Prosus N.V.

Gustav Mahlerplein 5
1082 MS Amsterdam
The Netherlands

www.prosus.com

To: OECD Centre for Tax Policy and Administration
Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA

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Tax challenges of digitalisation
Progress Report on Amount A of Pillar One
Prosus comments on the OECD's public consultation of 11 July 2022[1]

Opening remarks

Naspers Ltd and Prosus NV (hereafter "Prosus") are strong supporters of the international efforts to develop a global solution to remove imbalances in and to modernize and stabilize the international tax system. We also welcome the opportunity to provide further comments on the Pillar One design as it is reflected in the Progress Report published on 11 July 2022.

Prosus is a global consumer internet group and amongst the largest technology investors in the world. We grow by investing in leading local businesses and partnering with the local founders of these businesses. Our 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 (a local-to-local business model).

Prosus supports a fair, balanced, uniform and transparent tax system based on taxing profits within a harmonized, international framework aimed at companies paying their taxes locally (ie, in the countries where they operate and where their users and consumers reside) so that a level playing field is created in which local, regional and global companies are subject to the same taxes in the countries in which they operate and where their users and consumers reside.

For more information on our approach to tax please visit our tax microsite https://www.prosus.com/tax.

Summary of key points

- Prosus welcomes the technical progress made in the design of Amount A. As indicated in the Progress Report, some parts of the work are less advanced as opposed to others. There are open issues in the design of the rules that are expected to be stabilized in

[1] https://www.oecd.org/tax/beps/oecd-invites-public-input-on-the-progress-report-on-amount-a-of-pillar-one.htm

October. Moreover, the progress report does not yet reflect a consensus agreement. **This fact makes the understanding and the assessment of the actual impact of the rules a difficult exercise at this stage.** Also, it is critical for a better analysis and understanding of the application to have the **accompanying commentary and examples** available**.**

- Prosus therefore would like to stress that to receive meaningful public comments on these complex new rules a final round of public consultation on a technically mature and agreed set of rule would be essential.
- Prosus supports the commitment agreed by the Inclusive Framework in October 2021 to withdraw digital services taxes (DSTs) and not introduce similar measures in the future. **The scope of such commitment should be clarified. It should be made clear that there is no room for additional unilateral (digital services) taxes including sales and transaction type taxes targeted specifically at digital businesses.**
- Prosus also welcomes the recognition by the Inclusive Framework of the existence of different business models and the double counting issue. **We believe however that the current proposed design of the Marketing and Distribution Profits Safe Harbour (MDSH) is extremely complex and possibly not effective in reaching its aim.**

In our submission, we have included an introduction of our company and then commented on the aspects of the report that are more impactful/relevant for our business. After that, we have included our suggestions for the design of the rules.

Introduction of Prosus

Prosus is a global consumer internet group and one of the largest technology investors in the world. Prosus is listed on the Euronext in Amsterdam with a secondary listing on the Johannesburg stock exchange. Prosus is the international investment arm of Naspers, a South African company that is more than 100 years old and transitioned over the years from a traditional print media group into a global consumer internet group. Prosus is headquartered in Amsterdam.

Prosus has invested in 80+ companies active in more than 100 countries and serving more than 2 billion users. Amongst these investments, Prosus has meaningful (minority) investments in a number of listed internet companies including Tencent and Delivery Hero. Prosus's investment strategy, in addition to holding these important and valuable listed minority investments, is focused on backing local entrepreneurs who own and run internet companies that address big societal needs in markets with great growth potential. Prosus grows by investing in and acquiring leading local businesses and partnering with the local founders of these businesses. The businesses in which Prosus invests are typically local internet businesses established by local champions. These businesses employ their staff in the same country where they started and where their users or consumers reside. Revenues are reported locally and taxes on revenues and profits are paid locally.

Prosus developed a rather unique approach to tax on the back of its hyper local business model. We consider paying taxes as an important economic contribution to the societies in which we operate. This is in our opinion particularly important for digital companies whose business models are often questioned by regulators, policymakers, consumers and society at large. We strongly and actively support the international efforts to develop a global solution to remove imbalances from, and to modernize, the international tax system by creating a level playing field between local and global businesses and centralized and decentralized business models. In our view, taxes should be fair, balanced and uniform. Companies should pay taxes locally, where they operate and where their users and consumers are.

DSTs and commitment not to introduce such measures in the future

As set out above, Prosus prefers solutions that do not discriminate and treat all players equally, but that also lead to a level playing field if there are relevant differences between the businesses that need to be taken into account.

Unilateral DSTs as they have been proposed or introduced to date, do not level the playing field. They typically make no distinction between (1) centralized business models in which revenues leak from high-tax market countries to a centralized entity often established in a low or no tax country (as a result of which revenues and profits are currently reported outside the markets where the revenues arise), and (2) decentralized / local-to-local activities where revenues and profits are reported and taxed in the market. This often leaves in-market entrepreneurs with a competitive disadvantage of a higher tax burden in the market country compared to remote participants in that market. Also, unilateral DSTs are being implemented in an inconsistent way, leading to high costs and double taxation.

The October 2021 commitment of the Inclusive Framework members to remove existing DSTs and not introduce similar measures in the future was very much welcomed in that regard. In the Progress Report there is new wording added on this commitment that raises some questions. The new wording seems to somehow reduce the scope of the commitment by introducing a few cumulative requirements:

> *The MLC will also include a commitment not to enact DSTs or relevant similar measures, provided they impose taxation based on market-based criteria, are ring-fenced to foreign and foreign-owned businesses, and are placed outside the income tax system (and therefore outside the scope of tax treaty obligations). The commitment would not include value-added taxes, transaction taxes, withholding taxes treated as covered taxes under tax treaties, or rules addressing abuse of the existing tax standards.*

Even though we understand that this additional wording does not reflect final agreement as of yet, it would be important for the Inclusive Framework members to clarify the scope of the commitment and make clear that there is no room for additional unilateral taxes including sales and transaction type taxes targeted specifically at digital businesses. Prosus does not see the difference between a DST, VAT or transaction tax, as all are linked to sales of the group in a jurisdiction.

Our considerations on the proposed MDSH

The current proposed Amount A rules acknowledge the existence of double counting. This occurs when residual profits from local entrepreneurial activities are already taxed in the market where the consumers are. However, the rules as they are currently designed, fail to fundamentally deal with this issue and are designed in a fashion which introduces new distortions.

Firstly, the development of the MDSH is not as advanced as other elements of the Progress Report. In fact, key aspects of the MDSH design, including specific metrics to identify residual profits in a market country, the portion of the residual profits that will offset (and reduce) Amount A allocations, and the interaction of this adjustment with the elimination of the double taxation mechanism, are still under development. Those gaps in the rules make the proposed MDSH difficult to analyze and assess.

Secondly, the formulaic approach of the MDSH to approximate the residual profit in the market by reference to the deemed routine return of the group based on a return on payroll costs and depreciation of assets in the jurisdiction does not establish a reliable link between the local market residual profits and local market sales. The formula as established:

- Is extremely complex;
- Is based on the assumption that residual profits only arise when profits in a market exceed a return on sales of at least 10%. In current arm's length allocations of profits to routine sales- and distribution activities, which are based on a comparison with third party sales- and distribution activities, the profits of relatively routine sales and distribution activities are on average closer to 3% return on sales;
- Also considers as market related returns of the jurisdiction any returns generated by non-local activities, such as for example licensing of intangibles to foreign group companies etc. These are typically the activities generating the residual returns of the business. These profits are considered local profits both for the calculation of the residual profits already taxed in the jurisdiction, but also for the calculation of the Profit available for Elimination in the jurisdiction. With that, centralized businesses with their headquarters or IP ownership in big markets are being favored compared to decentralized businesses and centralized businesses having these centralized activities in small market jurisdictions. Centralized businesses in big market jurisdictions may be favored even more than if a MDSH would not be available, as in this situation it will no longer be the case that both centralized and decentralized businesses get an equal Amount A allocation even though the policy intention expressed by the political leaders was for the playing field to be levelled in favor of local businesses. If the formulaic approach is used, the Amount A allocation of the centralized business with centralized activities in a big market jurisdiction will likely be lower for that market than the amount A allocation of the decentralized business. And given the following bullet, this will likely not be offset by centralized business models having a higher amount A in the other market jurisdictions in which it operates.
- Interestingly, the formula starts with return on sales, but translates this into a return on payroll and depreciation to ultimately calculate the routine profits. This is contrary to the assumption in transfer pricing that for sales related activities a cost based return is seldom appropriate. The result is that the lower the level of activities in a country, the lower the routine return is deemed to be, even if the levels of sales are similar. Consequently, centralized business models are favored over decentralized business models, as apparently the higher level of activity in a country is automatically assumed to create additional routine returns, instead of the additional residual returns that typically are created with having the additional activities.
- Lastly, it is unclear why amount Y may only recognize a portion of the residual profits to offset and lower Amount A allocations.

As the formula is not fit for purpose to calculate the residual profits available in the market, it will not resolve the double counting issue. When the double counting issue is not resolved, the attempt to stabilize the international tax environment will also not succeed, as there will still be an incentive for market countries to start transfer pricing discussions on the level of profits allocated to the market. Moreover, the unlevel playing field between centralized and decentralized business models will likely grow, not diminish. This does not seem in line with the pressures from societies and politicians which underly the start of this project.

<u>Our proposal</u>

As illustrated in this and our earlier submissions, it is important to recognize the differences in business models and address this local-to-local issue to level the playing field. Prosus believes that it is possible to design a solution that on the one hand creates the possibility to tax remote digital participation business models in the markets, and on the other hand takes account of the fact that local-to-local businesses already pay taxes locally for the full value creation locally.

Prosus believes that this is feasible by creating a carve out/exclusion for local-to-local businesses. Such a carve-out would lead to significant simplification, as this means that the rules will not have to be applied where the profits are already appropriately allocated to the market jurisdictions. In addition the administrative costs for businesses and tax authorities should reduce significantly. A local-to-local business could be defined as a business that has activities which are performed in a market whilst generating revenues almost wholly from users and consumers from that market (e.g., 90%) and which have a business model that does not allow for shifting of the residual profits (or residual losses) to another country.

As a result, the digital tax measure would become more targeted in nature, addressing more specifically the unlevel playing field caused by the current tax system. It would also be simpler, fairer and save significant administrative costs.

Closing

Prosus will continue to support the efforts to develop a fair, balanced and uniform approach to international taxation and welcomes the opportunity to be part of future business consultations. To that end, Prosus encourages the OECD to hold additional public consultations when the rules are stabilized in October to ensure that the rules are aligned with business reality.

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

Contact

Serge de Reus
Group Head of Tax
Gustav Mahlerplein 5
NL-1082 MS Amsterdam
serge.reus@prosus.com

prosus