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IMPACT OF GLOBAL TAX CHANGES ON EMERGING COUNTRIES

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Soo-Jeong Ahn, Yulchon, Korea
Emil Brincker, Cliffe Dekker Hofmeyr, South Africa
Aseem Chawla, ASC Legal, India
David Weisner, Brown Brothers Harriman & Co, USA

Approach to Pillar One and Two

Africa: Current approach to Pillar One and Two and the Inclusive Framework ("IF")

- South Africa fully supports the IF initiative and is a signatory thereto
- Kenya and Nigeria still have reservations whereas only 23 of the IF countries are located in Africa
- South Africa is also a member of the African Tax Administration Forum ("**ATAF**"), which represents 40 of the 56 countries in Africa

Africa: ATAF perspective

Supports / appreciates:	Reservations
Exclusion of extractives sector from Pillar One	Some apprehension as to the extent of re-allocation of profits to African countries
No mandatory dispute resolution mechanism for issues relating to amount	Prefers minimum effective rate of 20% rather than 15% for Pillar Two
Residual profit is the allocation factor for Pillar One (even though preference is for at least 35% of residual profit to be allocated to market jurisdictions)	Prefers that a source based rule such as Undertaxed Payments Rule (“**UTPR**”) should be applied, but supports the fact that Subject to Tax Rule (“**STTR**”) will be a minimum standard that developing countries can require to be included in tax treaties
	Suggest that the STTR must include service payments in addition to interest, royalties and capital gains
	More work required to ensure a more equitable tax allocation and to stem Illicit Financial Flows from Africa

South Africa: Current status

- South Africa has not introduced a separate digital tax, even though it has considered same
- South Africa has introduced indirect taxes (VAT) at the rate of 15% on the supply of electronic services from a place in a foreign country (including an intermediary who facilitates the supply of electronic services), where at least two of the following circumstances are present –
    - The recipient is a resident of South Africa; or
    - Payment originates from a bank in South Africa; or
    - The recipient has an address in South Africa.

Korea: Current Approach to Pillars One & Two

Korean Government

- Cautious approach to digital taxation (both market and resident jurisdiction)
- No digital services tax, but added the extraterritorial VAT (10%)
- Income tax regime: not low-tax (27.5% max); CFC (17.5%)
- Active participation in OECD/G-20 Inclusive Framework's two-pillar solution discussions
- MOEF (Korean Ministry of Economy and Finance) fully embraces the OECD initiatives
- MOEF press release (Dec 20, 2021) immediately after the OECD officially published the Pillar Two model rules: plans to convene expert advisor meetings to come up with domestic law implementation by the 1H 2022

Korea: Current Approach to Pillars One & Two (cont'd)

Korean Business Community

- Concern of complexity: comments to give a sufficient transaction period and ample safe harbors
- Concerned of potentially increased tax burden: Companies operating in countries with low corporate tax rates and countries that provide various tax incentives

Expected Impact on Korean Businesses?

Pillar One

- Expected to affect 2 Korean companies (based on publicly available information)
- May affect more Korean companies from 2030 when the turnover threshold is reduced to EUR 10 billion
- About 80 foreign multinational companies expected to pay tax in Korea under Pillar One

Pillar Two

- Expected to affect 81 corporate groups that have operations in low-tax countries, and countries with tax exemptions - 150 subsidiaries

India: Current Approach to Pillar One and Two and the Inclusive Framework (‘IF’)

- India has also joined the G20-Organisation for Economic co-operation and Co-ordination (‘**OECD**’) inclusive framework aiming to reform International Tax Rules and ensure that Multinational Enterprises pay their fair share wherever they operate.

- However, India will have to roll back the Equalisation levy (‘**EL**’), its version of ‘Google Tax’, once the ‘Inclusive Framework’ and Global Minimum Tax regime stands implemented.

- India favours a wider application of the Global Minimum Tax Regime thereby ensuring that a fair allocation happens in favour of market economies and the collections are equivalent if not less than the estimated future tax collections from EL.

India: Current Approach to Pillar One and Two and the Inclusive Framework (‘IF’)

- India is in favour of a consensus solution which is simple to implement and user friendly.
- The solution should result in the *allocation of sustainable revenues* to market jurisdictions, particularly keeping the interest for developing and emerging economies.
- Presently, India’s tax structure is designed in a way that the income of foreign companies or Non-residents having Place of Effective Management (‘**POEM**’) in India are subject to comprehensive tax liability, the current rate of corporate income tax is at 25% & 17% for new Indian Manufacturing Companies, coupled with extensive taxing rights in the form of source rules in the form of withholding tax.
- India still professes retention of extensive taxing rights with ever expanding and stretching boundaries of source basis of taxation, through frequent amendments in its Domestic Tax Framework.
- Implementation of GloBE rules may require changes to the domestic tax legislation as well as to the current framework of the tax treaties which may be done through bilateral or multi-lateral negotiations so as to avoid double taxation which is not intended objective of the GloBE Rules.

Promoting Inbound Investments Contrasted with Trends in Enforcements

India Approach: Promoting Inbound Investments Contrasted with Trends in Enforcements

- The pillar two blueprint proposals are intended to address concerns of countries which are competing for inbound investment through low, or no, corporation tax rates. It aims to establish a framework which enables tax administration in establishing taxing rights to ensure that large MNEs (MNEs with global revenues exceeding €750 million) pay a minimal level of tax regardless of where they may be headquartered or where they operate.

- In a twist of fate, the lower corporate tax of 17% introduced by India for new manufacturing units in 2019 is just above the global minimum threshold rate of 15%. Therefore, this proposal ought not adversely impact inbound investments into India. In fact, it will allow India to focus on improving various non-tax factors and interventions to attract greater inbound investment flows.

India’s Approach (Contd..)

- At present, India’s minimum tax rate is 15% for new manufacturing units. That is just about the same as the proposed threshold minimum. So, an overseas company will not be put to any disadvantage even if they avail of the lowest rate of 15% of income tax in respect of new manufacturing units localised in India.

- For inbound investments, the competition based on the tax rate is something which India and other emerging economies could avoid with the buy-in of Global Minimum Tax- The likely question is ‘*Whither Tax Competition*.’

India : Trends in Treaties Negotiations

- Treaties based on the OECD model generally impose greater restrictions on a country's ability to tax inward investment; the UN model makes amendments to the OECD model that leave more of such rights intact.
- The revenue base of a government and its reliance on corporate tax plays a pivotal role in policy making.
- In a usual scenario of negotiation between developing and a developed country, the developing country accepts constraints on its ability to tax inward investors. These constraints can be evaluated under three categories:
  - Withholding tax (WHT) rates
  - Permanent Establishment (PE)
  - Other Provisions
- In return, the developed country agrees to bear the cost of eliminating any remaining double taxation incurred by its outward investors, by making allowances for the taxes they pay in the developing country.
- It is observed that capital-importing countries negotiated harder when the fiscal sacrifice entailed by a treaty had the potential to cost them more due to the asymmetries of bargaining power.

India : Trends in Enforcements

- Certain key trends in tax enforcement :
  - Adding strategic value to accelerate business model transformation
  - Rapid shift in operational transformation due to digital tax administration
  - Prioritizing data simplification and low-cost resourcing as a foundation

- One of the major changes expected is the shift to a Global Minimum Tax and a new digital economy tax regime, for which rules are yet to be framed.

- With the introduction of new rules, it is expected to have a reallocation of taxing rights under Pillar One that would bring meaningful and sustainable revenue for source and market countries. It is also anticipated that the GloBE rule would also address the concern that several companies perceived to be not paying their fair share of taxes in the source or market jurisdiction, shall pay their share of taxes.

India : Trends in Enforcements (Contd..)

- The aspects of quantum of revenue to be distributed are very important and thus, an optimal multilateral consensus solution, with both multilateral and individual country measures coexisting, will make the situation less chaotic. One is looking forward to a solution which is perceived as fair and equitable by at least a majority of stakeholders.

- Much of the negotiation is expected in 2022 for implementation in 2023. The same is expected to change the way, India levies tax on offshore digital economy firms having a customer base here.

- While India will get greater taxation rights over tech giants' profits that can be allocated for taxation here, India and some EU nations will have to withdraw the implementation of digital services tax such as Equalization Levy (EL).

South African approach: promoting inbound investments contrasted with trends in enforcements

- The South African Government has adopted an approach to broaden the tax base and to reduce the corporate income tax rate.
- The broadening of the tax base involves minimizing tax incentives, which are generally being phased out.
- It has been announced that the corporate income tax rate will reduce from 28% to 27% when the interest limitation rules and assessed loss limitation rules will be implemented.
- The decision to phase out incentives have been made as incentives encourage specific behaviour or activities and reduce the tax base, requiring higher tax rate for the rest of the economy.

South Africa approach (cont)

- Interest limitation rules pursuant to BEP's Action Plan 4 will be strengthened and introduced when the corporate income tax rate reduces to 27%. In this context a 30% of tax EBITDA principle has been adopted on the basis that the concept of interest includes interest rate swap agreements, finance cost element in finance lease payments and foreign exchange differences
- At the same time rules will be introduced to limit the use of assessed losses to 80% on the basis that tax must be paid on 20% of taxable income (a *de minimis* rule of R1 million will apply). Group taxation will still not be introduced.
- Strengthening of enforcement capability by introducing a high net worth unit and separate unit dealing with avoidance transactions

Korea: Trends in Tax Treaty Negotiations & BEPS Action Plans

MLI

- Early adopter
  - Signed in June 2017
  - Ratified in December 2019
  - Became effective in September 2020
- Reserved the application of most MLI articles
- Opted for the application of Article 6, Article 7, Article 16 and Article 17
  - Article 6 【Purpose of a Covered Tax Agreement】
  - Article 7 【Prevention of Treaty Abuse】
  - Article 16 【Mutual Agreement Procedure】
  - Article 17 【Corresponding Adjustments】

Korea: Trends in Tax Treaty Negotiations & BEPS (cont'd)

Notable MLI Provisions under Reservation

A. Mandatory Arbitration Provision

- Government is cautious – infrastructure
- As many developed countries are introducing mandatory arbitration, Korea is likely to follow other countries
- In 2020, domestic tax law amendment to provide a basis for go for arbitration once a treaty is amended.
  - Article 47 of the LCITA (Law for the Coordination of International Tax Affairs)
  - Effective from January 2021, Article 47 allows arbitration, upon application by the taxpayer, of a MAP case that is not finalized within the period prescribed in the relevant tax treaty

Korea: Trends in Tax Treaty Negotiations & BEPS (cont'd)

Notable MLI Provisions under Reservation (cont'd)

B. PE (Permanent Establishment) Provisions

- Korea has reserved the application of the PE provisions in the MLI
- But the tax law was amended to reflect the MLI and the 2017 OECD MTC
  - Expanded scope of "agent" for purposes of agent PE
    - Contract-concluding authority not required per se; principal role leading to conclusion of contracts and routinely concluded without material modification
  - Expanded scope of fixed-place PE
    - Two or more related corporations performing complementary functions in a place (places) in Korea that are part of cohesive business operation

Korea: Approach to Promoting Inbound Investments

Promoting Inbound Investments

- COVID impact: In 2020, the total number of foreign-invested companies and foreign direct investments decreased, but the number started to increase (relative to 2019) again in 2021 3Q
- Steady increase of inbound investments in Korea (other than COVID factors)
- Tax incentive phased out and aggressive tax authority: FDI incentive phased out → commercial attractions (semiconductor/automobile infrastructure; workforce; market) considered genuine drawing points

Amount of Foreign Direct Investment (in USD billion)*

	2019				2020				2021		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Total Investment (A)	15.03	17.05	14.87	17.53	14.75	13.05	10.75	18.56	11.30	16.97	17.01
% Change	51.9	23.5	7.6	26.2	-1.8	-23.4	-27.7	-5.9	-23.4	30.0	58.2
Repatriation (B)	1.66	2.69	3.25	5.98	3.14	4.85	2.53	4.31	3.67	4.04	4.33
Net Investment (A-B)	13.37	14.35	11.62	11.55	11.61	8.21	8.22	14.25	7.63	12.93	12.67
% Change	73.5	19.4	0.7	10.1	-13.2	-42.8	-29.3	23.4	-34.3	57.6	54.2

* Source: www.moef.go.kr/nw/nes/detailNesDtaView.do?menuNo=4010100&searchNttId1=MOSF_000000000057797&searchBbsId1=MOSFBBS_000000000028

Korea: Approach to Promoting Inbound Investments (cont'd)

Tax Audit on Corporate Taxpayers

- Since the COVID-19 pandemic, the number of tax audits on corporate taxpayers decreased, also reducing the amount of tax collected from tax audits
  - In 2020, the tax authorities conducted 3,984 tax audits and collected KRW 3.5 trillion from the tax audits (lowest amount in the last 5 years)
- Decreasing trend continued in 2021

Tax Audit Status*

	2016	2017	2018	2019	2020
Number of Tax Audits Conducted on Corporate Taxpayers	5,445	5,147	4,795	4,602	3,984
Tax Imposed (in KRW)	5.38 trillion	4.50 trillion	4.56 trillion	4.46 trillion	3.53 trillion

* Source: https://tasis.nts.go.kr/websquare/websquare.html?w2xPath=/cm/index.xml

Looking Forward: Tax Horizon

Korea: Looking Forward on the Tax Horizon

COVID-19 Budget Spending

- Supplementary budget spendings due to the damages caused by the pandemic – To sustain the overall economy, provide financial support for hard-hit sectors and ensure employment stability
  - 2020: KRW 66.8 trillion
  - 2021: KRW 49.8 trillion

Pressure to Collect Tax Revenue

- In December 2021, the National Assembly passed the budget for 2022: KRW 607.7 trillion
  - 8.9% increase from the 2021 budget (KRW 558 trillion)
- Expected national tax revenue for 2022: KRW 338.6 trillion (about half the budget spending)
- More pressure to collect taxes

India: Looking Forward on the Tax Horizon

- Ms. Janet Yellen, US Treasury secretary, discussed a shared interest between the United States & India to implement a 'robust' global minimum tax. Ms. Yellen has said global consensus would move the world a step closer to ending a '*race to the bottom*' on taxation and allow for critical investments in infrastructure, education and pandemic relief. In light of the recent developments, India favours a consensus solution that is 'simple to implement and simple to comply with.'

- United States continued engagement is a major accelerator leading to the consensus, whereas India's actions such as imposition of EL may threaten the fragile hope for a consensus-based solution. Nevertheless, India's support for the Pillar One and Pillar Two proposals perhaps indicate a willingness to make the deal work.

- The balancing act is the preservation of '*source-based*' taxation (without compromising) vis-à-vis participation in Inclusive Framework.

South Africa: Looking forward: the tax horizon

- The South African economy recovered faster than expected in 2021, but is expected to enter a stagnation phase
- Overcollections for the current year of assessment in excess of R120 billion
- The revenue authorities recently issued a discussion document on the introduction of an Advanced Pricing Agreement (“**APA**”) system. However, there should be room to amend APAs on the basis that it will take 3 to 4 years to implement an APA programme
- Focus on treaty negotiation to date was to introduce a minimum dividends tax rate of 5% in treaties given the recent judgment that resulted in dividends to the Netherlands being subjected to a dividends tax rate of 0% based on the most favoured nation principle

Questions?