The exclusion of the received dividend from the parent's GloBE tax base qualifies as a permanent difference compared to financial accounting. Both the income and the taxes on the income are included in the computation of the effective tax rate of one jurisdiction, i.e. the subsidiary's jurisdiction.

However, when the subsidiary distributes a dividend that benefits from a dividend deduction regime the Blueprint - Pillar Two introduces an exception to the general rule. In this case, the (tax) deduction of the dividend is also applied on the GloBE tax base in the subsidiary's jurisdiction. In parallel, the dividend is not excluded from the GloBE tax base in the parent's jurisdiction[4]. The covered taxes on the dividend distribution are then also allocated to the parent's jurisdiction. Thus, withholding taxes on the dividend distribution in the subsidiary's jurisdiction qualify as covered taxes for the computation of the effective tax rate in the parent's jurisdiction. Again, both the dividend income and the related taxes are included in the computation of the effective tax rate of one jurisdiction, i.e. the parent's jurisdiction.

A discrepancy would arise where, for example, a withholding tax on the dividend, would be allocated to the subsidiary's jurisdiction. As a result, the effective tax rate in the subsidiary's jurisdiction would be too high as the withholding taxes are included as covered taxes, but the (deductible) dividends remain excluded. In this example, the effective tax rate in the parent's jurisdiction takes into account the received dividend, but not the withholding taxes. The effective tax rate in the parent's jurisdiction would, in this example, constitute a high-risk for the GloBE tax even though a correct amount of taxes was paid on the dividend income.

SAICA wishes to obtain the confirmation that the GloBE rules assure under all circumstances that GloBE income and related covered tax are allocated to the same jurisdiction, as set out in the above paragraphs.

SAICA believes that mechanisms must be further developed for MNEs to anticipate or remedy any potential mismatch in the allocation rules in specific circumstances.

[4] Draft blueprint, para. 68-72 and 157-160

We look forward to hearing from you.

Yours sincerely

Christian Wiesener
Chairperson: Transfer Pricing Subcommittee

Dr Sharon Smulders
Project Director: Tax Advocacy

The South African Institute of Chartered Accountants