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FEEDBACK SUMMARY
PUBLIC CONSULTATION ON THE PROPOSED UNIFIED APPROACH UNDER PILLAR ONE
HOSTED BY NATIONAL TREASURY WITH ATAF
DBSA MIDRAND
[22 January 2020]

GENERAL

SAICA attends various discussions and meetings on behalf of members with National Treasury ("NT"), South African Revenue Service ("SARS") and other stakeholders (internal and external). These meetings represent an opportunity for them to obtain further information on any tax matter from the public and discussions and views expressed do not represent policy or decisions. Furthermore, these discussions do not represent an undertaking by SARS, NT or other stakeholders, but merely statements of their understanding or how they perceive or anticipate a particular matter to be addressed.

The below Feedback Summary should be seen in the above context as merely attempts to inform SAICA members of the discussions and of any proposals that were made during such discussions.

FEEDBACK SUMMARY

ATAF and the National Treasury (NT) thanked the delegates for attending and the following matters were discussed and points raised during the various opening remarks and panel discussions:

- **INTRODUCTION**
  - Global businesses – digital or not – are all affected by the OECD proposals.
  - Broader implications of tax justice need to be considered and African countries have a concern that their share of tax revenue is going to shrink further.
  - Africa has a dependency on aid and is heavily reliant on debt. Africa needs funds to aid domestic development and hence must secure its tax base.
  - The right choices must be made to secure better taxing rights. Developing countries have a resistance to move away from ALP and want to keep a high threshold.
  - Currently there are tentative positions but no hard positions have been taken as yet.
  - USA current views – Pillar 1 should be optional, otherwise they will opt out. What will the impact be for others?

SESSION 1 – THE CURRENT POLITICAL LANDSCAPE FOR ADDRESSING THE TAX CHALLENGES FROM THE DIGITILISAITON OF THE ECONOMY IN AFRICA

Thulani Shongwe ATAF (chair)
Anthony Munanda (TechnicalAdvisor ATAF)
Ben Dickenson (Head Global Relations OECD)
Lazalle Terrblanche (Chair AITA)
Susanne Ruiz (Oxfam)
Yanga Mputa (Chief Director, NT)

- Proposals under Pillar 1 – new nexis rule that does not depend on physical presence & revised profit allocation rules (allocate to market jurisdictions).
- Unified approach comprises 3 amounts: Amount A, Amount B and Amount C

AMOUNT A – portion (%) of residual profit

- Profit allocated to market jurisdictions (formulaic approach)
- Technical issues that need further consideration:
  - MNEs in scope (*de minimus* test)?
  - Activities in scope (consumer facing businesses)?
  - Carve out of certain business activities (extractive, financial services)?
  - Nexus rules to determine eligible market jurisdiction?
  - Allocation of tax base – group accounts or segmented eg. region/industry?
  - Quantum of routine profits?
  - Determination of residual profits (Amount A)?
  - What are allocation keys?
  - Treatment of losses?

AMOUNT B – fixed return for baseline distribution functions

- Fixed returns could vary by industry/region
- Proposal will provide simplification in administration, increase certainty & reduce disputes
- Technical issues that need further consideration:
  - Definition of baseline activities?

- Profit measure to be used – EBIT or PBT?
- Use of benchmarking studies to determine fixed percentages?
- Explore different fixed % of profit measure for different industry/regions?

AMOUNT C- additional return for activities exceeding those covered in Amount B based on TP analysis.

- Apply current TP rules to activities in market jurisdictions going beyond baseline activity covered by fixed return in Amount B
- Introduce appropriate robust measures to eliminate double tax & resolve disputes (mandatory binding arbitration)

- **QUESTION: SHOULD SOUTH AFRICA CONSIDER UNILATERAL MEASURES?**

- Current position: Some countries have already implemented measures, eg social media tax, VAT on digital services in SA, Ghana: VAT, Nigeria proposal re digital tax on income. DST already introduced in France, UK in draft, Canada busy looking at this. 40 unilateral measures in place currently.

Mr Ben Dickinson:

- Sense of urgency (eg. French/US dispute); *tax war can lead to trade war*!
- Stem tide of unilateral measures. Must have political solution by end 2020. Key meeting next week.
- Technical work will extend beyond 2020, but broad agreement on architecture of Pillar I & II (Global minimum tax) as a package must be obtained.
- Complexity: 137 countries + first time MNE treated as a group
- Benefits for Governments:
  - **a.** more money for African governments (especially SA)
  - **b.** simplicity (Amount B)
  - **c.** above will ensure certainty (formulaic approach & fixed returns)
  - **d.** improved dispute resolution procedures
- US safe harbour request is difficult to understand – will be interrogated next week in Paris.
- Problems in Pillar II eg. tax incentives in some countries.
- SA, Nigeria, Ivory Coast & Senegal are leading in Africa.

Ms Susana Ruiz:

- This is a matter of tax justice, ensure fairness & sustainability for African continent.
- Principle is radical but scope should be expanded.
- Need an economic impact assessment as countries can't make decisions without it.
- Recommendations:
  - push for Pillar I & Pillar II as integrated package,
  - scope of business must not be ring-fenced to digital companies - expand to all sectors

- can't have carve-outs.
- Historical opportunity – it depends on us.

Ms Lazelle Terblanche:

- Merits of approach & implementation of Pillar I & II were discussed at ATAF Conference in Uganda in 2019.
- Planning for implementation is NB!
- Challenges in Africa: not just law & legal framework but way in which countries implement it. Get the basic right – opportunity going forward as currently not there. Unpredictability & fairness. Laws vague & unclear – disputes go on for years/decades. Illicit flows – linked to politicians.
- Governments must support Revenue Authorities (RAs) to ensure they have the resources (scarce TP skills & ability to understand new rules & dispute processes).
- Dispute resolution – wasted time & money. Local assessments not adequately considered, RAs personnel change & delays indefinite.
- ATAF is against binding arbitration – business wants alternatives (co-operative compliance etc).
- *Fairness – double tax is an issue!*
- Many hurdles and businesses welcome further engagement.

Mr Matthew Gbonjubola – Director Intl Tax FIR & ATAF Technical

- 'A' is not very big.
- Doing all this work for very little.

Questions:

- *How can we ensure that interpretation will be consistent – we need consistent interpretation*!
- ATAF - Focus on areas that are common to prevent un-coordinated treatment.
- *APA – how will this work with new rules? Start of TP & new rules? Meaning of 'consumer product'? (B2C transactions).*
- There must be a coordinated approach, instrument will be there to be implemented.
- *All this work for R10? Certain that more $ coming in than going out? Is this Global Formulary Apportionment in disguise?*
- Pillar I integration with current TP rules: Amount A is formulary apportionment. No TP rules here. Through politically established formula.
- Overlap of amount A and B should be addressed by Amount C - Amount A should not be subject to TP rules.
- Non-taxation not an option, but proposals aren't ring-fence to those businesses only.
- Amount A – not subject to TP rule, but overlap with Amount A & C, so more work needed on this.
- *How likely is it that this will see the light of day if the USA pulls out?*

- US originated the issue of moving beyond purely digital platforms. Fundamentally, the US is totally committed to the process.
- US proposes "safe harbours", but it is not clear what is meant with this.
- Discussion next week should show how this can be resolved.
- OECD is just standard, because nothing else exists. OECD countries = 99% of global profits, therefore, they won't just stand there and let others dictate taxing rights. OECD needs to demonstrate that it can lead the matter and find a solution.

SESSION 2 – THE UNIFIED APPROACH – 'AMOUNT A' PROPOSALS

Yanga Mputa (Chair)
Karl Muller (Unilever)
Ted Silkiluwasha (ATAF Technical and Tanzania Revenue)
Luthando Mvovo (Vodacom)
Hayley Reynolds (NT)

- Amount A = New taxing right – various carve outs, consideration to include banks in the carve out list.

Ms Haley Reynolds:

- Economic impact analysis done by NT; similar to OECD results
- Key pieces of architecture that need consideration in deciding to adopt this:
    a. Revenue threshold – $750m threshold
    b. Carve-outs – B2C; part in, part out
    c. PBT threshold – split (non-routine & deemed residual amount); (from SA perspective, the lower the threshold the better, for African countries as well); SA will gain revenue from inbound MNE but will also be losing from MNE in SA operating in Africa. Numbers are not big – worst case scenario: -1% to +1% of CIT revenue, so won't have big impact on SA, but may be bigger in other African countries. OECD did top down approach using CbCR databases. NT used bottom-up approach (company by company), but results similar to OECD results.
    d. Revenue threshold – developing countries would want this to be as low as possible.
- Strategic point of view: from a fiscal position it is NB for global consensus & PBT should be lower & larger share of residual profit allocated to market.
- SA MNE concerns – NT open to their views.

Mr Ted Sililuwasha:

- Discussion of Amount A, ATAF not prescribing to countries, only advising and demonstrating potential impacts.

Mr Karl Muller:

- Unilever submissions links sustainability goals & tax reform.
- Risk – complex two-tier tax system is being created.

- Supports Amount A with no minimum country threshold, but ensure no double taxation.
- *Trade-off between complexity & tax impact*. Must be simple & must have impact for it to work! In practice: various models.

- What profits do you use? Group AFS, but exclude extraordinary profits.
- Intangibles – no clear definition (market, technology, trade etc)
- Return vs risk – brand intangibles
- Where is residual housed? Mostly in operating subsidiaries in the market. intangible country would get profit, then issue with WHT already paid,
- How complex a simple idea *can become.*
- Arbitration would remove exclusive right to country to preform audit.

Mr Luthando Mvovo:

- We should be considering what was original BEPS purpose.
- 'Amount A' only applies where no group entity in the market jurisdiction where company takes risk.
- 23 African countries participating in inclusive framework. Implementation in African countries not great. Global consensus undermined.
- *MNEs want simplicity & certainty*.

<u>Questions:</u>

- *Africa free trade agreement interaction with this?*
- Consensus based solution so all should be onboard.
- *How will losses dealt with?*
- Not modelled due to uncertainty around it.
- *Why PBT for IP allocation? Profitability ratio; Trade or market intangibles?*
- PBT ratio has not yet been decided.
- Dispute will move from whether or not LRD to whether or not type of business that falls in the ambit of Amount A.
- Value in market needs to be taxed. You have access to a market so you need to pay tax on this profit. Brands & royalty income – routine profit is actually risk & capital. Policy rationale for Amount A – jurisdictions not being able to tax: users create value so tax this value.
- *Segmentation – will create more complexity.*
- Trade-off between simplicity & accuracy.
- Scope creep – widened scope from digital economy.

SESSION 3 – 'AMOUNT B' PROPOSALS

Lee Corrick (Chair)
Martin Chileshe (ATAF Technical and Zambia Revenue)
Tim McDonald (Procter & Gamble)
Louise Weingrod (Johnson & Johnson)

- ‘Amount B’ - Fixed return that goes to baseline routine marketing & distribution (M&D) activities
- Approximation for ALP.
- Introduced quicker as no changes to DTA’s, MLIs necessary.
- May raise definitional issues & then disputes

Questions:

Mr Martin Chileshe (ATAF, Zambia):

- Distribution companies make losses.
- Fixed return will help developing countries that have skills shortages to use scarce skills for high risk cases.

Mr Tim McDonald (Proctor & Gamble):

- 7 yrs & $10m for APA; Double taxation & unilateral measures are the concern.
- Country compromise is a given. Modest gains from Amount A.
- China opposing Pillar 2. Can’t pick, Pillar 1 & 2 come as a package.
- estimation that only about 50 countries have a database and skilled resources to perform TP review/audits.
- Debating SG&A approach by J&J.
- S&P 1200 make 12.5% profit.
- Went above ALS to ensure that countries not making anything from amount A get amount B.
- Suggestion (see P&G submission on OECD website): broadly in line with ALS: 15-18%. Three proposals. Cap put more on B than A – to give more & to eliminate disputes. Audit done at parent company level. Shouldn’t deviate from international law ito WTO.

Ms Louise Weingrod (Johnson & Johnson):

- Beare our fair share. *Take out friction on routine distributors*. Limited risk distributor
- 3 principles **–** innovation (R&D), dispute avoidance, simplification & certainty (b2G, b2b, b2)
- International tax system - changed it but not fixed it
- Innovation risk must also be rewarded – stable innovative tax system

SESSION 3 – ‘AMOUNT C’ PROPOSAL

Matthew Gbonjubola (Chair)
Franz Tomasek (SARS)
Johan Langerock (Oxfam)
Shelton Chiguma (Zimbabwe Revenue Authority and ATAF Technical)

Mr Franz Tomasek (SARS):

- Amount C remains after A&B & subject to ALP.
- Amount C depends on comprehensiveness of A&B definitions (narrow or broad)

- Mandatory binding arbitration – uncomfortable for some due to inequality of resources, knowledge etc

Mr Johan Langerok (Oxfam):

- ALP + mandatory arbitration for dispute resolution
- ‘Amount C’ - One paragraph in OECD doc & 2 in appendix & they contradict each other.
- Dispute prevention & resolution: Politically no support for mandatory arbitration.
- *Focus on prevention – make rules simple & clear.*
- Amount C is there because amount A & B not clear.
- Have CbC reporting – not public, but should be more public to prevent disputes.
- Prevention vs resolution: resolution costs a lot.
- With Arbitration: decision is taken almost like court, but then there is no recording
- *Suggestion: Have a transparent body making public rulings (published)*
- C applied in routine approach but appendix also includes more than M&D?

Mr Shelton Chigumira (ATAF, Zambia):

- Biggest challenge arises from how well we did the job on Amount A and B.
- If there should be consensus, then consensus re Amount C is also required. He is concerned that this may become a deal breaker, but there should be less challenges than re Amount A and B.

Questions:

- *Amount A: standalone nothing to do with TP, it is formulary approach. But document says that Amount A is "deemed residual profit" re qualifying entities. Does A then apply to "activities" or not? Not clear! Amount C is also talking about non-routine.*
- Amount A – is all presumptive. B – you approximate ALP. C – captures something more (para 69 of OECD document appendix – envisages a possible overlap).
- Alternatives to mandatory binding arbitration – APAs + public rulings. Multi-lateral framework (CbC reporting between countries).
- MAP procedures – 8-9 years: timelines needed
- Be careful what you sign up for re Amount C.
- There is need for clarity regarding what the proposal is about, amounts A, B and C.
- Only if there is a nexus will there be an Amount B and potentially C. Digital businesses mostly don’t have presence in country and therefore would not have Amount B and C.

OVERALL CONCLUSION

- No problem with Revenue Authority taking their fair share BUT
- Fear of double taxation is the issue
- Needed:
    a. How reduce double taxation as this restricts trade?

b. Focus on dispute prevention rather than resolution
c. Fairness, transparency & accountability

- All inter-related & complex as a moving target
- Threshold not finalised – $750m,
- No concrete position taken yet by NT
- Harder for developing countries to push back, because SA does not have the critical mass
- Thanks was expressed for businesses and their input. NT will discuss this over the next two days before attending the OECD meeting next week.