

9 DECEMBER 2021

TAX & EXCHANGE CONTROL ALERT

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The BEPS Project: Where are we now?

In order to curb tax base erosion and profit shifting (BEPS) by multinational enterprises (MNEs) that take undue advantage of low tax jurisdictions, the Organisation for Economic Co-operation and Development (OECD) (in conjunction with the G20) introduced the BEPS Project in 2015. The BEPS Project aims to ensure that profits are taxed in the jurisdiction where the economic activities generating such profits are performed.



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The BEPS Project: Where are we now?

This statement contains the Two-Pillar Solution to establish a new framework for international tax, as well as a detailed implementation plan that envisages the implementation of this new framework by 2023.

In order to curb tax base erosion and profit shifting (BEPS) by multinational enterprises (MNEs) that take undue advantage of low tax jurisdictions, the Organisation for Economic Co-operation and Development (OECD) (in conjunction with the G20) introduced the BEPS Project in 2015. The BEPS Project aims to ensure that profits are taxed in the jurisdiction where the economic activities generating such profits are performed.

While significant strides have been made in the implementation of the 15 Actions of the BEPS Project, there are still certain gaps that remain. One of these gaps pertains to the ability of large MNEs to earn substantial income in jurisdictions where they are not paying corporate income tax.

In order to address this, the members of the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) agreed to the *Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (2021 Statement) on 8 October 2021. This statement contains the Two-Pillar Solution to establish a new framework for international tax, as well as a detailed implementation plan that envisages the implementation of this new framework by 2023.

Introduction to BEPS and the G20 Inclusive Framework

The shifting of profits by MNEs to lower or no tax jurisdictions has an adverse impact on economies globally as this practice (amongst others) erodes the tax base in countries with higher tax rates.

In particular, this leads to unhealthy tax competition between jurisdictions and undermines the integrity of tax systems, often taking undue advantage of developing countries and low income jurisdictions.

In 2016, the OECD and the G20 established the Inclusive Framework, which ensures that member countries (with a special emphasis on developing countries) can participate on an equal footing in the development of standards on BEPS related issues. At present, there are 141 countries working together to implement the 15 Actions outlined in the BEPS Project to reduce tax avoidance and BEPS.

Recent developments

In October 2020, subsequent to discussions pertaining to the tax challenges posed by the digitalisation of the economy, the OECD released a "blueprint" for a Two-Pillar Solution to address the said tax challenges. A year later, the 2021 Statement was issued by the OECD/G20 and was agreed to by 136 members of the Inclusive Framework. As previously indicated, the 2021 Statement contains a detailed implementation plan pertaining to the Two-Pillar Solution.

The 2021 Statement provides the following guidance for the implementation of the Two-Pillar Solution.

The BEPS Project: Where are we now?...continued

Pillar One aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs operating in those countries.

Pillar One

Pillar One aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs operating in those countries. This will be done by re-allocating taxing rights over 25% of the residual profit of the largest and most-profitable MNEs to the jurisdictions where the customers of those MNEs are situated. The 2021 Statement indicated that "residual profit" is defined as profit in excess of 10% of an MNE's global revenue.

It should be noted that, pursuant to the reallocation of profits highlighted above, Pillar One introduces a new special purpose nexus rule permitting the allocation of its profits to a market jurisdiction only to the extent that the MNE derives at least:

- €1 million in the case of jurisdictions with a GDP in excess of €40 billion; or
- €250,000 in the case smaller jurisdictions with a GDP lower than €40 billion.

Pillar One also seeks to promote tax certainty through mandatory and binding dispute resolution procedures, with an elective regime to accommodate certain low-capacity countries.

Of importance in respect of the implementation of Pillar One is the removal of digital service taxes and other similar measures. To this end, digital service taxes will be replaced by the taxation of the reallocated profits envisioned under Pillar One.

The last key element of Pillar One involves the establishment of a simplified and streamlined approach to the application of the arm's length principle in specific circumstances. This element is focused on the needs of developing, low capacity countries who will benefit from less onerous rules.

Pillar One is intended to apply to MNEs with a global annual turnover in excess of €20 billion and profitability above 10%, calculated using an averaging mechanism. The turnover threshold is likely to be reduced to €10 billion euros after a period of seven or eight years should this Pillar be implemented successfully.

2021 RESULTS

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Stephan Spamer ranked by CHAMBERS GLOBAL 2019-2021 in Band 3: Tax.



The BEPS Project: Where are we now?...continued

In terms of the GloBE rules under Pillar Two, a global minimum tax of 15% will be imposed on all MNEs that generate annual revenue over €750 million.

Pillar Two

Pillar Two consists of:

- two interlocking domestic rules (together the Global anti-Base Erosion (GloBE) rules), being-
 - an Income Inclusion Rule (IIR), which imposes a top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and
 - an Undertaxed Payment Rule, which denies deductions or requires an equivalent adjustment to the extent that the low tax income of a constituent entity is not subject to tax under an IIR; and
- a treaty-based rule (the Subject to Tax Rule (STTR)) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate.

In terms of the GloBE rules under Pillar Two, a global minimum tax of 15% will be imposed on all MNEs that generate annual revenue over €750 million. It is worth noting that government entities, international organisations, non-profit

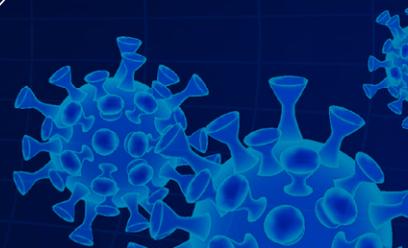
organisations, pension funds and investment funds that are the ultimate parent entities of an MNE group are not subject to the GloBE rules.

The GloBE rules will operate to impose a top-up tax using an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined with reference to financial accounting income (with specified adjustments). In respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within four years and are taxed at or above the minimum level.

In terms of the STTR, Inclusive Framework members that apply nominal corporate income tax rates below the STTR minimum rate to interest and royalty payments (amongst others) would (when requested to do so) implement the STTR into their bilateral tax treaties with members of the Inclusive Framework that constitute developing countries. The taxing right under the STTR will be limited to the difference between the minimum rate (9% at present) and the tax rate actually imposed on that payment by the jurisdiction in question.

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The BEPS Project: Where are we now?*...continued*

By its own admission, the 2023 deadline set by the OECD/G20 to fully implement the Two-Pillar Solution is quite ambitious and there is still a significant amount of work to be done.

Forthcoming developments

In order to facilitate the swift and consistent implementation of Pillar One, a multilateral convention (MLC) will be developed by the OECD/G20 to introduce a multilateral framework for all jurisdictions that join the Inclusive Framework, regardless of whether a tax treaty currently exists between the relevant jurisdictions. The MLC will be supplemented by an explanatory statement that describes the purpose and operation of the rules and processes. The text of the MLC and the accompanying explanatory statement are expected to be finalised by February 2022.

Furthermore, model rules (intended to give effect to the GloBE rules) and a model treaty provision (intended to give effect to the STTR) were to be developed by the end of November 2021 in order to give effect to Pillar Two. A multilateral instrument (MLI) will also be developed by mid-2022 to facilitate the implementation of the STTR in the relevant bilateral treaties.

It is the intention of the Inclusive Framework to finalise the implementation of both Pillar One and Pillar Two by 2023.

Interestingly, despite the 30 November 2021 deadline having passed, no model rules or model treaty provision (as proposed in terms of Pillar Two) have, to date, been published by the OECD/G20.

Comment

On the basis that BEPS can have a significantly negative economic impact, especially on developing countries, the movement towards the actual implementation of the Two-Pillar Solution is likely to be a welcome step in ensuring a fairer distribution of tax revenue in the tax jurisdictions where those profits are generated.

Under Pillar One, it is estimated that taxing rights on more than \$125 billion of profit are expected to be reallocated to market jurisdictions each year, whereas Pillar Two is estimated to generate around \$150 billion in new tax revenues globally per year. These results are expected to significantly stabilise the international tax system.

By its own admission, the 2023 deadline set by the OECD/G20 to fully implement the Two-Pillar Solution is quite ambitious and there is still a significant amount of work to be done (on a global level and especially on a domestic level) before the Two-Pillar Solution will be fully effective. However, now that the Two-Pillar Solution is coming into being, it will be important for MNEs to take cognizance of the thresholds referred to under each Pillar to determine whether they will be subject to the new rules of international taxation.

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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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