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**EQUITABLE GROWTH, FINANCE & INSTITUTIONS INSIGHT**

# The Global Minimum Tax: from agreement to implementation

*POLICY CONSIDERATIONS, IMPLEMENTATION OPTIONS, AND NEXT STEPS*

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# ABSTRACT

*In October 2021, a historic two-pillar international agreement was reached among 137 countries of the OECD/G20 Inclusive Framework on BEPS to address the twin challenges of globalization and digitalization. Pillar One will reallocate tax revenues to the country of the consumer. Pillar Two introduces a global minimum effective tax for MNEs (GMT). This paper focuses on implementation of the GMT. It provides an overview of the core GMT rules, examines implementation by countries thus far, evaluates the key policy considerations (including the impact on tax incentives), and provides a framework for evaluation of the implementation options. The paper also makes recommendations on practical steps in the implementation process, including administrative issues and consultation with key stakeholders. These discussions are expected to be particularly relevant for developing countries.*

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# Table of Contents

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## Glossary

This glossary summarizes important concepts discussed in this paper to facilitate the reader's comprehension. It focuses on the key terms of the International Agreement to tax multinationals, with a particular emphasis on the Global Minimum Tax (Pillar Two). For a detailed explanation of the Pillar Two rules, see Understanding The Global Minimum Effective Tax on Multinationals: Pillar 2: General Principles, Overview and Scope.

**Base Erosion and Profit Shifting Project (BEPS):** The OECD/G20 Base Erosion and Profit Shifting Project (or BEPS Project) is an initiative to set up an international framework to combat tax avoidance by multinational enterprises (MNEs) that use base erosion and profit shifting tactics. The project, led by the OECD's Committee on Fiscal Affairs, began in 2013 with OECD and G20 countries (https://www.oecd.org/tax/beps/).

**BEPS Actions:** Under a mandate from the G20, the OECD countries and associates developed and agreed on a series of actions to address base erosion and profit shifting by large multinationals in 2015. These actions included measures to address mismatches between tax systems that were being exploited through aggressive tax planning and to ensure there was a floor under intense tax competition by countries to curb further erosion of tax bases globally. The BEPS Actions[1] included four minimum standards that serve as key cornerstones of the BEPS project: Action 5—Combatting harmful tax regimes; Action 6—Prevention of tax treaty abuse and countering treaty shopping; Action 13—Country-by-Country Reporting; and Action 14—Mutual Agreement Procedures (MAP).

**Country-by-Country Reporting (CbCR):** Under BEPS Action 13, all large multinational enterprises (MNEs) are required to prepare country-by-country reports with aggregate data on the global allocation of income, profit, taxes paid, and economic activity among tax countries in which it operates. The OECD publishes aggregate CbCR data, including the number of MNE entities within a country, the number of employees, revenue, profit, and effective tax rates.

**Effective Tax Rate (ETR):** An underlying GMT principle is the 15% minimum effective rate, calculated on a jurisdictional blended basis[2] using recognized accounting standards and accepted methodologies for calculating taxable income in accordance with the GMT's Model Rules. In this paper, references to ETR rates paid by MNEs in countries are not calculated using the GMT base, but rather are estimates of the ETR paid using other sources (e.g., country-by-country reporting or using business databases, such as ORBIS).

1 https://www.oecd.org/tax/beps/beps-actions/.

2 It is the ETR of the MNE as a group (not each entity) within the jurisdiction.

**Global Intangible Low-Taxed Income (GILTI):** GILTI is a special way to calculate a US multinational company's foreign earnings to ensure it pays a minimum level of taxes. GILTI was adopted as part of the 2017 [Tax Cuts and Jobs Act (TCJA)](). Unlike the Global Minimum Tax (GMT), which is calculated on a country-by-country basis, GILTI is calculated on a global blending basis—i.e., a rate of 0% paid in one country can be blended with a rate of 35% paid in another country. The current GILTI rate is 10.5% which will increase to 13.125% in 2026. The US permits 80% of the tax paid to be considered a foreign tax credit, therefore the effective rate is currently 13.125% rising to 16.4% in 2026.

**Global Anti-Base Erosion Rules (GLoBE):** GLoBE is the official name of the architecture that will underpin operation of the Pillar Two Global Minimum Tax. The core GLoBE Rules are the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR). In this paper, we refer to the GLoBE Rules as the Global Minimum Tax (GMT) rules.

**Global Minimum Tax Model Rules[3] and Commentary:[4]** The October 2021 International Tax Agreement foresaw the need for Model Rules and Commentary to underpin the Global Minimum Tax (GMT).

The Model Rules are intended to provide governments with a precise template for implementing the GMT, providing an essential reference point for countries legislating for the GMT. The rules provide for a coordinated system of interlocking rules that: define the MNEs within the scope of the minimum tax; set out mechanisms for calculating an MNE's effective tax rate on a jurisdictional basis and for determining the amount of Top-up Tax payable under the rules; and impose the Top-up Tax on a member of the MNE group in accordance with an agreed rule order.

The rules also address the treatment of acquisitions and disposals of group members and include specific rules to deal with particular holding structures and tax neutrality regimes. The rules address administrative aspects, including information filing requirements, and provide for transitional rules for MNEs that become subject to the global minimum tax.

The Commentary provides MNEs and tax administrations with detailed and comprehensive technical guidance on the operation and intended outcomes under the rules and clarifies the meaning of certain terms. It also illustrates the application of the rules to various fact patterns. The Commentary is intended to promote a consistent and common interpretation of the GMT rules that will facilitate coordinated outcomes for both tax administrations and MNE groups.

**Implementation Framework:** The October 2021 International Tax Agreement provided for the development of an Implementation Framework to facilitate the coordinated implementation and administration of the GMT. The framework will provide agreed administrative procedures, such as filing obligations and multilateral review processes as well as consider the development of safe harbors to facilitate both compliance by MNEs and administration by tax authorities.

**Income Inclusion Rule (IIR):** The core GMT rule is the Income Inclusion Rule (IIR). It allows the country of an MNE's Ultimate Parent Entity (UPE) to impose Top-up Tax on the parent entity equal to the insufficiently taxed income of its foreign subsidiaries. For example, if a subsidiary pays 10% tax on profits of USD 1 billion in a particular country (i.e., USD 100 million), the home country of the UPE can apply a GMT Top-up Tax of an additional 5% tax on those profits (i.e., USD 50 million).

**In-scope MNEs:** The GMT rules apply to MNEs that meet EUR 750 million threshold as determined under BEPS Action 13 (country-by-country reporting). Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold. The GMT will also provide for a *de minimis* exclusion for those jurisdictions where the MNE has revenues below EUR 10 million and profits below EUR 1 million. (For details see *Understanding The Global Minimum Effective Tax on Multinationals: Pillar 2: General Principles, Overview and Scope*).

**OECD/G20 Inclusive Framework (IF) on BEPS:** The IF was established in 2016 to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS-related issues while reviewing and monitoring implementation of the BEPS Project. There are currently 141 IF members.[5]

**Pillar One:** Pillar One of the International Tax Agreement will re-allocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there. Specifically, MNEs with global sales above EUR 20 billion and profitability above 10% will be covered by the new rules, with 25% of profit above the 10% threshold to be reallocated to market jurisdictions. Pillar One also seeks to simplify transfer pricing rules for baseline marketing and

3 https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

4 https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf.

5 https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

distribution activities. The IF is developing a multilateral convention (MLC), aiming to be ready for countries' signatures around mid-2023, with ratification to follow.

**Pillar One Amount A:** This is the amount of profits to be reallocated to countries under Pillar One of the International Tax Agreement.

**Pillar One Amount B:** This aims to standardize the remuneration of related-party distributors that perform baseline marketing and distribution activities in a manner that is aligned with the arm's length principle. Its purpose is two-fold: 1) simplify the administration of transfer pricing rules for tax administrations and reduce compliance costs for taxpayers; 2) enhance tax certainty and reduce controversy between tax administrations and taxpayers.

**Pillar Two:** Pillar Two of the International Tax Agreement centers on the Global Minimum Tax of 15% and the Subject-to-Tax Rule.

**Qualified Domestic Minimum Top-up Tax (QDMTT):** The QDMTT is a domestic Top-up Tax a country can introduce to ensure that the MNE pays a minimum tax within the country. It prevents the application of the IIR and UTPR. The QDMTT is fully creditable against any liability under the GMT, preserving a jurisdiction's primary right of taxation over its own income. To ensure the integrity of the GMT, there is expected to be a formal IF process to review and qualify the domestic Top-up Taxes countries introduce.

**Safe Harbors:** The GMT Implementation Framework will include safe harbors and/or other mechanisms to ensure the administration of GMT rules is as targeted as possible and to avoid compliance and administrative costs disproportionate to the policy objectives. There is a separate safe harbor envisaged under Pillar One—the Marketing and Distribution Safe Harbor.

**Subject-to-Tax Rule (STTR):** Although part of Pillar Two, the STTR is separate to the GMT rules. This rule denies treaty benefits when IF members apply nominal corporate income tax rates below the agreed STTR rate to interest, royalties, and a defined set of other payments. The taxing right will be limited to the difference between the minimum rate and the tax rate on the payment. The minimum rate for the STTR is set at 9%. The implementation of this rule requires changes to domestic legislation and tax treaties.

**Substance-based income exclusion (substance carve-out):** GMT rules include a formulaic carve-out designed to approximate the level of substance in the jurisdiction. This substance-based income exclusion provides that the taxable base of the GMT is reduced by a percentage of payroll costs and the carrying value of tangible assets. The percentage of payroll costs starts at 10% and is gradually reduced each year until 2033, when it will be 5%. The percentage of the carrying value of tangible assets starts at 8%, gradually declining each year until it reaches 5% in 2033.

**Undertaxed Payments Rule (UTPR):** The UTPR is the secondary rule under the global minimum tax—i.e., it will apply after the IIR and serve as a backstop to the IIR. The UTPR would apply if, for example, the jurisdiction in which a group is headquartered has an effective tax rate below the minimum tax rate (the IIR itself does not apply to the headquarters' jurisdiction). Any Top-up Tax then would be collected under the UTPR by countries in which other group companies are located. The rule is scheduled to come into effect one year after the IIR. The UTPR is also known as the Undertaxed Profits Rule because it denies deductions or equivalent adjustments for undertaxed payments.

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# Executive Summary

## INTRODUCTION

The past decade has seen a period of reforms of the international tax framework to address base erosion and profit shifting, particularly through the Base Erosion and Profit Shifting (BEPS) Actions. The BEPS project made great strides in addressing low and zero taxation, increased tax transparency, ensuring multinational enterprises (MNEs) would need substance in profit-earning countries, and put in place multilateral mechanisms for dispute resolution.

However, the international tax framework remained under stress due to increasing globalization and the digitalization of the economy. Globalization has created opportunities for MNEs to arrange their businesses to minimize their global tax bills, often by shifting profits to jurisdictions, sometimes through complex mechanisms with little commercial rationale. Digital businesses do not require a physical presence in a jurisdiction where they earn large profits. In many cases, they pay little or no tax on income or profits generated within the jurisdiction.

In October 2021, a historic two-pillar international agreement was reached among 137 countries of the OECD/G20 Inclusive Framework on BEPS (hereafter, the IF) to address the twin challenges of globalization and digitalization. Pillar One will reallocate tax revenues to the country of the consumer. Pillar Two introduces a global minimum effective tax for MNEs. These are two distinct but connected pillars. This paper focuses on implementation of the global minimum effective tax, Pillar Two.

## THE DESIGN OF PILLAR TWO—GLOBAL MINIMUM EFFECTIVE TAX RATE (THE GMT)

The GMT is designed to ensure that large MNEs (annual revenue greater than EUR 750 million) pay a minimum effective tax of 15%. The purpose is to address the ongoing concerns about tax avoidance by MNEs and the so-called "race to the bottom" on corporate tax rates.

Countries, including non-members of the IF,[1] could have high economic and fiscal incentives to implement Pillar 2. The GMT's design means that a country can apply a Top-up Tax to the subsidiary[2] of an MNE that has been taxed below the minimum effective rate. If a country doesn't

1 Pillar 2 is non-mandatory (called common approach); i.e., countries are not required to implement the rules. By joining the multilateral agreement, however, they accept its adoption by others and commit to follow the agreed rules.

2 This is calculated on the basis of the effective tax rate (ETR) of all the entities within a particular country; i.e., there can be blending of rates within a country.

apply the GMT rate, it means that another jurisdiction (the source country or other countries in which the MNE carries on its business activities) [3] will collect those taxes. This eliminates the "advantage" of the country. Therefore, zero and low corporate income tax (CIT) countries have an incentive to implement Pillar Two as an opportunity to claim some revenues that would otherwise be claimed by others. For many countries, this can be achieved through implementation of a Qualified Domestic Minimum Top-up Tax (QDMTT).

## THE IMPORTANCE OF PILLAR TWO FOR DEVELOPING COUNTRIES

The GMT is an important development for the international tax framework and will benefit developing countries.

The minimum effective tax rate of 15% under Pillar Two is expected to lead to an increase in global corporate tax revenues. The OECD has estimated that the minimum effective tax rate will result in the collection of USD 150 billion in new revenues annually.[4]

This revenue gain is expected to come from two sources:

1. Jurisdictions will increase tax rates or introduce a Qualified Domestic Minimum Top-up Tax to ensure that insufficiently taxed profits in the jurisdiction are taxed at the minimum tax rate. Failing this, the jurisdiction of the parent entity will collect the Top-up Tax, or it can be collected as a backstop by other jurisdiction(s) with subsidiaries.
2. Pillar Two is expected to reduce the incentive for MNEs to shift profits to no or low-tax jurisdictions.

However, the rules are complicated and countries—particularly low-capacity ones—will need to consider implementation options as well as estimating potential revenue impacts.

## THE INVESTMENT LANDSCAPE

The GMT will have profound implications on countries' use of tax policy to attract inbound investment from MNEs—whether through statutory tax rates or tax incentives, such as tax holidays, zero-tax zones, and tax credits. With GMT implementation, countries will no longer be able to attract investment through zero or low rates that result in an ETR of less than 15%, and certain incentives will no longer be GMT compliant, such as tax holidays and zero-tax zones. Countries will still have scope to introduce Pillar Two-compliant incentives.

Despite the growing global prevalence of tax incentives, empirical evidence finds they play a limited role in influencing investor decisions and often lead to fiscal losses, especially in low-income countries that are already struggling with revenue mobilization. As long advocated by the World Bank and other development partners, it is essential that countries consider non-tax factors to strengthen a country's investment attractiveness, including the general business environment, investment in infrastructure and people/skills, and a strong public administration.

## PROGRESS TOWARD IMPLEMENTATION

There has been remarkable progress by the IF in developing the architecture to underpin the GMT with Model Rules finalized in December 2021 and the Commentary agreed to in early 2022. Work continues on the detailed Implementation Framework, including further administrative guidance, simplifications, and safe harbors. Implementation is now expected to be in 2024.

Countries are also taking steps to implement the global minimum tax. In this context, the European Union is close to agreeing on the Directive,[5] which will underpin implementation in the 27 EU Member States. Countries have launched public consultations on implementation —including Canada, Ireland, Malaysia, New Zealand, the Republic of Korea, Switzerland, and the United Kingdom. Switzerland, the United Kingdom, and the Republic of Korea publishing draft legislation to implement the Income Inclusion Rule (IIR). Mauritius has published draft legislation to implement the QDMTT, and the US administration is advocating legislation to closer align the existing minimum tax (GILTI) with the new GMT. More countries have signaled that they are evaluating implementation options.

## KEY POLICY CONSIDERATIONS

The GMT will have implications for many countries, although needed actions will depend on individual circumstances. For

3 Pillar 2 rules that allow for Top-up Taxes on the profits of foreign subsidiaries that have effective tax rates of less than 15%. Top-up taxation involves two concepts—the Income Inclusion Rule (IIR) by a parent jurisdiction and the Undertaxed Profits Rule (UTPR) by other jurisdictions in which the MNE carries on its business activities. They are collectively known as the Global Anti-Base Erosion (GLoBE) rules.

4 https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm

5 Twenty-six of the 27 EU Member States have agreed the proposed Directive.

instance, 23 countries currently have ETRs[6] below the 15% minimum rate, and many others have tax incentive regimes that include tax holidays, zero-tax zones, and tax credits, which can mean that MNEs have an effective tax rate below 15%.

Countries should take steps to analyze their CIT regimes to consider implementation options. In this context, implementation choices will depend on the following questions:

- Are there entities within the country that are within the scope of the GMT rules—i.e., the threshold of global annual revenues of EUR 750 million?
- If there are in-scope entities in the country, what is the effective tax rate applicable to those entities (the GMT base and detailed rules may be different depending on the country's tax code)?
- Are there US headquartered MNEs within the country affected by potential differences between US GILTI and the GMT?
- Are tax incentives within the country compatible with the GMT rules? If not compatible, could this impact private investment?

## POLICY OPTIONS

The global minimum effective tax rate for MNEs is a fundamental change to the international tax framework, and many jurisdictions will need to make reforms, whether to protect the tax base, to implement GMT rules, or to carry out a deeper (tax and investment policy) reform process. Countries have implementation options, but what they decide to do will depend not only on their own circumstances, including policy choices, but also the ongoing work at the IF to finalize the Implementation Framework.

A framework for considering these options is indicated below:

| STATUS QUO | LEVEL 1 PROTECTING THE TAX BASE | | LEVEL 2 IMPLEMENTING THE CORE GMT RULES | | LEVEL 3 CONSIDER BROADER CIT REFORM | |
|---|---|---|---|---|---|---|
| Do nothing | Introduce a QDMTT | Evaluate and reform tax incentive regime | Implement IIR | Implement UPTR *UTPR comes into effect one year after IIR | Broader CIT rate reform | Optimize tax incentive offering to the GMT rules |

### OPTION 1: 'DO NOTHING'

The nature of the GMT rules and the common approach means a country does not need to implement the model rules. The "do nothing" option is *on paper* feasible under the agreement, but it is not without risks, particularly for a country foregoing tax revenues because another country is topping-up taxes.

## LEVEL 1 MEASURES—PROTECTING THE TAX BASE

A specific feature of the GMT rules is that undertaxed profits can be topped up in other countries. It is recommended that countries take actions to ensure they do not lose tax revenues to other countries, thus the need to protect its tax base.

### OPTION 2: INTRODUCE A QUALIFIED DOMESTIC MINIMUM TOP-UP TAX

Countries can introduce their own Qualified Domestic Minimum Top-up Tax (QDMTT) based on the GMT mechanics, which is then fully creditable against any liability under the GMT, preserving the jurisdiction's primary right of taxation over its own income.

### OPTION 3: EVALUATE AND REFORM TAX INCENTIVES TO BE IN LINE WITH THE GMT

The GMT rules are likely to have implications for the viability of certain tax incentives. Therefore, it is prudent for countries to carry out an evaluation of their incentive regime. This is particularly relevant in cases where the tax provision (or a combination of reliefs) could lead to a scenario of an ETR of less than 15%.

## LEVEL 2 MEASURES—IMPLEMENT THE CORE GMT RULES

Level 2 measures are the implementation of the core GMT rules, the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR). The policy impetus for introducing these rules will depend on country-specific circumstances, particularly the profile of MNEs in the country, the applicable ETR, and implementation of Level 1 measures.

6 Source: World Bank Global Marginal Effective Tax Rate (METR) Database Report

### OPTION 4: INTRODUCE THE INCOME INCLUSION RULE

IIR is the core GMT rule. It is imposed on a parent entity after considering the insufficiently taxed income of a constituent entity.

Whether a country implements the IIR will primarily depend on whether it has UPEs of MNEs within its jurisdiction. Having UPEs within the country creates a strong case for implementing the IIR. If a country does not have UPEs, there should not be an immediate requirement to implement the IIR.

### OPTION 5: INTRODUCE THE UNDERTAXED PAYMENTS RULE (UTPR)

The UTPR will be particularly relevant for countries who have in-scope entities of MNEs and where the country/countries of the UPE of MNEs do not implement the IIR. The agreement envisions that the UTPR will come into effect one year after the IIR, allowing countries to defer decisions on implementing the UTPR.

## LEVEL 3 MEASURES— CONSIDERATION OF BROADER CORPORATE INCOME TAX REFORMS

The GMT is a significant development in international taxation. The core GMT rules, the IIR and the UTPR, are complex and it may not be necessary for all countries to implement them. However, this new international tax framework may provide opportunities for countries to reshape their CIT regimes, whether by broadening the tax base or initiating tax rate reforms, including revisiting their current tax incentives regime designed to attract investment.

### OPTION 6: CONSIDER BROADER CIT REFORM, INCLUDING RATE POLICY

An option for countries is to review their overall CIT regime to ensure that it is optimized for the new Pillar Two environment. Options include rate policy, simplification of the tax code, and base broadening. These options have the potential for an overall increase in tax revenues and investment attractiveness, although the choices and outcomes will depend on the circumstances within individual countries.

### OPTION 7: OPTIMIZE TAX INCENTIVE OFFERING WITHIN THE GMT RULES

Option 3 advocates that countries should review and reform tax incentives regimes to be compatible with Pillar Two GMT rules. These are important steps in protecting the tax base as well as avoiding low taxation of MNEs and top-up of taxes by other countries under the IIR or UTPR. Countries may also consider new incentives that are compatible with GMT rules.

## IMPLEMENTATION ROADMAP

It is recommended that countries take concrete steps now to prepare for the introduction of the GMT, recognizing that change creates uncertainty. This can be addressed through solid planning, good analysis, and open communications.

The World Bank recommends that countries:

### *1. ENSURE COMPATIBILITY WITH THE GMT RULES AND EVALUATE IMPLEMENTATION OPTIONS*

Countries may wish to signal that they will ensure that their tax codes will be compatible with the October 2021 agreement and GMT rules. Since work on practical implementation issues is still ongoing at the OECD, it would be premature to finalize implementation at this point.

### *2. CARRY OUT PREPARATORY WORK FOR IMPLEMENTATION*

It is recommended that countries already start the preparatory work for determining what reforms to their CIT regimes will be necessary to ensure conformity with the GMT.

### *3. ENGAGE WITH STAKEHOLDERS*

It is important that countries engage with stakeholders on implementation of the International Tax Agreement (specifically the GMT rules). Such communications can bring greater certainty to taxpayers, minimize disputes, and facilitate policy development.

## WORLD BANK SUPPORT

The GMT is very complex and uses new concepts in taxation. It is based on financial accounts, there is no one-size-fits-all solution, and implementation will provide challenges for both developed and developing countries alike.

The World Bank stands ready to support developing countries in implementing the rules.

Such support can include regional seminars with deep dives on the rules, technical assistance to countries on impact assessments, analysis of policy options, evaluation of tax incentives, and legislative drafting.

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# Introduction

## CONTEXT

The international tax framework has been under exceptional stress due to increasing globalization and the digitalization of the economy. Globalization has created opportunities for MNEs to arrange their businesses to minimize their global tax bills, often by shifting profits to jurisdictions, sometimes through complex mechanisms with little commercial rationale. Digital businesses do not require a physical presence in a jurisdiction where they earn large profits. In many cases, they pay little or no taxes on income or profits generated within the jurisdiction. The IMF estimates that tax avoidance and profit shifting in developing countries results in USD 200 billion per year in lost revenue from corporate income taxes. This is equivalent to the estimated revenue loss from the COVID-19 pandemic and larger than the official development assistance (ODA) developing countries receive each year.

## OBJECTIVE OF THE PAPER

The OECD/G20 Inclusive Framework on BEPS reached an agreement in October 2021 on a two-pillar solution to address the tax challenges of digitalization (Pillar One) and aggressive tax competition (Pillar Two). This paper focuses on Pillar Two, specifically on the rules designed to put a floor under tax competition through the global application of a 15% minimum effective tax rate (GMT).

The agreement's complexity will bring implementation challenges to many countries, particularly low-capacity ones. However, the introduction of the GMT can provide an opportunity for developing countries to reform and improve their current corporate tax regimes. Such reforms can provide a more sustainable and stable corporate tax regime to achieve the objectives of raising tax revenues to fund vital public services and, at the same time, delivering a tax code that can promote investment and growth.

This paper provides an analysis of the GMT's key elements and the practical implications for countries, including information on corporate tax policy and incentives, the policy options available to countries that decide to implement GMT rules, and recommendations for an implementation roadmap. This paper is the first of a series that will provide further guidance to countries as they navigate implementation of the new international tax framework.

# A DECADE-LONG JOURNEY OF CORPORATE TAX REFORM

The past decade has seen an intensive period of activity in bringing much needed reforms to an international tax framework that was creaking under the pressures of digitalization and globalization, diminishing the tax base of source countries. Much of this reform was driven by the G20 and OECD countries, but in recent years non-OECD countries, including developing and emerging economies, have taken a far more pro-active role in shaping the tax reform agenda through the OECD/G20 Inclusive Framework on BEPS (hereafter the IF). It now has representation from 141 countries.[1]

Under the G20 mandate, the OECD countries and associates developed and agreed in 2015 a series of actions to address base erosion and profit shifting by large multinationals. These actions included measures to address mismatches between tax systems that were being exploited through aggressive tax planning and to ensure there was a floor on intense tax competition by countries to curb further erosion of tax bases globally.

The BEPS Actions[2] included four minimum standards that serve as key cornerstones of the BEPS project:

- Action 5—Combatting harmful tax regimes
- Action 6—Prevention of tax treaty abuse and countering treaty shopping
- Action 13—Country-by-Country Reporting
- Action 14—Mutual Agreement Procedures (MAP)

According to the OECD[3] 2021 BEPs progress report:

> "The year 2021 marks a full five years since the implementation of the four BEPS minimum standards began, and it is clear that the BEPS project has resulted in tangible progress, irrefutably moving the needle in the direction of a world less susceptible to tax avoidance. Thanks to the efforts made by all OECD/G20 Inclusive Framework countries and countries to comply with the requirements imposed by the BEPS minimum standards, there is more coherence and transparency, and taxation is better aligned with substance."

While notable progress has been made, the corporate tax policy landscape has been dominated since 2015 by the part of the negotiation where agreement was not reached during the BEPS process—*Action 1: Addressing the Tax Challenges of Digitalization*. These discussions had focused on structural challenges to the international tax system arising from digitalization and new business models; specifically, where large MNEs were able to achieve scale without mass in market countries, resulting in the erosion of existing tax bases. Several countries saw potential in introducing revenue-based digital services taxes to address under-taxation in market jurisdictions. However, digital services taxes proved controversial and subsequently were a driver of trade disputes, and international consensus was not reached by 2018 on a common approach.

In 2019, the IF agreed that a two-pillar solution should be developed with Pillar One allocating a portion of profits to market countries (i.e., where consumed) and Pillar Two addressing remaining BEPS issues through the adoption of a GMT.

Blueprints for the two pillars were developed through OECD working parties, accepted by the IF, and published in October 2020,[4] with public consultations following and a clear objective to reach agreement by mid-2021. Significant progress was made between October 2020 and June 2021, although there were fundamental design changes proposed for Pillar One. It would concentrate on the largest and most profitable global businesses with threshold annual revenues of EUR 20 billion and profitability above 10%, applying to all sectors—a significant change from the mooted proposal of a threshold of EUR 750 million revenues, focused on digital supplies and consumer-facing businesses.

A key milestone in the process was the agreement at the London G7 Finance Minister meeting in June 2021, where G7 countries adopted a common position on the design of the International Tax Agreement.[5] At the IF meeting on July 1, 2021, the vast majority of countries reached an interim agreement.[6] The G20 Finance Ministers recognized this interim agreement at their July 2021 meeting, setting a clear timeframe by pledging that remaining issues would be resolved ahead of the Rome G20 leaders meeting in late October.

1 https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

2 https://www.oecd.org/tax/beps/beps-actions/.

3 https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2020-september-2021.pdf.

4 https://www.oecd.org/tax/beps/cover-statement-by-the-oecd-g20-inclusive-framework-on-beps-on-the-reports-on-the-blueprints-of-pillar-one-and-pillar-two-october-2020.pdf.

5 https://www.gov.uk/government/publications/g7-finance-ministers-meeting-june-2021-communique/g7-finance-ministers-and-central-bank-governors-communique.

6 The interim agreement represented a broad framework but key aspects were not finalized, such as the percent of taxes to be allocated under Pillar One and the minimum effective tax rate for Pillar Two.

Further discussions by the IF included finalizing key parameters, such as the allocation under Pillar One and the minimum rate under Pillar Two. On October 8, 2021, 137 IF members reached a final agreement, with an ambitious implementation timeframe of 2023. Four countries did not sign up.[7]

## POTENTIAL IMPACT OF THE INTERNATIONAL TAX AGREEMENT ON DEVELOPING COUNTRIES

The Two-Pillar Solution will be an important influence on direct tax policy in developing countries. They are likely to benefit from the Pillar One reallocation of taxing rights over businesses that have "scale without mass" in the country (i.e., reaching a large market without physical presence in the country). It is difficult to determine at this point how much developing countries will gain,[8] although the OECD has estimated the reallocation of profits at around EUR 125 billion annually. The simplified approach to applying the rules of transfer pricing to baseline marketing and distribution activities will also benefit developing countries (the so-called Amount B). Simplifying the handling of marketing and distribution activities will free up resources to address more complex and higher risk cases.

The minimum effective tax rate of 15% under Pillar Two is expected to lead to an increase in global corporate tax revenues. The OECD has estimated that the minimum effective tax rate will result in the collection of USD 150 billion in new revenues annually.[9] The estimate was made at the originally envisaged rate of 12.5%, and the OECD has signaled that revenue gains may be higher at the adopted minimum tax rate of 15%.

The revenue gains are expected to come from two sources:

1 Jurisdictions are likely to increase tax rates or introduce the Qualified Domestic Minimum Top-up Tax (QDMTT) to ensure that undertaxed profits in the jurisdiction are taxed at the minimum rate. If countries fail to act, the parent company's home jurisdiction will collect the Top-up Tax, or it can be collected as a backstop via the Undertaxed Paymentss Rule (UTPR).[10]

2 MNEs will face reduced incentives to shift profits to jurisdictions, leading to increases in tax revenues. Despite these provisions, potential pockets of jurisdictions may remain, creating incentives for MNEs to shift profits. Therefore, compliance activities will remain necessary, including anti-tax avoidance rules and full implementation of the BEPS Actions, particularly in the context of transfer pricing.

The new GMT rules will raise the floor on the CIT rates that countries can impose to 15% (there is currently no floor), but tax competition will not be eliminated. It will remain possible for countries to compete on rates and to offer compliant tax incentives, albeit within guardrails. However, there will be implications for tax policy in countries where in-scope MNEs currently benefit from rates below 15%, whether through changes in corporate tax rates or through restrictions on certain tax incentives.

## THE INVESTMENT LANDSCAPE

The GMT will have profound implications for the use of tax policy to attract investment. Whether through statutory tax rates or such incentives as tax holidays, zero-tax zones, and tax credits, countries have long used tax policy to attract inbound MNE investment. With the introduction of the GMT, countries will no longer be able to grant zero or low rates (with an ETR of less than 15%), and incentives such as tax holidays and zero-tax zones will be nullified (in general, any tax incentive not linked to real investment—see Section 5).

While certain incentives will no longer be GMT compliant, countries will have the scope to introduce Pillar Two compliant incentives. These can include unlimited loss carry-forward, accelerated depreciation, and GMT compliant refundable tax credits. Countries can look to optimize their tax incentive offering within the parameters of the new regime, recognizing that it incentivizes real investment; however, it would be prudent for countries to carry out cost-benefit analysis on such tax expenditures to ensure they have a clear policy rationale, are effectively designed to deliver intended policy objectives, and are reviewed periodically.

Despite the growing global prevalence of tax incentives, empirical evidence finds they play a limited role in influencing investor decisions and often lead to fiscal losses, especially in low-income countries already struggling with revenue mobilization. The World Bank and other development partners,

7 Kenya, Nigeria, Pakistan, and Sri Lanka did not join the agreement.

8 One view holds that the reallocation is likely to be larger in lower income countries than in high income countries as a proportion of current CIT revenues. However, the allocation is based on revenue generated; in absolute terms, it is more likely that the largest reallocation will be to the largest markets by value.

9 https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm.

10 The UTPR denies deductions or equivalent adjustment for undertaxed payments. Under the UTPR, the right to tax is based on where tangible assets and employees are located.

have long advocated that countries consider non-tax factors to strengthen their attractiveness for investment, including the general business environment, investment in infrastructure and people, and strong public administration.

## THE DESIGN OF PILLAR TWO—GLOBAL MINIMUM EFFECTIVE TAX RATE

Pillar Two is designed to ensure that large MNEs with annual revenues greater than EUR 750 million pay a minimum tax of 15%. The purpose is to address the ongoing concerns about tax avoidance by MNEs and the so-called "race to the bottom" on corporate tax rates.

The primary rule to achieve implementation is the **Income Inclusion Rule** (IIR). Under this rule the country in which the parent company of a MNE is taxable will impose a Top-up Tax on the profits of any foreign subsidiaries that have an effective tax rate of less than 15%.

Countries are not obliged to apply an IIR, and failure to implement it could undermine the impact of the rule and create an incentive for MNEs to locate the parent entity in countries that have no IIR. Pillar Two addresses this by introducing a backstop rule, the **Undertaxed Payments Rule** (UTPR). This allocates the **Top-up Tax** on the profits of lowly taxed entities, including those in the parent country, to the other countries in which the MNE carries on its business activities. The allocation key is based on a combination of tangible assets and employees in the countries applying the UTPR.

Together, the IIR and UTPR are known as the **Global Anti-Base Erosion (GLoBE) Rules**[11] (the GLoBE Rules are often referred to as the GMT rules in this paper).

## PROVIDING GUIDANCE AND ASSISTANCE TO COUNTRIES IN IMPLEMENTATION

As is typically the case with international tax reforms, the devil is in the details, and in this context intensive work is continuing at OECD working parties to finalize the technical work that will underpin the new global taxation framework.

Given the nature of the OECD agreement, it is important for countries to consider the impacts and policy options arising from the global agreement. Carrying out an analysis is critical given the nature of the GMT rules—notably, that they are not mandatory but also taking into account the model rules and commentary and what they may mean for the tax code more broadly.

Important questions arise for countries that will impact on policy choices for implementation in Box 1.

### Box 1: Key Implementation questions for countries

- Are there entities within the country that are within the scope of GMT rules—i.e., threshold of global annual revenues of EUR 750m?
- If there are in-scope entities in the country, what is the effective tax rate (ETR) applicable to those entities (the GMT base and detailed rules may be different to the country's tax code)?
- Are there US headquartered MNEs within the country affected by potential differences between US GILTI and the GMT?
- Are tax incentives within the country compatible with the GMT rules? If not, could this impact on investment into the country?

There are still critical implementation issues that have not yet been finalized. In this context, the OECD launched public consultations in March 2022,[12] which seek to get views from stakeholders on the GMT's implementation. A public hearing took place in April 2022. The consultations sought views with respect to: (i) stakeholders' desire for further administrative guidance and what issues should be addressed in the guidance; (ii) filing and information collection, including reporting and record keeping; (iii) suggestions to reduce compliance costs, including safe harbors and simplifications; and (iv) mechanisms to maximize rule co-ordination, increase tax certainty, and avoid the risk of double taxation.

The consultations' practical output remains to be seen, particularly how the process will feed into the next stage of technical discussions at the OECD Working Parties (WP11). However, one would expect the output with respect to simplifications and safe harbors will be very important for countries with ETRs above 15%.

In implementing this complex new international tax framework, many countries are considering the implications for their tax codes. This can be particularly challenging for

11 https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf https://www.oecd.org/tax/beps/pillar-two-GLoBE-rules-fact-sheets.pdf.

12 https://www.oecd.org/tax/beps/oecd-invites-public-input-on-the-implementation-framework-of-the-global-minimum-tax.htm.

low-capacity countries, particularly in cases where tax experts were not actively involved in the discussions at the OECD technical Working Parties.

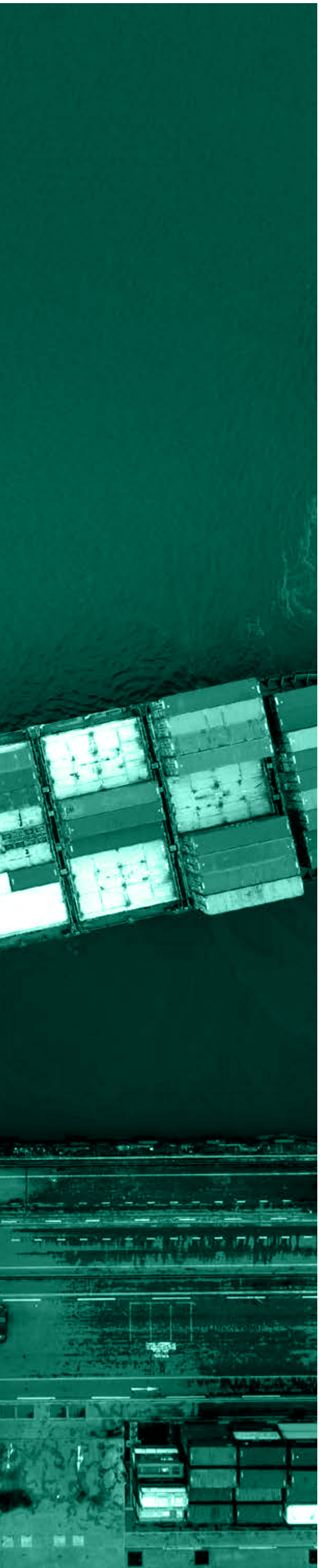
Several policy options will be available to countries in implementing the GMT rules. Such options are explored in this paper notably with respect to:

- Protecting the tax base.
- Implementing the core GMT rules; i.e., the IIR and UTPR.
- Consideration of broader CIT reform.

The annexes to this paper provide guidance for countries on identifying MNEs within their jurisdictions, estimating potential revenue gains, and strategies for stakeholder engagement during implementation.

This paper will be supplemented by detailed guidance and training materials on the Pillar Two rules, as well as more in-depth guidance on GMT rules and tax incentives, to support countries to better understand the complexity of the rules and the broader implications for their tax codes.

# 2.



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# Global implementation—state of play

## CURRENT STATE OF PLAY

The October 2021 OECD agreement set out an implementation date of 2023—"Pillar Two should be brought into law in 2022, to be effective in 2023, with the UTPR coming into effect in 2024."

As set out in the statement, and elaborated above, the core GMT rules comprise: (i) the IIR, which imposes Top-up Taxes on parent entities due to the low-taxed income of constituent entities; and (ii) the UTPR, which denies deductions or requires an equivalent adjustment to the extent the low-taxed income of constituent entities is not subject to tax under an IIR.

Significantly, the GMT rules will have the status of a common approach. This means that IF members are not required to adopt the GMT rules; however, if they choose to do so, they will implement and administer the rules in a way consistent with the outcomes provided for under Pillar Two, including model rules and guidance agreed to by the IF, and accept the application of the GMT rules applied by other IF members, including agreement on rule order and the application of any agreed safe harbors.

A detailed implementation plan was also approved in the October 2021 agreement, which includes the development of Model Rules, a Commentary to the Model Rules, transition rules, and importantly an Implementation Framework to cover agreed administrative procedures (e.g., detailed filing obligations, multilateral review processes), and safe harbors to facilitate both compliance by MNEs and administration by tax authorities.

Significant progress has been made in implementing Pillar Two since the political agreement reached in October 2021. The OECD has finalized the Model Rules and the Commentary, the EU is close to agreeing an EU Directive to implement the GMT rules in the 27 EU Member States. Key countries, including the Republic of Korea and the UK, are advancing their legislative processes. Canada, Malaysia, Mauritius, New Zealand, Switzerland, and the United States have also kicked off the implementation process (see Box 2 below and Annex 2).

This remarkable progress must be seen in the context of the extremely ambitious implementation timeframe of 2023, particularly because there was still substantial technical work to be completed at the time the political agreement was reached in October 2021.

The OECD has acknowledged that Pillar Two's implementation timeframe has effectively moved to 2024 and expressed optimism that a breakthrough will occur in the EU discussions in coming months. It is expected that progress in the EU, a bloc of 27 countries that includes members of the G7 and G20, will act as a catalyst for implementation elsewhere.

### Box 2: Overview of Implementation (as of August 2022)

**Canada** signaled the adoption of the GMT in the 2022 Budget Statement, and it has launched a public consultation on implementation.

The **EU** is currently finalizing a directive to legislate for the GMT rules for implementation in 2024. The proposed Directive has been agreed by 26 of the 27 Member States, with the current EU Presidency working towards getting full agreement in October 2022. EU Member States will be required to incorporate the GMT in national legislation.

**The Republic of Korea** announced the introduction of draft domestic legislation for a GMT in July 2022.

**Malaysia** launched a public consultation on the Pillar Two rules in August 2022.

**Mauritius** published draft legislation in July 2022 (as announced in the 2022/2023 budget speech) to apply a domestic Top-up Tax to ensure that resident companies of MNEs are taxed at a minimum rate of 15%.

**New Zealand** launched a public consultation on GMT implementation in May 2022.

**Switzerland** has committed to implement the GMT in 2024. It has already had public consultations on implementation and launched a consultation on the draft legislation to implement the GMT in August 2022.

The **UK** launched public consultations in early 2022, indicating legislation will be introduced in the Finance Act 2022, coming into effect in 2023. The UK published drafted legislation in July 2022.

In the **United States**, the administration has advocated legislation to align GILTI, the country's existing minimum tax, with the GMT. In late 2021, the US House of Representatives agreed to legislation to reform GILTI rules to increase the rate to 15% and apply it on a country-by-country basis, but this did not advance in the US Senate. The US agreed to a separate domestic minimum corporate tax of 15% in August 2022 through the Inflation Reduction Act. Work on aligning GILTI and the GMT is continuing at the IF.

There is also an open question with respect to the co-existence of the existing US minimum tax regime—the Global Intangible Low-Taxed Income (GILTI)—with the GMT rules as foreseen in the October 2021 agreement. Given the global reach of US MNEs, and without prejudicing ongoing discussions at the OECD, it is necessary to consider the interaction between the current GILTI and GMT rules. This is explored further in Section 4 below.


3.

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# The corporate income tax landscape today

Before considering policy considerations and options, it will be useful to review the current corporate income tax landscape because corporate rates and tax incentive policies will be impacted by the new global minimum effective tax rate for MNEs.

## CORPORATE INCOME TAX RATES

An estimated 23 countries have ETRs below 15%, and 26 countries have economy-wide weighted average ETRs less than 15% (Figure 1) (World Bank Global Marginal Effective Tax Rate (METR) Database Report). Countries with ETRs below 15% have a wide geographical spread, including both developed and developing countries. Several of these countries, including Ireland,[1] have already indicated reforms will be made to their tax codes to be compliant with the GMT rules.

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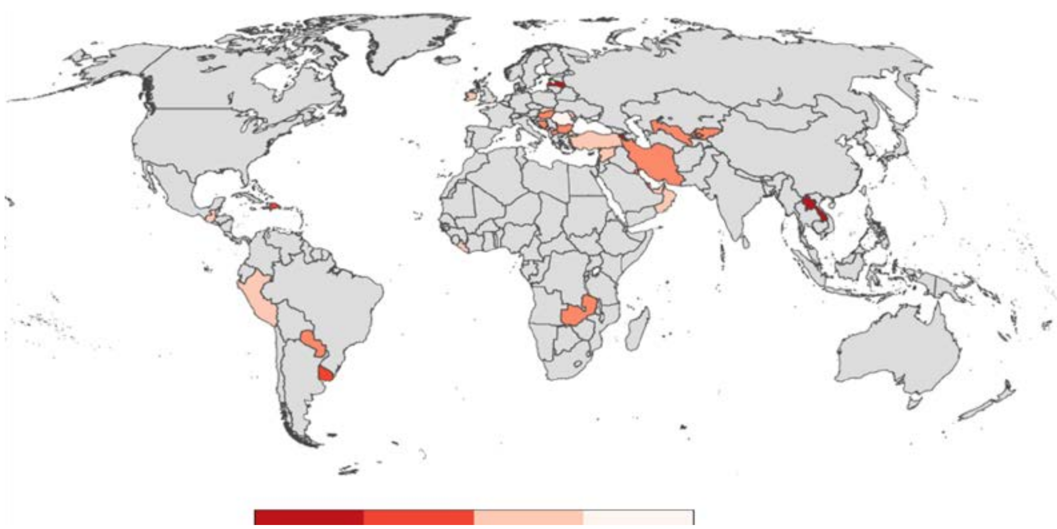
**FIGURE 1: Countries with statutory CIT rates or average effective tax rates below 15%**



*Source:* World Bank Global Marginal Effective Tax Rate (METR) Database

1 Statement by Paschal Donohoe, Minister for Finance (October 2021) https://www.gov.ie/en/speech/615f7-statement-by-minister-donohoe-on-decision-for-ireland-join-oecd-international-tax-agreement/.

## COUNTRIES WITH IN-SCOPE ENTITIES WITH ETRS LESS THAN 15%

Another factor to consider involves entities within a jurisdiction that may have an ETR of less than 15%, even though the aggregate ETR for the jurisdiction is greater than 15%. The reason for this may be due to tax incentives, including tax holidays, reduced rates including intellectual property (IP) boxes[2], special economic zones, non-qualifying R&D tax credits, super deductions for investment expenditure, and so forth (this is explored in greater detail in Section 5). In effect, the result is low-taxed profit within high-tax jurisdictions.

In this context, a February 2022 study carried out by ifo INSTITUTE on behalf of the German Federal Ministry of Finance estimated that 47.7% of low-taxed global profits sit in high-tax countries with an ETR greater than 15% (Table 1). It should be noted that this study uses aggregate country-by-country reporting (CbCR) data with known limitations.[3]

This study does not indicate the high-tax countries where such profits are earned and whether these profits could be *blended*[4] under the GMT rules to achieve an ETR of 15%. However, the identified level of profits is significant, and it is likely that even more countries will need to take policy decisions with respect to GMT implementation, including reforms to rates and/or tax incentive regimes.

>>>

TABLE 1: Undertaxed profits in high tax countries—ifo INSTITUTE, February 2022[5]

| BILLION EUROS | GERMAN CORPORATIONS | | EU27 CORPORATIONS EXCLUDING GERMAN CORPORATIONS | | ALL CORPORATIONS WITHOUT US CORPORATIONS | | ALL GROUPS INCLUDING US GROUPS | |
|---|---|---|---|---|---|---|---|---|
| | ACTIVITY WORLDWIDE | FOREIGN ACTIVITY | ACTIVITY WORLDWIDE | FOREIGN ACTIVITY | ACTIVITY WORLDWIDE | FOREIGN ACTIVITY | ACTIVITY WORLDWIDE | FOREIGN ACTIVITY |
| TOTAL PROFITS | 229 | 128 | 677 | 440 | 1.178 | 859 | 1.760 | 1.203 |
| GAINS IN JURISDICTIONS WITH EFFECTIVE TAX RATE ≥ 15 % | 181 | 80 | 465 | 284 | 775 | 539 | 1.149 | 674 |
| OF WHICH TAXED < 15 % | 104 | 37 | 249 | 130 | 382 | 240 | 544 | 293 |

Note: The values correspond to the averages over the reporting years from 2016 to 2019.

## TAX INCENTIVES UNDER THE CURRENT TAX RULES

The 2015 BEPS Actions have helped make progress in addressing many of the more egregious tax planning structures, including stateless entities within MNE groups and using cash boxes in zero-tax jurisdictions. However, the lack of a global minimum effective tax rate has maintained downward pressure on corporate income tax rates. In addition, there has been extensive tax competition between countries offering incentives, especially tax holidays, with countries under a lot of pressure from MNEs bargaining for tax incentives, setting countries against each other.

This competition has had a significant negative impact on revenues, seen in high revenue foregone/tax expenditures for developing countries that offer tax incentives and in revenues in the countries of the ultimate parent entities due to profit shifting.

The US GILTI regime implemented a minimum tax for US MNEs; significantly, this tax is calculated through global

2 Intellectual property (IP) box regimes (also referred to as patent boxes) provide lower effective tax rates on income derived from IP. Most commonly, eligible types of IP are patents and software copyrights. Depending on the patent box regime, income derived from IP can include royalties, licensing fees, gains on the sale of IP, sales of goods and services incorporating IP, and patent infringement damage awards.

3 For a discussion of known limitations of the CbCR data, see https://www.oecd.org/tax/tax-policy/anonymised-and-aggregated-cbcr-statistics-disclaimer.pdf.

4 It is conceivable under the GMT rules that an entity within a country is subject to low tax rates, but other entities have rates above 15%, ensuring that the MNE's profits in that country have an ETR of 15% or above.

5 Clemens Fuest, Felix Hugger und Florian Neumeier, ifo INSTITUTE; Grenzüberschreitende Geschäftsbeziehungen innerhalb von Unternehmensgruppen – Ausmaß und Reformoptionen Studie im Auftrag des Bundesministeriums der Finanzen vorgelegt von: fo Forschungsgruppe Steuer-und Finanzpolitik. See Table 48, Pg. 160 https://www.ifo.de/en/publikationen/2022/monograph-authorship/grenzuberschreitende-geschaftsbeziehungen.

blending. US MNEs could conceivably benefit from low taxes, including tax incentives, and *blend* these profits with higher taxes elsewhere without facing Top-up Tax in the US.[6]

> > >

**TABLE 2: Overview of tax incentives regimes across regions**

| REGION | TAX HOLIDAY | REDUCED RATE | INVESTMENT LINKED | SUPER DEDUCTIONS | R&D | SPECIAL ZONES |
|---|---|---|---|---|---|---|
| EAST ASIA & PACIFIC | 15 | 2 | 21 | 5 | 9 | 2 |
| EASTERN EUROPE & CENTRAL ASIA | 12 | 0 | 30 | 3 | 12 | 4 |
| LATIN AMERICA & CARIBBEAN | 15 | 4 | 24 | 4 | 5 | 6 |
| MIDDLE EAST & NORTH AFRICA | 8 | 3 | 15 | 0 | 3 | 0 |
| SOUTH ASIA | 1 | 1 | 4 | 0 | 1 | 0 |
| SUB-SAHARAN AFRICA | 15 | 6 | 26 | 4 | 9 | 3 |
| NORTH AMERICA | 2 | 0 | 2 | 0 | 2 | 0 |
| WESTERN EUROPE | 7 | 1 | 22 | 8 | 13 | 1 |
| TOTAL-> | 75 | 17 | 144 | 24 | 54 | 16 |

*Source: WB Incentives Global Database*

Table 2 presents a global overview of tax incentives, which indicates investment-linked incentives the most widely used, followed by tax holidays and R&D incentives. The tax-free zones in many countries in most cases include an exemption from all income taxes.

The compatibility of these incentives with GMT rules is explored further in Section 5.

6 The GMT rules will use jurisdictional rather than global blending. The US administration is advocating for a jurisdictional blending approach in reforms to the GILTI to align with the GMT rules.

# 4.

# Policy considerations for developing countries

## OVERVIEW

The October 2021 agreement raised questions with respect to implementation. Not all of them have been answered. Uncertainties remain for countries preparing to make policy decisions on implementation—the primary reason is the OECD is continuing to work on the Implementation Framework.

While recognizing the process is ongoing, it is already clear that many countries will need to consider reforms to their corporate tax regimes because they could otherwise face scenarios where profits earned in their jurisdictions could be subject to additional taxes in the jurisdiction of the parent company under the IIR or in other jurisdictions under the UTPR.

This is particularly pertinent for developing countries, which are weighing decisions on implementing complex rules in an unsettled and uncertain environment where doubts remain with respect to implementation in developed countries and where the Implementation Framework is not yet agreed. A further uncertainty is that by design, the GMT follows a common approach; i.e., the GMT is non-mandatory, and the architecture of the rules does not require all countries to implement the rules.

While appreciating that there are many moving parts to the GMT rules and that important aspects of the Implementation Framework are under development, it is timely for countries to reflect on the relevant policy considerations in contemplating implementation options that will be guided by a country's own circumstances. These policy considerations inform the subsequent sections on tax incentives, policy options, and implementation recommendations.

This section explores some of these policy considerations:

- The nature of GMT rules.
- Broad policy considerations for implementing GMT rules.
- The consequences for a country that does not implement the core GMT rules.
- Other implementation considerations—the threshold decision and company migration.
- Interaction between the GMT rules and US GILTI.

## THE NATURE OF THE GMT RULES

It is useful to recall that the GMT rules consist of two interlocking domestic rules:

i) An Income Inclusion Rule (IIR), which imposes Top-up Tax on a parent entity with respect to the income of a constituent entity; and

ii) An Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the income of a constituent entity is not subject to tax under an IIR

The nature of these rules will have important implications for countries with respect to implementation and broader corporate tax policy. There will be options available to countries on *how* they implement the GMT; in many cases, these options will depend on the individual circumstances as well as the ongoing work at the OECD on evaluation of country implementation and safe harbors.

## BROAD POLICY CONSIDERATIONS FOR IMPLEMENTING THE CORE GMT RULES

Under the IIR, the country in which the parent company of a MNE is taxable will impose a Top-up Tax on the profits of any foreign subsidiaries that have effective tax rates of less than 15%. If a country is the parent country of in-scope MNEs, there is a strong rationale to implement the IIR and benefit from any undertaxed profits in subsidiaries.

An important consideration for countries is the complexity of the IIR and the resources required to implement it. In this context, several countries, including in the EU, have highlighted that their effective tax rate was already above 15% and they had few or no Ultimate Parent Entities of MNEs in their country. The cost and complexity of implementing an IIR was disproportionate to the benefits.

The October 2021 agreement recognized the complexity of the GMT rules, and there is a commitment to examine simplification, positive listings, and safe harbors. This process is still ongoing and is expected to be finalized by end 2022. Therefore, it may be premature for countries that have in-scope subsidiaries of MNEs with ETRs above 15% to make definitive policy decisions on practical implementation, pending the outcome of these discussions.

Another issue for consideration is the taxes covered by the GMT rules. In some emerging economies and developing countries, certain sectors are levied turnover taxes in lieu of income taxes (mainly for simplicity). Those turnover taxes do not qualify as “covered taxes” under Pillar 2, and the MNE may be levied a Top-up Tax.

It should be recognized that a global, country-level minimum tax system is a significant undertaking that was never going to be simple. Implementation requires coordinated actions by countries through common rules. The new tax base and the way the covered taxes need to be calculated create additional complexity, which will be challenging for countries and MNEs alike, particularly in low-capacity countries.

## THE CONSEQUENCES FOR A COUNTRY THAT DOES NOT IMPLEMENT THE CORE GMT RULES

A question that will arise for countries is the consequences (if any) of not implementing the core GMT rules—i.e., the IIR and UTPR. As previously discussed, the agreement does not make implementation of the IIR and the UTPR mandatory, but IF countries agree to respect the rules applied in other countries.

As with other issues, the work on safe harbors will provide greater clarity to countries, especially those who have ETRs above 15% and who apply the QDMTT.

Possible scenarios are indicated below:

| SCENARIO | POTENTIAL CONSEQUENCE |
|---|---|
| NO IN-SCOPE MNES | Will depend on the outcome of the ongoing work on safe harbors. |
| UPE OF IN-SCOPE ENTITIES | Dependent on ETR. Could result in UTPR being applied by other countries if profits under taxed. Reputational damage. |
| IN-SCOPE SUBSIDIARIES OF MNES WITH ETR ≥15% | Will depend on the outcome of the ongoing work on safe harbors. |
| IN-SCOPE SUBSIDIARIES OF MNES WITH ETR <15% | Failure to implement will likely result in profits being taxed in other jurisdictions, unless the QDMTT is introduced. If ETR is achieved due to tax incentives, such incentives may be nullified. Potential reputational damage. |

## OTHER IMPLEMENTATION CONSIDERATIONS—THE THRESHOLD DECISION AND COMPANY MIGRATION

GMT rules will apply to MNEs that meet the EUR 750 million threshold, but countries are free to apply the IIR to MNEs headquartered in their country that do not meet the threshold. The IIR allows the country in which a group's parent company is resident to apply a Top-up Tax to the profits of foreign subsidiaries subject to a low effective rate of tax. The rule is similar in purpose to controlled foreign company (CFC) regimes, but CFC rules tend to be more complex and the IIR only applies to larger MNEs (turnover more than EUR 750 million). In addition, nothing prevents countries from choosing a lower threshold when applying the IIR to include domestic groups that are large in the context of the local economy. That would make it possible to charge Top-up Tax on the profits of these smaller groups' foreign subsidiaries.

If countries chose to apply the IIR to smaller groups, they would need to address the risk the policy might lead to company migrations. To avoid the IIR, a group could move its parent to a country that does not apply the IIR. For larger groups within the scope of the GMT rules, the parent's migration will not be effective because the backup UTPR will then apply. That is not so for smaller groups. However, provisions can be put in place domestically to deter this kind of tax-motivated migration. If a country wants to apply the IIR to smaller groups, it might want to introduce such rules, although it should recognize the technical complexity of the rules and the resulting administrative and compliance burdens. Countries will also need to consider whether applying a lower threshold could potentially deter new investment, which may not necessarily be tax driven but rather a response to additional compliance burdens that would not apply in another country.

Countries will also need to reflect on whether the parent country of an in-scope MNE is applying a lower threshold. This may impact the application of a domestic minimum tax within the country and will be important in drafting tax legislation to ensure that undertaxed profits are not inadvertently taxed by the country of the ultimate parent.

## INTERACTION BETWEEN THE GMT RULES AND US GILTI

Another policy consideration that may impact implementation is the interaction between GMT rules and US GILTI rules. In 2017, as part of a wider reform of its corporate tax code in the Tax Cuts and Jobs Act (TCJA), the US introduced a 10.5% minimum tax on Global Intangible Low-Taxed income (GILTI) to discourage profit shifting. The rules allow 80% credit for foreign taxes paid, making the effective GILTI rate 13.125%. If the foreign tax rate is 13.125% or higher, there will be no US tax after the 80% credit for foreign taxes. Under the TCJA, the GILTI rate is scheduled to increase to 13.125% in 2026 (an effective 16.4% with the 80% credit).

Unlike the GMT, the GILTI is calculated on a global blending basis, which means that profits taxed at 5% in one jurisdiction can be balanced out by profits taxed at 30% in another jurisdiction. The GMT rules are calculated on the basis of *jurisdictional* blending—it is not possible to *blend* rates between countries under the GMT.

The current US administration brought renewed energy to the discussions at the IF and was instrumental to the October 2021 multilateral agreement. However, the US did not commit to implementing the GMT Model Rules; rather, the agreement recognizes the co-existence of the US GILTI regime with GMT rules:

**GILTI co-existence**

> It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GLoBE Rules, to ensure a level playing field.

The US administration committed to reforming the GILTI rules to align more closely with the GMT in the context of a comprehensive reform package introduced in Congress as the "the Build Back Better Act." In late 2021, the House of Representatives agreed to legislation reforming GILTI with an effective rate of 15% and jurisdictional blending. However, this legislation has not yet progressed in the Senate. In August 2022, the US agreed to a minimum corporate tax ensuring that large US businesses pay a minimum rate of 15%. The tax is similar in concept to the QDMTT but with design differences.[1]

The US administration signaled a clear intention to implement the International Tax Agreement, but approval of the reforms is required by the legislature. The interaction between the current US GILTI and the GMT rules may need to be considered, recognizing that the work on GILTI co-existence is still ongoing at the OECD.

1 The US minimum corporate tax and the QDMTT share the broad objective of terms of ensuring a 15% effective rate is paid. However, important differences in the rules have been highlighted; see https://taxfoundation.org/inflation-reduction-act-minimum-tax/.

# 5.

# Ensuring that tax incentives are GMT compliant

Evaluating the compatibility of tax incentives will be an important step for countries on the implementation roadmap. The GMT rules do not lead to harmonized tax rates; rather, they set a floor on tax competition, which will reduce incentives for profit shifting to achieve low or zero taxes. Although the GMT will not eliminate tax competition, it will facilitate investment in substance and provide for qualifying tax incentives.

A key feature of the GMT is that the minimum rate of 15% is an effective rate. This effective rate will be calculated on a country-blending basis using recognized accounting standards and using prescribed methodologies for calculating taxable income in accordance with the Model Rules.

## IMPLICATIONS FOR EXISTING TAX INCENTIVE REGIMES

GMT rules will have implications for the design of incentives within tax codes, and countries face the risk that certain incentives will not be GMT compliant. Tax holidays, very low concessional rates, and zero-rate free-trade zones are expected to be caught by the GMT rules. If so, the incentive's benefit to the investor is substantially negated: The tax investors save simply becomes payable elsewhere. The practical effect of a non-qualifying domestic incentive is to transfer part of a country's tax base to other countries.

Countries should carry out an evaluation of their incentives regimes to consider whether they are GMT compliant and remain consistent with the policy objectives of encouraging substance and investment.

A key consideration is how to transition from old rules to the new GMT-compliant ones. This will first require a clear analysis of existing tax incentives' compatibility with GMT rules, followed by a managed reform process to align non-compliant incentives with GMT rules. A policy choice that may need consideration is whether to have a uniform tax incentive structure for all businesses operating in the country or to have specific rules applying to Pillar Two in-scope MNEs.

## SUBSTANCE-BASED INCOME EXCLUSION (SUBSTANCE CARVE-OUT)

The GMT rules include a formulaic carve-out (deduction)[1] to approximate the level of substance an MNE has in a country based on payroll and tangible assets. This carve-out, designed to give some benefit to real investment, was a key aspect of the political agreement.

The carve-out will exclude an amount of income equal to 5% of the carrying value of tangible assets and payroll. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually by 0.2 percentage point for the first five years and by 0.4 percentage point for tangible assets and by 0.8 percentage point for payroll for the last five years.

The payroll costs that qualify for the carve-out include:

- Wage and salary costs.
- Employee benefits that provide a direct personal benefit to the employee (like health insurance and pension contributions).
- Payroll taxes and social security contributions borne by the employer.

The tangible assets carve-out:

- Is based on the average carrying value (net of accumulated depreciation) in the financial statements of assets located in the jurisdiction.
- Tangible assets that qualify include property, plant and equipment, natural resources as well as licenses for the use of immovable property or exploitation of natural resources.

It is expected that incentives related directly to costs incurred, such as full deductibility and accelerated depreciation, should qualify toward the carve-out calculation. However, enhanced or super deductions (e.g., a 130% deduction for an investment expenditure) should not qualify because they grant a favorable permanent book tax difference; therefore, they may require a Top-up Tax, even in high-tax jurisdictions

## QUALIFYING TAX CREDIT REGIMES

A notable aspect of the GMT rules is their recognition of certain tax credits, such as research and development credits. However, the rules put parameters around what constitutes a qualified tax credit and the conditions for such incentives. These will be important considerations for countries that currently offer such credits or are considering offering them. The rules introduce an important distinction between the treatment of refundable and non-refundable tax credits—the former being considered as income and thus more beneficial with respect to the impact on the ETR and the latter being considered a direct tax credit and thus benefits may be negated if the incentive reduces the ETR below 15%.

Depending on the impact on ETRs, this may mean that a country may need to reconfigure their current credit regime to ensure compatibility, preserve the benefit, and perhaps most important ensure the credit meets its policy objective.

Annex 4 sets out some examples to highlight the importance of the design of tax credit incentives with respect to consistency with the GMT rules.

## COMPATIBILITY OF TAX INCENTIVES WITH THE GLOBAL MINIMUM TAX

The compatibility of tax incentives with GMT rules has been one of the key discussion points since the agreement was reached in October 2021 and the Model Rules were finalized. Using a traffic light system, the Tax Foundation[2] examined various incentives' compatibility with the GMT rules. The UN Conference on Trade and Development took a similar approach in an analysis of Pillar Two's implications for tax incentives in its June 2022 *World Investment Report 2022*,[3] which relied on a working paper prepared by WU Vienna University of Economics and Business-Institute for Austrian and International Tax Law.[4]

Work is ongoing at the World Bank on the interaction of tax incentives in the new minimum tax rate environment. The initial analysis (below) arrives at conclusions about various tax incentives' compatibility with GMT rules. These conclusions are similar to those of the Tax Foundation, UNCTAD, and WU

1 Annex 3 provides an illustration of the methodology for calculating the GMT, including with respect to the substance-based income exclusion.

2 https://taxfoundation.org/oecd-global-minimum-tax-rules/ (Daniel Bunn, December 2021).

3 World Investment Report 2022; UNCTAD; June 2022; https://unctad.org/webflyer/world-investment-report-2022.

4 The Treatment of Tax Incentives under Pillar Two; WU Vienna University of Economics and Business-Institute for Austrian and International Tax Law; June 2022; https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4132515.

Vienna University of Economics and Business-Institute for Austrian and International Tax Law. The World Bank includes the proviso that much will depend on individual country-level circumstances in deciding whether a particular tax incentive can be compatible under the GMT.

>>>
### TABLE 3: Tax incentives and the GMT

| INCOMPATIBLE WITH THE GMT[5] |
|---|
| • Tax holiday arrangements<br>• Zero corporate tax<br>• Effective tax rates below 15% in the absence of the QDMTT<br>• Tax-free zones |
| **MAY BE COMPATIBLE BUT WILL DEPEND ON CIRCUMSTANCES[6]** |
| • Reduced-rate incentives (Patent, IP boxes)<br>• Non-GMT compliant tax incentives on refundable tax credits[7]<br>• 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)<br>• Preferential rates above 15% for start-up businesses<br>• Unlimited loss carry-forward<br>• Accelerated depreciation<br>• GMT-compliant Refundable Tax Credits[8] |

Countries can review tax incentives with this guidance in mind. However, individual country circumstances will influence compatibility—not the least of which is how an incentive will impact the ETR. For example, a tax incentive that reduces rates may lead to a 20% effective rate in one country with a headline rate of 30%, but the same tax incentive in another jurisdiction could result in a ETR below 15%. In the absence of a domestic Top-up Tax, it could lead to Top-up Taxes in another country under the IIR.

It is also important to stress that countries should consider that some incentives will be GMT compatible, but it would be prudent to carry out cost-benefit analysis of such tax expenditures to ensure they have a clear policy rationale, are effectively designed to deliver the intended policy objective, and are reviewed periodically.

## MANAGING THE TRANSITION FOR TAX INCENTIVES

The transition to GMT rules will present challenges. This will need careful management because MNEs may have legitimate expectations linked to specific commitments, and consultations with the taxpayers involved will be important.

Managing the transition on tax incentives will also be important, particularly where it is envisaged that a particular incentive will not be compatible with the GMT rules or may need to be reformed. Consultations with taxpayers[9] will be important in terms of managing expectation, forward planning, and input on design.

One of the biggest challenges will be for jurisdictions who have offered tax holidays to MNEs, on a statutory or concessional basis. The GMT rules will effectively nullify the benefits of the tax holidays. In the absence of a QDMTT to achieve an ETR of 15%, there will be a Top-up Tax by other jurisdictions.

Tax holiday arrangements may include conditionality, such as MNE commitments on the number of employees, capital investment over a period of years, or direct investments in infrastructure (e.g., access roads, servicing sites, education programs).

Potential policy options are:

1. Apply a Qualified Domestic Minimum Top-up Tax (ETR 15%) to such MNEs, rather than bring them within the scope of the headline tax rate.
2. Apply the statutory rate to the taxpayer but create a fund to invest in infrastructure, capacity building, or education to benefit the MNE and society more broadly.
3. Combination of both options; i.e., apply the top-up and create an investment fund.

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5 These are unlikely to be compatible unless there is a possibility to blend rates at a jurisdictional level or such incentives may be targeting out-of-scope entities (e.g., smaller businesses below the threshold or purely domestic businesses).

6 Individual country circumstances will be particularly relevant for this category of incentives with respect to compatibility.

7 A Qualified Refundable Tax Credit will be treated as income under GMT rules, while a Non-Qualified Refundable Tax Credit will be treated as a reduction in tax. The latter will be potentially subject to a Top-up Tax that will nullify the impact of the tax credit.

8 Qualified refundable tax credits could reduce ETRs below 15% and therefore would need to be assessed. Annex 4 includes examples of the implications of tax credits' design under GMT rules.

9 For instance, Ireland recently commenced a consultation with stakeholders on the design of the R&D credit and knowledge development box regimes, which specifically highlighted the potential impact of the GMT rules and the Subject-to-Tax Rule (STTR). https://www.gov.ie/en/consultation/d12cb-public-consultation-on-the-research-development-tax-credit-and-the-knowledge-development-box-april-2022/.

# 6.

# Policy options for implementation of the Global Minimum Tax and broader corporate tax reforms

## GUIDANCE ON POLICY OPTIONS

The global minimum effective tax rate for MNEs is a fundamental change to the international tax framework, and many jurisdictions will need to make reforms, whether to protect the tax base, implement the core GMT rules, or carry out a deeper reform process. Countries have implementation options. What options they take will depend on their own circumstances including policy choices and ongoing work at the IF to finalize the Implementation Framework.

An underlying GMT principle is that the minimum rate of 15% is an effective rate that will be calculated on a jurisdictional blended basis[1] using recognized accounting standards and methodologies for calculating taxable income in accordance with the OECD Model Rules. In addition, an expected peer review process will evaluate conformity of individual country laws with the Model Rules to certify them as "qualified."

An open question is whether countries outside the IF can take measures to ensure compatibility with GMT rules.

Given that Pillar Two is a common approach, the expectation is that countries will have a choice of policy options to implement GMT rules and/or ensure compatibility with the rules. This will be particularly relevant for countries with an ETR for in-scope entities of MNEs within the country below 15% (using the GMT base). It will also be important where countries have UPEs (in respect to implementing the IIR) and where countries may have subsidiaries of MNEs (the UTPR).

The policy options for implementing the GMT include (some are complementary):

- Adopting the core GMT Rules—the IIR and UTPR.
- Introducing a domestic Top-up Tax (QDMTT) to achieve the 15% minimum tax within the country.

1 It is the ETR of the MNE (not each entity) within the jurisdiction.

- Implementing a statutory corporate tax rate above the minimum of 15%[2] that could be applied to both in- and out-of-scope businesses. This could include an option to rationalize and simplify the corporate tax code with a rate above the global minimum but applying to a broader base of businesses.
- Withdrawing/adjusting tax holiday arrangements that are not compliant with GMT rules.
- Amending other tax code provisions to ensure they are GMT compliant; e.g., R&D tax credits.
- Introducing GMT-compliant incentives to encourage investment.

The IF discussions with respect to safe harbors may also be relevant because they could provide administrative simplifications for MNEs.

## POLICY OPTIONS

In considering potential policy options, it is useful to group them into four scenarios, recognizing that implementation will depend on the circumstances within a country and that implementation of core GMT rules is not mandatory.

A framework for considering these options is indicated below:

| STATUS QUO | LEVEL 1<br>PROTECTING THE TAX BASE | | LEVEL 2<br>IMPLEMENTING THE CORE GMT RULES | | LEVEL 3<br>CONSIDER BROADER CIT REFORM | |
|---|---|---|---|---|---|---|
| Do nothing | Introduce a QDMTT | Evaluate and reform tax incentive regime | Implement IIR | Implement UPTR *UTPR comes into effect one year after IIR | Broader CIT rate reform | Optimize tax incentive to the GMT rules |

### OPTION 1: DO NOTHING

GMT rules and the common approach mean a country does not need to implement the Model Rules. While the "do nothing" option is *on paper* feasible under the agreement, it is not without risks, particularly with respect to a country foregoing tax revenues by leaving room for another country to impose a Top-up Tax. Of course, this will depend on whether a country has in-scope MNEs, either UPEs or subsidiaries, and whether these entities have ETRs less than 15%. Whether this option is feasible in practice may depend on the safe harbor rules currently being developed by the IF.

An additional risk to this approach is that countries that do not implement any reforms could be vulnerable to being included on negative lists,[3] which could harm investment opportunities and may lead to reputational risks.

## LEVEL 1 MEASURES—PROTECTING THE TAX BASE

A specific feature of the GMT rules is that undertaxed profits can be topped up in other countries. It is recommended that countries take actions to ensure that they do not lose tax revenues to other countries—thus the need to protect its tax base. The options identified are (i) to introduce a Qualified Domestic Minimum Top-up Tax (QDMTT), which is an important part of the architecture of the GMT rules, and (ii) to evaluate and reform (as necessary) tax incentive offering to ensure they are GMT compatible and can continue to meet policy objectives. It is also relevant that these options can help raise revenues, particularly for countries where MNEs are taxed below 15%.

2 GMT rules, including the substance-based income exclusion, means that the statutory CIT rate, even if above 15%, may not result in a GMT ETR of 15%. Thus a QDMTT may be relevant for many countries.

3 For example, the EU Code of Conduct has a listing process for non-cooperative countries. In December 2021, EU Finance Ministers invited the EU Code of Conduct Group to take the work of the Group forward "by further exploring how to enhance the EU listing process based on progress at the international level" https://data.consilium.europa.eu/doc/document/ST-14814-2021-INIT/en/pdf.

## OPTION 2: INTRODUCE A QUALIFIED DOMESTIC MINIMUM TOP-UP TAX

GMT rules contemplate the possibility that jurisdictions will introduce their own Qualified Domestic Minimum Top-up Tax (QDMTT) based on GMT mechanics. The tax is fully creditable against any liability under the GMT, preserving a jurisdiction's primary right of taxation over its own income. This alternative to achieving the objective of a 15% ETR is provided for in the Model Rules through the QDMTT (see Box 3 for the definition and Chapter 5 of the Model Rules[4] for more details).

The QDMTT applies a domestic Top-up Tax to profits arising locally that would otherwise be subject to a tax rate of less than 15%. This could be a case where the headline tax rate is below 15% or where an entity benefits from an effective tax rate below 15% arising from certain tax incentives that may not be GMT compatible.

**Box 3: Definition of a QDMTT under the OECD Model Rules**

Qualified Domestic Minimum Top-up Tax means a minimum tax that is included in the domestic law of a country and that:

(a) determines the Excess Profits of the Constituent Entities located in the country (domestic Excess Profits) in a manner that is equivalent to the GLoBE Rules;

(b) operates to increase domestic tax liability with respect to domestic Excess Profits to the Minimum Rate for the country and Constituent Entities for a Fiscal Year; and

(c) is implemented and administered in a way that is consistent with the outcomes provided for under the GLoBE Rules and the Commentary, provided that such country does not provide any benefits that are related to such rules.

A Qualified Domestic Minimum Top-up Tax may compute domestic Excess Profits based on an Acceptable Financial Accounting Standard permitted by the Authorized Accounting Body or an Authorized Financial Accounting Standard adjusted to prevent any Material Competitive Distortions, rather than the financial accounting standard used in the Consolidated Financial Statements.

Several countries have already signaled that they are considering the introduction of a QDMTT as a means of ensuring that an effective rate of 15%[5] is achieved. Such a policy option is expected to be a key feature of country implementation; otherwise, there is potential for losing tax revenues to other countries.

QDMTT design will be very complex because it will need to very closely follow the rules for constructing income and covered taxes under GMT rules to be effective at closing any top-up opportunities. There is likely to be a process, through the IF and specifically OECD Working Party 11 (on Aggressive Tax Planning), to determine whether a domestic Top-up Tax is qualified under the Model Rules. The intention is to provide certainty to IF members and MNEs.

## OPTION 3: EVALUATE AND REFORM TAX INCENTIVES TO BE IN LINE WITH THE GLOBAL MINIMUM TAX

As discussed in Section 5, GMT rules are likely to have implications for the viability of certain tax incentives, making it prudent for countries to evaluate their incentives regimes. This is particularly relevant in cases where the tax provision (or indeed a combination of reliefs) could lead to an ETR of less than 15%, which could result in a Top-up Tax being applied in other countries under the IIR or UTPR or could be nullified by a qualifying domestic Top-up Tax.

Although such an evaluation will depend on country-specific circumstances, Table 4 illustrates scenarios (non-exhaustive) and suggests potential reform measures a country may wish to consider:

4 https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

5 Mauritius has proposed draft legislation to apply the QDMTT https://budgetmof.govmu.org/documents/2022_23budgetspeech_english.pdf . The UK, Ireland, and Canada have signaled they are considering QDMTTs: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045663/11Jan_2022_Pillar_2_Consultation_.pdf; https://www.gov.ie/en/consultation/c68e4-public-consultation-on-pillar-two-minimum-tax-rate-implementation/ Tax Measures: Supplementary Information | Budget 2022.

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### TABLE 4: Tax incentives compatibility with the GMT

| 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.<br>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.<br>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.<br>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. |

## LEVEL 2 MEASURES—IMPLEMENT THE CORE GLOBAL MINIMUM TAX RULES

Level 2 measures involve implementation of the core GMT rules—the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR). The policy impetus for introducing these rules will depend on country-specific circumstances, particularly the MNEs' profile in the country, and the applicable ETR, taking into account implementation of Level 1 measures.

### OPTION 4: INTRODUCE THE INCOME INCLUSION RULE

The primary core GMT rule is the Income Inclusion Rule (IIR). This rule imposes a Top-up Tax on a parent entity with respect to the income of a constituent entity.

Whether a country implements the IIR will primarily depend on whether it has UPEs of MNEs within its jurisdiction. If a country does not have UPEs, there should not be an immediate requirement to implement the IIR. Conversely, there is a strong case for countries with UPEs of MNEs to implement the IIR. The IIR may become relevant if there are large domestic businesses within a jurisdiction that would seek to expand operations in other countries.

It should be noted that there will be a process at the IF with respect to certification of qualifying rules, including the IIR, to ensure that they are consistent with the Model Rules.

### OPTION 5: INTRODUCE THE UNDERTAXED PAYMENTS RULE

Countries are not obliged to apply an IIR, and failure to implement could undermine the impact of the rule and create incentives for MNEs to locate their parent entities in countries that have no IIR. GMT rules addresses this with a backstop rule, the Undertaxed Payments Rule (UTPR).

The UTPR is a highly complex rule that allocates the Top-up Tax on the profits of lowly taxed MNEs, including those in the parent country, to the other countries in which the MNE carries on business activities. The allocation key for these profits is based on a combination of tangible assets and employees in countries applying the UTPR.

The UTPR may be particularly relevant where countries have in-scope entities of MNEs and the country/countries of

6 The impact of the compatibility of refundable and non-refundable tax credits will depend on country-specific circumstances and specifically how they impact on ETRs; i.e., do they reduce the ETR below 15%. Annex 5 provides examples of the impact of different credits.

7 Broader tax credits include credits for creative industries (e.g., film, TV, and gaming).

the UPE of MNEs do not implement the IRR. As highlighted above, countries can protect their tax base with a QDMTT.

An important consideration is that the UTPR will not come into effect until one year after the IIR. The UTPR also has an exclusion for MNEs in the initial phase of their international activity.[8] The delayed implementation is helpful given resource constraints, and a decision to implement the UTPR can be deferred while taking into consideration global implementation of the IIR and the QDMTT.[9]

## LEVEL 3 MEASURES—CONSIDERATION OF BROADER CORPORATE INCOME TAX REFORMS

The global minimum tax is a significant development in international tax. The core GMT rules, the IIR and the UTPR, are complex, and it may not be necessary for all countries to implement these. However, this new international tax framework may provide opportunities for countries to reshape their CIT regimes, whether through broadening the tax base or considering tax rate reforms that may include revisiting their current tax incentives to attract investment.

### OPTION 6: CONSIDER BROADER CIT REFORM INCLUDING RATE POLICY

An option for countries is to review their overall corporate income tax regime to ensure it is optimized for the new Pillar Two environment. Tax incentives that typically benefit MNEs, such as tax-free zones and tax holidays, will not be compatible in this new environment if they result in ETRs of less than 15%.

Very generous tax incentives stood side by side with high corporate taxes applying to domestic businesses. The removal of incentives under GMT rules may provide an opportunity for countries to offer lower CIT rates that apply to all businesses within a country. Such rates would need to deliver an ETR of at least 15%, although countries could decide to implement a QDMTT as a backstop to avoid the possibility of a Top-up Tax being applied elsewhere. This option may be preferred depending on the outcome of the safe harbor discussions.

Offering this rate to all businesses could avoid a two-tier policy with large MNEs benefiting from preferential rates while out-of-scope business face higher CIT rates.

This policy option could be combined with simplification of the tax code and base broadening. It has the potential to lead to an overall increase in tax revenues and increase attractiveness for investment, although this will depend on circumstances within individual countries.

### OPTION 7: OPTIMIZE TAX INCENTIVE OFFERING IN LINE WITH THE GLOBAL MINIMUM TAX RULES

Option 3 advocates that countries should review and reform tax incentives regimes to be compatible with the GMT rules. This is an important step in protecting the tax base and avoiding low taxation of MNEs and the resulting Top-up Taxes by other countries under the IIR or UTPR.

As another option, countries may wish to consider new incentives that are compatible with the GMT rules, including incentives identified in Section 5. The proviso applies that countries should ensure that tax incentives are tied to a clear policy rationale, effectively designed to deliver the policy objective, measurable, and reviewed periodically.

## IMPLEMENTATION OF THE GLOBAL MINIMUM TAX—DECISION MATRIX FOR DEVELOPING COUNTRIES

The decision matrix below provides further guidance to countries with respect to the Implementation Framework depending on certain scenarios (Table 5).

It is not intended to be definitive or cover all situations because the GMT has many moving parts. Rather, it provides food for thought for the decision-making process. If broader CIT reforms are to be considered, it will be necessary for countries to carry out the required economic analysis and consult with key stakeholders.

8 GMT rules provide for a UTPR exclusion for MNEs in the initial phase of their international activity, defined as those MNEs with a maximum of EUR 50 million in tangible assets abroad and operations in no more than five other jurisdictions.

9 If the UPE countries of MNEs implement the IIR, and other countries implement the QDMTT, the UTPR should not need to be activated.

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**TABLE 5. Implementation of the Global Minimum Tax—decision matrix for developing countries**

| SCENARIOS | STATUS QUO | LEVEL 1<br>PROTECTING THE TAX BASE | | LEVEL 2<br>IMPLEMENTING THE CORE GMT RULES | | LEVEL 3<br>CONSIDER BROADER CIT REFORM | |
|---|---|---|---|---|---|---|---|
| | DO NOTHING | INTRODUCE A QDMTT | EVALUATE AND REFORM TAX INCENTIVE REGIME | IMPLEMENT IIR | IMPLEMENT UPTR<br>*UTPR COMES INTO EFFECT ONE YEAR AFTER IIR | BROADER CIT RATE 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 | x | ✓ | ✓ | ✓✓ | ✓ | ✓ | ✓ |
| COUNTRY HAS SUBSIDIARIES OF IN-SCOPE MNES | ? | ✓ | ✓ | ? | ? | ✓ | ✓ |
| COUNTRY HAS ENTITIES OF IN-SCOPE MNES WITH AN ETR OF <15% | x | ✓✓ | ✓✓ | ? | ? | ✓ | ✓ |
| COUNTRY HAS LARGE DOMESTIC BUSINESSES | x | ✓ | ✓ | ? | ? | ✓ | ✓ |
| COUNTRY IS SEEKING TO ATTRACT INVESTMENT FROM IN-SCOPE MNES | x | ✓✓ | ✓✓ | ? | ? | ✓ | ✓ |

*✓✓- Strongly recommended ✓ - Recommended*

*? – For consideration—will depend on country circumstances, policies, and safe harbors*

*X – Not recommended*

## POLICY CONSIDERATIONS ON SCENARIOS

| | |
|---|---|
| COUNTRY HAS NO IN-SCOPE MNES | GMT rules only apply to MNEs with annual global revenues of EUR 750 million. A de minimis applies to these rules. Entities are not in scope if they have revenues in a country of less than EUR 10 million and profitability of less than EUR 1 million.<br>A country will need to review aggregate CbCR data and tax administration data to evaluate whether there are in-scope entities of MNEs.<br>If a country does not have in-scope entities, then **there is no pressing need** to implement reforms. However, taking no action entails risks to listing processes and attracting investment. A potential option would be implementing a QDMTT, which would only apply to in-scope entities. This would ensure a tax code that would prevent leakage in case circumstances changed and in-scope entities were later in the jurisdiction, perhaps through new investment or a merger/acquisition. |
| COUNTRY IS THE UPE OF IN-SCOPE MNES | If there are Ultimate Parent Entities of in-scope MNE groups within a country, implementing the IIR is strongly recommended. It would also be prudent to implement the UTPR to reduce any incentive for the MNE to relocate to another country.<br>The decision to implement a QDMTT will depend on a country's effective rates. It would be essential if a country has entities with ETRs below 15%. As a matter of course, tax incentives should be reviewed and reformed as necessary.<br>As with other options, there may be a case to consider broader corporate tax reforms, including base broadening. |

| | |
|---|---|
| **COUNTRY HAS SUBSIDIARIES OF IN-SCOPE MNES** | If a country has subsidiaries of in-scope entities in cases where the ETR is at least 15%, an analysis of potential implementation options is recommended.<br>The case for implementing different options, including the QDMTT, the IIR and the UTPR, will depend on the nature of the existing regime (including tax rates) and is likely to depend on the safe harbor rules that will be forthcoming from the OECD.<br>For countries with UPEs of in-scope MNEs that do not implement the IIR, a UTPR could be important and implementation should be kept under review.<br>A country can protect its tax base by introducing a QDMTT, and this may be prudent depending on the outcome of the safe harbor rules.<br>An evaluation of tax incentives' compatibility with GMT rules and broader investment policy is advised. |
| **COUNTRY HAS ENTITIES OF IN-SCOPE MNES WITH AN ETR OF <15%** | If a country has entities of in-scope MNEs with an ETR of <15%, it is strongly recommended to implement a QDMTT to avoid Top-up Taxes being collected in the country of the UPE of in-scope MNEs. It would also be prudent to review/reform tax incentives, particularly where the country's statutory rate is above 15%.<br>A UTPR could be important if the country of the UPE of in-scope MNEs does not implement the IIR, and implementation should be kept under review.<br>Broader corporate tax reforms should be considered with a backstop of the QDMTT. |
| **COUNTRY HAS LARGE DOMESTIC BUSINESSES** | There may be revenue benefits for a country from ensuring that domestic businesses are subject to the minimum effective tax rate and reviewing tax incentives and broader corporate income tax policy.<br>It could be the case that there are large domestic businesses within a jurisdiction that do not have entities outside that jurisdiction but may expand operations in the future.<br>It may also be prudent to implement a QDMTT and consider implementing an IIR in case of low taxation in the country of subsidiary entities. |
| **COUNTRY IS SEEKING TO ATTRACT INVESTMENT FROM IN-SCOPE MNES** | Given that 137 countries are committed to implementing or respecting the GMT rules, the expectation is that this will become a global standard. Therefore, compliance with the GMT rules, along with an incentive-friendly tax system within GMT guardrails, will be an important indicator for investors. Such compliance may be determined by safe harbor rules, including the application of a QDMTT. |

## KEY TAKEAWAYS

Box 4 summarizes the key takeaways in considering policy options for developing countries.

### Box 4: Key takeaways for implementation

I. The global minimum tax is an important development in the international tax architecture that provides an **opportunity for countries to review their corporate income tax regimes**.

II. **For many countries the "do nothing" option is not viable**. At the very least, countries will need to assess whether in-scope 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.

IV. **It may not be necessary for countries 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.

# 7.

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# A roadmap toward implementation

This section builds on Sections 4, 5, and 6, which examined key policy considerations, tax incentives, and implementation options for countries with respect to Pillar Two GMT rules.

### Recommendation 1—Confirmation the country will ensure compatibility with GMT rules and evaluate implementation options

Countries may wish to signal that they will ensure their tax codes will be compatible with the October 2021 agreement and GMT rules. The signal may note progress on implementation in the EU and in G20 and OECD countries.

The current expectation is that legislation will be introduced in 2022-2023, with the IIR applying from 2024 and the UTPR applying from 2025.

Since work is still ongoing at the OECD with respect to practical implementation, it would be premature for a jurisdiction to finalize implementation at this point, although preparatory work should be undertaken.

Regardless the option(s) chosen, it is key for countries to provide tax certainty on the path ahead to support a friendly business climate. While the new tax rules are being finalized in the IF, important considerations for countries is providing clear communications on policy considerations to stakeholders and ensuring that preparatory work is ongoing. The communications are important to better managing expectations and providing tax certainty to MNEs as well as the broader investment climate. While the implementation timeframe remains uncertain, **it is recommended that countries commence the preparatory work for reforms to their CIT regime**. A number of steps will need to be taken, some of them complex, and these steps should be undertaken at an early stage.

It is important that the process be supported by a project team from the finance ministry and the tax administration. Consultations may be needed with other areas of government such as the ministries for enterprise and foreign affairs.

**Recommendation 2—Carry out preparatory work for implementation**

It is recommended that countries already start preparatory work for determining necessary reforms to ensure conformity of their CIT regimes with the GMT. This preparatory work includes the following steps:

- Establish a project team of officials in the finance ministry and tax administration to guide implementation.
- Analyze CbCR data to evaluate the number of in-scope MNEs and their ETRs.
- Estimate revenue impact of implementing the GMT if ETRs below 15%.
- Carry out an analysis of existing tax incentives in terms of compatibility with the GMT Model Rules.
- Identify possible policy options for implementation, particularly with respect to tax rates and tax incentive policies.
- Carry out an analysis of existing legislation and identify possible legislative amendments subject to decisions on policy options.

**Recommendation 3—Stakeholder engagement**

It is important that countries engage with stakeholders on implementation of the International Tax Agreement, specifically with respect to the GMT rules. The communications can not only assist in bringing greater certainty to taxpayers (and minimizing disputes) but also facilitate important input into the policy development process.

This consultation process can examine:

- Implementation options; e.g., application of the Qualified Domestic Minimum Top-up Tax.
- Broader policy options.
- Legislative amendments and administrative arrangements, including simplification/ compliance obligations.
- Tax code reforms needed to ensure conformity with GMT rules; e.g., tax incentives.
- Transition arrangements and timing of implementation.

Ensure transparency in the consultation process, particularly regarding how it will feed into policy and legislation. In line with good practices and with reference to cooperative compliance frameworks, a dialogue between individual taxpayers and the revenue administration may be necessary to better understand potential implications and issues.

A critical element in a tax reform process is ensuring certainty. In this context, communication with stakeholders can be beneficial in terms of managing expectations and involving stakeholders in the policy development process.

Stakeholder consultations are recommended in implementing the GMT. The extent of the engagement will depend on the circumstances in each country. The engagement can offer an opportunity to get feedback on policy options, including possible simplifications in the tax code. This consultation process will be especially important where an analysis of the tax code identifies inconsistencies between GMT rules and existing tax incentive arrangements, such as tax-free zones or tax holidays. These regimes sometimes include contractual commitments between a country and an MNE/investor (e.g., fiscal stability pacts). In these cases, it is important that there is early engagement to arrive at mutually beneficial arrangements that acknowledge GMT rules will not recognize such arrangements if the ETR on a jurisdictional blending basis is lower than 15%. These arrangements could also help to better manage potential controversies and save money and time for both taxpayers and governments.

## WORLD BANK SUPPORT

The global minimum tax rules are highly complex, and the new system introduces many moving parts that impact policy considerations. Some complexity also arises in such an exercise because of the need to find compromises to achieve the necessary consensus. In addition, there are knowledge gaps for officials in many countries that were not actively involved in developing the Model Rules.

Well-resourced countries have indicated that the GMT is a challenging exercise and have already started the implementation process by establishing internal project teams and commencing public consultations. Implementing the GMT is expected to be very challenging for low-capacity countries; in this context, the World Bank stands ready to support countries in implementing the rules.

Support can be through regional seminars, including deep-dive technical sessions on the Model Rules, implications for tax incentives, broad policy options, public consultation strategy, and recommendations for implementation. Such seminars can also facilitate the building of networks within the regions.

Given the complexity of the rules, it is expected that there will be a demand to provide technical assistance on a country level. The World Bank is well-placed to provide such assistance upon request, recognizing that countries will have different needs and priorities.

**World Bank support can involve:**

i) Capacity building with tax officials, such as providing detailed training on the GMT rules through workshops that can help shape countries' policymaking processes.

ii) Supporting developing a realistic roadmap.

iii) Assisting with impact assessments.

iv) Supporting assessments of existing tax incentives and compatibility with GMT rules.

v) Providing advice on policy implications and options, including to tax incentives.

vi) Assisting with the public consultations (process and analysis).

vii) Assisting with drafting of legislation and implementation.

# Annex 1 – October 2021 International Tax Agreement for Pillar Two

The following text is an extract from the October 2021 Agreement

## OVERALL DESIGN

Pillar Two consists of:

- two interlocking domestic rules (together the Global anti-Base Erosion Rules (GLoBE) rules): (i) an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and (ii) an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR; and
- a treaty-based rule (the Subject to Tax Rule (STTR) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GLoBE rules.

## RULE STATUS

- The GLoBE rules will have the status of a common approach. This means that IF members:
- are not required to adopt the GLoBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the IF;
- accept the application of the GLoBE rules applied by other IF members including agreement as to rule order and the application of any agreed safe harbors.

## SCOPE

The GLoBE rules will apply to MNEs that meet the 750 million euros threshold as determined under BEPS Action 13 (country by country reporting). Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold.

Government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds are not subject to the GLoBE rules.

## RULE DESIGN

The IIR allocates top-up tax based on a top-down approach subject to a split-ownership rule for shareholdings below 80%.

The UTPR allocates top-up tax from low-tax constituent entities including those located in the UPE jurisdiction. The GLoBE rules will provide for an exclusion from the UTPR for MNEs in the initial phase of their international activity, defined as those MNEs that have a maximum of EUR 50 million tangible assets abroad and that operate in no more than 5 other jurisdictions.[1] This exclusion is limited to a period of 5 years after the MNE comes into the scope of the GLoBE rules for the first time. For MNEs that are in scope of the GLoBE rules when they come into effect the period of 5 years will start at the time the UTPR rules come into effect.

## ETR CALCULATION

The GLoBE rules will operate to impose a top-up tax using an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined by reference to financial accounting income (with agreed adjustments consistent with the tax policy objectives of Pillar Two and mechanisms to address timing differences).

In respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within 4 years and taxed at or above the minimum level.

1 An MNE is considered to operate in a jurisdiction if that MNE has a constituent entity in that jurisdiction defined for purposes of the GMT rules.

## MINIMUM RATE

The minimum tax rate used for purposes of the IIR and UTPR will be 15%.

## CARVE-OUTS

The GLoBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is 5% of the carrying value of tangible assets and payroll. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last five years.

The GLoBE rules will also provide for a *de minimis* exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million.

The GLoBE rules also provide for an exclusion for international shipping income using the definition of such income under the OECD Model Tax Convention.

## SIMPLIFICATIONS

To ensure that the administration of the GLoBE rules are as targeted as possible and to avoid compliance and administrative costs that are disproportionate to the policy objectives, the implementation framework will include safe harbors and/or other mechanisms.

## GILTI CO-EXISTENCE

It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GLoBE rules, to ensure a level playing field.

### SUBJECT TO TAX RULE (STTR)

IF members recognize that the STTR is an integral part of achieving a consensus on Pillar Two for developing countries. IF members that apply nominal corporate income tax rates below the STTR minimum rate to interest, royalties and a defined set of other payments would implement the STTR into their bilateral treaties with developing IF members when requested to do so. The taxing right will be limited to the difference between the minimum rate and the tax rate on the payment. The minimum rate for the STTR will be 9%.

### IMPLEMENTATION

Pillar Two should be brought into law in 2022, to be effective in 2023, with the UTPR coming into effect in 2024.

*Note: The implementation timeframe has changed since the October 2021 agreement. It is now envisaged that countries will bring it into law over the course of 2022 and 2023, with effective implementation in 2024.*

# Annex 2 – State of Play of Global Implementation of Pillar Two (as of August 2022)

## CANADA IMPLEMENTATION

In April 2022, Canada joined the group of countries commencing implementation of Pillar Two of the October 2021 agreement. Like other countries, Canada signaled an open date in 2023 for implementation. The government's April 2022 Budget[1] announced the intention "to implement Pillar Two, along with a domestic minimum Top-up Tax that would apply to Canadian entities of MNEs that are within the scope of Pillar Two. The government anticipates that draft implementing legislation would be publicly released for consultation and the IIR and domestic minimum Top-up Tax would come into effect in 2023 as of a date to be fixed. The UTPR would come into effect no earlier than 2024."

Canada also launched a public consultation in the April Budget, the principal purpose of which "is to ensure that the draft legislation takes account of any necessary adaptations of the Model Rules to the Canadian legal and income tax context, rather than to seek views on the major design aspects of the Model Rules or broader policy considerations."

## EUROPEAN UNION IMPLEMENTATION

The European Commission published a proposal for an EU Directive (the Minimum Tax Directive) in late December 2021, which transposes GMT rules into an EU legislative instrument that will bind the 27 EU Member States to implement through national legislation. This proposal for a Directive closely followed the agreement and the Model Rules, which were finalized by the OECD working party in November 2021 and published in December 2021 following agreement by the IF.

EU-level negotiations have proceeded rapidly with discussions by EU Finance Ministers in March, April and June 2022 being close to reaching unanimous agreement[2] on a legal text – there is an expectation now that agreement can be reached in October 2022. Concessions were made in the negotiations that are likely to have broader implications for implementation elsewhere. The first is that EU Member States with fewer than 12 in-scope Ultimate Parent Entities can delay implementation of the IIR. The rationale addressed concerns raised by several smaller EU Member States with respect to the cost-benefit of implementing the IIR in cases of a small number of in-scope MNEs and an ETR greater than 15%. There would be no material revenue gain for these jurisdictions. The Commission proposal had foreseen implementation of the IIR for all EU Member States, which went beyond the common approach in the October 2021 agreement.

The second concession—the one particularly relevant for countries outside the EU—is the proposal that member states will be required to transpose the directive into national legislation before end 2023, applying to taxable periods commencing on or after December 31, 2023. This is broadly in line with implementation in 2023, which was foreseen by the October 2021 agreement, but the reality is EU Member States' implementation will to all intents and purposes be 2024. This responded to the views, voiced by several Member States, that introducing legislation to transpose the IIR into national legislation in 2022 was not possible because of parliamentary procedures and the work on critical aspects not yet been finalized at the OECD. The expectation is that this will be welcomed by many countries globally, who were facing similar implementation challenges. Such a timeframe will also be welcomed by taxpayers, given that implementation may require systems development.

## REPUBLIC OF KOREA IMPLEMENTATION

As part of 2022 tax reform, the Korean Ministry of Strategy and Finance (MOSF) announced the introduction of draft domestic legislation for a global minimum tax on July 21.[3]

1 Tax Measures: Supplementar y Information | Budget 2022.

2 So far, 26 of the 27 EU Member States have agreed the Directive. Poland lifted its reservation opposing agreement in June 2022. In the same month, however, Hungary decided to oppose agreement. Czech Republic, which now holds the EU Council of Ministers Presidency, has stated it will seek agreement in October 2022. https://www.euractiv.com/section/politics/short_news/czech-eu-presidency-aims-for-15-corporate-tax-deal-by-end-of-october/.

3 https://www.pwc.com/us/en/services/tax/library/korea-releases-draft-pillar-two-rules.html.

## MALAYSIA IMPLEMENTATION

In August 2022,[4] the Malaysian Ministry of Finance published a Budget 2023 Public Consultation Paper (PCP) titled "The Implementation of GLoBE Rules in Malaysia." The comprehensive document specifically explores the benefits of implementing a QDMTT and examines the role of tax incentives under the GMT, asking for suggestions on "how Malaysia could incorporate its current incentive schemes into the framework of the [GMT] Rules to ensure the incentives remain relevant to attract FDIs."

## MAURITIUS IMPLEMENTATION

The Ministry for Finance, in its 2022/2023 Budget Speech,[5] announced the intention to introduce a QDMTT to ensure resident companies of larger multinationals are taxed at a minimum rate of 15%. The bill proposes to introduce this tax on a date that remains to be decided. The tax will be imposed in accordance with the GMT developed by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). Draft legislation was published in July 2022 for consultations.

## NEW ZEALAND IMPLEMENTATION

In May 2022, New Zealand Inland Revenue launched a consultation[6] on implementation of GMT rules, scheduled to run into July. While recognizing the uncertainties about the implementation timeframe, the staff consultation was launched "on the basis that if the required critical mass of other countries does adopt GLoBE Rules, the Government will need to decide whether to join them in doing so. If the Government does decide to adopt the rules, then consistent with the October Statement it may be desirable for the IIR to apply in New Zealand from 2023 and it will certainly be desirable for it to do so from 2024." The consultation addresses key questions relating to implementation.

The consultation clarifies that New Zealand has not decided whether to adopt GMT rules, recognizing the October 2021 agreement does not require it. But the country accepts the rights of others to apply the IIR and the UTPR. However, New Zealand's consultation does refer to the current views of staff "that if a critical mass of countries adopts, or is highly likely to adopt, GLoBE Rules, (they) would recommend that New Zealand take steps to join them. This will ensure New Zealand rather than other countries collects the revenue from any undertaxed constituent entities of New Zealand headquartered groups."

## SWITZERLAND IMPLEMENTATION

In January 2022, Switzerland announced it would be applying the GMT, effective January 1, 2024.[7] The Swiss intend to **implement** GMT **by means of a constitutional amendment. Based on that decision, a temporary ordinance should ensure the minimum tax rate comes into force on the announced date. In addition, Switzerland signaled that** the minimum tax rate would only apply to multinational companies with annual turnover of at least EUR 750 million and that the taxes will be collected by the cantons for their benefit. Switzerland has already held a public consultation on implementation and launched a consultation on GMT draft legislation in August 2022.[8]

## UNITED KINGDOM IMPLEMENTATION

In January 2022, the UK launched a public consultation on the implementation of the GMT.[9] The process signals the UK's intention to implement GMT in line with the Model Rules and apply the EUR 750 million threshold.

Significantly, with perhaps relevance to developing countries, the UK is exploring the introduction of a QDMTT (or DMT), justifying that:

> "Rather than allowing a foreign country to charge Top-up Taxes in relation to any low-taxed profits of a group's entities in the UK, the UK would instead impose that Top-up Tax… This is because a [Domestic Minimum Tax] DMT would only ensure that any additional tax on UK economic activities and profits that results from the Pillar 2 minimum tax framework is to the benefit of the UK Exchequer. In

4 See press release https://www.mof.gov.my/portal/en/news/press-release/budget-2023-tax-related-pcp and consultation https://budget.mof.gov.my/pdf/konsultasi-awam/Public-Consultation-Paper-Globe-Rules-TAX.pdf.

5 See budget speech https://budgetmof.govmu.org/documents/2022_23budgetspeech_english.pdf and draft legislation https://mauritiusassembly.govmu.org/Documents/Bills/intro/2022/bill1422.pdf.

6 https://taxpolicy.ird.govt.nz/-/media/project/ir/tp/publications/2022/2022-ip-oecd-pillar-two/2022-ip-oecd-pillar-two-pdf.pdf?modified=20220505013401&modified=20220505013401.

7 https://www.efd.admin.ch/efd/en/home/steuern/steuern-international/implementation-oecd-minimum-tax-rate.html.

8 https://www.admin.ch/gov/fr/accueil/documentation/communiques.msg-id-89967.html.

9 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045663/11Jan_2022_Pillar_2_Consultation_.pdf.

other words, businesses would in most cases pay the same level of tax on their UK profits whether there was a DMT or not, but rather than allow another country to collect that tax, a DMT would ensure the tax is paid to the government."

This is a clear recognition that alternative approaches could lead to circumstances where the tax is paid to other countries.

The UK published draft legislation to apply the IIR in July 2022.[10] The proposed operative date for the IIR in the UK is fiscal years beginning on or after December 31, 2023, mirroring the EU and others, including Switzerland.

## UNITED STATES IMPLEMENTATION

In the US, the Biden Administration has been a strong supporter of the October 2021 agreement. The US introduced a minimum tax regime similar to the GMT rules in 2017—the Global Intangible Low-Tax Income (GILTI), part of the Tax Cuts and Jobs Act (TCJA). Under existing rules, GILTI applies an effective rate of 10.5% (scheduled to increase to 13.125% in 2026). The GILTI rules also allow for a foreign tax credit (FTC) of up to 80% of the foreign income taxes paid by controlled foreign companies. A key difference: The existing US GILTI regime is calculated on a blended worldwide basis, while GMT rules are calculated on the basis of jurisdictional blending.

GILTI co-existence with the GMT is recognized in the October 2021 agreement: "It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GLoBE Rules to ensure a level playing field."

The US administration has committed to reform the GILTI to apply the 15% rate and to calculate the rate on a jurisdictional basis in line with the October 2021 agreement.[11] It will be important for countries with US MNEs to evaluate any differences between GILTI and GMT rules that could impact policy options for implementation.

In August 2022, the US agreed a 15% minimum corporate tax, which is similar in concept to the QDMTT in ensuring that large US businesses pay a minimum rate of 15%, although there are design differences.[12]

10 https://www.gov.uk/government/publications/introduction-of-the-new-multinational-top-up-tax.

11 https://home.treasury.gov/news/press-releases/jy0629.

12 The US minimum corporate tax and the QDMTT share the broad objective of terms of ensuring a 15% effective rate is paid. However, important differences in the rules have been highlighted; see https://taxfoundation.org/inflation-reduction-act-minimum-tax/.

# Annex 3 – Identifying in-scope MNEs and estimating revenues

Revenue impact is a key determining factor in implementing the GMT rules. In (many) countries, effective tax rates for all in-scope MNEs within the country exceed 15%; there will be no Top-up Tax on the ultimate parent and no additional revenue will flow to any country. For countries with ETRs of in-scope MNE's are below 15%, estimating the revenue impact has merit and can feed into decisions on policy options.

Calculating potential revenues gains from introducing an IIR is not a simple exercise. A number of factors need to be considered:

- What is the ETR of in-scope entities taking into account the GMT base?
- What are the entities' current revenues and profits (calculated on an entity-by-entity basis or from general assumptions based on headline CbCR data)?
- What are the results of a calculation based on a domestic Top-up Tax or applying a new rate to estimate the revenue impact?

Initially, the analysis should be carried out on a static basis because it will be very difficult to predict firm-level behavior. Limitations on the CbCR data should be recognized. The most recent available public data relates to 2017, a period preceding full BEPS implementation and the 2017 US tax reforms, which may have already impacted firm-level behavior.[1] As a result, it is important that countries also use other sources of data, including information held by tax administrations, that can help ensure greater accuracy on revenue estimates.

## 1. Identifying in-scope MNEs

### USING AGGREGATE CBCR DATA

Under BEPS Action 13, all large MNEs are required to prepare a country-by-country report (CbCR) with aggregate data on the global allocation of income, profits, taxes paid, and economic activity among tax countries in which it operates. This CbCR is shared with tax administrations in these countries for use in high-level transfer pricing and BEPS risk assessments.

The Ultimate Parent Entity (UPE) of an MNE Group prepares and files its CbCR with the tax administration in its jurisdiction of tax residence. That tax administration will automatically exchange the CbCR with the tax administration in each jurisdiction listed in the CbCR as being a place in which the MNE group has a constituent entity resident for tax purposes. This will be carried out under an international agreement permitting automatic exchange of information (AEOI)—such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAAC), a Double Tax Convention (DTC), or a Tax Information Exchange Agreement (TIEA). A Qualifying Competent Authority Agreement (QCAA) that sets out the operational details of the exchange of CbCR data will also need to be in place. Approximately 100 countries have implemented CbCR,[2] with peer reviews ongoing. This is a welcome development, but many developing countries, including members and non-members of the IF, have either not yet fully implemented CbCR or are not currently receiving the data. This creates limitations to the use of this data to analyze in-scope MNEs at the global level. However, the OECD CbCR database provides country-level information on in-scope entities, reflecting data[3] provided by respective countries.

1 Research carried out in 2021 by Seamus Coffey, University College Cork, on behalf of Ireland's Department of Finance and presented in "The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of US multinationals" has indicated a substantial shift in the destination of outbound royalty payments from Ireland. Where previously these payments would have gone to zero-tax jurisdictions, a significant amount of the payments now go directly to the US, an indicator IP was moved to the US. See https://assets.gov.ie/137516/be3d5981-44be-4cbf-9b60-2174e5d5efb3.pdf .

2 See https://www.oecd.org/tax/automatic-exchange/country-specific-information-on-country-by-country-reporting-implementation.htm#cbcrequirements.

3 OECD country CbCR data are available at https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT#.

For illustrative purposes, a selection of data from 2017 aggregate CbCRs is used below to provide key indicators for a sample of countries:

| COUNTRY | US MNES IN- SCOPE | NON-US MNES IN -SCOPE | TOTAL MNES IN-SCOPE | EMPLOYEES (000'S) | TOTAL REVENUE (USD MILLIONS) | PROFITS (USD MILLIONS) | TAX (CASH) (USD MILLIONS) | ETR CASH* |
|---|---|---|---|---|---|---|---|---|
| Barbados | 170 | 40 | 210 | 1.5 | 24,877 | 6200 | 22.8 | 0.37% |
| Chile | 378 | 542 | 920 | 847 | 266,549 | 25,492 | 45,47 | 17.8% |
| Costa Rica | 192 | 164 | 362 | 1,201 | 20,157 | 1,560 | 319 | 20.4% |
| Dominican Republic | 128 | 96 | 224 | 91 | 7,761 | 1,088 | 214 | 19.6% |
| Fiji | 19 | 25 | 44 | 3.7 | 853 | 128 | 28 | 21.5% |
| Georgia | 27 | 48 | 75 | 6.5 | 2,166 | 125 | 11 | 8.9% |
| Indonesia | 280 | 910 | 1,190 | 1,608 | 306,233 | 34,137 | 9,565 | 28% |
| Mexico | 895 | 1,108 | 2,003 | 3,937 | 871,445 | 54,938 | 18,769 | 31.3% |
| South Africa | 412 | 663 | 1,075 | 1,204 | 240,480 | 28,432 | 5,063 | 17.8% |
| Thailand | 401 | 1,037 | 1,438 | 1,110 | 293,405 | 23,947 | 3,980 | 16.6% |
| Vietnam | 180 | 693 | 873 | 622 | 61,609 | 5,242 | 895 | 17.1% |

**The CbCR also include data with tax paid on an accrued basis. This may result in a different tax rate.*

## INDIVIDUAL COUNTRY ANALYSIS

The CbCR data also allow a country to carry out an analysis of all entities within that country that come within scope of the GMT. Below is an example for Vietnam:[4]

| Year | 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Grouping | All Sub-Groups | | | | | | | |
| | Financial Variables | | | | | | | |
| Variable | Number of CbCRs | Number of CbCR Sub Groups | Number of Entities | Total Revenues | Profit (Loss) before Income Tax | Income Tax Paid (on Cash Basis) | Income Tax Accrued - Current Year | Number of Employees |
| **Ultimate Parent Jurisdiction** | | | | | | | | |
| Australia | 18 | 18 | 25 | 624,861,071 | 107,182,369 | 17,272,186 | -3,368,236 | 3,215 |
| Denmark | 15 | 15 | 24 | 604,421,225 | 25,581,818 | 9,051,335 | 5,577,503 | 8,530 |
| France | 55 | 55 | 134 | 1,842,173,804 | 110,196,154 | 30,561,407 | 28,139,415 | 16,000 |
| Germany | 66 | 66 | 98 | 2,713,718,745 | 209,274,620 | 41,449,597 | 47,564,464 | 18,280 |
| Italy | 15 | 15 | 18 | 580,986,709 | 45,838,992 | 5,632,020 | 7,670,636 | 4,686 |
| Japan | 383 | 383 | 1,027 | 37,077,336,158 | 3,384,079,974 | 559,916,564 | 546,979,815 | 444,289 |
| Luxembourg | 15 | 15 | 27 | 340,878,598 | 18,619,296 | 639,981 | -870,180 | 3,827 |
| Spain | 5 | 5 | 17 | 148,481,944 | 45,932,448 | 16,866,578 | 17,882,211 | 212 |
| Switzerland | 19 | 19 | 28 | 1,907,537,168 | 177,534,810 | 35,323,209 | 32,903,474 | 14,298 |
| United States | 180 | 180 | .. | 9,343,102,413 | 714,806,209 | 125,769,067 | 136,597,797 | 69,562 |
| Bermuda | 8 | 8 | 11 | 108,471,352 | 10,974,417 | 2,407,513 | 2,354,325 | 3,023 |
| China (People's Republic of) | 44 | 44 | 73 | 2,501,128,779 | 164,457,609 | 14,585,983 | 18,608,456 | 22,823 |
| India | 15 | 15 | 19 | 970,837,712 | 68,639,665 | 3,902,595 | 2,942,447 | 2,864 |
| Indonesia | 1 | 1 | 3 | 103,622,233 | 1,511,816 | 0 | 0 | 689 |
| Malaysia | 13 | 13 | 24 | 360,806,050 | -4,727,380 | 2,890,747 | 2,970,354 | 2,064 |
| Singapore | 20 | 20 | 81 | 2,378,614,831 | 163,076,531 | 28,486,464 | 27,804,092 | 8,288 |
| South Africa | 1 | 1 | 2 | 2,608,492 | -499,700 | 0 | 0 | 94 |

*Source: OECD tax database*

4 The 2017 data for Vietnam was customised using the OECD database.

The table shows that Vietnam reported 873 in-scope MNEs in 2017, employing a total of 623,000 employees while generating revenues of USD 62 billion and profits of USD 5.2 billion. The taxes paid on those profits (cash basis) were USD 894 million, indicating a tax rate of 17.1% was levied on those MNEs.

While this example illustrates how to identify in-scope MNEs within Vietnam, the indicated tax rate is not conclusive because it may not take account of differences between the existing tax base and the GMT Model Rules. In addition, this calculation may not take into account tax rates for individual MNEs with effective rates lower than 15% due to tax holidays or other tax incentives that may not be GMT compliant. For this reason, there may be a need to use other information sources, including tax administration data, to estimate revenue gains and impacts.

## COUNTRY LEVEL ANALYSIS

### USING CBCR DATA

There are sensitivities about using CbCR data for purposes other than high-level transfer pricing risks. However, Pillar Two is intended to address remaining BEPS issues, and it is reasonable to assume that using the data (while protecting taxpayer confidentiality) can help inform finance ministries and tax administrations on implementation of GMT rules. In using CbCR data, care will be needed where only a small number of entities within a country are within scope of CbCR—this could reveal tax rates paid and breach taxpayer confidentiality.

The OECD has produced guidance on CbCR data, and it is important than countries are familiar with it:[5]

> "The ability of a country to obtain and use CbC Reports is conditional upon it using CbCR information appropriately. This condition is described in paragraphs 25 and 59 of the Action 13 Report, and is given effect through Article 6(1) of the model legislation and paragraph 2 of Section 5 of the multilateral and model bilateral CAAs. For these purposes, appropriate use is restricted to:
>
> - high level transfer pricing risk assessment
> - assessment of other base erosion and profit shifting related risks
> - economic and statistical analysis, where appropriate."

With respect to using CbCR data for economic and statistical analysis, the OECD guidance clarifies that:

> "the Action 13 Report does not contain guidance with respect to the ability of tax authorities to use information in CbC Reports for assessing other BEPS-related risks or for economic and statistical analysis. CbCR information may be used for economic and statistical analysis, where appropriate (e.g., such use is not appropriate where it is not permitted under the relevant tax convention or TIEA) but no other details on this are provided. The Action 13 Report also does not define the term "BEPS-related risks"."

The CbCR data can provide a country with high-level information to identify MNEs in their country that are in scope of GMT rules or the equivalent. This information, coupled with other sources available to a tax administration or publicly available information, can assist in determining the ETR for an entity under GMT rules and help guide decisions on implementing of Pillar Two and on its revenue impacts.

A limitation for developing countries is that many of them do not receive the company specific data. Therefore, other sources of information will be needed for revenue estimates and policy decisions. A suggested hybrid approach is identified below, which uses aggregate and other information sources.

### HYBRID APPROACH

Alternative sources of information may be necessary given the limited availability of company specific CbCR data for many developing countries. These may include, for example, the Orbis database, which could be complemented by tax administration data and liaisons between the tax administration and businesses within the jurisdiction.

A public consultation (see Annex 5) may be useful in this context, complemented by engagement with large accounting practices that can indicate which clients are in scope of GMT rules and estimate the ETR within the jurisdiction.

5 https://www.oecd.org/tax/beps/beps-action-13-on-country-by-country-reporting-appropriate-use-of-information-in-CbC-reports.pdf.

# 2. Guidance to assist in calculating revenue gains in implementing the IIR

The GMT Model Rules are complex with many intricacies, not least of which are rules with respect to the substance carve-out. Calculating revenue gains from implementing the IIR will depend on what policy option is taken.

Countries could decide to estimate revenue impact on an entity level, which would give greater precision, but all information may not be available. Perhaps a more pragmatic approach is to carry out a detailed analysis on a sample of entities and to scale this up to the full population combining CbCR data with other sources (e.g., Orbis) that can provide more up to date revenue and profit data. This analysis can be extended by scenarios that can account for the GMT objective of reducing incentives to shift profits.[6]

## CALCULATION OF TOP-UP TAX AT ENTITY LEVEL (STATIC ANALYSIS) FOR A SAMPLE OF COMPANIES AND SCALE UP TO THE FULL POPULATION

A suitable methodology for estimating revenues gains from GMT implementation is to calculate the Top-up Tax's yield over the existing tax rate, making appropriate assumptions and using key parameters under the Model Rules. An important caveat is that a country may be relying on historical data when carrying out such a calculation.

a) Calculate the GLoBE income for the entity—an estimate of the financial income of an entity in the jurisdiction.

b) GLoBE income will need some adjustments to reflect the Model Rules:

- Excluded dividends; excluded equity gain or loss—avoids double counting of previously taxed income and aligns with participation exemptions and similar relief common to many IF jurisdictions;
- Policy disallowed expenses—disallows deduction for illegal payments;
- Stock-based compensation—prevents Top-up Tax arising in the context of book-to-tax differences associated with stock-based compensation plans.

c) Identify and adjust (as necessary) covered taxes.

d) The amount of covered taxes with respect to an entity in a jurisdiction is divided by the GLoBE income in the jurisdiction to determine the Effective Tax Rate (ETR) for the entity in the jurisdiction.

e) When the ETR is below the minimum rate, the Top-up Tax percentage for the jurisdiction is calculated by subtracting the ETR from the minimum rate (e.g., if the ETR is 10%, the Top-up Tax is equal to 15% - 10% = 5%).

f) The Top-up Tax percentage is then multiplied by the excess profit in the jurisdiction to determine the amount of Top-up Tax. Excess profit for the jurisdiction is equal to the GLoBE income less the substance-based income exclusion (i.e., an excluded routine return on tangible assets and payroll).

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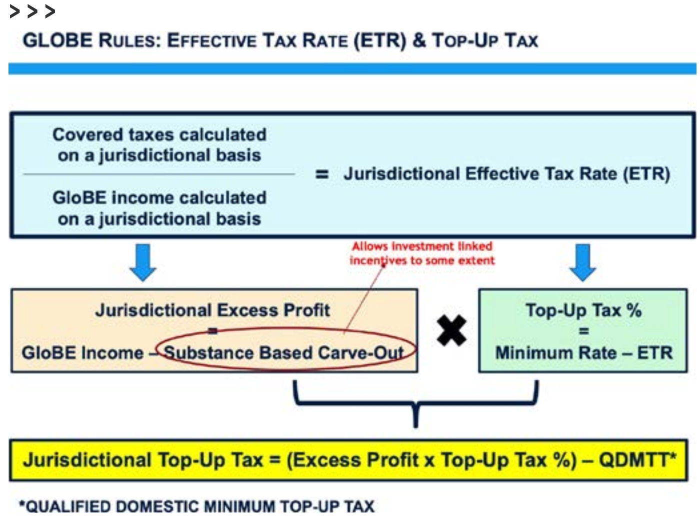


*Source: Understanding The Global Minimum Effective Tax on Multinationals: Pillar 2: General Principles, Overview and Scope;* https://thedocs.worldbank.org/en/doc/e95e21b019d5aaf94d37aff0ad9203c9-0350032022/understanding-the-global-minimum-effective-tax-on-mnes-pillar-2

6 Another factor to be considered, in time, is revenue benefits that may accrue due to implementation of Pillar One, both in respect to Amount A (reallocation of taxing rights) and Amount B (simplified transfer pricing for routine activities).

# Annex 4 – Examples of compliant and non-compliant tax credits and implications

## THE TREATMENT OF QUALIFIED TAX CREDITS

The GMT Model Rules set out what constitutes qualified and unqualified tax credits.

**Qualified Refundable Tax Credit** means a refundable tax credit designed in a way such that it must be paid as cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit under the laws of the country granting the credit. A tax credit that is refundable in part is a Qualified Refundable Tax Credit to the extent it must be paid as cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit under the laws of the country granting the credit.

A Qualified Refundable Tax Credit does not include any amount of tax creditable or refundable pursuant to a Qualified Imputation Tax or a Disqualified Refundable Imputation Tax.

A **Non-Qualified Refundable Tax Credit** means a tax credit that is not a Qualified Refundable Tax Credit but that is refundable in whole or in part.

The distinction is important because a Qualified Refundable Tax Credit will be treated as income; in contrast, a Non-Qualified Refundable Tax Credit will be treated as a tax reduction, potentially subject to a Top-up Tax that will nullify the impact of the tax credit.

The examples below highlight the difference:

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### EXAMPLE 1a: Qualified Refundable Tax Credit with ETR of 15%

| DESCRIPTION | EUR MILLION | EUR MILLION |
|---|---|---|
| Profits | | 800 |
| Gross CT (i.e., at 15%) | 120 | |
| R&D credit | (30) | |
| Net CT | | 90 |
| **GLOBE CALCULATION** | | |
| ETR | 14.46% (i.e., 120 / 830) | |
| Top-up % | 0.54% (i.e., 15% - 14.46%) | |
| Top-up Tax | | 4.48 (i.e., 830 x 0.54%) |

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### EXAMPLE 1b: Non-Qualified Refundable Tax Credit with ETR of 15%

| DESCRIPTION | EUR MILLION | EUR MILLION |
|---|---|---|
| Profits | | 800 |
| Gross CT (i.e., at 15%) | 120 | |
| R&D credit | (30) | |
| Net CT | | 90 |
| **GLOBE CALCULATION** | | |
| ETR | 11.25% (i.e., 90/ 800) | |
| Top-up % | 3.74% (i.e., 15% - 11.25%) | |
| Top-up Tax | | 30 (i.e., 800 x 3.75%) |

These examples demonstrate the importance of ensuring that the design of tax incentives, such as R&D tax credits, are consistent with GMT Model Rules. Example 1a demonstrates that the net benefit of a qualified tax credit of EUR 30 million with an ETR of 15% would be EUR 25.43 million. In Example 1b, the same tax credit would give no benefit.

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### EXAMPLE 2a: Qualified Tax Credit with ETR of 18%

| DESCRIPTION | EUR MILLION | EUR MILLION |
|---|---|---|
| Profits | | 800 |
| Gross CT (i.e., at 18%) | 144 | |
| R&D credit | (30) | |
| Net CT | | 114 |
| **GLOBE CALCULATION** | | |
| ETR | 17.35%<br>(i.e., 144 / 830) | |
| Top-up % | 0% as ETR above 15% | |
| Top-up Tax | | 0 |

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### EXAMPLE 2b: Non-Qualified Tax Credit with ETR of 18%

| DESCRIPTION | EUR MILLION | EURMILLION |
|---|---|---|
| Profits | | 800 |
| Gross CT<br>(i.e., at 18%) | 144 | |
| R&D credit | (30) | |
| Net CT | | 114 |
| **GLOBE CALCULATION** | | |
| ETR | 14.25%<br>(i.e., 114/800) | |
| Top-up % | 0.75%<br>(i.e., 15% - 14.25%) | |
| Top-up Tax | | 6<br>(i.e., 800 x 0.75%) |

These examples demonstrate that in a country has a CIT rate of 18% (i.e., above the 15% minimum tax), a non-compliant tax incentive could lead to a scenario whereby the ETR could go below 15%, and thus bring a country into a position where subsidiaries of MNEs would incur Top-up Tax under an IIR in the parent country in the absence of a QDMTT.

# Annex 5 – Guidance on developing a consultation strategy

## OVERVIEW

Carrying out public consultations on GMT implementation can identify specific issues relevant to the country, including aspects of the GMT legislation and perhaps also broader tax policy. Several countries, including Canada, Ireland, Malaysia, New Zealand, and the UK have already commenced public consultations.

The process should not seek to consult on the Model Rules, which have been agreed by the IF. Rather, the focus should be on implementation of the rules in the country. The consultations may also facilitate engagement by the finance ministry and/or the tax administration with individual taxpayers, representative bodies, and practitioners. A country could decide to have two rounds of consultations, the first a scoping exercise and the second discussions focused on the draft legislation.

This process can be valuable and ensure that reforms are road-tested and do not lead to unforeseen consequences. In addition, a consultation is a useful exercise in signaling to key stakeholders that a country is considering implementation—particularly relevant because the GMT follows a common approach. A country may also wish to signal potential policy choices. Examples are the UK and Canada signaling adoption of the QDMTT and New Zealand indicating (the view of staff) that it would recommend implementation if GMT rules are being implemented in other key jurisdictions.

It is important that consultations are well-publicized to the target audience, with an expectation of a transparent process. In line with good practices, it is important to consider: allowing a reasonable period for responses (4-6 weeks), carrying out an analysis of responses, pursuing further engagement on issues as appropriate, and ensuring the consultation is a genuine exercise to feed into the policy development process.

## CONSULTATION DESIGN

The consultation can include a narrative on the International Tax Agreement, the broad purpose of the consultation, particular policy issues that may be under consideration, details on the date for submission of responses, the email address/physical address for submission, information on follow-up, and information on whether responses will be published.

To ensure that responses are focused, it is useful to include a series of questions that are tailored to a country's particular implementation needs as well as referencing the specific legislation to be amended.

Suggested questions, which draw on similar consultations, include:

1 Are there any particular issues relevant to GMT implementation, including any with respect to taxpayer certainty?

2 Are there any specific issues with respect to the interaction between domestic legislation and the GMT Model Rules, bearing in mind the importance of ensuring consistency and coordination with other countries' rules and the limited flexibility permitted by the common approach reflected in the Model Rules?

3 Do respondents have suggestions as to existing [*xxx Tax Act* ] provisions that should or should not be made applicable for the purposes of the GMT legislation, including any of the administrative and enforcement provisions?

4 Do respondents have any suggestions regarding the design of the domestic minimum Top-up Tax? Are there any issues or uncertainties with how such a tax is treated under the Model Rules?

5 Are there any aspects of existing tax law, including tax incentives, that may not be compatible with the Model Rules or could benefit from reform arising from the Model Rules? Are there any transition issues that may need to be addressed?

6 Are there any other specific aspects of domestic legislation or administration that need to be considered in the context of GMT implementation?

7 Are there any other aspects of the tax code and administrative practices that could benefit from reform in the context of ensuring a growth-friendly tax system that can support sustainable public finances?

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