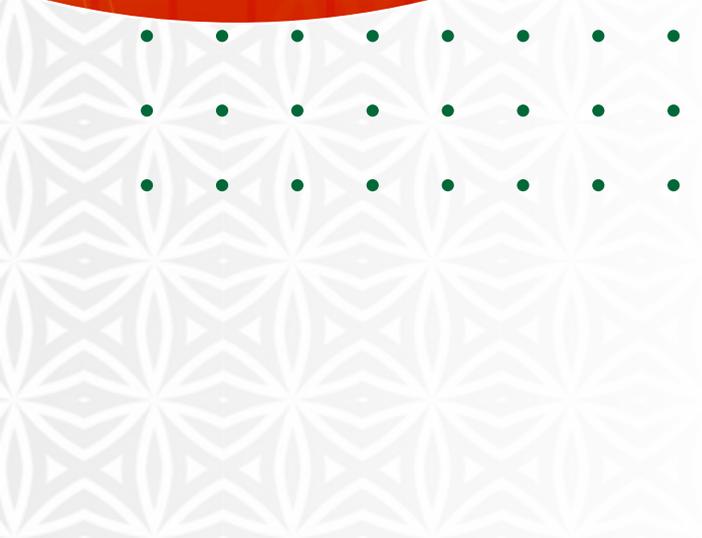
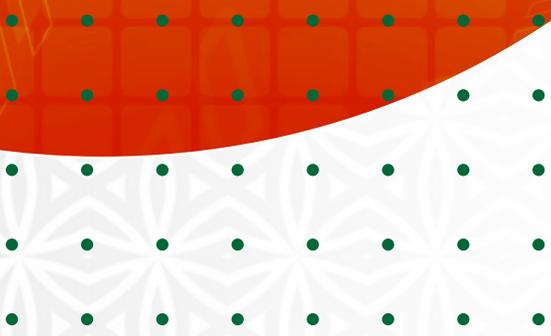


23

ATAF SUGGESTED APPROACHES

TO DRAFTING DOMESTIC MINIMUM TOP-UP TAX LEGISLATION



An ATAF Publication

AFRICAN TAX
ADMINISTRATION FORUM

FORUM SUR
L'ADMINISTRATION
FISCALE AFRICAINE

Copyright notice

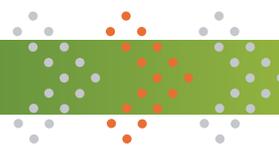
Copyright subsisting in this publication and in every part thereof.

This publication or any part thereof may not be reproduced, transmitted, transcribed, or otherwise stored or translated into any language or computer language, in any form or by any means, without the prior written permission of the African Tax Administration Forum (ATAF), an international organisation with full legal standing and established, in terms of the Vienna Convention on the Law of Treaties, on 8 October 2012.

Any unauthorised reproduction or adaptation of this publication will constitute a copyright infringement and render the doer liable under both civil and criminal law.

Restrictions on use

The information contained in this publication constitutes privileged information belonging to ATAF, any member country of ATAF and its subsidiaries. This information is furnished in confidence with the understanding that it will not, without prior written permission from ATAF, be used for purposes other than for what is intended.



INTRODUCTION

In December 2021, the Inclusive Framework - the broad coalition of countries and jurisdictions collaborating to address the tax challenges arising from the digitalisation of the economy - published the Global Anti-Base Erosion (GloBE) Model Rules. This was followed by the accompanying commentary in March 2022.

The GloBE rules comprise of two interlocking domestic 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 member of a multinational enterprise (a “constituent entity”); and (ii) an Undertaxed Profits Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low-taxed income of a constituent entity is not subject to tax under an IIR. The IIR is the primary rule and the UTPR only acts a backstop to the IIR. This means that the ordering of the GloBE rules generally works in favour of residence countries (in most cases developed countries) to the detriment of source countries (usually developing countries).

It is important to bear in mind that the IIR and UTPR will enable jurisdictions to collect top-up tax in respect of low tax outcomes (e.g. those generated by the granting of tax incentives) whether or not the constituent entities of a multinational enterprise are located in countries that are Inclusive Framework members or not. Likewise, a country can implement the GloBE rules whether they are Inclusive Framework members or not.

The Inclusive Framework has agreed that 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 the GloBE model rules, Commentary and guidance agreed to by the Inclusive Framework. They also agree to accept the application of the GloBE rules applied by other Inclusive Framework members, including agreement as to rule order and the application of safe harbours.

The GloBE rules will apply to multinational enterprises (MNEs) that meet the threshold of annual consolidated revenue of EUR 750 million, similar to the one that applies under BEPS Action 13 (country by country reporting). Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold. Government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group and certain holding vehicles used by such entities, organisations or funds are not subject to the GloBE rules.

How might African countries benefit from the GloBE rules?

Very few, if any, African countries will collect the top-up tax under an IIR as most African countries have very few, if any, UPEs resident in their country.

The African Tax Administration Forum (ATAF) has - throughout the long negotiations on these rules - called for the source-based rule of the UTPR to be the primary rule under Pillar Two in order to assist in redressing the current imbalance in the allocation of taxing rights between residence and source jurisdictions. ATAF has consistently advocated for the UTPR to be applied in priority to the IIR, and we were disappointed that the agreement gives priority to the IIR and that the UTPR will only apply in very limited circumstances. As the UTPR is only a backstop to the IIR, it is also unlikely the UTPR will result in significant additional tax for African countries.



However, the GloBE rules provide for source countries to take priority in certain circumstances before the IIR and UTPR, with a rule referred to as a “Qualified Domestic Minimum Top-Up Tax (QDMTT).” ATAF sees a critical opportunity for African countries through the introduction of a QDMTT (see also the ATAF policy brief on this issue).¹ That is the subject of the Suggested Approaches in this document.

A QDMTT offers the opportunity to collect revenue. It allows source countries to collect the top-up tax on low tax outcomes generated by tax incentives in their own country rather than allowing the residence jurisdictions to collect the top-up tax through the IIR.

The GloBE rules may also relieve some of the pressure African countries face to grant tax incentives which, in many cases, are inefficient and often wasteful. Under the GloBE rules where a tax incentive results in an effective CIT rate of less than 15%, the GloBE rules will lead to another tax jurisdiction, usually the jurisdiction of the UPE, collecting the difference between the effective tax under the tax incentive and the minimum effective tax rate of 15% (i.e. the top-up tax). This changes the landscape of tax competition when it comes to offering tax incentives, because source jurisdictions will not be under the same pressure to provide incentives such as tax holidays, given that effective tax rates below 15% will only lead to a residence country collecting that remaining tax.

The QDMTT is one way to redress those pressures of tax competition. However, there are other ways and African countries should also consider a wider reform of their tax incentives in light of the GloBE rules. ATAF stands ready to assist in this area, alongside supporting those that wish to pursue a QDMTT.

Enacting a Domestic Minimum Top-Up Tax (DMTT) in Africa

If an African country decides to enact a DMTT, it will need to carefully consider the design of that DMTT and the extent to which it should align with the IIR. This is for two reasons. Firstly, if it is not deemed to be aligned enough with the IIR to be considered a “Qualified DMTT” under the OECD Inclusive Framework peer review process (see below), the tax accrued under the DMTT may not qualify as a deduction in the computation of the jurisdictional top-up tax for IIR purposes. In that case, it would be treated as a credit in the effective tax rate computation and there will still be top-up tax on the excess profits under the IIR. This means that the top-up tax on the excess profits would still be payable under the IIR or UTPR (for example, collected in the jurisdiction of the UPE). This may impact adversely on foreign direct investment.

Secondly, if the DMTT is not closely aligned to the IIR it may result in either the DMTT not collecting all of the top-up tax in the African country, or in it collecting more tax than the top-up tax - which may again impact adversely on foreign direct investment.

In implementing a DMTT, African countries should also consider the need to consult with other government agencies, particularly where responsibility for tax incentives are under the purview of such agencies. Those agencies may not be aware of the complexities of whether another jurisdiction may be able to collect the tax given away under the tax incentive, and providing that context may be helpful in taking the DMTT through legislative processes successfully. In addition, African countries may wish to inform and engage other stakeholders including the business community on the introduction of the DMTT, in the interests of maintaining a transparent legislative process.

¹ See ATAF (2023), *Responding To the Implementation of The Global Minimum Taxation: Policy Considerations*, available at https://events.ataftax.org/index.php?page=documents&func=view&document_id=203