Ref: #774917

Submission File

1 September 2023

Organisation for Economic Co-operation and Development (OECD)
Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
2 rue Andre-Paris
Paris
France

BY E-MAIL:TransferPricing@oecd.org

Dear Sir/Madam

SAICA COMMENTS ON AMOUNT B OF PILLAR ONE

1. On 14 October 2020, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) released the report "Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint".

2. The Blueprint stated that Amount B was intended to streamline the process for pricing baseline marketing and distribution activities in accordance with the arm's length principle (ALP), thereby aiming at enhancing tax certainty and reducing resource-intensive disputes between taxpayers and tax administrations. The Blueprint additionally noted that Amount B should address the needs of low-capacity jurisdictions (LCJs).

3. The OECD subsequently issued a Public Consultation Document on 17 July 2023, requesting input on the proposed suggestions for Amount B under Pillar 1 ("**The Consultation Document**").

4. We hereby present our comments on behalf of the South African Institute of Chartered Accountants' (SAICA) Transfer Pricing Committee.

5. 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.

6. 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.

7. 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. Chartered Accountants are highly valued for their versatile skill set and creative lateral thinking, that's why all of the top 100 Global Brands employ Chartered Accountants.

8. The SAICA Transfer Pricing Committee, has commenced work on the Unified Approach and what this could mean for multinational groups operating in Africa.

SCOPING CONSIDERATIONS

9. We support the OECD's aim to simplify the application of the arm's principle and the mitigation of double taxation resulting in a reduction of transfer pricing disputes. Many African tax jurisdictions are resource-constrained and therefore any simplification in determining an arm's length return is welcome.

10. However, this needs to be balanced with the fact there is a real lack of certainty in Africa relating to the categorisation of baseline marketing and distribution activities.

11. The Consultation Document makes reference to the following terms:
    - Baseline Distribution
    - Core Distribution; and
    - Non-Baseline Contributions.

12. We agree with the proposal that this is determined by a formula to assert intensity of the distributor, e.g., the use of operating expenses to sales or value adding expense to sales threshold for distributors. If the distributor's operating expenses or value adding expenses to sales ratio fall below a threshold relevant to its industry and region, it should achieve a margin, being "Amount B".

13. However, 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.

14. Operating expenses would be defined as the costs between the gross profit and operating profit level, whereas value adding expenses could simply be costs or expenses incurred by the in-market "distributor" which is not external, e.g., employment costs, depreciation, and other overheads, but excluding third party advertising and marketing costs, foreign exchange gains/ losses. In addition, we do not believe this should be considered in isolation. The existence of intangibles and assets will also play an important role. We therefore agree that additional tests including ratio of operating assets to sales and liquidity should be included in any qualifying scoping criteria.

15. Historically the guidelines and discussion documents have referred to limited risk and full risk distribution activities. In addition, it is generally agreed that the level of risk assumed

is largely driven by the management and responsibility for the risk through the functions undertaken.

16. Submission: It would be useful to align these concepts in the context of Amount B. For instance, that baseline distribution activities would typically result in the distributor assuming only limited risks.

17. This could assist in drawing a distinction between those distributors that make non-baseline contributions and hence assume a higher level of risk. Furthermore, as indicated in our previous submission, other factors need to be considered.

18. For instance, where there has been a significant year on year movement (e.g., 20% or more) in either the distributor's 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).

19. The commercial reality is that the losses can arise (also in third party transactions) as a result of adverse market conditions. This formulaic exclusion test acknowledges this. It is a reality in the African region that entities may be suffering significant foreign exchange losses as result of dramatic currency depreciation against the US$ and Euro.

20. We note the Consultation Documents reference to examples of non-baseline contributions and agree with these.

21. We also welcome the exclusion of services transactions and commodity transactions.

NON-DISTRIBUTION ACTIVITIES

22. We note the comments made in the Consultation Document relating to the inclusion of distribution activities in scope where these can be adequately separated from other activities undertaken. We would comment that even if this were the case, many operations which undertake multiple activities inevitably cross subsidise making comparison with separated distribution activities in an integrated operation inherently different from a stand-alone distribution business.

23. Practically using inclusion tests such as operating expenses to sales revenue and asset tests would make such an analysis subjective and open to different analysis and interpretation.

24. Submission: We therefore are of the view that only entities which operate as distributors without any other activities should be potentially in scope.

APPLICATION OF THE MOST APPROPRIATE METHODOLOGY

25. In adopting the TNMM as the appropriate method we have the following comments:

26. We are not convinced that the test for baseline distribution activity is the reliability of a one-sided method. This is suggesting the method should drive the functional profile. We maintain that determining baseline distribution should be based on a functional analysis and that the method applied should be based on the availability of appropriate comparable data, including the existence of internal comparable data. Only if the TNMM presents itself as the most appropriate method should it be adopted, which is in line with the guidance set out in the guidelines.

27. Submission: In this regard we welcome the proposal to allow the use of the comparable uncontrolled price method and the use of internal comparables where they are found to be reliable.

28. However, as the analysis is aimed at testing baseline marketing activities for the sale of goods, we would also propose that the resale price method should be given the same inclusion status subject to the reliability of comparable data.

DETERMINING AN ARM'S LENGTH RANGE

29. The Consultation Document refers to a pricing matrix drawn from a global database set. This considers operating assets to sales intensity, operating expenses to sales intensity and various industries. We welcome this approach.

30. Submission: From an Africa perspective we would also encourage investigation and corroborative data for Africa 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. In the absence of reliable comparables in Africa, when stress testing an appropriate operating margin for companies subject to Amount B, to evaluate “all in risk groups"[1] operating in Africa.

31. Surely distributors cannot earn more than all-in risk entities/ entrepreneurs. This data can frame broad profitability, i.e., be indicative of a ceiling of returns.

32. We also consider that returns should be capped with reference to group profitability. the economic impact to a market jurisdiction if the target margin for Amount B is too high.

ADDRESSING GEOGRAPHICAL DIFFERENCES

33. The proposal for addressing differences between jurisdictions appears oversimplified in that it implies that there must be a premium or discount from the global data set. As indicated above, the absence of data coupled with economic challenges in Africa often results in a variance from data sets obtained from publicly available global data.

34. Whilst the inclusion of adjustment to account for geographical differences is welcomed, reliance on sovereign credit ratings is flawed. Risk varies considerably between various

[1] MNEs that carry on a consolidated basis all the functions, assets and risks of the value chain within that economic unit.

industries, even in countries considered high risk and applying the adjustment without consideration of this will skew the results. Also no data has been provided on the source used by Aswath Damodaran, NYU Stern School of Business and the methodology applied to calculate the sovereign credit rating. The concern is whether that sovereign credit rating is universally agreed and accepted in the context of the geo-politics that exist today between countries.

35. In addition, the net country risk adjustment seems to assume that an entity will always be expected to make positive margins, particularly in a non-investment grade sovereign credit rating (e.g. CCC- of 8.6%), which is not a total reflection of economic and commercial reality in that market.

CORROBORATIVE ANALYSIS

36. We are also hesitant to agree that it would be appropriate to rely on only one profit level indicator, being return on sales and welcome the proposal that a corroborative analysis be used.

37. Submission: We request this not be limited to the Berry Ratio and propose using PLIs such as Return on Working Capital to assist with the reliability of the analysis. Also, PBT as a margin would provide for more simplicity and certainty, given the variable interest rates and variable accounting of foreign exchange gains/ losses in Africa (above and below the EBIT level).

DOCUMENTATION

38. We agree with the statement that administrations should refrain from requesting the taxpayer to produce or submit information already in the hands of the tax administration.

TRANSITIONAL ISSUES

39. No comments.

TAX CERTAINTY

40. No comments.

ANNEX A: RELEVANT BENCHMARKING SEARCH CRITERIA

41. We submit that the reliance on a 50% independence filter appears very broad.

42. For example, in South Africa, the independence in respect of inbound intragroup transactions is 20% and in most (developing) countries, the filter is 25%.

43. Submission: While a 50% filter increases the number of potential comparables it reduces the comparability and we suggest that a 25% would be more appropriate, alternatively, a sense check in terms of which the results when applying a 50% independence filter as opposed to a 25% independence filter should be compared.

We look forward to hearing from you.

Yours sincerely

Christian Wiesener

Chairperson: Transfer Pricing Subcommittee

Karen Miller

Member: Transfer Pricing Subcommittee

Lesedi Seforo

Project director: Tax Advocacy

The South African Institute of Chartered Accountants