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To: OECD Centre for Tax Policy and Administration

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Tax challenges arising from digitalization – Levelling the playing field

Prosus views the OECD/G20 Inclusive Framework on BEPS Reports on Pillar One and Pillar Two Blueprints¹

Summary

Prosus is a strong supporter of the international efforts to develop a global solution to remove imbalances in and to modernize the international tax system by creating a level playing field. We also welcome the opportunity to provide comments on the Pillar One and Pillar Two design as reflected in the Reports on the Blueprints published on 12 October 2020.

Summary of key points (related to sections I, VI, VII and VIII of the consultation document):

1. Our entities generally perform their commercial activities, generate their (residual) profits and pay their taxes on revenues and profits in the local markets where their consumers and/or users are located (a local-to-local business model).
2. An approach where entities performing local entrepreneurial activities (and having a local-to-local business model) are excluded from the scope of Amount A would better reflect the policy rationale behind the proposal. It prevents double counting issues and leads to more administrative simplicity for businesses and tax administrations alike.

¹ Written response to public consultation 12 Oct 2020-14 Dec 2020; <https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm>.

3. Local entrepreneurial activities could be defined as activities which are performed in a market generating revenues almost wholly from users and consumers from that market (e.g., 90%) and which have a transfer pricing model that does not allow for shifting of the residual profits (or residual losses) to another country (e.g., because intra group services or use of intellectual property are rewarded based on the cost-plus method).
4. The local entrepreneurial issue is universal and should therefore also be recognized for Automated Digital Services (ADS), and not only for Consumer Facing Businesses (CFB).
5. The marketing and distribution safe harbor approach as proposed in the draft therefore addresses a very relevant issue and is a helpful recognition of that issue, but adds significantly more complexity than a carve-out for local activities.
6. Where digital services taxes (DSTs) also include local entrepreneurial activities in their scope, it would be important for these to be either withdrawn, switched off, or, as an intermediate solution, be creditable against other local taxes for all digital activities undertaken, not only for those companies that are in scope for Amount A.
7. In addition, it is important that there is clarity on the Group definition for Pillar One and Two purposes and follows the Country-by-Country Reporting framework in accordance with the BEPS Action 13 (again to avoid double counting).

Introduction of Prosus

Prosus (www.prosus.com) is a global consumer internet company and amongst the largest technology investors in the world. Prosus owns the international operations of South African Naspers Group (www.naspers.com) and was listed in September 2019 on the Euronext in Amsterdam. Prosus directly employs more than 20,000 people globally, with many more employed by its associates. Prosus is the largest non-US and non-Chinese technology investor in the world and its businesses are active in more than 80 developed and developing countries around the world. Prosus' operations are highly decentralized and designed to support local digital entrepreneurship. Substantive activities are undertaken in the individual markets out of locally established entities, with revenues and profits reported locally and taxed in these local markets. Naspers owns approximately 72.5% of the shares in Prosus.

General Comments on the Pillar One Blueprint

Prosus supports the positions taken by some governments that companies should pay taxes locally, where their users and consumers are. Prosus understands that, for simplicity reasons, such an exercise is undertaken by proxy, by deeming residual profits and allocating these based on a formula under Amount A of the Unified Approach. However, in our opinion such an approach should recognize local business models where profits and revenues are already taxed in the local market when they arose. Otherwise the proxy solution may lead to an arbitrary re-allocation of profits between local markets. Such re-allocation will not serve any policy objective which has been expressed in

connection with Pillar One. Besides unnecessary complexity and administrative costs, the result will be unfair. This will in particular be the case when a profitable local business is acquired by a foreign group. Without there being any change in the activities of the local business, profits may be allocated to other markets in which the acquiring group is active. For the resident state of the local business this will be an unfair loss of tax revenue.

The pending proposals as developed by the G20/OECD Inclusive Framework on BEPS and unilaterally proposed and introduced DSTs could create distortions that discourage local entrepreneurship. This is because the proposals may lead to “double counting” if Amount A is also applied to local entrepreneurial business models. For DSTs the additional layer of taxation will come on top of paying corporate income taxes (and indirect taxes) in the local markets, which disincentivizes and discriminates local technology development. This is at stark contrast with almost all governments introducing tax or other incentives to promote technology development in their countries.

The Unified Approach acknowledges the existence of the double counting issue, but only for CFB. For these businesses the Blueprint proposes the marketing and distribution safe harbor. For ADS, such a safe harbor is not foreseen. It is not clear to us why this is the case, as clearly such local business models also are used by businesses which are performing ADS activities. Moreover, CFB are increasingly performing ADS while maintaining their decentralized models. From this perspective, the double counting requires an adequate solution for all types of businesses.

In our comments below we will answer the questions posed in the consultation document related to Pillar One which are most relevant to our business, in particular those on scope (Section I), the development of a loss carry-forward regime (Section VI), the section on Double Counting Issues (Section VII) and the Process of determining who should bear the Amount A Tax Liability (Section VIII).

In addition to the points specifically identified by the Inclusive Framework, we would appreciate the specific confirmation by the Inclusive Framework that the definition of group for Pillar One and Two purposes will follow the definitions used for Country-by-Country Reporting in accordance with the BEPS Action 13 minimum standard.

Comments in Response to Specific Questions Raised in Consultation Document

Scope of Amount A (Section I)

- A level playing field between businesses in the same circumstances, independent of their business models, is essential to facilitate trade and economic growth. A neutral design of the tax rules is therefore important. In our opinion this means that all remote sales from a central location outside the country where the consumers or users are located - whether through digital means or not - should be treated equally;
- In addition, the situation should also be avoided that taxation of entities performing fully or practically fully local entrepreneurial activities is different dependent on whether they are locally owned or part of an MNE group. An approach where entities performing local entrepreneurial activities are

excluded from the scope of Amount A would better reflect the policy rationale behind the proposal. It prevents double counting issues from arising and would lead to more administrative simplicity for businesses and tax administrations alike;

- Within Prosus we are therefore of the opinion that we should not fall within the scope of Amount A to the extent our activities are undertaken in the individual markets out of locally established entities, with revenues and profits reported locally and taxed in these local markets;
- Local entrepreneurial activities could be defined as activities which are performed in a market, generating revenues almost wholly from users and consumers from that market (e.g., 90%) and which have a transfer pricing model that does not allow for shifting of the residual profits (or residual losses) to another country (e.g. because intra group services or use of intellectual property are rewarded based on the cost-plus method);
- The local entrepreneurial issue is universal and should therefore also be recognized for ADS, and not only for CFB;
- The marketing and distribution safe harbor approach as proposed in the draft therefore addresses a very relevant issue and is a helpful recognition of that issue, but it adds much more complexity than a local activities carve-out. We will come back to that later in Section VII;
- Prosus recognizes the need for simplicity and clear design of the scope of the new rules. We believe that the carve-out for local activities as suggested above would lead to more administrative simplicity for businesses and tax administrations alike. All entities performing local entrepreneurial activities would remain unaffected by Amount A. The new Amount A rules would then focus better on the activities for which these rules were apparently intended: entrepreneurial activities and business models under which revenues and residual profits are shifted away from the market countries where the consumers or users are located to a centralized entrepreneur (often located in a low or no tax jurisdiction);
- Where the scope of DST's will include local entrepreneurial activities, it would be important for these to be withdrawn or switched off, or as an intermediate measure, be creditable against local taxes, for all digital activities undertaken, not only for those companies that are in scope for Amount A;
- Finally, it is important to have clarity on the role of associates in the definition of "MNE Group" for the purposes of Pillar One (and Pillar Two). Prosus appreciates a specific confirmation by the Inclusive Framework that the definition of "MNE Group" will follow the definitions used for Country-by-Country Reporting in accordance with the BEPS Action 13 minimum standard.

Loss carry-forward regime (section VI)

- Prosus welcomes the recognition by Pillar One of tax losses. Compared to DSTs (which are typically revenue based) this feature of Pillar One is a better recognition of business reality in which start-ups are initially lossmaking. Loss-recognition is an important feature of a tax system that promotes innovation and will benefit both businesses and governments. After all, start-up companies that usually invest in innovative ideas with a long-term growth

potential likely will not be profitable for a number of years. Levying taxes such as DSTs of such loss-making start-ups will make start-ups much more expensive, and with that will hamper innovation;

- In the same fashion, Prosus highlights the importance of ensuring that pre-regime losses are recognized. Only economic profits should be taxed within the context of Amount A.

Double counting issues (section VII)

- The Blueprint acknowledges the existence of double counting. This occurs when residual profits from local entrepreneurial activities are already taxed in the market where the consumers are. But the Blueprint only does so for CFB. As mentioned above, we would like to stress that the exact same issues arise for ADS companies. Therefore, the recognition of the issue should expand to ADS;
- As highlighted above, we are of the strong opinion that the issue of double counting should be avoided by creating a carve out/exclusion from the scope of Amount A for entities performing local entrepreneurial activities. The marketing and distribution safe harbor does not fully address the issue. The marketing and distribution safe harbor (expanded for ADS) could be retained as a fallback option;
- The marketing and distribution safe harbor assumes that residual profits are always positive. Hence, Amount A allocations are “taken back” for countries as far as there are already residual profits allocated to the country. But, of course, residual profits link to undertaking entrepreneurial activities and such activities may result in (residual) profits, but also in losses. Such losses are negative residual profits. The marketing and distribution safe harbor does take back allocation of Amount A for activities already generating sufficient residual profits in the markets but does not remove these entities as potential surrendering entities. As a result, if a company has affiliates within the group which perform local entrepreneurial activities and some of these generate significant profits, while others generate losses, the current drafting of Pillar One will lead to profits from the profitable local entrepreneurs being allocated to the loss making entrepreneurs, without there being any link between these activities. This is unfair and arbitrary, in particular in the countries where the profitable local enterprises are located;
- A local activities carve-out avoids these issues. Both loss making and profitable local entrepreneurial activities will be excluded and treated as local entities. The marketing and distribution safe harbor could be maintained for activities which are primarily, but not fully, local, and which do generate more than the Amount A levels of residual profits. For those activities, the marketing and distribution safe harbor would take away the double counting issue;
- Expanding the safe harbor to ADS will be an easy task if the scope of application of the safe harbor on ADS follows the general definition of ADS for the purposes of Pillar One with the simple addition that it needs to take place in the market jurisdiction.

Process of determining who should bear the Amount A Tax Liability (Section VIII)

- Prosus welcomes the recognition in the Blueprint of the importance to eliminate double taxation and also the recognition of the issue of reallocating profits between markets that are not connected (par. 613 of the Blueprint);
- The proposals on eliminating double taxation show that this exercise becomes very complex if the aim is to ensure that the elimination of double taxation takes account of the facts and circumstances in specific situations, such as whether there is a connection between the market where Amount A is allocated and the market of the surrendering entity. Our proposed carve-out for entities performing local entrepreneurial activities would save businesses and tax administrations the need to go through the whole - complex - Amount A exercise in situations for which a reallocation of the profits was not intended. The profits are already taxed in the local markets. Even though in some situations the outcome of applying the marketing and distribution safe harbor or the elimination of double taxation rules would be the same (being no additional taxation in the local country), the administrative costs of going through the exercise, and the operational risk of getting it wrong, will be much lower when a carve-out solution would be used.

General Comments on the Pillar Two Blueprint

Prosus believes that the Pillar Two proposal is highly complex. Its introduction may result in an onerous compliance burden and material administrative costs. We are in favor of a balanced and simple approach that is targeted at those situations that are problematic from a base erosion and profit shifting (BEPS) perspective.

Given that the Pillar Two rules will be implemented on an optional basis by jurisdictions, it is important that the key parameters of the rules are well-delineated and that any departures are based on clear principles.

In our comments below we will answer the questions posed in the consultation document which are most relevant to our business, in particular those on the carry-forwards and carve-out (Chapter 4), the simplification rules (Chapter 5) and the special rules for Associates (Chapter 8).

Comments in Response to Specific Questions Raised in Consultation Document

Carry-forwards and carve-out (Chapter 4)

- Prosus welcomes the recognition in the Blueprint of carry-forwards for losses (including pre-regime losses). As previously mentioned, levying taxes to loss making (start-up) companies hinders the ability to invest and grow and it hampers innovation;
- We believe that such carry-forwards should be indefinite and not limited in time.

Simplification rules (Chapter 5)

- Prosus welcomes the four simplification options that the Inclusive Framework is considering and believes that they are critical in achieving the objectives of Pillar Two in a less burdensome manner;
- Prosus believes that further simplifications should be introduced that will relieve the compliance burden for administrations and taxpayers significantly. For MNE groups like Naspers or Prosus that have a global footprint and presence in a significant number of jurisdictions, jurisdictional blending would require annual effective tax rate (ETR) calculations in many jurisdictions. This is a burdensome process, while the effective tax rate of such groups may be well above the desired minimum rate;
- Simplification measures would not only reduce the administrative burdens. It will also be in line with the policy objectives of the Pillar Two proposal as it will only apply to groups which can be considered as compliant and representing low risks for governments (proved by the high percentage of global ETR).

Special rules for Associates (Chapter 8)

- Prosus took note of the considerations to introduce a special income inclusion rule (IIR) for Associates. However, we are very concerned that such a rule introduces additional complexities. In particular the limited information available at the shareholder level will trigger complexities. Moreover, it could be assumed that, following global agreement on Pillar Two, each independent MNE group would already be subject to the GloBE rules. That should be a sufficient safeguard for any concerns around BEPS.

We hope the above comments are helpful and would be happy to respond to any questions regarding this submission.

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