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Submission File

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Organisation for Economic Co-operation and Development (OECD)
Tax Policy and Statistics Division,
Centre for Tax Policy and Administration
2 rue Andre-Paris
Paris
France

BY E-MAIL: TFDE@oecd.org

Dear Sir/Madam

COMMENTS ON THE UNIFIED APPROACH UNDER PILLAR ONE

1. We present our comments and submissions on behalf of the South African Institute of Chartered Accounts' (SAICA) Transfer Pricing Committee on the public consultation document 'Secretariat Proposal for a "Unified Approach under Pillar One' released by the OECD on 9 October 2019.

2. We thank the OECD for the opportunity to provide constructive comments in this regard. SAICA continues to believe that a collaborative approach is best suited in seeking solutions to complex challenges.

BACKGROUND

3. It is the OECD's hope to restore stability and certainty in the international tax system, address possible overlaps with existing rules and mitigate the risks of double taxation. As part of this endeavour, focusing specifically on the digitalisation of the economy, the OECD Secretariat has issued a proposal to advance international negotiations to ensure large and highly profitable Multinational Enterprises (MNEs), including digital companies, pay tax wherever they have significant consumer-facing activities and generate their profits.

4. The new OECD proposal brings together common elements of three competing proposals from member countries, and is based on the work of the OECD/G20 Inclusive Framework on BEPS, which groups 134 countries and jurisdictions on an equal footing, for multilateral negotiation of international tax rules, making them fit for purpose for the global economy of the 21st Century.

5. The proposal, which is the focus of this submission, re-allocates some profits and corresponding taxing rights to countries and jurisdictions where MNEs have their markets. It ensures that MNEs conducting significant business in places where they do not have a physical presence, be taxed in such jurisdictions, through the creation of new

rules stating (1) where tax should be paid ("nexus" rules) and (2) on what portion of the relevant profits they should be taxed ("profit allocation" rules).

6. SAICA's Transfer Pricing Committee's comments on these proposals will be discussed next.

COMMENTS ON THE PROPOSALS

Unified Approach – Amount A

7. The comments provided below, although pertaining to certain of the specific questions listed on page 17 of the OECD's proposal document requesting comments, are limited to the matters of most importance to and raised by the SAICA Transfer Pricing committee.

8. Under the proposed 'Unified Approach', Amount A would focus on, broadly, *large consumer* (including user) *facing businesses*. There are various challenges in defining and identifying the business in scope.

9. Submission: Given the objectives in Pillar 1, we recommend that the following be **excluded** from the large businesses envisaged in the 'unified approach':

10. In respect of *materiality*, a large business that has consolidated group revenue below the CbC reporting threshold (i.e. EUR 750 million or equivalent in local currency) **and** that has net sales from a market jurisdiction below a certain limit – for example EUR 50 million or equivalent in local currency.

11. In respect of *profitability*, a large business that is part of a MNE group with a net profit margin below a certain percentage (for example 10%) **and** the MNE has substance in the market **and** the local tax resident has a net profit margin below a certain percentage (for example 10%).

12. In respect of *inter-company transactions*, large businesses (that are local tax residents) where inter-company transactions are less than a certain percentage (for example 10%) of third party transactions.

13. In respect of *industry/regulation*, large businesses that are highly regulated entities, for example, banks, mobile telephone operators and insurance companies. The reason for this is because profit shifting by these type of companies is unlikely due to stringent non-tax regulations that apply. Therefore, inserting more compliance requirements on these businesses would be counter-productive and appear to be unnecessary.

14. In respect of *operating/business model*, a group of companies with substantial local substance. In order to determine this, either a quantitative test could apply (for example, more than 100 employees) or a qualitative test could apply (for example, where there is a local entrepreneur that is an incorporated company and tax resident in the jurisdiction with a functional profile that is complex (decentralised operating model), which could, applying traditional transfer pricing guidelines, lead to it being selected as the tested party). Examples of businesses that operate these operating models include extractive

industries (oil and gas, mining), mobile telephone operators, fibre network operators, automotive manufacturers (which also house the local market distribution operations), engineering, procurement and construction ("EPC") operators, hospitals and clinics, hotel and casino operators, banks and insurance companies.

Unified Approach – Nexis rule

15. Under the proposed 'Unified Approach', a new nexus rule would be developed that is not dependent on physical presence but largely based on sales. This new rule would be applicable in all cases where a business has a sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, **irrespective of its level of physical presence in that jurisdiction**. It is submitted that the simplest way of operating the new rule would be to define a revenue threshold in the market (the amount of which could be adapted to the size of the market) as the primary indicator of a sustained and significant involvement in that jurisdiction …"

16. Submission: Carved out of these rules should be businesses with a significant physical presence carrying on business activities in that jurisdiction.

17. Defining and applying country specific sales thresholds is necessary but would be administratively burdensome as they would need to be monitored and potentially adjusted at least annually, particularly in developing countries with high inflation.

Group Profits – Amount A

18. The relevant measure for calculating the group profits that need to be used for determining 'Amount A' is currently suggested as being the MNE group's profits that can be derived from the consolidated financial statements.

19. Submission: We agree that using the MNE group's profits is probably the least time consuming and simplistic form of calculating 'Amount A'. However, there are various nuances that may affect this figure that would not accurately reflect the consumer-facing activities that generate the profits in a particular country. For example, business strategies such as market penetration, or government incentives such as R&D tax claims, or foreign exchange differences, particularly in countries with volatile currencies. These would need to be adjusted for. In addition, differences in accounting standards may impact and this could be overcome by referring to one specific accounting standard and we suggest IFRS.

20. Although time and costs may increase in order to obtain and compare the necessary information required, it is submitted that regional profitability should be considered instead.

Double Taxation – Amount A

21. Regarding the elimination of double taxation in relation to 'Amount A', existing domestic and treaty provisions will apply. From a South African perspective, claiming foreign tax credits is burdensome, time consuming and very difficult to achieve due to practical

issues. It is expected that unless local processes will improve significantly, this would negatively impact businesses, should the proposal be accepted.

22. 'Amount B' explores the possibility of using fixed remunerations, reflecting an assumed baseline activity, for marketing and distribution activities. In order to simplify matters and prevent disputes, firstly, a clear definition of the activities that qualify for the fixed return is needed. Secondly, the determination of the quantum of the fixed return needs to be resolved and could be established in a variety of ways, for example as a single fixed percentage, fixed percentage that is varied per industry/region or another alternative method.

23. Submission: Since 'Amount B' seems to be designed to function as a simplification mechanism it is suggested that the determination of what constitutes 'marketing and distribution activities' is linked to a simplified functional profile. Thus, only entities displaying pure (routine) marketing and distribution activities and no other functions such as manufacturing should be taken into account when considering the application of 'Amount B'. ,

    In addition, although more burdensome to establish, it is submitted that a percentage based on industry norms would be most appropriate for determining the quantum of the fixed return.

Dispute Resolution – Amount C

24. 'Amount C' deals with the additional profit that arises from a dispute between market jurisdiction and the taxpayer over any element of the OECD proposals – that is, when the marketing and distribution activities taking place in the market jurisdiction go beyond the baseline level of functionality and therefore warrant a profit in excess of the fixed return contemplated under 'Amount B', or that the MNE group or company perform other business activities in the jurisdiction unrelated to marketing and distribution.

25. Submission: The lack of suitable dispute resolution mechanisms such as APAs and limited MAPs is a common problem in South Africa and other African countries, resulting in protracted disputes and double taxation. Therefore, the proposal regarding 'Amount C' would put a taxpayer operating in South Africa or other similar jurisdictions at an unfair disadvantage as the costs and time incurred to resolve these types of conflicts are high and long, and the desired result is often not achieved.

26. It is therefore submitted that the proposal be carefully considered and, should it be deemed suitable, the relevant jurisdictions be required to ensure that suitable functioning dispute resolution processes and appropriate administrations be put in place. In this regard, taxpayers must be given the assurance that these procedures (APAs, MAPs etc) will be completed within a reasonable period of time (maximum 12 months).

Yours sincerely

Christian Wiesener
Chairperson: Transfer Pricing Committee

Dr Sharon Smulders
Project Director: Tax Advocacy