OECD GLOBAL TAX DEAL

KEY ELEMENTS, OPPORTUNITIES AND CHALLENGES

GLOBAL FINANCIAL INTEGRITY

ACODE

List of abbreviations

ATAF - African Tax Administration Forum

BEPS - Base Erosion and Profit Shifting

CSO - Civil Society Organization

DST- Digital Service Tax

FACTI - Financial Accountability, Transparency & Integrity

ICRICT - Independent Commission for the Reform of International Corporate Taxation

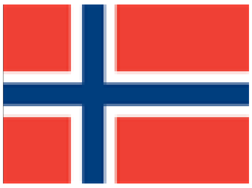
MAP - Mutual Agreement Procedure

MNEs - Multinational Enterprises

OECD - Organisation for Economic Co-operation and Development

STTR - Subject-to-tax rule

Global Financial Integrity and ACODE wish to thank the Government of Norway for supporting this project.



What is the OECD/G20 high-level tax deal?

The global tax deal represents a major reform to the rules governing the international tax system, aiming to bring an end to tax havens and profit-shifting by multinational enterprises (MNEs). By introducing a global minimum tax rate and new profit reallocation rules, the deal aims to give countries a fairer chance to collect tax revenues from MNEs operating in or generating revenues from their jurisdictions. The deal was negotiated under the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), and finalized in October 2021.[1]

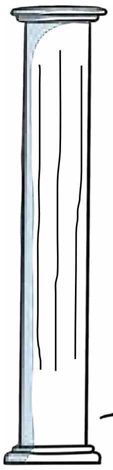
What is the OECD/G20 Inclusive Framework on BEPS?

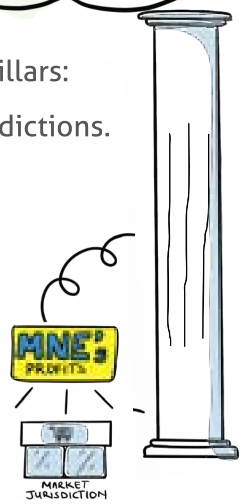
The Framework represents a group of countries and jurisdictions working together to address systemic issues within the global taxation system that cause an inequitable distribution of tax revenues among countries and jurisdictions. The framework operates under the leadership of the OECD, but any country or jurisdiction is allowed to join and participate.

The deal specifically aims to address challenges that arise from the digitalization of the economy, and is broken down into two pillars:

» Pillar 1 aims to reallocate MNE profits and taxing rights to market jurisdictions.

» Pillar 2 introduces a global minimum tax rate.





TIMELINE
OF THE GLOBAL TAX DEAL

June 2016
The OECD establishes the Inclusive Framework on BEPS with an initial 82 members.[2]

October 2020
The Inclusive Framework releases the blueprints for the two-pillar solution to address tax challenges arising from digitalization of the economy.[3]

June 2021
The Finance Ministers from G7 countries announce a global minimum corporate tax rate of at least 15% to end the race to the bottom in corporate taxation.[4]

July 2021
134 member countries and jurisdictions of the Inclusive Framework join the two-pillar Statement, but leave some key parameters to be decided in October.

October 8, 2021
136 members of the Inclusive Framework join the finalized Statement with a detailed implementation plan.

October 31, 2021
G20 endorses the two-pillar OECD tax agreement.

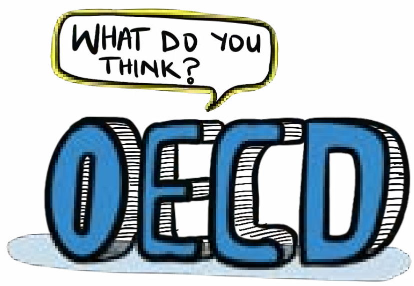
2022
Projected timeline for the development of model legislation, a multilateral convention, and multilateral instrument to implement the two-pillar solution.

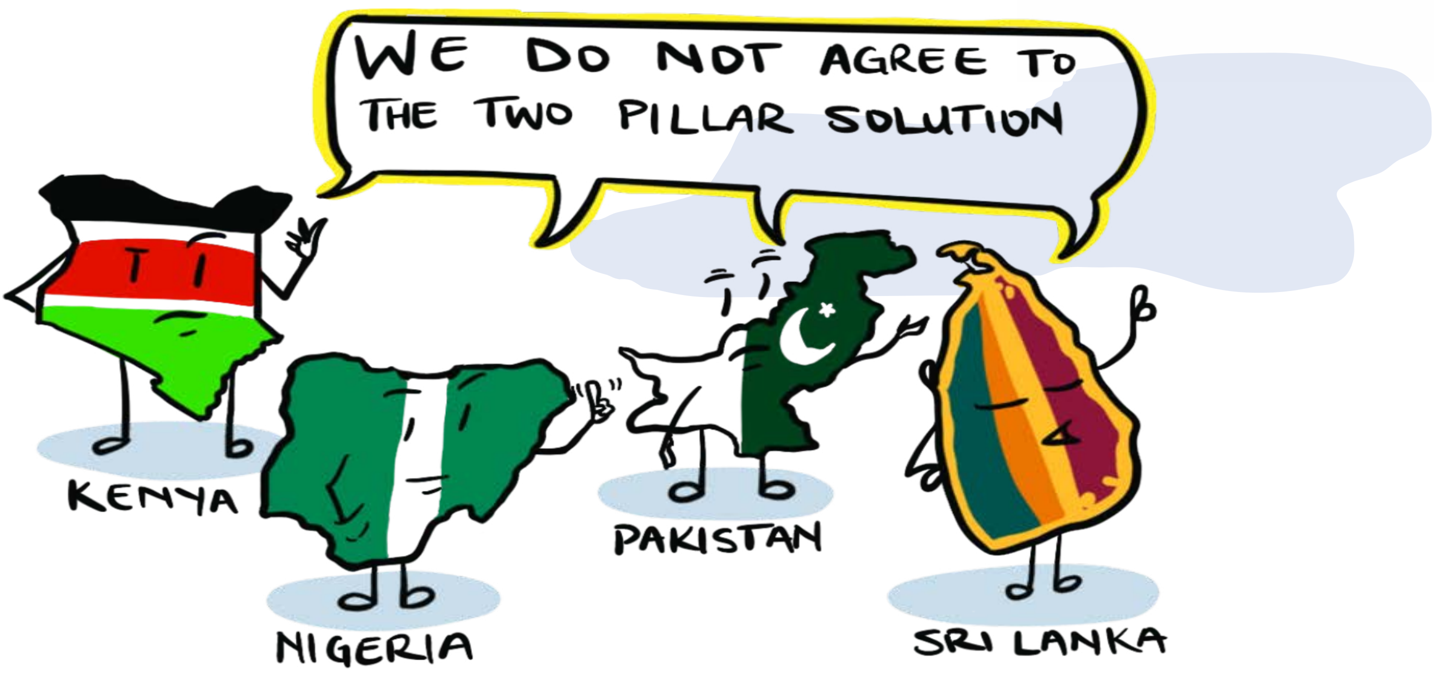
2023
Target for the multilateral convention to come into effect.

Breakdown of countries' participation

The negotiations for the OECD tax deal took place within the OECD/G20 Inclusive Framework on BEPS. A total of 140 jurisdictions were part of the Inclusive Framework when the negotiations were taking place. After conclusion of the high-level agreement in October, Mauritania joined the Inclusive Framework as the 141st member in November, and also agreed to the two-pillar statement.[5]

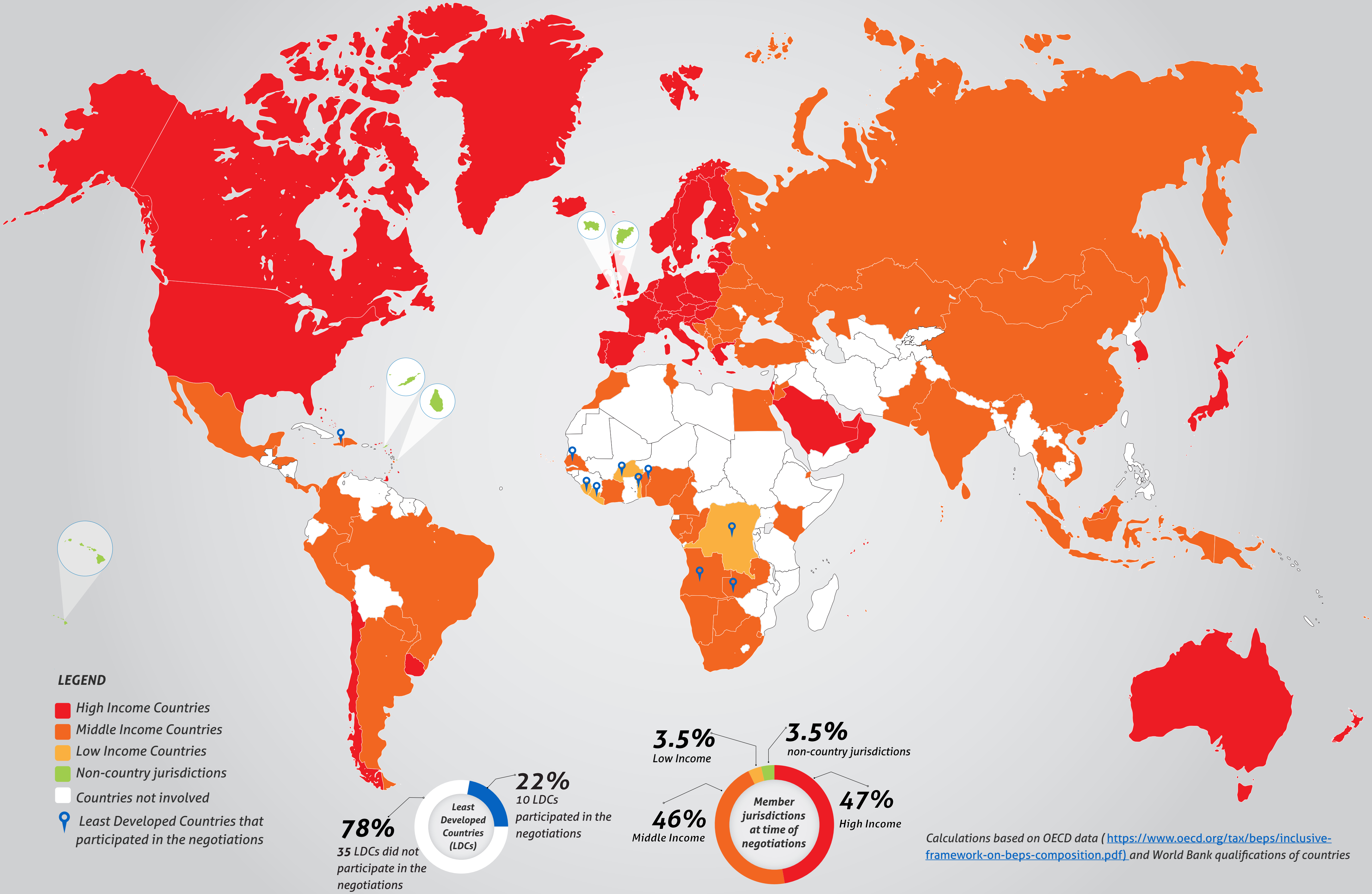
In total, 137 of the 141 member jurisdictions have agreed to the two-pillar solution while Kenya, Nigeria, Pakistan and Sri Lanka opted out. Some of the concerns around the deal and reasons why these countries rejected it are further explained as 'pros and cons' in the rest of this brief.





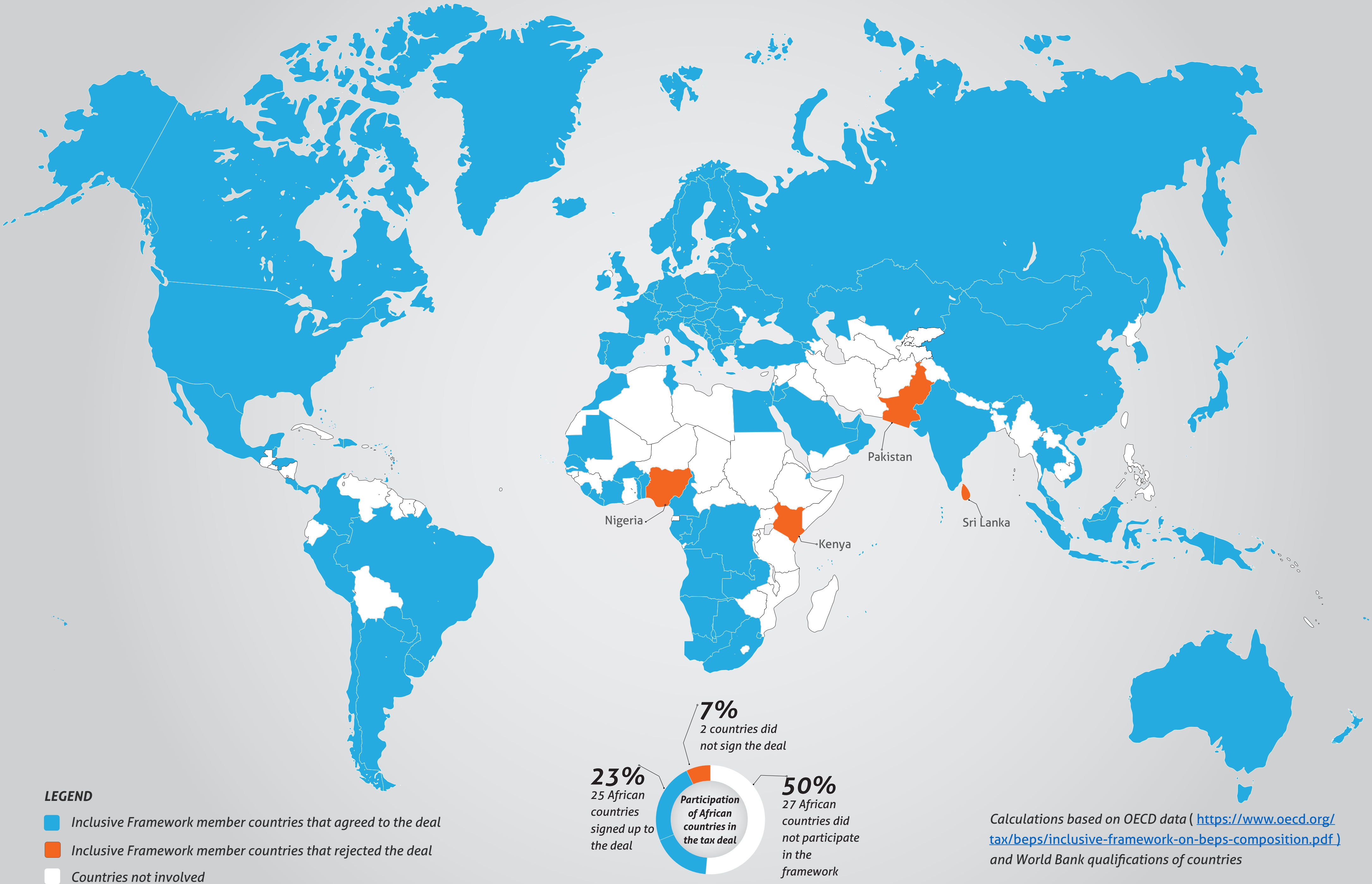
The maps below reflect the breakdown of jurisdictions' participation at time of the negotiations, and the final tally of member jurisdiction positions at the conclusion of the deal.

Breakdown of countries' participation in Inclusive Framework negotiations



Calculations based on OECD data (https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf) and World Bank qualifications of countries

Breakdown of countries' participation in the OECD global tax deal



LEGEND

Inclusive Framework member countries that agreed to the deal

Inclusive Framework member countries that rejected the deal

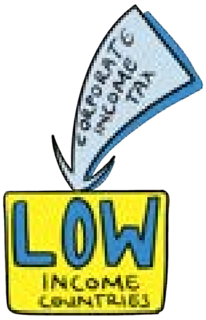
Countries not involved

Calculations based on OECD data (https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf) and World Bank qualifications of countries

Pros of the tax deal negotiations process

+ Inclusive Framework

The Inclusive Framework allows all interested countries and jurisdictions to participate in the negotiations of international tax standards on equal footing. It has global membership from all geographic regions, including representation from 70% of countries outside the OECD and G20.[6]



The participation of developing countries in the two-pillar agreement is especially important, given that low-income countries rely more heavily on corporate income tax as a source of government revenue than high-income countries.[7]

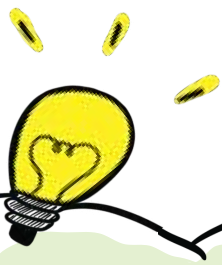
Cons of the tax deal negotiations process

- Lack of transparency in negotiations

Although the agreement was negotiated under the Inclusive Framework, a substantive part of the process was carried out within the G7 and G20. This in turn made the process less transparent and gives rise to the concern that smaller and less rich countries were not given equal participation.[8]

- Exclusion of majority of developing countries

Although the Inclusive Framework allows all interested jurisdictions and countries to become members, there are conditions and annual fees they have to commit to in order to join. The majority of African (52%) and Least Developed (78%) countries have not joined the framework. Civil society organizations (CSOs) have pointed out that this makes the agreement less inclusive than it purports to be.[9]



The majority of African (52%) and Least Developed (78%) countries have not joined the Framework.

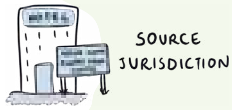
KEY ELEMENTS OF THE TWO-PILLAR GLOBAL TAX DEAL & THEIR PROS AND CONS

Pillar 1: Redistribution of profits and taxing rights

Under the current global taxation system, countries can only tax corporations that have a physical presence within their jurisdiction. With technological advancements making it possible for companies to sell goods and services globally without a physical presence, many countries have lost the opportunity to collect taxes from multinationals that generate substantial revenue from their jurisdictions. Pillar 1 therefore seeks to compel the largest MNEs to reallocate part of their profits and pay taxes to market jurisdictions.

What are the types of jurisdictions in international taxation?

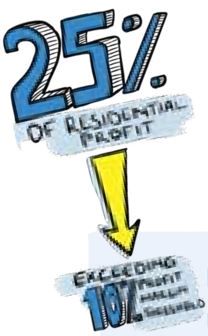
The home country or jurisdiction where the MNE is established or headquartered. *Also 'home' or 'headquarter' jurisdiction.*

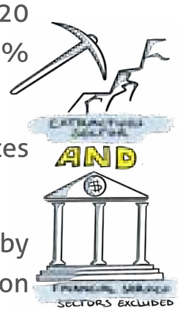


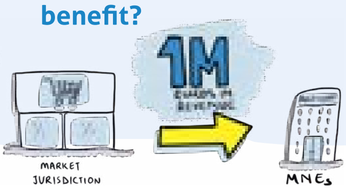
The host country or jurisdiction where the MNE operates from. *Also 'host' or 'operations' jurisdiction.*

The country or jurisdiction where the final sale of an MNE's goods and services are made.

KEY ELEMENT	DESCRIPTION
Which companies does it apply to?	Only about 100 of the biggest and most profitable MNEs are in-scope, namely those with a global turnover above €20 billion (approx. US$22.6 billion or UGX 80.7 trillion) and >10% profitability. Companies in the extractives and regulated financial services sectors are excluded. There is a provision to expand the scope after 7 years, by reducing the turnover threshold to €10 billion (US$11.3 billion or UGX 40.3 trillion).
How much profit would be reallocated?	The reallocation rule applies to only part of an in-scope company's profits, namely 25% of residual profit. This is referred to as 'Amount A'. Residual profit refers to taxable profits exceeding a threshold of 10% profit margin.
How much tax are we talking about?	Taxing rights on more than US$125 billion (UGX 445 trillion) in profit are expected to be reallocated to market jurisdictions each year.[10]
Which jurisdictions benefit?	Market jurisdictions with nexus. That is, jurisdictions where the in-scope MNE derives at least €1 million (US$1.13 or UGX 4 billion) in revenues. For smaller jurisdictions with a GDP below €40 billion (US$45.3 billion or UGX 161.4 trillion), the nexus will be set at €250,000 (US$283,000 or UGX 1 million).



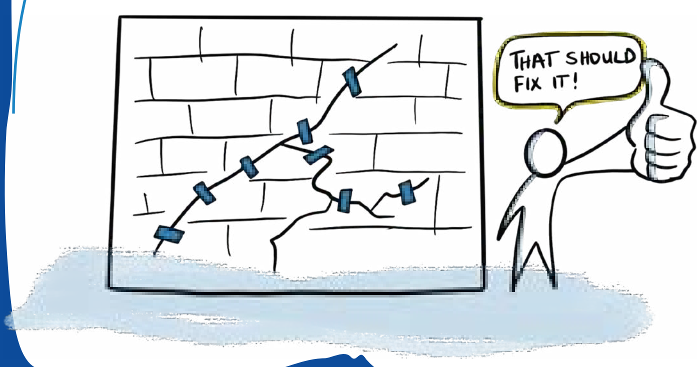


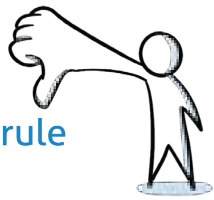


Pros of the reallocation rule

+ Fairer distribution of profits and taxing rights

The rule requires MNEs to pay taxes where their sales and users are located. Many of today's big tech and digital services companies are headquartered in high-income countries, but conduct activities and earn significant profits in countries where they have no physical presence. Pillar 1 prevents MNEs from dodging their tax liability/responsibility in market jurisdictions, which are often developing countries.

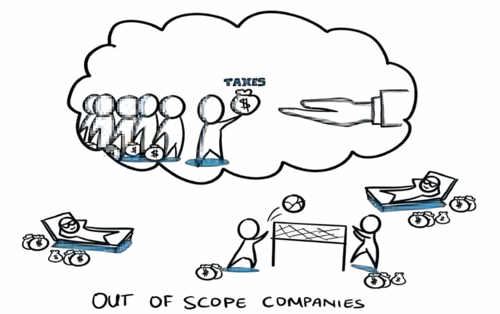




Cons of the reallocation rule

- Too many MNEs out-of-scope

The scope of companies to which this deal is applicable is narrow and leaves out many of the companies operating on the African continent, including Uganda. The deal also excludes companies working in the extractives industry, even though this sector has been flagged to be more susceptible to illicit financial flows.[11]



- Limited impact for developing countries

The reallocation rule applies to only a small portion of the profits (25% of 'residual profits' above 10% profitability) of about 100 corporations that qualify (those with more than 20 billion euros in profit). Oxfam estimates this would result in only US$140 million (UGX 500 billion) and US$8 billion (UGX 28.5 trillion) in annual revenue for low-income and middle-income countries respectively.[12] As such, it is unlikely this will bring about structural changes in international corporate tax distribution, and may not even be worth the implementation costs for the smallest developing countries.[13]

Nigeria expressed concern with pillar 1 particularly, claiming that the OECD's assessment of the economic impact for developing countries was unreliable. Although Nigeria made no disclosures of its own calculations on potential revenue, their conclusion was that it was not worth the high cost of implementation.[14]

KEY ELEMENT

Requirement to give up Digital Services Tax

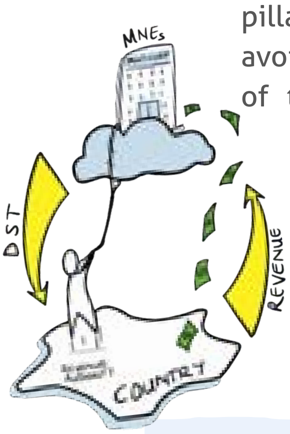
DESCRIPTION

Countries and jurisdictions that joined the deal will be required to remove all unilateral measures such as digital services tax (DST) imposed on non-resident companies, and no new such taxes may be implemented while the agreement is being implemented (between October 31, 2021 and December 31, 2023).

Pros of DST removal

+ Stability in the international tax system

DST are unilateral taxes adopted by countries like Kenya to tax the digital services provided by companies that do not have a physical presence in those countries. Such unilateral measures have often been met with retaliatory trade sanctions from the countries where those (big tech) corporations are headquartered. As these target companies are now to be taxed under pillar 1, the removal of DST aims to avoid both double taxation and the risk of trade disputes.

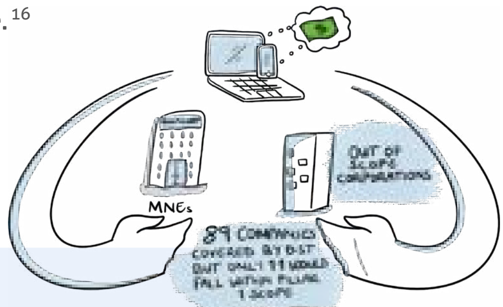


Cons of DST removal

- Robs developing countries of tax revenue

Whereas the scope of corporations under Pillar 1 is limited, the requirement to remove unilateral measures such as DST applies to all MNEs, including out-of-scope corporations. It also removes the right to levy unilateral measures in the future. As a result, the obligation to sign away DST could, in some cases, cost countries more than the tax gains they are likely to receive under the pillar 1 of the agreement.[15]

This element was the main reason for Kenya to reject the deal. Kenya's 1.5% DST covers 89 companies – while only eleven companies in Kenya would fall within the pillar 1 scope.[16]



KEY ELEMENT

Mandatory dispute resolution

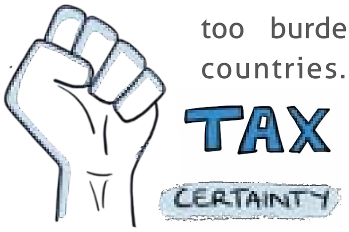
DESCRIPTION

In-scope MNEs will benefit from mandatory and binding dispute prevention and resolution mechanisms, to avoid double taxation for 'Amount A' (i.e. the residual profit to be taxed under pillar 1). However, an elective binding dispute resolution mechanism will be available for developing economies that have not encountered meaningful levels of Mutual Agreement Procedure (MAP) disputes under the BEPS framework.[17]

Pros of mandatory arbitration

+ Tax certainty and elective mechanism

The mandatory dispute prevention and resolution mechanism deals with risks of double taxation, thereby contributing to tax certainty. The availability of the elective, rather than mandatory, mechanism aims to ensure that the rules are not too burdensome for low-capacity countries.



Cons of mandatory arbitration

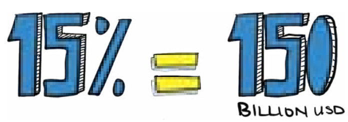
- Mandatory for some limited capacity countries

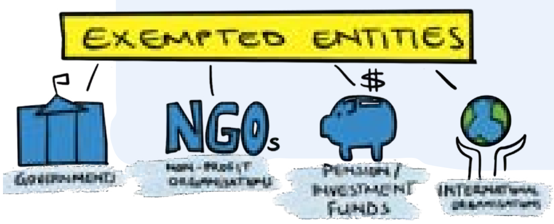
The binding dispute resolution element is only available as an elective if certain conditions are met, so not all developing countries with limited capacity will be able to qualify. The mandatory dispute resolution element was one of the reasons for Kenya and Nigeria to disapprove of the deal because of concerns around losing sovereignty due to tax issues having to be resolved in residence countries.[18]

Pillar 2: Global minimum tax rate

For a long time, countries have been grappling with the problem of MNEs avoiding taxation by shifting their headquarters to low-tax jurisdictions or tax havens. The OECD estimates that countries lose US$100-240 billion (UGX 356 – 854 trillion) worth of revenue annually to BEPS practices, which is the equivalent to 4-10% of the global corporate income tax revenue.[19] To address this, pillar 2 introduces a global minimum tax rate.

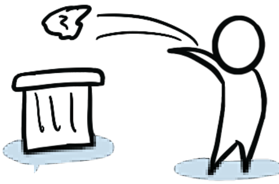
KEY ELEMENT	DESCRIPTION
Minimum tax rate	Pillar 2 introduces a global minimum corporate tax rate of 15%. It is estimated that this will generate around US$150 billion (UGX 534 trillion) in additional global tax revenues annually.[20]
Which companies does it apply to?	The minimum rate will apply to any company with an annual revenue of over €750 million (US$850 million or UGX 3 trillion). Exempted entities include 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.[21]



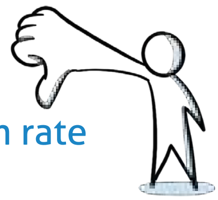


Pros of global minimum tax

+ Eliminates tax havens and tax competition



The global minimum tax rate reduces pressure on (developing) countries to offer tax incentives to attract foreign investment, while it also lessens incentives for MNEs to shift their profits to countries with no or low corporate income taxes.[22]

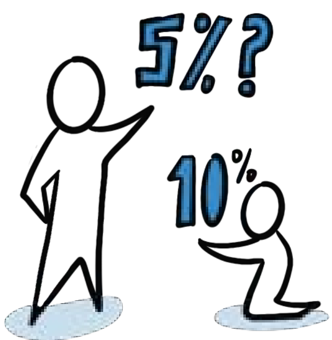


Cons of global minimum rate

- The 15% rate is too low

Globally, the average corporate tax rate is close to 25%,[23] with some countries like Nigeria charging 30% or more.[24] As such, a 15% rate will leave incentives for tax competition and avoidance intact. Many CSOs therefore consider it insufficient,[25] especially because both the Independent Commission for the Reform of International Corporate Taxation (ICRICT) and FACTI Panel proposed higher rates of 25% and 20-30% respectively.[26]

KEY ELEMENT	DESCRIPTION
Which jurisdictions benefit from collecting the tax?	The minimum tax rate is to be collected by residence jurisdictions, which is the country or jurisdiction where the corporation has its headquarters. The agreement does not require jurisdictions to set their rate at 15%, but gives residence countries the right to claim the difference in uncollected taxes with a 'top-up tax' on the subsidiary of an MNE that is taxed less than that minimum rate in another jurisdiction. Pillar 2 provides an opt-out option. Only if the residence jurisdiction does that, will countries where multinationals operate (source jurisdictions) be allowed to collect the top-up tax.[27]



Pros of priority for residence jurisdictions

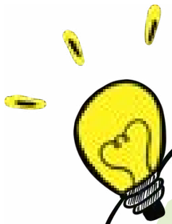
+ Easy administration

The priority for residence jurisdictions to levy the 'top up' tax makes the rule easier to administer, because each multinational will pay tax to one single country.

Cons of priority for residence jurisdictions

- Unfair to developing countries

As most MNEs are headquartered in high-income countries, the revenue generated under pillar 2 will disproportionately advantage them instead of low-income countries.[28] According to calculations by Oxfam, G7 and EU countries will take home more than two-thirds of the revenue while the world's lowest-income countries receive a mere 3% of the revenue.[29] This is considered particularly unfair as low-income countries generally rely more heavily on corporate income tax as a source of revenue, yet will not benefit from this rule as much.



> *G7 and EU countries will take home more than two-thirds of the revenue while the world's lowest-income countries receive a mere 3% of the revenue.*

KEY ELEMENT	DESCRIPTION
Subject-to-tax rule (STTR)	The STTR will allow source jurisdictions, which are the jurisdictions and countries where operations take place, to retain their right to tax certain base-eroding payments made by companies to related parties abroad, such as interests and royalties which benefit from reduced withholding taxes under tax treaties. Specifically, the STTR requires member countries that apply a corporate income tax rate below 9% to interest and royalties, to change their bilateral treaties with developing countries to allow them to tax such payments.

Pros of STTR

+ Addresses concerns of unfair allocation

The STTR protects the right of source jurisdictions (usually developing countries) to tax certain tax-eroding payments made to related parties abroad, like interest and royalties, when they are not taxed at the minimum rate of 9%.[30] This addresses in part some of the concerns that the priority granted to residence jurisdictions under pillar 2 is unfair to developing countries.

Cons of STTR

- "A weak consolation prize"

CSOs consider the STTR as a "weak consolation prize," given that it is lower than the 15% minimum rate, and "does not protect countries from base erosion through inflated interests or royalties embedded in the cost of goods sold." The application of the STTR moreover relies on the cooperation of tax havens to sign new treaties.[31]

KEY ELEMENT	DESCRIPTION
Substance carve-outs	The substance carve-out rule will reduce the tax base on which the 15% minimum rate will be applied, by exempting certain low-taxed activities that have real substance. Specifically, a company will be able to deduct 5% of employee compensation costs and tangible assets from the tax base that the home jurisdiction can levy the top-op tax on.[32]

Pros of substance carve-outs

+ Allows tax incentives for genuine foreign investment

The substance carve-out rule allows for countries to still offer incentives that attract genuine and substantial business activities, like building a hotel or investing in a factory.[33] As it only applies to real economic activity, it is in line with the objective of combatting artificial profit-shifting.

Cons of substance carve-outs

- Risk defeating the purpose of a minimum rate

Substance carve-outs allow companies to escape the minimum rate as long as they have sufficient operations (assets and employees) in, for example, a tax haven. It therefore encourages companies to shift their economic activities to jurisdictions with low tax rates, which risks defeating the purpose of the minimum rate: limiting tax competition.[34]

WHAT CAN CIVIL SOCIETY DO?

Currently, it is estimated that US$100 billion to US$240 billion (UGX 355 - 850 trillion) — 4% to 10% of global corporate income taxes — in revenue is lost each year because MNEs take advantage of gaps and mismatches between different countries' tax systems.[35] Africa loses approximately US$50 billion (UGX 175 trillion) each year through illicit financial activities of MNEs and wealthy individuals, and approximately US$88.9 billion (UGX 311.2 trillion) in capital flight.[36] This situation has been exacerbated by the digitalization of the economy, which the OECD tax deal seeks to address. However, civil society has on multiple occasions called on the OECD to address fundamental shortcomings in the deal and on countries to otherwise reject the deal. The main concern is that the added tax revenues under the two-pillar solution will disproportionately benefit high-income countries rather than low-income, developing, and African countries – leaving systematic inequalities in tax distribution intact.

Tax revenues under the two-pillar solution will disproportionately benefit high-income countries – leaving systematic inequalities in tax distribution intact.

This is especially concerning considering the low level of participation in the negotiations by these countries, including Uganda.

CSOs that are advocating for tax justice in Africa can engage in the following ways:

1

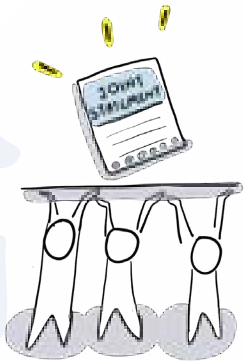
Undertake analytical research to point out the merits and demerits of this deal, and comparatively analyze it against other tax models like the African Tax Administration Forum (ATAF) position, and the implications of the deal on revenue collection and the economy.

2

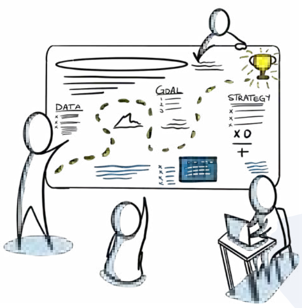
Mobilize other CSOs to undertake a campaign aimed at helping the relevant ministries, departments and agencies in Uganda to be able to understand pro and cons so that governments make decisions from an informed position.[37]

3

Liaising with other CSOs in the country and the East African region at large to prepare and issue a joint statement on the deal. Similar interventions have already been made by CSOs in Asia.[38] Issuing a joint statement as CSOs in East Africa will not only highlight your position on the deal but also build on the voices of like-minded organizations in other regions.



4



Holding strategic engagements with the relevant ministries, departments and agencies and regional bodies to share your position on the deal, and advocate for them to adopt your proposals towards this deal. These strategic engagements will be informed by the research and analysis undertaken by CSOs on the pros and cons of the deal.

ENDNOTES

1. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021
2. OECD/G20, Inclusive Framework on BEPS
3. OECD, Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint & Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint, 14 October, 2020
4. G7 Finance Ministers and Central Bank Governors' Communiqué, 5 June 2021
5. OECD, Mauritania joins the Inclusive Framework on BEPS and participates in the agreement to address the tax challenges arising from the digitalisation of the economy, 4 November, 2021
6. OECD/G20, Inclusive Framework on BEPS, What is BEPS?
7. Ibid
8. Eurodad & Financial Transparency Coalition, Who is really at the table when global tax rules get decided?, October 2021
9. Ibid
10. OECD, OECD/G20 Inclusive Framework on BEPS Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, FREQUENTLY ASKED QUESTIONS, October 2021
11. Financial Transparency Coalition, Combating Illicit Financial Flows in the Extractives Sector in Asia, 2020
12. Oxfam America, Are the global tax proposals in the interests of low- and middle-income countries? August 16, 2020
13. Oxfam's Position on the Two-Pillar Solution to Address the Tax Challenges of the Digitalization of the Economy, October 2021
14. Nigerian Tribune, FIRS Gives Reason Why Nigeria Is Yet To Sign OECD Corporate Tax Agreement, December 1, 2021
15. Oxfam's Position on the Two-Pillar Solution to Address the Tax Challenges of the Digitalization of the Economy, October 2021
16. Reuters, Kenya spurns global tax deal, saying numbers need 'interrogation', 13 October, 2021
17. Oxfam's Position on the Two-Pillar Solution to Address the Tax Challenges of the Digitalization of the Economy, October 2021
18. Quartz Africa, Why Kenya and Nigeria haven't agreed to a historic global corporate tax deal, 2 November, 2021
19. OECD/G20, Understanding tax avoidance
20. OECD, OECD/G20 Inclusive Framework on BEPS Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, FREQUENTLY ASKED QUESTIONS, October 2021
21. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021
22. Oxfam America, Are the global tax proposals in the interests of low- and middle-income countries?, August 16, 2020
23. Oxfam, Didier Jacobs, Show us the money, 20 August 2021
24. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021

25. See, for example, FEMNET, NAWI & TJNJA, The G7's Global Minimum Corporate Tax Rate A Good Deal for the African Continent?, September 2021
26. FACTI Panel, FINANCIAL INTEGRITY FOR SUSTAINABLE DEVELOPMENT, February 2021
27. Oxfam America, Are the global tax proposals in the interests of low- and middle-income countries?, August 16, 2020
28. EU Tax Observatory, Revenue Effects of the Global Minimum Tax: Country-by-Country Estimates
29. Oxfam America, Are the global tax proposals in the interests of low- and middle-income countries?, August 16, 2020
30. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021
31. Oxfam's Position on the Two-Pillar Solution to Address the Tax Challenges of the Digitalization of the Economy, October 2021
32. See the following resource for a more comprehensive explanation: EU Tax Observatory, Substance-based carve-outs
33. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021
34. Oxfam's Position on the Two-Pillar Solution to Address the Tax Challenges of the Digitalization of the Economy, October 2021
35. OECD/G20, Understanding tax avoidance
36. UN Economic Commission for Africa, Illicit financial flows: why Africa needs to "track it, stop it and get it
37 These include Uganda Revenue Authority, Ministry of Finance, Planning and Economic Development, Ministry of Foreign Affairs and the Office of the Attorney General, as well as the Solicitor General.
38. APMDD, STATEMENT: Asian Civil Society Organizations Call to Reject the OECD/G20 Global Tax Deal, 21 July 2021

Authors

Kaisa de Bel

Jackie Wahome

James Muhindo

Design

Kennedy Njagi, www.thinkillustrate.com

For any enquiries or more information, kindly contact us at:

GFI: Kaisa de Bel, Policy Analyst, kdebel@gfintegrity.org and Jackie Wahome, Policy Analyst - East and Southern Africa, jwahome@gfintegity.org

ACODE: James Muhindo, National Coordinator CSCO, james.muhindo@acode-u.org

GLOBAL FINANCIAL INTEGRITY

ACODE