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What does the global tax deal mean for lower-income countries?

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Revenue challenges and opportunities in Africa following the COVID-19 pandemic

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In this session

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- 130 countries in G20 / OECD ‘Inclusive Framework’ signed up to global tax reforms
  - ‘Pillar One’ new taxing rights for consumer countries on largest multinational enterprises (MNEs)
  - ‘Pillar Two’ global minimum tax of at least 15%

1. Why was a global deal needed?
2. Will lower-income countries gain from new ‘Pillar One’ taxing rights?
3. How can lower-income countries benefit from the global minimum tax?

- However…
  - Not all details agreed – negotiations will continue this year, then needs legislating
  - Reforms are complex – only covering some elements and only at a high level

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Why was a global deal needed?

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Two reforms to address two problems

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Home country
(High tax)

Parent company

Profits

Intermediate countries
(Low tax or preferential regime)

Intellectual property

Sales and marketing

Finance

Manufacturing

Profits

Consumer countries
(High tax)

Local sales

'Race to the bottom'

'Scale without mass'

- Global minimum tax of at least 15%

- Reallocate some profits of largest MNEs to consumer countries regardless of physical presence

Source: adapted from Addressing the Tax Challenges of the Digital Economy. Action 1: 2015 Final Report. OECD (2015)

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Will lower-income countries gain from Pillar One?

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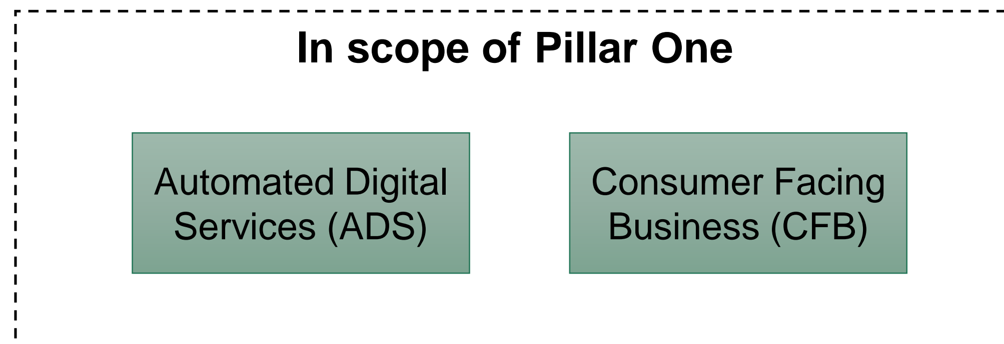
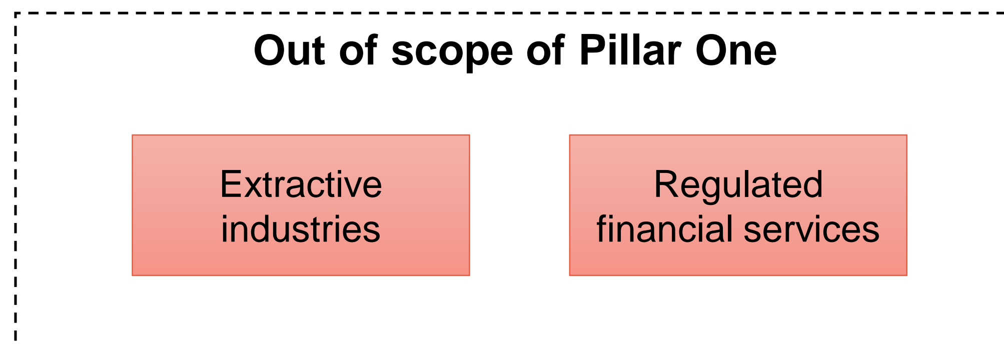
Only applies to some of the largest MNEs

- Only MNEs with global revenues > EUR 20bn (could be reduced to EUR 10bn after 7 years)
- Some MNEs not included because activities are ‘out of scope’



Challenges from digital economy most acute



Excluding extractives benefits lower-income countries that depend on oil and gas or mining revenues

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Global gains modest, but LICs will share

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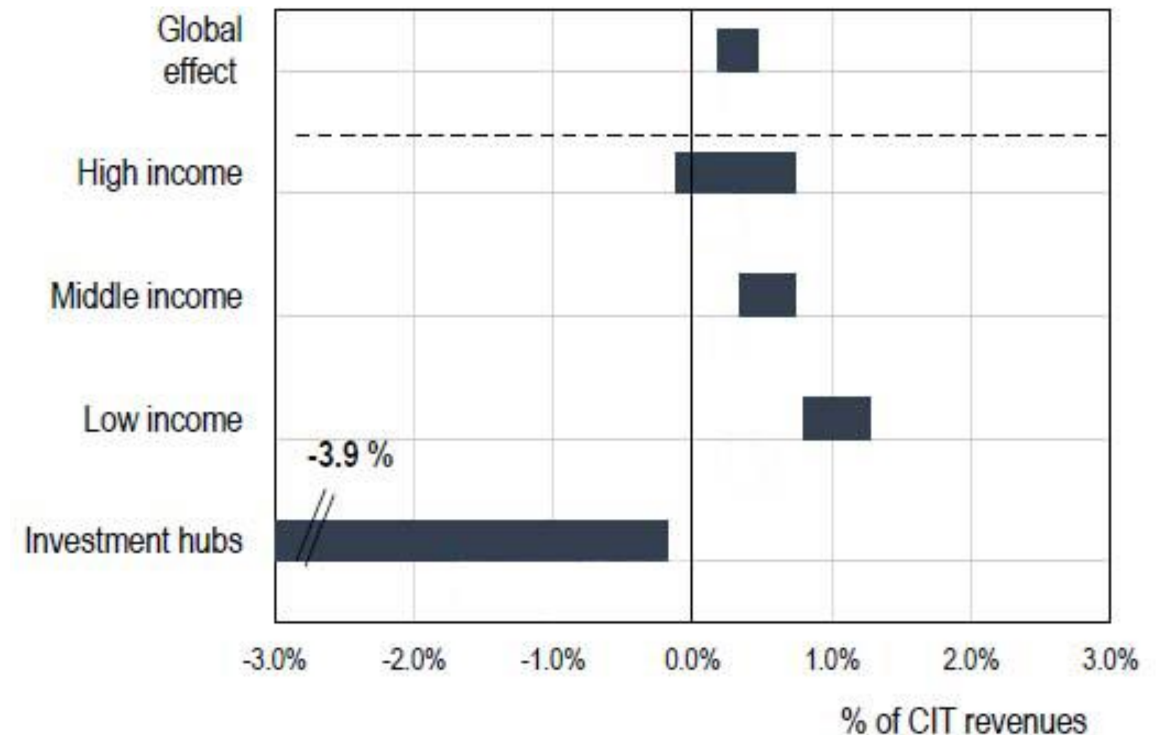
- Global gains modest
  - Only reallocating 20-30% of 'residual profits' above 10% – 'at least $100bn'
  - Increases global CIT revenues by < 1% due to reallocating profits from low-tax investment hubs to higher-tax countries
- Lower-income countries will share in the benefits
  - Special domestic revenue threshold for small countries (EUR 250,000)
  - LICs *could* gain most relative to current CIT revenues

Indicative distributional impacts of Pillar One



Note: assumes EUR 750mn global revenue thresholds and 20% reallocation of residual profits above 10%
Source: Tax Challenges Arising from Digitalisation – Economic Impact Assessment. OECD (2020)

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How can lower-income countries benefit from the global minimum tax?

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First taxing rights assigned to home country

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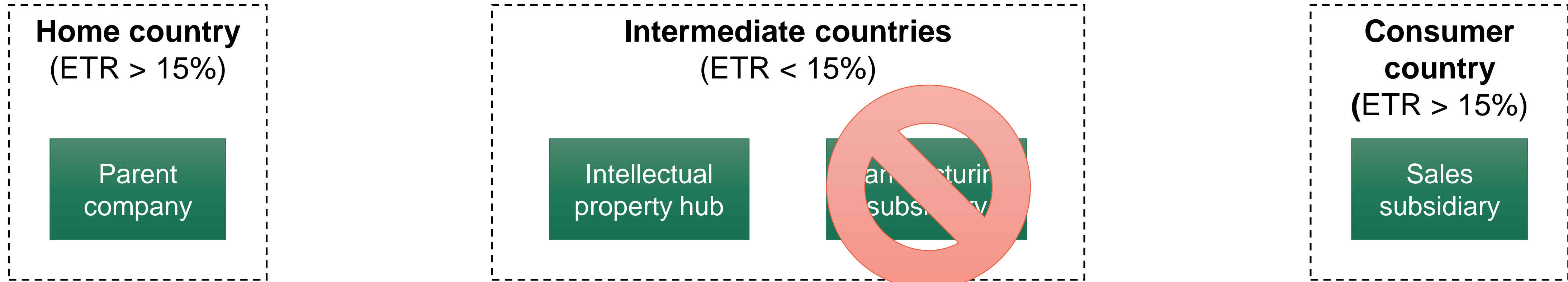
- All MNEs with global revenues > EUR 750 million (c. 8,000 MNEs)



Income inclusion rule (IRR)

- Imposes top-up tax on parent company for undertaxed profits in countries with effective tax rate (ETR) < 15%

Substance-based carve out

- Exclude some income from ETR calculation based on percentage of asset values and payroll costs
- Can result in ETRs < 15% in countries with more economic activity
- Tax competition likely to continue, e.g. for manufacturing

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High-income countries gain the most

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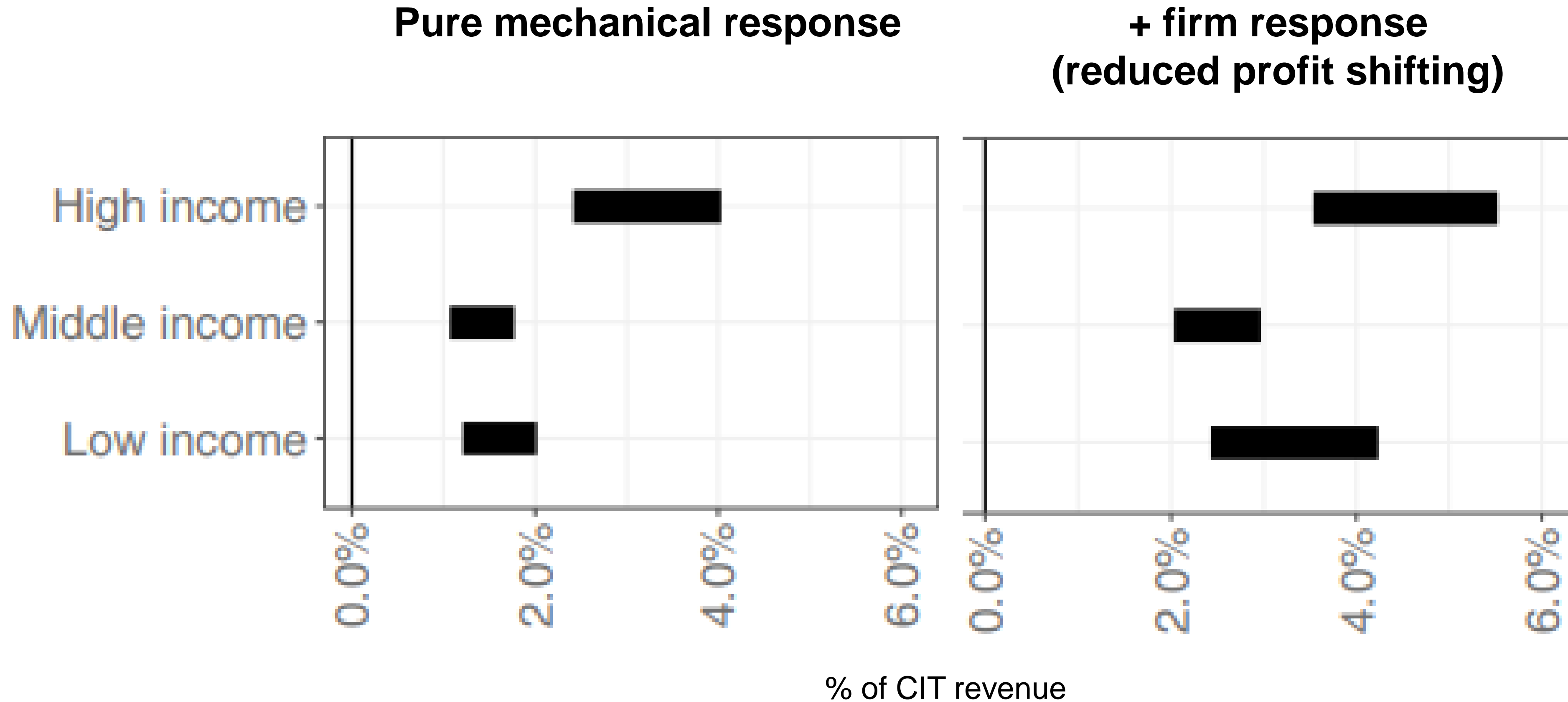

Source: Tax Challenges Arising from Digitalisation – Economic Impact Assessment. OECD (2020)

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Three things lower-income countries can do

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1. Push for higher minimum tax rate
   - Statutory CIT rates in lower-income countries high on average
   - Incentive to shift profits remains
   - Higher minimum rate reduces incentive, but will other countries agree to this?

2. Avoid effective tax rates below global minimum rate in own jurisdiction
   - Transfer of taxing rights from low-income to high-income countries
   - Difficult in practice. Renegotiate tax incentives? Create a domestic minimum tax of 15%?
   - Risk of international arbitration where MNEs have contracts with State

3. Use the new ‘subject to tax rule’ (STTR) to address profit shifting

Use STTR to address profit shifting

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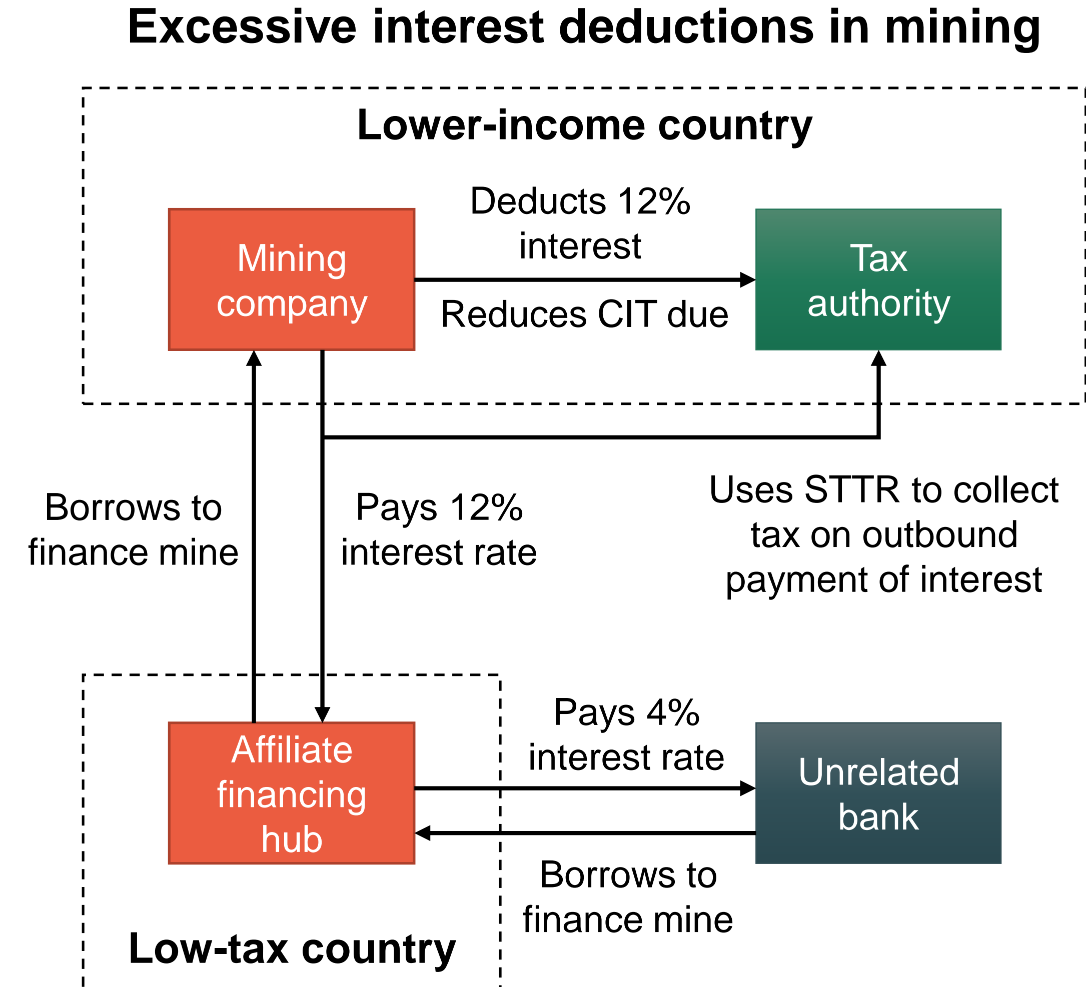
- Subject to tax rule (STTR) allows lower-income country to apply tax on high-risk outbound payments to affiliates in low-tax countries
- Tax rate based on difference between nominal tax rates in two countries up to 9% of payment amount
- Top up to withholding tax therefore requires amendments to bilateral tax treaties to implement
- Global deal includes agreement from countries to amend a treaty if a developing country requests



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Conclusions

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Conclusions

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- Pillar One benefits likely to be small overall but lower-income countries will get a share
- Pillar Two mostly benefits high-income countries, lower-income countries can:
  - Push for a higher minimum rate
  - Avoid taxing below minimum rate
  - Apply the ‘subject to tax rule’
- Reforms are not likely to end all global tax problems
  - Tax competition will continue
  - Lower-income countries will need to continue to build capacity in revenue authorities to address international tax avoidance

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