AFRICAN TAX ADMINISTRATION FORUM
FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

Pillar Two Proposals

Overview of the GloBE proposal

Rationale for pillar 2

- Address remaining Base Erosion and Profit Shifting issues associated with low taxation
- Provide jurisdictions with the ability to "tax back" group profits that are subject to a low effective rate of tax

Key design considerations

- Determine the scope
- Avoid double taxation
- Co-ordination and tax certainty
- Balance between accuracy and simplicity

Income not subject to tax at a minimum rate

- Income inclusion rule
- Subject to tax rule
- Switch-over rule
- Undertaxed payments rule

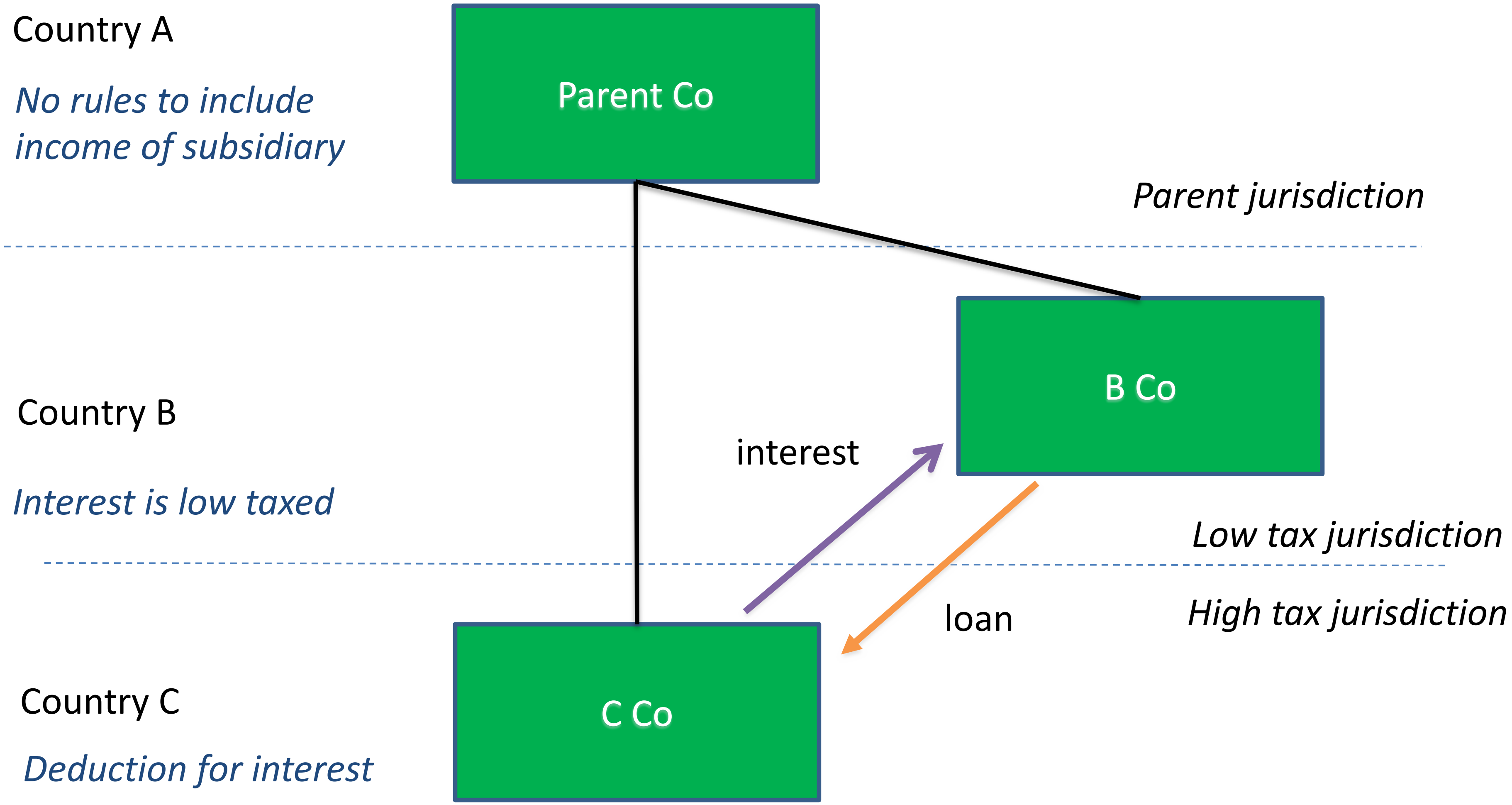
Overview of the GloBE proposal

Income inclusion rule	Tax on base eroding payments	Co-ordination
• Inclusion rule • Switch-over rule	• Undertaxed payments rule • Subject to tax rule	• Rule co-ordination • Simplification • Thresholds • Compatibility with international obligations

Effect of proposal is to reduce the incentive for shifting profits from high to low tax jurisdictions thereby protecting the tax base of both the parent and source jurisdiction

Does not interfere with the right of a jurisdiction to set its own tax rate although it limits the advantage of very low rates

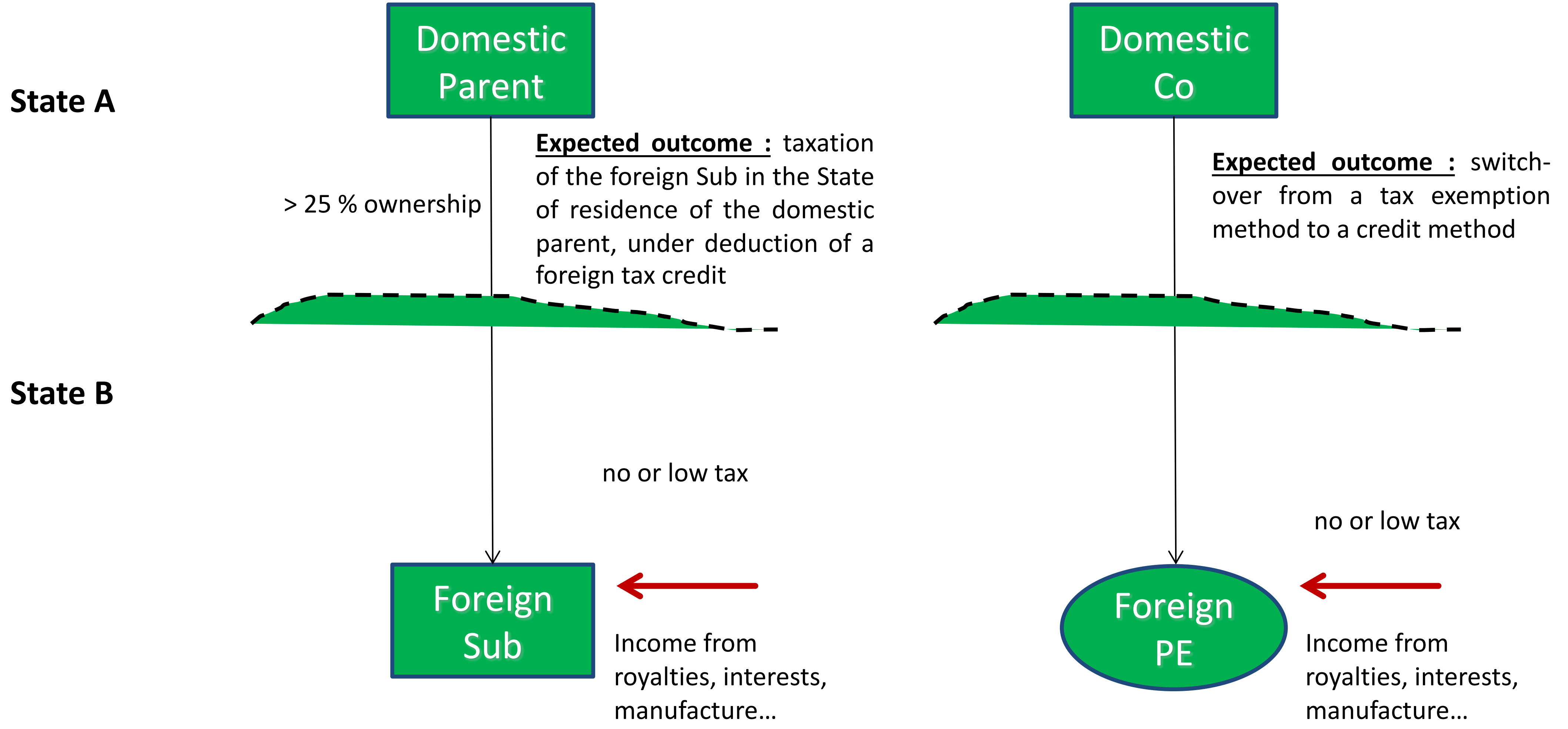
Illustration



Examples for Discussion

Low Taxed Income inclusion rule

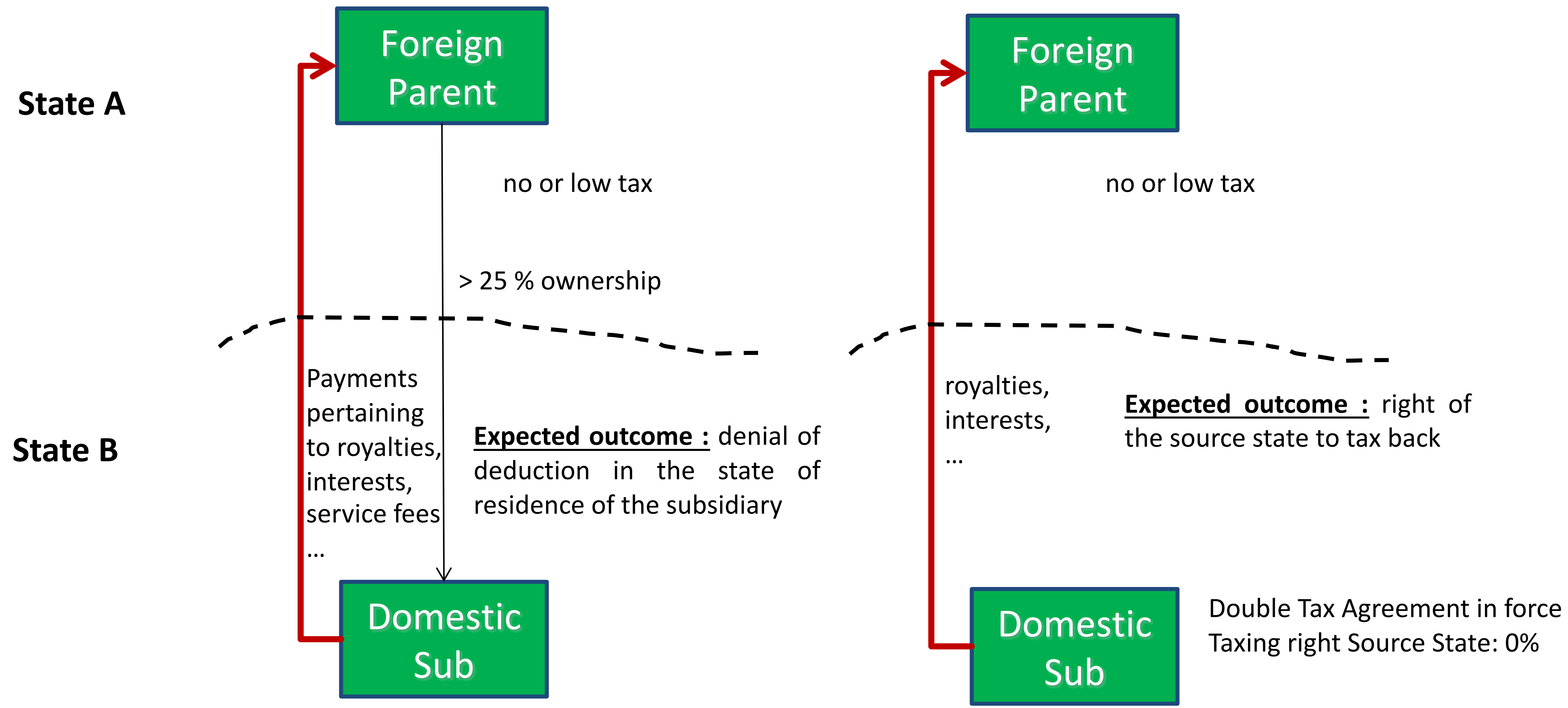
Switch-over rule



Example for Discussion

Undertaxed payments rule

Subject to tax rule



Subject to Tax Rule

- This rule would allow the source jurisdiction to subject a payment to withholding or other taxes at source and/or deny treaty benefits on certain items of income

- Where this payment is not subject to tax at a minimum rate in the other contracting state.

Six possible components of a STT rule

- **Adjusted nominal rate trigger**. The rule is triggered when a payment is subject to a nominal tax rate in the payee jurisdiction that is below the minimum rate, after adjusting for certain permanent reductions in the tax base that are directly linked to the payment.

- **Applied to transactions.** The STT would apply at a transaction (item of income) level between residents of two contracting states.

Six possible components of a STT rule

- **Applied between related parties**. The rule only applies to payments to related parties, defined by reference to a de facto control test.

- **Materiality threshold**. Could apply a threshold to limit compliance costs and ensure the rule was focussed on those structures that pose the most profit shifting risks.

- The threshold could apply to restrict the application of the subject to tax rule to those cases where the payer makes payments to related parties that, in aggregate, exceed a certain fixed amount or a percentage of the payer's costs.

Six possible components of a STT rule

- **Using a top up approach.** The effect of the rule will be to allow the payer jurisdiction to apply a top-up tax to bring the tax on the payment up to the minimum rate and that interacts in a coordinated manner with any existing withholding rate in the treaty.

- **Covered payments.** The rule will apply to a defined set of payments giving rise to base erosion concerns

Covered Payments

Covered payments

- The rule might cover payments presenting a greater risk of base erosion ("high-risk BEPS payments"), including interest, royalties and defined service fees .
- These payments should be those that present the most obvious and serious ongoing BEPS risks
- These payments could be identified by reference to a principles based definition or a definitive list of certain categories of payment.
- These two approaches could be combined, for example by defining high-risk payments and supplementing this with a list of certain categories of payments that were within or outside of the definition.

Service payments

- Service payments could be considered as presenting a greater BEPS risk if the value of the service is primarily based on mobile factors such as capital, assets or risks that are owned or assumed by the service provider.

- Conversely, payments for services would seem to present a lower risk from a BEPS perspective if their value is primarily linked to functions performed by the service provider.

Pillar Two - African Tax Impact

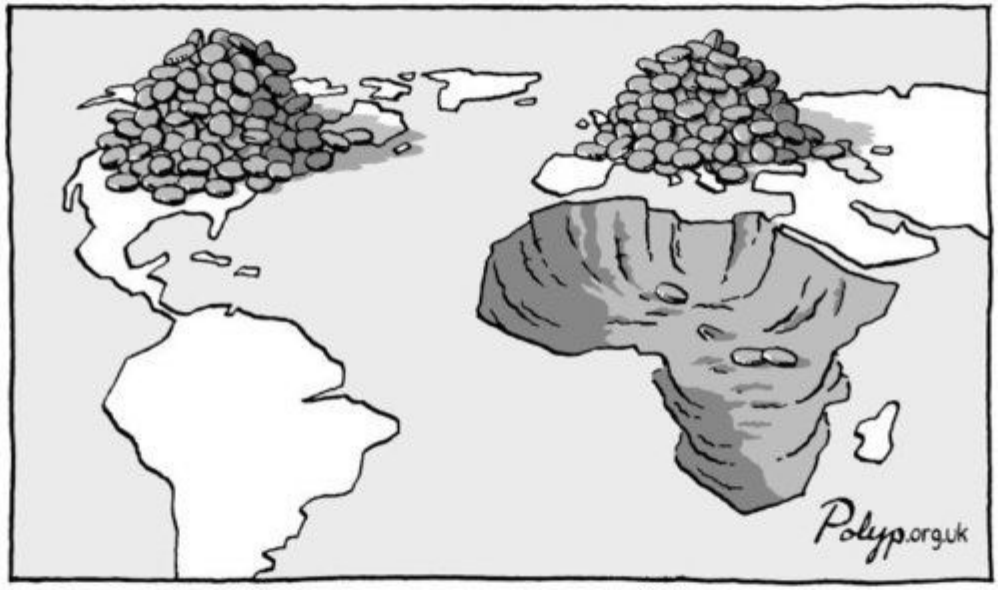
- The OECD forecast that the amount of tax reallocated under Pillar Two will be far greater than under Pillar One.
- Those forecasts includes additional revenue due to a reduction in profit shifting

  - Will this be correct if minimum effective rate is between 10% and 15%?
  - African rates on average between 25% and 35% so up to 25% saving through profit shifting
  - Basic tax planning strategies and low risk of detection/effective challenge where limited capacity

Pillar Two - African Tax Impact

- What will be the impact of jurisdictional or global blending on that rate?
- Majority of ATAF members opposed to global blending
- Will negate the policy objective of Pillar Two

Impact on African Tax Incentives



'GOLD DIGGERS'

- What will be the impact on tax competition and tax incentives in Africa?
- Incentives can lead to the effective rate in the country being as little as half the statutory rate
- Should countries consider removing incentives in combination with reducing the statutory rate?

Subject to Tax Rule

- African countries concerned about how that additional tax will be reallocated between residence and source jurisdictions?
- UTPR backstop to IIR
- Prima facie if the subject to tax rule is applied first, source jurisdictions should be the main beneficiaries
- Mitigate base eroding payments risk

Subject to Tax Rule

- However unless all Inclusive Framework (IF) members commit to include the rule in any treaty where the treaty partner requests it, and

- The rule is broad in scope to include all types of base-eroding payments such in particular interest, royalties and service fee and preferably capital gains,

- the rule will in practice be ineffective.