September 2022

WTS ICT Service Line Newsletter

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Argentina

Tax court rules on PE under Belgium-Argentina tax treaty

20 May 2022 saw the Argentine Tax Court ("ATC") rule in the case *"Solvay Indupa SAIC s/apelación – Impuesto a las Ganancias"* as to whether a Belgium company should be regarded as having an Argentine PE in view of the "work site" and "service PE" standards. The case was entered for the taxpayer, considering that the time threshold was not met, while the work site PE issue was a controversy in financial years different to the ones under assessment.

The Argentine Revenue Service ("ARS") considered that the Belgium Company Solvay S.A. ("Solvay") had a PE in the country during the years 2001 to 2006, in which it provided technical assistance to its Argentine affiliate, "Indupa". Interestingly, the ARS blamed the latter – namely the Argentine payer – for not acting as a domestic withholding agent that had made payments to an unregistered taxpayer.

The tax assessment was based on two different activities carried out by Solvay in Argentina, namely: (i) the execution of a construction work destined to expand a production plant in Bahia Blanca, Argentina, owned by the Argentine-affiliated company Indupa. To perform such work, an unrelated construction company was hired in Argentina, for a term beyond two years, which took place before the years under assessment; and (ii) the provision of the advisory and technical assistance services required for the maintenance of the quality of the production of such plant.

The ATC took the side of the taxpayer. In its ruling, the ATC considered the provisions of the Double Tax Treaty between Argentina and Belgium ("DTT"). Indeed, from the evidence produced in the case, the ATC deemed that it was properly proven that the construction was actually carried out by an Argentine subcontractor (i.e. Techint S.A.), and not by Solvay, during the financial years excluded from the notice of deficiency. Accordingly, the ATC ruled that this fact may not be reasonably introduced in a different financial period. Also, regarding the advisory and technical assistance services, it was proven that the employees of Solvay stayed in Argentina for only 58 days per year, on average, which was well below the minimum physical presence threshold required by the DTT (i.e. a period of six months within any twelve-month period). Consequently, the ATC understood that none of the two factors mentioned by the ARS was adequate to determine the existence of a PE of Solvay in Argentina, and therefore it ruled in favour of the company.

The ATC also made clear that the recently broader PE standards, introduced by the 2018 tax reform, may not be used to frame this controversy, as the financial years in controversy well preceded such tax reform.

It should be noted that the reform broadens the Argentine PE definition, following OECD-BEPS Action 7 standards. These standards resulted in a new income tax provision (Section 22), which is quite broad (i.e. includes any in-country person, working on behalf of a non-resident, who assumed risks that are attributable to the latter, among others). Such income tax provision has been challenged by local tax scholars for being inconsistent with many double tax treaties already executed by Argentina (like the Belgium-Argentina one). While such a controversy has not been present in the Solvay case, scholars' expectations are that – in view of the higher priority of treaty law vis-à-vis domestic legislation – domestic income tax standards may not alter the treaty law outcome, to the extent that they are clearly incompatible.

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Austria

Double taxation risk in connection with software as a service

On 1 June 2022, the Austrian Ministry of Finance (MoF) issued a statement (EAS 3436), saying that it is changing its understanding of how certain IT services are qualified in the double tax treaty (DTT) with China. The change in opinion can lead to double taxation and affects double tax treaties with other countries.

The underlying question the MoF was asked in the statement was whether China has the right to withhold tax according to Article 12 of the respective DTT, when an Austrian company provides IT services such as software as a service (SaaS) and infrastructure as a service (IaaS).

The definition of royalties in Article 12 of the DTT between Austria and China still follows the terminology of the OECD model tax treaty before 1992 and includes *"the use of or the right to use industrial, commercial or scientific equipment"*. This term has been excluded from the OECD commentary with the 1992 update but is still included in the UN model tax convention commentary. The term "equipment" was nonetheless defined in neither of the two commentaries. In the past, the Austrian MoF has argued that the term "equipment" does not necessarily mean tangible assets and that immaterial assets can therefore also be regarded as equipment.

However, in the 2017 update of the UN commentary, the UN makes clear that "equipment" cannot include intellectual property. Furthermore, the commentary states that the customer must have possession or control of equipment.

Based on these grounds, the Austrian MoF now is of the opinion that the use of "equipment" cannot be assumed in "classic" software transfers via external data carriers or in SaaS. Software is an intangible asset that should not be covered by the term "equipment". Furthermore, while infrastructure will generally qualify as "equipment", the UN commentary also states that the customer must have possession or control of the equipment. Hence, if the user does not obtain power of disposal over the infrastructure, IaaS must be qualified as a service and Article 7 of the DTT with China will apply.

In its statement, the Austrian MoF also pointed out that in the case of mixed contracts (e.g. delivery of equipment in conjunction with a transfer of know-how), the individual sub-components of the contract must generally be assessed separately and might lead to different tax effects.

Using the term "software" or "software licence" in a contract may directly trigger tax consequences in some Asian, African and South American countries, usually in the form of withholding taxes. Furthermore, non-OECD member states usually negate the separate assessment of various components of a contract, hence the entire contract – even the delivery part – might be subject to "withholding tax on software". In connection to Software transactions Austria generally adopts the following classification of the OECD:

(1) Acquisition of partial rights in a copyright
(2) Acquisition of partial rights in a copyright which only allow the proper operation of the e.g. software
(3) Acquisition of full rights in a copyright

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Due to the recent changes only (1) above is qualified as royalties in accordance with Art 12 DTT with China by the Austrian MoF. Previously also (2) above was considered as royalties in accordance with Art 12 DTT with China if the right was granted for a limited period of time. Hence, it is very likely that domestic IT service provider will in future face a higher double taxation risk relating to China and other DTT partner jurisdictions. To eliminate such double taxation taxpayers might be forced to make use of a mutual agreement procedure

Please do not hesitate to get in touch with us if you wish to discuss potential tax risks regarding software or IT services.

France

Double tax treaties: application of the double tax treaties and beneficial ownership CE, 20 May 2022, n° 444451 Sté Planet

In its decision, the French supreme tax court (Conseil d'Etat) had to decide whether, in the presence of intermediary companies, the treaty with the state of residence of the beneficial owner should be applied instead of the treaty with the state of the recipient of the payment.

In this case, the French company Planet paid royalties to Les Mills Belgium SPRL, a Belgian company, and to Les Mills Euromed Limited, a Maltese company, in consideration for the sub-distribution of collective fitness programmes developed by the company Les Mills International LTD, established in New Zealand. Originally, the sums were paid directly to the New Zealand company, which was the parent of the recipient companies.

These sums were subject to the withholding tax of Article 182 B of the French tax code by the tax authorities, reduced by the tax authorities to the rate of 10% provided for by the double tax treaty between France and New Zealand, in the belief that Les Mills International LTD was the true beneficial owner of these sums.

Planet contested this reasoning and considered that, on the contrary, the Franco-Belgian and Franco-Maltese double tax treaties should apply. This permitted the exemption of the royalties paid to the Belgian entity from the French withholding tax on the basis of the DTT between France and Belgium.

The French supreme court, relying on the OECD commentaries on Article 12 of the OECD model double tax treaty, considers the provisions of Article 12(2) of the Franco-New Zealand tax treaty (which provides that "however, such royalties may also be taxed in the state in which they arise and according to the laws of that state, but if the person receiving the royalties is the beneficial owner, the tax so charged shall not exceed 10 per cent of the gross amount of the royalties") are applicable to French source royalties whose beneficial owner resides in New Zealand, even if they have been paid to an intermediary established in a third country, provided that it is evidenced that the NZ entity is the beneficial owner of these amounts. The mere fact taken into consideration by the Marseille administrative court of appeal that "the New Zealand company Les Mills International LTD should, pursuant to an agency agreement signed on 2 December 1998 between that company and the company Planet, be regarded as the actual beneficiary of the sums in dispute paid by the French company to the Belgian and Maltese companies" is not sufficient.

The French supreme court therefore refers the case back to the administrative court of appeal for retrial.

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At this stage, the main impact of the decision is that the notion of beneficial owner effectively dictates the DTT to be applied subject to the wording of this treaty, provided it is objectively evidenced, on the basis of the facts and circumstances of each case. In other words, the French tax authorities cannot just ignore the apparent situation and challenge the apparent recipient to sustain that only the French WHT would apply; in such a case, they must also have evidence as to who is the beneficial owner and apply the DTT based on this new factual situation.

Indonesia

The development of the OECD's two-pillar solution in Indonesia

With the Law Number 7 of 2021 ("Law 7/2021") regarding the harmonisation of tax regulations which came into force on 1 January 2022[1], the Indonesian government signals its readiness to implement the Pillar Two from the Organisation for Economic Co-operation and Development (OECD) two-pillar solution. It is specifically mentioned in Article 32A of Law 7/2021, which amends the previous clause by putting broader provisions concerning agreement or cooperation with other countries or jurisdictions in the context of avoiding double taxation and the prevention of tax evasion.

Article 32A of Law 7/2021 stipulates that the government has a right to enter into a taxation agreement with a country or jurisdiction partner[2], either bilateral or multilateral, for the purpose of: (i) avoidance of double taxation and prevention of tax evasion, (ii) prevention of tax base erosion and shifting profits, (iii) exchange of tax information, (iv) assistance of tax collection and (v) other tax cooperation.

The elucidation of Article 32A of Law 7/2021 explains that the provision aims to promote economic cooperation with other countries, particularly with taxation, as well as to cope with the dynamic development of international tax landscape. The implementation shall be carried out under special legal instruments (lex-specialis). It also provides further explanations on the above purposes (point (i) to (v)), which are consistent with the international conception.

Article 32A of Law 7/2021 provides foundation to the implementation of Pillar Two. It shows Indonesia's commitment to responding positively to the OECD's initiative, being part of the BEPS Inclusive Framework. Further implementing regulations are expected in line with the OECD's timeline of Pillar Two implementation.

Digital service tax

Digital service tax is covered in the OECD's Pillar One. If Pillar One is finally released, digital service tax that is unilaterally implemented must be abolished.

Currently, Indonesia has the Law Number 2 of 2020 ("Law 2/2020") which includes the provision of taxation on the digital economy by foreign businesses. It stipulates that foreign sellers, foreign service providers and/or foreign digital-business providers may be deemed to have a permanent establishment in Indonesia if they meet "significant economic presence". Significant economic presence is designated by: (i) consolidated

1 the sixth amendment to the current income tax law.
2 the previous regulation only settled at this part.

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gross turnover of the business group, (ii) amount of sales in Indonesia and/or (iii) active digital media users in Indonesia. Where the tax treaty negates such a permanent establishment, they will be imposed by "electronic transaction tax".

That said, this provision has not yet been implemented. Considering that Indonesia is part of the Inclusive Framework which has agreed to the OECD's two-pillar approach, the implementation of digital service tax in Indonesia may follow global implementation as led by the OECD.

Kenya

National tax policy: a more certain future tax regime?

Traditionally, the government of Kenya has been introducing changes to tax laws every year, mainly through an annual finance act. In recent years, Kenya has experienced a very volatile tax regime, which has created serious uncertainty for existing and potential investors in Kenya. Some changes have been inconsistent or against core tax principles.

For instance, April 2020 saw the government introduce a raft of tax legislative changes to minimise the effects of the COVID-19 pandemic on businesses and individuals. Among these changes was a reduction in the standard corporate income tax rate and the top personal income tax rate from 30% to 25% and an increase in personal relief. Two months later, with the finance act, the Government introduced new taxes, including a minimum income tax, and did away with numerous tax exemptions. Some of the exemptions had existed in the law for a year.

In July this year, the National Treasury released the first draft of the National Tax Policy to the public for comments. The Policy contains principles and guidelines on tax legislation and administration. According to the National Treasury, the policy is intended to promote a predictable tax environment for business and to enhance equity in tax administration. Kenya is among the pioneers in Africa for putting a national tax policy in place.

The proposed principles and guidelines cover the enactment of tax laws, tax rates and tax incentives, as well as tax administration. Among the key ones is the proposal to review tax laws once every 5 years. We expect that in between there will be minor amendments, thereby increasing predictability for significant tax changes. It also proposes stakeholder engagement before changes are made to tax laws.

The policy also suggests a standard income tax rate for all companies (currently at 30%) and a fixed preferential income tax rate, equivalent to 50% of the standard rate. While the guideline is commendable and promotes equity in the corporate income tax regime, there is a need to harmonise the proposals with existing tax incentive regimes, which currently offer preferential corporate income tax rates ranging from exemptions (0%) to 25%. There are also guidelines to make refund processes efficient and effective.

The policy is currently undergoing the public participation process, which allows various stakeholders to present proposals for the enrichment of the policy, before parliamentary approval. If adopted, there will be a sense of optimism for a more certain future tax regime in Kenya.

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Netherlands

The saga on the withholding tax exemption continues

Introduction

The Amsterdam Court of Appeal denied the dividend withholding tax exemption for a distribution to a Belgian family holding company due to lack of substance. This case is highly relevant to all foreign personal and family holdings that invest in the Netherlands.

Background

The Netherlands does not levy dividend withholding tax on dividend distributions to corporate shareholders in the EU/EEA or jurisdictions with which the Netherlands has a double tax treaty (the "WHT Exemption").[3] The WHT Exemption is not applicable to holding companies that lack physical presence, when they are used to obtain access to the WHT Exemption and it concerns a wholly artificial arrangement. Many personal/family holding companies lack physical presence and often do not have employees and the holding company's owners would not be entitled to this exemption had they owned the shareholding in the distributing company directly.[4] One can therefore debate whether the use of a personal holding or family company should be considered a wholly artificial arrangement.

The case

The case concerned a Belgian holding company ("**holding**") that was held by a Belgian family. The holding received a dividend from a Dutch BV ("**BV**"), serving as private equity pooling vehicle. The holding did not have its own office space or employees. However, the holding paid a management fee to an affiliated entity for management services and the use of its premises. The holding owned various other investments and was actively involved with the management of those other investments.

The decision of the Court of Appeal

According to the Court of Appeal, the holding had the main purpose to avoid Dutch dividend withholding tax. This is because the (ultimate) shareholders in holding are individuals who are not entitled to the WHT Exemption.

The Court of Appeal ruled that the holding was an artificial arrangement because:

- The holding had no (own) personnel and office facilities.
- The decision-making of the holding is fully in the hands of members of the family.

The Court of Appeal mentioned that the absence of active involvement could be an indication of the absence of economic activity and thus an indication of an artificial arrangement. The Court of Appeal also considered if there was an obligation to reinvest any income and that the family was free to request a distribution at any time.

Hence, the WHT Exemption was denied.

Atlas notes

It is recommended that the applicability of the WHT exemption is carefully reviewed prior to any dividend distribution. Alternatively, distributions can be postponed until the Supreme Court ruling. The WHT Exemption can be discussed in advance with the Dutch tax authorities.

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3 Provided the shareholding equals or exceeds 5% of the nominal and paid-up capital.
4 Individuals are not entitled to the WHT Exemption.

Pakistan

Changes in the corporate tax rate structure

The federal government has recently introduced various changes in the corporate tax rate structure with the Finance Bill 2022. These changes have been implemented by Finance Act 2022 by way of amendments made in the Income Tax Ordinance, 2001 (the "Tax Ordinance") effective 1 July 2022. Certain changes, as explained here, are also applicable for tax year 2022 (financial year ended on 30 June 2022), given the prevailing economic situation in the country.

The changes relating to the corporate tax rate structure for different categories of companies are as follows:

Small companies

Small company is a special status assigned to companies fulfilling conditions laid down under clause (59AB) of Section 2 of the Tax Ordinance. The tax rate for small companies has been reduced to 20% from 21%.

However, an additional tax, introduced as 'super tax on high-earning persons', is inter alia applicable to small companies ranging from 1% to 2% of 'income' as defined in the newly inserted Section 4C of the Tax Ordinance. The rates of super tax for tax year 2022 and onwards are as follows:

Tax Year	Section 4	Section 4C
2022	21%	*1% ~2%
2023	20%	

*1% for income between PKR 150 million to PKR 200 million. 2% for income between PKR 200 million to PKR 250 million.

Banking companies

For banking companies, the tax rate has been increased from 35% to 39%. Super tax as per Section 4B of the Tax Ordinance is restricted up to tax year 2022 at the rate of 4%.

For tax year 2023, banking companies will be subject to newly introduced super tax on high-earning persons (Section 4C) whereas super tax as per Section 4B will no longer apply. Super tax on the income of banking companies will be 10% if the income for the year exceeds PKR 300 million for tax year 2023.

The new tax rates are summarised as follows:

Tax Year	Section 4	Section 4B	Section 4C
2022	35%	4%	–
2023	39%	–	*1% ~10%

*1% for income between PKR 150 million to PKR 200 million. 2% for income between PKR 200 million to PKR 250 million. 3% for income between PKR 250 million to PKR 300 million. 10% for income above PKR 300 million.

Other companies
The existing corporate tax rate of 29% remains unchanged. However, super tax imposed under Section 4C ranging from 1% to 10% of income is also applicable for tax year 2022 and onwards. The revised tax rates are tabulated below:

Tax Year	Section 4	Section 4B	Section 4C
2022	29%	0%	*1% ~10%
2023	29%	–	

*1% for income between PKR 150 million to PKR 200 million. 2% for income between PKR 200 million to PKR 250 million. 3% for income between PKR 250 million to PKR 300 million. 4% for income above PKR 300 million.

For tax year 2022, the rate of super tax under Section 4C is 10% instead of 4% for certain business sectors having income above PKR 300 million, i.e. airlines, automobiles, beverages, cement, chemicals, cigarette and tobacco, fertiliser, iron and steel, LNG terminal, oil marketing, oil refining, petroleum and gas exploration and production, pharmaceuticals, sugar and textiles.

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Poland

Polish Deal 2.0 – further changes in Corporate Income Tax

28 June 2022 saw a bill published to amend the Corporate Income Tax Act and certain other legislation. As a rule, the new law would enter into force on 1 January 2023. The legislative process is still in progress.

The scope of changes is broad and some of them, if they finally enter into force, may have a cross-border impact.

Withholding tax (WHT)
As of 1 January 2022, passive income payments above PLN 2 million which the remitting agent makes to foreign affiliates during a tax year are generally subject to WHT at the statutory rate of 19% or 20% (pay and refund mechanism). The tax refund may then be applied for, if respective conditions are met and proved.

One way to benefit from preferential tax treatment, even regarding the surplus above PLN 2 million, is for the remitting agent's management to submit a representation of the Board. The other is to obtain a preference statement from the tax authorities.

According to the bill, the validity of the representation of the Board allowing for exemption from the pay and refund mechanism will be extended until the end of the tax year in which it is made (instead of for just a further two months, as it is now).

This change will apply to payments made after 31 December 2022. There is a dispute regarding the validity of representations already given in 2022 and another amendment of the law is expected.

"Shifted income"
As of 1 January 2022, tax on "shifted income" has already been imposed on Polish entities which bear certain costs (e.g. service fees, royalties, debt financing costs).

According to the bill, taxation rules will be modified. "Shifted income" will mean tax-deductible costs from the statutory list, incurred by the taxpayer for the benefit of a non-resident related party if the following conditions are met jointly:

- the ratio of those costs to total tax-deductible costs amounts to at least 3%;
- the related party's passive income is subject to full or partial tax exemption or to taxation at an effective rate below 14.25% in the country of its headquarters, management, registration or location;
- at least 50% of all of the related party's income is passive income from the taxpayer or taxpayer's affiliate companies;
- at least 10% of passive income is transferred by the related party in any form to some other entity (while the related party deducts or credits such expenses for tax purposes or such income is treated as profit distributable as a dividend or other kind of corporate profit distribution).

The law also provides for tax exemptions which should be analysed using a specific factual background.

Hidden dividend
Certain payments made to foreign related parties were supposed to be treated as a "hidden dividend" not earlier than as of 1 January 2023 and thus, fully excluded from tax-deductible costs.

However, according to the recent tax bill, provisions on "hidden dividends" will ultimately be repealed.

Minimum income tax
In general, taxpayers who incur losses or do not reach a specific profit ratio are subject to minimum income tax. Current law also provides for some exemptions.

According to the bill, the profit ratio to be verified will increase from 1% to 2%. Additionally, the calculation methodology will change and there will be new exemptions.

Furthermore, taxpayers liable for minimum income tax will be relieved from the duties for the duration of the year (from 1 January 2022 to 31 December 2022).

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Portugal

Remote permanent establishment/remote work

The discussion on whether remote working could generate a permanent establishment ("PE") dates back to 2012, when the OECD first suggested that an example covering a "home office" should be included in the commentaries (see here).

The pandemic boosted discussions on the topic, as companies adapted to the fact that workers were working remotely for sanitary/travel restrictions, leading to their businesses being conducted beyond borders. The OECD secretariat issued guidance on the impact of COVID-19 on (among other things) the PE risk (see here), emphasising the exceptional and temporary circumstances that justify a mitigation of the criteria that could lead to the creation of a PE.

After the pandemic, remote working is no longer imposed by temporary restrictions: it is becoming a new standard. Remote working is embedded in the *work-life balance* policies around the globe and workers remain outside the country of residence of their employers by choice, rather than in the interest/instructions of the employer. Remote workers may develop part of the company's core activities, even if there is no intention of the company to carry out a business in that specific location. The challenge regarding the new norm created by remote working "for the benefit of the worker" is not solved by the methodology suggested by the OECD commentaries, international doctrine or case law.

Portugal has been a successful destination for digital nomads, but also for individuals seeking a good quality of life (considering the country's education and health infrastructure and the tax benefits available for individuals, such as the *non-habitual residents' regime*). In the absence of guidelines from the Portuguese tax authorities, we have been increasingly asked to perform PE risk assessments by companies that become aware their staff are working from Portugal – like in many other jurisdictions.

To mitigate a PE risk for foreign companies, we have performed a case-by-case analysis and have recommend some defensive measures to reduce the risk of a PE:

1. **Workplace:** the worker's (primary) workplace should be at the company's premises; if the worker performs professional activities from abroad (e.g. Portugal), this should not be determined, nor funded by the employer – remote working is a prerogative of the worker, not at the interest of the employer;

2. **Remuneration:** the employer should not bear any additional costs to cover the worker's expenses. In our view, the PE risk increases if the employer bears any costs associated with remote working – this may lead to amendments of employment contracts and internal policies on fringe benefits for cross-border activities. In cases where a "standard worker" becomes a "mobile worker", if remuneration remains unchanged it is a further indication that remote work is not part of the employer's enterprise;

3. **Quality standards:** in order to work remotely, the worker may need to bear costs strictly related to their professional functions (e.g. dedicated internet connection, hardware, etc.). The intervention of the employer should remain in standard terms (e.g. providing a laptop, mobile phone, etc.). If working remotely is at the worker's discretion, it is their responsibility to ensure performance in a professional manner;

4. **Payroll services:** except where legally required, the employer should not offer payroll services and other personal assistance outside its country of residence; paying income taxes, social security charged and/or undertaking tax compliance activities may require the employer to register in the other country and to interact with public authorities, indicating an intentional and permanent presence therein.

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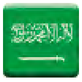
Irrespective of the above, global mobility should be addressed from a comprehensive and harmonised perspective at the OECD and EU level, and eventually future tax disputes will help to clarify how tax authorities and tax courts interpret the matter.

Saudi Arabia



Zakat, tax, & customs authority re-launches tax amnesty initiative

The Zakat, tax, & customs authority ('ZATCA') announced the re-launch of the initiative to abolish fines and exemption from penalties regarding all tax laws managed by ZATCA for a period of six months, starting 1 June 2022 until 30 November 2022, with the aim of mitigating the economic effects of the establishments because of the COVID-19 pandemic.

The authority clarified that the fines included in the exemption decision are as follows:

- Penalty for late registration.
- Penalty for late payment.
- Penalty for late filing of returns in all tax systems.
- The fine for correcting the return for VAT.
- In addition to fines for field control violations related to the application of electronic billing.

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The relief is not granted for penalties regarding tax evasion and penalties that had been settled before the issuance date.

South Africa

The modernisation of South Africa's tax and exchange control regime

South Africa ('**SA**') has a long-standing history of being an attractive market for foreign investors and serving as a gateway for investing into the rest of Africa. However, in recent years foreign investment into SA has declined mainly due to rising political and economic uncertainty and competition from other Sub-Saharan African regions. To attract foreign investment, the SA government has endeavoured to advance the process of systematically doing away with its exchange controls and amending taxation laws in an effort to support economic growth, increase inward investment and reduce unemployment.

Exchange controls were recently relaxed with regard to the so-called 'loop' structures (i.e. where an SA resident holds an investment in SA through a foreign entity), which was accompanied by various income tax amendments specifically aimed at addressing tax avoidance opportunities arising from such relaxation. These amendments dealt with, inter alia, the taxation of controlled foreign companies ('**CFC**') (such as local dividends received by a CFC) and the disposal of shares held in a CFC. The SA National Treasury further confirmed its commitment to the modernisation of exchange controls by making several proposals during the 2022 National Budget Speech, including increasing the foreign direct investment limit for companies from ZAR 1 billion to ZAR 5 billion where certain requirements are met.

One of the tax-related measures implemented to stimulate economic growth is the reduction of the corporate income tax ('**CIT**') rate from 28% to 27% for tax years ending on or after 31 March 2023. This is expected to improve the business environment for both local and foreign entities, whilst remaining respectful of the OECD's Pillar Two principles. Although this change in the CIT rate is generally welcomed by businesses operating in SA, measures are being implemented to increase the SA tax base to counter the loss of revenue arising from, *inter alia*, the rate reduction. These measures include:

(i) Limiting the extent to which tax losses can be utilised in a tax year, to the greater of ZAR 1 million or 80% of taxable income. In the context of companies with a taxable income exceeding ZAR 1 million, at least 20% of their taxable income will therefore remain subject to CIT.

(ii) Reducing the limitation of the deduction of interest on certain cross-border loans where there is a controlling relationship between the debtor and the creditor, to 30% of a company's 'adjusted taxable income' (i.e. tax EBITDA) (previously up to 60%) in alignment with international and OECD standards.

In the 2022 legislative amendment cycle, further measures have been proposed to increase the tax base, for example limiting tax exemptions applicable to CFCs with regard to SA-sourced royalty income and dividend income emanating from hybrid equity instruments.

It is anticipated that the SA parliament will ratify the OECD Multilateral Instrument ('**MLI**') in the near future, which will bring about certain changes to SA's double taxation agreements with other co-signatories of the MLI.

Recent SA tax and exchange control trends align with international developments to make South Africa a more favoured investment destination, whilst maintaining a balance between base protection, the curbing of tax avoidance and adherence to international best practises.

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United Kingdom

Pillar 2: draft Income Inclusion Rule (IIR) legislation and consultation response

On 20 July 2022, the UK government released the draft legislation on the Pillar 2 Income Inclusion Rule (IIR) along with its response to the public consultation on the UK implementation of Pillar 2. The draft legislation is intended to be introduced in Finance Bill 2022–23 (expected to receive royal assent in early 2023) and will apply to accounting periods commencing on or after 31 December 2023 (which is aligned with the proposed EU implementation).

In the consultation response, the UK government reiterated their view that the UK implementation of Pillar 2 rules should closely follow the OECD model rules. In areas where there is currently ambiguity, the UK intends to seek for resolution by working with its international partners as part of the OECD Implementation Framework to best ensure international consistency.

The response has also provided an opportunity for the UK government to share their position on the following key areas:

› **Undertaxed Profits Rule (UTPR):** still intended to be introduced, although an update on the timing and design of the UTPR to be released at a later date due to the impact of wider developments internationally.

› **Domestic Minimum Tax (DMT):** considers there are strong arguments in favour of a UK DMT to ensure that the UK exchequer receives any additional tax on UK economic activities applied from Pillar 2. The introduction will continue to be considered but, if introduced, it is envisaged that it would have the same threshold as the Pillar 2 rules and apply to both UK and foreign-headed MNEs (along with potentially wholly domestic groups).

› **GILTI:** notwithstanding any reform to the GILTI rules to be Pillar 2-compliant, it is expected that any tax paid under the current GILTI rules would be included in the covered taxes of the CFC for the purposes of both the IIR and UTPR. This contrasts with the hybrid mismatch provisions where specific rules were introduced to prevent GILTI from being regarded as a foreign CFC charge.

› **Safe harbours:** supportive of a safe harbour where there is a qualified DMT in place as this could provide real benefits to both businesses and tax administrations, and is committed to taking this forward with international partners. Also open to other safe harbours using either CbCR data or statutory tax rates, but considers it may be too difficult to gain a consensus.

› **Tax Compliance Process:** intention to work with international partners to produce standardised GloBE Information Return along with a centralised reporting system. From a UK perspective there will be a one-off registration requirement along with annual notification requirements in line with the model rules. The UK penalty regime is aligned with the existing corporation tax penalties.

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