A Guide for Developing Countries on How to Understand and Adapt to the Global Minimum Tax

DRAFT FOR CONSULTATION

Written by Allison Christians, Thomas Lassourd, Kudzai Mataba, Eniye Ogbebor, Alexandra Readhead, Stephen Shay, and Zach Pouga Tinhaga

15th December 2022

IISD
International Institute for Sustainable Development

ISLP
International Senior Lawyers Project

Agenda

- Introduction: Eniye Ogbebor, ISLP
- Presentation of toolkit: Steve Shay, ISLP, Thomas Lassourd, Kudzai Mataba, IISD,
- Panel discussion: Suranjali Tandon, Rutha Maina, Zach Pouga
- Questions and answers
- Conclusion

What is the global minimum tax?

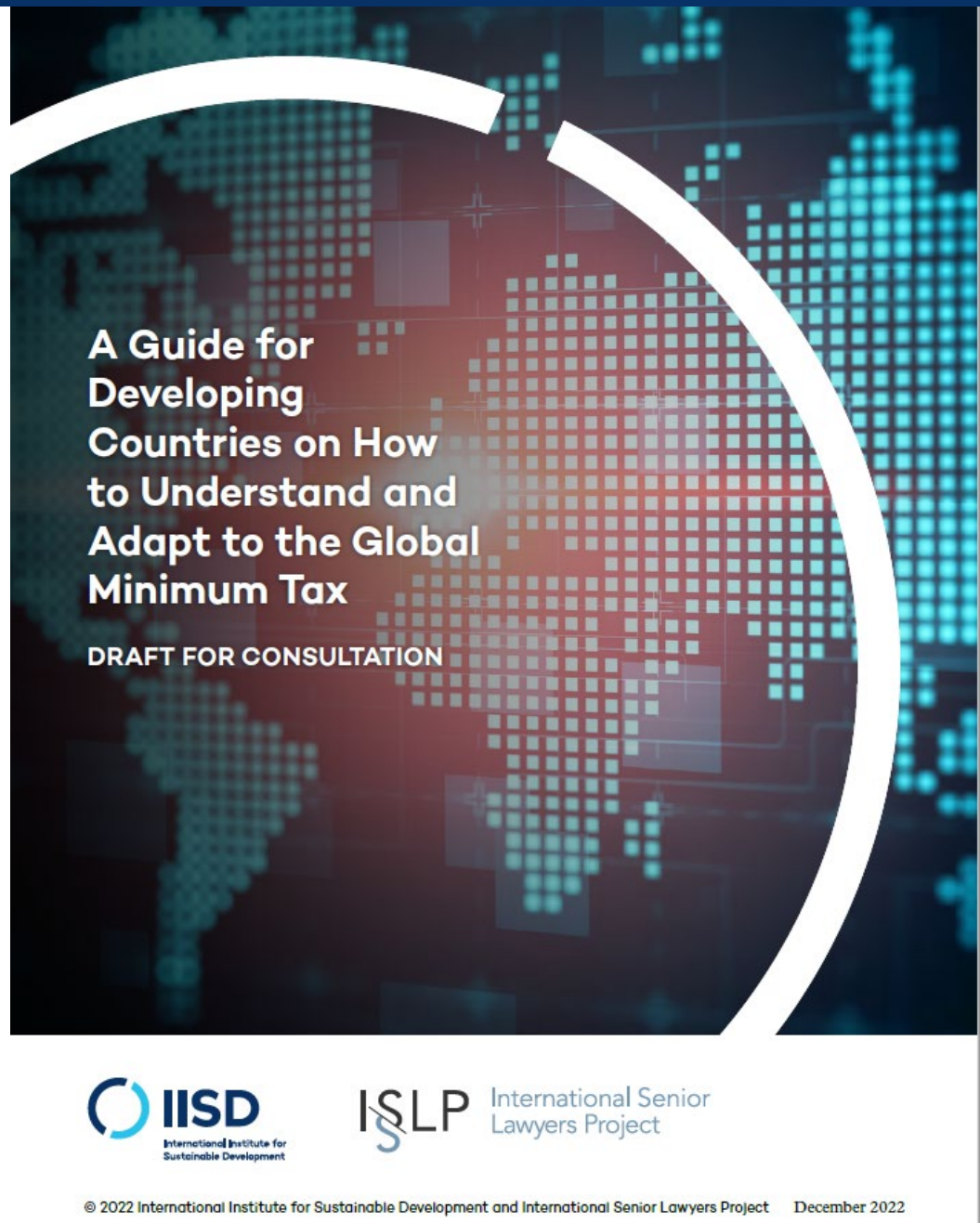
Pillar Two of the OECD/G20 Inclusive Framework on BEPS Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy

- **Pillar One**: allocating taxing rights to the market country
    - Traditional 'tax nexus' requires businesses to have a physical presence in a jurisdiction before being liable to pay tax there
    - Pillar 1 aims to address this challenge by establishing a new 'taxing right' in the market country – dispensing with the need to have a physical presence.

- **Pillar Two / Global Anti-Base Erosion (GloBE):** a 15% minimum effective tax rate
    - Tax competition continues to erode the tax base of nations
    - Pillar 2 aims to stop tax competition through a global minimum effective tax rate
    - Scope: multinational companies with annual turnover > 750 million euros

IISD-ISLP Guide seeks to:

- Explain the global minimum tax (GloBE) rules
- Provide a framework for a country to examine:
  - the potential applicability of GloBE to its taxpayers, and
  - the interplay of GloBE rules with its domestic tax system, including investment incentives
  - potential policy responses
- Provide a step-by-step approach to assess the likely economic impact of GloBE on a country.
- Identify potential legal constraints on domestic tax reforms.



Part I: How Pillar Two Works

How Pillar Two Works

A series of rules will allow either residence countries or source countries to impose a minimum tax so that income in each country is taxed at a 15% effective tax rate.

- **The Effective Tax Rate (ETR) is calculated annually at the jurisdictional level:**

$$\frac{\text{Adjusted covered taxes of all entities in the jurisdiction}}{\text{GloBE income of the jurisdiction}} = \boxed{\text{Effective tax rate (ETR) for the jurisdiction}}$$

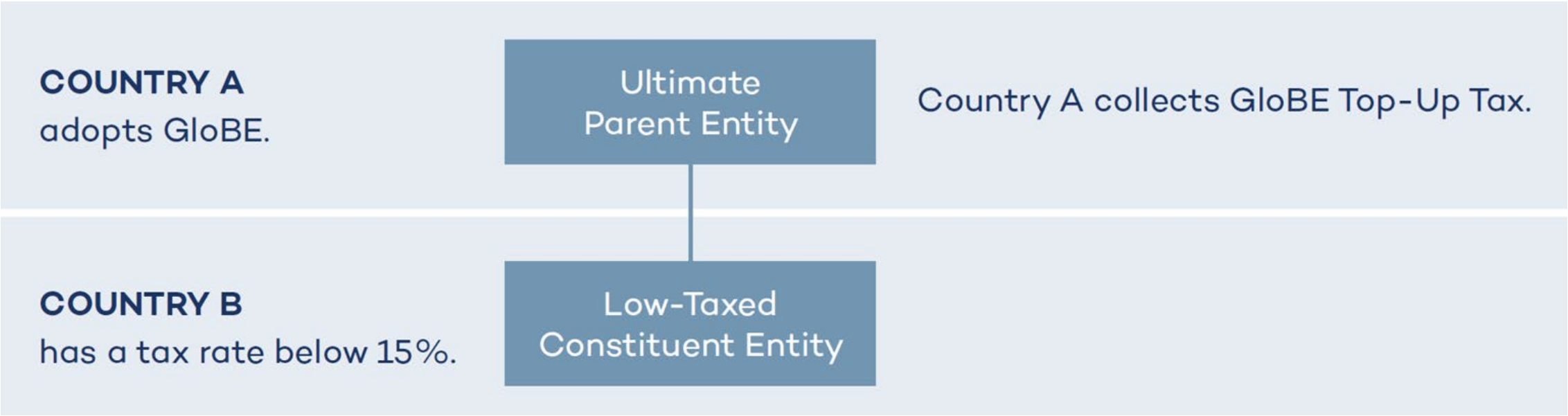
Covered taxes = tax paid on taxable profits in accordance with each country's local tax rules in the relevant year.

GloBE Tax Base is the profit (or loss) before income tax as determined using the relevant financial accounting standard (e.g., IFRS, GAAP, OHADA)

How Pillar Two Works

If the effective rate on constituent entities in a source country is below 15%, an income inclusion rule (IIR) permits an ultimate parent entity (UPE) to collect the difference between the ETR and 15% as a "top-up" tax.

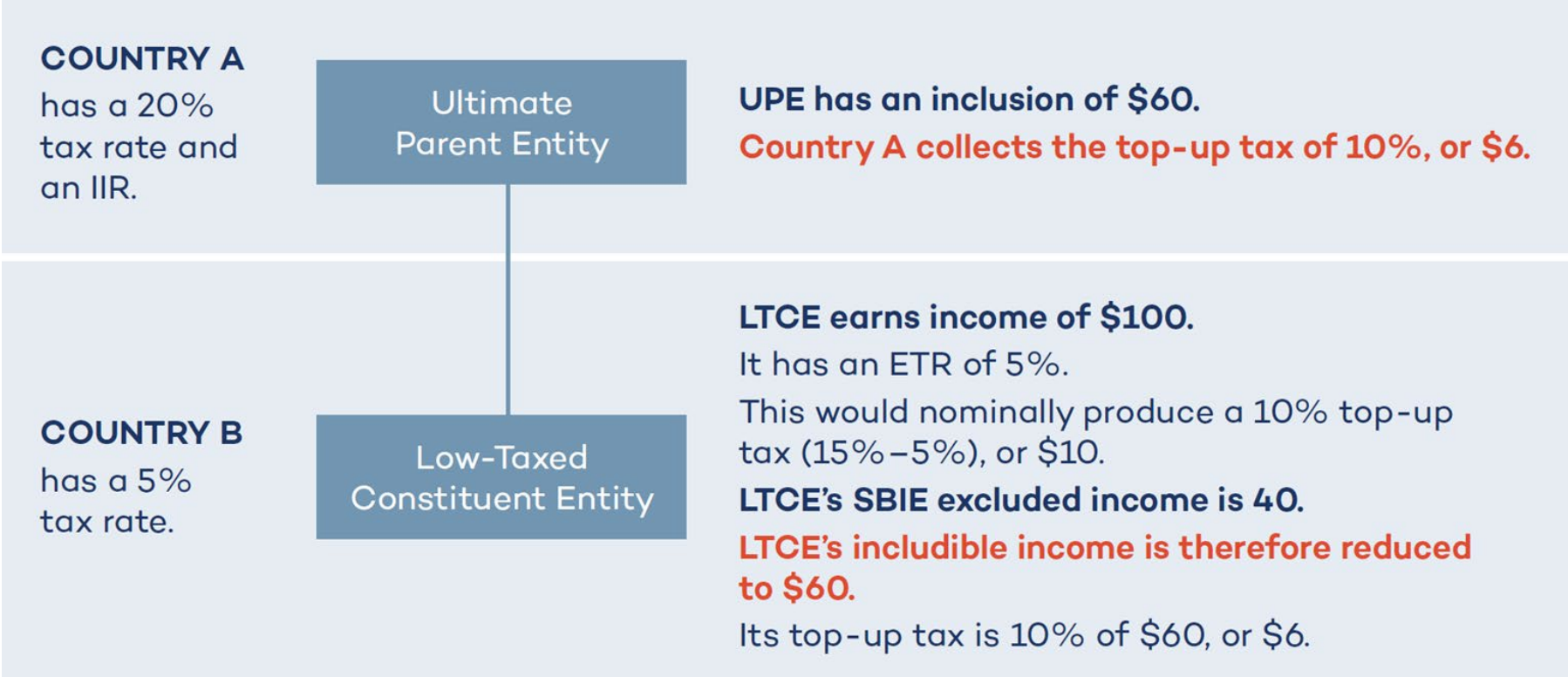
- **Income inclusion rule (IIR)**



How Pillar Two Works

A substance-based income exclusion (SBIE) protects from top-up tax an amount based on a percentage of tangible property and payroll (so this amount is taxed under the source country's domestic tax law).

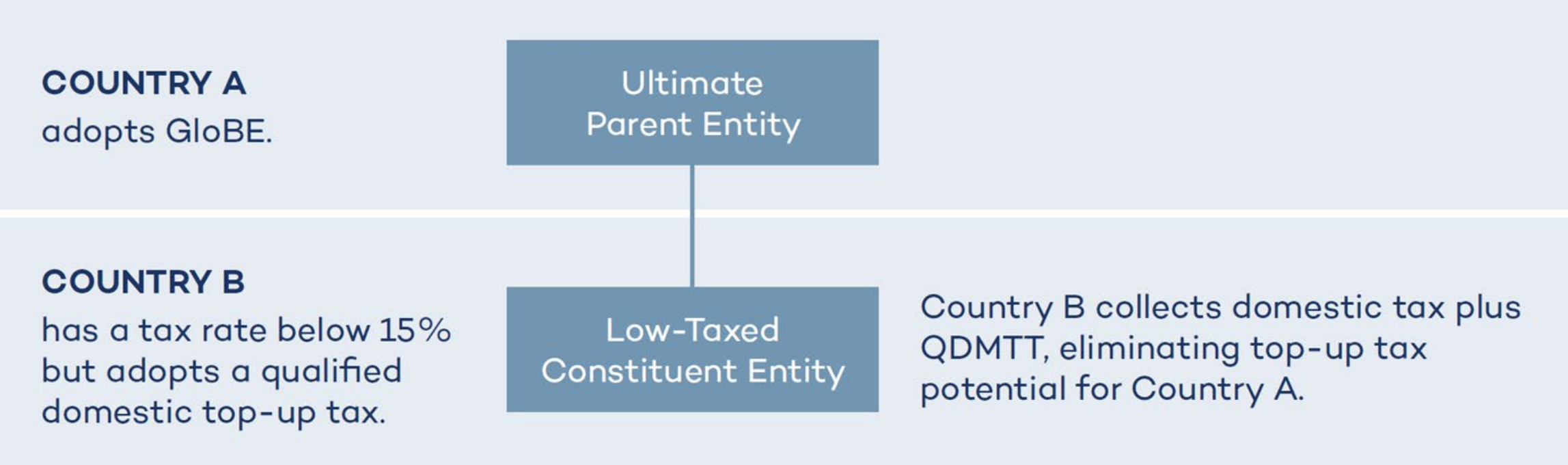
- **Substance-based income exclusion**



How Pillar Two Works

If the ETR for constituent entities in a source country is below 15%, in addition to the SBIE applying, the country may adopt a qualified domestic top-up tax to collect any top-up tax itself.

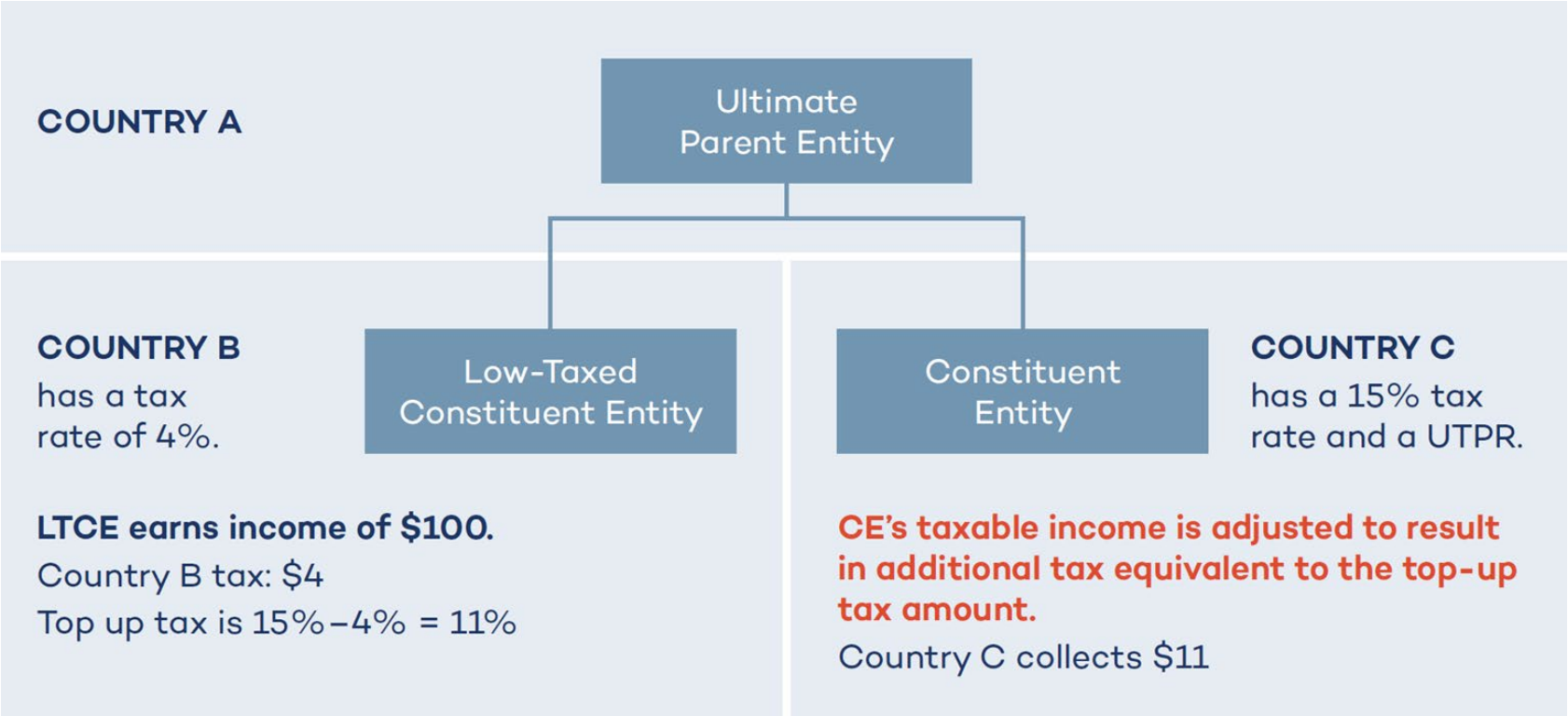
- **Qualified Domestic Top-Up Tax (QDMT)**



How Pillar Two Works

If there is top-up tax after the SBIE (and no QDMT), and no country collects an IIR, an undertaxed profit rule (UTPR) permits a country with a constituent entity in the same group to collect the top-up tax.

- **Undertaxed Profits Rule**



Part II: Adapting Domestic Tax Policies to Pillar Two

Possible revenue impacts of the global minimum tax

No impact. There are no companies in scope of GloBE with low taxed profit in your jurisdiction.

There is top up tax from the low taxed profits of companies in scope of GloBE in your jurisdiction.

Foreign countries collect top up tax from low taxed profits in your jurisdiction.

You increase domestic taxes on companies in scope of GloBE with low taxed profit in your jurisdiction.

How can governments respond to the global minimum tax?

There are three main options:

Option 1: Domestic Minimum Tax

- Qualified Domestic Minimum Tax
- Generalized Domestic Minimum Tax

Option 2: Review Incentives

Option 3: Focus on Other Priorities

Review tax incentives

Tax Incentive Types	Likely Impact of GLoBE
Profit based incentives	
Income Tax Holidays and Export Processing Zones	**High** – Will significantly reduce the GloBE ETR for periods in which it is applicable and likely lead to the payment of top up tax, depending on the size of the carve-out for payroll and tangible assets.
Reduced Tax Rates, Business Credits, Withholding Tax Relief, Preferential Treatment of Long-Term Capital Gains	**Medium** - Will in many cases reduce GloBE ETR but the ETR reduction may not always lead to the payment of top-up tax.
Cost Based Incentives	
Tax Deferrals, Investment Allowances, Extended Carry forward Periods, Deductions for Qualifying Expenses	**Limited** – Likely not to reduce GloBE ETR and lead to the payment of top-up tax. The GloBE rules use a version of deferred tax accounting mechanisms to adjust for timing differences.[13] There are however limitations to the use of deferred tax accounting and in some cases the GloBE rules may lead to top up tax because of timing differences.
Payroll Tax Incentives, Property Tax Reductions, Exemptions from Indirect Taxes	**No impact** – Payroll taxes and other employment-based taxes, as well as social security contributions, are not covered taxes under the GloBE rules. Taxes based on ownership of specified items or categories of property are distinguishable from taxes based on a corporation's equity and should not be covered taxes under the GloBE rules. Consumption taxes, such as sales taxes and value-added taxes (VATs), are not covered taxes under the GloBE rules

Source: authors

Part III: Assessing the Likely Impact of GloBE on Your Country

Assessing the Likely Impact of GloBE on Your Country

Early analyses shows most of the top-up tax under GloBE rules is likely to be generated in developed economies and low-tax developing economies, although this ignores important but uncertain behavioral and dynamic changes.

Revenue Effects of the Global Minimum Tax Under Pillar Two

Table 3 Revenues of a 15% Global Minimum Tax With Carve-Outs of 5% on Tangible Assets and Payroll by Country Classification Under the Income Inclusion Rule and the Qualified Domestic Top-Up Tax in 2021 EUR Billion

	Headquarters Scenario (Income Inclusion Rule)		*Host Country Scenario (Qualified Domestic Top-Up Tax)*	
Classification	*Number of Countries*	*Revenue in 2021 EUR bn*	*Number of Countries*	*Revenue in 2021 EUR bn*
Developed	34	133.4	41	95.5
of which G7	7	*89.5*	7	*17.4*
Developing	48	21	108	49.2
In transition	1	0.2	13	0.1
Least developed	0	0	35	0.1
Undetermined	-	-	-	10.5
Total	83	154.5	197	154.5

Baraké, M., Chouc, P.-E., Neef, T., & Zucman, G. (2022). Revenue effects of the Global Minimum Tax under Pillar Two [pre-publication] [Article]. Intertax, 50(10) [pre-publication]

Assessing the Likely Impact of GloBE on Your Country

There is still a significant amount at stake for developing economies that can only be captured by adjusting taxation at source.

Figure 2. Foreign affiliates of MNEs above the EUR 750 threshold face low ETRs across regions

Share of jurisdictions in the region by bins of the statutory tax rate (STR) and effective tax rates (ETR), 2018

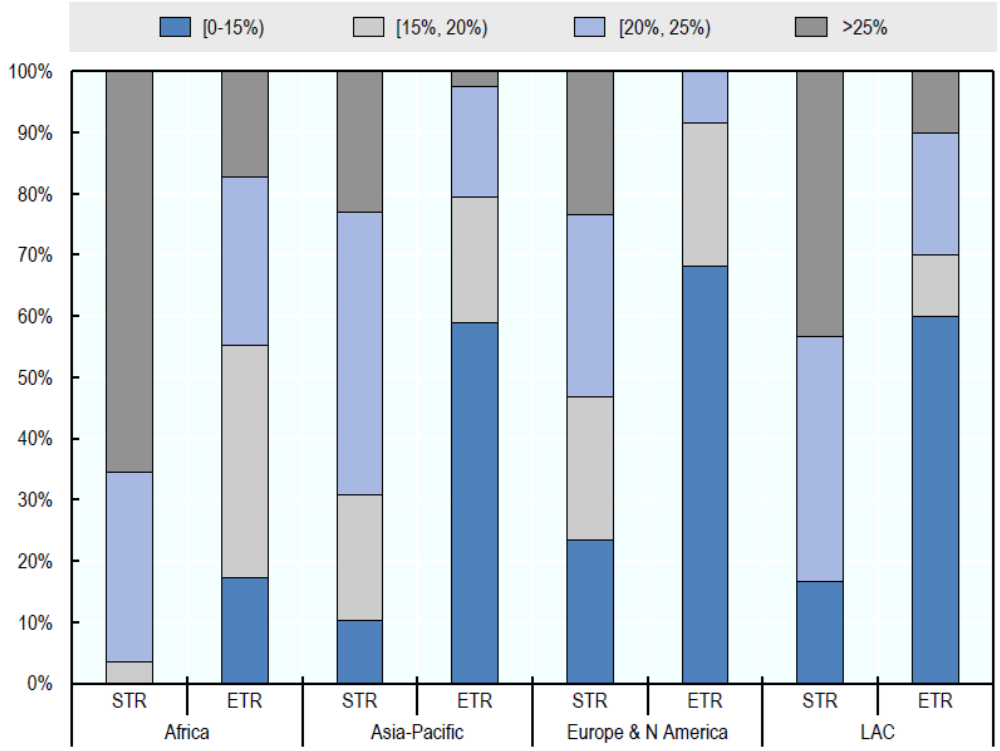
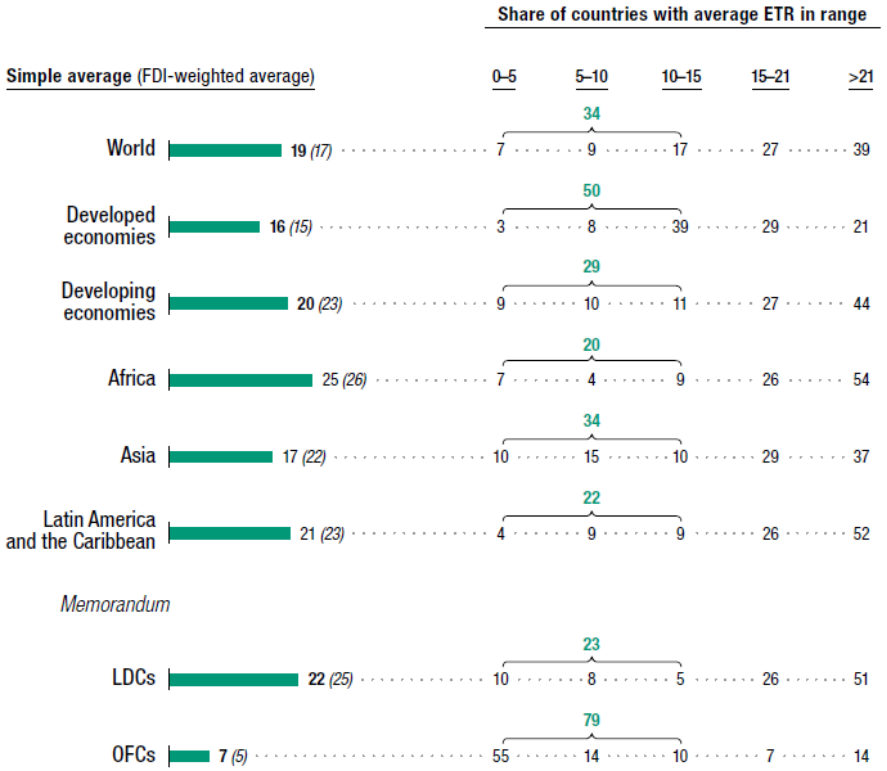


Figure III.3. Distribution of average effective tax rates of foreign affiliates of large MNEs across host countries, 2017 (Per cent)



Source: UNCTAD; CbCR-based ETRs from Garcia-Bernardo and Janský (2022).
Note: World, economic groupings and regions do not include OFCs. CbCR = country-by-country reporting, ETR = effective tax rate, LDCs = least developed countries, OFCs = offshore financial centres.

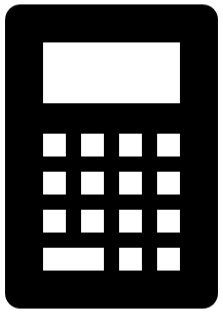
Organisation for Economic Co-operation and Development. (2022). *Tax incentives and the Global Minimum Corporate Tax: Reconsidering tax incentives after the GloBE rules.*

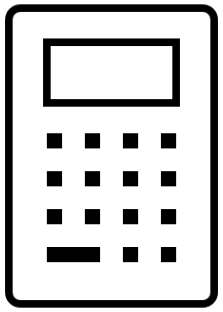
Assessing the Likely Impact of GloBE on Your Country

Each country should do its own impact assessment based on country-by-country reports and/or taxpayer data.

Step-by-Step Approach

- ✓ Compile a list of all taxpayers in the country with at least EUR 1 million in income and EUR 10 million in revenues.
- ✓ Identify the ultimate parent company of each taxpayer.
- ✓ Among these, list the entities in MNE groups with an annual turnover of over EUR 750 million.
- ✓ Collect domestic statutory accounts of each taxpayer that show deferred tax to adjust the cash tax reported in CBC reports and financial accounts according to GloBE rules.
- ✓ Calculate the GloBE ETR for the previous 4 years for each MNE with branches in the country. Blend Covered Taxes and accounting profits for all entities of each MNE in the jurisdiction.
- ✓ Calculate the SBIE:
- ✓ Sensitivity analysis





Part IV: Assessing Potential Legal Barriers to Domestic Tax Reforms in Your Country

Potential legal constraints on governments' responses to the global minimum tax

Stabilization in domestic law and investment contracts.

What can countries do?

- Require a unilateral acknowledgment from the taxpayer that UTPR applies and host country top-up would not result in damages.
- Renegotiate stabilized fiscal terms in investment contracts

Potential investment treaty constraints on governments' responses to the global minimum tax

The risk of arbitration emanating from Investment Treaties

Countries should consider the impact of : Expropriation, National Treatment, Most Favoured Nation and Fair and Equitable Treatment Clauses on any domestic responses.

What can countries do to lower their overall risk?

- Ensure any reforms in response to GloBe are enacted in full accordance with the domestic legislative process and apply in a fair and equitable manner to all affected foreign investors.
- Renegotiate affected Investment treaties.
- Revise tax-carve outs in treaties .

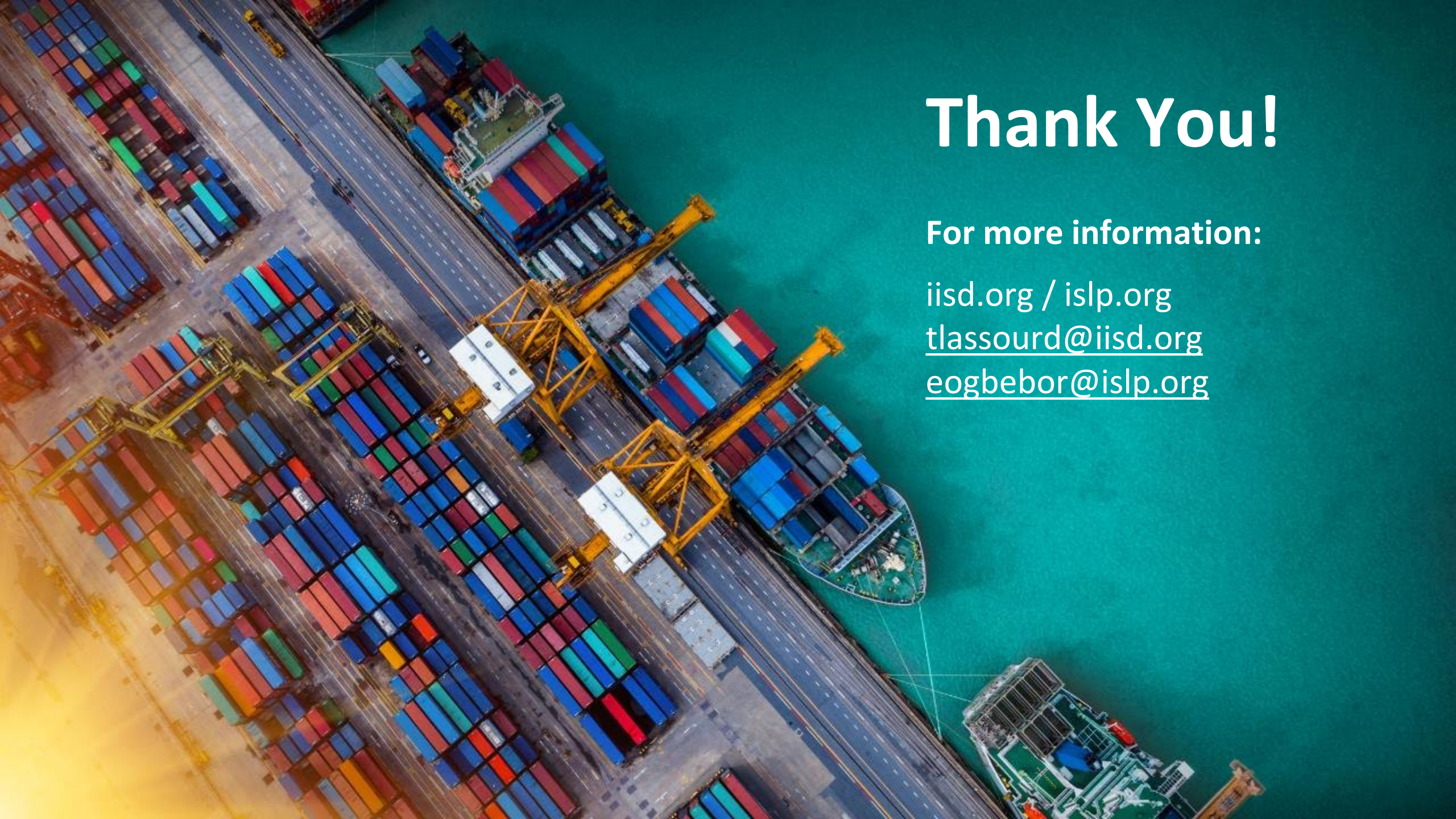
Proactive Steps That the OECD Could Take to Mitigate Potential Legal Risks Posed by Fiscal Stabilization

1. Encourage companies to comply with any unilateral disclosure requirements imposed by countries.

2. Encourage companies to disclose to shareholders when they have been requested by a country to waive a stabilization obligation that lowers the company's ETR below the globally agreed rate in the host country.

3. Encourage courts and tribunals to adopt a holistic view of damages relating to the implementation of GloBE measures.

4. Encourage countries to review BITs that contain particularly broad FET clauses,



Thank You!

For more information:

iisd.org / islp.org
tlassourd@iisd.org
eogbebor@islp.org