PILLAR II

UNDERSTANDING THE GLOBE RULES

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CONTENTS

Introduction I

Overview of the Reform of International Tax Regime

BEFORE	NOW
INTERNATIONAL TAX REGIME 1.0	**INTERNATIONAL TAX REGIME 2.0**
• Physical presence requirement	• Lack physical presence (Amount A)
• Arm´s length standard (for TP)	• Formulary approach (Amount B)
• Benefit principle	• Single tax principle (Pillar 2)
• Source taxation of active income	• Taxation by residual country to prevent double non-taxation:
• Residence taxation of passive income	✓ Residence taxation of active income (IIR)
	✓ Source taxation of passive income (UTPR & STTR)

Source: World Bank

Introduction II

Pillar 2: General Principles

POLICY OBJECTIVES

1. Ensure MNEs pay a minimum rate of tax in every jurisdiction they operate in
2. Reduce the incentive to shift profits to low or no tax jurisdictions (BEPS)
3. Place a floor on tax competition between jurisdictions

COMMON APPROACH

- Inclusive Framework members are NOT required to adopt GloBE rules
- GloBE rules must be implemented consistently with Pillar 2 outcomes
- Accept application of GloBE rules by other Inclusive Framework members

IMPLEMENTATION

- Pillar 2 builds on the BEPS project
- Effectiveness of GloBE rules relies on consistent implementation across different jurisdictions
- National consultations to translate GloBE rules into domestic law

Source: World Bank

Introduction III

Pillar 2: GloBE vs Non-GloBE Rules?

GLOBE RULES

INCOME INCLUSION RULE (IIR)

- Top-up tax on UPE in respect of the low taxed income of its subsidiaries
- Operates as a minimum tax (GILTI)
- Protects tax base of UPE

UNDERTAXED PAYMENT RULE (UTPR)

- Functions as a back-up rule to IIR
- Denies deductions or equivalent adjustment for undertaxed payments
- Allocation based on where tangible assets and employees are located

NON-GLOBE RULES

SUBJECT TO TAX RULE (STTR)

- Denies treaty benefits in the absence of sufficient taxation below minimum rate
- Applies to certain related party payments
- Creditable as covered tax under GloBE
- Requires changes to domestic laws and tax treaties

QUALIFIED DOMESTIC MINIMUM TOP-UP TAX

- Prevents application of IIR and UTPR
- Collects domestic top-up tax from Pillar 2
- Creditable against any top-up tax due

Source: World Bank

Introduction IV

What is GloBE?

- **What is GloBE ?**
  - GloBE is part of BEPS 2.0 and is a key aspect of the Pillar 2 proposal which comprises of a set of interlocked rules: Income Inclusion Rule (IIR) and Undertaxed Profit Rule (UTPR) with possible interaction with the Qualified Domestic Top-up Tax (QDMTT).
  - together the rules target payment of global minimum tax of 15% by MNEs with a global turnover > EUR 750 million

Introduction V

BEPS 1.0 vs BEPS 2.0

BEPS 1.0 VS BEPS 2.0 : Tax Base Protection from Different Perspectives

- factors that contribute to erosion of tax base of a given juridiction include actions considered immoral (e.g, tax avoidance), illegal actions (tax evasion) and legal actions (like voluntary lowering of tax payable either through incentives or by reducing the statutory rates).
- while tax evasion is practically a matter to be tackled through tax compliance and enforcement measures, BEPS 1.0 was designed to deal with tax avoidance in the context of international corporate tax in a globalised economy while BEPS 2.0 (GloBE) is primed to tackle the tendency by jurisdiction to engage in unhealthy tax competition (race to the bottom) by continued reduction of tax payable by MNEs.

WATAF, GloBE & The World

☐Why Should WATAF Members Care About GloBE?

- of WATAF's 15 members, 10 are also members of the Inclusive Framework on BEPS (IF)
- while the rule is being developed by IF, based on common approach, it is not compulsory for memebers of inclusive framework.
- However, the rule will affect both IF and non-IF members of WATAF excerpt if they have no in-scope MNEs doing business in their jurisdictions or their effective tax rate is more than 15%.
- A cursory survey show that all WATAF memebrs will be impacted by the GloBE (reasons: while the average headline tax rate is high; the average ETR of WATAF members are much lower owing to tax incentives, etc)
- once GloBE is Implimented, the difference between effective tax rate collected from the in-scope MNEs and a 15% ETR will be collected by the Jurisdiction of the Ultimate parent entity of the MNEs or some intermeditate jurisdiction if WATAF members fail to collect same.

WATAF, GloBE & The World II

- countries taking Steps to implement the Rules

Source: OECD

BASICS OF the GloBE RULES I

MNE Groups with ≥ EUR 750 million annual revenue

→

Tax, subject to jurisdictional ETR, < 15%

→

GloBE Rules are Inapplicable where a Country's ETR under exisiting CIT ≥ 15%

no top-up tax

Qualified Domestic Minimum Top up Tax (QDMTT)

Applies in source jurisdiction

Income Inclusion Rule (IIR)

Applies in parent jurisdiction under a top-down approach

UTPR

Allocates top-up tax to all entities in group using a substance-based allocation key

BASICS OF GloBE RULES II

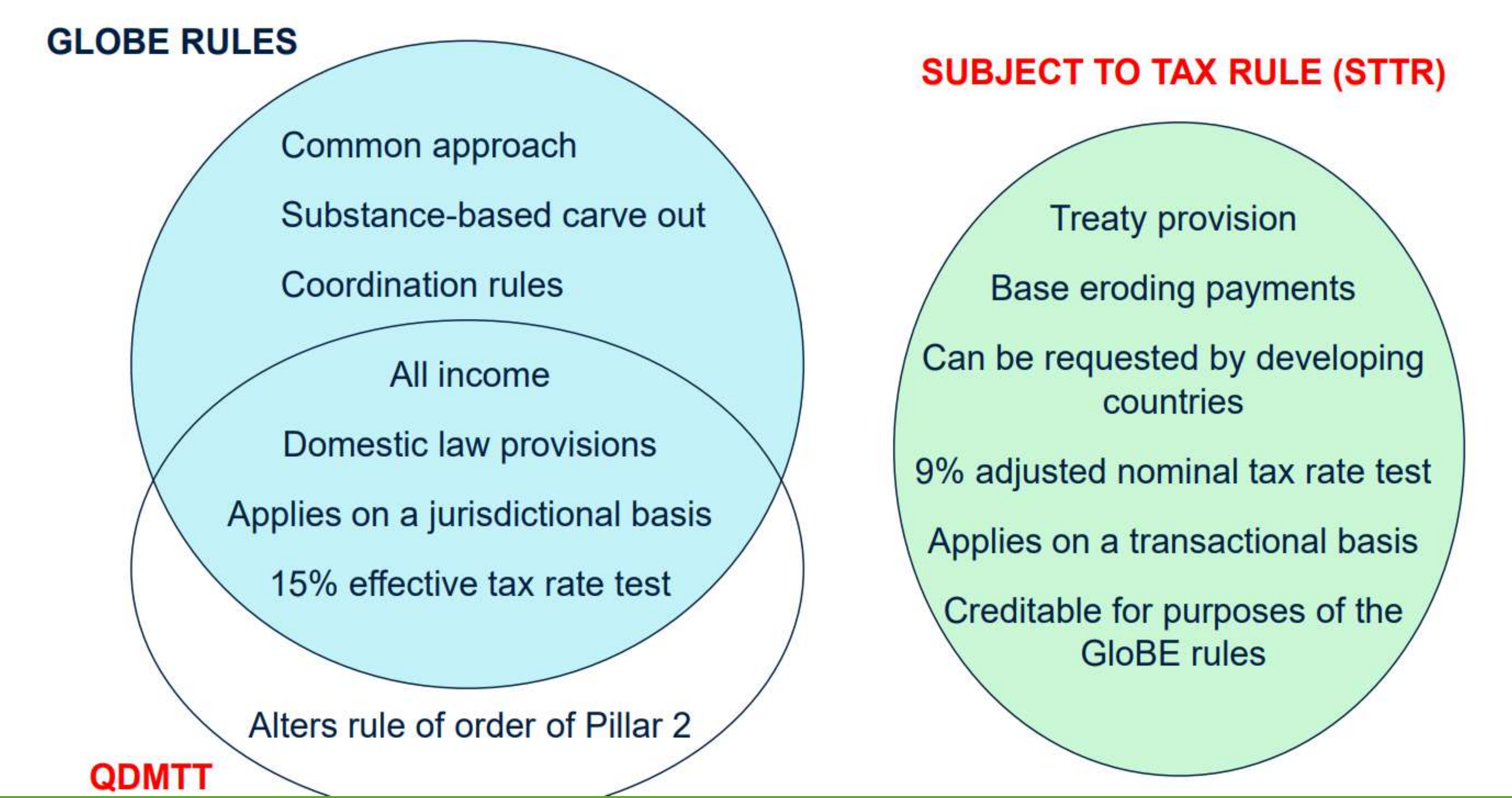
- ☐The minimum tax is 15% ETR (note the difference between ETR and Headline Tax Rates)
- ☐The Income Inclusion Rule is the Primary Rule, it kicks in once the source jurisdiction is unable to tax at 15% ETR and there is no QDMTT. The Rule re-inforces the right of the Resident country to tax the MNEs, as its resident, to ensure that its income is brought to a minimum of 15% ETR.
- ☐UTPR serves as a backstop to the IIR, applies when the jurisdiction of UPE did not adopt the IIR.
- ☐QMTT when applied by the the source Jurisdiction could forestall the application of the GloBE rules.
- ☐Substance carve-out (SBIE) applies to calculations of taxes payable both under the IIR, QDMTT and UTPR.

BASICS OF GloBE RULES III

- **The ETR is obtained by dividing Adjusted covered taxes by the GloBE income**
- **The ETR of an MNE with multiple PEs or subsisdiaries in a jurisdiction is determined by blending the ETR in the jurisdiction.**
- **GloBE Income or Loss is calculated for each Constituent Entity (CE)**
- **Starting point is the income or loss shown in the financial statements used in preparation of the consolidated financial statements of the UPE**
- **Items held in consolidation are included in the computation of GloBE Income or Loss if they can be reliably traced to CE**
- **gains and losses on certain debt and equity methods or foreign currency gains and losses are generally excluded from the computation of GloBE Income or Loss**

MECHANICS OF THE GloBE RULES

Designs & Interactions



Source: World Bank

MECHANICS OF THE GloBE RULES

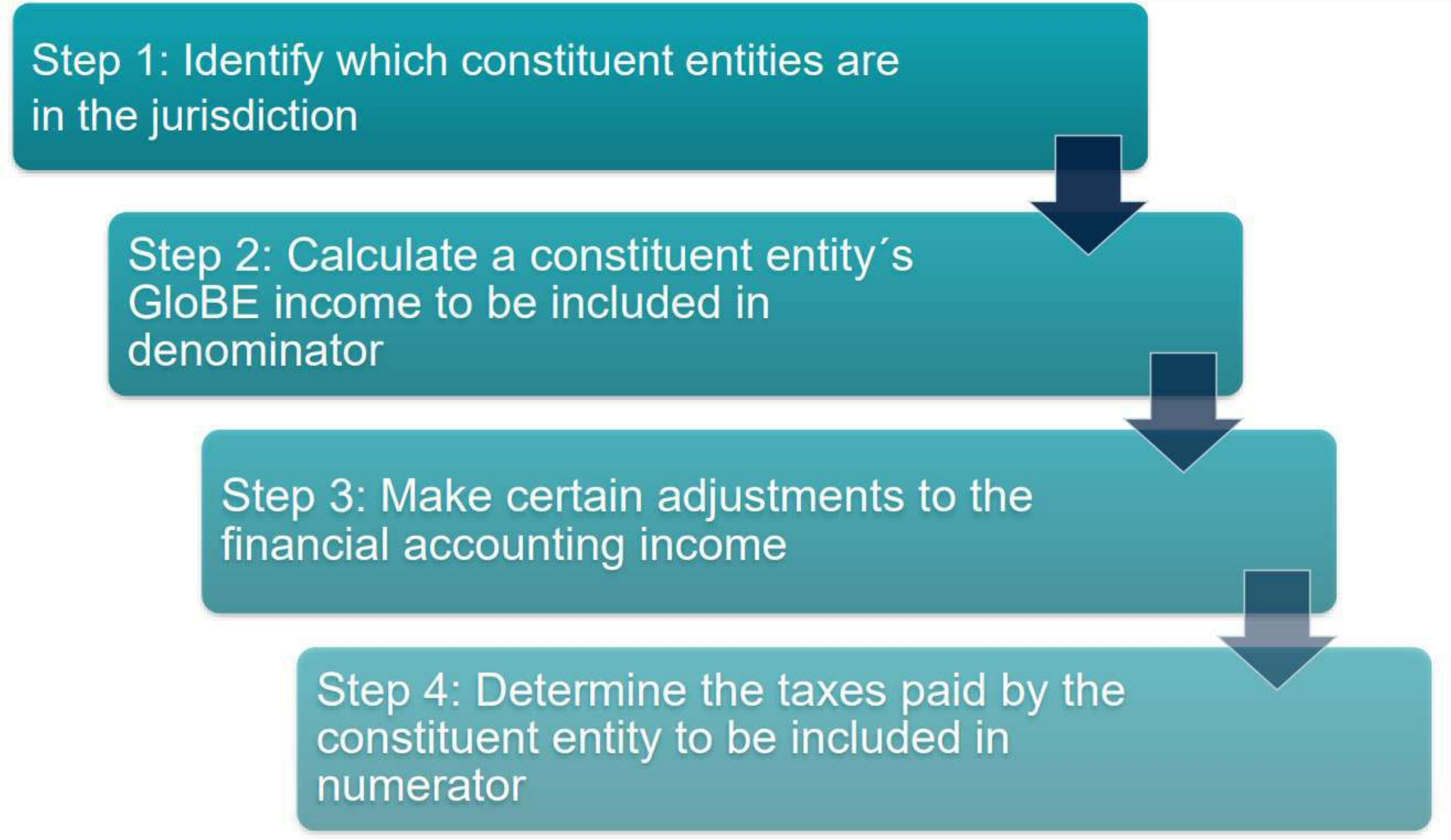
Scope

Scenarios	**MNE Group** *Does business operate in more than one jurisdiction?*	**Revenue >750 M €** *Consolidated revenue in at least 2 out of 4 previous fiscal years*	**In Scope of GloBE Rules?**
#1	✓	✓	✓
#2	✓	✗	✗
#3	✗	✓	✗
#4	✗	✗	✗

Source: World Bank

MECHANICS OF THE GloBE RULES

Steps for Effective Tax Rate Calculation



Source: World Bank

MECHANICS OF THE GloBE RULES

Steps for Top Up Tax Rate Calculation

Step 1
Identify whether there is net GloBE income in the jurisdiction

Step 2
Calculate the ETR in jurisdictions with net GloBE income

Step 3
Compute the top up tax percentage

Step 4
Calculate the substance based carve-out

Step 5
Compute the jurisdictional top-up tax

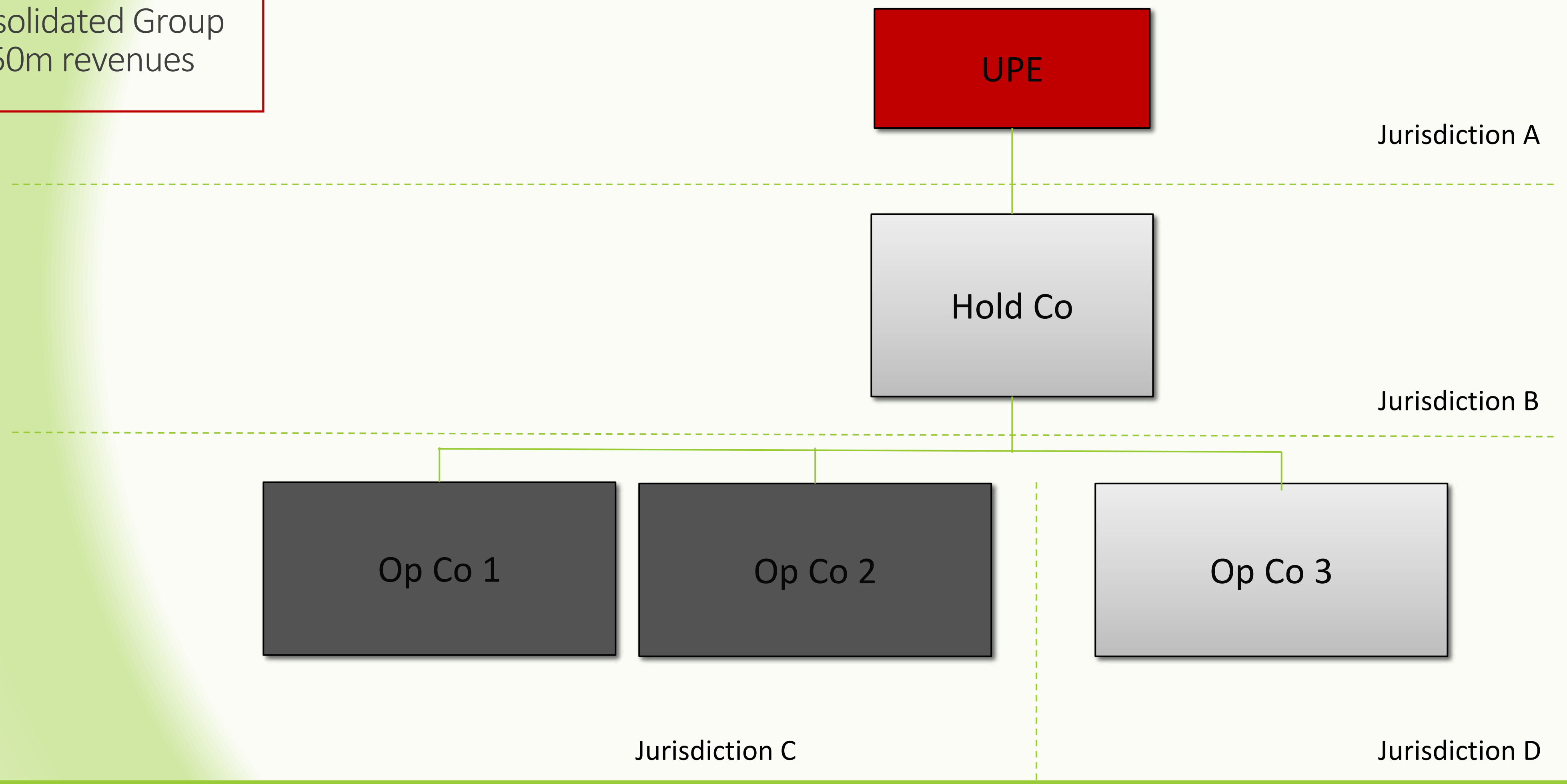
Step 6
Allocate a jurisdiction´s top-up tax to constituent entities

Source: World Bank

THE GloBE RULES APPLICATION

Structure of the Relevant MNE Group

Consolidated Group
≥ 750m revenues



THE GloBE RULES APPLICATION

ETR Determination

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

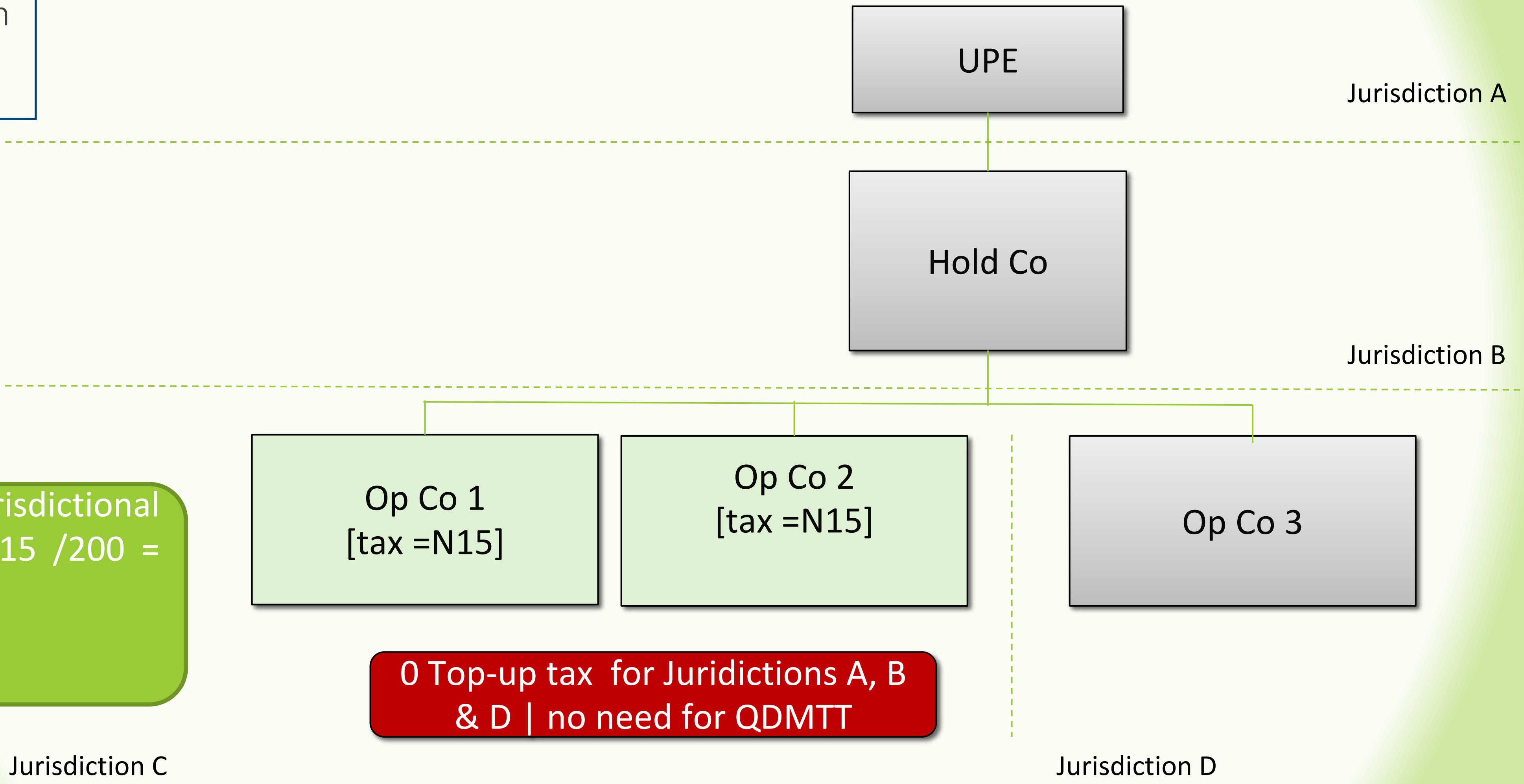
Covered Taxes:
Taxes on income or profits
Taxes on distributed profits and deemed profit distributions
Taxes imposed in lieu of a CIT
Taxes on retained earnings and corporate equity

Taxes not covered:
Some of the taxes not covered
indirect taxes, payroll and property taxes
Tax paid under the IIR
Additional tax paid under the UTPR

THE GloBE RULES APPLICATION

Interaction with Corporate Income Tax (CIT)

Op Co 1 & Op 2 each earns an Income of N100.

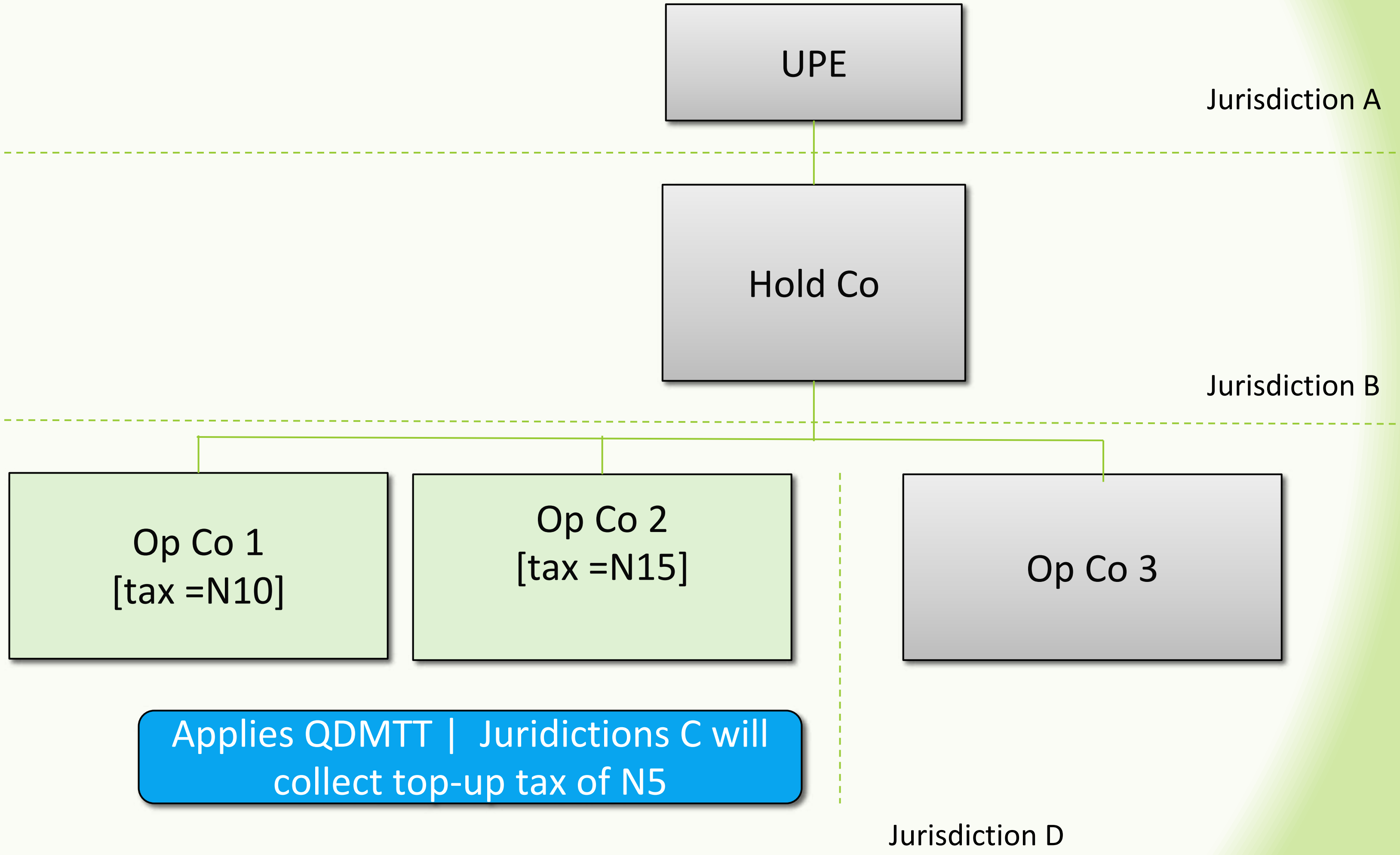


ETR (with Jurisdictional blending) = 15 + 15 /200 = 0.15 x 100 =15%
CIT = 15%

THE GloBE RULES APPLICATION

Application of QDMTT

Op Co 1 & Op 2 each earns an Income of N100.



ETR (with Jurisdictional blending) = 10 + 15 /200 = 0.15 x 100 =12.5%
Top up tax = 15%- 12.5% =2.5% X N200) = N5

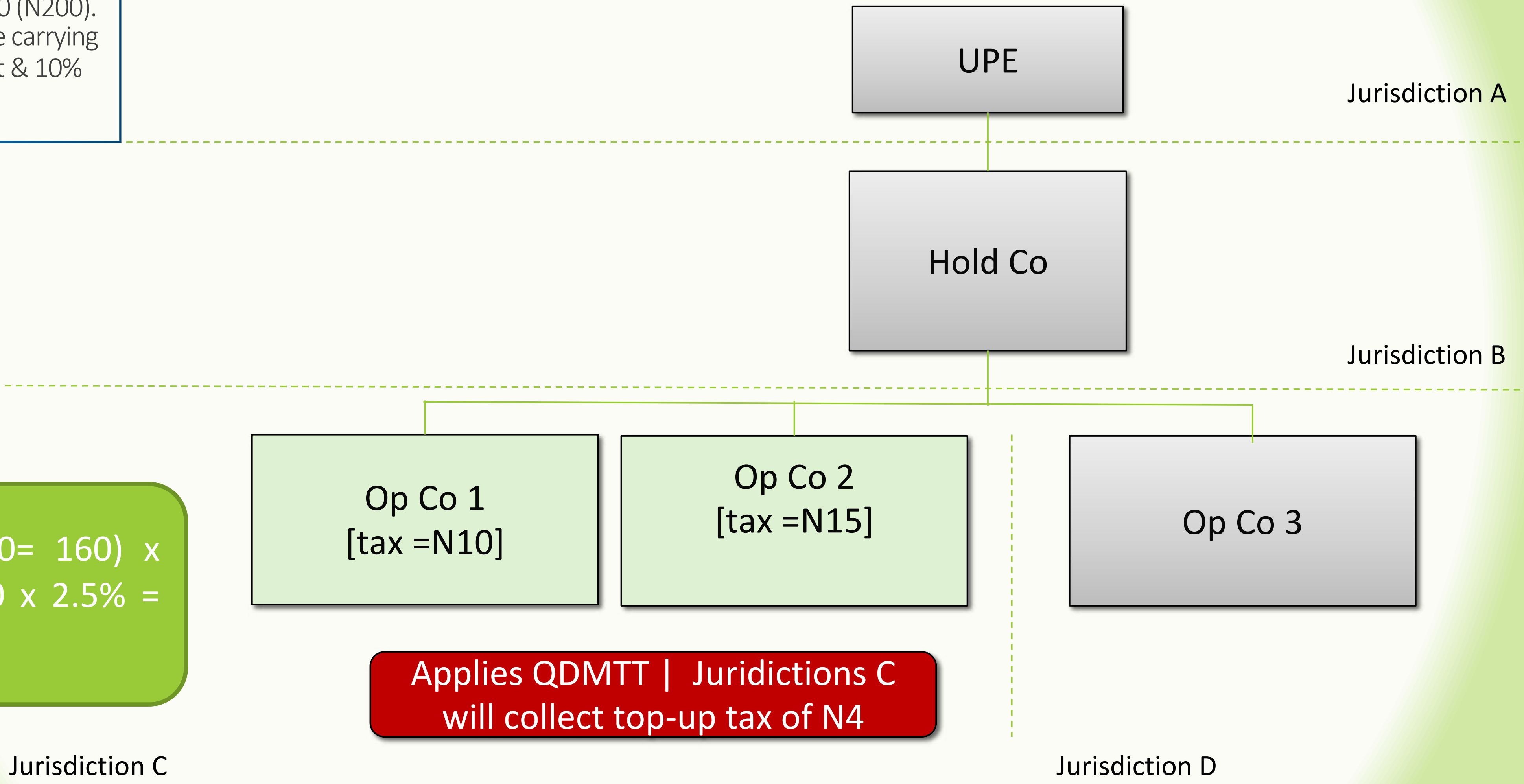
Jurisdiction C

THE GloBE RULES APPLICATION

Application of QDMTT with SBIE

- Op Co 1 & Op 2 each earns a GloBE Income of N100 (N200). SBIE = 40 (i.e 8% of the carrying value of tangible asset & 10% of payroll expenses)

ETR = 12.5%
Top tax = (200-40= 160) x 15% -12.5% = 160 x 2.5% = **N4**



THE GloBE RULES APPLICATION

Application of IIR with SBIE

- Op Co 1 & Op 2 each earns a GloBE Income of N100 (N200).
  SBIE = 40

Jurisdiction has IIR, collects N4 top-up tax

UPE

Jurisdiction A

Hold Co

Jurisdiction B

Op Co 1
[tax =N10]

Op Co 2
[tax =N15]

Op Co 3

ETR = 12.5%
Top tax = (200-40= 160) x 15% -12.5% = 160 x 2.5% = **N4**

No QDMTT

Jurisdiction C

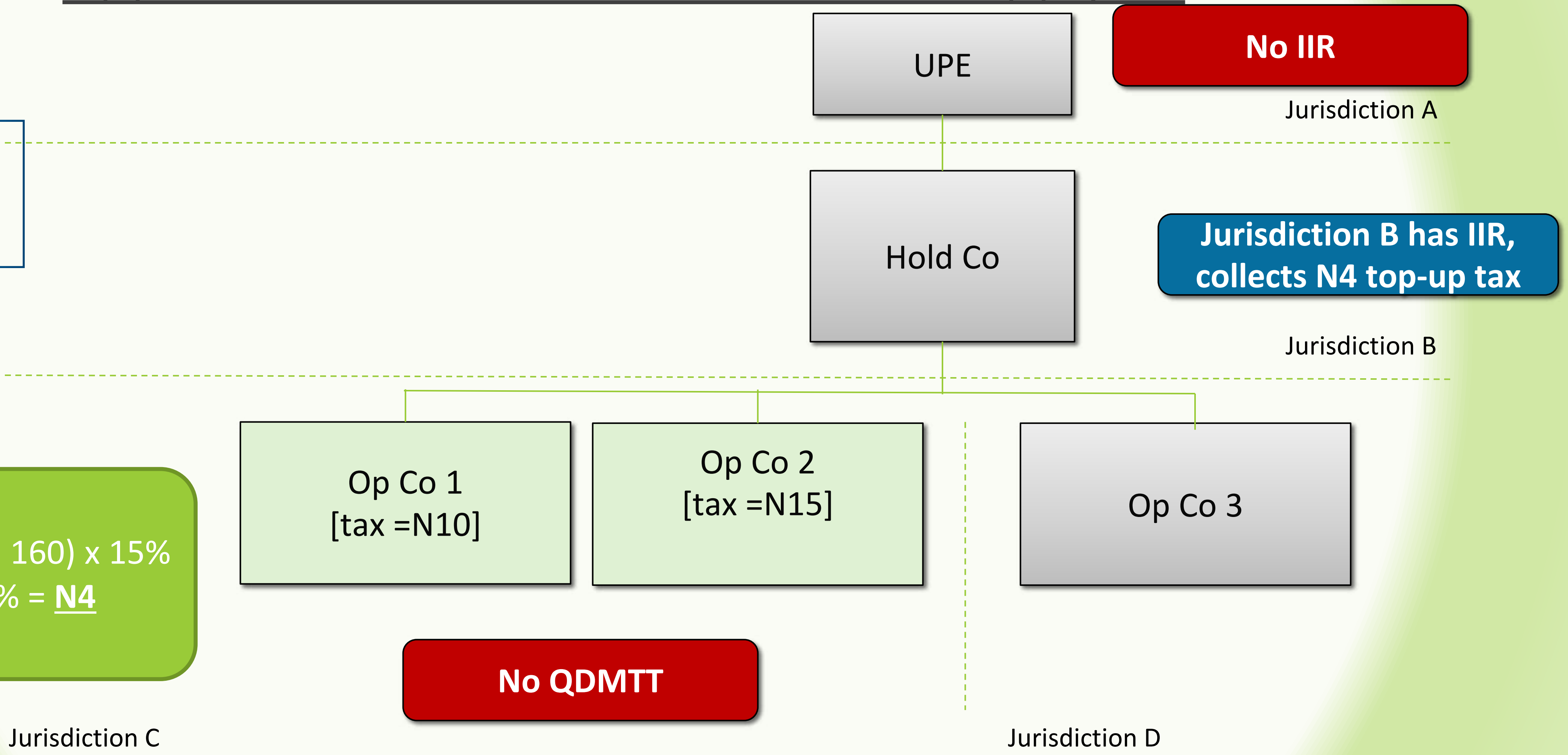
Jurisdiction D

THE GloBE RULES APPLICATION

Application of IIR where UPE doesnt Apply IIR

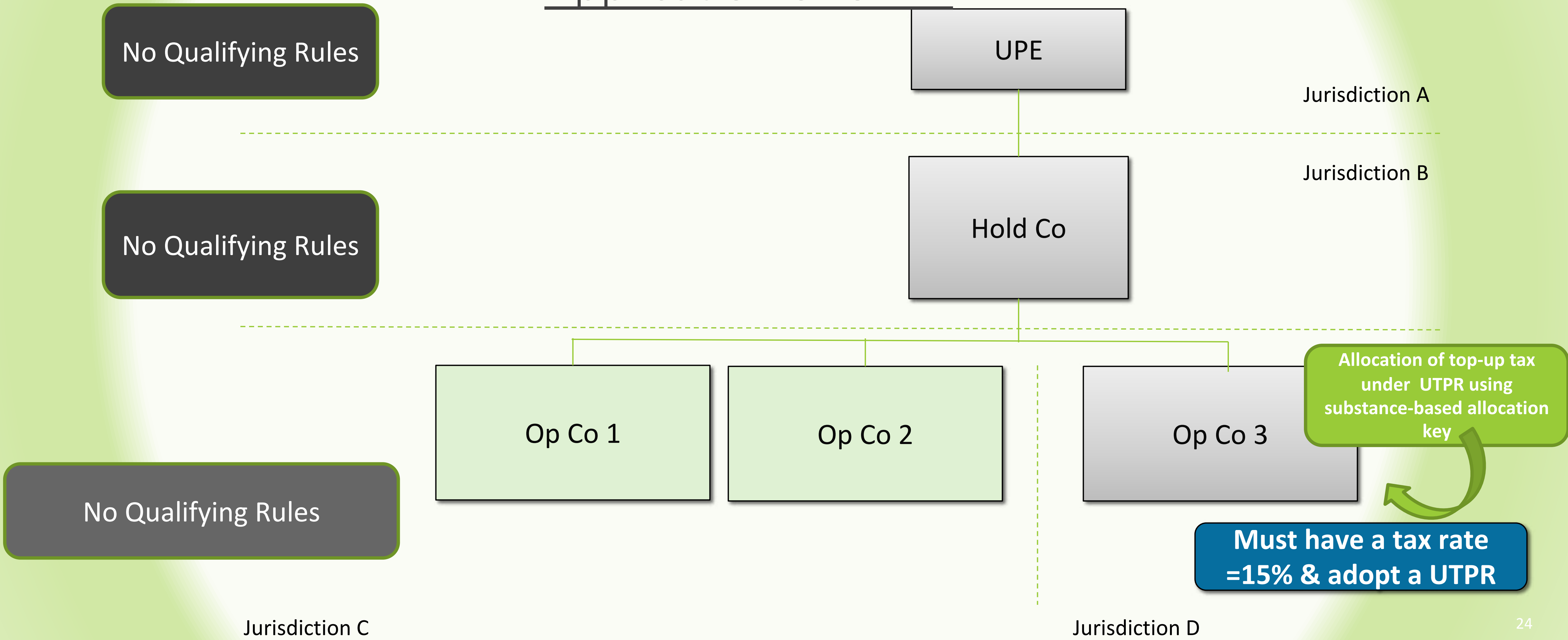
- Op Co 1 & Op 2 each earns a GloBE Income of N100 (N200).
  SBIE = 40

ETR = 12.5%
Top tax = (200-40= 160) x 15% -12.5% = 160 x 2.5% = **N4**



THE GloBE RULES APPLICATION

Application of UTPR



THE GloBE RULES APPLICATION

Is QDMTT the Answer?

WATAF FAFOA
WEST AFRICAN TAX ADMINISTRATION FORUM | FORUM DES ADMINISTRATIONS FISCALES OUEST AFRICAINES

- **QDMTT -**
  - is the only rules out of the three rules that seems to favour source taxing right.
  - should, at best, be one of the several options available for source countries
  - however, its has severe limitations including: -
    - Applies only to MNEs with turnover > 750 million euros (says nothing about 1000s of others doing businesses in WATAF jurisdiction).
    - meddling with source countries **prior right** to tax income sourced from their jurisdiction in accordance with its domestic legislation- and seeking to restrict such right without a treaty.
    - seeking to subject source country's domestic legislations to vigorous qualifying process which may violate legislative privileges or the sovereign rights of the source jurisdiction. Doesnt consider the propriety of subjecting laws by non-IF members to such qualification.
    - threatening to discountenance taxes imposed by source jurisdiction under the guise of not recorgnising such taxes as covered taxes
    - introducing SBIE to compasate assets and payrol expense that may have been compasated under CIT.
    - two complex to impliment and admnister and prone to BEPS

The GloBE & TAX INCENTIVES

WATAF FAFOA
WEST AFRICAN TAX ADMINISTRATION FORUM | FORUM DES ADMINISTRATIONS FISCALES OUEST AFRICAINES

Tax incentives	Likely impact of GloBE
Profit-based incentives	
Income tax holidays, including in export processing zones	**High:** Will significantly reduce the GloBE ETR for periods in which they are applicable and likely lead to the payment of top-up tax, depending on the size of the carve-out for payroll and tangible assets.
Business credits	**Medium to High:** The distinction between refundable and non-refundable tax credits and their differential impact on the calculation of the GloBE ETR—as well as the further differentiation of qualified and nonqualified refundable tax credits—will determine the risk of business credits.[24]
Withholding tax (WHT) relief	**Medium to High:** WHT on payments of income (other than distributions to owners) is treated as a Covered Tax in the recipient's country and not the source country, while WHTs on distributions to owners are attributed to the source country. Accordingly, reductions in WHTs imposed by a source country on distributions, as an incentive for investment, are affected by application of Pillar Two in the source country if the reduction in effective rate results in an ETR for the distributing entity below the minimum tax rate.[25]

Source: IISD.org

The GloBE & TAX INCENTIVES

Tax incentives	Likely impact of GloBE
Cost-based incentives	
Reduced tax rate, additional deductions for qualifying expenses	**Medium:** Will, in many cases, reduce GloBE ETR, but the ETR reduction may not always lead to the payment of top-up tax.
Tax deferrals, investment allowances, longer loss carry forward periods, preferential treatment of long-term capital gains[26]	**Limited:** Likely to not reduce GloBE ETR and lead to the payment of top-up tax.
Payroll tax incentives, property tax reductions, exemptions from indirect taxes[27]	**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, are not Covered Taxes under the GloBE rules.

Source: IISD.org

The GloBE & TAX INCENTIVES

INCOMPATIBLE WITH THE GMT[5]

- Tax holiday arrangements
- Zero corporate tax
- Effective tax rates below 15% in the absence of the QDMTT
- Tax-free zones

MAY BE COMPATIBLE BUT WILL DEPEND ON CIRCUMSTANCES[6]

- Reduced-rate incentives (Patent, IP boxes)
- Non-GMT compliant tax incentives on refundable tax credits[7]
- Cash incentives (will be considered as grant income for IIR purposes)

SHOULD BE COMPATIBLE WITH THE GMT

- Tax incentives targeted at pure domestic companies (not part of an MNE group)
- Preferential rates above 15% for start-up businesses
- Unlimited loss carry-forward
- Accelerated depreciation
- GMT-compliant Refundable Tax Credits[8]

Source: World Bank

The GloBE & TAX INCENTIVES

WATAF FAFOA
WEST AFRICAN TAX ADMINISTRATION FORUM | FORUM DES ADMINISTRATIONS FISCALES OUEST AFRICAINES

INCENTIVE	COMPATIBILITY WITH GMT RULES	POTENTIAL REFORM OPTIONS
Tax holidays	A tax holiday for an in-scope MNE may result in an ETR of 0% and therefore is not compatible with the GMT rules.	Withdraw tax holidays with appropriate transitional arrangements. Consultations with stakeholders is strongly recommended, particularly where tax holidays have a statutory basis (e.g., fiscal stability pacts).
Reduced rates	Depending on the rate applied, a reduced CIT rate, such as IP box regimes, may not be compatible with GMT rules or will be diluted by the rules. An added consideration with reduced rates is the Subject to Tax Rule in Pillar Two, which can apply where rates are less than 9%.	Withdraw the reduced rate, including as part of broader tax reform. Increase the CIT rate to ensure the ETR for in-scope MNEs is at or above 15%.
Tax-free zones	Tax-free zones are not likely to be compatible with GMT rules as far as corporate taxes are concerned.	Withdraw CIT free tax zones with appropriate transitional arrangements.
Tax credits[6] including R&D tax credits and other tax credits[7]	A tax credit's design will determine its treatment under GMT rules. For instance, a refundable tax credit (under certain conditions) will benefit from a more favorable treatment than a non-refundable tax credit. Rules consider the former as "income," while the latter is considered a tax credit and will reduce the ETR, and the benefit may be nullified.	Consider reforming non-refundable tax credits to ensure they are refundable and compliant with GMT rules. Revisit the value of the credit to ensure it is does not reduce the ETR below 15% and lead to Top-up Taxation in another country. A QDMTT can provide a backstop to ensure that any Top-up Tax is not taxed elsewhere under the IIR.

Source: World Bank

THE POLICY OPTIONS

- ☐ **TAX INCENTIVE REFORMS**
- ☐ **ALTERNATIVE MINIMUM TAX**
- ☐ **DMTT**
- ☐ **QDMTT**

Policy Options

SCENARIOS	STATUS QUO DO NOTHING	LEVEL 1 PROTECTING THE TAX BASE INTRODUCE A QDMTT	LEVEL 1 PROTECTING THE TAX BASE EVALUATE AND REFORM TAX INCENTIVE REGIME	LEVEL 2 IMPLEMENTING THE CORE GMT RULES IMPLEMENT IIR	LEVEL 2 IMPLEMENTING THE CORE GMT RULES IMPLEMENT UPTR *UTPR COMES INTO EFFECT ONE YEAR AFTER IIR	LEVEL 3 CONSIDER BROADER CIT REFORM BROADER CIT RATE REFORM	LEVEL 3 CONSIDER BROADER CIT REFORM OPTIMIZE TAX INCENTIVES TO THE GMT RULES
COUNTRY HAS NO-IN-SCOPE MNES (FOREIGN OR DOMESTIC)	?	?	?	?	?	✓	✓
COUNTRY IS THE UPE OF IN-SCOPE MNES	×	✓	✓	✓✓	✓	✓	✓
COUNTRY HAS SUBSIDIARIES OF IN-SCOPE MNES	?	✓	✓	?	?	✓	✓
COUNTRY HAS ENTITIES OF IN-SCOPE MNES WITH AN ETR OF <15%	×	✓✓	✓✓	?	?	✓	✓
COUNTRY HAS LARGE DOMESTIC BUSINESSES	×	✓	✓	?	?	✓	✓
COUNTRY IS SEEKING TO ATTRACT INVESTMENT FROM IN-SCOPE MNES	×	✓✓	✓✓	?	?	✓	✓

Source: World Bank

Conclusion

WEST AFRICAN TAX ADMINISTRATION FORUM | FORUM DES ADMINISTRATIONS FISCALES OUEST AFRICAINES

I. **The global minimum tax is an important development in the international tax architecture that provides an opportunity for countries, including WATAF members, to review their corporate income tax regimes, especially with respect to profit based tax incentives.**
II. **For many WATAF members the "do nothing" option is not viable. At the very least, countries will need to assess whether inscope MNEs (domestic and foreign) operate within the country and evaluate the existing tax code, particularly tax incentive regimes.**
III. **Qualified Domestic Top-up Taxes (QDMTT) are an important feature of the rules and can ensure that the minimum tax is applied and taxes are not topped-up elsewhere. However, countries may design Alternative Minimum Taxes that ensures the same or equivalent outcome.**
IV. **It may not be necessary for WATAF countries, especially those without UPE, to implement the core GMT rules—the IIR and UTPR.**
V. **Clarity is still needed with respect to how non-IF countries, which include many developing countries, can comply with the new GMT regime.**