Amount A: Overview and Implications for Developing Countries

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BACKGROUND OF AMOUNT A

COMPROMISES ALONG THE WAY

IMPORTANT TECHNICAL ISSUES

FRAMEWORK FOR DEVELOPING COUNTRIES TO EVALUATE AND MAKE DECISIONS

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Background of Amount A

To understand the implications of the proposed Amount A, it is essential we review our original objectives and evaluate whether and to what extent they are being met

Background of Amount A

- Tax Challenges of Digitalisation of the Economy were one of the focus areas of the BEPS Project: Discussed in the BEPS Action 1 Report
- It was recognised that digitalisation could exacerbate BEPS and had broader tax challenges
- The key question being: '*How taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions*'
- In other words, we started with questioning the validity of the existing taxing right allocation based only on physical presence considering newer and ever evolving digital business models

Background of Amount A

- To this end, there were many proposals on the table:
  - *G24: Significant Economic Presence may establish nexus and Profit Allocation through Fractional Apportionment: simple & objective criteria*
  - "User participation model" based nexus and Residual/ Non-routine Profit Split
  - "Marketing Intangibles" based nexus and Residual/ Non-routine Profit Split
- OECD Secretariat Compromise: Unified Approach for Amount A unifying the key features of the proposal on the table
- Amount A stems from the original unified approach

Key features of Amount A: Building Blocks

- Scope rules: Revenue and Profit Threshold, Exemption to Extractives and RFS, Defence and Autonomous Domestic Businesses
- Nexus: Based on a threshold Revenue Sourced to a jurisdiction
- Revenue Sourcing: Location of Ultimate Consumer
- Profit Allocation: Allocation key for deemed residual profits
- Elimination of Double Taxation: allocation of relieving responsibilities to jurisdictions
- MDSH: Decides when a Jurisdiction already has adequate profits
- WHT: Coverts WHT into profits to be allocated to source jurisdictions and reduced from residence jurisdiction calculations

Key features of Amount A

Administrative filings and tax collections

Tax certainty framework for Amount A:

- Scope certainty
- Advance certainty
- Comprehensive certainty
- Dispute resolution

Tax certainty framework for issues related to Amount A:

- MAP
- Mandatory/ Elective dispute resolution

Removal of DSTs

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Compromises along the way

Cascading effect?

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Starting Point from a Development Country perspective

- SEP and Fractional Apportionment

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Compromises along the way

- Unified approach
  - Nexus based on the revenue sourced to a jurisdiction
  - Profit allocation based on:
    - “Deemed Residual Profits” – Profits in excess of 10% consolidated group profits
    - “Percentage Allocation” i.e. only 25% of deemed residual profits to be allocated

Compromises along the way: Progressive reductions in the in-scope profit under Amount A

- Scope
  - Limited to very few MNEs: Revenue threshold >20B
  - Scope exclusions
- Profit Allocation: Implications of mixing allocation of additional profits based on a ‘new’ nexus with the existing profits allocated based on physical presence
  - MDSH: Do developing countries already have excess profits under existing rules?
  - WHT
- Elimination of Double Taxation: Will developing countries that may have higher nominal or routine profitability on account of higher inflation and cost of capital be classified as having ‘deemed residual profits’ – end up giving relief under Amount A

Compromises along the way: Tax Certainty

- Scope of the issues related to Amount A that are subject to mandatory dispute resolution mechanisms

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Some positives – retained from the original

Acceptance that physical presence is not adequate in the Digital Age

Nexus based purely on revenue derived from the jurisdiction of ultimate consumer

Allocation based on a formula

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Overall Economic Impact? May not be very significant

Existing studies use broad assumptions and only indicate a magnitude of expected revenue impact

Studies are not able to accurately account for MDSH and EoDT

No study accounts for WHT in the calculations reliably

Calculations based on Depreciation and Payroll are difficult as accurate Group level and Country data is not available

Difficult to estimate the impact of elimination given the tiered structure and RoDP based calculations in the Tier 3

Difficult to predict MNE behaviour change from Amount A: Corporate Profits are mobile; and Amount A may change based on MDSH and EDT rules

Technical Issues

MDSH: Do developing countries have ‘excess profits’ under the Amount A rules

WHT: If WHT were a part of the ‘new nexus’, then how is the nexus ‘new’

EoDT: Uncertainty in calculations

Administration and Tax Certainty: Capacity for implementation?

MDSH Metric

- Return on ***Depreciation and Payroll*** based on Consolidated Group Threshold level
- Developing countries have lower costs and lower salaries – denominator will be smaller and RoDP in developing countries will be larger
- Developing countries may have higher nominal profitability since interest rates and inflation rates are higher
- Does this mean they have excess profits?
- *Cost based denominator does not favour developing countries*
- Protection in the form a '3% ROR'
- Is the percentage enough to classify a country as having excess profits?

MDSH Setoff

- Set-off of 90% of excess profits in certain cases (as against 25% in case of only M&D) against Amount A
- Considering a 25% allocation is this okay?

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WHT

- Does the compromise on new nexus leave scope for accounting of WHT i.e. why should WHT be included in the calculations?
- WHT will increase calculation of excess profits in market jurisdictions for purpose of MDSH calculation
- WHT will decrease calculation of elimination profits in residence jurisdictions for purpose of EoDT
- Reduces an already limited Amount A reallocation based on existing source rules which are not connected to the new nexus

EoDT

- Can developing countries end up eliminating?
- ‘Tier 3’ calculations are difficult and unpredictable
- Consolidated group level payroll figures are not available
- Elimination threshold RoDP may be breached in developing countries on account of cost savings

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Capacity constraints in developing countries

Approach is complex and difficult to administer

Role of LTA is significant

Capacity to audit, raise disputes, participate in ongoing certainty discussions

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Framework for technical decision making

How Amount A fits into existing legal and constitutional framework

Economic Impact Assessment: Revenue and Investment impact and withdrawal of existing Unilateral Measures

Administrative implementation costs: Capacity building costs for implementation and participation in the proposed multilateral certainty framework

Countries relying on existing de-minimis thresholds: Thresholds are mostly static without much scope for revision – may introduce sudden cliff edge effects as soon as they are crossed

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Thank you