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Preventing International Tax Competition and the Race to the Bottom: A Critique of the OECD Pillar Two Model Rules for Taxing the Digital Economy – A Developing Country Perspective

This article assesses the OECD Pillar Two Model Rules from a developing country perspective. The article will assist developing countries in deciding whether the Model Rules are suitable for their economies, and whether they should implement alternative provisions that are in line with the aims of the Model Rules.

1. Introduction

The concept of "tax competition" refers to a situation in which countries rival each other in adopting strategic tax policies in the design of their tax systems to attract new investments.[1]1 As states are sovereign jurisdictions that have a right to determine their own tax policy, they can adopt competitive tax policies to lure economic activity away from other countries to their shores by, for example, lowering fiscal burdens (through tax cuts, tax breaks or tax subsidies) to either encourage the inflow of productive resources or discourage the exodus of those resources.[2] Tax competition might not be bad if, among other things, it counters a political bias towards excessive public expenditure (or where it counters governments' tendency to over tax) by ensuring that tax rates are kept at optimum levels.[3] However, the tax policies that a country adopts may result in harmful tax competition when countries engage in a "race to the bottom" by offering the lowest tax rates, which ultimately undermines the tax sovereignty of nations.[4] The race to the bottom often results in the so-called "winner's curse" in that a country could have secured the investment after winning the race only to realize that it has given up too much because the intended benefit from the investment is negligible.[5] The bidding wars from the race to the bottom also result in a so-called "prisoner's dilemma",[6] in that competing countries soon realize that they would be better off by not offering incentives as they mainly benefit the foreign investors at the expense of the state and the welfare of its citizens. Nevertheless, the state may feel compelled to offer the incentive to maintain a competitive business environment.[7] Even though countries are sovereign jurisdictions that have a right to determine their own tax policy (by, for example, using their tax laws to influence the use of capital), the 2015 International Monetary Fund (IMF) Working Paper, asserts that one country's tax policy can cause spillover effects on other countries' tax bases.[8] The race to the bottom causes such spillover effects that put the integrity of the corporate income tax system at stake and damage all countries in the long run.[9] Developing countries, with smaller markets, have more to lose in such a race as they often compete in offering tax incentives to attract foreign investment, yet none of the countries becomes better off in the long run.[10]

The race to the bottom is evidenced by the decline in global corporate tax rates over the last few decades.[11] OECD member countries show the most significant decline – from 32.3% in 2000 to 22.9% in 2021 (a decline of 9.4%) – followed by Latin American Countries (LACs) – with a decline from 26.8% in 2000 to 19.1% in 2021 (a decline of

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1. T. Rixen, *Tax Competition and Inequality: The Case for Global Tax Governance*, 17 Global Governance, p. 449 (2011), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1488066 (accessed 24 Oct. 2022).
2. A.P. Morriss & L. Moberg, Cartelizing Taxes: Understanding the OECD's Campaign against Harmful Tax Competition, 4 Columba J. Tax L. 1, p. 9 (2012).
3. The G20 Development Working Group (International Monetary Fund (IMF), OECD, UN and World Bank), *Options for Low Income Countries: Effective and Efficient Use of Tax Incentives for Investment*, p. 9 (15 Oct. 2015) [hereinafter *Options for Low Income Countries*].
4. P. Biggs, *Tax Incentives to Attract FDI*, (2007), Meeting of Experts on FDI, Technology and Competitiveness – A conference convened in honour of Sanjaya Lall, United Nations Conference on Trade and Development (UNCTAD), Palais des Nations, Geneva 8-9, March 2007, available at https://vi.unctad.org/fdiCD/sessions/Session3/Biggs.pdf (accessed 18 Aug. 2022).
5. S. James, *Incentives and Investment: Evidence and Policy Implications*, in *Investment Climate Advisory Services of the World Bank Group*, (World Bank 2009), available at https://elibrary.worldbank.org/doi/abs/10.1596/27875 (accessed 12 Apr. 2022).
6. J. Morisset & N. Pirnia, *How Tax Policy and Incentives Affect Foreign Direct Investment*, Policy Research Working Papers, p. 19 (2000), available at https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-2509 (accessed 18 Aug. 2020); and S. Killian, *Where is the Harm in Tax Competition? Lessons from US Multinationals in Ireland*, 17 Critical Perspectives Acctg., p. 1073 (2006), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1015048 (accessed 24 Oct. 2022).
7. OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998) [hereinafter *Harmful Tax Competition]*.
8. E. Crivelli, R. de Mooij & M. Keen, *Base Erosion, Profit Shifting and Developing Countries*, IMF Working Paper WP/15/118, p. 4 (May 2015).
9. OECD, *Addressing Base Erosion and Profit Shifting* p. 16 (OECD 2013), Primary Sources IBFD.
10. A.W. Oguttu, *International Tax Competition, Harmful Tax Practices and the Race to the Bottom: A Special Focus on Un-strategic Tax Incentives in Africa*, 51 Comp. & Intl. L. J. S. Afr. 3, pp. 293-219 (2018).
11. K.A. Clausing, *Corporate Tax Revenues in OECD Countries*, 14 Intl. Tax & Pub. Fin. 2, p. 121 (2017).

7.7%). In Africa, the average corporate tax rate was 26.8% in 2021, while the average for Asia was 19.2% in 2021.[12] This trend poses a threat to the corporate income tax, which forms a significant percentage of many developing countries' tax bases.[13] Increased collection of corporate tax would rebalance the tax system, and reduce overall reliance on tax on labour, property and consumption.[14] Despite the decline in corporate tax rates globally, corporate tax revenue as a percentage of gross domestic product (GDP), which represents the effective tax rate (ETR), has on average remained stable. As such, it is presumed that treating the ETR as the relevant indicator would address harmful tax competition and the concerns about the race to the bottom in taxation.[15]

On 20 December 2021, the OECD published the "Global Anti-Base Erosion" (GloBE) Model Rules, or the "GloBE rules", which set a global minimum corporate tax rate of 15% on large Multinational Enterprise (MNE) groups to establish a floor on tax competition with regard to corporate income tax.[16] The OECD asserts that the GloBE rules are a "landmark reform to the international tax system",[17] and that they will prevent harmful tax competition in developing countries by shielding them from the pressure to offer inefficient incentives so that they can mobilize domestic resources in a better way.[18]

This article assesses the validity of this assertion. It sets out the background that led to the development of the GloBE rules (*see* section 2.), and explains the operation of the complex rules (*see* section 3.), which many resource-constrained developing countries that were not engaged in the international discourse leading to the development of the rules will find instrumental. Due to space limitations, the author does not delve into detailed explanations of the accounting and formulas relating to how the tax is calculated. In the same vein, the article does not explain how the rules apply to specific entities or regimes. Rather, the article analyses the salient features of the rules and their design aspects (which may impact their effectiveness in preventing tax competition) from the perspective of developing countries (*see* sections 4., 5., 6., 7., 8. and 9.). This includes a discussion of the impact that the GloBE rules may pose on some countries' domestic tax provisions, tax incentive regimes and treaty provisions (*see* sections 6. and 7.) which countries should consider so that they make informed policy decisions before they adopt the rules. Finally, the article's conclusions and recommendations are set out (*see* section 10.). The ultimate purpose of this article is to assist developing countries in deciding whether the GloBE rules are suitable for their economies, and whether they can implement alternative provisions that are in line with the GloBE's aims.

2. Background: Previous OECD Efforts to Address Tax Competition and the Race to the Bottom

Concerns about harmful tax competition are not new. They were brought to the forefront when the OECD issued its watershed report on "Harmful Tax Competition" in 1998, in which it stated that both "tax haven jurisdictions"[19] and "preferential tax regimes"[20] are harmful tax practices that may lead to the depletion of other countries' tax bases and the distortion of financial and investment flows among countries.[21] The OECD recommended, inter alia, that countries should intensify international cooperation.[22] However, its initiative was criticized as a disguise to impose a uniform tax system on all nations.[23] US legislators called the OECD's initiative destructive to tax havens' competitive status within the global economy.[24] In this context, Paul O'Neil, the then US Secretary of State, stated that:

> I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, group of countries, should interfere in any other countries' decision about how to structure its own tax system... The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonise world tax systems. The United States simply has no interest in stifling the competition that forces governments – like businesses – to create efficiencies....[25]

As a result, the OECD toned down its approach in its June 2000 follow-up report,[26] which shifted focus from

12. OECD, *Corporate Tax Statistics* p. 13 (3rd edn., OECD 2021).
13. M.C. Durst *Beyond BEPS: A Tax Policy Agenda for Developing Countries*, ICTD Working Paper 18 p. 8 (2 June 2014), available at http://dx.doi.org/10.2139/ssrn.2587802 (accessed 17 Sept. 2020).
14. US: Department of the Treasury, Remarks by Assistant Secretary for Tax Policy Lily Batchelder on Global Corporate Tax at the Hutchins Center at Brookings Institute and the Urban-Brookings Tax Policy Center (15 Apr. 2022), available at https://home.treasury.gov/news/press-releases/jy0717 (accessed 29 May 2022) [hereinafter Remarks by Assistant Secretary for Tax Policy].
15. Clausing, *supra* n. 11.
16. OECD, *OECD Releases Pillar Two model rules for domestic implementation of 15% global minimum tax* (20 Dec. 2021), available at www.oecd.org/tax/beps/oecd-releases-pillar-two-model-rules-for-domestic-implementation-of-15-percent-global-minimum-tax.htm (accessed 4 Feb. 2022) [hereinafter *OECD Releases Pillar Two Model Rules].*
17. Id.
18. OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy – Inclusive Framework on BEPS* para. 54 (OECD 2019) [hereinafter *the Programme of Work to Develop a Consensus Solution].*
19. OECD, *Harmful Tax Competition*, *supra* n. 7, at para. 75 described tax havens as jurisdictions that actively make themselves available for the avoidance of tax that would have been paid in high-tax countries. They are characterized by high levels of secrecy in the banking and commercial sectors, a lack of transparency and effective exchange of information with other governments and a lack of substantial business activities by taxpayers.
20. Id. also notes that "harmful preferential tax regimes", which are evident in both tax-haven and high-tax jurisdictions, are recharacterized by having no or low ETRs on income. The regimes are ring-fenced, and there is a general lack of transparency and effective exchange of information with other countries.
21. Id.
22. Id., at paras. 67-71.
23. B. Spitz & G. Clarke, *Offshore Service* pp. 14-20 (Butterworths 2002).
24. C. Scott & R. Goulder, *U.S Congressman Owens Calls for US Government to Rescind Support of OECD Tax Competition Initiative*, 22 Tax Notes Intl., p. 1202 (2001).
25. Paul O'Neil, *What is the US Position on Offshore Tax Havens: Hearing Before the Permanent Subcommittee on Governmental Affairs*, 107th Cong. 49 (2001) as quoted by J.G. Salinas, *The OECD Tax Competition Initiative: A Critique of its Merits on the Global Market Place*, 25 Houston J. Intl. L. 3, p. 550 (2003), available at www.hjil.org/articles/hjil-25-3-salinas.pdf (accessed 25 Oct. 2022).
26. OECD, *Towards Global Tax Co-operation: Report of the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal*

"harmful tax competition" to "harmful tax practices", noting that:

> ... the project is not primarily about collecting taxes and is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates. Rather, the project is about ensuring that the burden of taxation is fairly shared and that tax should not be the dominant factor in making capital allocation decisions. The project is focussed on the concerns of OECD and non-OECD countries, which are exposed to significant revenue losses as a result of harmful tax competition. Tax base erosion as a result of harmful tax practices can be a particularly serious threat to the economies of developing countries. The project will, by promoting a co-operative framework, support the effective sovereignty of countries over the design of their tax systems.[27]

The OECD was also criticized for using this initiative as a forerunner for establishing itself as a "world tax organisation"[28] by getting all countries to abolish harmful tax competition so that they are allocated shares of the world tax revenues by collective agreement.[29] Writing in 2001, Weiss[30] argued that such a development would be absurd because international tax competition is not limited to tax incentives since countries compete with one another on numerous other fronts. Weiss[31] also argued that, if a worldwide pool of tax revenues were to be fixed, each country would try to enlarge its share by providing its "customers" with other non-tax incentives, and that international tax competition in its present form would simply take on a new character. Governments could offer other goods and services, and their citizens would be free to choose a location that best satisfies their needs.[32] There was much doubt, however, whether the OECD's attempt to root out tax competition would achieve success. In 2015, (17 years after issuing the 1998 Harmful Tax Competition report), the OECD published 15 Actions to curtail "base erosion and profit shifting" (BEPS).[33] In Action 5, which deals with countering harmful tax practices, the OECD emphasized that its erstwhile policy concerns about harmful tax practices were still relevant because the ensuing race to the bottom could ultimately drive applicable tax rates to zero for all countries, whether or not this is the tax policy a country wished to pursue.[34] The OECD also stated that its work on harmful tax practices is not intended to promote the harmonization of income taxes or tax structures, nor to dictate to any country what should be the appropriate level of tax rates, but rather to reduce the distortionary influence of taxation and encourage free and fair competition to take place.[35] Action 5 also noted that, over the years, the OECD had focussed on preventing harmful tax practices by tax havens rather than by preferential tax regimes, and that it had ignored the "lack of economic substance" in preferential tax regimes, whereby they could create a legal or commercial environment to attract investments that are purely tax driven, with no measures to prevent opportunities for minimizing tax.[36] Thus, over the years, many countries had set up preferential tax regimes,[37] such as intellectual property (IP) regimes, headquarter company regimes, distribution and service centre regimes, financing and leasing regimes, fund management regimes, banking and insurance regimes, shipping regimes and holding company regimes,[38] which offer low taxes to attract investments.[39] The development of these regimes increased with the rise of the digital economy as its mobility encouraged digital companies to migrate their intangible IP to low-tax jurisdictions to avoid paying tax in their home countries.[40] This fuelled tax competition in offering preferential deductions or exemptions from tax for digital companies and the race to the bottom in offering better tax incentives. To address this matter, Action 5 recommended that countries be required to ensure that tax on profits derived by MNEs should be aligned with the "substantial activities" that generate them so as to prevent purely tax-driven operations.[41] Countries were also required to improve transparency through spontaneous exchange of information on rulings related to preferential tax regimes.[42] However, the OECD's 2018 Interim Report on the Tax challenges of the digital economy[43] noted that harmful tax practices still remained as MNEs could send a few people to purportedly run a company in a low-tax jurisdiction and thereby manipulate the "substantial activity" test.[44] These risks prevailed because Action 5 only attempted to counter harmful tax practices without outlawing low- or zero-tax regimes. Thus, MNEs could enjoy low (or even zero) tax in low- (or even zero) tax coun-

Affairs: Progress in Identifying and Eliminating Harmful Tax Practices (OECD 2000).

27. Id., at p. 5.
28. A.J. Cockfield, *The Rise of the OECD as an Informal 'World Tax Organisation' Through National Responses to E-Commerce Tax Challenges*, 8 Yale J. L. & Tech., p. 140 (Spring 2006), available at https://yjolt.org/sites/default/files/cockfield-8-yjolt-136_0.pdf (accessed 25 Oct. 2022).
29. R.S. Avi-Yonah, *Globalisation, Tax Competition, and The Fiscal Crisis of the Welfare State*, 113 Harvard L. Rev., p. 1662 (May 2000), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=208748 (accessed 25 Oct. 2022).
30. M.B. Weiss, *International Tax Competition: An Efficient or Inefficient Phenomenon?*, 16 Akron Tax J., pp. 126-27 (2001), available at https://ideaexchange.uakron.edu/cgi/viewcontent.cgi?article=1103&context=akrontaxjournal (accessed 25 Oct. 2022).
31. Id., at p. 127.
32. Id., at p. 124.
33. OECD, *Action 8-10 Final Report 2015 – Aligning Transfer Pricing Outcomes with Value Creation* (OECD 2015), Primary Sources IBFD. The 15 Action measures are intended to ensure that profits are taxed where economic activities generating the profits are performed and where value is created. *See* OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD 2013), Primary Sources IBFD.
34. OECD, *Action 5 Final Report 2015 – Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance* p. 23 (OECD 2015), Primary Sources IBFD [hereinafter the *Action 5 Final Report* (2015)].
35. Id.
36. OECD, *Harmful Tax Competition*, *supra* n. 7, at para. 55.
37. M. Herzfeld, *News Analysis: Political Reality Catches Up With BEPS*, Tax Analysts (3 Feb. 2014).
38. OECD, *Action 5 Final Report* (2015), *supra* n. 34, at paras. 23-24.
39. L. Evers, H. Miller & C. Spengel, *Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations*, 22 Intl. Tax & Pub. Fin. 3. p. 503 (2015), available at https://link.springer.com/article/10.1007/s10797-014-9328-x (accessed 25 Oct. 2022).
40. OECD, *Action 1 Final Report 2015 – Addressing the Tax Challenges of the Digital Economy* para. 223 (OECD 2015), Primary Sources IBFD [hereinafter the *Action 1 Final Report* (2015)].
41. *Action 5 Final Report* (2015), *supra* n. 34, at para. 23.
42. Id., at para. 45.
43. OECD, *Tax Challenges Arising from Digitalisation – Interim Report* (OECD 2018), Primary Sources IBFD.
44. *Action 5 Final Report* (2015), *supra* n. 34, at para. 37.

tries, as long as the country committed to exchanging information with its treaty partners on its rulings regarding its preferential tax regime.

In Action 1, the OECD acknowledged that harmful tax practices are exacerbated by the digital economy, which poses challenges to taxation that go beyond BEPS matters, and acknowledged the need for new rules for taxing the digital economy.[45] In January 2019, the OECD issued a Policy Note,[46] in which it set out its two-pillar solution to resolve the challenges of the digital economy. Pillar One aimed to ensure a fairer distribution of profits and taxing rights among countries with regard to large MNEs.[47] Pillar Two, which is the focus of this article, addresses the remaining BEPS issues and suggests measures to block harmful tax competition and the race to the bottom.[48] A Public Consultation document on the two Pillars was released in February 2019,[49] and, on 12 October 2020, the Blueprints of Pillar One[50] and Pillar Two[51] were issued. On 8 October 2021, 136 members of the OECD's Inclusive Framework, which includes many developing countries, entered a political agreement on the two-pillar solution to address the tax challenges arising from the digitalization of the economy.[52] However, a number of developing countries (for example, Kenya, Nigeria, Pakistan and Sri Lanka) did not agree to the two-pillar solution.[53]

On 20 December 2021,[54] the OECD published the Pillar Two GloBE Model Rules, which provide countries a template for implementing domestic rules to establish a floor on tax competition with regard to corporate income tax.[55] The policy intent of the GloBE rules is to provide a coordinated tax system that ensures that large MNE groups pay a global minimum tax of 15% on the income arising in each of the jurisdictions where they operate.[56] The GloBE rules recognize that, although jurisdictions are free to determine their own tax systems, other jurisdictions also have the right to protect their tax base where income is taxed at a low effective rate.[57] Thus, the rules provide countries a right to a "tax back" by imposing a "top-up tax" on profits arising in a jurisdiction where the ETR is below the minimum rate.[58] The Commentary to the Model Rules was released on 14 March 2022 to provide tax administrations and taxpayers guidance on the interpretation and application of the rules.[59] The OECD also published a document with illustrations of the application of the GloBE rules.[60] This will be followed by the development of an implementation framework focused on administration, compliance and coordination issues relating to Pillar Two.

Clearly, the GloBE rules show a drastic shift in global attitudes towards tax sovereignty and the acceptance of a global minimum tax that was objected to in the past. The rules portray the significant achievement among a large number of countries in reaching consensus on how to reverse the race to the bottom on corporate tax rates in an increasingly digitalized and globalized economy.[61] The GloBE rules have been designed to "accommodate a diverse range of tax systems", including different tax consolidation rules, income allocation, entity classification rules, as well as rules for specific business structures, such as joint ventures and minority interests. As such, some provisions of the GloBE rules will not apply to all jurisdictions or each in-scope MNE. It should also be noted that the GloBE rules hold the status of a "common approach" in that countries are not obliged to apply them.[62]

3. The Operation of the GloBE Rules and Their Implications for Developing Countries

3.1. Scope of the GloBE rules

Article 1.1 of the GloBE rules provides that the scope of the rules applies to:

> constituent entities that are members of an MNE Group that has annual revenue of EUR 750 million or more in the consolidated financial statements of the ultimate parent entity (UPE) in at least two of the four fiscal years immediately preceding the tested fiscal year.[63]

This restricted scope, which is the same for country-by-country (CbC) reporting,[64] is intended to minimize the compliance and administration costs of adopting the rules while preserving the overall impact and revenue benefits.[65] Article 1 of the GloBE rules sets out

45. OECD, *Action 1 Final Report* (2015), *supra* n. 40, at paras. 208 and 248.
46. OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note* (OECD 2019).
47. OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* p. 4 (OECD 2021), available at www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf (accessed 14 Oct. 2021) [hereinafter the *Two-Pillar Solution].*
48. OECD, *Programme of Work to Develop a Consensus Solution*, *supra* n. 18, at para. 53.
49. OECD, *Public Consultation Document: Addressing the Tax Challenges of the Digitalisation of the Economy (13 February – 6 March 2019)*, Base Erosion and Profit Shifting Project para. 3 (OECD 2019), Primary Sources IBFD.
50. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* para. 24 (OECD 2020).
51. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint* (OECD 2020) [hereinafter the *Report on Pillar Two Blueprint].*
52. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 3.
53. O.A. Williams, *Developing Countries Refuse to Endorse G7 Corporation tax Rate*, Forbes (June 2021), available at https://www.forbes.com/sites/oliverwilliams1/2021/06/30/developing-countries-refuse-to-endorse-g7-corporation-tax-rate/?sh=76129c9c4f0c (accessed 8 Nov. 2022).
54. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
55. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, Inclusive Framework on BEPS art. 1.1 (OECD 2021), Primary Sources IBFD [hereinafter the *GloBE Model Rules (Pillar Two)*].
56. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
57. OECD, *Programme of Work to Develop a Consensus Solution*, *supra* n. 18, at para. 50.
58. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
59. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)* para. 3 (OECD 2022), Primary Sources IBFD [hereinafter the *Commentary to the GloBE Model Rules (Pillar Two)*].
60. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples* (OECD 2022), Primary Sources IBFD.
61. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
62. Id.
63. OECD, *GloBE Model Rules (Pillar Two)*, *supra* n. 55, at art. 1.1.
64. OECD, *Action 13 Final Report 2015 – Transfer Pricing Documentation and Country-by-Country Reporting* para. 52 (OECD, 2015), Primary Sources IBFD [hereinafter the *Action 13 Final Report* (2015)].
65. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, art. 1.1, at para. 5.

the following definitions that are relevant in understanding the scope of the GloBE rules:

- Article 1.2 defines an "MNE Group" as "any group that includes at least one entity or Permanent Establishment [PE] that is not located in the jurisdiction of the ultimate parent entity [UPE]". A "group" means a collection of entities that are related through ownership or control of the assets, liabilities, income, expenses and cash flows of those entities.
- Article 1.3 defines a "constituent entity" as any entity that is included in a group and any permanent establishment (PE) of a main entity.
- Article 1.4 defines the "Ultimate Parent Entity" (UPE) as the entity that owns, directly or indirectly, a controlling interest in any other entity, and is not owned, by way of a controlling interest, directly or indirectly, by another entity, or it is the main entity of a group.
- Article 1.5 excludes the following entities from the scope: governmental entities, international organizations, non-profit organizations, pension funds, investment funds that are UPEs or real estate investment vehicles that are UPEs. The exclusion of these entities is intended to protect their status as tax-neutral investment vehicles.[66] For regulatory or commercial reasons, these excluded entities are usually prevented from directly holding assets or carrying out specific functions. In terms of article 1.5.3, a filing constituent entity may elect not to treat an entity as an excluded entity for a period of five years.

3.2. Minimum tax payable

3.2.1. In general

The GloBE rules set the global minimum tax at 15%, as defined in article 10.1, which will apply to MNE groups with annual revenues in excess of EUR 750 million. It is a top-up tax that will be applied to profits in any jurisdiction whenever the ETR in that jurisdiction is below the 15% minimum rate.

3.2.2. Comments

The OECD estimates that the global minimum tax will generate USD 150 billion in additional global tax revenues annually.[67] Additional benefits will arise from the stabilization of the international tax system and the increased tax certainty for taxpayers and tax administrations.[68] There is, however, little evidence to demonstrate that the GloBE rules will benefit developing countries. The OECD impact analysis shows that the GloBE rules will mainly benefit countries like China, the United States and some European countries, which are the main home countries for large MNEs.[69]

The G24[70] considers the 15% minimum tax rate to be too low to effectively deter harmful tax competition.[71] The US "Made in America Tax Plan" tax reforms (issued on 31 March 2021 under the Biden administration) proposed a minimum rate of 21%, which received considerable worldwide support.[72] The UN Financial Accountability Transparency & Integrity (FACTI) Panel recommended setting the global minimum corporate tax rate at between 20% and 30%.[73] The African Tax Administration Forum (ATAF) has indicated that the minimum ETR should be at least 20% if it is to be effective in protecting African tax bases and reducing profit shifting by MNEs.[74] If the ETR of 15% is not effectively implemented, it will provide a strong incentive for MNEs to shift profits out of countries with higher rates – typically low-income countries.[75] The 15% rate will not ensure competitive equality for developing countries, as most of them have corporate rates of 25% or higher.[76] The low rate will continue to encourage MNEs to shift profits out of host countries by reducing their global ETR rates below the standard rates applicable in most countries. A higher rate would contribute to higher resource mobilization, which would help developing countries achieve the Sustainable Development Goals (SDGs) and the 2030 Agenda.[77] The 15% rate should be reconsidered when the rules are reviewed, and it should be regarded as the floor and the ceiling to prevent the

66. Id., art. 1.5.1, at para. 42.
67. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
68. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 5.
69. OECD, *Tax Challenges Arising from Digitalisation: Economic Impact Assessment*, Inclusive Framework on BEPS p. 61 (OECD 2020).
70. "The G24 represents the interests of developing countries in economic issues and consists of 28-member countries plus China (as a "special invitee"). Six of the G-24 countries are also G20 members: Argentina, Brazil, China, India, Mexico, and South Africa. In addition to those in the G20, a further 12 of the G-24 members are also "Inclusive Framework" members: Colombia, Cote D'Ivoire, Egypt, Gabon, Haiti, Kenya, Morocco, Nigeria, Pakistan, Peru, Sri Lanka, and Trinidad and Tobago". *See* MNT MNE Tax, *G-24 warns that global tax deal will fail without better terms for developing countries* (21 Sept. 2021), available at https://mnetax.com/g-24-warns-global-tax-deal-will-fail-without-better-terms-for-developing-countries-45752 (accessed 16 Mar. 2022).
71. Id.
72. US: The White House Briefing Room, Fact Sheet: The American Jobs Plan (31 Mar. 2021), available at www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/ (accessed 12 May 2021).
73. UN: FACTI, *Financial Integrity for Sustainable Development* p. 30 (UN 2021) and Independent Commission for the Reform of International Corporate Taxation (ICRICT), *Taxing multinationals: ICRICT calls for an ambitious global minimum tax to stop the harmful race to the bottom*, (Dec. 2019), available at www.icrict.com/press-release/2019/12/9/m9fwnyj7krhupqbasqygn9kkx9msai (accessed 1 Aug. 2022).
74. ATAF Communication, *130 Inclusive Framework Countries and Jurisdictions Join a New Two Pillar Tax Plan to Reform International Taxation Rules – What Does this Mean for Africa?* (ATAF 1 July 2021), available at www.ataftax.org/130-inclusive-framework-countries-and-jurisdictions-join-a-new-two-pillar-plan-to-reform-international-taxation-rules-what-does-this-mean-for-africa (accessed 3 Aug. 2021) [hereinafter *130 Inclusive Framework Countries*].
75. The BEPS Monitoring Group, *Comments on the Proposals for a Global Anti-Base Erosion Minimum Corporate Tax* p. 9 (10 Feb. 2022) [hereinafter *Comments on the Proposals*].
76. S.B. Diasso, *Global Minimum Tax Rate: Detached from Developing Country Realities*, South Centre Tax Cooperation Policy Brief 23 (11 Feb. 2022), available at www.southcentre.int/tax-cooperation-policy-brief-23-11-february-2022/ (accessed 1 Aug. 2022).
77. South Centre, *Statement by the South Centre on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, available at www.southcentre.int/wp-content/uploads/2021/07/SC-Statement-on-IF-Two-Pillar-Solution-FINAL.pdf (accessed 25 Sept. 2021) [hereinafter Statement by the South Centre on the Two Pillar Solution].

minimum from becoming the maximum.[78] Countries should work together to ensure a progressive increase of the rate.[79]

3.3. The top-up tax and the rule order

3.3.1. Opening comments

In terms of articles 2.1.1 and 2.1.2 of the GloBE rules, a constituent entity that is the UPE of an MNE group or an intermediate parent entity of an MNE group that is located in an implementing jurisdiction and owns (directly or indirectly) an ownership interest in a low-taxed constituent entity at any time during the fiscal year should pay tax equal to its allocable share of the top-up tax of its low-taxed constituent entity. According to the OECD:

> [The] top-up tax does not operate as a direct tax on income, rather, it applies to the excess profits calculated on a jurisdictional basis and only to the extent those profits are subject to tax in a given year below the minimum rate.[80]

The top-up tax is imposed on a member of an in-scope MNE group in accordance with two rules (the "Income Inclusion Rule" (IIR) and the "Undertaxed Payment Rule" (UTPR) – *see* sections 3.3.2. and 3.3.3., respectively) that are applied in an agreed order rule.[81]

3.3.2. Allocation of top-up tax under the IIR

The IIR, which is the primary allocation rule, imposes top-up tax on a parent entity in respect of the low-taxed income of a constituent entity by requiring the UPE to bring into account its share of the income of each constituent entity located in a low-tax jurisdiction, and then it taxes that income up to the minimum rate.[82] In effect, under the IIR, the minimum tax is paid at the level of the parent entity, in proportion to its ownership interests in those entities that have low-taxed income.[83] The rules also allow the IIR to be applied by a parent entity in which there is a significant minority interest, to minimize leakage of low-taxed income.[84]

3.3.3. Allocation of top-up tax under the UTPR

3.3.3.1. In general

The UTPR is the secondary allocation rule. In terms of article 2.4.1 of the GloBE rules, the UTPR operates by ensuring that the constituent entities of an MNE group located in a given jurisdiction are denied a deduction (or required to make an equivalent adjustment under domestic law) in an amount resulting in those constituent entities having an additional cash tax expense equal to the UTPR top-up tax amount for the fiscal year allocated. Denied deductions can include those in respect of an allowance for depreciation, amortization and notional expense or non-economic loss (such as a deemed interest expense).[85] Denying a taxpayer a deduction generally increases the cash tax expense for that taxpayer by increasing the net income subject to tax in that jurisdiction.[86]

The UTPR may also take the form of an adjustment that results in the group entities paying their share of the top-up tax remaining after the IIR.[87] Such adjustments, which are left to the domestic law of the UTPR jurisdictions to implement,[88] could take the form of an additional tax levied directly on a resident taxpayer in an amount equal to the allocated UTPR top-up tax amount. Alternatively, a jurisdiction could include an additional amount of deemed income representing a reversal of deductible expenses incurred in a current or prior period, or a jurisdiction could choose to reduce an allowance or deemed deduction to reflect an allocation of top-up tax.[89] Article 2.4.2 of the GloBE rules provides that, if the adjustment is insufficient to produce an additional cash tax expense for the fiscal year that is equal to the UTPR top-up tax amount allocated to the implementing jurisdiction, the difference should be carried forward to the succeeding fiscal years and be subject to the adjustment. Article 2.5 provides that the total UTPR top-up tax that is allocated to the jurisdiction[90] for a fiscal year should be equal to the sum of the top-up tax calculated for each low-taxed constituent entity of an MNE group, subject to any adjustments.

3.3.3.2. Comments

The second application of the UTPR, which host countries (mostly developing countries) would apply, shows that the application of the GloBE rules could permanently cement global inequality in taxing rights.[91] It should also be noted that, while the October 2020 Pillar Two Blueprint stated that the UTPR could be applied "through a limitation or a denial of a deduction for payments made to related parties or could be in the form of an additional tax",[92] article 2.4.1 of the GloBE rules only refers to the denial of a deduction or an equivalent adjustment under domestic law. The dropping of the aspect dealing with "an additional tax" shows how the GloBE rules restrict the taxing rights of

78. Kuldeep Sharma, *Global Minimum Corporate Tax: Interaction of Income Inclusion Rule with Controlled Foreign Corporation and Tax-sparing Provisions*, South Centre Tax Cooperation Policy Brief 22, (12 Jan. 2022), available at www.southcentre.int/tax-cooperation-policy-brief-22-12-january-2022/ (accessed 11 May 2022).
79. Id.
80. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, at pt. 2.
81. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
82. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, at para. 5.
83. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 410.
84. OECD, *Pillar Two Rules in a Nutshell* (OECD), available at www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf (accessed 5 Feb. 2022) [hereinafter *Pillar Two Rules in a Nutshell*].
85. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, art. 2.4.1, at para. 45.
86. Id., art. 2.4, at para. 44.
87. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
88. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, art. 2.4.1, at para. 46.
89. Id., art. 2.4.1, at para. 47.
90. Id., art. 2.5, at para. 67.
91. I. Ovonji-Odida, V. Grondona & Abdul Muheet Chowdhary, *Two Pillar Solution for Taxing the Digitalized Economy: Policy Implications and Guidance for the Global South*, South Centre Research Paper 161 p. 13 (26 July 2022), available at www.southcentre.int/wp-content/uploads/2022/07/RP161_Two-Pillar-Solution-for-Taxing-the-Digitalized-Economy_EN.pdf (accessed 1 Aug. 2022).
92. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 519.

host countries.[93] The UTPR is also limited by the fact that it may only apply to the largest and most profitable MNEs, and only if they pay less than 15% ETR in each jurisdiction in which they operate. The number of US corporations that could be potentially affected by UTPRs is incredibly small. It is estimated that only 0.02% of US corporations exceed these thresholds as a percentage of US corporate returns.[94]

3.3.4. Rule order

3.3.4.1. In general

Article 2.1 of the GloBE rules provides that the home or intermediary country of an MNE has the priority right to apply the top-up tax on undertaxed income using the IIR, and then the host country can apply the backup right to apply the UTPR.[95] The UTPR rule acts as a backstop to the IIR to ensure that the minimum tax is paid where an entity with low-taxed income is held through a chain of ownership that does not result in the low-taxed income being subject to tax under an IIR. Thus, no top-up tax may be treated as giving rise to an adjustment under the UTPR in respect of a constituent entity that is controlled, directly or indirectly, by a foreign constituent entity that is subject to an IIR.[96] One of the reasons why the UTPR is a backstop rather than the primary rule is because the UTPR requires a higher level of administrative cooperation as there will be subsidiaries in several jurisdictions.[97]

3.3.4.2. Comments

The rule order noted in section 3.3.4.1. has been a major cause of criticism from host countries, which are largely source-based countries. The IIR rule works best for residence-based countries and entities based in these countries (most of which are developed countries), which pushed for the IIR to be the primary rule for application of the rules.[98] This approach does not ensure a level playing field between all jurisdictions, which the OECD promised.[99] Developing countries that are mainly hosts to MNEs would gain little or nothing directly from the GloBE rules as they give the prior right to MNE home or intermediary parent countries to apply a top-up tax.[100] During the discussions that led to the development of these rules, the ATAF called for the UTPR to be applied in priority to the IIR to assist in redressing the current imbalance in the allocation of taxing rights between residence and source jurisdictions, but this was strongly opposed by many developed countries that would be beneficiaries of the IIR.[101] The priority status of the IIR also has the danger of reinforcing the perception that headquarter jurisdictions are those that have the taxing right on untaxed income, which is harmful for source countries.[102]

3.4. Computing GloBE income and losses

3.4.1. Opening comments

3.4.1.1. In general

Article 3.1.2 provides that the starting point for the GloBE rules is the financial accounting net income or loss of each constituent entity of an MNE group, determined under the financial accounting standard used by its UPE in the preparation of the consolidated financial statements for the fiscal year.[103] The financial accounts provide a uniform measure of income that can be applied in all jurisdictions, thereby providing a base that is harmonized across all jurisdictions, and, since they draw on the information already used in the preparation of consolidated financial statements, they reduce the MNE group's compliance costs.[104] Where it is not "reasonably practicable" to determine the financial accounting net income or loss based on the accounting standard used in the preparation of consolidated financial statements of the UPE, article 3.1.3 provides that another standard may be used, provided that it ensures "reliable" information.

3.4.1.2. Comments

The challenge of using financial accounts is that there are normally differences in financial accounts based on the International Financial Reporting Standards (IFRS) and countries normally require financial statements of a subsidiary company in that country to be presented in terms of local Generally Accepted Accounting Principles (GAAP).[105] The local GAAP may also differ from that of the parent country's local GAAP. These differences need to be reconciled to ensure accuracy and consistency in any analysis. Financial accounts may have been treated differently if posted above or below the operating profit line, which influences the measurement of the tax base. Moreover, financial accounts often include uncertain tax benefits, and may need to be adjusted to cater for over- or underestimated net profits. This is why financial accounts

93. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 19.
94. US: Department of the Treasury, Remarks by Assistant Secretary for Tax Policy, *supra* n. 14.
95. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, at para. 5.
96. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 459.
97. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
98. International Chamber of Commerce (ICC), *Comments on OECD Public Consultation Document on The Global Anti-Base Erosion (Globe) Proposal Under Pillar Two: Addressing The Tax Challenges of The Digitalisation of The Economy* p. 2 (Nov. 2019) 2, available at https://iccwbo.org/publication/icc-comments-on-oecd-public-consultation-document-reports-on-the-pillar-one-and-pillar-two-blueprints-tax-challenges-arising-from-digitalisation/ (accessed 8 Nov. 2022).
99. OECD, *Programme of Work to Develop a Consensus Solution*, *supra* n. 18, at para. 13.
100. A.W. Oguttu, *Base Erosion and Profit Shifting: A Blueprint for Africa's Response* sec. 14.7.3. p. 606 (IBFD 2021), Books IBFD.
101. ATAF Communication, *130 Inclusive Framework Countries*, *supra* n. 74.
102. South Centre, *Statement by the South Centre on the Two Pillar Solution*, *supra* n. 77.
103. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, art. 1.1, at para. 10.
104. Id., at art. 1.1. para. 7.
105. OECD, *Public Consultation Document: Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two (8 November 2019 – 2 December 2019)* p. 10 (OECD 2019), available at www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf (accessed 23 Aug. 2020).

are generally not suitable for determining the tax base. Tax accounts are built for that purpose.[106]

3.4.2. Adjustments in determining GloBE income or loss

3.4.2.1. In general

In order to better align the financial accounts with tax accounts, the GloBE rules provide for certain adjustments in order to determine the GloBE income or loss of a constituent entity.[107] Under article 3.2.1 of the GloBE rules, the permanent differences that can be adjusted are net taxes expense, excluded dividends, excluded equity gain or loss, gain or loss from disposition of assets and liabilities, asymmetric foreign currency gains or losses, policy-disallowed expenses, prior period errors and changes in accounting principles, and accrued pension expenses. The consideration for these differences has been kept to a minimum and is made where necessary to reflect common permanent differences.[108] Article 4.4 sets out rules for addressing temporary differences that arise when income or loss is recognized in a different year for financial accounting and tax.

3.4.2.2. Comments

It should be noted that financial accounts have a different objective and purpose from that of tax accounts, which have been built for a tax system.[109] The use of financial accounts in calculating the ETR, albeit with some defined adjustments, reverses the normal approach in which tax authorities have powers of detailed examination that are independent of audited financial accounts, which allow MNEs discretion in determining the tax base, thereby further widening the information asymmetries between taxpayers and tax authorities.[110] It should be noted that the power to collect tax information is normally given to tax authorities independently of audited financial accounts. The efforts of the European Commission to abandon the GAAP financial accounts and develop a Common Consolidated Corporate Tax Base (CCCTB) illustrates the importance of a common standard to calculate the tax base.[111] Since article 3.1.3 of the GloBE rules recommends that another standard may be used, provided that it ensures "reliable" information, it is recommended that focus should be placed on the consolidated tax accounts of the parent entity. This would ensure coordination with Action 13 of the OECD/G20 BEPS Project, which requires the UPE of an MNE with annual consolidated turnover of EUR 750 million to file CbC reports.

106. PwC, *Comment letter in response to OECD consultation paper on the unified approach under Pillar 1* p. 11 (12 Nov. 2019), available at www.pwc.com/us/en/tax-services/publications/insights/assets/OECD-Pillar-1-Paper-PwC-Response-Final.pdf (accessed 27 Apr. 2020).
107. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, at para. 7.
108. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
109. Oguttu, *supra* n. 100, at sec. 14.7.3. p. 603.
110. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 4.
111. European Commission, Common Consolidated Corporate Tax Base Working Group (2007), available at https://taxation-customs.ec.europa.eu/common-consolidated-corporate-tax-base-ccctb_en (accessed 8 Nov. 2022).

3.4.3. Exclusion of shipping income from computation of GloBE income and loss

3.4.3.1. In general

Article 3.3.1 of the GloBE rules provides that:

> for an MNE Group that has international shipping income, each constituent entity's international shipping income and qualified ancillary international shipping income shall be excluded from the computation of its GloBE income or loss for the jurisdiction in which it is located. Where the computation of a constituent entity's international shipping income and qualified ancillary international shipping Income results in a loss, the loss shall be excluded from the computation of its GloBE Income or Loss.

Article 3.3.2 defines international shipping income as the net income obtained by a constituent entity from the transportation of passengers or cargo by ships that it operates in international traffic, whether the ship is owned, leased or otherwise at the disposal of the constituent entity. This includes:

- transportation under slot-chartering arrangements and on charter fully equipped, crewed and supplied;
- leasing of a ship on a bareboat charter basis for transportation of passengers or cargo in international traffic, to another constituent entity;
- participation in a pool, a joint business or an international operating agency for the transportation of passengers or cargo by ships in international traffic; and
- the sale of a ship used for the transportation of passengers or cargo in international traffic provided that the ship has been held for use by the constituent entity for a minimum of one year.

The foregoing definition is the same as that in article 8 of the OECD Model.[112] In terms of article 3.3.6, in order for a constituent entity's international shipping income and qualified ancillary international shipping income to qualify for the exclusion from its GloBE income or loss, the constituent entity must demonstrate that the strategic or commercial management of all ships concerned is effectively carried on from within the jurisdiction where the constituent entity is located.

3.4.3.2. Comments

The exclusion of international shipping income is vulnerable to abuse. The tax avoidance in the shipping industry by using tax havens and flags-of-convenience nations[113] may create situations in which the "strategic or commercial management of all ships concerned" is carried out in some location that is not the jurisdiction of the constituent entity. Base erosion will continue if MNEs do not clearly establish that the "strategic or commercial management of all ships concerned" is effectively carried out in the jurisdiction of the constituent entity so that only nominal or relatively minor activities qualify for this exclusion.[114]

112. Most recently, *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.
113. A.W. Oguttu, *International Tax Law: Offshore Tax Avoidance in South Africa* pp. 135-136 (Juta 2015).
114. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p 12.

3.5. Covered taxes

In terms of article 4 of the GloBE rules, the covered taxes are income taxes, which are defined in a way to provide consistent and flexible recognition across a wide range of tax systems. This excludes non-income-based taxes, such as indirect taxes, payroll and property taxes. Article 4.2.1 sets out the following covered taxes:

(a) Taxes recorded in the financial accounts of a constituent entity with respect to its income or profits or its share of the income or profits of a constituent entity in which it owns an ownership interest;
(b) Taxes on distributed profits, deemed profit distributions, and non-business expenses imposed under an eligible distribution tax system;
(c) Taxes imposed in lieu of a generally applicable corporate income tax; and
(d) Taxes levied by reference to retained earnings and corporate equity, including a tax on multiple components based on income and equity.

Since the definition of covered taxes refers to "applicable corporate income tax" and "deemed profit distributions", the GloBE rules also provide for allocation of income taxes that are charged as a withholding tax or following the application of a controlled foreign company (CFC) regime.[115]

3.6. Computation of the ETR and the top-up tax

3.6.1. Opening comments

Taxpayers within scope of the rules calculate their ETR for each jurisdiction where they operate and pay top-up tax for the difference between their ETR per jurisdiction and the 15% minimum rate. Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the MNE. The ETR of an MNE is calculated by imposing a top-up tax using an ETR test that is calculated on a jurisdictional basis.[116] The jurisdictional ETR computation requires the assignment of the income and taxes among the jurisdictions in which the MNE operates and to which it pays taxes. In terms of article 5.1.1 of the GloBE rules, the ETR of the MNE group for a jurisdiction with net GloBE income should be calculated for each fiscal year. This would be equal to the sum of the adjusted covered taxes of each constituent entity located in the jurisdiction divided by the net GloBE income of the jurisdiction for the fiscal year. Once the ETR has been calculated, the computation of the top-up tax owed is the difference between the 15% minimum rate and the ETR in the jurisdiction.[117]

3.6.2. The domestic top-up tax

3.6.2.1. In general

The GloBE rules also consider that, if jurisdictions have their own "Domestic Minimum Top-Up Tax" (DMTT) that is consistent with the rules, such a tax would be treated as a covered tax and be credited against any liability under the GloBE rules, thereby preserving a jurisdiction's primary right of taxation over its own income. Thus, article 5.2.3 allows countries to apply a DMTT to a constituent entity of a foreign-based MNE. This ensures the minimum ETR of 15% on the profits that an MNE's subsidiaries declare in that country. The DMTT has to meet certain conditions – hence the term "Qualified DMTT" (QDMTT) – for it to be deducted from the top-up tax payable under the IIR (or the UTPR).

With regard to rule order (*see* section 3.3.4.), the QDMTT will effectively change the order in which jurisdictions are entitled to charge top-up taxes where the ETR of an entity is below the 15% global minimum rate. In terms of the GloBE rules, the QDMTT is prioritized over the IIR or the UTPR, such that a jurisdiction with a QDMTT becomes the first in line to receive any top-up revenue from entities located in its jurisdiction. If a jurisdiction does not have a QDMTT, that revenue would go to another country in terms of the rule order under the GloBE rules.

3.6.2.2. Comments

The inclusion of the QDMTT appears to have been a concession to the Europe Union's low-tax Member States, which act as investment hubs by offering low taxation for profits channelled to intermediary conduit entities. For instance, in light of the recommendations of the OECD/G20 BEPS Project, Ireland had already set its corporate tax at 12.5%,[118] and was not willing to change it to the 15% minimum rate.[119] Including the QDMTT in the GloBE rules would allow such low-tax Member States to retain their role as investment hubs and continue to apply a rate lower than 15% (to out-of-scope MNEs) while benefitting from the rules.[120]

Be that as it may, the QDMTT may also enable other source states to capture additional revenue under Pillar Two.[121] Since source countries have the primary right to tax under the QDMTT, if they do not tax they will relinquish tax to other states. The ATAF is contemplating designing a suggested approach for drafting the QDMTT rules that its member countries could adopt to avoid giving away their taxing rights. It is, however, important to note that developing countries tend to face challenges in administering refundable tax credits, and these challenges may be exacerbated by QDMTTs when refundable tax credits are offset against taxes paid by MNEs for covered taxes. Countries will also have to consider how to levy QDMTTs without imposing additional tax through increased covered taxes. Some countries may be tempted to shift corporate taxes to the QDMTT so that it is not limited

115. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
116. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 8.
117. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.

118. Deloitte, *Your move in the right direction: Investing in Ireland* (2017), available at www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/IE_T_invest_in_ireland_0517.pdf (accessed 5 Aug. 2022).
119. CNBC, *Global tax deal inches closer as holdout Ireland agrees to sign up* (7 Oct. 2021), available at www.cnbc.com/2021/10/07/ireland-corporate-tax-rate-.html (accessed 5 Aug. 2022).
120. M.P. Devereux, J. Vella & H. Wardell-Burrus, *Pillar 2: Rule Order, Incentives and Tax Competition*, Policy Brief, Oxford University Centre for Business Taxation, pp. 7-9 (14 Jan. 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4009002 (accessed 5 Aug. 2022).
121. R.S. Collier, *Could Pillar 2 Be Enough?*, Oxford University Centre for Business Taxation (24 Jan. 2022), available at https://oxfordtax.sbs.ox.ac.uk/article/could-pillar-2-be-enough (accessed 29 May 2022).

to MNEs in scope. However, such countries will collect less tax if they apply the QDMTT to all MNEs. Countries should create separate rules for in-scope MNEs and out-of-scope MNEs. In creating such separate rules, countries should note that the QDMTT will not help developing countries that generally have corporate income tax rates well above 15%. It may be more advantageous for countries that wish to attract real investment in assets and jobs to offer low or even zero-tax rates that are protected by the substance-based carve-out (*see* section 3.6.3.).[122] Here, it should be noted that there are concerns that, whereas the GloBE minimum rate of 15% would establish a floor, the QDMTT would establish a ceiling for all states and could make tax competition more acute.

3.6.3. The substance-based income exclusion

3.6.3.1. In general

Article 5.3.1 of the GloBE rules provides that the net GloBE income for the jurisdiction should be reduced by the "substance-based income exclusion" when determining the excess profit for purposes of computing the top-up tax. This exclusion carves out 5% of the sum of the payroll and tangible assets for each constituent entity, excluding constituent entities that are investment entities, in that jurisdiction.[123]

Under article 5.3.3, the "payroll carve-out" is equal to 5% of a constituent entities' eligible payroll costs of "eligible employees" that perform activities for the MNE group in a jurisdiction. Since this carve-out depends in part on the "number of eligible employees", it is intended to reflect the real activities of the constituent entity in that jurisdiction. Article 10.1.1 defines eligible employees as:

> employees, including part-time employees, of a constituent entity that is a member of the MNE Group and independent contractors participating in the ordinary operating activities of the MNE Group under the direction and control of the MNE Group.

Article 10.1.1 defines "eligible payroll costs" as:

> employee compensation expenditures (including salaries, wages, and other expenditures that provide a direct and separate personal benefit to the employee, such as health insurance and pension contributions), payroll and employment taxes, and employer social security contributions.

Under article 5.3.4 the tangible asset carve-out for a constituent entity is equal to 5% of the carrying value of "eligible tangible assets" located in a jurisdiction. Article 5.3.4 defines "eligible tangible assets" as:

(a) property, plant, and equipment located in that jurisdiction;
(b) natural resources located in that jurisdiction;
(c) a lessee's right of use of tangible assets located in that jurisdiction; and
(d) a licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets.

A filing constituent entity of an MNE group may make an "annual election" not to apply the substance-based income exclusion for a jurisdiction by not computing the exclusion or claiming it in the computation of top-up tax for that jurisdiction in the GloBE information return(s) filed for the fiscal year.

3.6.3.2. Comments

Although the substance-based carve-out appears to weaken the GloBE rules' primary objective of reducing tax competition,[124] by excluding constituent entities that are investment entities from the substance-based income exclusion, the rules essentially accommodate jurisdictions that offer tax incentives for substantial business activities. This exception of investment entities has been welcomed by developing countries as it would prevent regressive effects on poor countries.[125] Although there are criticisms about the ineffectiveness of tax incentives in encouraging foreign direct investment (FDI),[126] the G20 Development Working Group affirms that well-structured tax incentives have the potential to contribute to a country's economic development.[127] The exemption to the substance-based carve-out ensures equity for developing countries and can offer some tax incentive to encourage economic development.[128] This approach is in line with the guidelines on the effective use of tax incentives that were developed by the G20 Developing Working Group[129] and also those of the OECD Peer Review of minimum standards of Action 5 of the OECD/G20 BEPS Project, which tested the substance requirements of countries' tax regimes.[130]

With regard to the payroll carve-out, the definition of eligible employees, which includes part-time employees, is of particular concern to the gig economy, a free market system in which organizations hire flexible temporary independent workers for short-term commitments by using gig apps and digital technology to connect custom-

122. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 2.
123. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 9.
124. M.P. Devereux et al., *What Is the Substance-Based Carve-Out under Pillar 2? And How Will it Affect Tax Competition?*, Oxford University Centre for Business Taxation, EconPol Policy Brief 39 p. 1 (17 Nov. 2021), available at https://oxfordtax.sbs.ox.ac.uk/what-is-the-substancebased-carveout-under-pillar-2-and-how-will-it-affect-tax-competition (accessed 26 Oct. 2022).
125. M.P. Devereux, *The OECD Global Anti-Base Erosion (GloBE) Proposal*, Oxford University Centre for Business Taxation p. 11 (Jan. 2020), available at https://oxfordtax.sbs.ox.ac.uk/globe (accessed 26 Oct. 2022).
126. S. James & S. van Parys, *Investment Climate and the Effectiveness of Tax Incentives*, World Bank Group (2009); A.S. Abbas & A. Klemm, *A Partial Race to the Bottom: Corporate Tax Developments in Emerging and Developing Economies*, 20 Intl. Tax & Pub. Fin., pp. 596-617 (2013); and R. de Mooij & S. Ederveen, *Corporate Tax Elasticities: A Reader's Guide to Empirical Findings*, 24 Oxford Rev. Econ. Policy 4, pp. 680-697 (2008), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1331828 (accessed 26 Oct. 2022).
127. The G20 Development Working Group, *Options for Low Income Countries*, *supra* n. 3, at p. 3.
128. T. Dagan, *International Tax Policy Between Competition and Cooperation* p. 4 (Cambridge U. Press 2017) and P. Hongler, *Justice in International Tax Law: A Normative Review of the International Tax Regime* sec. 1.2. pp. 7-8 (IBFD 2019), Books IBFD.
129. The G20 Development Working Group, *Options for Low Income Countries*, *supra* n. 3, at p. 6; and IMF, OECD, UN and World Bank, *Striking the Right Balance between an Attractive Tax Regime for Domestic and Foreign Investment, by Using Tax Incentives for example, and Securing the Necessary Revenues for Public Spending, is a Key Policy Dilemma*, IMF Policy Paper (2011).
130. OECD, *Action 5 Final Report* (2015), *supra* n. 34, at para. 45.

ers and gig workers.[131] The gig economy poses challenges to tax collection in the jurisdictions in which independent workers operate. Thus, the status of many gig workers is often subject to dispute.[132] It is recommended that an objective standard on eligible employees should be developed.

In addition, the inclusion of "independent contractors participating in the ordinary operating activities of the constituent entity" in the definition of eligible employees contradicts the legal status of independent contractors, which differs from employees that have a dependent employee-employer relationship.[133] Since the activities of an independent contractor are not considered as those of its principal, payments made to independent contractors cannot constitute employee compensation expenditures. Clearly, the inclusion of independent contractors in the definition of eligible employees is an anomaly that needs to be rectified. The carve- out of "independent contractors participating in the ordinary operating activities of the MNE Group under the direction and control of the MNE Group" also involves a high degree of subjectivity in determining whether specific independent contractors will be "under the direction and control of the MNE Group", which may create opportunities for abuse. An easy-to-administer objective standard is required to ensure that the constituent entity actually accepts the obligations of an employer and does not treat personnel as independent contractors.[134]

3.6.4. The de minimis exclusion

Under article 5.5 of the GloBE rules, a de minimis exclusion applies to constituent entities located in the same jurisdiction when their aggregated revenue is less than EUR 10 million and their profits are less than EUR 1 million.[135] In this regard, article 5.5.1 provides that, at the election of the filing constituent entity, the top-up tax for the constituent entities located in a jurisdiction should be deemed to be zero for a fiscal year if the average GloBE revenue of such jurisdiction is less than EUR 10 million and the average GloBE income or loss of such jurisdiction is a loss or is less than EUR 1 million.

3.7. Administration provisions: Filing obligations and safe harbours

The administration of the GloBE rules is designed to preclude compliance and administrative costs that are disproportionate to the policy objectives by providing for an internationally coordinated approach to administering the rules. Under article 8.1.1, each constituent entity located in a jurisdiction implementing the GloBE rules should file a "GloBE information return" with the tax administration of that jurisdiction, unless the filing is done by either the UPE or a designated filing entity located in a jurisdiction that has a qualifying competent authority agreement in effect with the jurisdiction that is implementing the rules. In terms of article 8.1.4, the GloBE information return should be filed in a standard template that is developed in accordance with the GloBE Implementation Framework.

The GloBE administration provisions also provide for the possibility of "safe harbours" in article 8.2, which can reduce administrative burdens where particular operations of an MNE are taxable above the minimum rate. In terms of the "safe harbour" provisions, at the election of the filing constituent entity, the top-up tax for a jurisdiction (the safe-harbour jurisdiction) should be deemed to be zero for a fiscal year when the constituent entities located in this jurisdiction are eligible for a GloBE safe harbour, provided that the conditions stipulated under the GloBE Implementation Framework are applicable for that fiscal year.

3.8. Transitional rules

3.8.1. In general

Article 9 sets out some transitional rules that take existing tax attributes into account, including all pre-existing tax losses, so as to reduce compliance burdens when an MNE first comes into scope of the GloBE rules.[136]

With regard to determining the ETR for a jurisdiction in a transition year, and for each subsequent year, article 9.1.1 provides that the MNE group should take into account all of the deferred tax assets and deferred tax liabilities reflected or disclosed in the financial accounts of all of the constituent entities in a jurisdiction for the transition year. Such deferred tax assets and liabilities must be taken into account at the lower of the minimum rate or the applicable domestic tax rate. Under article 9.1.2, deferred tax assets arising from items excluded from the computation of the GloBE income or loss must be excluded from the computation when such deferred tax assets are generated in a transaction that takes place after 30 November 2021. Article 9.1.3 requires asset transfers after 30 November 2021 to be brought into the GloBE, based on the carrying value on the books of the disposing entity upon disposition.

3.8.2. Comments

Article 9.1.3 of the GloBE rules is particularly important because of the strategy that, prior to implementation of Pillar Two, some MNEs may adopt to intentionally create artificial deductions that could significantly reduce tax payments, including top-up tax for many years following implementation of Pillar Two, unless countered.[137] Article

131. B. Balaram, J. Warden & F. Wallace-Stephens, Good Gigs. A fairer future for the UK's Gig economy, Royal Society for the encouragement of Arts, Manufactures and Commerce (Apr. 2017), available at www.thersa.org/globalassets/pdfs/reports/rsa_good-gigs-fairer-gig-economy-report.pdf (accessed 19 Mar. 2022).
132. OECD, *The Sharing and Gig Economy: Effective Taxation of Platform Sellers*, Forum on Tax Administration (FTA) (OECD 2019).
133. Art. 5(5) and (6) *OECD Model* (2017).
134. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 16.
135. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 9.
136. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
137. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at pp. 16-17.

9.1.3. should be strengthened because intra-group transfers of assets, in particular of intangible assets, are often tax motivated and have no actual economic effect, other than artificial deductions that encourage BEPS. MNEs often make such intra-group asset transfers when neither the jurisdiction of the transferor constitute entity nor the home jurisdiction of the MNE taxes the transfer.[138] In this regard, the BEPS Monitoring Group notes that it sees:

> no reason for limiting article 9.1.3 to transfers that occur after 30 November 2021. Rather, the article should apply to all such transfers that occur before the commencement of a transition year.[139]

The article 9 transition rules also provide a phased introduction of the rules through a gradual reduction of the substance-based income carve-out over the first 10 years of Pillar Two.[140] In terms of article 9(2), the substance-based income exclusion (*see* section 3.6.3.) will be replaced with the values set out in the table in article 9(2) for each fiscal year beginning in each of the following calendar years.

The transitional rules set limitations on the application of the UTPR when an MNE is in its initial phase of expanding abroad. Under article 9.3.2, MNE groups are excluded from the UTPR in the "initial phase of their international activity", which implies that, for a fiscal year, they have constituent entities in no more than six jurisdictions, and the sum of the net book values of tangible assets of all constituent entities located in all jurisdictions other than the reference jurisdiction does not exceed EUR 50 million. Under article 9.3.4, this exclusion is limited to a period of five years after the MNE comes within the scope of the GloBE rules. This implies that the top-up tax that would be considered in determining the UTPR top-up tax should be reduced to zero during the initial phase of an MNE group's international activity. The OECD indicated that the GloBE rules should be introduced into law in 2022, to be effective in 2023, with the UTPR coming into effect in 2024.[141]

3.8.3. Further comments

The transitional rules, which exclude from the UTPR MNE groups in the initial phase of their international activity, may be open to abuse by MNEs avoiding any top-up tax for the stipulated five-year term. Some MNEs could set up profit-shifting schemes by setting up the bulk of their activities in one jurisdiction and limited personnel or operations in the jurisdictions where users and customers are located. The home jurisdictions of such MNEs may be low-taxed jurisdictions that may choose not to impose an IIR. That this transitional rule applies solely to the UTPR (applied by host countries) and not to the IIR demonstrates further how the priority status of the IIR weakens the taxing rights of host countries.[142] This is further aggravated by the fact that the implementation of the UTPR has been relegated to the very end of the process and will only come into effect in 2024.

3.9. The subject to tax provision

3.9.1. In general

The Inclusive Framework's agreement on the GloBE rules includes a political commitment for participating countries to agree to include in their tax treaties a "Subject to Tax Rule" (STTR), if requested to do so by developing countries that are members of the Inclusive Framework.[143] This is based on the recognition that the STTR is an integral part of achieving a consensus on Pillar Two for developing countries. The STTR targets risks to source jurisdictions posed by BEPS structures relating to intra-group payments that take advantage of low nominal rates of taxation in the jurisdiction of the payee.[144] The STTR entails a switch-over rule in circumstances that otherwise commit the contracting parties to the use of the exemption method.[145] The minimum rate of the STTR is 9%, which will apply to certain categories of payments, such as interest, royalties and a defined set of other payments that present BEPS risks because they relate to mobile capital, assets or risk.[146] Countries that apply nominal corporate income tax rates below the STTR minimum rate to these payments would implement the STTR into their bilateral tax treaties with developing members, when requested to do so.[147]

3.9.2. Comments

Although the STTR is a welcome concession for developing countries, in order for it to be effective in addressing BEPS, its set of defined payments must include capital gains and service payments that pose high BEPS risks to developing countries.[148] Otherwise, developing countries may choose to sign tax treaties based on the UN Model, which includes article 12A on service fees and article 12B on automated digital services (which are not in the OECD Model).[149]

Developing countries have raised concerns about the 9% minimum rate of the STTR. The G24 called for a high minimum rate because, in most tax treaties, interest and royalties rates are generally 10% or 15% and even higher.[150] The 9% minimum rate may only benefit countries that have negotiated tax treaties with lower withholding tax

138. Oguttu, *supra* n. 113, at p. 129.
139. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 17.
140. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
141. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 9.
142. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 19.
143. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 9.
144. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 566.
145. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 11.
146. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 566.
147. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 9.
148. ATAF Communication, *130 Inclusive Framework Countries*, *supra* n. 74 and G24, *Comments of the G24 on the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy agreed by 134 Jurisdictions of the Inclusive Framework on the 1st of July 2021* para. 6 (19 Sept. 2021) [hereinafter *Comments of the G24 on the Statement on a Two-Pillar Solution*].
149. Oguttu, *supra* n. 100, at sec. 14.8. pp. 608-609. *See also UN Model Double Taxation Convention between Developed and Developing Countries* arts. 12A and 12B (1 Jan. 2021), Treaties & Models IBFD.
150. G24, *Comments of the G24 on the Statement on a Two-Pillar Solution*, *supra* n. 148, at para. 7.

rates, which may have to be amended to meet the STTR rate.[151] With regard to tax treaties with higher rates, the STTR does not offer BEPS protection.[152] Since the STTR will only be included in tax treaties upon request by developing countries, it is likely that developed countries that have tax treaties that overly restrict host country taxation would be reluctant to amend them to include the STTR.

A model treaty provision to give effect to the STTR will be developed as a stand-alone treaty rule that would apply to covered payments between connected persons (excluding certain entities), provided that a materiality threshold is exceeded.[153] The model treaty provision will be supplemented by a commentary that explains the purpose and the operation of the STTR, and a Multilateral Instrument (MLI) will be developed to facilitate the swift and consistent implementation of the STTR.[154] The G24 recommended that the STTR should be a simple transaction-based rule that does not require a materiality threshold to be triggered or a low-return exclusion, as this would limit the application of the rule, add layers of complexity and provide tax avoidance opportunities.[155]

4. Factors That Impact the Effective Implementation of the GloBE Rules

Although many countries were involved in the consultations that led to the development of the rules, the fast pace of the discussions and the short timeframes in which to comment on very lengthy and complex documents made it very difficult for capacity-constrained developing countries to keep up. Thus, comments were largely provided by better-resourced developed countries and the advisers of the business community, who steered the final product to suit their circumstances. Often the comments from the Global South, regional tax bodies (such as the ATAF) and civil society organizations were side-lined to accommodate the interests of large developed countries, such as the United States, which threatened to pull out of the discussions, and had to be appeased, or otherwise, international consensus would fail.

There was no consultation on the final text of the GloBE rules, which indicates that there is no intention to revise the text at this stage. The technical details of the rules are of a mind-boggling complexity even for specialists in international tax.[156] The Business and Industry Advisory Committee (BIAC) to the OECD, which comprises tax professionals employed by MNEs, expressed concern that the cumulative effect of the complexity of the rules could render them incapable of operation, as they may prove to be an administrative and compliance struggle for taxpayers and tax authorities.[157] The African Union has decried the complexity of the rules.[158] So has the UK government, which has recognized that while the Commentary to the Model Rules explains the details, businesses will have to take time to comprehend the concepts.[159]

Some of the complexity arises from the formulaic approach, which may not feasible in some circumstances as not everything boils down to percentages. For example, with the changing business models, employees do not need to be present to fulfil substance requirements. Complexities also arise because the Model Rules are layered on top of existing rules, which will make it difficult for tax administrations, particularly those in under-resourced developing countries to implement and administer the rules.[160] The rules will also pose many practical and interpretation issues, which may create uncertainties[161] and increasing disputes with greater denial of deductions.[162] Double taxation could also arise where the top-up tax applies in circumstances in which there is no net GloBE income for a jurisdiction, which may adversely impact cross-border trade and investment.[163]

Initially, the OECD had set the implementation date of the Model Rules for 2023.[164] This date was unrealistic because the adoption of the rules needs parliamentary approval in many countries, and funds should have been budgeted to implement the rules. At the World Economic Forum meeting in Davos, Switzerland, in May 2022, the OECD Secretary General conceded that the timeframe for implementing the rules was rather unrealistic, and that the practical implementation for countries should start from 2024 onwards.[165]

151. South Centre, *Statement by the South Centre on the Two Pillar Solution*, *supra* n. 77.
152. Oguttu, *supra* n. 100, at sec. 14.7.4. p. 607.
153. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 573.
154. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 11.
155. G24, *Comments of the G24 on the Statement on a Two-Pillar Solution*, *supra* n. 148.
156. EY, *OECD Releases Commentary and illustrative examples on Pillar Two Model Rules* (21 Mar. 2022), available at www.ey.com/en_gl/tax-alerts/oecd-releases-commentary-and-illustrative-examples-on-pillar-two-model-rules (accessed 22 Mar. 2022) [hereinafter *OECD Releases Commentary and Illustrative Examples*].
157. Business at OECD (BIAC), *Letter to OECD Working Part II Regarding the 20th December 2021 Pillar Two Model Rules, of 6 January 2022*, available at https://biac.org/wp-content/uploads/2022/01/01-06-2022-Business-at-OECD-BIAC-6-Jan-Pillar-Two-Issues-Letter-1.pdf (accessed 9 Nov. 2022) [hereinafter *Letter to OECD Working Part II*].
158. African Union, *Speech by Commissioner for Economic Affairs African Union Commission for 4th High-Level Tax Policy Dialogue* (26 Aug. 2020), available at https://au.int/en/pressreleases/20200826/speech-commissioner-economic-affairs-au-ataf (accessed 10 Oct. 2022).
159. UK: HM Treasury and HM Revenue & Customs (HMRC), OECD Pillar 2: Consultation on implementation para. 1.20 (Jan. 2022), available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045663/11Jan_2022_Pillar_2_Consultation_.pdf (accessed 5 Aug. 2022) [hereinafter OECD Pillar 2: Consultation].
160. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 3.
161. The BEPS Monitoring Group, *Comments on The Model Rules for Digital Economy* (9 Feb. 2022), available at https://www.bepsmonitoringgroup.org/news/2022/2/9/comments-on-the-model-rules-for-the-globe (accessed 11 Nov. 2022).
162. Uday Ved & Wrutuja Soni, *Consequences of BEPS and the Globe Rules Under Pillar Two*, Intl. Tax Rev. (27 June 2022), available at www.internationaltaxreview.com/article/2aaa5hiiweysnd7xygk5c/sponsored/consequences-of-beps-and-the-globe-rules-under-pillar-two (accessed 1 Aug. 2022).
163. Business at OECD (BIAC), *Letter to OECD Working Part II*, *supra* n. 157.
164. OECD, *OECD Releases Pillar Two Model Rules*, *supra* n. 16.
165. Reuters, *OECD chief sees global digital tax deal pushed back to 2024* (24 May 2022), available at www.reuters.com/markets/oecd-chief-quietly-optimistic-about-eu-global-minimum-tax-deal-approval-2022-05-24/ (accessed 31 May 2022).

5. Will the GloBE Rules Be Effective in Reducing Tax Competition?

The objective of the GloBE rules is to reduce the incentive for states to offer low taxes on source taxation. The rules do not eliminate tax competition, but they set limitations on it. The effectiveness of the rules in reducing tax competition will depend upon how they are implemented in each country. The OECD envisages that the rules will relieve pressure on developing countries to provide excessively generous tax incentives to attract foreign investment, while providing carve-outs for activities with real substance.[166] Developing countries may have to follow a balanced approach as they consider the impact of the GloBE minimum rate on their tax systems and the need to preserve their tax incentives to attract FDI.

As discussed in section 3., the GloBE rules include a number of provisions (summarized below) that collectively reduce their effectiveness to reduce tax competition.

- The minimum rate of 15% is too low to effectively deter tax competition in developing countries that have higher corporate tax rates.
- The operation of the rules excludes international shipping income, and yet shipping MNEs have been a major cause of base erosion and tax competition in tax havens and flags-of-convenience nations.
- The GloBE rules give the priority right to apply the top-up tax on undertaxed income to the home country through the IIR, and only a backup right to the host country to apply the UTPR. This will impact the ability of the rules to effectively prevent tax competition in host countries.
- The UTPR, which is the rule most advantageous to developing countries, will not apply to MNE groups during the "initial phase" of their international activities.[167]
- The QDMTT may encourage continued tax competition, contrary to the aims of the GloBE.
- The STTR will not benefit developing countries that have treaty rates above the 9% minimum rate of the STTR.

The design of the rules also means that the tax base on which the ETR is calculated, combined with the relatively low minimum of 15%, would still allow considerable tax competition between governments to offer incentives, such as generous allowances.[168]

166. OECD, *Two-Pillar Solution*, *supra* n. 47, at pp. 4-5.
167. South Centre, *Statement by the South Centre on the Two Pillar Solution*, *supra* n. 77.
168. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 2.

6. Implementability of the GloBE Rules in Developing Countries

Various international bodies for developing countries, such as the G24,[169] the ATAF[170] and the South Centre,[171] have welcomed the GloBE rules and the fact that the OECD has promised to provide technical assistance to support developing countries to implement the rules.[172] However, the GloBE rules may not be implementable in many developing countries.

The rules apply to constituent entities that are members of MNE groups that have an annual revenue of EUR 750 million or more in the consolidated financial statements of the UPE in at least two of the four fiscal years immediately preceding the tested fiscal year.[173] Therefore, the rules will not be implementable in developing countries where MNEs have less than EUR 750 million in consolidated revenues. The rules will most likely be applicable to a few developing countries that have MNEs that submit CbC reports for which the EUR 750 million threshold is also applicable.[174] In addition, even if an MNE group falls within the scope of the rules, some MNEs' group entities are excluded, for example, government entities, international organizations and non-profit organizations, and pension, investment or real estate funds. Furthermore, a de minimis exclusion applies where the aggregated revenue for the constituent entities located in the same jurisdiction is less than EUR 10 million and the profits are less than EUR 1 million.[175]

It should be noted, however, that, even in countries where the rules could be implementable, since the GloBE rules have the status of a common approach,[176] member countries of the Inclusive Framework are not required to adopt the rules. If they choose to adopt the rules, they have to implement and administer them in a way that is consistent with the GloBE rules, the Commentary to the Model Rules (including the agreement regarding rule order) and any agreed safe harbours.[177]

Notably, South Africa's Minister of Finance indicated in the 2022 Budget Review that South Africa, as a member of the Steering Group of the Inclusive Framework, would embark on the adoption of the GloBE rules and that proposals for the legislative amendments to implement the rules would be carried out.[178] The 2022 Budget Review shows that South Africa could become one of the first developing countries to implement the rules and grapple with the practical complexities of the legislative integra-

169. G24, *Comments of the G24 on the Statement on a Two-Pillar Solution*, *supra* n. 148.
170. ATAF Communication, *130 Inclusive Framework Countries*, *supra* n. 74.
171. South Centre, *Statement by the South Centre on the Two Pillar Solution*, *supra* n. 77.
172. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 5.
173. OECD, *GloBE Model Rules (Pillar Two), supra* n. 55, at art. 1.1.
174. OECD, *Action 13 Final Report* (2015), *supra* n. 64, at para. 52.
175. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 9.
176. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, at para. 1.
177. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 8.
178. ZA: National Treasury, *Budget 2022 – Budget Review* (23 Feb. 2022) 46, available at www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf (accessed 1 Aug. 2022).

tion into domestic law of the new international rules for taxing the digital economy.[179] Some countries may have to adopt a wait-and-see approach before adopting the rules in order to determine how the implementation firms up in other countries.

It should also be noted that, although the GloBE rules are optional, there could be unintended consequences for countries that do not adopt the rules if their trading partners adopt the rules. If, for example, an in-scope MNE is headquartered in a country that adopts the rules and that MNE has a subsidiary company in a country that does not adopt the rules, and if there is a top-up tax in the home country, there will be implications for the subsidiary in the non-adopting country, which may cause tax disputes.

The OECD has indicated that countries may adopt other measures that are in line with the GloBE's aims.[180] Indeed, leading OECD member countries had already adopted similar measures, which they intend to retain on the reasoning that they are compatible with the GloBE's aims. An example is the US Global Intangible Low-Taxed Income (GILTI) regime (enacted under the Tax Cuts and Jobs Act of 2017), which provides for a minimum level of tax in the United States on the foreign income of an MNE group.[181] While the GILTI and GloBE rules have a similar purpose and overlapping scope, the design of GILTI differs from GloBE in various respects. To make the GILTI rules more effective, the Biden administration tabled the Build Back Better Act (BBBA) on 19 November 2021, which entails the reform of the rules to apply on a CbC basis and by increasing the GILTI ETR to 15% (in line with the GloBE rules), but, at the time of writing this article, the BBBA was yet to be approved by the US Senate.[182] Given the pre-existing nature of the GILTI regime and its legislative intent, the Inclusive Framework has indicated that it intends to give consideration to the conditions under which the GloBE rules will co-exist with GILTI in order to ensure a level playing field.[183] In January 2022, the United Kingdom released a consultation paper inviting public comments on how the GloBE rules should be translated into UK domestic legislation. However, it was indicated that this did not imply that there will be a removal of existing anti-avoidance measures that "counteract arrangements which are designed to shift particular streams of income out of the UK tax base".[184]

Considering that the aforementioned developed countries intend to retain their current measures, developing countries that find the GloBE rules unfair or too complicated to implement should also have the right to use their current provisions or introduce variants to the rules, as long as they are consistent with the GloBE's aims. A possible approach for developing countries is to introduce or strengthen "Alternative Minimum Corporate Taxes" (AMCTs), which are income taxes based on turnover and are already in existence in many countries.[185] AMCTs place a floor on the percentage of taxes payable so that taxpayers pay a "minimum" amount of tax to the government.[186] Currently, a number of African countries levy AMCTs at very low rates, which are on average around 1% of turnover. Examples include Burkina Faso, Chad, Gabon, the Ivory Coast and Tanzania.[187] AMCTs are compatible with tax treaties, less susceptible to base erosion, not complicated to implement, simple to apply, effective, and they provide certainty to taxpayers. African countries with limited capacity should consider introducing AMCTs and adopting them to suit the GloBE's aims.[188] AMCTs have been largely designed as a corporate tax fallback in an effort not to deter inward investment.[189] Countries should now consider them as essential elements of rebalancing the application of the global minimum tax more fairly among countries in which MNEs have real activities.[190] AMCTs could also be used to ensure that profits are taxed at a minimum ETR of 15%.

A question that could arise is whether AMCTs would qualify as covered taxes under the GloBE rules and if tax credits would be granted. Based on the definition of "covered taxes" in article 4.2.1 of the GloBE rules, which includes "corporate income taxes and taxes levied by reference to retained earnings and corporate equity", AMCTs qualify because they are income taxes that are based on a company's turnover. The Commentary to the Model Rules also states that:

> the tax imposed under the GloBE rules is closer in design to an international alternative minimum tax that uses standardised base and tax calculation mechanics to identify pools of low-taxed income within an MNE Group and imposes a co-ordinated tax charge that brings the Group's ETR on that income in each jurisdiction up to the Minimum Rate.[191]

Where AMCTs are modified to suit the GloBE's aims, they would be in line with the Commentary to the Model Rules, which further states that "the design of the IIR and UTPR as top-up taxes do not restrict a jurisdiction from legislating those rules under a corporate income tax system

179. Tsanga Mukumba, *How to rule the GloBE: OECD/G20 commentary on Pillar Two model rules for 15% global minimum tax*, Cliffe Dekker Hofmeyer (14 Apr. 2022), available at www.cliffedekkerhofmeyr.com/en/news/publications/2022/Practice/Tax/tax-and-exchange-control-alert-14-april-2022-how-to-rule-the-globe-oecd-g20-commentary-on-pillar-two-model-rules-for-15-percent-global-minimum-tax.html (accessed 1 Aug. 2022).
180. OECD, *Two-Pillar Solution*, *supra* n. 47, at p. 8.
181. US: Internal Revenue Code (IRC) of 1986, sec. 951A. *See also* US: Tax Cuts and Jobs Act of 2017.
182. Tax Policy Centre, *Biden's "Undertaxed Profit Rule" Would Complete US Adoption of BEPS Pillar 2* (27 Apr. 2022), available at www.taxpolicycenter.org/search?filter=Biden%E2%80%99s+%E2%80%98Undertaxed+Profit+Rule%E2%80%99+Would+Complete+US+Adoption+of+BEPS+Pillar+2&sort_by=search_api_relevance&items_per_page=25 (accessed 27 Oct. 2022). *See also* US: Build Back Better Act (BBBA).
183. OECD, *Pillar Two Rules in a Nutshell*, *supra* n. 84.
184. HM Treasury & HMRC, OECD Pillar 2: Consultation, *supra* n. 159, at para. 13.11.
185. Ovonji-Odida, Grondona & Chowdhary, *supra* n. 91, at p. 28.
186. Deloitte, *The Minimum Alternate Tax (MAT) on Companies: Challenges and Way Forward* p. 4 (2019).
187. Deloitte, *Guide to Fiscal Information: Key Economies in Africa* pp. 58, 28, 119, 150 and 318, respectively (2018).
188. M. Durst, *Taxing Multinational Business in Lower-Income Countries: Economics, Politics and Social Responsibility* p. 96, International Centre for Tax and Development (ICTD) (2019).
189. Id.
190. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 6.
191. OECD, *Commentary to the GloBE Model Rules (Pillar Two)*, *supra* n. 59, at para. 2.

in its domestic law”.[192] The design of these rules should, however, ensure compatibility with tax treaties so that tax credits can be granted to prevent double taxation.[193] Tax treaties that impose undue restrictions on AMCTs, therefore, can be renegotiated. AMCTs can be compatible with the GloBE, and should be regarded as an essential complement to ensure that they contribute to a fair and effective taxation of MNE profits.[194] Developing countries may have to consider whether the use of safe harbours in the GloBE rules could offer more benefits for them.

Since the GloBE rules have the status of common approaches, developing countries that do not want to implement the rules should not be pressured into adopting them, or penalized for adopting alternatives that are more suitable for them. The ATAF cautions that implementation of the GloBE rules must be done responsibly, and in consideration of the fact that not all countries have a similar capacity to implement the rules. Since many countries are not members of the Inclusive Framework, and some Inclusive Framework member countries have not joined the agreement, the ATAF further cautions that political pressure should not be brought on such countries to apply these rules or to join the Inclusive Framework.[195]

7. Impact of the GloBE Rules on Developing Countries’ Tax Treaties That Protect Tax Incentives

The GloBE rules will impact countries that offer tax incentives with an ETR that is below the 15% rate, even if their corporate tax rate may be much higher. This is particularly so for developing countries that have signed tax sparing provisions in their tax treaties in order to encourage foreign investment. The rationale for “tax sparing” provisions needs explanation. When countries (particularly developing countries) grant tax incentives to foreign investors, the benefit of the tax incentive may be limited if, for instance, their treaty partner grants a tax credit (for taxes actually paid in a foreign country) to relieve their residents from double taxation. Since the foreign investor would not have paid foreign taxes as a result of a tax incentive, they would not have availed themselves of a tax credit in their home country. To prevent the benefit of the tax incentive being lost in increased tax payments in the investor’s home country, developing countries often insist on having a “tax sparing” provision in their tax treaties,[196] which requires the investor’s residence country to allow their residents to retain the advantages of tax incentives by pretending that tax was levied and thus sparing the taxation of foreign source income of such residents.[197] The GloBE rules will impact the tax sparing provisions because spared taxes are not considered to be covered taxes for calculating the ETR of the constituent entity. This may result in tax disputes, which will impact the ability of developing countries to use tax sparing provisions to encourage FDI. Such countries have to renegotiate and remove these provisions from their tax treaties.[198]

Some countries have entered into bilateral investment treaties (BITs), which protect tax incentives offered to foreign investors of one state in the other state.[199] BITs normally contain “fiscal stabilisation clauses”,[200] which make it hard to withdraw tax incentives without compensation. If countries implement the GloBE minimum tax, which establishes a floor to tax competition, disputes will arise regarding fiscal stabilization clauses in BITs, and MNEs may resort to arbitration to resolve the disputes.[201] Arbitration, however, poses challenges for developing countries due to the costs involved and the lack of experience in investment arbitration procedures, which often take place in the residence states of the investors.[202]

BITs also normally include a “Most Favoured Nation” (MFN) clause, under which the contracting state in which the investment is made (the host state) is obliged to give investors from the other contracting state (the investor’s residence state) no less favourable treatment than it grants to investors from third countries.[203] The MFN clause allows investors to ask for the treatment in another BIT or any other agreement that may be more favourable.[204] Since BITs do not specifically state that the other international agreement should be a BIT,[205] foreign investors could demand that higher rates in BITs be lowered to the GloBE minimum rate. This would create uncertainties and disputes regarding a country’s investment regime. It is important, therefore, that the OECD provides for a phasing-in period to allow developing countries that wish to adopt the GloBE rules, and have MNEs that fall within the scope of the GloBE rules, to revise their tax regimes

192. Id.
193. A.B. Lyon, *Cracking the Code: Making Sense of the Corporate Alternative Minimum Tax*, Brookings Institute (1997).
194. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 2.
195. ATAF, *A new era of international taxation rules – What does this mean for Africa?* (8 Oct. 2021), available at www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa (accessed 18 Oct. 2021) [hereinafter *A new era of international taxation rules*].
196. UN, *Handbook on Selected Issues on Administration of Double Tax Treaties for Developing Countries* p. 35 (UN 2013).
197. A.W. Oguttu, *The Challenges of Tax Sparing: A Call to Reconsider the Policy in South Africa*, 65 Bull. Intl. Taxn. 1 (2011), Journal Articles & Opinion Pieces IBFD.
198. Sharma, *supra* n. 78.
199. K. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 Harvard Intl. L. J. 2, p. 469 (2000).
200. H. Mann, *Stabilization in investment contracts: Rethinking the Context, Reformulating the Result*, Inv. Treaty News, International Institute for Sustainable Development (IISD) (7 Oct. 2011), available at www.iisd.org/itn/2011/10/07/stabilization-in-investment-contracts-rethinking-the-context-reformulating-the-result/ (accessed 7 Aug. 2022).
201. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 7.
202. South Centre, *Statement by the South Centre on the Two Pillar Solution*, *supra* n. 77.
203. R. Dolzer & C. Schreiber, *Principles of International Investment Law* p. 184 (Oxford U. Press 2008).
204. K. Gordon & J. Pohl, *Investment Treaties Over Time - Treaty Practice and Interpretation in a Changing World*, OECD Working Papers on International Investment 2015/02 p. 7 (OECD 2017).
205. For example, the *Republic of South Africa-Senegal Bilateral Investment Treaty*, art. 10; the *Republic of South Africa-Spain Bilateral Investment Treaty*, art. 11; the *Republic of South Africa-Switzerland Bilateral Investment Treaty*, art. 11; and the *Republic of South Africa-United Kingdom Bilateral Investment Treaty*, art. 11. *See* SARS, *Trade Agreements*, available at https://www.sars.gov.za/legal-counsel/international-treaties-agreements/trade-agreements/ (accessed 9 Nov. 2022).

by removing tax incentives. Some countries may also have to renegotiate their BITs.

8. Impact of the GloBE Rules on Countries' CFC Provisions

Implementing the GloBE rules will essentially imply layering the rules on top of the existing domestic tax system. This may create overlaps and a lack of coordination, which could result in tax disputes. Countries need to take time to fully understand the impact that the GloBE rules could have on their current tax system. Of particular concern is the impact that the GloBE rules could pose on countries' CFC rules, which in some respects operate like the GloBE rules. Countries normally enact CFC rules to prevent tax deferral by ensuring that resident shareholders in foreign companies are taxed on the undistributed income of the foreign companies (the CFC), as if that income had been repatriated to the resident shareholders as soon as it was earned by the foreign company.[206] Although CFC rules have been largely adopted by developed countries that have the administrative capacity to cast their tax net more widely, a few developing countries, such as South Africa, have CFC rules.[207] Just like the GloBE rules, some countries' CFC rules apply a jurisdictional approach in that the legislation identifies companies located in low-tax jurisdictions whose income is taxed below a certain rate, then the undistributed income of that foreign company is attributed pro rata to the domestic shareholders and taxed directly in their hands.[208]

The CFC rules are akin to the top-up tax of the GloBE rules, which deny deductions or treaty benefits if the profits or certain payments are not subject to a globally agreed minimum tax rate.[209] Under the GloBE rules, the IIR effectively operates by requiring the UPE to bring into account its share of the income of each constituent entity located in a low-tax jurisdiction and taxing that income up to the minimum rate. The IIR imposes a top-up tax only on that portion of the low-tax income of a foreign constituent entity that is beneficially owned (directly or indirectly) by the member of the group that applies the IIR (the parent).[210] Thus, the operation of CFC rules is in some respects similar to the operation of the IIR in that it triggers an inclusion at the level of the shareholder, where the income of a CFC is taxed at below the effective minimum tax rate.[211]

Most CFC rules have a "high-tax country exemption" provision, i.e. if there is a certain level of taxation in a foreign country, tax will not be imputed to the resident shareholders.[212] CFC rules also tend to have exclusions for non-governmental organizations, shipping, investment funds and financial services. Like the GloBE rules, CFC rules impact mainly jurisdictions with no substance requirements and low levels of corporate tax.[213] Thus, most CFC rules contain an exemption for genuine business activities, which mirrors the carve-out for substance requirements for the GloBE rules. Countries have to consider whether there will be overlaps between the IIR and their CFC rules, and, specifically, whether the application of the GloBE's 15% minimum tax would render their exemption for genuine business activities irrelevant.

Countries will also have to consider whether the application of the GloBE's minimum rate would override their CFC rules. Since the GloBE rules only apply to MNEs that meet the EUR 750 million threshold, CFC rules will continue to apply to companies that do not meet that threshold. For companies that meet the threshold, it is not clear whether both the CFC rules and GloBE rules will apply to them. If both systems apply, countries have to consider the order of application and whether changes to CFC rules will be required. For countries that are not sure how to proceed, it may be better to use a wait-and-see approach since there will be first-mover countries to learn from. Nevertheless, what can be presumed is that the implementation of the GloBE rules may be much easier for countries that have CFC rules than for those that do not have them.

9. Political Dynamics That Impact on the Implementation of the GloBE Rules

The GloBE rules have no legal status or binding force until they are enacted into domestic law by countries. However, political dynamics may hinder or delay the implementation of the rules into domestic law. From the onset, the OECD indicated that Pillar Two is a backstop to Pillar One.[214] The assumption was that Pillar One rules would be finalized before the Pillar Two rules. Nevertheless, on 20 December 2021, the OECD published the Pillar Two GloBEModel Rules,[215] but the discussion document on the first building blocks for the Pillar One was only issued on 4 February 2022.[216] The delays in developing the Pillar One rules are due in part to the fact that some states were:

> keen to prioritise Pillar Two given the pressure on tax revenues following the economic fallout posed by the COVID-19 global pandemic, coupled with the relatively higher tax yields expected from Pillar Two compared to Pillar One.[217]

The other reasons were the daunting challenges of agreeing on the detail of Pillar One and its implementation, the perceived double taxation challenges it could pose, the tax

206. L. Olivier & M. Honiball, *International Tax: A South African Perspective* p. 558 (5th edn., Siber Ink CC 2011).
207. ZA: Income Tax Act (ITA) 58 of 1962, sec. 9D.
208. B. Arnold & M. McIntyre, *International Tax Primer* p. 94 (Kluwer L. Intl. 2016).
209. A. Greenbank, G. Price & R. Kinghall Were, *Re-born in the USA: Will the OECD tax plans now be made in America?*, MacFarlanes (4 Apr. 2021), available at www.macfarlanes.com/what-we-think/in-depth/2021/re-born-in-the-usa-will-the-oecd-tax-plans-now-be-made-in-america/ (accessed 29 May 2022).
210. OECD, *Report on Pillar Two Blueprint*, *supra* n. 51, at para. 410.
211. Oguttu, *supra* n. 100.
212. Arnold & McIntyre, *supra* n. 208.
213. Id., at p. 96. An example is the "foreign business establishment" exclusion to CFC rules in section 9D of South Africa's ITA 58 of 1962.
214. OECD, *Programme of Work to Develop a Consensus Solution*, *supra* n. 18, at para. 55.
215. OECD, *GloBE Model Rules (Pillar Two)*, *supra* n. 55, at art. 1.1.
216. OECD, *OECD launches public consultation on the tax challenges of digitalisation with the release of a first building block under Pillar One* (4 Feb. 2022), available at www.oecd.org/tax/beps/oecd-launches-public-consultation-on-the-tax-challenges-of-digitalisation-with-the-release-of-a-first-building-block-under-pillar-one.htm (accessed 29 May 2022).
217. Collier, *supra* n. 121.

certainties that could result in numerous disputes, and the fact that its implementation could be delayed by domestic law timing issues and constitutional issues.[218]

The finalization of the Pillar Two GloBE rules before Pillar One presented a political anomaly as countries were uncertain about the implementation of the GloBE rules. For instance, on 22 December 2021, the European Commission published a draft Directive for the implementation of the GloBE rules, with some modifications in light of EU law requirements.[219] The draft Directive does not automatically enter into effect in the national laws of the Member States, but must be implemented in their own ways.[220] Thus, various Member States began considering the implementation of the rules, and countries like Ireland issued public consultation papers on the same.[221] However, on 12 April 2022, Poland vetoed the implementation of the draft Directive, with the Polish Secretary of State reasoning that Pillar Two (which had to be implemented before Pillar One) had an explicit legal link to Pillar One, which is the main piece of the Inclusive Framework's two-pillar solution.[222] Although the French Finance Minister reasoned that it is "not possible" to establish an enforceable link between Pillar One and Pillar Two, the Polish Secretary of State asserted that:

> Polish companies should not be subjected to the global minimum tax under Pillar Two without ensuring that large digital companies are fully taxed under the profit reallocation rules under Pillar One.[223]

These political uncertainties need to be resolved as many countries were waiting to see how the Member States implement the rules before adopting them. Unlike other regions, the Court of Justice of the European Union (ECJ) ensures that EU law is observed in all Member States, and that any disputes that could arise regarding the interpretation of a directive are resolved.[224] However, there would still be issues about the compatibility of EU laws with interpretations of the GloBE rules by non-EU Member States that will adopt the rules.[225]

There are also political uncertainties regarding the adoption of the GloBE rules in the United States, even though it is expected to be one of the main countries that would benefit from the rules as they are akin to the GILTI rules that its MNEs are already complying with.[226] As explained in section 6., at the time of writing this article, the Biden administration's proposals to amend the US GILTI rules so that they are in line with the GloBE rules had not yet been stalled due to political buy-in challenges in the US Senate.[227]

In other countries, the adoption of the Pillar One and Two rules may be delayed or hindered as parliamentary approval will be required to adopt the rules into domestic law, a process that can be quite lengthy in many countries. Countries will also need to give careful thought to how they should enact and implement the rules to prevent overlaps with their current systems, a process which cannot be hurried, especially in resource-constrained developing countries where the allocation of budgeted resources could be allocated to other matters of priority concern.[228] Furthermore, although revenue authorities may consider the GloBE rules important in reducing the race to the bottom, other government departments, such those dealing with investment, may consider the implementation of the GloBE rules as hindering FDI. This may result in political conflicts, which may delay or prevent the implementation of the rules.

10. Conclusions and Recommendations

The GloBE rules aim to reduce tax competition and the race to the bottom of reducing corporate tax rates. At the World Economic Forum meeting in Davos, Switzerland, in May 2022, the OECD Secretary General argued that, once there is a "critical mass of countries imposing a minimum level of corporate tax on profits generated in their jurisdictions, it's very hard for other countries not to follow".[229] He called on countries to align themselves with the global standard, as not doing so implies that they "leave money on the table for other countries to collect".[230] The required "critical mass", the extent of which is not clear, will be hampered by political dynamics (*see* section 9.), which may hamper implementation of the rules in many countries.

Although the GloBE rules open a new way forward, this article has set out various challenges that may impact their effectiveness in preventing tax competition and the race to the bottom in developing countries. The complexity of the rules causes uncertainty about how effectively they will operate in practice. The administrative difficulties the rules will impose on both taxpayers and tax admin-

218. Id.
219. European Commission, Proposal for a Council Directive on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union, COM(2021) 823 Final (22 Dec. 2021).
220. EY, *OECD Releases Commentary and Illustrative Examples*, *supra* n. 156.
221. IE: Department of Finance, Consultation on Pillar Two Minimum Rate Implementation (26 May 2022), available at www.gov.ie/en/consultation/c68e4-public-consultation-on-pillar-two-minimum-tax-rate-implementation/# (accessed 27 Oct. 2022).
222. Grant Thornton, *Poland vetoes Pillar 2 rule implementation in EU* (12 Apr. 2022), available at www.grantthornton.com/library/newsletters/tax/2022/hot-topics/april-12/poland-vetoes-pillar-2-rule-implementation-in-eu.aspx (accessed 29 May 2022) [hereinafter *Poland vetoes Pillar 2 rule implementation in EU*].
223. Id.
224. European Union, Court of Justice of the European Union (CJEU [ECJ]), available at https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/institutions-and-bodies-profiles/court-justice-european-union-cjeu_en (accessed 12 Mar. 2022).
225. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75.
226. Grant Thornton, *Poland vetoes Pillar 2 rule implementation in EU*, *supra* n. 222.
227. WTS Global, *The US' role in global adoption of Pillar 1 and Pillar 2 / ongoing conversations in the US on tax reform / a status update on us tax reform* (21 Dec. 2021), available at https://wts.com/global/publishing-article/20211221-usa-tp-nl~publishing-article?language=en (accessed 31 May 2021).
228. Oguttu, *supra* n. 100, at sec. 15. p. 619.
229. The Guardian, *Historic OECD international tax deal pushed back to 2024* (24 May 2022), available at www.theguardian.com/business/live/2022/may/24/davos-day-2-world-food-crisis-imf-ec-nato-ukraine-pandemic-live-update?filterKeyEvents=false&page=with:block-628cbe7f8f08e646defacd81#block-628cbe7f8f08e646defacd81 (accessed 31 May 2022).
230. Id.

istrations should not be underestimated. In its present state, the design of the GloBE rules does not appear equitable for host countries and may not be of much benefit to them. The public consultation that led to the GloBE rules shows that the concerns that were consistently raised by developing countries (largely the host countries of MNEs) were largely ignored. It is, therefore, no wonder that the final rules show that they are skewed to benefit developed countries (largely home countries of MNEs). The fact that there was no public consultation on the text of the Model Rules raises concerns about the "path dependency" theory, which suggests that once the initial "building blocks" are laid and solidified, they are more difficult to change in the future.[231]

In light of the foregoing, a long-term solution to the various challenges that impact the effectiveness of the GloBE rules requires that the OECD should not set the rules in stone.[232] There is considerable scope for further development of the GloBE rules to remedy their current defects and limitations, and to improve the way they function so that they are more equitable and effective in achieving the GloBE's aims.[233] The Model Rules and the Commentary to the Model Rules should be subject to a review process, and they should be modified and updated regularly to ensure that they are fully inclusive of the interest of all countries.[234] Flexibility is needed to ensure that the rules are not treated as "one size fits all". The rules should not preclude countries from adopting other measures that are compatible with its aims, if such measures would be more appropriate for their contexts. This would ensure that the GloBE rules contribute to long-term, sustainable and comprehensive international tax reform.

231. Ovonji-Odida, Grondona & Chowdhary, *supra* n. 91, at p. 13.

232. The BEPS Monitoring Group, *Comments on the Proposals*, *supra* n. 75, at p. 2.

233. ATAF, *A new era of international taxation rules*, *supra* n. 195.

234. Ovonji-Odida, Grondona & Chowdhary, *supra* n. 91, at p. 28.