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TAX & EXCHANGE CONTROL **ALERT**

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Pillars of (digital) society: G20/OECD endorse the new nexus and pave the way for a 15% minimum global tax

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On 1 July 2021, 130 member states of the G20/Organisation for Economic Co-operation and Development/ G20 (OECD) Inclusive Framework on Base Erosion and Profit Shifting (BEPS) signed the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Statement).

The Statement affirms the signatory states' commitment to key aspects of the G20/ OECD's BEPS Action 1 policy proposals. These aim to adapt international tax law to cater for the nature of the modern, digitalised economy. The Statement acknowledges that the way the current international tax regime works does not properly allocate revenue to jurisdictions that host economic activity by multinational businesses.

The progress on this aspect of the BEPS project is largely attributable to the US' efforts to have the G7 and then G20 endorse a 15% minimum global tax. At the date of publication 131 out of 139 Inclusive Framework member states had signed the statement – representing approximately 90% of global GDP.

Our Tax & Exchange Control Alert of 3 December 2020 outlines the nature of the issues presented by the digitalised economy to current tax systems and the history of the OECD's policy development process up to the end of 2020, when technical blueprints for the two pillars were published.

The Statement does not depart greatly from the substance of technical blueprints, but does provide more detail on the proposed manner of implementation for the two pillars, along with planned timelines.

Pillar One – new nexus

Pillar One proposes a new basis for a jurisdiction to claim a right to tax a multinational enterprise or group (MNE). The taxing right would be based on the existence of a significant economic – not necessarily physical – nexus existing in the country. In essence, where a country hosts market or end consumers, it would get a right to tax a portion of the revenue generated by that consumption.

The Statement indicates that the proposal is to have Pillar One implemented through a multilateral instrument. The Statement indicates that the following limitations in scope would apply to the nexus rules:

- The nexus rules will only be triggered for a country where an MNE derives €1 million in revenue from such country. For jurisdictions with GDPs that are lower than €40 billion, the trigger will be sourced revenue of €250,000.
- Only MNEs with a global turnover of above €20 billion and profitability of above 10% would be subject to taxation by various countries under the nexus rules.
- The nexus rules will not apply to certain sectors, including, at this stage, extractives and regulated financial services.

The proposed quantum to be taxed under the nexus rules is 20–30% of residual profit, being profit in excess of 10% of revenue. This amount will be allocated amongst the jurisdictions which host the markets that are the sources of this revenue.

Pillars of (digital) society: G20/OECD endorse the new nexus and pave the way for a 15% minimum global tax*...continued*

It has been proposed that the multilateral instrument containing the rules be open for signature in 2022, with the nexus rules coming into effect in 2023.

Where residual profits of an MNE are already taxed in a market jurisdiction, safe harbour provisions would limit the amount to be attributable to that jurisdiction.

The Statement indicates that the nexus rules under the proposed multilateral instrument will be administered by a single entity and that principles and guidance around the amounts to be attributed based on particular industries or types of transactions will be developed. Further, disputes, including around the amounts to be attributed to particular market jurisdictions, will be determined in a mandatory and binding manner.

It has been proposed that the multilateral instrument containing the rules be open for signature in 2022, with the nexus rules coming into effect in 2023.

Pillar Two – GloBE and STTR rules

Pillar Two comprises two sets of proposed rules aimed at ensuring that MNEs carry a basic global tax burden. These are the Global anti-Base Erosion Rules (GloBE rules) and Subject to Tax Rules (STTR). The GloBE rules are to be the mechanism through which a minimum global tax burden is to be imposed on MNEs.

It is proposed that these model rules for both the GloBE rules and STTR be published in an implementation plan for Pillar Two, in order to allow member countries to enact the provisions in 2022, for an effective date in 2023.

GloBE rules

The first set of rules under Pillar Two have been termed the GloBE rules and comprise rules to be enacted by individual countries, aimed at:

- imposing a top-up tax on parent companies through an income inclusion of low taxed income of a subsidiary entity, and
- denying deductions or applying other adjustments for undertaxed payments to the extent that these tax benefits have not been eliminated by taxation under the top-up tax on the parent company.

The GloBE rules will apply to MNEs that have an effective global group burden of less than 15%. The effective tax rate will be calculated based on a common definition of covered taxes and – with the necessary adjustments for timing and policy – a tax base determined by reference to financial accounting income of the MNE.

The GloBE rules will provide a carve out for tangible assets and payroll that will exclude an amount of at least 5% of income. At present, certain types of income are excluded, including shipping income as defined in the OECD Model Convention.

STTR

The STTR is a proposed amendment to bilateral double taxation treaty provisions aimed at allowing developing countries to tax cross-border interests, royalty and other specific payments where these payments are not taxed at the 15% minimum rate by the destination country.

Pillars of (digital) society: G20/OECD endorse the new nexus and pave the way for a 15% minimum global tax*...continued*

The implementation of these rules will undoubtedly have a major impact on the business models and practices of multinational enterprises across the globe

This taxing right will be limited to the difference between the 15% and actual rate of taxation imposed by the destination country.

Comment

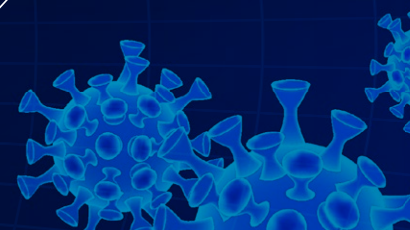
The current tax regime was not designed for the business models being implemented today. The physical nexus rules, such as permanent establishment and residence tests, in international tax law are not necessarily capable of capturing the vast amounts of intangible economic activity that occur in our digital world.

The Statement presents an ambitious timeline of 2023 for the implementation of one of the most significant changes in taxation. The implementation of these rules will undoubtedly have a major impact on the business models and practices of multinational enterprises across the globe.

As seen with the impact that flowed from the implementation of other BEPS interventions, it is critically important for businesses to keep abreast of the developments around the Two-Pillar approach to future proof their corporate structures and operational models.There are significant differences between the types of expenses that may be claimed by individuals in terms of South African tax law and in terms of Australian tax law. However, the principles laid down by the tribunal in this case are noteworthy for those South African individuals, and more particularly South African employees, who are considering claiming deductions in respect of the expenses that they have incurred pursuant to their employment.

Tsanga Mukumba

CDH'S COVID-19 RESOURCE HUB



A cautionary tale? SARS ruling places employment tax incentive under the microscope

The definition of *"employee"* in the ETI broadly encompasses a combination of the labour law concept of an employee and the tax law concept of an employee.

On 6 July 2021, the South African Revenue Service (SARS) published Binding Private Ruling 367 (BPR 367) which determined that students in a proposed training programme would not be considered *"employees"* as contemplated in the Employment Tax Incentive Act 26 of 2013 (ETI Act) and that the applicant taxpayer would not be entitled to claim an employment tax incentive (ETI) in respect of them. This ruling was published on the back of much public discussion around certain schemes utilising the ETI and is important for all advisors, taxpayers and proposed employees or beneficiaries of these schemes. This article discusses the background facts and SARS' ruling as well as the implications for all relevant stakeholders of the ETI.

How does the ETI work and who can claim it?

Before unpacking BPR 367 it is worthwhile revisiting how the ETI generally works and what requirements need to be met in order to claim it. If an employer is eligible to receive the ETI in respect of a *"qualifying employee"*, the employer may reduce the total amount of employees' tax generally payable to SARS thereby incentivising organisations to employ youthful job seekers.

Importantly, to claim the ETI, an organisation must qualify as an *"eligible employer"*. In addition, the eligible employer must hire a *"qualifying employee"*. *"Employee"* is specifically defined in section 1 of the ETI Act as a natural person:

- who works for another person; and
- who receives, or is entitled to receive remuneration, from that other person, but does not include an independent contractor.

The definition of *"employee"* in the ETI broadly encompasses a combination of the labour law concept of an employee and the tax law concept of an employee as contemplated in the Fourth Schedule to the Income Tax Act 58 of 1962 (ITA). We previously wrote in our Special Budget Alert on 24 February 2021 that the National Treasury proposed amending the definition of *"employee"* to counter certain abusive schemes in the market. While the publication of draft legislation giving effect to the proposal is imminent which will give one a better idea of the policy rationale behind the proposed pending change to the definition of *"employee"* (and the extent of the amendment), BPR 367 may give some further clues as to SARS current thinking around the concept.

Background facts of BPR 367

In BPR 367, a resident company (Applicant) and a resident non-profit company (Company B), proposed entering into an agreement with the stated purpose that students would be employed by the Applicant for purposes of obtaining a qualification.

The Applicant would then sign agreements with the students for a period of 12 months and pay the students a monthly salary. The Applicant would not be under any obligation to employ the students after the 12-month training programme had been completed.

The students would then consent to forfeit their monthly salaries in order to be trained by Company B. The students would be on the Applicant's payroll and protected by its group life policy, however, importantly, the students would not be required to do any work for the Applicant. The main duty of a student would be to attend training courses *"virtually"* at the skills centres

A cautionary tale? SARS ruling places employment tax incentive under the microscope*...continued*

There is no question that South Africa faces an ever increasing unemployment problem, particularly for the youth, and incentives such as the ETI are intended to play a critical role in rectifying these issues.

hosted by Company B. Furthermore, there would be no expectation that a student would have to report to the Applicant's offices on a daily basis.

However, there was the possibility that the students would be expected to make themselves available to perform specific forms of work such as marketing, printing and distribution of pamphlets for the Applicant. Practically, the Applicant would only call on them to perform these ad hoc activities to the extent that doing so would not interfere with their studies. Company B would, for all intents and purposes, exercise supervision and control over the students by way of mentors assigned to each of them, and these mentors would monitor and supervise the students to ensure they progressed successfully through the training course.

SARS ruling

Based on the specific set of facts, SARS ruled the following:

- no student would meet the definition of an "*employee*" in section 1(1) of the ETI Act; and
- the Applicant would not be entitled to claim an incentive, as contemplated in the ETI Act, in respect of any of the students.

Discussion

The ETI was introduced in 2014 for purposes of encouraging employers to hire young and less experienced work seekers. It was thus specifically aimed at increasing employment and skills levels in South Africa's unemployed youth. Notwithstanding this critical purpose, the recent unrest in South Africa raises important questions in relation to its efficacy. There is no question that South Africa faces an ever increasing unemployment problem, particularly for the youth, and incentives such as the ETI are intended to play a critical role in rectifying these issues.

However, considering the proposed amendments announced in the 2021 Budget, it appears that the National Treasury identified schemes similar to the one described in BPR 367, which it believes are not within the original purpose and ambit of the ETI Act. BPR 367 evidently builds on the revenue authorities' circumspection of these types of ETI arrangements.

Implications of BPR 367 for taxpayers

In terms of section 83 of the Tax Administration Act 28 of 2011 (TAA), a binding private ruling applies to a person only if:

- the provision or provisions of the Act at issue are the subject of the "*advance ruling*";
- the person's set of facts or transaction are the same as the particular set of facts or transaction specified in the ruling;
- the person's set of facts or transaction fall entirely within the effective period of the ruling;
- any assumptions made or conditions imposed by SARS in connection with the validity of the ruling have been satisfied or carried out; and
- the person is an applicant identified in the ruling.

A cautionary tale? SARS ruling places employment tax incentive under the microscope*...continued*

Binding private rulings are not binding on taxpayers and do not constitute *"practices generally prevailing"*, however, BPR 367 certainly makes it clear that these schemes are under SARS' microscope.

Considering the above, binding private rulings are not binding on taxpayers and do not constitute *"practices generally prevailing"*, however, BPR 367 certainly makes it clear that these schemes are under SARS' microscope. While published rulings are fact specific and do not reveal all the facts pertaining to them, it is interesting that the facts in BPR 367 did not make it clear that the students would have to render meaningful services to the Applicant during the 12 month *"employment period"*. However, even if the legal agreements envisaged the students possibly rendering some services to the Applicant, the issue is often in the implementation of these schemes as the contracts and agreements may intend for there to be services rendered, but in practice very little is in fact implemented.

Ultimately, the announcement in the 2021 Budget and BPR 367 reaffirm that the ETI is currently being very carefully monitored by the revenue authorities. As such, all taxpayers claiming the ETI would be well advised to consult with professional tax advisors to assess the impact of the pending amendments (as well as historical arrangements) for purposes of ensuring compliance and remedying any deficiencies. Should a taxpayer be uncertain whether it would qualify for the ETI by entering into a specific arrangement, it should first consult with its professional tax advisors. It can also consider applying to SARS for an advance tax ruling, similar to what the Applicant in BPR 367 did. It is worthwhile noting that audits of ETI claims are on the increase and taxpayers should be aware that SARS may impose penalties and interest in appropriate circumstances.

Jerome Brink and Louis Botha

2021 RESULTS

CHAMBERS GLOBAL 2018 - 2021 ranked our Tax & Exchange Control practice in Band 1: Tax.

Emil Brincker ranked by CHAMBERS GLOBAL 2003 - 2021 in Band 1: Tax.

Gerhard Badenhorst ranked by CHAMBERS GLOBAL 2009 - 2021 in Band 1: Tax: Indirect Tax.

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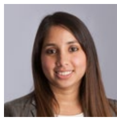

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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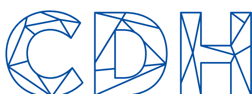

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