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Global Minimum Taxation of Multinationals: Opportunities and risks for some African States

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Abstract

To face the challenges posed by the digitization of the economy, the OECD's Inclusive Framework has developed two Pillars to address tax base erosion and profit shifting. The objective of Pillar Two is to define the minimum amount of tax to be paid by multinational enterprises in the jurisdictions where they operate. The OECD's Inclusive Framework has adopted an average effective rate of 15% for this purpose. The objective of this study is to show whether the implementation of Pillar Two in African jurisdictions constitutes an opportunity or a risk for them.

The results show that it is an opportunity for countries with a low effective tax rate and a risk for countries with a high effective tax rate. Therefore, setting a 15% income tax rate for non-resident multinationals is an opportunity for some African countries. For it would constitute for these countries a source of additional tax revenue mobilization. For this reform to be an opportunity for Africa, however, the minimum effective tax rate must be raised to at least 20%, as was demanded by the African Tax Administration Forum (ATAF).

The risk that lies in the application of an effective rate of 15% for Africa as a whole is that some African countries might have to reduce their effective tax rate. This would be a loss of revenue for those African countries. Since most countries in the African jurisdiction have effective tax rates and statutory corporate income tax rates that are more than 20 percent, above the set average effective rate, multinationals would seek to shift their profits to the countries with the most advantageous taxation. This could lead to a transfer of profits to other jurisdictions.

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Pour faire face aux défis posés par la numérisation de l'économie, le Cadre inclusif sur le BEPS de l'OCDE a élaboré une approche reposant sur deux piliers pour lutter contre l'érosion de la base d'imposition et le transfert de bénéfices. L'objectif du deuxième pilier est de définir le montant minimum d'impôt qui doit être acquitté par les entreprises multinationales dans les territoires où elles opèrent. À cette fin, un taux effectif moyen de 15 % a été fixé. L'objectif de cette étude est de vérifier si la mise en œuvre du deuxième pilier dans les pays africains constitue une opportunité ou un risque pour ceux-ci.

Les résultats montrent qu'il s'agit d'une opportunité pour les pays ayant un taux d'imposition effectif faible et d'un risque pour ceux qui ont adopté un taux d'imposition effectif élevé. Par conséquent, l'établissement d'un taux d'imposition de 15 % pour les multinationales non résidentes constitue une opportunité pour certains pays africains en ce qu'il leur offre la possibilité de bénéficier de recettes fiscales supplémentaires. Mais pour que cette réforme soit bénéfique à tous, il faut que le taux effectif minimum d'imposition soit porté à 20 % au moins, comme l'a demandé le Forum de l'administration fiscale africaine (ATAF).

Le risque lié à l'application d'un taux effectif de 15 % pour l'ensemble de l'Afrique réside dans le fait que certains pays africains pourraient être contraints de réduire leur taux effectif d'imposition, ce qui ne serait pas sans conséquence sur le montant de leurs recettes fiscales. Étant donné que la plupart des pays africains ont des taux d'imposition effectifs et des taux légaux d'imposition des sociétés supérieurs de plus de 20 % au taux effectif moyen qui a été fixé, les multinationales pourraient être tentées de déplacer leurs bénéfices vers des pays où la fiscalité est la plus avantageuse, conduisant ainsi à un transfert de bénéfices vers d'autres territoires.

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El Marco Inclusivo de la OCDE, a fin de abordar las dificultades que plantea la digitalización de la economía, ha desarrollado dos pilares para hacer frente a la erosión de las bases imponibles y el traslado de beneficios. El objetivo del Pilar 2 es definir el impuesto mínimo que deben pagar las empresas multinacionales en las jurisdicciones donde operan. El Marco Inclusivo de la OCDE ha adoptado un tipo efectivo medio del 15 % a tal fin. El objeto de este estudio es demostrar si la aplicación del Pilar 2 en las jurisdicciones africanas consti-

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tuye una oportunidad o un riesgo para ellas.

Los resultados indican que el pilar presenta una oportunidad para los países con un tipo impositivo efectivo bajo y un riesgo para los países con un tipo impositivo efectivo alto. Por consiguiente, el hecho de fijar un tipo impositivo del 15 % sobre la renta para las multinacionales no residentes supone una oportunidad para algunos países de África, ya que, para ellos, constituiría una fuente de movilización adicional de los ingresos tributarios. Sin embargo, para que esta reforma represente una oportunidad para África, el tipo impositivo efectivo mínimo debe elevarse al menos hasta el 20 %, tal como ha reivindicado el Foro Africano de Administración Tributaria (FAAT).

La aplicación de un tipo efectivo del 15 % para África en su conjunto conlleva el riesgo de que algunos países africanos tengan que reducir su tipo impositivo efectivo. Esto supondría una pérdida de ingresos para dichos países africanos. Dado que la mayoría de los países de las jurisdicciones africanas tiene tipos impositivos efectivos y tipos impositivos sobre la renta de las sociedades superiores al 20 %, por encima del tipo efectivo medio establecido, las multinacionales tratarían de trasladar sus beneficios a los países con la fiscalidad más ventajosa. Esto podría dar lugar a un traslado de los beneficios a otras jurisdicciones.

Introduction

Base Erosion and Profit Shifting (BEPS) by multinationals are topics that have featured prominently in the international tax debate in recent years. Multinationals, are for the most part subject to the taxation of their country of establishment. However, multinationals that engage in tax avoidance do not hesitate to adjust their transfer prices and undertake other practices to move their profits to the countries where the tax system is most advantageous.

The Pillar Two solution from the Organisation for Economic Co-operation and Development's (OECD) Inclusive Framework aims to provide a comprehensive response to this issue by ensuring that large multinational enterprises pay a minimum level of tax on their profits. Tax revenue corresponding to the difference between the amount of tax actually paid by multinationals and the 15% rate is expected to raise about $150 billion in additional global tax revenue each year in accordance to the OECD's Inclusive Framework (2021)[1]. This is a measure to make the international tax system fair.

The reform proposed by the OECD on the taxation of the income of large non-resident multinationals in Africa is causing a stir among African tax administrations. It is therefore appropriate to assess the feasibility and conditions of implementation of the said reform. For this purpose, a study must be carried out in order to highlight the advantages or the risk that it constitutes for Africa.

The objective of this study is to analyze, through the macroeconomic data available on multinationals operating in Africa, the effects to be expected by the various jurisdictions of the new taxation. This paper is divided into five parts. The first part provides the background to the study, the second part presents Pillar Two, the third part presents the source of the data and its processing, the fourth part presents the results, and the last part presents the outlook for African countries.

Background

BEPS has always been a crucial issue between States. Thus, the OECD, which in 2013 defined 15 action plans and adopted them in 2015, aims to find a solution to this problem. The implementation of Action 11 of BEPS seeks to facilitate the analysis of corporate taxation and the phenomenon of BEPS.

According to the OECD, BEPS is the definition of plans and strategies to take advantage of loopholes and mismatches in international tax regulations to artificially shift profits from multinational enterprises to a location where economic activity is not widespread (Vasudevan, 2021)[2].

On October 8, 2021 the members of the OECD/Group of Twenty (G20) Inclusive Framework on BEPS adopted the declaration on the tax challenges posed by the digitization of the economy. This solution comprises of two pillars. Pillar One redistributes profits to market jurisdictions while Pillar Two ensures that the large multinational enterprises pay a minimum tax rate of 15% in the jurisdiction where it operates (OECD, 2021a)[3]. It aims to regulate competition in the taxation of profits of multinational enterprises by setting a minimum tax rate for countries to protect their tax base.

Pillar Two

Pillar Two addresses BEPS issues and focuses on measures to achieve a minimum effective tax rate. A minimum rate of 15% was agreed upon. This new minimum tax rate will be applied to companies or groups of companies with an annual turnover of at least 750 million euros and will cover a total number of 8,000 to 9,000 entities worldwide according to the OECD estimations[4].

Composition of Pillar Two

Pillar Two is composed of the following elements:

Two global measures to combat base erosion. These are:

- The Global Anti Base Erosion (GLoBE) rules, which consist of:

(i) an Income Inclusion Rule (IIR), which subjects a parent entity to an additional tax on the low-taxed income of its component constituent entity

(ii) an Under-Taxed Payments Rule (UTPR), which denies deductibility or requires an equivalent adjustment where a constituent entity's low-taxed income is not subject to tax under an the Income Inclusion Rule (IIR); and

- The Subject to Tax Rule (STTR) which is a treaty-based rule that gives source jurisdictions a limited right to tax certain related party payments taxed at a rate below 9%. The Subject to Tax Rule will count as a covered tax for the BEPS rules.

As per the OECD Inclusive Framework, the BEPS rules will have the status of a common approach. As noted, multinational enterprises to which the BEPS rules of Pillar Two will apply are those with at least 750 million euros of turnover. Countries are given the flexibility to subject Ultimate Parent Entities (UPEs) to the Income Inclusion Rule even if the recommended turnover threshold is not met. However, public entities, international organizations, non-profit organizations, pension funds or investment funds that are UPEs of a MNE Group or any holding structure used by such entities, organizations or funds are not subject to the GloBE rules. The minimum tax rate used for purposes of the GloBE Rules will be 15% (OECD, 2021b)[5].

Exceptions have been made to the BEPS rules with respect to the substance criteria. Any amount of income representing 5% of the net value of tangible assets and payroll will be excluded. For the 10-year transitional period, an exemption of 8% of tangible net worth and 10% of payroll, applying an annual reduction of 0.2 percentage points, will be allowed for the first five years, and 0.4 percentage points for tangible assets and 0.8 percentage points for payroll for the last five years. An exclusion is also provided for multinational enterprises in jurisdictions with revenues of less than €10 million and profits of less than €1 million (OECD, 2021b)[6].

The application of the BEPS rules will allow countries to levy an additional tax based on the effective tax rate criterion that will be calculated jurisdiction by jurisdiction. The effective tax rate will be calculated as the ratio of total tax paid to accounting income (OECD/G20, 2021b)[7]. According to Vasudevan (2021) any discrepancy between financial activities and actual economic activities in a country can be considered as indicative of BEPS practices.

Implementation

Pillar Two is expected to be transposed into law in 2022, for effective entry into force in 2023, with the UTPR taking effect in 2024[8].

A multilateral instrument will be developed to facilitate the rapid and consistent implementation of the STTR in the relevant bilateral treaties; an implementation framework will be defined to facilitate the coordinated deployment of the GloBE rules, covering the administrative procedures adopted (detailed reporting requirements, multilateral review mechanisms, etc) and the protection regimes adopted to facilitate compliance by multinational enterprises, and their management by the tax authorities. The GloBE rules set out the method for calculating the tax base in detail. They are expected to take effect in 2023.

Data Source and Processing

The data used in this study are derived from jurisdictional aggregates, particularly with respect to the effective tax rate. According to the OECD Inclusive Framework (2021), the minimum tax rate is used for the purposes of the IIR and the UTPR. It must be at least 15%. The GloBE rules will allow for an additional tax to be levied based on an effective tax rate test calculated on a jurisdiction-by-jurisdiction basis, using a common definition of covered taxes and a tax base determined by reference to accounting income (with adjustments for Pillar Two tax policy objectives and mechanisms to address timing differences)[9].

In this study we will also use the effective tax rate and the statutory corporate tax rate because of the lack of data on sales and accounting income as the tax base for African jurisdictions.

This leads us to focus our analysis on these different tax rates. Statutory corporate income tax rates are the nominal tax rates to which companies are subject and allow for comparisons across countries and over time of the tax regimes that normally apply to them[10].

The Average Effective Tax Rate (AETR) measures the average tax that a company pays on an investment project that generates positive economic profits. It is defined as the difference between pre- and post-tax economic profits, relative to the net present value of pre-tax earnings, less actual economic depreciation[11].

It is calculated using the following formula:

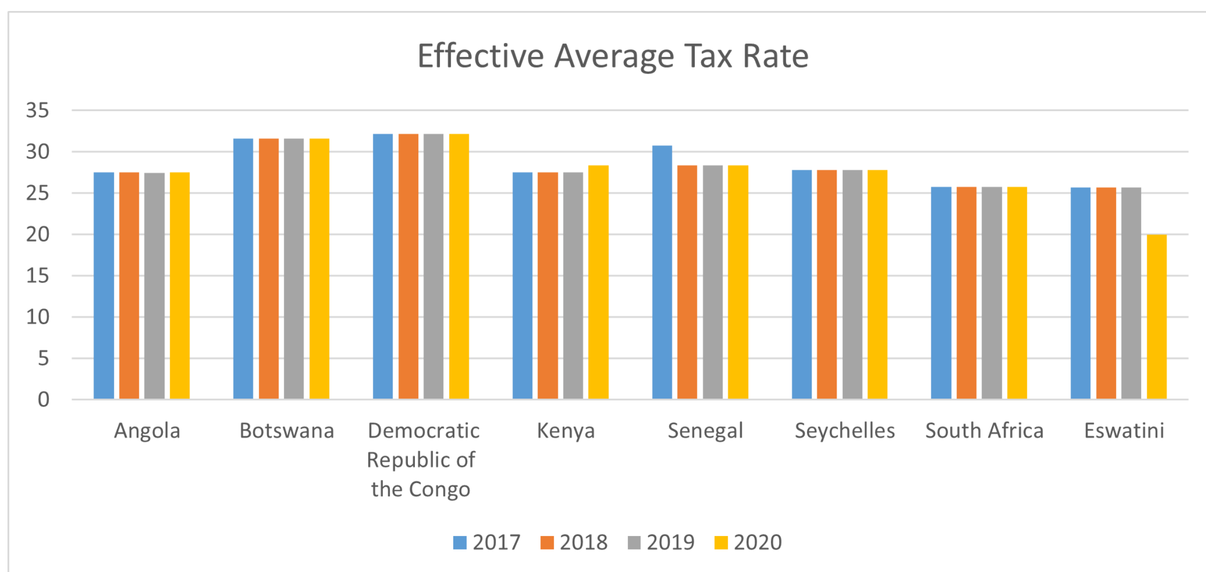
$$AETR = ((Economic\ Profit\ NPV\ before\ Tax) - \frac{(Economic\ Profit\ NPV\ after\ tax)}{(Net\ Profit\ NPV\ before\ tax)}$$

With NPV= Net Present Value

When considering the effective tax rate, the statutory tax rate on corporate income, data are not available for all countries in the African jurisdiction. The data used for the effective tax rate cover the years 2017 to 2020 and 2016 to 2021 for the statutory tax rate on corporate income. This analysis took into account available aggregate data for selected African countries. Of the 54 countries in Africa, only 8 countries have their aggregate data available on the effective tax rate and 15 countries for the statutory corporate income tax rate published by the OECD.

The results of the processed data will be presented using graphical analysis to show the situation of the countries in Africa and to show what the countries in Africa would gain or risk from the implementation of Pillar Two. However, a difference between the effective tax rate on a country-by-country basis and the OECD average could be an indicator of BEPS practices at the country level. Thus, multinational companies will be tempted to transfer their profits to entities located in jurisdictions where the tax rate is close to the OECD average.

Figure 1: Effective Average Tax Rate



Source : https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT#

Reporting of Results

The presentation of results focuses on the effective tax rate and the statutory tax rate on corporate income for those African countries for which data are available.

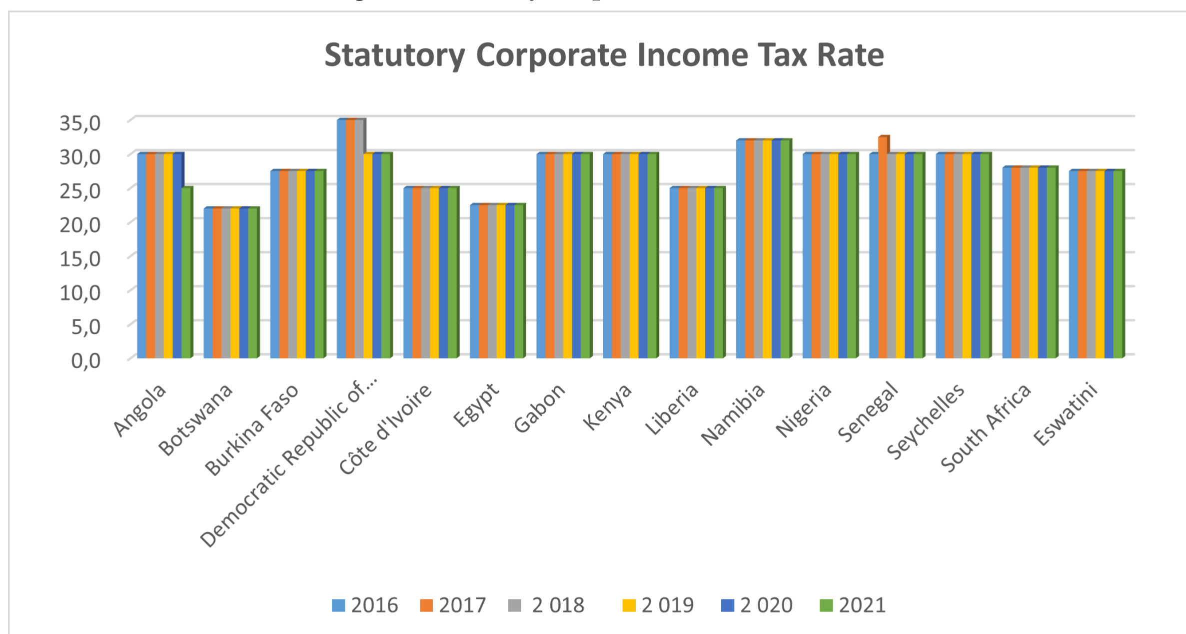
Analysis of Figure 1 shows that the average effective tax rate for these countries ranges from 20 to 32.2 percent over the period 2017 to 2020. The average effective tax rate for these countries has not changed for most except for Kenya, which increased from 27.5 percent in 2017 to 28.4 percent in 2020, for Senegal, which decreased from 30.8 percent in 2017 to 28.4 percent in 2020, and Eswatini, which also decreased from 25.7 percent in 2017 to 20 percent in 2020.

The analysis in Figure 2 shows that the statutory corporate tax rate for the selected countries is between 22 percent and 35 percent from 2016 to 2020. In 2021, this rate fell slightly to between 22 and 32 percent. Over the period 2016-2021, Botswana has the lowest statutory corporate income tax rate of 22 points, while Namibia has the highest rate of 32 percent. Angola and the Democratic Republic of Congo saw a 5 percentage point drop in the statutory tax rate from 2016 to 2021, from 30 to 25 percent and 35 percent to 30 percent, respectively. While it remained unchanged for most countries over the same period.

Prospects for African States

The results reveal that this new taxation system presents an advantage for the countries of residence. This is be-

Figure 2: Statutory Corporate Income Tax Rate



Source : https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT#

cause the taxation of the incomes of the non-resident multinationals will allow these countries, if this reform were to be applied, to have an additional tax resource. However, the question relating to the application of the new system of taxation of multinationals, in particular the effective tax rate and the threshold remains to be studied in depth.

In view of all these results, we see that the implementation of Pillar Two could be an opportunity for African states. For it constitutes a tax niche that would grant additional resources to these countries. The tax rate on the revenues of non-resident multinational companies set at 15% by the OECD is a good initiative for African states and would fill this gap. However, when we look closely at the effective tax rates and the statutory tax rate of African countries, we see that they are all above the average proposed by the OECD.

In order for African countries to benefit from this reform, they must advocate and lobby to raise the level of this rate to 20% as was stated at the last African Tax Administration Forum conference on July 1, 2021[12]. This is in order to be closer to the minimum floor rate of the effective tax rate and the statutory tax rate of African countries and to limit BEPS practices. Otherwise, African countries with an effective tax rate higher than the OECD indicative rate will find themselves obliged to reduce their effective rate in order to avoid profit shifting.

For African countries to fully benefit from this reform, they will have to reform their tax legislation by taking into account the new data related to the digital economy in order to fill the legal gap that exists for this purpose: to find a way to capture the financial flows of non-resident multinational companies in order to tax them. African countries must also sign partnership agreements with each other for information sharing. Similarly, there must be collaboration between the central bank of each country and the tax authorities in order to access the financial flows of multinational companies that operate without being established locally.

Conclusion

This study reveals that BEPS practices could be limited or avoided if all African countries were to implement the Pillar Two recommendations in terms of respecting the average tax rate set. However, given that the effective tax rate of the countries studied is between 20-35%, the average rate proposed by the OECD should be reviewed.

It should also be noted that the tax rate is not the only way to attract a foreign investor as investment flows are determined by a multiplicity of other factors.

This study used data from a small number of African countries. Access to information from other countries would allow a broader analysis for many other states of the African continent.

Endnotes:

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[6] See https://www.oecd.org/fr/fiscalite/beps/declaration-sur-une-solution-reposant-sur-deux-piliers-pour-resoudre-les-defis-fiscaux-souleves-par-la-numerisation-de-l-economie-octobre-2021.pdf.

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