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The GloBE Rules: Challenges for Developing Countries and Smart Policy Options to Protect Their Tax Base

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Abstract

The OECD global minimum tax of 15%, known as the Global Anti-Base Erosion (GloBE) Rules, have meant that developing countries need to consider what policy responses to take to ensure they collect the minimum tax and not cede it to developed countries. One option being promoted by the OECD is the "Qualified Domestic Minimum Top Up Tax" (QDMTT), with the claim that it will help developing countries collect the minimum tax of 15%. This Policy Brief points out that under the QDMTT MNEs can still pay zero taxes, it does not guarantee tax collection, it is complex to administer, it curtails national sovereignty in the form of the "peer review" mechanism and it is relevant mainly for tax havens which are destinations of profit shifting. The Brief then outlines policy options relevant for developing countries, namely Alternative Minimum Taxes (AMTs) and reform of tax incentives.

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L'impôt minimum mondial de 15 % adopté sous l'égide de l'OCDE et connu sous le nom de règles globales de lutte contre l'érosion de la base d'imposition (GloBE) a eu pour conséquence d'inciter les pays en développement à réfléchir aux mesures politiques à prendre pour s'assurer de percevoir cet impôt minimum et à ne pas le céder aux pays développés. L'une des options promues par l'OCDE réside dans l'imposition d'un « impôt minimal sur le plan national » (Qualified Domestic Minimum Top Up Tax ou QDMTT*) censé leur permettre de percevoir l'impôt minimum de 15 %. Comme le montre le présent rapport sur les politiques, la mise en œuvre de cet impôt ne signifie pas pour autant qu'il sera acquitté par les multinationales, qui pourront continuer d'y échapper. Il n'existe par ailleurs aucune garantie qu'il pourra être recouvré tant il est complexe à administrer. Enfin, il contribue, par un mécanisme de « révision par les pairs » à remettre en cause la souveraineté nationale et revêt un intérêt avant tout pour les paradis fiscaux, principales destinations du transfert de bénéfices. Le rapport présente les options politiques ouvertes aux pays en développement, à savoir l'impôt minimum de remplacement (IMR) et une réforme des mécanismes d'incitation fiscale.*

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El tipo impositivo mínimo mundial del 15 % que plantea la OCDE, conocido como reglas GloBE (acrónimo de Global Anti-Base Erosion), ha conllevado que los países en desarrollo tengan que examinar las medidas en materia de políticas que deben adoptar para asegurarse de recaudar el tipo impositivo mínimo y no cederlo a los países desarrollados. Una opción que promueve la OCDE es el "impuesto complementario mínimo nacional admisible", al reivindicar que ayudará a los países en desarrollo a recaudar el tipo impositivo mínimo del 15 %. En este informe sobre políticas se señala que las empresas multinacionales seguirán pagando cero impuestos con el impuesto complementario mínimo nacional admisible, un tributo que además no garantiza la recaudación de impuestos, es complejo de administrar, limita la soberanía nacional en forma del mecanismo de "revisión por pares" y es relevante principalmente para los paraísos fiscales a los que se destina el traslado de beneficios. En el presente informe también se exponen otras posibilidades en materia de políticas que son de interés para los países en desarrollo, a saber, los impuestos mínimos alternativos y la reforma de los incentivos fiscales.

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1.0 Introduction

As several jurisdictions move to adopt the Global Anti-Base Erosion (GloBE) rules, the benefit of limiting tax competition and the expectation that such rules created to boost extra revenue across the world cannot be over-emphasized. However, it has become imperative to note that the rules, by design, will impact on countries differently depending on whether a country is developed or developing, a source or resident jurisdiction.

While the developed countries, where most of the parent entities of the in-scope Multinational Enterprises (MNEs)[1] are resident enjoy the benefits of the Income Inclusion Rule (IIR) which is the key rule, the developing countries can only hope to benefit via the Under-Taxed Profit Rule (UTPR) which serves as a backstop to the IIR and only applies where, for any reason, the IIR fails to apply. It has been claimed that the Qualified Domestic Top-Up Tax (QDMTT) could benefit developing countries, but the rule has been criticized as primarily benefiting the intermediate jurisdictions.[2] In any case, the QDMTT only applies to excess profits attributed to a country by the MNE under the existing international tax rules, after a substance-based carve out. Also, for QDMTT to apply, the domestic legislation seeking to implement same must have been put through a rigorous peer review process at the Inclusive Framework (IF).

The implementation of the GloBE rules would do nothing to prevent profit shifting out of source countries, and as such cannot be relied on by developing countries to stop base erosion. Instead, such countries should adopt more appropriate policy choices to protect their tax base. The choices of which policy option a country takes with respect to the GloBE rules should be critically reviewed by each country to ensure that such option is best aligned to their economic interest.

This policy brief seeks to highlight the implications of these rules and their pitfalls for developing countries, and outline smart policy options that may be quickly adopted by such countries given that "do nothing" is not a viable option for developing economies.

2.0 The General Principles

The GloBE seeks to ensure that MNEs that have global turnover of €750 million and above are taxed at an effective rate of 15% in each country where they attribute profits under current international tax rules.[3] The rationale is to address unhealthy tax competition by limiting the ability of MNEs to shift profits so they are taxed at a low rate in jurisdictions where they have no economic substance (employees or physical assets). The aim of the GloBE is to reduce the competition between countries to reduce their tax rate on corporate profits, particularly for large MNEs.[4] The rules are developed as a common approach. This means that countries, including the members of the IF, are not compulsively mandated to adopt the rules, but if they opt to do so they equally commit to accept their adoption by others and to comply with the agreed framework. Additionally, IF members also commit to respect the adoption of the GloBE rules by other countries even when the relevant member did not adopt the rules by itself.

The GloBE operates by allocating rights to countries to apply a top-up tax on profits that are taxed below the minimum effective tax rate (ETR) of 15% in the country where those profits are attributed under current international tax rules. There are three interacting rights. The country of residence of the ultimate parent entity (UPE) of an MNE corporate group (the MNE's home country) can apply the IIR to levy the top-up tax. This has priority over the right of the country in which the income is derived (the source, or MNE host country) to apply the UTPR.

However, a right has also been given to countries where profits have been attributed that are taxed below the minimum ETR to apply a qualified domestic top-up tax (QDMTT). The IIR and the UTPR allow a top-up tax on profits that have been shifted *to other countries*, to deter profit shifting *to them*. However, the QDMTT applies to profits that have been attributed to that country and *could in any case have been taxed there*. This will mainly benefit the countries that act as conduits, offering low tax rates to encourage profits to be shifted there. Nevertheless, the QDMTT has been given priority over both the IIR and the UTPR.

Most developing countries are only hosts to foreign-owned MNEs, so they must try to tax their profits at source, if they are earned in that country. They are main targets for the techniques used by MNEs to shift profits out, and attribute them to low-tax jurisdictions. MNEs can also defer taxation on these low-taxed profits by its home country as long as they are not repatriated there. The GloBE allocates the rights to tax these undertaxed profits according to its priority rules. **In terms of fairness the right of priority should go first to the country where they are earned, second to the home country, and third to any intermediate jurisdiction.** However, the GloBE's priority rules are the reverse. The country where profits are earned comes last, the home country next-last, and the *de facto* first priority is given to countries that offer low tax rates to encourage profits to be shifted to intermediary entities.

The rules kick in once the income attributed to a group's entities within a country is subject to a combined effective tax rate below 15%. Effective tax rate is calculated on a jurisdictional basis and is determined by dividing adjusted covered taxes of all the constituent entities of the MNE with the net GloBE income of the MNE within the jurisdiction. Covered taxes are generally direct taxes on income or profits. They include taxes on distributed profits and deemed profit distributions, taxes imposed in lieu of a Corporate Income Tax (CIT), taxes on retained earnings and corporate equity. The adjusted covered taxes of all the Constituent Entities in a jurisdiction are divided by the net GloBE income in that jurisdiction to determine the effective tax rate (ETR). The difference between the mini-

mum rate and the ETR is the top-up tax percentage to be applied to the Excess Profit in the jurisdiction to determine the top-up tax in that jurisdiction. The Excess Profit is the net GloBE income reduced by a formulaic substance based income exclusion.[5] The Top-Up tax for a jurisdiction is the top-up tax percentage multiplied by the Excess Profit, but minus any Domestic Top-Up Tax (DMTT). Hence, any DMTT directly reduces the amount of top-up tax that would otherwise be applicable under an IIR or a UTPR.

The rule priority determines which country has the prerogative to top-up the tax payable to ensure the minimum ETR. Countries applying a QDMTT are jurisdictions that apply an effective tax rate below 15% to profits reported there, due to tax incentives or preferential tax regimes. Incentives on profits where there are real economic activities (physical assets and employees) are protected by the substance-based income exclusion. Hence, any additional low-taxed profits declared in that jurisdiction are excess profits that have likely been shifted there from other countries, and would be subject to a top-up tax under the GloBE rules. By applying a QDMTT, that country can ensure that it collects the top-up tax instead of other countries, but only from MNEs in scope of the GloBE.

For any remaining top-up tax that may be payable (where QDMTT is inapplicable) the prior right is for the MNE's home country, which can apply the IIR, by including top-up tax due from Constituent Entities in the tax payable by their Parent. If the country of residence of the ultimate parent entity does not apply an IIR, that right devolves to the countries of residence of any intermediate parent entity. Only where the intermediate jurisdictions and the jurisdictions of the UPE have no qualifying rules is the MNE host country allowed to adjust the taxable profits of taxable affiliates in that country to collect the top-up tax, via the UTPR. Where there are more than one qualifying jurisdictions, the top-up tax is shared amongst the jurisdictions using substance-based allocation keys.

3.0 The Concerns for the Developing Countries about the GloBE Rules

The move to stop the race to the bottom may benefit developing countries by (i) reducing the pressure on them to offer tax incentives to attract inward investment, and (ii) encouraging behavioural changes to reduce shifting of excess profits by MNEs into low-tax jurisdictions. However, the design of the GloBE Rules itself makes it unsuitable for most developing countries. The issues range from general to specific.

A. General Issues with the GloBE Rules

I. Scope

The Rules only apply to MNEs with at least €750 Million in global turnover. This quantitative limit will exclude many MNEs that have a significant presence in small economies. They also exempt constituent entities if the aggregate GloBE income is less than €1 million and revenue less than €10 million in the country concerned.[6] There are also many specific exemptions, including Governmental Entities, International Organisations, Non-profit Organisations, Pension Funds, and Ultimate Parent Entities that are Investment Funds or Real Estate Investment Vehicles.[7] The Rules also carve out international shipping income from the GloBE tax base.[8] This exclusion is at odds with the underlying principles of the GloBE, given that income from international shipping is often undertaxed in the countries in which it is taxable, mostly high-income countries.

These exemptions and exclusions have a combined impact of cutting down on the GloBE tax base and minimising revenue collectible under the rules. They also create a dual regime where different rules may apply to MNEs, some in the same industry.[9] This provides a potential significant challenge for the developing economies, with limitations in capacity and personnel, to handle the arbitrage that may result from this dual regime.

Concerns have also been expressed that given the nature and ability of the MNEs to design corporate structures to reduce tax, the scope exceptions may provide incentives or opportunity to restructure the group to avoid the effects of the minimum tax for competitive advantage.[10]

II. Complexities of the Rules and Implementation Challenges

The GloBE comprises 72 pages of model rules, plus over 200 pages of Commentary, a 76-page Guidance on the GloBE Information Return, a 91-page Administrative Guidance, and several safe harbour rules. All of these are highly technical and difficult to understand, even for experts. For jurisdictions wishing to implement a Qualifying DMTT, there is also the additional burden of crafting detailed domestic rules which may also run into many pages.[11] The rules will also be under continuing development due to clarifications in the Guidance and Commentary and perhaps revisions with the potential to bring more complexities and additional volume.

The Rules are not implemented through a tax treaty. Hence, implementation requires suitable legislation in the domestic legal framework of an implementing jurisdiction. This could be done in either of two ways: one, by simply enacting the Model Rules as drafted by the the Organisation for Economic Co-operation and Development (OECD), or alternatively, by drafting domestic rules that comply with the Model Rules. Either way, implementation in domestic legislation level would pose a significant challenge to developing economies.

Structurally, the nature of the rules makes it difficult for them to be included into the existing legal framework of many countries by way of amendment. Enactment also raises a lot of issues. In effect, legislators would be expected to enact into law, provisions that they hardly understand, and also ensure that they are fully consistent with the model rules. In view of the complex nature of the rules and the low capacities in some developing countries,

it is doubtful whether such countries will truly benefit from the process.

Furthermore, for such complex rules, implementation and compliance will always be difficult. This will impose a high cost of implementation, particularly on the tax administration. The dual regime introduced by the rules also means that all MNEs will no longer be taxed in a consistent way. This makes a very strong case for developing jurisdictions to go for simpler but effective alternatives where possible.

III. The Minimal Revenue Returns

The GloBE gives first priority to countries where the MNE attributes excess profits under current rules, to apply a QDMTT to collect the top-up tax. The next priority is for the MNE home country (the country of residence of the ultimate or intermediate parent entity) to apply the top-up tax to excess profits taxed below the minimum ETR, under the IIR. Only if neither a QDMTT nor IIR is in force can the source country apply the UTPR to adjust the taxable profits of any in-scope MNE affiliates resident and taxable in that country. The UTPR is designed as a backstop, to ensure that the income is taxed at an effective rate of 15% even where the UPE and the intermediate jurisdictions have failed to implement an IIR.

Very few MNEs have a parent resident in a developing jurisdiction: only 11 countries classified by the United Nations (UN) as developing are resident countries for parents of in-scope MNEs, and these are all upper-middle income countries (such as Brazil, China, India and South Africa), and no least-developed country is included.[12] The vast majority of low- and middle-income countries are only hosts to foreign-based MNEs.

A recent study estimates the global additional revenue potential gains of the GloBE rules at between $68 billion and $105 billion. This is based on the assumption that the United States continues to apply the current version of its Global Intangible Low-Taxed Income (GILTI); if it were revised to align with the GloBE, the revenue gains would increase by 75%. The study concludes: "In the likely scenario that no-tax and low-tax jurisdictions implement QDMTTs to capture the additional revenue domestically, investment hubs would retain $95 billion or 89 percent of total revenue gains. High income countries would attract nine percent of the total revenue increase whereas middle income and low-income countries would gain almost nothing from the reform".[13]

The revenue impact of the rules therefore makes a case for the developing economies to be innovative about other alternatives through which they may raise more revenue for the development of their people and economy.

These minimal revenue returns may also make it more difficult for developing economies to convince their legislators to invest time and resources in enacting the qualifying rules.

B. Specific Issues with the GloBE Rules and QDMTT

I. The Issues with the QDMTT

In addition to the two main rules of the GloBE, an option has been included for countries to apply a domestic top-up tax which, if it complies with the model rules can be treated as a QDMTT. Some have argued that this can be beneficial for developing countries. The advantage of the QDMTT is that it takes up the top-up tax that would otherwise be payable either to the home country (under the IIR) or the host country (under the UTPR). On the surface, this seems attractive. However, on closer examination, it becomes clear that the DMTT does not benefit source countries, where MNEs generally declare low levels of income, but jurisdictions where MNEs report substantial excess profits.

The QDMTT will only result in tax collection if the MNE actually declares substantial profits in the source jurisdiction in excess of the profits which are already exempt under the substance-based carve-out. If it does not, and shifts profits out through tax avoidance techniques, then there will be no tax to collect even under a QDMTT. It is somewhat misleading to call it a "minimum tax" which gives the impression there is a guarantee of tax collection, which is not true.

Furthermore, the QDMTT allows only a top-up tax to bring the ETR in that country of MNEs in scope of the GloBE up to the minimum of 15%. Hence, the QDMTT essentially benefits jurisdictions which offer tax rates below 15% to attract MNEs to declare excess profits in that country. These are 'investment hubs', intermediary jurisdictions that act as conduits for profits shifted out of source countries. These are the jurisdictions that will be the main beneficiaries, receiving an estimated 89% of the top-up tax under the current GloBE rules, as mentioned above.

Also, jurisdictions implementing a QDMTT must do so in a manner that is consistent with the prescribed model and produces comparable outcome as the GloBE rules. Only after passing a peer review process, at the IF, would the rules be deemed "qualified". This begs the question as to how non-IF members could implement the rules.

In any case, proponents have adduced several reasons as justification for having QDMTT. Some of the QDMTT justification and a critical analysis thereof are hereby outlined.

QDMTT and the Prior Right of Tax by Source Jurisdictions

It has been claimed that QDMTT confers a prior right to tax the top-up tax on the source jurisdiction hence it takes precedence over the GloBE rules and ensures that the top-up tax is collected in the source state. While it is true that QDMTT takes precedence over IIR and UTPR in the rule ordering, it should be noted that with or without QDMTT, the source state has the prior right to tax income derived from its jurisdiction. Any tax on corporate income that it applies should be treated as a 'covered tax' under the

GloBE and take precedence over both the QDMTT and the IIR. The GloBE rules, being a secondary taxing right, do not apply where the source state has taxed the income effectively at a minimum of 15% ETR.

In practice, the QDMTT tends to constrain the exercise of the prior right of the source state to tax by unduly dictating the manners in which such rights should be exercised through a rigorous qualifying process. It is far easier for source countries to devise measures that are more suited to their own circumstances, which would be simpler to apply, and can be effective against profit-shifting, which the QDMTT does nothing to prevent.

Many developing countries still suffer from profit-shifting due to weak rules around issues like interest deductibility, artificial avoidance of permanent establishment, and payments to non-residents of royalties and of fees for services, which greatly reduce taxes payable in a jurisdiction. The QDMTT has no effect on any of this. Even OECD countries have enacted their own measures to combat such practices. For example, the United Kingdom intends to continue its diverted profits tax, which aims at artificial avoidance of a permanent establishment. The US' Build Back Better Act, which is an alternative to Pillar 2 equivalent rules, included provisions for limitation of interest deductibility. For domestic subsidiaries of foreign MNEs, the Act limits deductions of net interest expenses to 110 percent of the ratio of the domestic subsidiary's Earnings Before Interest, Tax, Depreciation and Amortization ("EBITDA") to the MNE's EBITDA.[14]

QDMTT and the Race to 15% ETR

The GloBE aims to ensure that the tax imposed in any jurisdiction do not surpass 15% ETR.[15] Hence, the top-up tax under the QDMTT is only the difference between the ETR in that country and 15%. For the QDMTT, that is a maximum, not a minimum. However, source countries remain free to apply whatever rate they choose to profits that they consider to be derived in their jurisdiction. Most developing countries apply standard rates on corporate income of 25%, 30% or higher. The effect of the QDMTT is to encourage countries to offer a rate of no more than 15% on excess profits that are declared in that jurisdiction. This encourages competition to reduce CIT rates, which may mean that the GloBE's 15% minimum becomes a maximum.

QDMTT and the Rules Coordination

It has been posited also that QDMTT is critical because it ensures rules coordination which is required for jurisdictions to apply the rules consistently. However, while rule coordination is necessary for GloBE rules, including the QDMTT, to allocate the top-up tax, the same cannot be said for other taxes on income or profit derived from activities in the jurisdiction. Countries remain free to determine their own rules to tax persons resident or activities taking place in their jurisdiction.

The promotion of the QDMTT may have the effect of discouraging developing countries from implementing measures they may find more suitable for them. These include Alternative Minimum Taxes (AMTs), which are easy to implement, and unlike the QDMTT may be designed to restrict profit-shifting (see further below).

There appears to be some underlying similarity between QDMTT and Amount A and in the rationale for which they have been pushed for adoption; both are meant to stop turnover based taxes, with QDMTT for AMTs and Amount A for Digital Services Taxes (DSTs). Both AMTs and DSTs have much higher revenue potential for developing countries compared to the OECD Two Pillar solutions and are far easier to implement.

QDMTT, Data and the Mirage of Ease of Administration

Developing countries will be encouraged to adopt a QDMTT and join the GloBE scheme, despite its complexity, because of the Inclusive Framework. This is designed to provide some sort of centralised administration, based on MNEs submitting a single GloBE Information Return, which aims to reduce the compliance burden on the MNEs, and may also alleviate the administrative concerns of many countries. However, it will also entail developing countries giving up any control over how this tax is designed, assessed and collected. In effect the GloBE will become a supranational tax administered by the OECD Secretariat and the leading OECD countries' tax administrations.

QDMTT and Creditability of Source Taxes

QDMTT has been praised for ensuring that taxes imposed are recognised and credited by resident countries. The reality of the matter is that even where there is no treaty, the burden of relief of double taxation is always on the state of residence of the MNE parent entity, and the decision of whether to accord a unilateral relief on its MNE or not as well as the consequences is that of the residence state alone. Pillar 2 GloBE rules will be implemented without a treaty. Developing countries should therefore not concern themselves with what is absolutely not within their remit.

In any case, the GloBE rules themselves are clear that any tax that is a tax on income, or one 'in lieu of' a generally applicable income tax, will be treated as a 'covered tax' for the purposes of calculating the ETR.

The Group Level Implementation of QDMTT

The design of QDMTT requires a group level implementation as a result of which the implementing legislation must sanction a tax treatment of an MNE at the group level. Most developing countries tax on entity basis and rarely on group basis. Such tax administrations, particularly small administrations, are therefore likely to face significant challenge in enforcing QDMTT on a jurisdiction basis. This is something most of them have not done before and something they are not required to do if they go for minimum tax with corresponding denial of deduction provisions in their domestic legislation.

4.0 Policy Options for Developing Countries in View of the GloBE Rules

Irrespective of a country's stance towards the Two Pillar solution, including the GloBE rules, it is well within the sovereign right of every jurisdiction to set its domestic tax policies. This will include the right, whether within or outside the context of the Two Pillar solution, to reform the existing legal framework to protect its tax base or increase taxes collectible from domestic or foreign entities doing business within the jurisdiction.

Since the goal of GloBE generally is to mitigate base erosion and profit shifting (BEPS) and specifically to ensure that large multinational groups pay an effective tax rate of 15% everywhere they operate, any form of non-discriminatory domestic reform that produces consistent results should be accepted. A country generally should be at liberty to adopt its own version of domestic tax reforms, according to its own economic realities and domestic policy priorities.

This segment outlines options available for countries in view of the need to have a fiscal policy response to the GloBE implementation.

A. Alternative Minimum Taxes

Alternative Minimum Taxes (AMTs) guarantee that taxable entities meet a minimum tax obligation, irrespective of the deductions and incentives they may utilize. The specific design or implementation of AMTs can vary depending on the objectives of each country. While we do not advocate for AMT threshold at €750 million, the AMTs may be designed to have bigger scope than the GloBE rules but also with some threshold that exempts small and vulnerable businesses from the scope or that has a sector sensitive rate applicable to entities based on their peculiarities and profit margins.

I. AMT Based on Financial Accounts (Book Income)

AMT could be based on Financial Accounts or Book Income. This model has been implemented by some countries, like the United States. The tax is calculated based on the financial accounting rules of the country. This design helps to limit the tax benefits that companies can obtain from tax incentives such as investment allowances or non-refundable tax credits.

Tax preference items which receive favourable treatment under the regular tax system may be subject to adjustments or disallowed under this design of AMT. The aim therefore will include identification of those items within book income and appropriately adjusting or eliminating them. The AMT rate would be determined to ensure that the entities are taxed at either 15% ETR or whatever is the desired level of minimum tax liability for the country concerned. The rate would be applied to the adjusted book income to calculate the minimum tax liability.

Designing an AMT based on book income, for jurisdictions adopting this approach for the first time, may also require compliance and reporting requirements for taxpayers that may be different from the existing requirement. This would involve detailed documentation and disclosure of book income, adjustments, and computations to determine the AMT liability. Clear guidelines and instructions would need to be provided by jurisdictions to ensure accurate reporting and minimize potential disputes. However, jurisdictions that apply International Financial Reporting Standards (IFRS) and require filing of Audited Financial Statement may already have all the information required to administer the rules.

II. AMT Based on Modified Income

Another approach for implementing AMT involves using modified income as the tax base. To arrive at modified income, adjustments would be made to the taxpayer's regular tax return income. These adjustments may include disallowing or limiting certain deductions, exemptions, or credits that are allowed under the regular tax system. The goal is to create a modified income to curtail the advantages that companies can obtain from a range of tax incentives that have been introduced over the years. India adopts this approach by applying a minimum rate to the tax base while restricting deductions. Pakistan, since 2014, levies alternate corporate tax (ACT) as a minimum tax liability on most companies at the rate of 17% or the corporate tax liability determined under the taxing statutes.

III. Based on Turnover and/or Assets

An alternative method of structuring AMT involves utilizing turnover and/or assets as the foundation for computing the minimum tax. Numerous low- and middle-income countries have adopted minimum taxes that rely on gross revenues. This approach is simpler to administer because it blocks the usual base erosion and profit shifting schemes regularly adopted by the MNEs to reduce their taxable income. Its calculation is also easier for both the taxpayer and the tax administration. However, it fails to account for variations in profit margins across sectors or businesses, and it can disproportionately impact small and medium-sized enterprises. Nevertheless, the rules may be scoped to exempt small and medium-sized enterprises or apply differing rates to several sectors.

IV. Domestic Solution for Base Eroding Payment to Low Tax Jurisdictions

Recently, countries like Australia and Ireland have proposed to include a provision in their domestic law that denies deduction for payment made to entities in low tax jurisdictions, such as royalties or fees for services.[16] Belgium employs an anti-base erosion regime since 2010 under which individual payments to low tax jurisdictions need to be declared explicitly, with the deductibility being subject to proof of genuine business purpose and lack of artificial constructions.

Countries could introduce similar provisions in their domestic law which are simple to implement. The term "low tax jurisdictions" could be defined as jurisdictions with less than 15% effective corporate tax rate. Once deduction is denied, the relevant country may apply its do-

mestic CIT rate which, for most developing countries, are historically higher than 15%[17] or such other rate according to their national context.

Such a rule would have similar outcomes as the adoption of the Subject To Tax Rule (STTR), but with a much broader scope of application and without going through the long-drawn process of adopting STTR into a bilateral tax treaty or the STTR Multilateral Instrument. It will also help protect the tax base of the countries not adopting STTR at all. It must be kept in mind that developing countries also have the UN version[18] of the STTR to choose from for incorporating into their bilateral treaties should they decide to use the STTR approach.

B. Tax Incentive Reforms

The GloBE rules will have far reaching implications for the design of tax incentives within the domestic legal framework of many jurisdictions. As explained in section 2, the GloBE rules protect incentives that result in real economic activity in the country, by excluding from the excess profits that can be subject to a top-up tax income that reflects economic substance, defined in terms of a return on physical assets and employee remuneration costs.

For non-compliant tax incentive regimes, the impact of the GloBE is to neutralise the benefit that will otherwise accrue to the relevant MNEs by ensuring that income not taxed as result of the incentive is taxed by the jurisdiction of the Ultimate Parent or an intermediary parent entity of the relevant MNE. Even when an MNE is considered stateless, the rules have detailed provision outlining how the untaxed income would be taxed by some country somehow.

Hence, the impact of the GloBE on a given tax incentive regime depends on both the nature of the incentive and its effects. Incentives that are not explicitly substance-based like tax holidays, very low concessional rates, and zero-rated free-trade zones may not be protected. There is likely to be only limited impact on tax deferrals, investment allowances, longer loss carry forward periods, preferential treatment of long-term capital gains, etc. It is projected to have no impact on substance-based incentives like accelerated depreciation, payroll-based incentives, property tax reductions, exemptions from indirect taxes, etc.

Given that many developing jurisdictions have high headline tax rates but low effective tax rates owing to tax incentive regimes, they are therefore encouraged to utilise this opportunity to overcome political consideration in cutting down on non-substance-based incentives. The existing incentives may be rejigged to focus on regimes that are based on substance as this is likely to attract real investment that provide jobs and also help shore up the economy.

Suffice it to say, that irrespective of other measures a country may take with respect to the GloBE rules, tax incentive reform presents an organic approach to tax base protection and have the potential to yield more revenue than most other approaches. A coordinated approach to dealing with issues around incentives may be required at a regional level, like Africa, Asia or Latin America. This is to avoid another form of undue competition where MNEs that are below the threshold would be incentivised to abandon jurisdictions that have incentive reforms for another that has not. This is more pronounced for jurisdictions in Africa with Free Trade Agreements.

5.0 Conclusion

The GloBE rules disproportionally favour the developed countries, and its implementation has potential negative impact on the tax bases of developing economies as income left untaxed by source jurisdiction up to 15% ETR will be taxed by resident jurisdictions, mostly developed economies. Source jurisdictions, including most countries in the Global South often have high headline tax rates but low ETR owing to tax incentives and unhealthy tax competition. Some rules, including the QDMTT, have been prescribed as panacea for developing countries' GloBE related problems. However, complexities, lack of capacity and outright overreach of some of the rules have been identified in this brief as capable of depriving developing jurisdictions of any benefits from the rules. Tax incentive reforms, AMTs, general corporate income tax reforms along with targeted anti-BEPS measures like denial of deduction of payments to low tax jurisdictions are therefore recommended as smart and more effective policy options for developing countries to protect their tax base and ensure they are not negatively impacted by the implementation of the GloBE rules by developed countries.

Endnotes:

[1] About 90% of the in-scope MNEs are from Organisation for Economic Co-operation and Development (OECD) countries.

[2] The BEPS Monitoring Group, *Taxing Multinationals: the BEPS proposals and alternatives* (2023).

[3] OECD, *Tax Challenges Arising from the Digitalization of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (Paris, OECD Publishing, 2021). Available from https://www.oecd.org/tax/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-782bac33-en.htm.

[4] The so called "race to the bottom" on corporate tax rates.

[5] Substance based carve out, also known as the Substance Based Income Exclusion is comprised of 5% of eligible payroll expenses and 5%of eligible tangible asset value. However, under rules for 'transitional relief' (article 9.2) the payroll carve-out rate begins at 10% and is reduced by 0.2% per year over 10 years, and the asset rate begins at 8% and is similarly reduced progressively over 10 years.

[6] See the *de minimis* exemption under Article 5.5 of the GloBE Model Rules.

[7] For detailed entity exemptions, see Article 1.5 of the OECD, *Tax Challenges Arising from the Digitalization of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (Paris, OECD Publishing, 2021). Available from https://www.oecd.org/tax/tax-challenges-arising-from-digitalisation-of

-the-economy-global-anti-base-erosion-model-rules-pillar-two-782bac33-en.htm.

[8] See Article 3.3 of the OECD, *Tax Challenges Arising from the Digitalization of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (Paris, OECD Publishing, 2021). Available from https://www.oecd.org/tax/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-782bac33-en.htm.

[9] This is the case where an MNE meets the 750 million Euros while another in the same industry is short of such a threshold.

[10] Y. Biondi, "Corporate Control and Exceptions to Minimum Corporate Taxation: A Step Toward Fairness or Financialisation?" (2022).

[11] African Tax Administration Forum (ATAF) suggested approach has 61 sections and over 50 pages.

[12] M. Barake, E. Le Pouhaër, Tax Revenue from Pillar One Amount A: Country-by-Country Estimates (2023).

[13] F. Reitz, "Revenue Effects of the OECD Corporate Tax Reform - An Updated Impact Assessment of Pillar Two", IFF-HSG Working Paper No. 2023-17, July 2023, p. 39. Available from https://ile.unisg.ch/wp-content/uploads/2023/07/17-WP-Reitz.pdf. Even this seems an under-estimate, as it classifies Lichtenstein and Puerto Rico as high income countries, not investment hubs.

[14] Build Back Better Act, H.R. 5376, § 138111(a).

[15] See the ATAF Suggested Approach to Drafting Domestic Minimum Top-Up Tax Legislation at https://events.ataftax.org/index.php?page=documents&func=view&document_id=191 (accessed 30 July 2023).

[16] The Australian proposal is an anti-abuse measure that applies to payments for intangible assets made to group entities located in tax havens. See https://www.grantthornton.com.au/insights/client-alerts/denial-of-tax-deductions-cross-border-payments-for-intangibles/#:~:text=The%20Government%20has%20released%20anti,entities%20in%20low%20tax%20jurisdictions .

[17] See https://www.southcentre.int/tax-cooperation-policy-brief-23-11-february-2022/.

[18] See https://financing.desa.un.org/document/crp12-united-nations-model-double-taxation-convention-sttr-0.

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