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Africa Tax Symposium – Webinar Edition

Pillar Two-The African Dimension
Potential Practical Impact of Pillar Two on Business in Africa

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Uncertainty for taxpayers in Africa

- Very few African countries indicated their position on Pillar two;
- Silence concerning for business and creates uncertainty;
- Are the rules as optional as they are made up to be?
- Consequences for African countries that don’t adopt pillar two;
- Potential to indirectly apply to taxpayers in non-pillar two country;
- Short time frames for implementation of pillar two rules (2023 and 2024).

Pillar Two Impact on Tax Incentives by African Countries?

- **Generally used by African countries to attract FDI;**
- **Range from Special economic zones, R&D to activity based tax incentives;**
- **Impact of top-up on business benefiting from tax incentives if their effective tax rate (ETR) is below 15%;**
- **African countries may need to review their tax incentives;**
- **Example:** ABC Ltd, a company tax resident in Country A has a foreign subsidiary, XYZ Ltd, tax resident in Country B. The corporate tax rate in Country B is 30%. However, Country B provides special economic zones tax incentive in the area where XYZ Ltd is operating, resulting in ETR of 14% for XYZ Ltd. Country B has not adopted or implemented pillar two while country A has adopted pillar and intends implementing it.
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What About Domestic minimum tax rules?

- **Few countries considering some form of domestic minimum tax (Qualified Domestic Minimum Top-Up Tax);**
- **Including the United Kingdom, Switzerland and Singapore;**
- **Purpose is to avoid losing revenue to other countries;**
- **Domestic minimum tax could apply to multinational enterprise (MNE) groups falling within the EUR 750 million threshold;**
- **Exclude:**
  - MNEs falling below EUR750 million threshold and
  - Wholly domestic companies
- **Enable countries to levy own top-up tax on profits of their taxpayers;**
- **May not need a threshold to apply the rules;**
- **Countries would collect to top-up tax instead of ultimate parent jurisdiction.**

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African Tax Administration Forum (ATAF) Perspectives on Pillar Two

Presenter Name: Anthony Munanda

Technical Advisor, International Taxation, African Tax Administration Forum (ATAF)

The GloBE Rules

- **General comment**
  - The overall policy objective of the Global Anti-Base Erosion (GloBE) rule is address the race to the bottom.
  - The Organisation for Economic Co-operation and Development (OECD) estimates that the GloBE rules will generate around USD 150 billion in new revenues globally every year.
- **ATAF Concern 1: The global minimum rate of 15%**
  - The rate is ineffective in addressing artificial profit shifting from Africa by some multinational enterprises (MNEs) as most African countries have corporate income tax (CIT) rates ranging between 25% to 35%.
  - MNEs would only be disincentivised from such profit shifting in Africa if all its profits are tax at least at 20%, no matter in which jurisdiction the profits are reported.

The GloBE Rules

- **ATAF Concern 2: The rule order**
  - The rule order gives priority to the Income Inclusion Rule (IIR), and the Undertaxed Payment Rule (UTPR) will only apply in very limited circumstances.
  - This outcome does not help in redressing the current imbalance in allocation of taxing rights between the source and residence states which currently favours the residence states at the detriment of the source states (usually the developing countries).
    - A significant part of global low taxed income relates to financial flows from source states.
    - Thus, a fairer outcome would have been to apply the UTPR in priority of the IIR.

The GloBE Rules

- **ATAF Concern 3: Complexity of the rules and the fast process**
  - The GloBE rules are highly complex and yet the design work of the Model Rules was an extremely fast process.
  - The complexity of the rules may have an impact on tax compliance burdens on taxpayers and also create administrative burdens to tax administrations especially where there limited resources.
  - For administrations
    - Access the information will be critical: MNE filing obligation & sharing of information with Tax Administrations
    - Building administrative capacity to review the declarations e.g computations on carve-outs in case of source states

The GloBE Rules

- **Impact on tax incentives**
  - The computation of the Effective Tax Rate (ETR) of an MNE group for a jurisdictions triggers the impact of the GloBE rules on existing tax incentives.
  - MNE ETR in a Jurisdiction = $\frac{\text{Sum of Adjusted Covered Taxes}}{\text{Net Globe Income}}$
  - Tax incentives that contribute to a reduction of covered taxes are likely to make a normal tax jurisdiction a low tax jurisdictions for the purposes of GloBE rules e.g.
    - Tax holidays
    - Reduction in CIT rates
    - Special allowance or deductions against the taxable income

The GloBE Rules

- **Impact on tax incentives**
  - This may trigger behavioral change amongst governments that have been under pressure to grant tax incentives with the hope of attracting FDI.
  - Continuing to grant these tax incentives amounts to giving away taxing rights to the residence states through application of IIR.
    - IIR imposes top –up tax of a constituent entity on the parent entity located in the residence states (developed economies).

The GloBE Rules

- **Impact on tax incentives: Possible Responses**

  - Governments in developing countries can respond by reforming the necessary tax incentives to attract real investments as the GloBE rules provides for substance based income exclusion.

  - Excess Profits = Net GloBE Income - Substance based Income Exclusion

  - Another possible response is enactment of Qualified Domestic Minimum Top-Tax
    - ATAF is in the progress of developing a *Suggested Approach to Drafting Domestic Minimum Top-Tax Legislation* to assist countries that may consider enacting such a law to avoid giving away their taxing rights.

Subject To Tax Rule (STTR)

- **The positive outcome under Pillar Two for developing countries**
  - Especially those with low tax treaty rates

  - Minimum standard that most African and other developing countries can require to be included in bilateral tax treaties with Inclusive Framework members that apply nominal corporate income tax rates below the STTR minimum rate of 9%.
    - Developing countries with GNI per capita, calculated using the World Bank Atlas method, of USD 12,535 or less in 2019.

  - However, there are concerns on the minimum rate being lower than tax treaty rate observed in some jurisdictions.

Subject To Tax Rule (STTR)

- **ATAF Concerns**
  - A narrow scope of STTR will not help in addressing Base Erosion and Profit Shifting (BEPS) in African and in other developing countries.

  - The defined set of payment should include capital gains, management and technical fees.
    - These items pose significant BEPS risk to many source countries; hence their inclusion in the STTR would help in assisting these countries to protect their tax bases.

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Pillar Two – The African Dimension

Presenter Name: Titus Mukora

Partner, PwC Kenya

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GloBE Rules- Income Inclusion Rule (IIR) and the Undertaxed Payment Rule (UTPR)

Membership

Only 26 African countries are part of IF - and of those 2 did not sign the statement on Pillar 1 and 2

Scope (€750M)

Africa head quarter companies may be excluded. Export Processing Zones (EPZ), textile manufactures (subsidiaries of Asian MNEs) may not be in scope

-loss of tax revenue to developed world

Substance-based Income Exclusion (substance carve out)

The Payroll carve out may not be significant (lowly paid employees in local currency)- need for modelling.

Qualified Domestic Minimum Top-Up Tax

African countries may unilaterally pass some version of the domestic inclusion rule

Subject To Tax Rule (STTR)

Treaty based- Implementation challenge?

Relevance in Africa? withholding tax levels tend to be between 15 - 20% - may not affect many DTAs

STTR

Practical considerations for Africa

Implementation

Complexity of Pillar 2 and complexity of getting ratification through parliaments

Compliance

The Compliance burden maybe disproportionate to the revenue earned-risk of exit from the African market

Modeling

There is need for modeling of the impact of the substance carve out.

Tax reform

The 15% Corporate Tax and 9% withholding tax may be seen as the ideal benchmark rates in African countries.

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Session 2
Pillar Two– the African Dimension
Extractive Industries

Presenter Name: Dr Alison Futter

Group Tax Manager, PetroSA

Extractive Industry Concerns with Pillar Two

- **The threshold** for companies to be included in Pillar Two is set at EUR 750 million of global consolidated annual gross revenue. , which is likely to exclude many smaller but significant companies operating in African countries**.**

- **The way that taxes and profits will be assessed** to calculate an effective tax rate by country and by year will be different from local tax rules.

- **Fiscal Stability Agreements**

- **Because of their design, Pillar Two rules would create more direct revenues for richer and larger countries**—where mining companies are headquartered—than for African countries.

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Pillar Two-Next Steps for the Inclusive Framework

Presenter Name: Marlene Nembhard Parker

Deputy Commissioner General- Legal Support Division, Tax Administration Jamaica, Ministry of Finance and the Public Service

Implementation of 2 Pillar solution

- **How we avoid the pace and complexity of the current Inclusive Framework (IF) negotiations which has led to many developing countries being unable to fully participate in the current negotiations**
  - “ Historic global tax deal “ came with an ambitious timetable for implementation.The timetable has always been perceived as unrealistic .
  - Appears that outstanding issues have led to further negotiations.
  - Rules being developed are very complex.
  - Resources and capacity of some members of the IF were not considered .
  - Discussions and formulation of the implementation rules are currently being led by the Secretariat, Steering Group,TFDE, various Working Parties.
  - With exception of few developing countries, discussions dominated by developed countries , most likely to benefit from the 2 Pillar solution.

Implementation

- **Outstanding Concerns**
  - Concerns raised about :
    - complexity of implementation measures;
    - consensus on tax certainty regime;
    - unilateral measures;
    - critical mass;
    - political and geopolitical issues
  - Whether the implementation deal is at risk due to the foregoing factors.

Implementation

- **Dissemination of information and engagement of developing countries**
  - The IF should ensure that there are mechanisms in place to disseminate the information in an appropriate way which contemplates the different levels of development among its 141 strong membership.
  - This exercise should be as robust as when the countries were being encouraged to sign the consensus.
  - Capacity building is important, but first developing countries must understand the negotiations and the policies being adopted.
  - Regional bodies could assist in this endeavour.

Implementation

- **Technical Briefings**
  - Appropriate mechanisms of dissemination, could include ongoing technical briefings in collaboration with regional bodies .The African Tax Administration Forum (ATAF) model is an excellent example.
  - Much of what is published by the Organisation for Economic Co-operation and Development (OECD) on the 2 Pillar solution contains complex details.Technical briefings must consider the range of capacity of the membership of the IF.
  - Appropriate measures should include economic impact analysis.

Implementation

- **Sustaining political engagement and organization at regional level**
  - There must be a recognition that implementation of the 2 Pillar solution goes beyond developing technical work and capacity building. While the consensus was a political decision of 141 governments, few countries have remained engaged.
  - Sustaining those countries which have disengaged should be a high priority, starting with the political hierarchy .
  - Regional meetings could be arranged to assist with re-engagement of political hierarchy as well as other stakeholders.

Implementation (con')

- **Internal public consultations and assessment of legislative , technical and administrative needs**
  - Additionally, not all IF members have been able to engage their various internal stakeholders, relevant government ministries and departments, business communities, civil societies.
  - IF members need to assess their legislative regimes to contemplate changes arising from the 2 Pillar solution.
  - Members also need to assess their human resource and technological needs.

Strengthening developing countries involvement

- **How do we help developing countries build their resources to ensure their full and effective participation going forward**
  - While 2 Pillar solution is seen as creating a new taxing right, it has also highlighted the divisions within the IF between developing and developed countries, and the overall inequity in the global tax system.
  - Developing countries already face issues in negotiating bilateral Double Tax Agreements (DTAs), such as foregoing taxing rights to gain foreign direct investments (FDIs). Multilateral negotiations such as the current one, are far more complex.

Strengthening developing countries involvement

- **Participation in negotiation process**
  - For the most part, negotiating multilateral policies and instruments developed by the OECD is perceived as excluding developing countries .
  - Perceived as just involving the Secretariat, the Committee on Fiscal Affairs (CFA) Bureau countries and a few handpicked developing countries.
  - This undermines the inclusiveness as well as the principle of transparency.Countries are asked to agree to/sign a fait accompli.

Strengthening participation of developing countries

- **Developing countries must design strategy of active participation in work of IF**
  - Developing countries need to consider that at the moment the IF is the only multilateral platform which allows for their input on global tax issues, however limited .
  - Developing countries must also change, by building much greater political awareness of the importance of the global standards for domestic resource mobilization (DRM) in their countries and address the need to bring political weight and greater technical resources to the global standard negotiations.

Strengthening participation of developing countries

- **Developing countries should take stock**
  - Developing countries must assess the current overall base erosion and profit shifting (BEPS) initiative and identify which are more aligned to their developmental goals, including DRM and the overall Sustainable Development Goals (SDG) agenda .
  - Access OECD or regional assistance to conduct economic and revenue impact analysis, prior to signing multilateral convention, including the Pillar 1 Multilateral Convention (MLC). Developed countries have the means to conduct their own analysis.
  - Conduct cost/ benefit analysis of the overall engagement with IF and global tax landscape.
  - Evaluate the benefits of the BEPS package and determine which measures are in country's best interest.

Strengthening participation of developing countries

- **Consider international tax policy and other tax sovereignty issues**
  - Establish internal international tax policy which must be consistent with domestic goals.
  - Policy should be reflected in country’s model DTA and supported by domestic law provisions.Often, developed countries reject proposals in the negotiations of DTAs on the basis that the proposal is in breach of domestic law.
  - Discussions on tax certainty in the 2 Pillar solution also raised this issue.
  - Consider the cost of ceding tax sovereignty and source rights.

Strengthening participation of developing countries

- **Capacity Building**
  - The global tax rules are highly complex and changing the rules is technically very difficult. Delegates therefore need very specialized skills which are often in short supply in developing countries, their Ministries of Finance and tax administrations. This challenge is exacerbated by the speed and sheer volume of work involved in the current standard setting processes.
  - Limited resources due to domestic priorities compound the issue.
  - Develop capacity building roadmap to include internal training, building cadre of experts, access to programs such as Tax Inspectors Without Borders (TIWB), seminars and workshops offered by the multilaterals.
  - Engaging experts from other multilaterals.
  - Training in treaty negotiations, Advance Pricing Agreement (APA) negotiations, Mutual Agreement Procedure (MAP) process.

Strengthening participation of developing countries

- **Regional collaboration**
  - Developing countries should ensure, that where they are unable to provide input in multilateral treaty negotiations, they form partnerships within their regions and ensure that a regional perspective is represented at the development of these instruments.
  - The ATAF model is to be commended and should be adopted through regions. The main support that ATAF supplies is technical expertise from the OECD. This arms the region with not only technical competence, but it also somewhat mitigates the political influence.

Strengthening the participation of developing countries

- **Benefits of regional approach**
  - The regional collaborative approach offers the following:
    - countries have a stronger, more respected position
    - affords more influence on development on international tax policy
    - may resolve intra- regional conflicts
    - can galvanize political will

Outstanding issues for consideration by the IF

- Many developing countries consider the two-pillar solution does not address their key concerns regarding the allocation of taxing rights and address artificial profit shifting out of developing countries that have relatively high CIT rates.
- The two-pillar solution is seen as a step in the right direction but should be only the beginning of the work to address these issues. If more is to done on this work the above process issues need to be addressed .A much more radical change is needed to the international tax rules to address these two issues.
- This requires developed countries to listen to the concerns of developing countries and be more open to fundamental changes to the rules, to bring an end to the culture of taking away developing countries' taxing rights with one hand, to give it back in aid and loans in the other hand.
- This will require developed countries to take a more whole of government approach whereby global tax policy decisions are influenced by other government agencies and not only Ministries of Finance and tax administrations.

Outstanding issues for consideration of IF

- Consider whether more attention should be paid to DRM and SDG issues.
- Begin discussions on how the issue of tax and climate change will addressed by the IF.

Recent Developments

- Report by OECD to G20 on strengthening involvement of developing countries (under Italian presidency, focus continues under Indonesian presidency.
- Appointment of co-chair from developing country.
- Upgraded mandate of the Advisory Group on Global Dialogue for Tax Matters. Successful meeting held in April.
- Ministerial Dialogue in November 2021.This should be a continued.
- Expansion of Capacity Building Programs to include sessions on tax and sustainable development, tax and tourism, other bespoke programs.
- Discussions on TIWB program to go beyond providing only audit experts