FOCUS

GLOBAL MINIMUM TAX

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Considering the globalization and digitalization of the economy, government tax policymakers around the world have been working on proposals that could significantly change long-standing international tax rules. The OECD[1]/G20[2] project on addressing the tax challenges of the digitalization of the economy began in 2019 and builds on the final reports issued in 2015 in the earlier project on Base Erosion and Profit Shifting (BEPS).[3] The current project is referred to as BEPS 2.0 and consists of Pillar One and Pillar Two.

The work on BEPS 2.0 is being conducted through the Inclusive Framework, which consists of 141 participating jurisdictions, including Curaçao.[4] In October of 2021, the OECD released a statement (the October Statement) reflecting the agreement reached by 136 of the Inclusive Framework members on core design features of the two-pillar solution developed in the BEPS 2.0 project.[5] Mauritania has since become a member of the Inclusive Framework and joined the October Statement, bringing the total number of jurisdictions participating in the agreement to 137.[6] The October Statement sent a clear signal that the international tax landscape will soon be fundamentally transformed.

The changes being developed would significantly alter the overall international tax architecture under which multinational enterprises (MNEs) operate. According to the OECD, each pillar addresses a different gap in the existing rules that currently allow MNEs to reduce their tax liabilities. First, Pillar One should apply to about

TERRENCE MELENDEZ

100 of the biggest and most profitable MNEs by re-allocating part of their profit to the countries of their consumers.[7] Even though Pillar One's approach to assigning a greater share of taxing rights over the global business income of MNEs to market countries is interesting at the very least, the focus of this article is on Pillar Two.

Pillar Two should apply to a much larger group of MNEs and consists of a series of interlocking rules that allow countries to impose additional tax on low-taxed foreign income to which they have a connection.

This way MNEs organizing their affairs in a manner that their profits in a jurisdiction are subject to a low effective tax rate, would still end up paying a minimum of 15% in taxes on those profits. Based on OECD's calculations, the implementation of Pillar Two would generate around USD 150 billion in additional global tax revenues annually.[8]

Pillar Two includes two rules that countries can implement in their domestic tax laws, known together as the Global anti-Base Erosion rules (GloBE Rules), and a treaty-based rule. The GloBE Rules cover the domestic implementation of the 15% global minimum tax and are made up by the Income Inclusion Rule (IIR) and its backstop, the Undertaxed Payments Rule (UTPR). [9 10] In December of 2021, the OECD released the Pillar Two model rules (Model Rules) for domestic implementation of the GloBE Rules.[11]

Generally, a MNE and its group entities (Constituent Entities) are in scope of the GloBE Rules if the annual revenue in the consolidated financial statements of the ultimate parent entity (UPE) is EUR 750 million or more for two out of the four fiscal years immediately preceding the tested year.[12] However, according to the October Statement, jurisdictions are free to apply the IIR to MNEs headquartered in their country even when the threshold of EUR 750 million is not met. [13]

MNEs in scope of the GloBE Rules would have to calculate their effective tax rate (ETR) for each jurisdiction where they operate and pay a top-up tax insofar their ETR per jurisdiction is below the 15% minimum rate.[14] For example, if an in-scope MNE has Constituent Entities with an ETR of 13% in a specific foreign jurisdiction, the applicable top-up tax would, in short, be 2%. [15 16]

The primary GloBE Rule that creates the liability to top up tax for a member of an in-scope MNE is the IIR. The IIR requires that a parent entity pays its allocable share of the top-up tax with respect to a low-taxed Constituent Entity and includes an ordering rule that operates through a top-down approach, starting with the UPE. If the UPE is not located in a jurisdiction that has implemented the IIR, the highest parent entity in the ownership chain located in a jurisdiction that has implemented the IIR pays its allocable share of the top-up tax instead. [17 18]

As a backstop, the UTPR comes into play in case no parent entity in the ownership chain of the low-taxed Constituent Entity applies the IIR. In such scenario the UTPR works by allocating top-up tax to jurisdictions where the MNE is active, based on a two-factor formula. [19]

The third element of the Pillar Two global minimum tax framework is the Subject to Tax Rule (STTR), which is a treaty-based rule that allows source jurisdictions to impose withholding tax on certain related party payments that are subject to tax below a minimum rate of 9%. [20] The in-scope payments for purposes of the STTR are interest, royalties and other type of payments that are yet to be defined. In this respect, a nominal rate test should apply to the item of income, after adjusting for certain permanent changes in the tax base that are directly linked to the payment or the entity receiving it.[21] Therefore, if the payment involved is taxed at a nominal rate lower than 9%, then the tax treaty will grant a taxing right to the country of the payor based on the STTR for the difference.[22]

[1] Organization for Economic Co-operation and Development.
[2] The G20 includes the European Union and 19 individual countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States.
[3] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241046-en.
[4] For a complete list of the Inclusive Framework members, please visit: https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.
[5] OECD (2021), Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy – 8 October 2021, OECD, Paris, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.
[6] The four jurisdictions that did not join the October Statement are Pakistan, Kenya, Nigeria and Sri Lanka.
[7] OECD/G20 (2021), Inclusive Framework on Base Erosion and Profit Shifting (BEPS) Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, Frequently Asked Questions, https://www.oecd.org/tax/beps/faqs-statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.
[8] See footnote 7.

According to the implementation plan in the October Statement, the Pillar Two rules should be brought into domestic law in 2022 to be effective in 2023, except for the UTPR which is to enter into effect in 2024. The GloBE Rules are designed as a common approach, which means that Inclusive Framework members, such as Curaçao, are not required to adopt the GloBE Rules but if they choose to do so, they should implement and administer the rules in a way that is consistent with the Model Rules. [23] Inclusive Framework members are also required to accept the application of the GloBE Rules by other Inclusive Framework members.

The OECD expects to release the commentary relating to the Model Rules in early 2022. In addition, the Inclusive Framework is developing the model treaty provision for the STTR and a multilateral instrument for its implementation, which the OECD expects to also release in the early part of this year. Finally, the OECD notes the work to be done on development of an implementation framework addressing administration, compliance and coordination matters related to Pillar Two and announces that a public consultation event on the implementation framework will be held in February 2022.

It is important for MNEs to evaluate the potential impact of the global tax changes both on their tax positions and on their data and compliance processes and systems. MNEs should also monitor activity in relevant jurisdictions related to the implementation of the global minimum tax rules through changes in domestic tax legislation. On the other hand, the Inclusive Framework members and other countries should decide on how best to deal with the implications and opportunities related to these international tax developments.

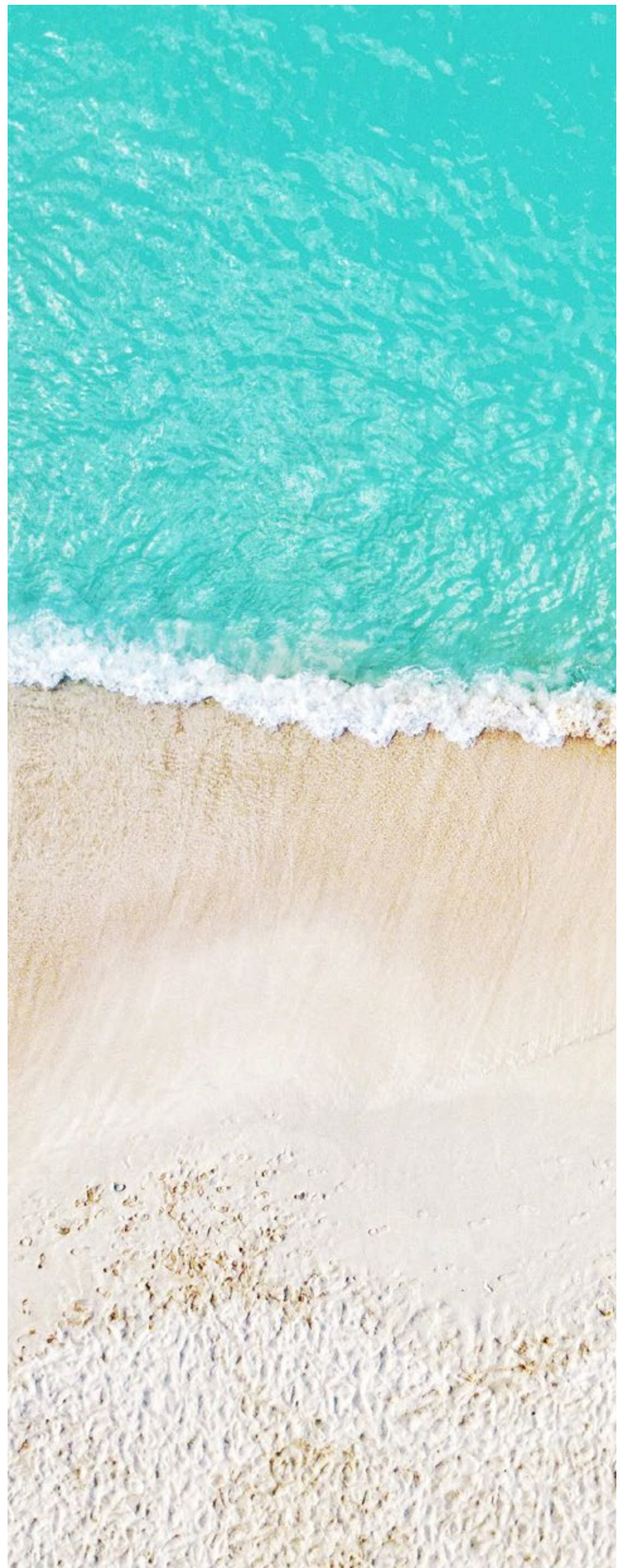
[9] In OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en, chapter 6, the switch-over rule has also been presented. In short, the switch-over rule would enable a parent entity to apply the IIR to the income of a permanent establishment in a treaty situation. However, the switch-over rule has not been discussed in the most recent Pillar Two related publications by the Inclusive Framework.
[10] The October Statement indicates that the minimum effective tax rate for purposes of the IIR and the UTPR will be 15%.
[11] OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.
[12] Governmental entities, international organizations, non-profit organizations and pension funds are, among others, excluded from GloBE Rules. For the complete list of exclusions from the GloBE Rules, I refer you to chapter 1 of the Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (oecd.org) (footnote 11).
[13] See footnote 5.
[14] The rules for calculating the income and the taxes attributable to that income, in order to determine the ETR, are explained in chapters 3 and 4 of Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (oecd.org) (footnote 11).

PILLAR TWO AND ITS IMPACT ON CARIBBEAN JURISDICTIONS

Terrence Melendez commented on two statements made by Germaine Rekwest regarding the impact of Pillar Two on Caribbean jurisdictions.

Statement by Germaine Rekwest:
Pillar Two will mainly adversely impact the small Caribbean jurisdictions with large international financial services sectors. It is therefore expected that jurisdictions like Suriname will be less affected by Pillar Two.

Comment by Terrence Melendez:
Due to Pillar Two, in-scope MNEs with group entities in Caribbean jurisdictions with low effective tax rates will end up paying a minimum of 15% in taxes on their profits booked there (subject to carve outs for real, substantial activities). However, one should also keep in mind that the MNEs will not be able to transfer these group entities and/or activities to a different jurisdiction just to lower the effective tax rate, as the minimum global tax rate of 15% would apply regardless. Therefore, it is important for these Caribbean jurisdictions to adjust to this new international tax landscape by re-inventing themselves and identifying other ways to successfully compete with jurisdictions instead of with low tax rates. By introducing different incentives, leveraging the expertise gathered over the many years of providing international financial services and adding real economic value for their customers, the Caribbean jurisdictions should still be able to market their



services in the future and support commercial transactions that are not merely tax driven. Regarding Suriname, it is important to mention that Suriname is not a member of the BEPS Inclusive Framework.[24] Considering the corporate tax rate in Suriname, which is higher than 15%, and the type of companies typically established there, such as mining companies, Pillar Two would indeed seem less impactful for in-scope MNEs with respect to their operations in Suriname. Nonetheless, the Pillar Two developments should still be monitored as it is possible for the jurisdictional effective tax rate of group entities in Suriname to be less than 15% due to, for example, application of a tax holiday or other tax incentives for business enterprises in Suriname.

Statement by Germaine Rekwest: Caribbean members of the BEPS Inclusive Framework are committed to implement Pillar Two in their legislation. So, these jurisdictions will be less flexible in introducing incentives to attract investment at rates lower than 15%.

Comment by Terrence Melendez: Since the GloBE Rules will have the status of a common approach, the Caribbean members of the Inclusive Framework are not required to implement these rules or to increase their corporate tax rates.

So, these jurisdictions will in principle still be able to introduce tax incentives with rates lower than 15% if they want. However, the Caribbean jurisdictions will in any case be required to accept the application of the GloBE Rules by other Inclusive Framework members, such as the jurisdiction of the (ultimate) parent entity of the low-taxed entity in the Caribbean. Therefore, introducing a tax incentive that leads to a low effective tax rate in the Caribbean jurisdiction would not help to attract in-scope MNEs, as this would still lead to a top-up tax charge abroad.

Considering the above, a jurisdiction in the Caribbean with a tax system that leads to an effective tax rate of less than 15% may consider introducing a higher tax rate for businesses with a consolidated turnover in excess of EUR 750 million, to collect a top-up tax locally instead. In addition, they should consider introducing different incentives to distinguish themselves from the competing jurisdictions (as previously mentioned).

[15] That top-up percentage is subsequently applied to the so-called GloBE income in the respective jurisdiction, after deducting a substance based income exclusion and in accordance with Chapter 5 of Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (oecd.org) (footnote 11).
[16] Please note that if a jurisdiction has a domestic minimum (top-up) tax that is consistent with the Pillar Two Model Rules, such domestic tax can be credited against any Pillar Two minimum tax liability.
[17] Details regarding the IIR and the UTPR are outlined in chapter 2 of Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (oecd.org) (footnote 12).
[18] A de minimis exclusion applies where there is a relatively small amount of revenue and income in a jurisdiction.
[19] The two-factor formula of the UTPR, in short, relies on the carrying value of the intangible assets and number of employees in the respective jurisdiction.
[20] The October Statement indicates that the nominal tax rate used for the application of the STTR will be 9%.
[21] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en, chapter 9.
[22] Please note that the STTR has priority over the GloBE Rules and that any taxes incurred due to the application of the STTR should be considered when determining the ETR per jurisdiction for the Constituent Entities for GloBE Rules purposes.
[23] See footnote 5.
[24] https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf