

# **SOUTH AFRICA'S RESPONSE TO THE DIGITAL ECONOMY'S DIRECT TAX CHALLENGES – PART 1\***

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## **SUMMARY**

International tax rules were developed more than a century ago. At their core is the principle that profits should be taxed where economic activities physically take place and where value is created. Advances in technology and the progression of the fourth industrial revolution have changed how businesses around the world operate and have given rise to the “digital economy”. Businesses no longer need to be “physically” present in a jurisdiction but can operate digitally or virtually anywhere in the world. New business models such as e-commerce, payment services, app stores, online advertising, cloud computing and participative network platforms have emerged. The digital economy and these new business models pose various challenges to the effectiveness of rules on the current jurisdiction to tax; businesses are able to derive significant economic benefits from a country without a “taxable nexus” to such country – for example, without the creation of a fixed place of business, permanent establishment or establishing a place of effective management. The digital economy is global in nature and, therefore, policy actions dealing with the global economy need a global approach. The Organisation for Economic Co-operation and Development (OECD) has taken a leading role in developing new direct-tax rules that will address the tax challenges posed by the digital economy and has agreed to develop a two-pillar solution that can be consented to internationally and implemented by countries. Pillar one proposes new rules on tax nexus and profit allocation for large multinational enterprises (MNEs) that meet certain revenue and profitability thresholds. The rules do not require MNEs to be physically present in a jurisdiction. Pillar two proposes mechanisms to ensure large MNEs pay a minimum level of tax (currently set at 15 per cent) regardless of where their headquarters are or the jurisdictions in which they operate. Some countries (such as the United Kingdom (UK), United States of America (USA), India, and Nigeria) have opted to take unilateral measures as they wait for a global solution. These unilateral measures are often uncoordinated and give rise to some undesirable consequences, such as double taxation. South Africa has decided to wait for global consensus and is currently not taxing the digital economy through its direct-tax rules. Although the OECD solutions are helpful proposals on taxing the digital economy and are a step in the right direction, it is submitted that they are not completely suited for South Africa as a developing African country; they do not consider some of South Africa’s unique circumstances, such as the prevalence of corruption, semi-skilled tax administration and limited resources. South Africa should not merely adopt the rules blindly but should adapt them to suit its needs as a developing country. South Africa needs to protect its tax base while embracing the digital economy; perhaps, while it waits for a global solution, it could strengthen its source rules as recommended by the Davis Tax Committee. This article is divided into two parts. Part 1 evaluates the suitability

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\* This article largely forms the basis of the author’s PhD study focused on South Africa’s response to the direct-tax challenges.

of South Africa adopting the OECD global solutions to the direct-tax challenges posed by the digital economy in a developing African country; Part 2 evaluates whether South Africa's response to these challenges is the best option by considering the approach and consequences of select developed and developing jurisdictions (that is, USA, UK, Nigeria and India) adopting unilateral measures while waiting for an OECD global solution.

## 1 INTRODUCTION

International tax rules were developed more than a century ago.<sup>1</sup> At the core of international tax rules is the principle that profits should be taxed where economic activities physically take place and where value is created.<sup>2</sup> Advances in technology and the progression of the fourth industrial revolution (4IR)<sup>3</sup> have changed how businesses around the world operate. Businesses no longer need to be “physically” present in a jurisdiction but can operate digitally or virtually anywhere in the world.<sup>4</sup> New business models such as e-commerce, payment services, app stores, online advertising, cloud computing and participative network platforms have emerged.<sup>5</sup> The digital economy and these new business models pose various challenges to the effectiveness of current rules regarding countries' jurisdiction to tax; businesses are able to derive significant economic benefits from a country without a “taxable nexus” to such country – for example, without the creation of a fixed place of business, permanent establishment or establishing a place of effective management.<sup>6</sup>

The digital economy is global in nature and, therefore, policy actions dealing with the global economy need a global approach.<sup>7</sup> The Organisation for Economic Co-operation and Development (OECD)<sup>8</sup> has taken a leading role in developing new rules on direct tax that will address the tax challenges posed by the digital economy, and has agreed to develop a two-pillar solution for international consent and implementation by countries.<sup>9</sup> Pillar one proposes new rules on tax nexus and profit allocation for large

<sup>1</sup> OECD *Tax Challenges Arising from Digitalisation – Interim Report* (2018) 3.

<sup>2</sup> *Ibid.*

<sup>3</sup> The fourth industrial revolution (4IR) refers to the latest industrial revolution where major advances in technology such as artificial intelligence, robotics and the Internet of Things are merging the biological, physical, and digital worlds. See Schwab “The Fourth Industrial Revolution, What It Means, How To Respond” (2016) World Economic Forum <https://www.weforum.org/agenda/2016/01/the-fourth-industrial-revolution-what-it-means-and-how-to-respond/> (accessed 2022-06-27).

<sup>4</sup> OECD *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report* (2015) 54.

<sup>5</sup> OECD (2015) 54.

<sup>6</sup> OECD (2015) 66.

<sup>7</sup> OECD *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS* (2020) 3.

<sup>8</sup> The OECD is an international organisation that works to develop policies and find solutions to a range of social, economic, and environmental challenges. See [www.oecd.org/about](http://www.oecd.org/about) (accessed 2022-06-30).

<sup>9</sup> OECD/G20 Base Erosion and Profit Shifting Project (BEPS) “Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy” (8 October 2021) <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> 1

multinational enterprises (MNEs) that meet certain revenue and profitability thresholds,<sup>10</sup> and pillar two proposes mechanisms to ensure large MNEs pay a minimum level of tax (currently set at 15 per cent) regardless of where their headquarters are or the jurisdictions in which they operate.<sup>11</sup> Some countries (such as the United Kingdom (UK), United States of America (USA), India, and Nigeria) have opted to take unilateral measures to tax the digital economy in the meantime as they wait for an OECD global solution. These unilateral measures are often uncoordinated and give rise to some undesirable consequences such as double taxation.<sup>12</sup> South Africa has decided to wait and not introduce any unilateral measures while it waits for a global solution from the OECD.<sup>13</sup>

This article critically reviews South Africa's position in relation to direct-tax challenges arising from the digitalisation of the economy. In Part 1, the article first sets out the challenges that the digital economy poses internationally to direct tax in the context of the current more-than-century-old direct-tax rules; it then sets out the OECD-proposed two-pillar solutions and determines if these proposed solutions are suitable for adoption by South Africa as a developing African country. The article then makes recommendations for South Africa and draws a conclusion. Part 2 (forthcoming) will determine if South Africa's response is the best option by considering its approach and the consequences of select developed and developing jurisdictions (that is, UK, USA, Nigeria and India) adopting unilateral measures while waiting for an OECD global solution.

## **2 INTERNATIONAL TAX CHALLENGES OF THE DIGITAL ECONOMY**

### **2.1 Fourth industrial revolution and the digital economy**

The 4IR refers to the current and developing environment where major advances in technology such as artificial intelligence, robotics and the Internet of Things are merging with the biological, physical and digital worlds.<sup>14</sup> The 4IR is evolving at an exponential pace and has the potential to increase global income levels and the quality of communication for people around the world.<sup>15</sup> The digital economy is a by-product of the 4IR and is fast becoming the economy itself. The OECD has defined the digital economy as

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<sup>10</sup> OECD (2020).

<sup>11</sup> OECD BEPS *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS* (2021).

<sup>12</sup> Oguttu "A Critique from a Developing Country Perspective of the Proposals to Tax the Digital Economy" 2020 12(4) *World Tax Journal* 799–828 806.

<sup>13</sup> Business Tech "There is a Big Problem With South Africa's Plan for Digital Tax" (15 February 2021) <https://businesstech.co.za/news/technology/468144/theres-a-big-problem-with-south-africas-plans-for-digital-tax> (accessed 2022-06-29).

<sup>14</sup> Schwab <https://www.weforum.org/agenda/2016/01/the-fourth-industrial-revolution-what-it-means-and-how-to-respond/>.

<sup>15</sup> *Ibid.*

“a broad range of economic activities that include using digitised information and knowledge as the key factor of production, modern information networks as an important activity space, and the effective use of information and communication technology as an important driver of productivity growth and economic structural optimization.”<sup>16</sup>

The key features of digitalisation from a tax perspective include mobility in respect of intangibles such as software, users and business functions, heavy reliance on data, network effects,<sup>17</sup> use of multi-sided business models in which the sides of the markets may be in different jurisdictions, tendency of monopoly or oligopoly in certain business models, and volatility because of low barriers to entry and evolving technology.<sup>18</sup>

Digitalisation makes it possible for a business to carry on economic activity without personnel needing to be present.<sup>19</sup> Advances in ICT ensure that distance is not a deterrent to trade and increases the number of customers a business can target and reach.<sup>20</sup> Certain tasks, previously performed by local personnel, can now be performed by automated equipment at a cross-border level. Thus, the growth of customers for a business in a jurisdiction no longer always requires the level of local infrastructure and personnel that would have been needed in a pre-digital age.<sup>21</sup> This means that businesses have flexibility in choosing the location where their substantial business activities will take place.<sup>22</sup>

## 2.2 Challenges for the direct-tax rules

### 2.2.1 Rules on the jurisdiction to tax

Before a country can levy tax on an amount, there must be a tax nexus (or connection) between the amount and the country, or a connection between the person who received the amount and the country.<sup>23</sup> The two main principles underlying the taxation of income are “source” and “residency”<sup>24</sup> principles. In terms of the source principle of taxation, persons are taxed on income that originates from the geographical confines of the country irrespective of the residency of the person.<sup>25</sup> The justification for a source

<sup>16</sup> G20 2016 China <https://www.mofa.go.jp/files/000185874.pdf>.

<sup>17</sup> This entails that the decision of a user can have a direct impact on the benefit derived by other users. For e.g., a user using a cellphone network can create congestion of the network and slow down its efficiency for other users.

<sup>18</sup> OECD (2015) 55–73. See also OECD (2018) 24–25.

<sup>19</sup> OECD (2015) 66. See also Harpaz “Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First Century Economy” 2021 46(17) *The Yale Journal of International Law* 57–101 58.

<sup>20</sup> OECD (2015) 100.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.*

<sup>23</sup> Croome (ed) Oguttu, Muller, Legwaila, Kolitz, Williams and Louw *Tax Law: An Introduction* (2013) 26; Olivier and Honiball *International Tax: A South African Perspective* 5ed (2011) 6 and 9.

<sup>24</sup> Some jurisdictions use citizenship/nationality and domicile. See Olivier and Honiball *International Tax: A South African Perspective* 6 10.

<sup>25</sup> Croome *et al Tax Law: An Introduction* 26; see also Olivier and Honiball *International Tax: A South African Perspective* 9.

basis of taxation is that a taxpayer should contribute towards the costs of running the country that enables the taxpayer to generate income.<sup>26</sup> In terms of the residence principle of taxation, residents are taxed on their worldwide income whatever the source of the income because they have an intrinsic connection to the country.<sup>27</sup> The justification for a residence basis of taxation is that a resident of a country enjoys the protection of the State and as such should contribute towards the cost of the government of the country where the taxpayer resides.<sup>28</sup>

South Africa has adopted a combination of these principles of taxation.<sup>29</sup> In terms of the gross income definition that forms the basis of taxable income on which the tax liability of a person is determined, South African tax residents are required to include their worldwide accrual and receipts to their gross income, while non-residents are only required to include accruals and receipts arising from a South African source.<sup>30</sup> For a company to be tax resident in South Africa, it must be incorporated, established or formed in South Africa or have its place of effective management (POEM) in South Africa.<sup>31</sup> The definition of a resident excludes any person who is deemed to be exclusively a resident of another country for purposes of the application of any double-tax agreement entered into by South Africa.<sup>32</sup> The term “incorporated” is not defined in the Income Tax Act<sup>33</sup> (Act). A company incorporated in terms of section 13 of the Companies Act<sup>34</sup> is resident in South Africa mainly because its formation and incorporation are in South Africa regardless of where the company operates or is managed. “POEM” is also not defined in the Act. Interpretation Note 6<sup>35</sup> regards a POEM as the place where key management and commercial decisions necessary for the carrying on the business of the company as a whole are made in substance.<sup>36</sup> Both incorporation and having a POEM require a company to have some form of physical presence before being considered tax resident, and therefore liable for tax in South Africa on its worldwide receipt and accruals.

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<sup>26</sup> Olivier and Honiball *International Tax: A South African Perspective* 9.

<sup>27</sup> Croome *et al Tax Law: An Introduction* 27; Olivier and Honiball *International Tax: A South African Perspective* 10.

<sup>28</sup> Olivier and Honiball *International Tax: A South African Perspective* 19.

<sup>29</sup> Stiglingh (ed) *Silke: South African Income Tax* (2022) 26.

<sup>30</sup> *Ibid.*

<sup>31</sup> S 1(1)(b) of the Income Tax Act 58 of 1962.

<sup>32</sup> S 1(1) of the Income Tax Act 58 of 1962.

<sup>33</sup> 58 of 1962.

<sup>34</sup> 71 of 2008.

<sup>35</sup> SARS “Income Tax Interpretation Note No. 6” Issue 2 (03 November 2015). SARS interpretation notes are not binding on the courts and the Commissioner, as was held in ITC 1675 (2000) 62 SATC 219 AT 229A.

<sup>36</sup> SARS Interpretation note 6 4. See also the unreported case of *Oceanic Trust Co Ltd NO v CSARS* case number 22556/09 (WCC) 13 June 2011, where the court held that the place of effective management is the place where “key management and commercial decisions that are necessary for the conduct of the entity’s business are in substance made”. This definition is consistent with the OECD’s commentary on Article 4 of the Organisation for Economic Cooperation and Development Model Tax Convention on Income and on Capital, 2017.

Non-resident companies are liable for direct tax in South Africa if the receipts and accruals they derive are from a South African source.<sup>37</sup> The term “source” is not defined in the Act, and as such is left to be interpreted by the courts.<sup>38</sup> The source of income in South Africa can be determined in terms of statutory rules, treaty provisions or common-law provisions.<sup>39</sup> The statutory rules specify the source of a number of income streams (mostly passive income) such as royalties, dividends and interest.<sup>40</sup> Section 9(2)(k)(ii) of the Act provides that the disposal of a movable asset by a non-resident will be from a South African source if the asset is effectively connected to a permanent establishment (PE)<sup>41</sup> of that non-resident in South Africa. The Act does not deal with the source of services (other than a very limited reference to government public entities in section 9(2)(h)) and guidance for this is as per common-law rules.<sup>42</sup> The statutory source rules are to a large extent also found in double-tax treaties with a few exceptions.<sup>43</sup> The profits of a company that is not tax resident in South Africa may be taxed in South Africa if the profits derived by the company are attributable to a PE in South Africa.<sup>44</sup> A PE gives a taxing right to the source country where the PE is situated.<sup>45</sup> Article 5(1) of the OECD Model Tax Convention on Income and on Capital (OECD MTC), read with article 7(1), provides that a PE is a “fixed place of business through which the business of an enterprise is wholly or partly carried on”. It includes, *inter alia*, a place of management, an office or a factory but excludes the use of facilities for activities of a preparatory nature such as storage, display or delivery. A PE will also exist if there is a person in another country that acts on behalf of the company and habitually concludes or plays the principal role leading to the conclusion of contracts in the name of the foreign company. A PE, therefore, requires some level of physical presence in a country.<sup>46</sup> Whether a website or the location of a server may be considered for the physical-presence-test element has been considered.<sup>47</sup> A website is not a tangible asset and as such cannot be a fixed place of business for purposes of the meaning of the term “permanent establishment”.<sup>48</sup> A server has a physical location that could create a PE if used to conduct business of the enterprise.<sup>49</sup> An MNE

<sup>37</sup> Definition of “gross income” in s 1 of the Income Tax Act 58 of 1962.

<sup>38</sup> Olivier and Honiball *International Tax: A South African Perspective* 11; Croome *et al Tax Law: An Introduction* 43.

<sup>39</sup> Stiglingh *Silke: South African Income Tax* 826.

<sup>40</sup> See s 9 of the Income Tax Act 58 of 1962.

<sup>41</sup> PE is defined in s 1 of the Income Tax Act with reference to the definition of article 5 of the OECD Model Tax Convention.

<sup>42</sup> Stiglingh *Silke: South African Income Tax* 830.

<sup>43</sup> Stiglingh *Silke: South African Income Tax* 826.

<sup>44</sup> See relevant articles on double tax agreement entered into by South Africa, in terms of OECD Model Tax Convention, article 5 read with article 7.

<sup>45</sup> Croome *et al Tax Law: An Introduction* 42; see also Oguttu and Van der Merwe “Electronic Commerce: Challenging the Income Tax Base?” 2005 17 *SA Merc LJ* 316.

<sup>46</sup> Oguttu and Van der Merwe 2005 *SA Merc LJ* 316. See also Oguttu and Tladi “E-commerce: A Critique on the Determination of a ‘Permanent Establishment’ For Income Tax Purposes from a South African Perspective” 2009 1 *Stel LR* 74–94 75; Harpaz 2021 *The Yale Journal of International Law* 61.

<sup>47</sup> Oguttu and Van der Merwe 2005 *SA Merc LJ* 317.

<sup>48</sup> See par 42.2–42.3 of the commentary on article 5 of the OECD MTC.

<sup>49</sup> *Ibid.*

may avoid the creation of a PE by making sure that a server is located outside a country.<sup>50</sup> In the digital space, it is possible for software programs to perform the tasks that a dependent agent would normally perform for an enterprise – for example, processing sales and electronic payments. Since a software program is not a person<sup>51</sup> as defined, it would not be a “person acting on behalf of” and as a result would not create a PE for an enterprise.<sup>52</sup>

In the classic case of *CIR v Lever Bros*,<sup>53</sup> the court held that, in order to determine whether income is from a South African source, it must be established what the originating cause is and then determine the location of the originating cause. If there is more than one originating cause, the dominant cause must be ascertained.<sup>54</sup> If the dominant cause cannot be determined, there may be an apportionment of income.<sup>55</sup> Therefore, in terms of the *CIR v Lever Bros* case, income will be sourced in South Africa if the originating cause of the income is located in South Africa. The originating cause of income from services rendered is the service supplied and it is located where the service is rendered.<sup>56</sup> It may be difficult to locate where digital services are rendered. Various variables may have to be considered – for example, where the input is being produced, the location of the server that provides the input, and the location of the customer receiving the services.<sup>57</sup> Applying the *CIR v Lever Bros* case to the digital economy might be problematic. There could be a problem with determining the location of the originating cause as enterprises without a physical presence in South Africa, and with their servers not located in South Africa, may offer a loophole.

A non-resident company may also be liable for tax in South Africa on some of its income in the hands of its resident shareholder if it is considered to be a controlled foreign company (CFC) of the resident shareholder. A CFC is defined in section 9D of the Act as a foreign company where more than 50 per cent of the total participation rights or voting rights in that company are directly or indirectly held by one or more residents, or the financial results of that foreign company are reflected in the consolidated financial statements (prepared in terms of International Financial Reporting Standards 10) of a resident company. CFC rules are anti-avoidance rules in place to ensure the taxation of profits that are diverted offshore.<sup>58</sup> It is clear from the above rules that the current principles of taxation (that is, residence and source rules) require companies to have some form of physical presence in South Africa before they can be liable for direct-tax in South Africa. As such, South Africa does not currently have a direct-tax<sup>59</sup> measure for taxing the digital economy.

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<sup>50</sup> Harpaz 2021 *The Yale Journal of International Law* 62.

<sup>51</sup> Article 3 of the OECD MTC defines a “person” as an individual, company and any other body of persons.

<sup>52</sup> See also Oguttu and Van der Merwe 2005 *SA Merc LJ* 319.

<sup>53</sup> 1946 AD 411 442.

<sup>54</sup> Olivier and Honiball *International Tax: A South African Perspective* 12.

<sup>55</sup> *Ibid.*

<sup>56</sup> *CIR v Epstein* 1954 (3) SA 689 (A).

<sup>57</sup> See also Oguttu and Van der Merwe 2005 *SA Merc LJ* 305–322 315.

<sup>58</sup> Stiglingh *Silke: South African Income Tax* 871.

<sup>59</sup> South Africa does tax the digital economy through its value-added tax rules.

## 2 2 2 Digital economy direct tax challenges

The digital economy poses various direct and indirect tax challenges. The main direct-tax challenges covered in this article are in respect of the tax nexus, tax treatment of data and the characterisation of income in the digital economy.

Tax nexus refers to the connecting factor between income or taxpayer and a particular jurisdiction. As discussed above, the main tax connection between a taxpayer and South Africa is the existence of some form of "physical presence". Digitalisation removes the need for physical presence.<sup>60</sup> Businesses can now operate in a jurisdiction on a large scale without having any physical presence in that jurisdiction,<sup>61</sup> thus making it possible for businesses to conduct substantial business activities and engage with their customers remotely using a website or some other digital means without creating a tax nexus.<sup>62</sup> The ability of a business to operate in a jurisdiction without any physical presence in that jurisdiction thus poses a direct-tax challenge<sup>63</sup> as profits that a digitalised business derives in a market jurisdiction could remain untaxed because there is no tax nexus between the digitalised business and the market jurisdiction.<sup>64</sup>

Business models in the 4IR rely heavily on data.<sup>65</sup> This reliance on data may pose direct-tax challenges both in terms of the tax treatment of the data and the characterisation of income.<sup>66</sup> Different types of income received by non-residents in South Africa have different tax consequences.<sup>67</sup> The digital economy creates income-characterisation problems as it may change the nature of products and services.<sup>68</sup> For example, the supply of a database or the downloading of software may result in income for performance of a service, a royalty for the use of intellectual property, or profit from the sale of a product.<sup>69</sup> It is important to distinguish the different types of income as they have different tax consequences. It may be difficult to determine into which category among the existing categories of income the income from the digital economy falls. For example, one could question whether payments for cloud computing should be treated as royalties, fees for technical services or business profits.<sup>70</sup> The characterisation of income of a transaction can result in different tax treatments.<sup>71</sup> For example, under most South African double-

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<sup>60</sup> Oguttu and Van der Merwe 2005 *SA Merc LJ* 317.

<sup>61</sup> OECD (2015) 98.

<sup>62</sup> Hardy "Taxation and the Digital Economy: European and International Initiative to Create a Fair Tax System" (2018) Brussels blog, [nautaudutilh.com/en/information-centre/news/taxation-and-the-digital-economy-european-and-international-initiatives-to-create-a-fair-system](http://nautaudutilh.com/en/information-centre/news/taxation-and-the-digital-economy-european-and-international-initiatives-to-create-a-fair-system) (accessed 2022-04-13).

<sup>63</sup> OECD (2015) 98.

<sup>64</sup> Harpaz 2021 *The Yale Journal of International Law* 58.

<sup>65</sup> *Ibid.* Data can broadly be referred to as the information that is collected digitally, and which creates value for MNEs.

<sup>66</sup> *Ibid.*

<sup>67</sup> See also Oguttu and Van der Merwe 2005 *SA Merc LJ* 312.

<sup>68</sup> *Ibid.*

<sup>69</sup> *Ibid.*

<sup>70</sup> OECD (2015) 104.

<sup>71</sup> OECD (2015) 106.

tax treaties, business profits would be taxable in South Africa only if attributable to a PE located in South Africa, whereas royalties would be subject to a withholding tax in South Africa if paid by a South African tax resident.<sup>72</sup>

### 3 SOLUTIONS PROPOSED BY THE OECD

The OECD is the leading figure<sup>73</sup> in the work of addressing the challenges of the digital economy.<sup>74</sup> The OECD began the work on issues raised by electronic commerce in 1997.<sup>75</sup> The OECD found it important to try to create a consensus between business and government in some of the guiding principles that will form a framework at national and international levels for electronic commerce policies.<sup>76</sup> The OECD and the G20 (Group of Twenty),<sup>77</sup> in collaboration with over 125 countries, developed measures to tackle base erosion and profit shifting (BEPS)<sup>78</sup> strategies (BEPS Package). The BEPS Package resulted in the OECD producing 15 actions that serve to equip governments with domestic and international instruments to address BEPS strategies; in July 2013, the OECD released an Action Plan with 15 comprehensive actions<sup>79</sup> to ensure that profits are taxed where economic activities and value are created to generate those profits.<sup>80</sup>

<sup>72</sup> OECD (2015) 107. And s 9(2)(c) of the Income Tax Act.

<sup>73</sup> There are other players such as the UN but for purposes of this article, the focus is on the OECD.

<sup>74</sup> OECD (2015) 98.

<sup>75</sup> Ypsilanti "A Borderless World: The OECD Ottawa Ministerial Conference and Initiatives in Electronic Commerce" 1999 *The Journal of Policy, Regulation and Strategy for Telecommunications Information and Media* 23–33 24.

<sup>76</sup> Ypsilanti *The Journal of Policy, Regulation and Strategy for Telecommunications Information and Media* 25.

<sup>77</sup> The G20 is an international forum for governments and central bank governors from 20 major economies. The members include, among others, South Africa, China, India, the United Kingdom and the United States of America. The G20 was established with the aim of studying, reviewing and promoting discussions on policies in respect of the promotion of international financial stability. See [www.dfaf.gov.au/trade/organisations/g20](http://www.dfaf.gov.au/trade/organisations/g20) (accessed 2022-06-30).

<sup>78</sup> The OECD provides that BEPS relates to "arrangements that achieve low or no taxation by shifting profits away from the jurisdictions where the activities creating those profits take place or by exploiting gaps in the interaction of domestic tax rules where corporate income is not taxed at all". See OECD *Addressing Base Erosion and Profit Shifting* (2013) 14.

<sup>79</sup> The Action plans are: Action 1: Address the Tax Challenges of the Digital Economy; Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements; Action 3: Strengthen Controlled Foreign Companies Rules; Action 4: Limit Base Erosion via Interest Deduction and Other Financial Payments; Action 5: Counter Harmful Tax Practices More Effectively, Taking Into Account Transparency And Substance; Action 6: Prevent Treaty Abuse; Action 7: Prevent the Artificial Avoidance of PE Status; Action 8: Assure That Transfer Pricing Outcomes are in Line With Value Creation With Respect to Intangibles; Action 9: Assure That Transfer Pricing Outcomes are in Line With Value Creation With Respect to Risks and Capital; Action 10: Assure That Transfer Pricing Outcomes are in Line With Value Creation With Respect to Other High Risk Transactions; Action 11: Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address It; Action 12: Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements; Action 13: Re-Examine Transfer Pricing Documentation; Action 14: Make Dispute Resolution Mechanisms More Effective; and Action 15: Develop a Multilateral Instrument.

<sup>80</sup> OECD (2018) 17.

In 2015, the OECD/G20 issued Action 1: Addressing the Tax Challenges of the Digital Economy (OECD BEPS Action 1), which formed part of the 15 BEPS Actions, to address BEPS in relation to the digital economy. The OECD BEPS Action 1 discussed, among other issues, direct-tax challenges posed by the digital economy such as the issue of nexus, tax treatment of data, and the characterisation of income; and suggested solutions such as the modification of existing PE rules, withholding taxes on certain digital transactions and an equalisation levy.<sup>81</sup> When the OECD BEPS Action 1 was adopted, countries that were participating in the BEPS Project had not reached an agreement on the recommendations made.<sup>82</sup> Consequently, none of the recommendations were agreed to as international standards but countries could unilaterally introduce any of the recommended solutions into their domestic law provided they did not conflict with existing tax treaties and international obligations.<sup>83</sup>

In 2016, the OECD established the OECD/G20 Inclusive Framework (which includes non-OECD members) to discuss and collaborate on the challenges and implementation of the BEPS Project.<sup>84</sup> On 16 March 2018, the OECD issued an Interim Report entitled the "Tax Challenges Arising From Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project" (OECD 2018 Interim Report), which analysed developments of the digital economy, unilateral measures taken by countries to address the broader tax challenges posed by the digital economy, and the implementation of the measures relevant to digitalisation.<sup>85</sup> The OECD 2018 Interim Report recognised the need for a global solution to address the tax challenges of the digital economy.<sup>86</sup> The members of the OECD/G20 Inclusive Framework agreed to review the current existing tax-nexus and profit-allocation rules and work towards the delivery of globally agreed rules that would effectively address the direct-tax challenges posed by the digital economy.<sup>87</sup> On the 23 January 2019, the OECD issued a Policy Note for Addressing the Tax Challenges of the Digitalisation of the Economy in terms of which the OECD/G20 Inclusive Framework agreed to review and develop proposals for taxing the digital economy, grouped into two pillars that would form the basis for consensus.<sup>88</sup> One pillar would focus on the broader tax challenges (nexus data, and characterisation) and the other pillar would deal with the remaining BEPS issues.<sup>89</sup> Accordingly, a programme of work to develop a consensus solution to the tax challenges arising from the digital economy was adopted in May

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<sup>81</sup> Significant economic presence deals with the situation where a business uses digital technology to engage in the economic life of a country frequently and in a sustained manner without having a physical presence in that country. The solution will create a taxable presence in a country for a non-resident enterprise that has significant economic presence in such a country through the use of digital economy.

<sup>82</sup> OECD (2018) 134.

<sup>83</sup> *Ibid.*

<sup>84</sup> OECD (2020).

<sup>85</sup> *Ibid.*

<sup>86</sup> OECD (2020) 10.

<sup>87</sup> OECD (2018) 173 and 178.

<sup>88</sup> OECD *Addressing the Tax Challenges of Digitalisation of the Economy – Policy Note* (2019) 1.

<sup>89</sup> *Ibid.*

2019 and was endorsed by the G20 in June 2019.<sup>90</sup> The programme of work mandated the OECD Secretariat to conduct an economic and tax revenue analysis and impact assessment of the Pillar One and Pillar Two proposals (Economic Impact Analysis).<sup>91</sup> The Economic Impact Analysis provided that Pillar One and Pillar Two could increase global corporate income tax (CIT) revenues by about USD 50 to 80 billion a year and that a consensus based multilateral solution for implementing Pillar One and Pillar Two would be more desirable for increased investment and economic growth than would be the case without an agreement by the Inclusive Framework.<sup>92</sup>

### 3 1 Pillar One

In 2020, the OECD issued a report on the blueprint for Pillar One (Pillar One Blueprint), which sets out the main aspect of Pillar One and identifies the areas where political decision is needed to complete the solution.<sup>93</sup> Pillar One proposes new tax-nexus and profit-allocation rules for large MNEs that meet certain revenue and profitability thresholds.<sup>94</sup> Among other proposals, it extends taxing rights to jurisdictions where businesses operate and have a sustained presence,<sup>95</sup> albeit remotely without a physical presence.<sup>96</sup> The new taxing right (also referred to as “Amount A”) will only apply to MNE groups with a global turnover above 20 billion euros<sup>97</sup> (and profitability above 10 per cent calculated using an averaging mechanism).<sup>98</sup> A market jurisdiction will be allocated the new taxing right in terms of the in-scope MNEs when such MNEs derive at least 1 million euros (250 000 euros for smaller jurisdictions with GDP lower than 40 billion euros) in revenue from that jurisdiction;<sup>99</sup> 25 per cent of residual profit (which is profit in excess of 10 per cent of revenue) will be allocated to market jurisdictions with a nexus using a revenue-based allocation key.<sup>100</sup>

The African Tax Administration Forum (ATAF)<sup>101</sup> suggested that the threshold should be country specific, considering the relative size of the country’s economy, to ensure that smaller economies are not excluded from

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<sup>90</sup> OECD (2020) 3.

<sup>91</sup> OECD (2020) 4.

<sup>92</sup> OECD (2020) 10–11.

<sup>93</sup> OECD (2020) 3.

<sup>94</sup> *Ibid.*

<sup>95</sup> An activity test will be the base of determining if a business has a sustained presence requiring the application of the new taxing right.

<sup>96</sup> *Ibid.*

<sup>97</sup> Turnover is to be reduced to 10 billion euros if implementation is successful.

<sup>98</sup> OECD/G20 BEPS Project <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> 1.

<sup>99</sup> *Ibid.*

<sup>100</sup> OECD/G20 BEPS Project <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> 2.

<sup>101</sup> ATAF is an international organisation that provides a platform for African tax administrations to collaborate and cooperate with each other. See [www.ataftax.org](http://www.ataftax.org).

the nexus rules.<sup>102</sup> The OECD rejected ATAF's suggestion that part of the routine profit of in-scope MNEs be relocated to market jurisdictions or that 35 per cent of residual profits be allocated to market jurisdictions.<sup>103</sup> The Amount A taxing right will be implemented through changes to existing domestic laws and by making use of a multilateral convention (MLC).<sup>104</sup> Model rules are being developed that will be used by countries as a basis to give effect to the new taxing right in their domestic legislation.<sup>105</sup>

### 3 2 Pillar Two

Pillar Two (referred to as global anti-base erosion (or GloBE)) proposes mechanisms to ensure that large MNEs pay a minimum level of tax (15 per cent) in a jurisdiction in which they operate.<sup>106</sup> Pillar Two applies to MNE groups with consolidated group revenue equal to or exceeding 750 million euros.<sup>107</sup> Taxpayers falling into the scope of the Pillar Two rules calculate their effective tax rate for each jurisdiction in which they operate, and pay a top-up tax for the difference between their effective tax rate per jurisdiction and the 15 per cent minimum rate.<sup>108</sup> Governments can determine their own tax systems and still set their own corporate income tax (CIT) rates but if MNEs are paying less than the 15 per cent global minimum rate, the MNE's country of residence has a right to "top up" the tax.<sup>109</sup> ATAF has proposed that the minimum rate be set at least 20 per cent (not 15 per cent) as most African countries have a statutory CIT rate of between 25 and 35 per cent.<sup>110</sup> This proposal has not been accepted. On 20 December 2021, model rules to implement a global minimum tax were issued with key aspects generally planned to be implemented into domestic law in 2022 and to be effective in 2023.<sup>111</sup>

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<sup>102</sup> ATAF "ATAF's Opinion on the Inclusive Framework (Including the Unified Approach) and Pillar Two Proposals to Address the Tax Challenges Arising From the Digitalisation of the Economy" [https://events.ataftax.org/includes/preview.php?file\\_id=44&language=en\\_US](https://events.ataftax.org/includes/preview.php?file_id=44&language=en_US) [https://events.ataftax.org/includes/preview.php?file\\_id=44&language=en\\_US](https://events.ataftax.org/includes/preview.php?file_id=44&language=en_US) (accessed 2022-06-13) 2.

<sup>103</sup> ATAF "A New Era of International Taxation Rules – What Does This Mean for Africa?" (8 October 2021) <https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa> (accessed 2022-07-21).

<sup>104</sup> OECD (2020) 14.

<sup>105</sup> OECD "Pillar One – Amount A: Draft Model Rules for Tax Base Determinations" A public consultation document (18 February 2022 – 4 March 2022) <https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-tax-base-determinations.pdf> 2.

<sup>106</sup> OECD (2021) 14.

<sup>107</sup> OECD (2021) 15.

<sup>108</sup> OECD (2021) 45

<sup>109</sup> *Ibid.*

<sup>110</sup> ATAF <https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa>. South Africa's CIT rate for years ending on date between or on or after 31 March 2023 is 27 per cent (it was previously 28 per cent).

<sup>111</sup> *Ibid.*

## 4 SOUTH AFRICA'S POSITION

### 4.1 South Africa's response

South Africa is a developing African country. Although South Africa is not an OECD member and is thus not required to follow OECD policies, it has been awarded OECD observer status<sup>112</sup> in 2004, most of its double-tax agreements follow the OECD Model Tax Convention on Income and Capital,<sup>113</sup> and it is a member of the OECD BEPS Committee and the OECD/G20 Inclusive Framework on BEPS.<sup>114</sup> South Africa has chosen to await a consensus solution and has not yet taken any unilateral measures to tax the digital economy directly.<sup>115</sup> In order to implement the OECD solutions, South Africa will have to incorporate the rules into its domestic laws and ratify any treaty entered into. The OECD solutions are proving slow to implement; and not having unilateral measures in the meantime means that South Africa is losing out on the tax revenue it could be generating from taxing the digital economy using direct tax measures, as opposed to indirect tax in the form of value added tax (VAT).<sup>116</sup>

### 4.2 Suitability of OECD's solutions

The rules proposed by the OECD recognise that the current direct-tax rules, which require some form of physical presence before a country can tax a company, are insufficient to tax new business models under the digital economy, and as such the OECD has proposed new tax-nexus and profit-allocation rules that do not require physical presence.<sup>117</sup> The implementation of such rules by South Africa would ensure that South Africa does not continue to lose revenue from not having direct-tax rules that allow for the taxation of companies that are not physically present in South Africa but are operating in South Africa digitally. Oguttu notes that it is important for African countries to embrace the OECD BEPS Project, as it has the prospect of curtailing tax avoidance by MNEs, which will result in raising corporate tax revenues for these countries.<sup>118</sup> Valderrama argues that it is not clear how the solutions proposed by the OECD in addressing the challenges of the digital economy are beneficial to developing countries, and argues that it may shift developing countries' focus away from other tax matters unique to

<sup>112</sup> South Africa is able to attend the OECD meetings as an observer.

<sup>113</sup> Olivier and Honiball *International Tax: A South African Perspective* 270. The court in *CIR v Dowling* 1975 (4) SA 518 (A) 524 held that South Africa must consider the guidelines and interpretations contained in the OECD commentaries on concepts used by the OECD Model Tax Convention.

<sup>114</sup> OECD (2020) 3; OECD (2018) 19.

<sup>115</sup> Business Tech <https://businesstech.co.za/news/technology/468144/theres-a-big-problem-with-south-africas-plans-for-digital-tax>. However, it should be noted that, South Africa currently taxes the digital economy through its rules on value added tax, which have the result that consumers are liable for the digital tax, and not MNEs.

<sup>116</sup> See also Business Tech <https://businesstech.co.za/news/technology/468144/theres-a-big-problem-with-south-africas-plans-for-digital-tax>.

<sup>117</sup> OECD (2020) 64.

<sup>118</sup> Oguttu "Tax Base Erosion and Profit Shifting in Africa – Part 1: What Should Africa's Response Be to the OECD BEPS Action Plan?" 2015 48 *CILSA* 516–553 526.

them such as taxation of the informal economy.<sup>119</sup> ATAF notes that the reallocation of profits of MNEs using new tax-nexus rules is a step in the right direction but does not amount to a substantial shift in the allocation of taxing rights between residence- and source-based jurisdictions.<sup>120</sup> ATAF advocates for a substantial shift in the current rules for allocating taxing rights between residence- and source-based countries to allow for a more equitable allocation of taxing rights because the current rules favour residence-based jurisdictions to the detriment of developing African countries, which in most cases are the primary source jurisdictions.<sup>121</sup>

The OECD's main objective is to foster economic development and growth for its member countries.<sup>122</sup> There is a concern that the OECD proposals are possibly better suited to protecting the interests of the OECD members to further its main objective. However, the OECD has asserted that its role is not to make proposals that favour one group over another but is exploring a potential consensus solution that would be suitable for everyone, considering that some compromises would need to be made as it is impossible to please everyone.<sup>123</sup> It has also been questioned whether the OECD Inclusive Framework really provides an equal footing for developing countries or whether the platform includes developing countries as a mere formality and those countries do not really have a say.<sup>124</sup> The more developed countries have more bargaining power than developing countries and may sometimes use this to establish rules more suitable to themselves. For example, the CIT rate of most African countries is between 25 and 35 per cent; setting the global minimum CIT rate at 15 per cent is therefore not really suitable for most developing African countries, including South Africa (with a CIT rate of 27 per cent).<sup>125</sup> Christians is of the opinion that the OECD solutions will favour a few key players and be implemented using guidance and peer pressure.<sup>126</sup> Some of the key players in the process are stakeholders of key multinationals, and as such they have incentives to direct the consensus to their preferred position as far as is possible.<sup>127</sup> Should they not be able to direct the consensus, they have the political and administrative network connections and influence to slow down or even stop

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<sup>119</sup> Valederrama "About BEPS Inclusive Framework and the Role of the OECD" (2019) <https://globtaxgov weblog.leidenuniv.nl/2019/11/19/about-the-beps-inclusive-framework-and-the-role-of-the-oecd/> (accessed 2022-06-28).

<sup>120</sup> ATAF <https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa>.

<sup>121</sup> *Ibid.*

<sup>122</sup> OECD "What Is the OECD (Organization for Economic Cooperation and Development)?" (2019) <https://corporatefinanceinstitute.com/resources/knowledge/economics/oecd/> (accessed 2022-07-09).

<sup>123</sup> Dickinson "The Inclusive Framework Is Considering Radical Proposals, But In the Real World ..." (2019) <https://www.ictd.ac/blog/oecd-inclusive-framework-tax-proposals-negotiation/> (accessed 2022-06-13).

<sup>124</sup> See Christians "OECD Secretariat's Unified Approach: How to Get Things on a Truly Equal Footing" (2019) <https://www.ictd.ac/blog/oecd-secretariat-unified-approach-equal-footing/> (accessed 2022-06-13).

<sup>125</sup> ATAF <https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa>.

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*

a consensus that they really dislike.<sup>128</sup> In response to Christians, Dickenson argues that consensus is made by countries as sovereigns, and not as blocs of countries; as such there is no single European view.<sup>129</sup> Although countries might not be working in blocs, the ATAF is working together with the African Union and African countries in reviewing and implementing the OECD solutions.<sup>130</sup>

Kristen argues that some of the solutions proposed by the OECD may not be suitable for tax systems in Africa because of resource limitations and financial constraints in developing countries.<sup>131</sup> The need for ever-changing tax policies may be a challenge for developing countries as they have developing economies and as such may not be financially equipped to keep up with constantly changing tax policies.<sup>132</sup> The implementation of global solutions may also result in administrative systems incurring major expenses for training staff in order to apply and enforce the rules, which may be a blow for African countries with limited financial resources.<sup>133</sup> The move to global consensus is moving at a fast pace and developing countries may still need to understand the rules and how they will impact their existing tax systems.<sup>134</sup> Global consensus is necessary, but it should not be rushed.<sup>135</sup> The implementation of OECD solutions to digital-economy taxation challenges could pose administrative challenges for African developing countries.<sup>136</sup> African countries may struggle with enforcing compliance with new digital-tax rules as African countries have already announced that some MNEs are ignoring registration requirements for taxes such as VAT imposed in those countries.<sup>137</sup> African countries need also to consider the amount of political interference and corruption in some countries and how the tax administrators may be pressured to “go easy” on some MNEs that may be key players in the economy. This may be dealt with, however, by making sure that the rules adopted are hard to manipulate and are more formulaic.<sup>138</sup>

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<sup>128</sup> *Ibid.*

<sup>129</sup> Dickinson <https://www.ictd.ac/blog/oecd-inclusive-framework-tax-proposals-negotiation/>.

<sup>130</sup> ATAF Communications <https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa>.

<sup>131</sup> Kirsten “Taxing the Digital Economy – Why Is Africa Not Getting Its Fair Share?” (2019) [bdo.co.za/en-za/insights/2019/tax/taxing-the-digital-economy-why-is-africa-not-getting-its-fair-share](https://bdo.co.za/en-za/insights/2019/tax/taxing-the-digital-economy-why-is-africa-not-getting-its-fair-share) (accessed 2022-04-13).

<sup>132</sup> *Ibid.*

<sup>133</sup> Rukundo, “Addressing the Challenges of Taxation of the Digital Economy: Lessons for African Countries” (2020) ICTD Working Paper 105 (first published by the Institute of Development Studies in January 2020) 20.

<sup>134</sup> Oguttu 2020 *World Tax Journal* 823.

<sup>135</sup> Valederrama <https://globtaxgov weblog.leidenuniv.nl/2019/11/19/about-the-beps-inclusive-framework-and-the-role-of-the-oecd/>.

<sup>136</sup> Rukundo ICTD Working Paper 105 20.

<sup>137</sup> *Ibid.*

<sup>138</sup> *Ibid.*

## 5 RECOMMENDATIONS

Rukundo<sup>139</sup> urges African countries to participate in the discussions on global consensus solutions, but to consider that their challenges as African countries are different to those experienced by developed countries and as such solutions should also be unique to African countries.<sup>140</sup> The Davis Tax Committee<sup>141</sup> (DTC) cautioned South Africa against blindly following the lead of developed countries in implementing international tax developments and advised that South Africa should conduct its own research before implementing any solutions. There are measures that are in line with current international tax principles that developing countries can rely on to protect their tax bases while they wait for global consensus; these include strengthening their source rules, imposing withholding tax on service fees arising from digital services, negotiating the services article in the UN model,<sup>142</sup> or applying alternative minimum corporate taxes based on turnover.<sup>143</sup> The DTC recommended the introduction of new source rules in South Africa in the form of an inclusion in section 9 of the Act of rules that cover income from the supply of digital goods and services by non-residents as income sourced in South Africa.<sup>144</sup> The rules could provide that the supply of digital goods and services is sourced where the consumer is based.<sup>145</sup>

The implementation of such rules by South Africa would ensure that South Africa does not continue to lose revenue from not having direct-tax rules that allow for the taxation of companies that are not physically present in South Africa but are operating in South Africa digitally. Oguttu notes that it is important for African countries to embrace the OECD BEPS Project as it has the prospect of curtailing tax avoidance by MNEs and of raising corporate tax revenues of these countries.<sup>146</sup> South Africa should not rush to implement the rules but take time to research them and see how to adapt them in a way that will be suitable for South Africa.

## 6 CONCLUSION

Business models have changed and adapted owing to the advancement of ICT; as a result, businesses are now able to operate digitally and do not

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<sup>139</sup> Rukundo ICTD Working Paper 105 20.

<sup>140</sup> *Ibid.*

<sup>141</sup> The Davis Committee is a committee that was appointed to review the tax system of South Africa.

<sup>142</sup> S 12A of the 2017 UN model double tax convention between developed and developing countries allows countries to levy tax on payments made to non-resident providers of technical services even if the non-resident providers do not have physical presence in the country.

<sup>143</sup> Oguttu 2020 *World Tax Journal* 823.

<sup>144</sup> Davis Tax Committee "Executive Summary of Second Interim Report on Base Erosion and Profit Shifting (BEPS): OECD BEPS Project From a South African Perspective: Policy Perspectives and Recommendations for South Africa" (2016) [https://www.taxcom.org.za/docs/New\\_Folder3/1%20BEPS%20Final%20Report%20-%20Executive%20Summary.pdf](https://www.taxcom.org.za/docs/New_Folder3/1%20BEPS%20Final%20Report%20-%20Executive%20Summary.pdf) 9.

<sup>145</sup> Davis Tax Committee [https://www.taxcom.org.za/docs/New\\_Folder3/1%20BEPS%20Final%20Report%20-%20Executive%20Summary.pdf](https://www.taxcom.org.za/docs/New_Folder3/1%20BEPS%20Final%20Report%20-%20Executive%20Summary.pdf) 10.

<sup>146</sup> Oguttu 2015 *CILSA* 516–553 526.

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always need to be physically present in a jurisdiction before interacting with customers in that jurisdiction. This puts a lot of pressure on current direct-tax rules that were developed more than a century ago with traditional business models in mind. The current international direct-tax rules require some form of physical presence of a company in a jurisdiction before that jurisdiction can have the right to tax the profits of the company. This has resulted in many companies that operate digitally not being taxed in market jurisdictions where they operate virtually. The OECD has taken a leading role in developing new direct-tax rules that will address the tax challenges posed by the digital economy and has agreed to develop a two pillar solution that can be consented to internationally and implemented by countries. Pillar One proposes new nexus and profit-allocation rules for large MNEs that meet certain revenue and profitability thresholds,<sup>147</sup> and Pillar Two proposes mechanisms to ensure large MNEs pay a minimum level of tax (currently set at 15 per cent) regardless of where their headquarters are or the jurisdictions in which they operate.<sup>148</sup>

South Africa has decided to wait for global consensus and is currently not taxing the digital economy through its direct-tax rules. Although the OECD solutions are helpful proposals in regard to taxing the digital economy and are a step in the right direction, it is submitted that they are not completely suited to South Africa as a developing African country. For example, they do not consider some of South Africa's unique circumstances like the prevalence of corruption, semi-skilled tax administration and limited resources. South Africa should not merely adopt the rules blindly but should adapt them to suit South Africa's needs as a developing country. South Africa needs to protect its tax base while embracing the digital economy; and perhaps while it waits for a global solution, it could strengthen its source rules as recommended by the DTC.

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<sup>147</sup> OECD (2020).

<sup>148</sup> OECD (2021).