

# A Guide for Developing Countries on How to Understand and Adapt to the Global Minimum Tax



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## Executive Summary

**Many countries will be affected by the Pillar Two Global Anti-Base Erosion (GloBE) minimum tax proposal whether or not they respond with domestic measures.** The GloBE initiative creates a pool of potential tax revenues on in-scope corporate multinationals' incomes to be collected by GloBE participating countries (that host an entity in the multinational enterprise (MNE) group) whenever the effective tax rate of an entity (or entities) within the MNE group in the country falls below 15%. Some domestic tax measures intended to attract and keep foreign investment may lose their effectiveness as a result. Further, some of GloBE's impact may be indirect, providing lawmakers with an opportunity to consider policy reforms whether or not they adopt GloBE itself. It is in the interest of each country to examine the potential applicability of GloBE to its taxpayers and the interplay of GloBE rules with its domestic tax system in order to make informed decisions about whether and in what manner to respond. This guide seeks to provide information helpful to making such informed decisions.

**For countries that decide to respond legislatively, policy options range from “qualified” to general reforms.** Once GloBE is adopted by enough countries, some countries may be able to collect more tax revenues with corresponding domestic reforms. These reforms may include adopting a domestic minimum tax, whether as a GloBE-defined “qualified” domestic minimum tax or a general domestic minimum tax, or they may consider revisiting existing tax incentives, or a combination of these. Preserving existing incentives and rate structures for taxpayers outside the scope of GloBE while claiming the minimum tax on in-scope companies may be a priority for some countries. For other countries, general reforms may mobilize more domestic revenue and follow the overall international trend toward more comprehensive taxation of large multinationals. This guide examines a range of possible options and explains the general merits and challenges of each.

**The likely impact of GloBE on domestic revenues can be broadly estimated from publicly available data, and tax administrations could obtain more accurate estimates with country-specific data.** Country-by-country reporting provides some publicly available data that permits limited assessment of the likely tax revenue impacts for countries considering whether and how to respond to GloBE. Tax administrators should be able to access more detailed data with specific taxpayer information, including that obtained through information exchange. This guide provides an assessment using publicly available data and explains how countries could undertake more accurate assessments with more specific data.

**Existing treaties and other agreements may affect the impact of available policy choices.** Some domestic responses to GloBE may face legal barriers, including fiscal stabilization provisions that may prevent tax law changes for protected taxpayers, as well as some terms in existing bilateral and multilateral trade and investment treaties. Even where potentially applicable, many of these barriers may be overcome, depending on the specific terms in each case. This guide addresses the range and likelihood of possible barriers and alternative domestic responses thereto.

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## Abbreviations and Acronyms

<b>BEPS</b>	base erosion and profit shifting
<b>BIT</b>	bilateral investment treaties
<b>CBC</b>	country-by-country
<b>CFC</b>	controlled foreign corporation
<b>ETR</b>	effective tax rate
<b>FDI</b>	foreign direct investment
<b>FET</b>	fair and equitable treatment
<b>GloBE</b>	Global Anti-Base Erosion
<b>IIR</b>	income inclusion rule
<b>IISD</b>	International Institute for Sustainable Development
<b>ISDS</b>	investor–state dispute settlement
<b>ISLP</b>	International Senior Lawyers Project
<b>MFN</b>	most-favoured nation
<b>MNE</b>	multinational enterprise
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>QDMT</b>	qualified domestic minimum top-up tax
<b>SBIE</b>	substance-based income exclusion
<b>STTR</b>	subject-to-tax rule
<b>UTPR</b>	undertaxed payment rule
<b>WIR</b>	World Investment Report
<b>WTO</b>	World Trade Organization

## Introduction

As part of its work to reduce base erosion and profit shifting (BEPS), the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework has agreed in principle to a two-pillar approach to the taxation of large multinational groups. Pillar One seeks to reallocate limited taxing rights with respect to very large multinational groups (generally with consolidated revenues of EUR 20 billion or more) to market countries. Pillar One, the rules for which are still being finalized, is outside the scope of this guide.<sup>1</sup> Pillar Two seeks to achieve a global minimum tax rate of 15% on income earned by large multinational groups (generally, with consolidated revenues of EUR 750 million or more). This minimum tax is achieved through the Global Anti-Base Erosion regime (GloBE). Pillar Two is optional for members of the Inclusive Framework, but all members commit to respecting GloBE where it is adopted by other members.

Overall, GloBE aims to ensure that in-scope multinational groups pay an effective minimum tax rate of 15% in each country where they operate. However, GloBE does not achieve this goal by requiring adopting countries to increase their generally applicable domestic corporate income tax rate to 15%. Instead, when the income of a group's entities within a country is subject to a combined effective tax rate below 15%, GloBE effectively permits other countries to impose an additional tax to bring the effective rate to the agreed minimum. GloBE therefore creates a pool of potential tax revenues by country, to be collected by participating countries whenever the effective tax rate of an in-scope multinational group with an entity or entities in a country (each a "Constituent Entity") falls below 15%.<sup>2</sup> An additional and significant feature of GloBE is that for purposes of determining this rate, the effective tax rate (ETR) of a Constituent Entity is defined to include certain taxes paid at the controlling shareholder level, including in the form of controlled foreign corporation (CFC) taxes.<sup>3</sup>

One of the immediate impacts GloBE will have for many countries—whether or not they choose to adopt the rules themselves—will be to negate the effect of certain domestic tax measures on the Constituent Entities of in-scope multinational groups that have the effect of reducing the group's ETR. Some countries may find that their foregone tax revenues flow to other countries instead of being a benefit to the investor. As a result, it is in the interest of every

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<sup>1</sup> Pillar One may play a role in the operation of Pillar Two depending on how the two are integrated, but countries are proceeding to determine their approach to Pillar Two in the meantime.

<sup>2</sup> As observed in the text, the effective tax rate, or ETR, is determined for an in-scope multinational group in a country by aggregating the taxes and income of each of the Constituent Entities of the group in the country. In many countries there will be only one such Constituent Entity. For ease of exposition, this guide will speak in terms of the ETR of a single Constituent Entity as though there is only one such entity in a country.

<sup>3</sup> CFC taxes are taxes imposed on income that is deemed to be paid to a domestic shareholder by virtue of its ownership of a foreign corporation. The OECD's 2013 *Action Plan on Base Erosion and Profit Shifting* (<https://www.oecd.org/tax/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm>) called for developing recommendations regarding the design of CFC rules, which the OECD delivered in its 2015 Action 3 report.



country to examine the potential impact of GloBE on its taxpayers and with its tax system in order to make informed decisions about whether and in what manner to respond.

The purpose of this guide is to assist countries in making such informed policy decisions. Part I provides a brief and simplified explanation of the GloBE model rules as they are currently understood. Part II sets out the range of policy options countries may consider in adapting to GloBE. Part III provides a step-by-step approach for countries seeking to understand the likely impact of GloBE on their tax base. This discussion is supplemented by a high-level assessment of which countries are most likely to be directly impacted by the widespread adoption of a global minimum tax. Finally, Part IV analyzes potential legal considerations impacting countries that seek to enact domestic responses to GloBE.



# Part I: How Pillar Two Works

GloBE features a set of operating rules that assign rights to impose top-up tax on low-taxed income of a multinational group across various jurisdictions according to a designated order of taxing priority. The cornerstone of GloBE is the income inclusion rule (IIR), which is backstopped with the undertaxed profits rule (UTPR); in turn, both may be pre-empted by a qualified domestic minimum top-up tax (QDMT). Each element of GloBE is designed to backstop the other in such a way that they collectively bring a multinational group’s jurisdictional ETR on GloBE income that exceeds a substance-based income exclusion (SBIE), also described below, up to the GloBE’s 15% minimum tax rate. In order to apply the minimum tax on a roughly equivalent tax base across countries, GloBE income is based on a multinational group’s financial statement income, with adjustments, for each Constituent Entity. After a brief explanation of GloBE’s ETR calculation, the main elements of GloBE are each discussed, and examples are given.

## The GloBE Effective Tax Rate in a Nutshell

In simplified terms, the ETR is the ratio of a multinational group’s taxes paid or accrued on GloBE income in a country divided by the multinational’s GloBE income from that country. In order to arrive at the tax rate actually incurred by the taxpayer, the SBIE amount is not excluded from the ETR calculation.<sup>4</sup> The taxes on GloBE income that are included in the numerator are adjusted to take into account differences between taxable income as it is defined in GloBE and the local law definition, as well as to include some shareholder-level taxes imposed via CFC regimes.<sup>5</sup>

**Figure 1.** The basic calculation of the ETR under GloBE rules

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

Source: Authors’ diagram.

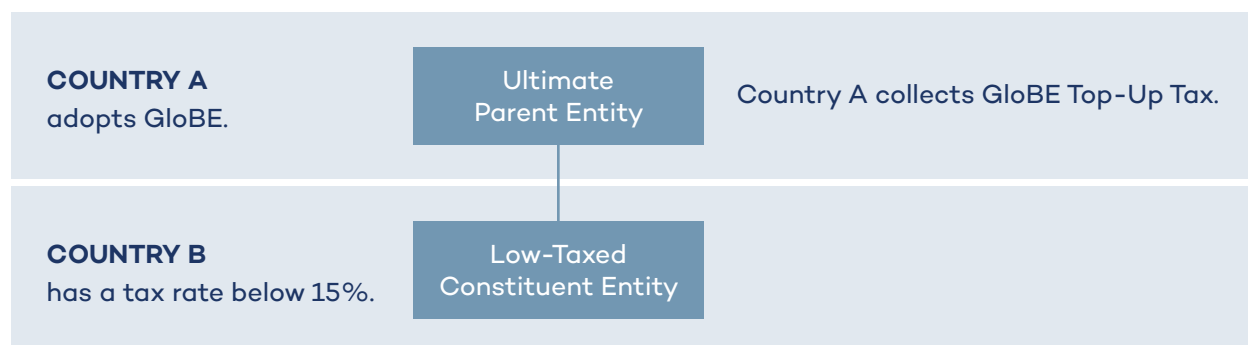
<sup>4</sup> However, the top-up tax applies only to the excess of GloBE income over the SBIE amount, as discussed more fully below.

<sup>5</sup> See “Covered Taxes,” below.

## Income Inclusion Rule

The IIR is effectively a backstop rule: where any Constituent Entity of a multinational group is subject to a low ETR at source,<sup>6</sup> the IIR may entitle the residence country of a parent or intermediate holding company to impose a top-up tax. The general idea of the IIR and the top-up tax allocation is illustrated in Figures 2 (basic operation) and 3 (operation when the top-level jurisdiction does not adopt GloBE).

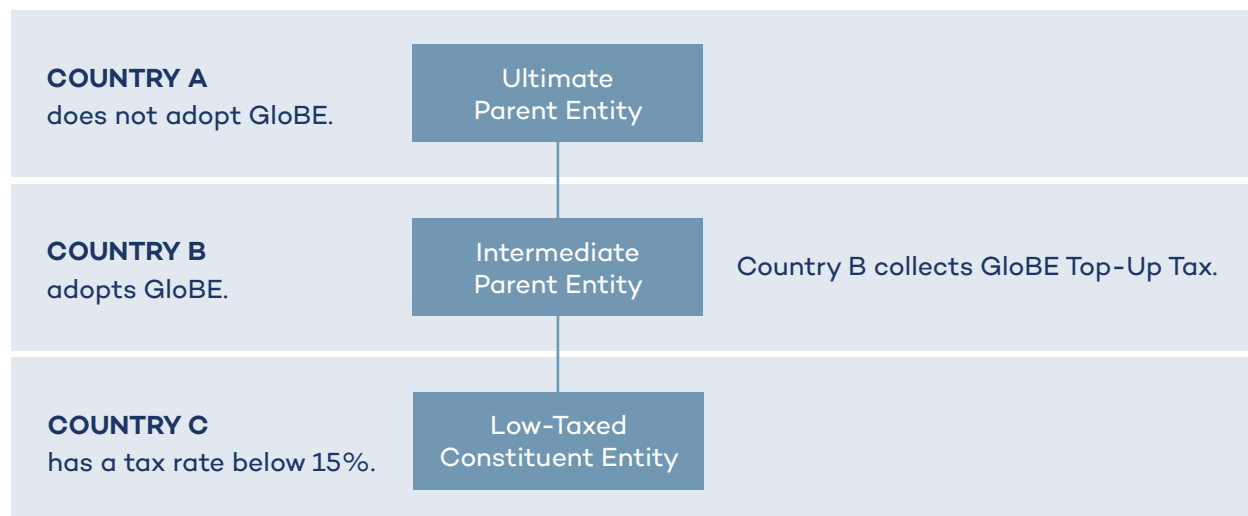
**Figure 2.** The basic operation of the IIR



Source: Authors' diagram.

<sup>6</sup> In describing a multinational group, “source” typically means a country in which activities that generate income take place while “residence” refers to the location of incorporation or management and control of any entity that controls another entity or entities of the group. The term “home” is typically used interchangeably for residence, while the term “host” is typically used interchangeably for source. The term “headquarters” is typically used interchangeably with home or residence country when describing the top-most entity of the group; in the OECD vocabulary, the headquarters company is the Ultimate Parent Entity, while constituent entities that control lower tier subsidiaries may be “Intermediate Parent Entities.” Low tax refers to any rate of tax below the 15% agreed minimum tax rate. This guide uses the terms that are most descriptive to the applicable circumstances.

**Figure 3.** Operation of IIR where the top-level jurisdiction does not adopt GloBE



Source: Authors' diagram.

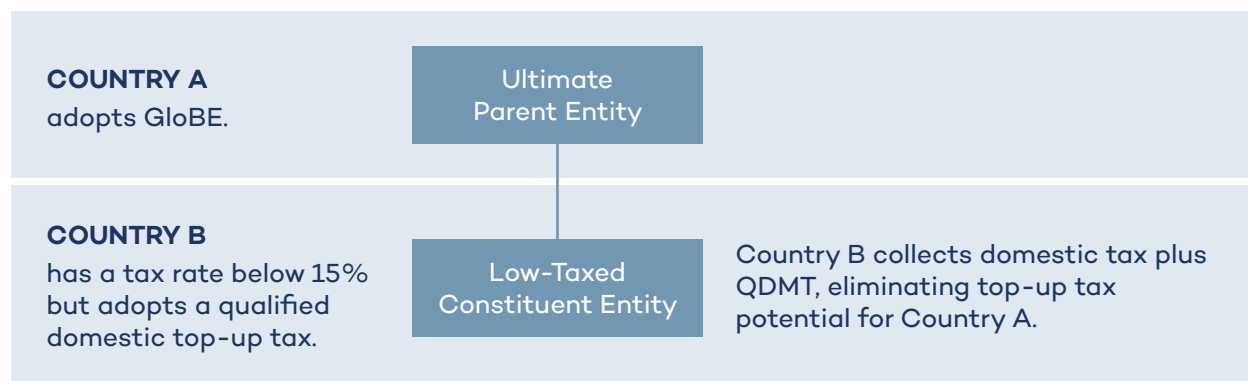
## Qualified Domestic Minimum Top-Up Tax

The GloBE rules also support the adoption of domestic minimum taxes. Adopting GloBE's QDMT preserves the first right of taxation to the source country, thus switching the country collecting the GloBE Top-Up Tax from an IIR- or UTPR-imposing country to the country where the income is earned. The OECD has stated that QDMTs will be recognized as “fully creditable against any liability under GloBE.”<sup>7</sup> The OECD Inclusive Framework confirmed in recent administrative guidance that source countries' QDMTs will take precedence over shareholder level taxes and will be treated as creditable against taxes imposed at the shareholder level by the parent country in the same way as other source country domestic taxes.<sup>8</sup> The general idea of the QDMT is illustrated in Figure 4.

<sup>7</sup> Organisation for Economic Co-operation and Development. (n.d.). *The Pillar Two rules in a nutshell*. <https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf>, at p. 1.

<sup>8</sup> Organisation for Economic Co-Operation and Development Inclusive Framework on BEPS. (2023). *Tax challenges arising from the digitalisation of the economy – Administrative guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*. <https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf>, at 69.

**Figure 4.** The basic operation of a QDMT



Source: Authors' diagram.

## Covered Taxes

As discussed above, the GloBE ETR is calculated by dividing the defined GloBE income in the jurisdiction by the defined “Adjusted Covered Taxes” in the jurisdiction. The calculation of each in-country Constituent Entity’s top-up tax therefore starts with Covered Taxes. These are defined to include the income taxes (or close relatives) recorded in the Constituent Entity’s financial statements, with certain adjustments.<sup>9</sup> The determination of a Constituent Entity’s ETR is complicated by the fact that GloBE counts taxes withheld on payments of income (e.g., interest, royalties, and services) as Covered Taxes of the recipient entity, taxes withheld on distributions as Covered Taxes of the entity distributing the earnings, and certain shareholder-level taxes on undistributed earnings of a subsidiary as if paid by the subsidiary (instead of by the shareholder). As such, GloBE computes the ETR of a Constituent Entity by reference to a combination of its actual (domestic) corporate income taxes recorded in the financial statements (with certain adjustments),<sup>10</sup> taxes withheld by others on income payments to it (both taxes and income would

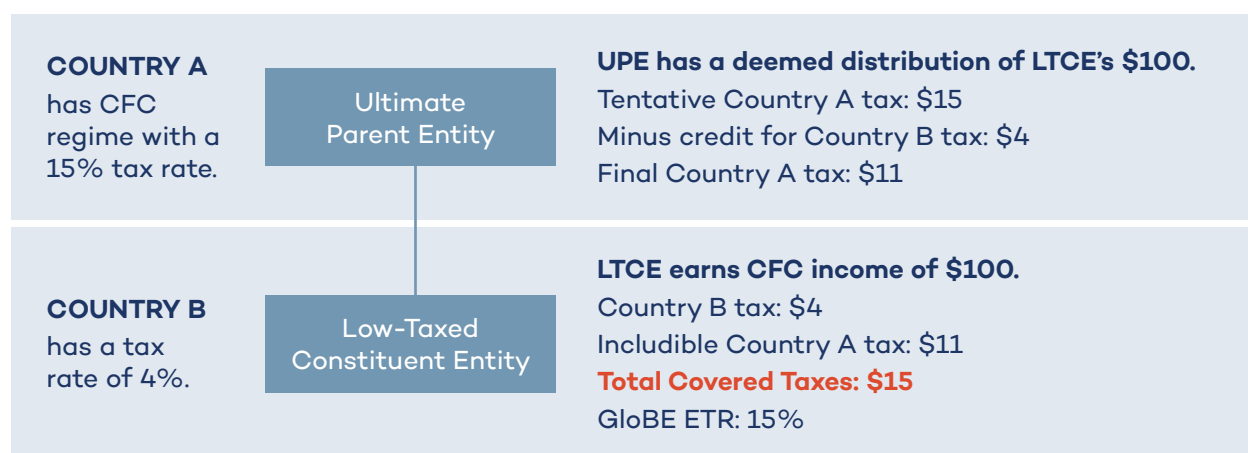
<sup>9</sup> The financial statement is the unconsolidated statement of the Constituent Entity. If the Constituent Entity engages in non-arm’s length transactions with other multinational group members, the unconsolidated financial statement must be adjusted to reflect arm’s length transactions. Because the multinational group’s consolidated financial statements eliminate intercompany transactions, the unconsolidated financial statement used in GloBE is unlikely to have previously been reviewed under the arm’s-length standard.

<sup>10</sup> One such adjustment results from the exclusion of capital gains and losses realized in sales of equity (“Excluded Equity Gains and Losses”) from financial statement income. Capital gains taxes paid on such income are not included as “Covered Taxes,” described below. The exclusion of both the income and the taxes from equity sales is generally symmetrical and therefore with neutral effect on MNE Groups, but may produce some mismatches of treatment across jurisdictions with different domestic rules for the taxation of equity sales. Where the operation of the Excluded Equity Gain or Loss rules or other financial statement adjustments called for under GloBE would tend to discourage developing countries from adopting revenue safeguards such as taxes on offshore indirect transfers (that is, transfers of entities owning an asset located in one country by a resident of another), the GloBE rules may require some reexamination to ensure developing countries are not disadvantaged by the current approach.

be recorded in its financial statements), and taxes paid on deemed distributions of its earnings by its direct or indirect shareholders (generally, CFC taxes).

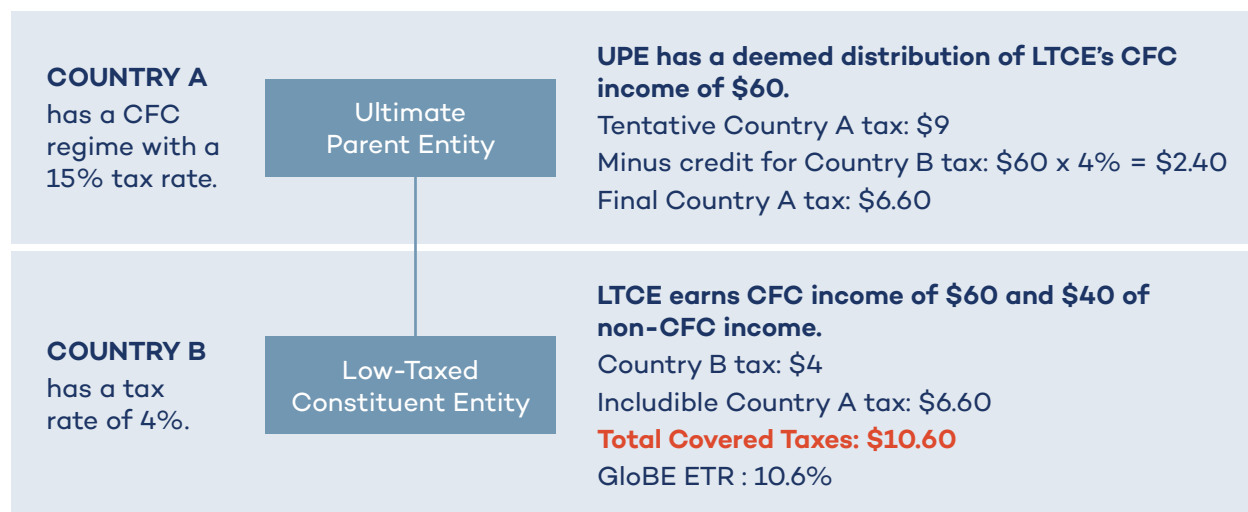
The goal of including CFC taxes is to recognize that shareholder-level taxes on undistributed income are effectively on income of the local Constituent Entity and should be counted in determining whether income is “Low-Taxed” such that a top-up tax might be available. Including these taxes in the ETR of Constituent Entities has the effect of reducing the available GloBE top-up tax potential. The operation of Covered Taxes is illustrated in Figure 5 (general inclusion rule) and Figure 6 (showing how the rule isolates CFC income from non-CFC income).

**Figure 5.** The inclusion of Covered Taxes in Constituent Entity ETR



Source: Authors' diagram.

**Figure 6.** Covered taxes in situations involving some CFC and some non-CFC income



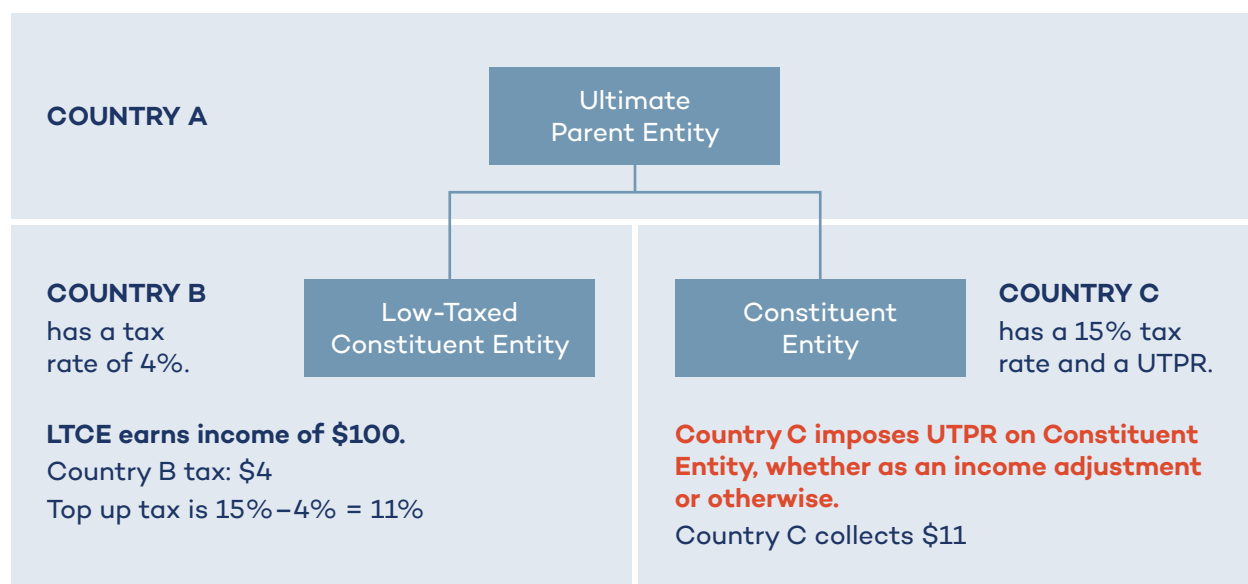
Source: Authors' diagram.

## Undertaxed Profits Rule

GloBE also features an Undertaxed Profits Rule, or UTPR (originally an undertaxed payments rule). A country’s UTPR would apply when an in-scope multinational group’s Constituent Entities do not pay at least a 15% ETR (i.e., there is no QDMT) and a top-up tax is not paid under an IIR in another jurisdiction. The basic idea of the UTPR is as a backstop. It preserves the primary entitlement of either (1) a relevant source country to forestall the application of an IIR by means of a QDMT, or (2) the ultimate parent entity’s home country to collect all of the top-up tax if it so chooses, while allowing intermediate countries to collect the top-up tax where the other eligible jurisdictions choose not to do so.

Thus, where an IIR exists, any potential UTPR is deemed to be zero.<sup>11</sup> In turn, a QDMT would have the effect of reducing the top-up tax amount subject to an IIR or a UTPR, as the case may be.<sup>12</sup>

**Figure 7.** Basic operation of UTPR



Source: Authors’ diagram.

The UTPR is designed to adjust the income of one or more Constituent Entities to produce a tax equivalent to the top-up tax amount that was calculated but not collected in respect of a low-taxed Constituent Entity elsewhere in the group (including if the ultimate parent entity is

<sup>11</sup> See GloBE Rules Art. 2.5.2.

<sup>12</sup> As such, adopting a QDMT or other domestic minimum tax may be a preferred policy choice where a country anticipates its local Constituent Entities will be subject to either an IIR or a UTPR elsewhere. This analysis is examined in Part II, below.



itself a low-taxed Constituent Entity). Where more than one jurisdiction hosting a Constituent Entity of the MNE group adopts a UTPR, each of the countries is designated a portion of the top-up tax amount according to an allocation key based on the number of employees and the net book value of tangible assets in each country. The UTPR amount may be collected from the local Constituent Entity in virtually any manner, including by denying deductions, adding deemed amounts to income, imposing a surcharge or excise, or otherwise. The basic operation of the UTPR is illustrated in Figure 7.

## Substance-Based Income Carve-Out

An important component of the GloBE rules' effect on domestic tax systems is the SBIE. This feature excludes certain income from the computation of the top-up tax, thereby reducing the impact of GloBE on in-scope low-taxed Constituent Entities that have substance-based income. The reduction is based on the amount of the in-scope Constituent Entities' tangible investment and payroll in the source country. In brief, when a low-tax Constituent Entity has specified assets or payroll expenses, the amount of income subject to GloBE top-up tax is reduced. Where the ETR is below 15%, the GloBE income is reduced by the SBIE. The effect is to reduce the amount of top-up tax imposed.

The OECD explains that the SBIE allows jurisdictions to “continue to offer tax incentives that reduce taxes on routine returns from investment on substantive activities, without triggering additional GloBE top-up tax.”<sup>13</sup> Ultimately, the SBIE will be set at 5% of the carrying value of tangible assets and 5% of payroll costs, but during a transition period of 10 years, the applicable rates are 8% and 10%, respectively.<sup>14</sup>

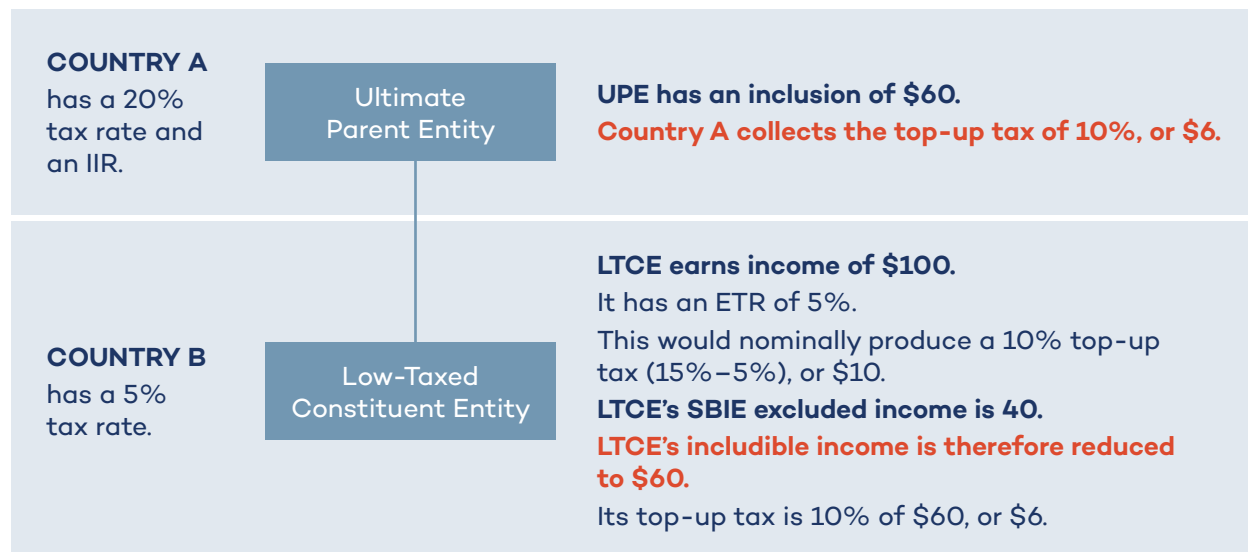
The basic operations of the SBIE are illustrated in Figure 8.

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<sup>13</sup> Organisation for Economic Co-operation and Development. (2021). *FAQs on model GloBE rules*. p. 3. <https://www.oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf>

<sup>14</sup> The SBIE will progressively decrease from 8% of the carrying value of tangible assets and 10% of payroll in a transition period of 10 years, declining annually by 0.2% for the first 5 years (for both tangible assets and payroll) and by 0.4% for tangible assets and by 0.8% for payroll for the last 5 years.

**Figure 8.** Basic operation of the SBIE



Source: Authors' diagram.

## Subject to Tax Rule

GloBE-adopting countries may consider adopting a subject-to-tax rule (STTR) if they have tax treaties with withholding rates that fall below the agreed minimum rate of 9%. An STTR modifies the outcome of existing tax treaties by allowing source countries to impose a top-up tax rate in addition to the existing treaty rate where the gross income paid is taxed in the payee's country at less than 9%. As currently proposed, the STTR would apply only to a prescribed set of deductible payments between related parties, including interest and royalties, and would not alter the rate of tax on other payments, such as those in respect of services, capital gains, or offshore indirect transfers.

Like other withholding taxes, the STTR is imposed on gross payments rather than net income. Under the current design, payments that are already subject to a rate of at least 9% would not be subject to an STTR but would remain subject to GloBE top-up tax if the entity's overall ETR falls below 15%. Accordingly, a jurisdiction adopting an STTR would apply it regardless of whether another jurisdiction has imposed top-up taxes through an IIR. Taxes triggered under the STTR constitute Covered Taxes for purposes of computing a jurisdiction's ETR with respect to a Constituent Entity.

Because an STTR would override the terms of existing treaties, a multilateral instrument will be developed by the Inclusive Framework to facilitate its implementation. Although implementation may require negotiation among countries, Inclusive Framework members with relevant tax rates below the STTR minimum rate have agreed to implement the STTR into their bilateral treaties with developing country members when requested. For countries without extensive treaty

networks, an STTR may be less effective than increasing domestic withholding taxes, an option that is always available regardless of whether the jurisdiction adopts GloBE.

## Summary

The GloBE rules create a pool of potential top-up tax to be collected by a country or countries. The pool of tax collectible under GloBE will be computed by reference not only to domestic corporate taxes but also to certain shareholder-level taxes on undistributed earnings. By default, the collecting country will be that in which the top-most parent entity of the multinational group (the ultimate parent entity) is resident. Intermediary countries may collect GloBE top-up tax if the top-most jurisdiction does not. If there is no such entity, the top-up tax is spread among participating countries in which there are one or more Constituent Entities of the multinational group, to be taxed under one or more UTPRs. A jurisdiction may pre-empt the default order by increasing the applicable rate of tax at source, such as by adopting a QDMT or, possibly, as discussed below, a general domestic minimum tax. In addition to the GloBE minimum tax, a country may modify its treaties to include an STTR that will limit the ability of investors to achieve base erosion via treaty-based withholding tax rates.



# Part II: Adapting Domestic Tax Policies to Pillar Two

Where GloBE is projected to result in top-up taxes being imposed elsewhere in respect of local taxpayers, governments should consider domestic responses. Countries have three main options in responding to GloBE. The first is to enact a domestic minimum tax in order to capture the top-up tax potential created by GloBE with respect to in-scope multinationals. This may be achieved with a qualified domestic minimum top-up tax (QDMT) as defined in GloBE or by a general domestic minimum tax that achieves results consistent with GloBE.<sup>15</sup> The complexity of GloBE may be a limiting factor for some countries, while a general domestic minimum tax potentially extends beyond the scope of GloBE as currently conceived. The second option, possibly in parallel with the first, is to revisit domestic tax incentives with a view to reducing the chance that GloBE will apply in the jurisdiction. Finally, countries may decide not to respond to GloBE at this time, whether because they are not likely to be significantly impacted by it or because they would benefit more by focusing their attention on other measures.

Each of the three options is discussed in turn below. A thorough assessment of the impact of GloBE on domestic taxpayers and domestic tax systems will assist countries in determining which option(s) is(are) currently optimal. Parts III and IV provide a step-by-step guide to making such assessments.

## Option 1: Introduce a Domestic Minimum Tax

A country with a domestic corporate income tax rate that is already at or above 15% could potentially achieve outcomes comparable to GloBE by selectively modifying domestic tax measures applicable to domestic Constituent Entities of in-scope multinational enterprise (MNE) groups, but this would require highly detailed and company-specific analysis to take the SBIE into account. In practice, governments may be better served by reviewing tax incentives systematically, as discussed under Option 2. In the meantime, a more immediate response would be to adopt either a GloBE-sanctioned QDMT, introduced above in Figure 4, or instead a generalized domestic minimum tax. The latter might be easier to design and implement but would reach taxpayers not within the scope of GloBE. The former would increase domestic taxes only on in-scope MNE group entities and only to the extent that such tax revenue would otherwise be collected by another country as a top-up tax, either through the income inclusion rule (IIR) or the undertaxed profits rule (UTPR). Each is discussed in turn.

### Qualified Domestic Minimum Tax

Adopting legislation that corresponds directly to the provisions set out in the GloBE model rules is likely the most certain path to collecting available top-up taxes while also preventing double taxation of income subject to foreign Covered Taxes (such as shareholder-level controlled foreign corporation (CFC) taxes). As such, where GloBE impacts local taxpayers, **a QDMT would increase domestic revenue without necessarily affecting the after-tax position of**

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<sup>15</sup> Regardless of their decision to adopt GloBE or not, countries can always institute a general increase in the rate of corporate income tax applicable to all taxpayers.

**in-scope multinational groups (so they should be neutral or even prefer to pay the tax locally) and without affecting companies that are excluded from the scope of GloBE.**

In their current form, the GloBE model rules define a QDMT as a domestic minimum tax that:

1. Determines the excess profits of Constituent Entities located in the country (domestic excess profits) in a manner that is equivalent to the GloBE Rules.
2. Increases the domestic tax liability with respect to domestic excess profits to the minimum rate for the country and Constituent Entities for a fiscal year.
3. Is implemented and administered in a way that is consistent with the GloBE rules and the commentary, so long as the adopting country does not provide any benefits that are related to such rules.

Domestic legislation setting out a QDMT that adheres to these GloBE rules could be drafted to apply:

- Whether or not another country in fact imposed a Covered Tax or top-up tax on the entity for a given period, or
- Only when another country or countries would otherwise impose Covered Taxes, top-up taxes, or both.

The objective of the second approach would be to reduce the circumstances in which the domestic rule applies when no top-up tax would apply.

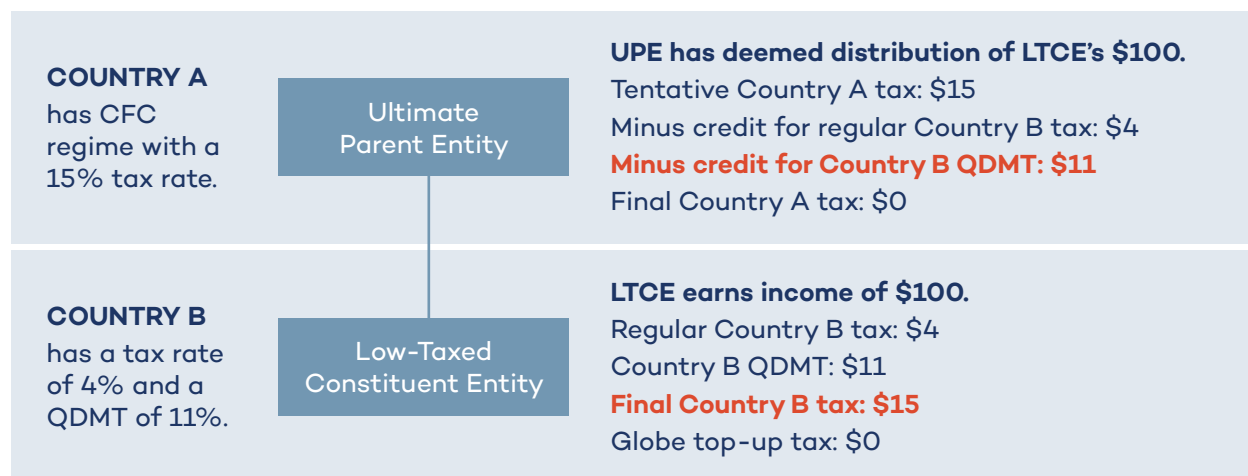
Despite the legal certainty and positive revenue effects that may be available by enacting a QDMT, it is anticipated that adopting GloBE rules generally would represent a significant undertaking for many countries. While it is possible for a country to adopt a QDMT without adopting the rest of the GloBE regime or rules, some countries may seek to reduce the domestic burden by relying on the efforts of other countries to implement GloBE. A country that does not adopt a QDMT should monitor the extent to which top-up taxes attributable to Constituent Entities in their country are paid to other countries. If the revenue loss is material, it may decide to subsequently adopt a QDMT.

## Note on Creditability

Outside of GloBE, domestic taxes on income would generally be expected to be creditable against shareholder-level taxes on undistributed income (that is, those collected through CFC and similar regimes). The expectation of creditability may be limited in some CFC regimes to prevent credits where foreign source-based taxes are subject to refund or repayment, or are designed to target taxes imposed because they will be creditable elsewhere while not imposing tax on income not subject to CFC taxes. Going further, the U.S. “global intangible low-taxed income regime” includes an arbitrary 80% limit on creditable taxes. While the creditability of a domestic tax against a CFC tax is a question of the shareholder country’s law, recent guidance has made

clear that the QDMT will take precedence over CFC taxes and accordingly should be creditable against and reduce or eliminate the CFC tax.<sup>16</sup> Figure 9 illustrates this view.

**Figure 9.** Creditability of source taxes against shareholder-level taxes



Source: Authors' diagram.

## Generalized Domestic Minimum Tax

Some countries may wish to adopt domestic tax reforms that are not strictly tethered to the terms and scope of GloBE but focus on domestic policy goals that align with the overall direction of GloBE. Some governments may, therefore, prefer a generalized domestic minimum tax to a “qualified” version.

Adopting a generalized domestic minimum tax does not depend on a country's overall stance toward GloBE. Instead, this is a policy choice available to any country, including Inclusive Framework members that do not adopt GloBE as well as countries that are not members of the Inclusive Framework. There are at least two arguments to support this statement. First, every country is entitled to design its domestic income tax system, whether within the context of GloBE or not. Domestic rules that broadly correspond with international residence and source standards should be respected by other countries. Second, since the goal of GloBE generally is to mitigate BEPS and specifically to ensure that large multinational groups incur an effective tax rate of 15% everywhere they operate, any form of non-discriminatory domestic reform that produces consistent results should be accepted. A country generally should be free to adopt its own version of a domestic tax, according to its own domestic policy priorities.

<sup>16</sup> Organisation for Economic Co-Operation and Development Inclusive Framework on BEPS. (2023). *Tax challenges arising from the digitalisation of the economy – Administrative guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*. <https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf>, at 69.

There is a range of possible designs of generalized domestic minimum taxes, from a quasi-QDMT to a much simplified turnover tax imposed in lieu of an income tax. Different designs will be treated differently under GloBE rules.

To achieve the highest level of certainty regarding the treatment of the domestic minimum tax by other countries in the context of GloBE, the domestic minimum tax will need to generally align with the parameters for a qualified domestic minimum tax. This means that the domestic minimum tax should, like a qualified version:

1. Determine the sum of the amounts of tax that have been or would be imposed by one or more foreign countries with respect to the income of a Constituent Entity as
  - a. Foreign Covered Taxes as defined in GloBE and
  - b. Top-up taxes as defined in GloBE. (If a Constituent Entity is in scope of the GloBE Rules but no other country has imposed or would impose Covered Taxes or top-up taxes with respect to the income of such Constituent Entity, this sum could be treated as zero).
2. Apply a domestic tax to the income of Constituent Entities at a rate that yields an amount of tax equal to that computed under (a); and
3. Provide that no refund, deduction, or other tax benefit is to be allowed where it would at any time reverse the tax imposed under (b).

With these features in place, a generalized domestic minimum tax would, like a QDMT, take precedence over the tax result a given taxpayer otherwise would obtain under the domestic law when doing so would result in an effective tax rate (ETR) below a specified rate.

However, domestic minimum taxes can depart from the template of a QDMT. A domestic minimum tax should be considered consistent with GloBE even if it differs from the qualified version: many members of the Inclusive Framework have had alternative minimum taxes for many years.<sup>17</sup> For example, the United States has imposed alternative minimum taxes on corporations at various times since 1969 and recently adopted a new corporate alternative minimum tax in the fall of 2022. In earlier years, the U.S. corporate minimum tax was, in effect, an excise tax on tax preferences (such as deductions for such items as percentage depletion, intangible drilling costs, bad debt, and inclusions for such items as interest on tax-exempt bonds) that exceeded a prescribed amount. Later versions required the taxpayer to compute taxable income under the regular rules and then do so a second time by excluding a list of adjustments and preferences; the taxpayer would ultimately owe the higher amount computed under the two scenarios.

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<sup>17</sup> For an analysis of design options for corporate AMTs and their revenue impacts see, for example, Aslam, A. & Delgado Coelho, M. (2021). *A firm lower bound: Characteristics and impact of corporate minimum taxation* (IMF Working Paper No. 2021/161). <https://www.imf.org/en/Publications/WP/Issues/2021/06/08/A-Firm-Lower-Bound-Characteristics-and-Impact-of-Corporate-Minimum-Taxation-49886>



The functionality of a generalized domestic minimum tax in raising revenues without creating double taxation depends on the tax taking priority over the GloBE-related claims of other jurisdictions with respect to the relevant taxpayer's GloBE income. In other words, the efficacy of this approach depends on the domestic minimum tax being included within the definition of Adjusted Covered Taxes, that is, in the determination of the multinationals' overall GloBE ETR. If not, the domestic minimum tax will risk adding layers of complexity and taxation to the local entity even as it continues to face GloBE top-up taxes elsewhere.

As discussed in Part I, Covered Taxes are defined to include the income taxes (or close relatives) recorded in the Constituent Entity's financial statements, with certain adjustments. Therefore, any domestic minimum tax based on some measure of corporate profits should be considered a Covered Tax under GloBE rules.

To avoid doubt with respect to its interaction with GloBE, a generalized domestic minimum tax that is not integrated with the regular income tax but is instead imposed on a different base (such as turnover), will need to be constituted as a tax "imposed in lieu of a generally applicable corporate income tax" (and thereby be a "Covered Tax" pursuant to GloBE Article 4.2.1(c)).<sup>18</sup>

In summary, a country that chooses not to adopt GloBE or not to adopt a QDMT as defined within GloBE could nevertheless choose to adopt a domestic minimum tax that is consistent with GloBE. Within the range of possible designs of domestic minimum taxes, a country could choose one that either achieves the same reallocation function as that indicated by the Model Rule-based QDMT or is considered a Covered Tax that increases the GloBE ETR of domestic entities above 15%.

## Option 2: Review Incentives

As outlined above, GloBE is likely to negate some of the benefit for investors of low effective tax rates at source, in whatever manner such rates may be effectuated. GloBE thus creates policy space for governments to revisit domestic tax incentives and implement reforms. In some countries, such reforms may be long overdue as well as being key to increasing domestic resource mobilization. In anticipation of GloBE's broad implementation, therefore, countries should consider which of their domestic measures—whether in legislation or investment contracts or otherwise—are likely to lead to ETRs under 15% and, therefore, potentially ripe for dismantling as ineffective policy tools. There is a growing consensus on the need to review tax incentives, particularly in light of GloBE. Recommendations from this section are broadly in line with recent

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<sup>18</sup> March 2022 Commentary on Article 4.2 of the OECD 2021 Model Rules states that "simplified methods" that substitute for income taxes will count. Resource rent taxes on extractive industries are specifically included, but a tax "imposed on an alternative basis that applies in addition to, and not as a substitute for, a generally applicable income tax ... would not fall under the 'in lieu of' test for Covered Taxes." This language might be read to suggest that existing domestic minimum taxes on a distinct base, such as turnover, risk being excluded as Covered Taxes even though their effect is to increase the ETR on income at source.

publications from the World Bank,<sup>19</sup> IMF<sup>20</sup> and the OECD<sup>21</sup> on the implications of GloBE for domestic tax incentives.

Some international aspects of a jurisdiction's taxation regime may affect the overall impact of tax incentives under the GloBE rules. For example, CFC rules may be applied on income earned in the country if it is considered to be "low-tax" by the ultimate parent entity's jurisdiction. As the GloBE rules allocate an investor's CFC tax to the controlled foreign entity itself toward the calculation of the GloBE ETR, this could lower or eliminate the need for a top-up tax. While considering the impact of GloBE rules on their use of tax incentives, governments will simultaneously need to map the impact of taxes imposed by other jurisdictions on in-scope MNE groups.

Governments will also have to consider the impact of tax incentives granted to in-scope companies in other foreign jurisdictions because the UTPR allows countries where subsidiaries are located to tax the low-taxed income of the ultimate parent entity as well, which means that any incentive at the level of the ultimate parent entity that brings the ETR below 15% could also be affected. This consideration is particularly important for countries that offer headquarter incentives.<sup>22</sup>

In addition to analyzing the impact of the ETR applied to in-scope MNE groups, governments will also need to factor in the potential effects of the SBIE on their tax incentive regime. The increase in tax due to the application of GloBE rules will depend on the amounts of payroll and tangible assets that companies have in a jurisdiction, which is closely related to the nature of the entities' business activities. Governments will need to consider the extent to which their tax incentive regimes encourage a high amount of substance relative to GloBE income when reconsidering their use of tax incentives.

Table 1 summarizes Appendix A, which identifies the most common types of tax incentives and assesses each in terms of its propensity to produce ETRs under 15%.<sup>23</sup> The precise impact of GloBE on each type of incentive depends upon a number of contextual factors, including the design of the particular incentive regime, the extent to which its beneficiary companies are within the scope of Pillar Two, the level of income to which it applies, and its interaction with the

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<sup>19</sup> World Bank. (2021). *The Global Minimum Tax: From agreement to implementation* [Overview booklet]. Information and Communications for Development. <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099500009232217975/p169976034c92506a0a1190bc5e3a05e3ed>

<sup>20</sup> International Monetary Fund. (2023). *International corporate tax reform*. <https://www.imf.org/-/media/Files/Publications/PP/2023/English/PPEA2023001.ashx>

<sup>21</sup> Organisation for Economic Co-operation and Development. (2022). *Tax incentives and the Global Minimum Corporate Tax: Reconsidering tax incentives after the GloBE rules*. <https://doi.org/10.1787/25d30b96-en>

<sup>22</sup> For further discussion on the impact of the SBIE on tax incentives please see Organisation for Economic Co-operation and Development. (2022). *Tax incentives and the Global Minimum Corporate Tax: Reconsidering tax incentives after the GloBE rules*. <https://doi.org/10.1787/25d30b96-en>

<sup>23</sup> For a more detailed analysis of tax incentives most likely to be affected by GloBE, see Ferreira Liotti, B., Ndubai, J. W., Maina, R. W., Lazarov, I., & Owens, J. (2022). The treatment of tax incentives under Pillar Two. *Transnational Corporations Journal*, 2(2). <https://doi.org/10.2139/ssrn.4132515>

mechanics of the GloBE rules. A comprehensive analysis is required for governments that seek to selectively prevent undertaxed income arising in their countries due to the widespread adoption of GloBE, but all countries may benefit by reviewing their incentive regimes for provisions that have become ineffective over time, whether or not as a result of GloBE. GloBE rules will counteract the benefit of some tax incentives by granting another jurisdiction the authority to collect a top-up tax wherever an in-scope MNE is taxed below 15%. Maintaining highly affected tax incentives will result in a jurisdiction forfeiting tax revenue while nullifying the investment promotion objective of the tax incentive as the MNE remains liable for the top-up tax.

**Table 1.** Impact of GloBE on types of tax incentives

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

<sup>24</sup> The GloBE rules treat qualified tax credits (which do not reduce taxes for ETR purposes) as income for the company, while non-qualified credits reduce taxes for the ETR. Both of these measures have the potential of reducing the GloBE ETR below the 15% mark: the qualified credits by increasing GloBE income that is not subject to tax, and the non-qualified credits to a greater extent by reducing covered tax expenses. For further discussion, see United Nations Conference on Trade and Development (UNCTAD). (2022). *World investment report*. <https://unctad.org/webflyer/world-investment-report-2022> for 2022 or Organisation for Economic Co-operation and Development. (2022). *Tax incentives and the Global Minimum Corporate Tax: Reconsidering tax incentives after the GloBE rules*. <https://doi.org/10.1787/25d30b96-en>

<sup>25</sup> WHT on payments other than distributions to owners would be a covered tax in the recipient’s country and the ETR in the recipient’s country would determine application of a top-up tax. If source country reduction in WHT on these payments would result in imposition of a top-up tax in the recipient country, the benefit to the investor is reduced commensurately and the WHT reduction should be reconsidered. On these grounds, the use of WHT reductions as an incentive should be analyzed carefully to determine whether the benefit justifies the loss in revenue.

Tax incentives	Likely impact of GloBE
<b>Cost-based incentives</b>	
Reduced tax rate, additional deductions for qualifying expenses	<b>Medium:</b> Will, in many cases, reduce GloBE ETR, but the ETR reduction may not always lead to the payment of top-up tax.
Tax deferrals, investment allowances, longer loss carry forward periods, preferential treatment of long-term capital gains <sup>26</sup>	<b>Limited:</b> Likely to not reduce GloBE ETR and lead to the payment of top-up tax.
Payroll tax incentives, property tax reductions, exemptions from indirect taxes <sup>27</sup>	<b>No impact:</b> Payroll taxes and other employment-based taxes, as well as social security contributions, are not Covered Taxes under the GloBE rules. Taxes based on ownership of specified items or categories of property are distinguishable from taxes based on a corporation's equity and should not be Covered Taxes under the GloBE rules. Consumption taxes, such as sales taxes and value-added taxes, are not Covered Taxes under the GloBE rules.

Source: Authors.

As the table indicates, tax incentives that reduce or fully eliminate tax are the most likely to affect a company's ETR (and therefore risk being rendered ineffective by GloBE), but countries may also wish to examine incentives that reduce the cost of investment without reducing the ETR below 15% and those applied to taxes that are not defined as Covered Taxes under the GloBE rules, since these incentives might be ineffective regardless of the reach of GloBE.

Governments that choose to revisit their tax incentive regimes may need to pursue a multi-pronged strategy. The most feasible first step is to suspend administrative or executive practices that involve offering incentives to new investors, but governments may also consider (1) removing ineffective incentives from existing laws; (2) renegotiating or terminating terms in investment contracts and treaties that provide for ineffective incentives; and (3) replacing tax incentives that are impacted by GloBE with those that are not. Each option is considered in turn below.

## Legislative Reforms

In pursuing legislative reform, international best practice suggests that tax incentives should be consolidated, along with their eligibility criteria, in the main body of tax law, in order to ensure

<sup>26</sup> The true impact of the treatment of preferential gains will depend on the activities that the MNE performs in the country and whether the beneficial capital gains treatment can be compensated by other items of income that are taxed above 15%. See United Nations Conference on Trade and Development, *supra* note 21 for further discussion.

<sup>27</sup> Note that if payroll taxes increase payroll they will have an indirect effect on SBIE.

that all applicable terms are accessible to the public. In many countries, incentives are dispersed across a variety of complex and unconnected legal sources, including:

- Corporate income tax laws
- Investment promotion laws
- Sector-specific laws (petroleum, mining, agriculture, fisheries, forestry, manufacturing, telecoms, etc.)
- Laws governing special economic zones
- Special statutory provisions or decrees
- Bilateral investment treaties (BITs)
- Bilateral trade agreements (especially for indirect taxes)
- Investment agreements, including concession agreements or production-sharing contracts for extractive industries
- Ad hoc government acts (e.g., decrees)

The process of identifying all ineffective tax incentives and charting a plan to dismantle them will be specific to each country. Appendix A of this document uses the incentive structures of Uganda and Zambia as illustrative examples.

## Treaty and Contract Reforms

Depending on the nature of incentives and how they have been awarded to specific investors, reforming existing contractual and treaty-based instruments could be more complex and require negotiations with affected companies. There may be legal barriers to revision if such incentives are protected under stabilization provisions in law or contract. These issues are examined in Part IV.

## Replace GloBE-Impacted Incentives With Non-Impacted Measures

Governments that seek to continue using tax for investment promotion to the extent still possible after GloBE may wish to replace tax incentives that GloBE renders ineffective, such as broad ETR-reducing tax holidays, with others that are less affected, such as certain deferral measures, investment allowances and transferable tax credits.<sup>28</sup> Such reforms should be carefully considered in light of global changes affecting investment patterns beyond the global minimum tax, for example as noted in the United Nations Conference on Trade and Development's (UNCTAD's)

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<sup>28</sup> International Monetary Fund. (2023). *International corporate tax reform*. <https://www.imf.org/-/media/Files/Publications/PP/2023/English/PPEA2023001.ashx> Some countries' tax regimes allow structures (often involving partnerships) that permit monetization of credits by effectively transferring their benefit to investors who can use the credits against other tax liability. Generally, such investors would not be in-scope MNEs for Pillar Two purposes. Countries should monitor such arrangements and future administrative guidance addressing how these arrangements are treated for purposes of Pillar Two.

*2022 World Investment Report (WIR)*.<sup>29</sup> Countries may be better served by investing in other determinants of capital location decisions, including physical infrastructure, human capital, and the rule of law.

It is not desirable to simply replace one source of revenue loss with another unless justified and implemented under the usual best practices standards, namely effectiveness, efficiency, transparency, and accountability.<sup>30</sup> Best practice recommendations also include tying incentives to specific targets, such as energy infrastructure, climate resilience, domestic processing, local employment targets, gender, and other attainment of the 2030 Sustainable Development Goals.

### Option 3: Focus on Other Priorities

Upon undertaking an assessment of the likely impact of GloBE, some countries may find that they will have few in-scope entities, or that few or none of their in-scope entities are likely to have local ETRs below 15%. For these countries, the cost of implementing GloBE may be greater than its expected benefit, at least under the current state of guidance on the proposal.<sup>31</sup> Not disturbing existing domestic tax arrangements that support investment may be a higher priority for those countries at this time. This situation may change as more local entities come within scope of GloBE or if future revisions at the international level broaden the range of GloBE's applicability. Countries should continue to monitor local and global developments to ensure that current tax policy decisions do not in the future result in unnecessary revenue loss (see Parts III and IV, below).

### Summary

Countries that expect to be significantly impacted by GloBE should consider whether to respond with domestic reforms to capture the top-up tax potential, whether with a QDMT or a general domestic minimum tax, or by modifying domestic tax incentives, or some combination of these approaches. Countries that expect little or no impact at this time may decide not to respond to GloBE specifically and instead pursue other domestic tax policy priorities. A thorough assessment of the impact of GloBE on domestic taxpayers and domestic tax rules will assist countries in determining which options are currently optimal. Parts III and IV provide a preliminary step-by-step guide to making such assessments.

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<sup>29</sup> UNCTAD, *supra* note 21.

<sup>30</sup> Platform for Collaboration on Tax. (2015). *Tools for the assessment of tax incentives for investment*. <https://www.tax-platform.org/node/6>

<sup>31</sup> If the decision not to adopt GloBE is mainly a result of capacity limitations, tax authorities may seek assistance from international organizations and providers of technical assistance such as the African Tax Administration Forum and the OECD.

Part III:  
Assessing the Likely  
Impact of GloBE on  
Your Country

This section aims to help countries determine the extent to which they are likely to be impacted by GloBE. The result may determine which domestic policy reform approaches are optimal at this time. It also provides our own preliminary assessment of which countries will most likely be impacted, drawing on recent literature on the expected reach of the global minimum tax at the country and regional levels.

## Country Assessments

Governments can precisely identify the presence of entities of in-scope multinational enterprise (MNE) groups in their jurisdictions with an effective tax rate (ETR) below 15%. A tax administration with access to (confidential) global country-by-country (CBC) reports of MNE Constituent Entities within its jurisdiction and each entity's domestic statutory accounts should be able to make an accurate assessment, including deferred taxes and simulating the impact of the substance-based income exclusion (SBIE). Tangible assets are part of CBC reports, and payroll could be identified or estimated from financial statements. However, these data are not available to the public. Tax authorities in lower-income countries themselves have yet to access it.<sup>32</sup> Inclusive Framework members may want to solicit an update to the country-specific Economic Impact Assessment of Pillars One and Two that the OECD shared in November 2020, with the specific goal of assessing the amounts of top-up tax at stake in their jurisdiction.<sup>33,34</sup>

Tax expenditure reports and databases built by ministries of finance may also provide an indication of the level of foregone revenue from profit-based tax incentives in a specific country, although they typically would not distinguish between in-scope and out-of-scope companies.<sup>35</sup>

In addition, we propose a step-by-step approach to make a detailed assessment, depending on the data sources available to governments. The tax administration is the most likely to have access to the required information.

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<sup>32</sup> Assistance may be sought from the OECD to implement automatic exchange of information between tax administrations.

<sup>33</sup> Organisation for Economic Co-operation and Development. (2020). *Tax challenges arising from digitalisation – Economic impact assessment: Inclusive framework on BEPS*. <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-economic-impact-assessment-0e3cc2d4-en.htm>

<sup>34</sup> In a webinar presentation of the revised revenue impact of Pillars 1 and 2 on January 18, 2023, the OECD indicated that such an update was forthcoming. Organisation for Economic Co-operation and Development. (2023). *Webinar: Economic impact assessment of the Two-Pillar Solution*. <https://www.oecd.org/tax/beps/webinar-economic-impact-assessment-two-pillar-solution.htm>

<sup>35</sup> The Global Tax Expenditure Database has public information on tax expenditure but does not seem very accurate for developing economies (<https://gted.net/data-visualisation/>). Country-based reports will be more accurate and comprehensive.



## Step-by-Step Approach

1. Compile a list of all taxpayers in the country with at least EUR 1 million in income and EUR 10 million in revenues. Any entity not meeting these criteria would be excluded from GloBE through the *de minimis* exclusion of the model rules (Article 5.5).
2. Identify the ultimate parent company of each taxpayer.
3. Find the annual turnover of the MNE group represented by the parent company for the last 4 years (e.g., public or private databases) and list the entities in groups with an annual turnover of over EUR 750 million.
  - a. Option 1: Request CBC reports for previous 4 years from each entity subsidiary of an MNE group with annual turnover over EUR 750 million, if legislation allows.
  - b. Option 2: Request CBC reports for previous 4 years from other jurisdictions' tax administration for each MNE group with annual turnover of over EUR 750 million identified in the previous step, if country is a member of the Inclusive Framework and has mechanisms in place to share taxpayer CBC information with jurisdictions of a country where the MNE is parented or headquartered or if it is a party to a tax information exchange agreement or bilateral tax treaty with such a country.
  - c. Option 3: Collect financial statements from MNEs with branches in the country, either publicly available or submitted to the tax authority.
4. Collect domestic statutory accounts of each taxpayer that show deferred tax to adjust the cash tax reported in CBC reports and financial accounts according to GloBE rules.
5. Calculate the GloBE ETR for the previous 4 years for each MNE with branches in the country. Blend Covered Taxes and accounting profits for all entities of each MNE in the jurisdiction.
6. To calculate the SBIE:
  - a. CBC reports contain tangible assets and number of employees. Multiply the number of employees by average salary in the company, or in the sector, or other proxy, depending on availability of data.
  - b. Financial statements of the company may include tangible assets and payroll. These figures may need some refinement to match the definition of the SBIE in the model rules and commentary.
  - c. Apply the SBIE percentage agreed in the model rules.
7. Sensitivity analysis (optional):
  - a. Calculate Step 3 with different turnover thresholds: e.g., EUR 750, 500, 250 and 100 million per year.

Many large multinational groups are undertaking this analysis. It is appropriate for tax authorities to request (formally or informally) that such groups with an entity in their country share their analysis (under protection of confidentiality or as otherwise agreed) in connection with a

governmental policy review of Pillar Two. Companies and governments have a shared interest in policy being based on accurate information.

## General Assessment From Publicly Available Information

Without access to detailed information from each country's domestic entities of in-scope MNEs, publicly available information can still be used to assess the likely impact of GloBE on the tax base of different countries. It paints only a partial picture but may be useful to policy-makers as an initial assessment of the impact of GloBE in their country.

With the fast pace of development of the GloBE model rules, the first analyses of its impact are just starting to emerge. From this emerging literature and existing public data regarding where MNEs book profits and pay taxes, we preliminarily conclude the following:

- From a static perspective, assuming no behavioural change by MNEs, most of the top-up tax under GloBE rules is likely to be generated in developed economies and low-tax developing economies, rather than in other developing countries. The main reason is that developed economies have lower average ETRs than developing economies, and larger relative stocks of foreign direct investment (FDI).<sup>36</sup>
- There is still a significant amount at stake for developing economies that can only be captured by adjusting taxation at source before another country can apply an income inclusion rule (IIR) or an undertaxed profits rule (UTPR).
- The exact amount at stake for each country is yet unknown. Publicly available data give us an indication, but they are likely to underestimate the exact amounts because of variance in ETRs of MNEs in a jurisdiction and the effect of profit shifting on the level of taxation of MNEs.
- The final impact of GloBE that takes into account behavioural changes by MNEs is more complex to anticipate. It depends on which country implements GloBE rules and/or adopts one of the options described in Part II and how MNEs restructure their tax planning in response. The net effect should be a reduction in profit shifting, which could benefit many countries regardless of their domestic policy choices.

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<sup>36</sup> UNCTAD, *supra* note 21.

## Public Data on Taxes Paid by MNEs

Aggregated CBC reports published by the OECD draw from the CBC reports filed by MNEs in the jurisdiction of their ultimate parent company, providing information on profits booked and taxes paid by these MNEs in their headquarter country and foreign jurisdictions.<sup>37</sup> Only in-scope MNEs with an annual turnover of EUR 750 million or more are included in CBC data. In 2018, the latest year recorded in the dataset, 47 countries provided this information but not at the same level of detail. Importantly, CBC data from the United Kingdom and the Netherlands, two important headquarter countries for MNEs, are not published at the level of the partner jurisdiction. Neither is Sweden's. Being 5 years out of date, CBC data may not be representative of the current situation, especially given the significant economic disruptions of 2020–22. Another limitation of using CBC data to analyze the impact of GloBE rules is that they include income taxes accrued and paid in a given year, not deferred tax expenses that are required to calculate the GloBE ETR.

We first draw on research undertaken by the EU tax observatory, regarding the revenue effects of the global minimum tax under Pillar Two (Baraké et al., 2022).<sup>38</sup> This research paper simulates two alternative revenue scenarios: one in which every country of residence of MNEs implements an IIR and no country implements a qualified domestic minimum top-up tax (QDMT); the other in which every country implements a QDMT (which makes IIRs irrelevant assuming the priority of QDMT over IIR in GloBE rules, as discussed above). These scenarios are not realistic, but they help illuminate the revenue implications of the GloBE rules and show that these implications depend on the tax policy response of countries affected by GloBE.

The main conclusions of the Tax Observatory paper are that:

- Developed economies (according to the UN “country classification”)<sup>39</sup> have the most revenue at stake under both IIR and QDMT scenarios but especially under an IIR. Of an estimated EUR 154 billion in top-up tax, developed economies that are the headquarters jurisdictions of the most MNEs, in particular the United States, Canada, Germany, Ireland, and the United Kingdom, would benefit the most from the adoption of an IIR alone. In contrast, richer countries (and especially G7 countries) would find their benefits

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<sup>37</sup> [https://stats.oecd.org/Index.aspx?DataSetCode=CBCR\\_TABLEI](https://stats.oecd.org/Index.aspx?DataSetCode=CBCR_TABLEI)

<sup>38</sup> Baraké, M., Chouc, P.-E., Neef, T., & Zucman, G. (2022). Revenue effects of the Global Minimum Tax under Pillar Two [pre-publication] [Article]. *Intertax*, 50(10) [pre-publication], pp. 1–22, <https://kluwerlawonline.com/journalarticle/Intertax/50.4/TAXI2022074>

<sup>39</sup> The UN World Economic Situation and Prospects 2022 groups countries in three broad categories of “developed economies,” “developing economies,” and “economies in transition.” The least developed countries (LDCs) are a subgroup of “developing economies,” determined by the United Nations Economic and Social Council. For further information see United Nations Department of Economic and Social Affairs. (2022). *World economic situation and prospects 2022*. <https://www.un.org/development/desa/dpad/publication/world-economic-situation-and-prospects-2022/#:~:text=After%20expanding%20by%205.5%20per,2022%2C%20which%20was%20launched%20today>. The table presents headquarter (IIR) and host (QDMT) scenarios with payroll and tangible asset carveouts in the long run.

materially reduced if countries where Constituent Entities would be subject to a top-up tax adopt a QDMT.

- Developing economies overall have more to gain from a QDMT than an IIR, although the potential revenue is concentrated in a few jurisdictions where low-taxed, in-scope MNE affiliates operate. The 13 countries that are categorized as “in transition” and the 35 as “least developed” have very little in-scope revenue at stake under GloBE rules.
- Low-tax countries would benefit the most from a QDMT because these are countries in which undertaxed affiliates of in-scope MNEs currently operate. The authors’ simulations identify the Netherlands (EUR 14.1 billion), Luxembourg (EUR 12.5 billion), the Cayman Islands (EUR 11.4 billion), Switzerland (EUR 8.1 billion), Bermuda (EUR 8.1 billion), and Singapore (EUR 7.9 billion), as the most prominent beneficiaries of a QDMT.<sup>40</sup> These observations ignore the possibility that once GloBE rules are implemented, taxpayers may shift operations among countries because they no longer stand to reap tax benefits from their current structures.

In its WIR for 2022, UNCTAD also provided simulations from bilateral CBC data to undertake a country-based assessment of the likely impact of GloBE on real investment.<sup>41</sup> This analysis aggregates the ETRs of affiliated companies, thus yielding an average effective tax rate of all of the Constituent Entities of all in-scope MNEs. The report finds that the global ETR is 19%, and that more than half of developed economies (and less than a third of developing economies) have an ETR below 15%. Among developing countries, the share of countries with average ETRs under 15% is larger in Asia (34%) than Latin America and the Caribbean (22%) and Africa (20%). Adding that most FDI to developing countries flows to those with average ETRs above 15%, the report concludes that most investments in developing countries will not be affected by GloBE.

In practice, as discussed in Part III above, GloBE rules will be based on the ETR of the Constituent Entities of each single in-scope MNE in each jurisdiction. The jurisdictional ETR will be under 15% for some companies and above 15% for others. As such, the average country ETR is likely to underestimate the number of companies that would be subject to top-up tax, especially when the low ETR is achieved via company-specific tax incentives in an otherwise high-tax jurisdiction. The WIR (p. 122) acknowledges that “the degree of underestimation of the impact depends on the distribution of the ETRs, which varies by country and is not empirically observable for most countries.” By simulating variance in ETRs within countries, UNCTAD concludes that “the impact on average (FDI-level) ETRs globally then becomes around twice the impact calculated in the scenario that disregards ETR variance.”

In addition, the report includes a new metric, based on Casella and Souillard (2022), the FDI-level average ETR, which takes into account profit shifting by MNEs out of high-tax countries toward low-tax countries. The key insight is that FDI-level average ETRs in high-tax countries are lower than their average ETRs because they include income that is currently shifted out of

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<sup>40</sup> Table 2 in Revenue effects of the global minimum tax under Pillar Two (Baraké et al., 2022)

<sup>41</sup> UNCTAD, *supra* note 21.

the country and not taxed, or at a much lower rate. They conclude that the difference between FDI-level ETRs and ETRs is 3.4 percentage points for developing economies and 1.9 percentage points for developed economies. This suggests that the impact of GloBE may be higher than otherwise estimated in developing economies, assuming that GloBE itself will make it harder for MNEs to keep any profit taxed under 15%. This analysis shows that the dynamic impacts of GloBE rules, which take into account the behavioural changes of MNEs, may be more relevant for many countries than the direct revenue collection from IIRs or QDMTs.

In a previous version of this guide, we looked at another measure of ETRs. Public CBC report data can be disaggregated one step further than a single average ETR per country, as in the two papers discussed above. Namely, the data can be analyzed in pairs of countries, where the ETR in country X is the average of all the Constituent Entities of MNEs whose ultimate parent is resident in country Y. Because of the limitations of CBC data, this type of analysis is better done for each individual country, where it is easier to identify data issues, than in aggregates.

## Summary

There is no doubt that some countries will be more immediately affected by GloBE than others. It is important for countries to assess where they fall on the scale, especially if, in principle, they do not want to see other countries collect taxes on income generated within their jurisdictions. Understanding the likely impact of GloBE in the near term may help countries determine how urgently to consider responding to GloBE and in what manner to craft their response, that is, with relatively more narrow or conversely more broad-based reforms as described in the previous part.

Part IV:  
Assessing Potential  
Legal Barriers to  
Domestic Tax Reforms  
in Your Country

Countries that determine that they will be affected by GloBE and seek to make changes to their domestic tax policy will need to review whether their ability to do so may, in some cases, be constrained by legal provisions intended to stabilize the fiscal environment.<sup>42</sup> These provisions may be found in domestic law, investment contracts, or Bilateral Investment Treaties (BITs). If an agreement is not reached with parties entitled to protection of these provisions, the protected person may seek to protect their position by initiating international arbitration under their investment contract or BIT. The likelihood of a successful claim will depend on a case-by-case analysis of the precise legal wording of the text and evaluation of precedential authority. Countries may further be constrained by their trade-related commitments made under the auspices of the World Trade Organization (WTO) framework; however, such legal constraints fall outside the scope of this discussion.<sup>43</sup>

In each case, a country will need to evaluate the legal and practical effects of enacting provisions that either do not cover the protected persons or, if they do, of exposure to risks of litigation or arbitration.

This section begins by briefly explaining what fiscal stabilization is; it then considers three main sources of fiscal stabilization and potential options for developing countries to address each one. It concludes by considering the potential role of corporate disclosures and the OECD/G20 Inclusive Framework toward mitigating the risks posed by stabilization clauses.

## The Meaning of Fiscal Stabilization

“Fiscal stabilization” clauses are provisions that are designed to limit (or could be interpreted as limiting) the ability of the government of the host jurisdiction to change the fiscal law applicable to an investor or investment in its territory. Stabilization clauses can also require economic compensation for enacting and enforcing such changes in law. These clauses can be found in domestic laws and investment contracts. BITs with investor–state dispute settlement (ISDS) provisions could also be interpreted as limiting the power of developing countries to dismantle ineffective tax incentives or adopt a qualified domestic minimum top-up tax (QDMT) or a generalized domestic minimum tax, which would benefit or apply to the stabilized taxpayer.

Few developed economies offer stabilization provisions in their domestic law or investment contracts.<sup>44</sup> Therefore, the stabilization issue is primarily an issue to be considered by developing

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<sup>42</sup> International Monetary Fund. (2023). *International corporate tax reform*. <https://www.imf.org/-/media/Files/Publications/PP/2023/English/PPEA2023001.ashx>

<sup>43</sup> For a broader discussion of the interaction between changes to domestic tax regimes and a country’s WTO obligations, see Daly, M. (2005). *The WTO and direct taxation* (Discussion paper 9). [https://www.wto.org/english/res\\_e/booksp\\_e/discussion\\_papers9\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/discussion_papers9_e.pdf).

<sup>44</sup> See Section 6 of International Finance Corporation. (2009, May). *Stabilization clauses and human rights: A research project conducted for IFC and the United Nations Special Representative of the Secretary-General on business and human rights*. <https://www.ifc.org/wps/wcm/connect/0883d81a-e00a-4551-b2b9-46641e5a9bba/Stabilization%2BPaper.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE-0883d81a-e00a-4551-b2b9-46641e5a9bba-jqeww2e>

and emerging economies. Stabilization may also affect developing economies that have not signed up to the GloBE rules but have stabilized preferential tax arrangements for multinational companies headquartered in countries that have signed up. In such cases, GloBE top-up tax revenue will go to the investor's home country or headquarter country while the stabilizing country may be limited in its ability to reverse the incentive to keep the revenue.

## Assessing the Legal Risk Associated With Fiscal Stabilization

### Fiscal Stabilization in Domestic Law

Some countries include fiscal stabilization provisions in their domestic law, such as tax laws, sector-specific laws (e.g., mining laws), or investment codes. Investors may seek to use these provisions to argue that they are exempt from changes in tax policy and possibly initiate investment arbitration. International investment arbitration can be provided to foreign investors by domestic laws, investment contracts, and BITs. Options for responding to this risk are covered in the section on BITs below.

### Fiscal Stabilization in Investor–State Contracts

Many developing and emerging economies have entered into special investment contracts with foreign investors. These contracts are particularly common in the extractive industries.<sup>45</sup> They typically govern the whole legal framework of the investment, and as such, cover a wide range of issues, including but not limited to tax. Some contracts may include tax incentives that are specifically covered by fiscal stabilization clauses. While stabilization provisions vary, they typically freeze the fiscal terms in the law or contract at the time a project begins. The result is that changes in the tax law (or broader legal framework) may not be applicable to existing investment projects or may require offsetting compensation, at least for a defined period of time.<sup>46</sup>

Any unilateral changes a host state makes to stabilized fiscal terms in response to GloBE may amount to overriding the contract. Should companies choose to contest application of these changes, countries that are not able to reach a negotiated agreement risk resolution by litigation, arbitration, or other dispute resolution procedures provided for in the law or agreement. It is difficult to predict how arbitral tribunals are likely to interpret such cases. In general, they have tended toward strict interpretations of stabilization provisions in investment contracts.<sup>47</sup> However, a finding of liability is distinct from finding the taxpayer suffered economic damage, which may

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<sup>45</sup> See the public repository <https://resourcecontracts.org/>.

<sup>46</sup> Nakhle, M. (2016). *Fiscal stabilization in oil and gas contracts – Evidence and implications*. Oxford Institute for Energy Studies. <https://www.oxfordenergy.org/publications/fiscal-stabilization-in-oil-and-gas-contracts-evidence-and-implications/>

<sup>47</sup> *Parkerings v Lithuania*. (2007), at para. 332: “It is each State’s undeniable right and privilege to exercise its sovereign legislative power ... Save for the existence of an agreement, in the form of a stabilisation clause or otherwise.”



not be the case under the GloBE since the taxpayer generally will be required to pay the top-up tax somewhere, if not the host state.

There may also be exceptions to stabilization. It could be argued that the fact that the OECD has pronounced on the global minimum tax with support from 140 governments makes it a new international norm that would justify derogation from legal obligations that would otherwise apply.<sup>48</sup> The OECD Guiding Principles on Durable Extractive Industry Contracts also tend in this direction with respect to the interpretation of fiscal stabilization provisions. Paragraph 54 of the Commentary states that “The adoption of bona fide anti-avoidance measures or the interpretation of existing laws by host governments to protect the revenue base against tax base erosion and profit-shifting... should not be considered a change in law constrained by stabilization clauses.” It confirms that stabilization clauses do not extend to anti-avoidance measures (e.g., transfer pricing rules), or measures that are not anti-avoidance as such, but broadly aim to combat tax avoidance—arguably the imposition of a global minimum tax. We believe it is possible to make coherent arguments in this regard, particularly where the stabilization provisions are too onerous and egregious. These approaches are not something we have seen in existing tax arbitrations or precedents, so it is uncertain whether they would lead to successful outcomes.

Ultimately, whether a tribunal rules that a country is prevented from applying measures that respond to GloBE rules with respect to a taxpayer will depend on the precise wording of the stabilization clause in the investment contract, not a generic notion of a stabilization clause. On a black letter interpretation, the clause may or may not cover laws that implement GloBE rules, or it may affect only a small number of taxpayers. Even if a stabilization clause is found to prevent the application of GloBE rules to a specific taxpayer, the taxpayer may have difficulty establishing that it has suffered damages if the net effect of a country’s response to GloBE is to claim tax that otherwise would be paid by a different Constituent Entity in another country.

If stabilization clauses in investment contracts are likely to be a risk to implementation of the global minimum tax, countries have at least two approaches.

## **Approach 1: Require a unilateral disclosure from the taxpayer**

A unilateral disclosure from the taxpayer that because the stabilized fiscal terms reduce the effective tax rate (ETR) below the globally agreed rate, it will pay the tax that would otherwise be paid to the source country to the residence country through an income inclusion rule (or to

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<sup>48</sup> This is the concept of “international public order” (or policy)—a set of foundational state interests that justify derogation from legal obligations that would otherwise apply. For example, it appears (as public policy) in the New York Convention as a ground for non-enforcement of a foreign arbitral award and in the United Nations Commission on International Trade (UNCITRAL) Model Law as a ground for set aside of an arbitral award by the courts of the seat of arbitration. From these two sources, it has been extrapolated backwards as a principle that arbitral tribunals would apply themselves to decline jurisdiction—for example, in cases of corruption—without the need for the more rigorous/legalistic inquiry that would otherwise be required into whether corruption vitiated a party’s consent to arbitration under the applicable law governing the arbitral agreement.

a third country under an undertaxed profits rule). In such cases, taxpayers are encouraged to voluntarily agree to pay the tax in the source country despite the stabilized fiscal terms.

If taxpayers choose not to comply with the host state's changes to the domestic law in response to GloBE, they may initiate arbitration. While they may succeed on liability, they would most likely lose on damages, assuming the taxpayer is required to pay the tax elsewhere. However, this assumes that the court or tribunal would take notice of the reduction of tax on another affiliate in another country. Even where this is not the case, companies may for practical reasons opt to pay the host government where operations are conducted rather than the country of the UPE paying a top-up tax under an IIR or the country of a constituent entity paying top-up tax under a UTPR.

The OECD could help support developing countries with respect to stabilization by strongly encouraging companies to comply with unilateral disclosure requirements, and courts and tribunals to adopt a realistic view of damages relating to GloBE specifically. Countries that remain concerned about their ability to secure the minimum tax using this approach could also negotiate a contract amendment, formalizing the obligation to pay the QDMT as discussed in Approach 2.

## Approach 2: Renegotiate stabilized fiscal terms in investment contracts

Some countries may prefer to renegotiate investment contracts, particularly if they wish to make changes to domestic tax legislation that go beyond the limited impact of a QDMT. For example, if a country implements a different type of generalized domestic minimum tax, or prefers to remove or modify specific tax incentives, or because an investment contract involves several contracts and several taxpayers with complex taxation structures. In such cases, modifying stabilized investment contracts will require mutual agreement between host countries and investors with potential trade-offs to reach agreement. This would not necessarily require a wholesale cancellation of stabilization provisions but a limited revision of stabilized fiscal terms that might otherwise prevent the application of new rules.

In the future, countries should avoid including fiscal stabilization provisions in investment contracts or domestic laws that could freeze or stabilize domestic effective tax rates below the global minimum tax level and/or limit the application of changes in domestic tax rules in response to GloBE.

## Bilateral Investment Treaties

Investment treaties with ISDS provisions introduce another potential source of legal risk for countries seeking to enact changes to their tax policy in response to GloBE rules. The vast majority of these treaties are BITs. This risk is not unique.<sup>49</sup> Investors could challenge any change

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<sup>49</sup> Growing consensus on the illegitimacy of BITs (and treaty-based ISDS in particular) has triggered comprehensive attempts at multilateral reform, most notably through Working Group III at UNCITRAL. Working Group III in particular is addressing concerns pertaining to lengthy and costly proceedings that often result in inconsistent decisions.

to domestic tax policy under a BIT. This is reflected in the significant growth in tax-related claims under investment treaties. Of the 1,190 publicly known ISDS cases filed between 1987 and 2021, 15% have involved tax-related claims.<sup>50</sup> This is despite newer-generation bilateral and regional investment treaties containing clear and unequivocal carve-outs for tax. One important advantage of GloBE is that the income will be subject to top-up tax somewhere, if not in the host country. This makes the likelihood of an investor bringing a claim against the host state for a GloBE-related claim low when evaluated on a cost-benefit basis.<sup>51</sup>

The country-specific risk of arbitration in response to changes in tax policy will depend on a case-by-case analysis of the provisions of each BIT a country has in force. This section provides some generalized reflections on the level of risk posed by the various standards of protection commonly afforded to investors through BITs. These include expropriation, non-discrimination, and fair and equitable treatment (FET). These reflections assume that countries adopt domestic measures that are aligned with the spirit and objectives of the GloBE framework.

## Expropriation

It is unlikely that domestic measures in response to GloBE rules would qualify as direct or indirect expropriation. An imposition of tax will only amount to direct expropriation where it is part of a set of measures designed to affect a dispossession beyond the ordinary scope of the taxing powers exercised by a state.<sup>52</sup> In the case of indirect expropriation, some claimants have argued that certain tax measures, such as windfall taxes or the removal of contractually agreed fiscal incentives, are economically equivalent to expropriation. However, tribunals have cautioned that only if a tax law is extraordinary, punitive in amount, or arbitrary in its incidence, would issues of indirect expropriation be raised.<sup>53</sup> Provided that countries adopt legislative measures closely aligned with GloBE, the likelihood that they will be found to have engaged in direct or indirect expropriation is low, especially since companies will be liable to make equivalent payments in other jurisdictions.

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<sup>50</sup> UNCTAD. (2022). *Facts on investor–state arbitrations in 2021: With a special focus on tax-related ISDS cases* (IIA Issue Note). <https://investmentpolicy.unctad.org/publications/1266/facts-on-investor-state-arbitrations-in-2021-with-a-special-focus-on-tax-related-isds-cases>

<sup>51</sup> This discussion has focused on potential legal restrictions on a host country adopting tax law changes that mitigate the risk of a top-up tax under Pillar Two. A separate question is whether an investor could make a claim that imposition of a top-up tax under an IIR or, particularly, the UTPR under Pillar Two is inconsistent with a fiscal stabilization provision in an investment agreement or a BIT. While many of the same arguments discussed in the text would apply, the UTPR is a novel instrument and may present distinct issues that do not have clear precedents.

<sup>52</sup> See *Quasar de Valores SICAV S.A., Orgor de Valores SICAV S.A., GBI 9000 SICAV S.A. and ALOS 34 S.L. v. The Russian Federation* (SCC Case No. 24/2007).

<sup>53</sup> See *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL (formerly *EnCana Corporation v. Government of the Republic of Ecuador*).

## National Treatment

The likelihood of successful arbitral claims based on the national treatment standard of protection is also likely to be low. This standard dictates that nationals from an investment source country should be treated at least as favourably as national or domestic investors. Although GloBE rules apply to MNEs, which in most developing countries will be foreign investors, the policy objective is not to target foreign investors but companies with consolidated revenues of over EUR 750 million. Moreover, all MNEs that meet this criterion should be subject to similar treatment in all jurisdictions that have signed up to GloBE, in which they are taxed below the globally agreed minimum rate. In any event, most non-discrimination clauses in BITs will carve out taxation matters, although such an exclusion is never absolute, no matter how clearly it is expressed.

## Most Favoured Nation

Tax is widely considered to be an exception to most-favoured nation (MFN) clauses, which lowers the likelihood of successful arbitral claims against measures that respond to GloBE rules, based on this standard of protection.<sup>54</sup> The MFN standard dictates that except in limited circumstances,<sup>55</sup> any favourable treatment afforded to one trading or economic partner must be afforded to all partners. The extension of the MFN principle to tax matters would severely limit a state's sovereignty by placing a waiver on its ability to selectively impose taxes based on its economic, political, or strategic interests with third states. The globally agreed-upon nature of the GloBE rules should significantly reduce the risk of any claims brought against a host country on this ground. Furthermore, MFN is rarely cited as a ground for legal claims in taxation matters.<sup>56</sup>

## Fair and Equitable Treatment<sup>57</sup>

The risk of claims being successfully brought against home states, on the grounds of a violation of the FET standard will depend on the processes that a country follows toward enacting domestic tax reforms in response to GloBE, as well as the substance of any such laws. FET provides the legal grounds for investors to challenge decisions taken by states in the exercise of their regulatory power, even where they are pursuing public interest objectives. It is one of the most common standards of protection that investors use to challenge states' conduct.<sup>58</sup> It has been the basis

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<sup>54</sup> De Melo Vieira, M. (2014). The regulation of tax matters in bilateral investment treaties: A dispute resolution perspective. *Dispute Resolution International*, 8(1).

<sup>55</sup> Particularly in regional economic communities and double taxation treaties.

<sup>56</sup> De Melo Vieira, *supra* note 47.

<sup>57</sup> For a more detailed discussion on FET see Sarmiento, F., & Nikièma, S. H. (2022). *Fair and equitable treatment: Why it matters and what can be done*. IISD Best Practice Series. <https://www.iisd.org/publications/brief/fair-equitable-treatment>

<sup>58</sup> Uribe, D. & Montes, M. (2019). *Building a mirage: The effectiveness of tax-carve out provisions in international investment agreements* (South Centre Investment Policy Brief No. 14). [https://www.southcentre.int/wp-content/uploads/2019/03/IPB14\\_Building-a-Mirage-The-Effectiveness-of-Tax-Carve-out-Provisions-in-International-Investment-Agreements\\_EN.pdf](https://www.southcentre.int/wp-content/uploads/2019/03/IPB14_Building-a-Mirage-The-Effectiveness-of-Tax-Carve-out-Provisions-in-International-Investment-Agreements_EN.pdf)

for claims against tax measures in a number of cases, including the withdrawal of tax incentives, suspension of tariff adjustments for public utilities, or refusal to reimburse taxes, among others. The FET standard may further have interactions with stabilization clauses, which may serve to place countries enacting domestic reforms at risk of arbitral claims. For example, the withdrawal or amendment of a specific tax incentive that is expressly stabilized in an investment contract would likely constitute a breach of the FET standard under a BIT.<sup>59</sup>

The relationship between FET and foreign investors' "legitimate expectations" is of utmost importance for tax-related matters because the concept of legitimate expectations may be used to broaden the scope of FET. A legitimate expectation can be understood to mean that the conditions that were applicable when the investment was made will not change over time or that specific commitments made by states in contracts or laws will not be modified. Different tribunals have recognized that FET requires a minimum standard of treatment for investors, and a violation of such standard would involve a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons.<sup>60</sup>

Consequently, it is advisable that countries enact any domestic tax reforms in response to GloBE in a manner that is not arbitrary, irrational, or disproportionate with regard to the interest of foreign investors. In practice, this means that normal legislative processes should be followed. Specifically, changes to the law should be carried out in a fair and transparent manner, according to the full law-making process of that jurisdiction, and applied in an equitable and consistent manner (e.g., to all "in-scope" MNEs.)

The FET standard of protection is the most significant risk factor under BITs for states seeking to enact domestic tax reforms in response to GloBE. However, it is not unfettered. Some BITs contain provisions that fully or partially exclude tax measures from scope. These are commonly referred to as "carve-outs."

## Carve-outs

Two forms of carve-outs have emerged in practice:

- Total exclusions exempt all tax matters from the ambit of a BIT without reservation. The objective is to ensure that no dispute-resolution body will have jurisdiction over any claims based on tax matters arising from that BIT.
- Partial tax exclusions exempt tax matters from certain chapters, provisions or aspects of a BIT, as well as certain types of taxes expressly listed in the BIT (e.g., income tax, capital gains tax etc.).

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<sup>59</sup> UNCTAD. (2021). *International investment agreements and their implications for tax measures: What tax policymakers need to know. A guide based on UNCTAD's Investment Policy Framework for Sustainable Development*. [https://unctad.org/system/files/official-document/diaepcbinf2021d3\\_en.pdf](https://unctad.org/system/files/official-document/diaepcbinf2021d3_en.pdf)

<sup>60</sup> Uribe & Montes, *supra* note 52.

While the presence of a carve-out significantly lowers the risk of arbitration on tax matters under BITs, the degree of “exclusion” will depend on the precise wording of the carve-out as well as the interpretation of the provision by a tribunal.<sup>61</sup> In practice, tribunals have asserted jurisdiction over tax matters even in the presence of a carve-out, particularly where claimants based their arguments on the state’s abuse of its power to tax or used a tax measure to illustrate the broader arbitrary nature of a state’s conduct.<sup>62</sup> The exclusionary impacts of carve-outs should, therefore, not be overstated.

Despite the potential limitations, carve-outs are the main mechanism through which tax-related matters may be excluded from arbitration under BITs. However, some BITs also contain explicit “conflict clauses” that assert the prevalence of the rights and obligations emanating from any tax convention over those granted through the BIT, in the event of any inconsistencies.<sup>63</sup> Where such a clause exists, a state may be indemnified from arbitration arising from any legitimate attempts to bring its domestic tax regime in compliance with GloBE rules. Furthermore, some BITs grant the tax authorities of host states the competence to “veto” a complaint by an investor arising from a taxation measure. If the competent tax authorities from both treaty countries agree that the tax measure is non-expropriatory, the investor is prevented from initiating arbitration. Honouring such provisions, where they exist, is one way that investment home states could support host states toward implementing the GloBE Pillar Two rules.

## Summary

The risk of arbitration under BITs is low, with the exception of FET as discussed above. Notwithstanding, countries with BITs that do not explicitly exclude tax measures may seek to renegotiate the BIT in question. Any review or renegotiation process will, however, need to be carried out in a holistic manner that acknowledges the interlinked relationships between domestic laws, investment contracts, and bilateral investment contracts, which is the aim of vertical coherence in international law.

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<sup>61</sup> Even if a BIT does contain a total exclusion with respect to tax, tribunals may still find in favour of the investor if they can demonstrate that the country introduced the tax measure in an abusive or unfair manner. See *RREEF v Spain*.

<sup>62</sup> 2021 study prepared by the Transnational Institute and Global Justice Now lists 42 ISDS tax-related procedures brought against states by private investors between 1995 and 2015. Among those cases, 28 were based on BITs, and among these 28, all BITs concerned contained taxation carve-out clauses.

<sup>63</sup> See Article 20 of Japan–Iraq BIT (2012).

## Proactive Steps That In-Scope Multinationals and the OECD Could Take to Mitigate Potential Legal Risks Posed by Fiscal Stabilization

### Corporate Disclosure

Another way to reduce the legal risk to countries enacting domestic tax reforms in response to GloBE is to directly encourage in-scope multinationals to agree to appropriate waivers of or revisions to stabilized provisions in the domestic law, investment contracts, and BITs. In this way, companies could lay the conditions under which they will not challenge steps taken by countries to introduce a QDMT and/or revise stabilized tax rates and incentives, to bring all in-scope companies operating in their jurisdiction up to the minimum ETR of 15%.

### Actions at the Multilateral Level to Further Reduce Legal Risk

To help developing countries mitigate any potential legal exposure as a result of complying with the global minimum tax, the OECD could include the following in the Commentary on GloBE:

1. Strongly encourage companies to comply with any unilateral disclosure requirements and pay the minimum tax they would otherwise pay, but for the stabilized fiscal terms, to the source state.
2. Strongly encourage companies to disclose to shareholders when they have been requested by a country to waive a stabilization obligation that lowers the company's ETR below the globally agreed rate in the host country.
3. Strongly encourage courts and tribunals to adopt a holistic view of damages relating to the implementation of GloBE measures.
4. Strongly encourage countries to review BITs that contain overly broad FET clauses, as well as other important investment treaty concerns for developing countries.

## Conclusion

The GloBE minimum tax regime has initiated momentum to review and reform corporate tax regimes around the world. GloBE is certain to have larger direct impacts on some countries than others, but as a global initiative, it is also poised to produce indirect impacts by altering the general tax sensitivity level of major multinational groups going forward. As such, lawmakers in every country should take steps to understand the challenges and opportunities evolving from GloBE, as well as the overall two-pillar approach to corporate tax reform. At a minimum, it will be useful to consider whether some domestic tax measures intended to attract and keep foreign investment are losing their effectiveness and whether tax revenues are being unnecessarily foregone as a result. Not all countries will necessarily benefit from undertaking reforms in response to GloBE at this time; some might instead consider how best to achieve other policy priorities while actively monitoring developments, including a possibly expanding reach of GloBE into their economies.

This guide sought to provide information helpful to making informed decisions regarding domestic policy options in light of GloBE. After providing a brief summary of GloBE's main features, it examined the range of possible policy responses, explained the key merits and challenges of each, provided an assessment method to understand GloBE's likely impact at the country level, and addressed a range of possible barriers to reform. The purpose of the guide is not to advocate for one approach or another but to lay out the main features of the evolving landscape of international tax with a view to assisting countries in forming coherent policy responses, especially where tax administration and enforcement resources are scarce and domestic revenue mobilization needs are significant.



## Appendix A. Impact of GloBE on Types of Tax Incentives

Tax incentive	How the incentive works	Likely impact of GloBE
<b>Profit-based incentives</b>		
Income tax holidays	This is a tax-free period or a period during which a corporate entity is exempted from paying income tax.	<b>High:</b> Will significantly reduce the GloBE ETR for long periods of time and likely lead to the payment of top-up tax, depending on the size of the carve-out for payroll and tangible assets.
Export processing zones (that include tax holidays)	These zones are commonly characterized by unlimited, duty-free imports of raw, intermediate input, and capital goods necessary for the production of exports as well as generous and long-term tax holidays and concessions to the firms.	
Reduced tax rate (i.e., intellectual property box regimes)	This refers to a deviation from the standard tax rate resulting in the application of a lower tax rate to specified economic activities.	<b>Medium:</b> Will, in many cases, reduce GloBE ETR, but the ETR reduction may not always lead to the payment of top-up tax.
Business tax credits	Business tax credits are an amount that companies can deduct from the taxes owed to a government. They are applied against the taxes owed, as opposed to a deduction that is used to reduce taxable income.	Under GloBE rules, tax credits that are refundable after 4 or more years are treated as a reduction in Covered Taxes in the year such credits are granted. On the other hand, qualified refundable tax credits, which must be paid within 4 years, are added to Covered Taxes when such credits are used to reduce current tax expenses.
Withholding tax (WHT) relief on interest payments, dividends, service fees, or management fees	When a company pays a dividend or interest income to a non-resident legal person, the tax authority in the issuer's jurisdiction will often automatically withhold a portion of that income as tax. A government may offer a reduced withholding tax rate on different types of payments to investors.	WHT on payments of income (other than distributions to owners) is treated as a Covered Tax in the recipient's country and not the source country while WHT on distributions to owners are attributed to the source country.
Additional deductions for qualifying expenses (i.e., training expenses, research and development, marketing expenses).	In order to encourage technology or skills transfers, governments may provide investors in selected sectors with the opportunity to deduct additional expenses from their taxable income, also called "super deductions," deviating from the standard tax code.	Accordingly, reductions in WHT imposed by a source country on distributions, as an incentive for investment, are affected by application of Pillar Two in the source country if the reduction in effective rate results in an ETR for the distributing entity below the minimum tax rate.

Tax incentive	How the incentive works	Likely impact of GloBE
<b>Cost-based incentives</b>		
Tax deferrals (i.e., accelerated depreciation) <sup>64</sup>	This refers to any one of several methods by which a company, for tax purposes, depreciates a fixed asset in such a way that the amount of depreciation taken each year is higher during the earlier years of an asset's life.	<p><b>Limited:</b> Likely not to reduce GloBE ETR and lead to the payment of top-up tax. The GloBE rules use a version of deferred tax accounting mechanisms to adjust for timing differences. When an item of income is recognized for GloBE purposes before it is recognized for local tax purposes, credit is given at the minimum rate for the tax that will be paid in the future with respect to such income. Because credit is given for tax to be paid in the future, the timing difference does not give rise to minimum tax. There are, however, limitations to the use of deferred tax accounting and in some cases the GloBE rules may lead to top-up tax because of timing differences.</p>
Investment allowance <sup>65</sup>	Investment allowances will allow a company to offset a percentage of its capital expenditure against its taxable income in the year that the money is spent rather than spreading it over time through normal depreciation rules.	
Longer loss carry forward period	This refers to an accounting rule that applies the current year's net operating loss to future years' net income in order to reduce tax liability. In some instances, the period into the future in which losses can be carried forward will be extended in order to free up cash flows for an investor.	
Preferential treatment of long-term capital gains <sup>66</sup>	This applies to the appreciation in value of capital (assets) held by enterprises if the capital (or assets) is held over a fixed period of time. Long-term capital gains (capital retained for longer than a minimum period) are usually taxed at a lower rate than short-term capital gains, with the intention of encouraging investors to retain funds for longer periods.	

<sup>64</sup> The DTL recapture applies to certain deferred tax liabilities, and generally accelerated depreciation on tangible assets will not be subject to recapture.

<sup>65</sup> Investment allowance could refer to an expense that is allowed earlier for tax than for accounting purposes. It could also refer to a permanent additional deduction for a portion of capex, for example, an expense allowed for tax that is higher than what is actually spent and in that case has a higher chance to lead to top-up tax because it is not a timing difference.

<sup>66</sup> The GloBE rules generally treat (realized) capital gains as part of GloBE income. If a country treats capital gains income preferentially and this preferential treatment leads to an ETR below 15%, the GloBE rules may affect the incentive up to the minimum tax rate of 15%. However, the real impact of this incentive will depend on the activities that the MNE performs in the given country and whether the beneficial capital gains treatment can be compensated by other items of income that are taxed above 15%, leading in this way to an overall ETR above 15%. See UNCTAD, *supra* note 21 for further discussion.

Tax incentive	How the incentive works	Likely impact of GloBE
Personal income tax relief/ payroll tax incentives	These usually take the form of imputation relief or preferential tax treatment for expatriates.	<b>No impact:</b> 1) Payroll taxes and other employment-based taxes, as well as social security contributions, are not Covered Taxes under the GloBE rules. 2)
Property tax exemptions/ reductions	Most commonly, these incentives will be characterized by property tax abatement programs, which allow partial or full reduction in property tax liability for certain manufacturing, commercial, or retail companies.	Taxes based on ownership of specified items or categories of property are distinguishable from taxes based on a corporation's equity and should not be Covered Taxes under the GloBE rules.
Exemptions from indirect taxes	This will usually take the form of exemptions from customs duties and/ or import taxes, value-added taxes, or sale taxes.	<b>No impact:</b> Consumption taxes, such as sales taxes and value-added taxes, are not Covered Taxes under the GloBE rules

## Appendix B. Likely Effect of GloBE on Tax Incentives: Illustrative examples

The following examples are based on publicly available information for purely illustrative purposes. The examples are not prescriptive by nature and only serve to illustrate the complexity of tax incentive domestic reform and seek to explore possible reform actions.

### Assessment of Uganda's Tax Incentives

#### High

- Industrial park/free zone rental income exemption
- Agro-processing income exemption
- Industrial park/free zone business income exemption
- Exemption of income derived from exporting capital and consumer goods
- Business income exemption for selected industries outside
- Industrial/free parks
- Income tax exemption of collective investment schemes<sup>67</sup>
- Exemption of income tax on amounts withdrawn from a rehabilitation fund to meet expenditure incurred under an approved rehabilitation plan
- Income tax exemption for aircraft operators

#### Medium

- 6% withholding tax (WHT) exemption<sup>68</sup> for compliant taxpayer
- Reduced tax rate for income derived from shipping
- Reduced WHT rate on payments made to mining and oil operations subcontractors
- Special withholding tax reductions contained in bilateral tax treaties

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<sup>67</sup> Chapter 7 of the GloBE rules provides for special rules for the computation of the ETR of a controlled Investment Entity. The income of Investment Entities and Insurance Investment Entities is often subject to little or no tax at the entity level. Article 7.4 calculates the ETR and Top-up Tax of these Entities on a standalone basis to prevent an MNE Group from blending this low-taxed income with income of other Constituent Entities.

<sup>68</sup> WHT on payments other than distributions to owners would be a covered tax in the recipient's country and the ETR in the recipient's country would determine application of a top-up tax. If source country reduction in WHT on these payments would result in imposition of a top-up tax in the recipient country, the benefit to the investor is lost, and the WHT reduction should be reconsidered. On these grounds the use of WHT reductions as an incentive should be analyzed carefully to determine whether the benefit justifies the loss in revenue.

## Limited

- Specialized carry forward losses for mining and petroleum operations
- Deductions for recovery of costs for work programs
- 100% depreciation rate for depreciable assets acquired for mining exploration
- Deduction of social infrastructure costs incurred in accordance with the mining lease
- Deduction for contribution made by a mining or oil operator to a rehabilitation fund
- Reduced depreciation rate on specialized equipment.
- 100% Deduction of training expenditure by any employer
- 100% deduction for scientific research expenditure

In Uganda, income tax exemptions are extended primarily through the Income Tax Act, specific investment contracts, double taxation agreements, bilateral investment treaties and ad hoc government acts (e.g., decrees). In 2017, deductions, deferrals, exemptions, reduced rates, and zero-rating were identified as the main sources of revenue losses, with exemptions being the largest contributor. In 2020, 21.43% of revenue across all tax bases was lost to exemptions.

In order to modify the ongoing incentive regime and adapt it to GloBE Uganda would have to:

1. Make amendments to the Income Tax Act of 2018 through a parliamentary process
2. Amend specific investment contracts, possibly through renegotiation
3. Amend ministerial decrees granting certain companies exemptions

## Assessment of Zambia's Tax Incentives

### High

- 0% tax rate on profits made on exports [10 years]
- 5-year tax holiday on priority sector income
- Temporary suspension of corporate income tax for manufacturers of ceramic products

### Medium

- Reduced corporate income tax for farming and agro-processing
- Reduced corporate income tax rates on farming profits
- Zero withholding tax rates on payments of interest dividends
- 0% tax rate on dividends declared on profits from exports
- Reduced corporate income tax rate for exporting companies

### Limited

- Input tax claims for pre-production expenditure for mining operations and manufacturers
- Extended carry-forward period for mining losses

### No impact

- 0% tax rate on mining products for export
- Value-added tax refund on purchase and export of locally manufactured products
- Reduced withholding tax on royalties and duties
- Reduced import duty on raw materials used in manufacturing
- Duty free importation of capital equipment for mine operators
- Exception from duty and value-added tax on manufacturing equipment

In Zambia, tax incentives are administered through the *Zambian Revenue Act*, the *Customs and Excise Act*, and the *Zambia Development Agency Act* as well as through specific investment contracts and bilateral investment treaties.

In order to undo the ongoing incentive regime Zambia would have to:

1. Make amendments to the *Income Tax Act* through a parliamentary process
2. Renegotiate or cancel specific investment contracts

