Tax Alert – Update on OECD Proposals on the digital economy – the state of play

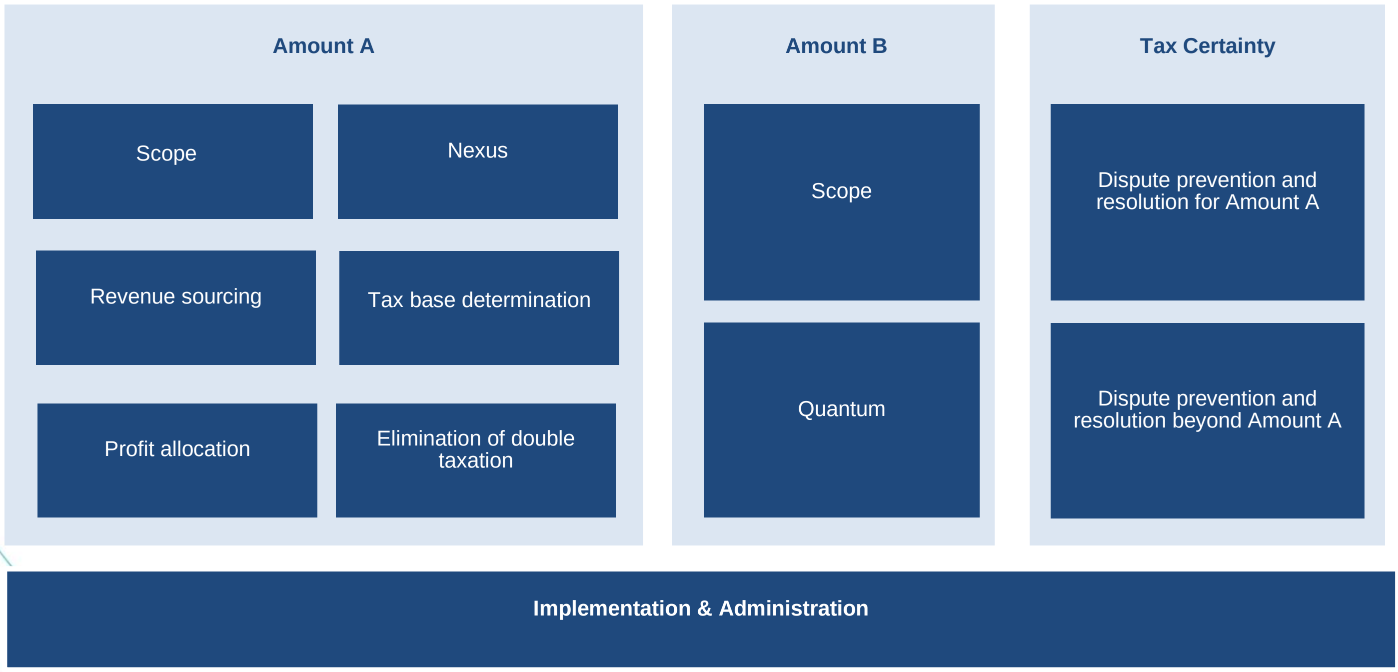
SAICA Transfer Pricing Committee
(special thanks to committee member Karen Miller)

The OECD proposals for taxing the digital economy hit a roadblock with the US' previous administration digging in its heels on certain aspects. The new administration has shown some signs of softening the approach to re-open the way forward on this project. The US has withdrawn its proposal on the adoption of a safe harbour for Amount A and is supporting consensus for reaching an agreement on the Pillar 1 proposal by mid-2021.

Pillar 1

The Pillar 1 blueprint released by the OECD for public comment in October 2020 received 201 submissions with 59% from the business sector, 17% from advisors and 7% from academia. From the business sector, 10% of submissions were from the IT and digital sector.

To recap, the key building blocks for Pillar 1 can be summarised as follows[1]:



[1] Source – OECD Secretariat presentation Pillar 1 – 14 & 15 January 2021

The key outcomes from the public comments were:

- Strong support for international consensus solution and the removal of unilateral measures;
- Convergence on the technical aspects of Amount A; and
- Calls for a simplification throughout the Amount A model to reduce compliance costs.

Some questions remain from the public submissions which will need to be taken on board by the OECD in its next round of deliberations, namely:

- The policy objectives and principles Pillar 1 is seeking to address;
- How to maintain a level playing field; and
- Should the model for Amount A be limited to residual profits only.

The public consensus noted some key political issues including the impact of various thresholds which will capture the application of the model for allocating an amount under Amount A, as well as the need for unilateral measures to be removed if Amount A is to be adopted. The technical issues also need addressing as it is clear from the thread relating to the public consultation is the need to simplify the model for determining Amount A.

Whilst there remain some divergent views on the scope, there remains support for a "de-minimis" in scope revenue exception, although what this will be remains a point of discrepancy.

Whilst there was less focus on the discussion around Amount B, one aspect which came through was the need to consider any safe harbour for the marketing and distribution return. Setting this too high could result in a disproportionate return for what would be considered a low margin, limited risk operation.

Elimination of double taxation remained a key area with the need to address complexity around the effective relief from double taxation. The general consensus from business was that an exemption (as opposed to a credit) method is preferred. There was clear strong support that a mandatory binding dispute resolution was needed to agree on the allocation of Amount A and possibly even for amounts beyond Amount A.

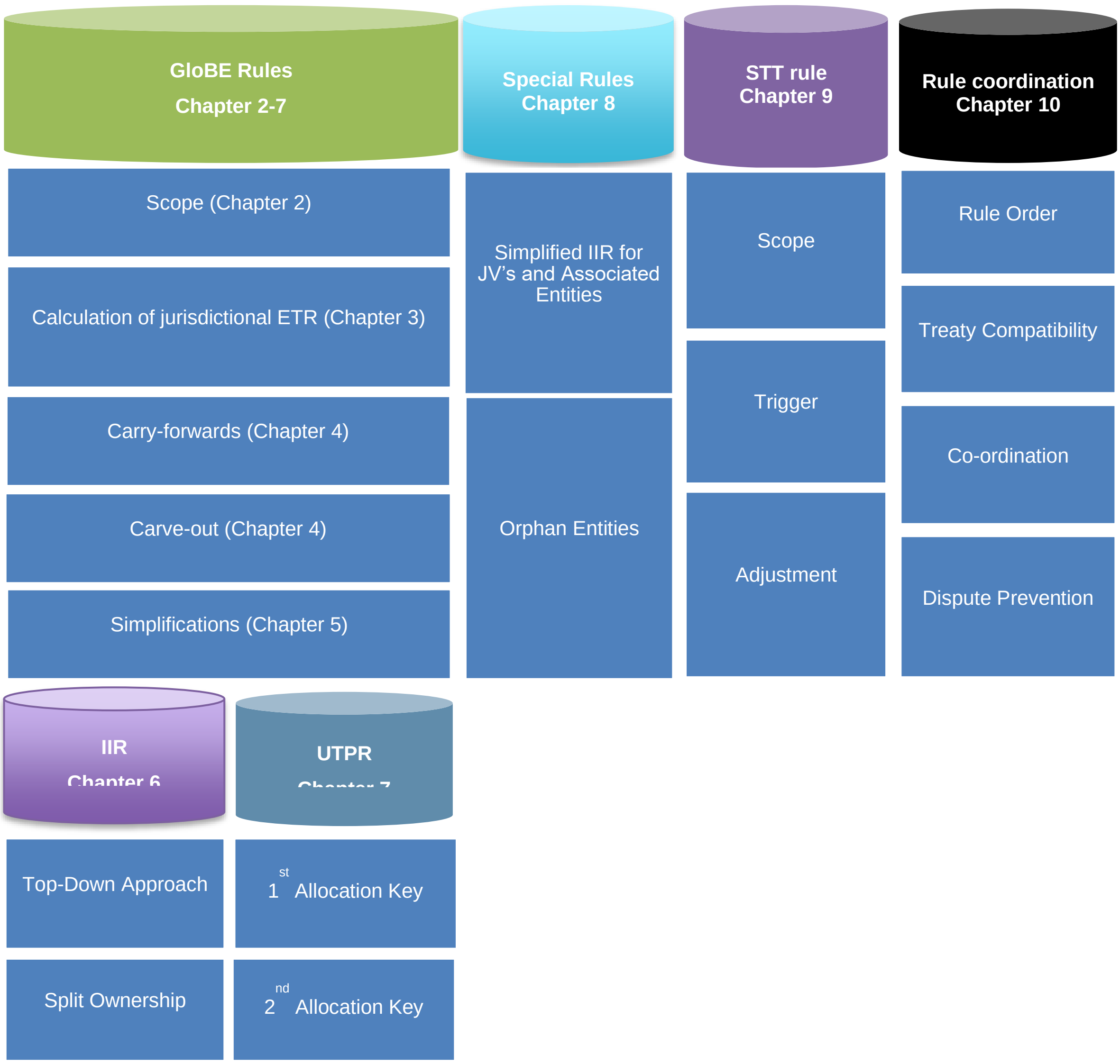
In the event the threshold for applying Amount A is set too high, there is a strong possibility certain countries will seek to retain unilateral measures to protect their tax base[2]. In addition, very few, if any, African countries have adopted mandatory binding resolution in addressing double taxation matters, in fact the entire mutual agreement process in Africa remains one of challenge.

[2] South Africa stated in the 2021 budget that if consensus is not reached in 2021 it will consider implementing unilateral measures.

Pillar 2

Like the Pillar 1 blueprint, the Pillar 2 blueprint also attracted significant comments with 197 submissions received by the OECD. The spread of submissions on Pillar 2 was similar with 18% coming from advisors and 59% from business.

To recap, Pillar 2 covered the following[3]:



The key outcomes from the public comments were:

- Broad support other than the exclusion on certain excluded entities, notably clarification from the funds industry; and
- Support for a phased implementation, perhaps based on revenue.

[3] Source – OECD Secretariat presentation Pillar 2 – 14 & 15 January 2021

Simplification remained the key topic of the discussion with the options for simplification being at the election of the taxpayer and part of the rules. It was also noted that any simplification measures should not impact the effectiveness of the Pillar 2 test. Four options were put forward on simplification in the blueprint which attracted the following comments.

- The introduction of tax administrative guidance was welcomed as a stable approach with ease of application, but it needs to be transparent and a-political;
- Use of the CBCR safe harbour could be adopted but this will depend on the adjustments required and the use of the data. For instance, it is noted that the data should only be used for risk assessment;
- The use of a de minimis profit exclusion carve-out will depend on the threshold used and the mechanism used to determine the profit. It was also felt a relative percentage was more suitable than an absolute number; and
- There was only limited support for a single effective tax rate calculation.

Under the GloBE rules there was general support for adopting a top-down approach for the income inclusion rule, but some concerns expressed over the split ownership rules and the threshold that should be applied. The complexity of the undertaxed payments rules was raised as a concern with calls for this to be simplified.

It was also felt that the scope of the subject to tax rules should be narrowed due to risks of over taxation. The order of the rules needs consideration with NGO's expressing concern that the subject to tax rules could be side-lined.

There was broad support for the use of a multilateral convention to ensure consistency and coordination in the application of the rules and provide a mechanism to avoid and mitigate double taxation risk.

The Pillar 2 rules are broad based anti-avoidance rules aimed at creating a minimum tax position for Multinationals. Many countries in Africa already have broad anti-avoidance provisions which could result in additional layers, complications and challenges in administration. The harsh withholding tax regime across Africa could create a real risk of double taxation in the absence of implementing the multilateral instrument. Bearing in mind the current multilateral instrument has yet to be adopted by almost all African nations does beg the question as to whether a further one will be adopted?

Conclusion

Pillar One and Pillar Two could increase global CIT revenues by about USD 50-80 billion per year. The exact gains would depend on the final design and parameters of Pillar One and Pillar Two, the extent of their implementation, the nature and scale of reactions by MNEs and governments and future economic developments. Reaching a consensus-based solution would prevent uncoordinated and unilateral measures (eg. digital service taxes) from being implemented by different countries and it would also prevent an increase in damaging tax and trade disputes which would undermine tax certainty and investment and result in additional compliance and administration costs.

Public comments on the Blueprints of Pillar I and Pillar 2 have called for simplifications and the OECD believes this can be advanced by July 2021 in order to make both Pillars fully implementable. The political conditions for a deal in July are present with very strong and positive messages from the new US Administration. SAICA will ensure that you are kept up to date with these developments and whether the landmark agreement on new tax will be reached in the second quarter of 2021.