



ATAF TECHNICAL NOTE

The Inclusive Framework's proposed two-pillar solution to address the tax challenges arising from the digitalisation of the economy

Background

After several years of negotiations, the Inclusive Framework issued a statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy on 1st July 2021. The agreement is a new two-pillar plan to reform international taxation rules. Seven of the Inclusive Framework's 139 members had not joined yet.

The statement is a high-level political statement and states that further technical design work will be carried out between July and August 2021 to finalize the agreement in October.

This Technical Note sets out the current position agreed by the Inclusive Framework and the further technical design work to be undertaken between July and October 2021.

Pillar One Rules

Scope of the new Amount A rules

The companies to which the Amount A rules will apply are the multinational enterprises (MNEs) with global turnover above 20 billion Euros and profitability above 10% (i.e., profit before tax/revenue). The turnover threshold is to be reduced to 10 billion Euros, contingent on successful implementation including of tax certainty on Amount A, with the relevant review beginning 7 years after the agreement comes into force, and the review being completed in no more than one year. The Extractives sector and Regulated Financial Services sector are excluded from the new rules.

The current OECD estimate is that this will result in just over 100 MNEs being in scope for the new Amount A rules including the largest and most profitable digital companies which may account for up to 40% of the global profits reallocated under Amount A.

Nexus

There will be a new special purpose nexus rule permitting the allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million Euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion Euros, the nexus will be set at 250 000 Euros. The special purpose nexus rule applies solely to determine whether a jurisdiction qualifies for the Amount A allocation. The Statement says that compliance costs (including on tracing small amounts of sales) will be limited to a minimum.

Based on World Bank Group data¹ 17 African IF members² will currently benefit from the lower nexus revenue threshold of 250,000 Euros.

ATAF has proposed that for market jurisdictions where the MNE is unable to verify whether or not the market revenue threshold has been met, a simplification rule would be used whereby the non-EU tail end sales would be deemed to arise in those jurisdictions where the MNE is unable to verify the level of sales and the MNE sales would be allocated among those jurisdictions using a pre-determined allocation key. ATAF further proposes a criterion of determining the eligible jurisdictions for this simplification measure. This proposal will be considered by the Inclusive Framework during the finalisation of the work between July and October 2021.

Quantum

For in-scope MNEs, between 20-30% of residual profit, defined as profit in excess of 10% of revenue, will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

Based on OECD estimates the in-scope MNEs residual profit under the above definition will be approximately USD500 billion per annum and therefore between USD100 billion (20%) and USD150 billion (30%) of that residual profit will be reallocated to market jurisdictions under Amount A. ATAF have expressed its concern that these proposals do not result in a sufficient and appropriate re-allocation of MNE profits to market jurisdictions and has called for at least 35% of the residual profits to be re-allocated to market jurisdictions.

Revenue sourcing

Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Tax base determination

The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward.

¹ [GDP \(current US\\$\) | Data \(worldbank.org\)](#)

² Benin, Botswana, Burkina Faso, Cabo Verde, Cameroon, Republic of Congo, Djibouti, Eswatini, Gabon, Liberia, Mauritius, Namibia, Senegal, Seychelles, Sierra Leone, Tunisia, and Zambia

Segmentation

Segmentation will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.

Marketing and distribution profits safe harbour

Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A. Further work on the design of the safe harbour will be undertaken between July and October 2021, including to take into account the comprehensive scope.

Elimination of double taxation

Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method. The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit.

Tax certainty

In-scope MNEs will be eligible for a dispute prevention and resolution mechanism, which will avoid double taxation for Amount A, including all issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and binding manner. Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism.

Consideration will be given to an elective binding dispute resolution mechanism for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of MAP disputes.

*ATAF are concerned that the Inclusive Framework has **only agreed to give consideration** to having an elective binding dispute resolution mechanism for issues related to Amount A for developing countries with no or low levels of MAP disputes and that are eligible for deferral of the BEPS Action 14 Peer Review.*

Both ATAF and the African Union have stated on many occasions to the Inclusive Framework that there should be no form of Mandatory Binding Dispute Resolution mechanisms for transfer pricing and permanent establishment disputes included in the Pillar One rules for countries where there is little double taxation risk as this would impose a demanding and complex process on such countries. It is therefore essential that this elective binding dispute resolution mechanism is made available to all African countries that have limited capacity and no or low level of MAP disputes.

The elective approach would mean that where there is a failed MAP case it would only enter into the binding dispute resolution mechanism if both countries involved in the MAP case elected, through their Competent Authorities, for the case to go through that process.

Amount B

The application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low-capacity countries. This work will be completed by the end of 2022.

ATAF and its members have expressed support for the introduction of a transfer pricing simplification rule for distribution and marketing activities and the African Union Common African Position states that the transfer pricing simplification rule (Amount B) must be broad in scope if it to be effective in increasing tax certainty. As this issue is still open for further discussion at the Inclusive Framework ATAF will continue to call for a wide range of distribution and marketing activities that include sales agency and commissionaire activities and limited and medium risk distributors to be in scope for Amount B.

Administration

The tax compliance will be streamlined (including filing obligations) and allow MNEs to manage the process through a single entity.

Unilateral measures

This Inclusive Framework state that the package will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies.

Implementation

The multilateral instrument through which Amount A is implemented will be developed and opened for signature in 2022, with Amount A coming into effect in 2023

Pillar Two Proposed Rules

Overall design

Pillar Two consists of:

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

Rule status

The GloBE rules will have the status of a common approach. This means that Inclusive Framework members:

- are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the Inclusive Framework.
- accept the application of the GloBE rules applied by other Inclusive Framework members including agreement as to rule order and the application of any agreed safe harbours.