RIS Discussion Paper Series

Cooperation in International Taxation: Two-Pillar Solution in BRICS Countries

Priyadarshi Dash and Arpit Barman

Discussion Paper # 299

RIS
Research and Information System
for Developing Countries
विकासशील देशों की अनुसंधान एवं सूचना प्रणाली

Cooperation in International Taxation: Two-Pillar Solution in BRICS Countries

Priyadarshi Dash and Arpit Barman

RIS-DP # 299

December 2024

RIS
Research and Information System for Developing Countries
विकासशील देशों की अनुसंधान एवं सूचना प्रणाली

Core IV-B, Fourth Floor, India Habitat Centre
Lodhi Road, New Delhi – 110 003 (India)
Tel: +91-11-2468 2177/2180; Fax: +91-11-2468 2173/74
Email: dgoffice@ris.org.in

RIS Discussion Papers intend to disseminate preliminary findings of the research carried out within the framework of institute's work programme or related research. The feedback and comments may be directed to: Email: dgoffice@ris.org.in. RIS Discussion Papers are available at www.ris.org.in

Cooperation in International Taxation: Two-Pillar Solution in BRICS Countries

Priyadarshi Dash* and Arpit Barman**

Abstract: Two-Pillar solution that aims to address the major challenges in international taxation and promote tax cooperation has received mixed response from the countries. In particular, varying policy interests of countries and complexities in implementation especially concerning revenue allocation and thresholds for multinational entities remain contentious. This paper attempts to capture the nuances relating to adoption of Two-Pillar solution as a framework by countries and the specific concerns with respect to its implementation. As BRICS countries are the leading emerging market and developing economies, the paper focuses on the issues relating to adoption and implementation of Two-Pillar solution in BRICS countries. Our analysis of the literature on the subject highlights both the benefits and limitations of the Two-Pillar solution, and lists some of the reform fields such as reducing the revenue threshold for in-scope entities, increasing residual profit reallocation, among others.

***Keywords*:** International Taxation, Two-Pillar Solution, BRICS, Tax avoidance, Base Erosion

Background

Digital transformation spurs innovation generates efficiency and improves service delivery while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change brings challenges in many policy areas, including taxation. The International Taxation framework of 1920s endorsed by the Financial Committee of the League of Nations, which is still referred, is unfit in today's era of digitalisation and globalisation. The use of this 100-year-old

* Associate Professor, RIS, Email: pdash@ris.org.in

** Research Assistant, RIS, Email: arpit.barman@ris.org.in

Previous version of this paper was presented at BRICS Think Tank Network for Finance conference in Moscow on 9th October 2024. The authors are grateful to Professor Sachin Chaturvedi, Director General, RIS for his support and encouragement. The author would like to thank the publication team at RIS. Views expressed are personal.

framework for determining where profits are to be taxed were suitable for goods mostly being traded physically, when international trade had relatively less share of GDP and global value chains were not complex (Nersesyan 2021). Unlike those days, in present global economic scenario two major problems arise relating to the existing international tax rules: firstly, profits of a foreign company can only be taxed in another country where it has a physical presence and secondly, most countries only tax domestic business income of Multinational Enterprises (MNEs), but not foreign income under the assumption that foreign business profits will be taxed where they are earned. This gives companies an opportunity to shift tax bases to jurisdictions (tax haven countries) which impose little to no tax and thus avoiding taxes (OECD 2021).

OECD estimates that corporate tax avoidance costs range between US$100-240 billion annually or 4-10 per cent of global corporate income tax revenues with developing countries being disproportionately affected.[1] In fact, the cost of tax avoidance almost equates to US$100 billion commitment of climate financing by the developed countries to developing countries annually under COP15 as reiterated by the Paris Agreement. Post-COVID-19, the world has been grappling with geopolitical challenges, sustaining livelihood, economic recovery, uneven growth across countries, growing inequality and unequal debt burden. In addition, many developing countries are facing financing gaps for achieving SDGs. In view of this financial constraint, leakages of financial resources via tax evasion, tax avoidance and illicit financial flows would be detrimental to sustainable development of countries. As of 2024, only 16 per cent of countries are on track to achieve SDGs by 2030 with an alarming 84 per cent of countries showing limited, even reversal in SDGs progress (Sachs, Lafortune and Fuller 2024). Notably, US$2.5-4 trillion would be required to close the financing and investment gaps (DESA-FSDO 2024).

Tax revenue remains a critical and sustainable source for the governments to fund various development programmes. In fact, predictable trend of tax revenues brings certainty to policy decisions and reduces the reliance on international assistance and contributes to

debt repayment, enhancing resilience to external shocks. While it is desirable to have higher tax revenue, tax collection rate in developing countries has been low, hovering between 15 to 20 per cent of GDP; compared to an average of 34 per cent in OECD countries in 2023. This pattern of tax collection falls short of the levels required to provide basic services and invest in SDG targets like poverty eradication, climate action, and environmental protection (UNDP 2024). As public finances continue to remain strained after the pandemic, there is an urgent need for international cooperation to ensure that the world's largest and most profitable MNEs pay their fair share of tax in the market jurisdictions where their customers are located.

Reforming the international tax system to address the challenges arising from the digitalisation of the economy and restoring stability in international taxation has been the core priorities for the international community. On this front, as part of OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS)[2] has devised a Two-Pillar Solution where Pillar One focuses on fairer distribution of profits and reallocation of taxing rights to market jurisdictions (expected to be developing countries), and Pillar Two puts a floor on tax competition on corporate income tax through the introduction of global minimum corporate tax rate. Further, OECD estimates that under Pillar One, taxing rights of US$200 billion of profits could be reallocated to market jurisdictions annually with an annual global tax revenue gain between US$13-36 billion (based on 2021 data). With respect to Pillar Two, the global minimum tax rate of 15 per cent is estimated to generate US$ 220 billion or 9 per cent of global corporate income tax revenues annually.[3] Additionally, stabilisation of international tax system and increased tax certainty for taxpayers and tax administrations are the major benefits that OECD hopes to achieve via the Two-Pillar solution.

Various G20 presidencies have also shown their commitment for the swift implementation of OECD/G20 Two-Pillar international tax package. For instance, the Russian G20 Presidency in 2013 addressed the issues of BEPS, tackling tax avoidance, promoting tax transparency and Automatic Exchange of Information, and facilitated the establishment of G20/OECD

BEPS project. Subsequently, the G20 presidencies of China (2016), Saudi Arabia (2020) and India (2023) continue to emphasize on promoting global cooperation for fair, sustainable and modern international tax system. The Brazilian G20 Presidency in 2024 reiterated the grouping's commitment towards international tax cooperation through the OECD/G20 IF on BEPS as stated in Ministerial Declaration on International Tax Cooperation. Likewise, the BRICS countries have deliberated upon the international taxation at a greater length. In fact, past BRICS chairships have called for tax cooperation and their commitment to minimise leakages due to tax evasion, tax avoidance and illicit financial flows.

Against this backdrop, this paper seeks to examine the problems with current international taxation in view of the rapid pace of digitalisation and consequent growth of digital economy. In particular, it highlights the key features of OECD/G20 Two-Pillar solution for promoting international tax cooperation with specific emphasis on BRICS countries, associated challenges and issues raised in its adoption by developing countries.

Challenges in International Taxation

Taxation has been a contentious policy issue for the countries worldwide for decades resulting in loss of precious resources. Although the severity of tax evasion, tax shifting, inefficiency in tax administration, etc., are known, unfortunately there has been sluggish progress in the international taxation framework in addressing these issues. In other words, the desired pace of reform in international taxation is seriously lacking which, in turn, makes it inadequate and ineffective to deal with the emerging issues.

Among many other issues, jurisdiction of tax often surfaces prominently. When a business venture crosses national borders, the question of where the resulting earnings are taxed arises. In principle, there are three possible methods to allocate taxation rights among multiple jurisdictions: (i) Source country - the country where production takes place; (ii) Residence country - the country where a corporation tends to be located; and (iii) Destination country - the country where actual sales take place. The key role of international tax architecture is to allocate

taxing rights between jurisdictions to prevent potential conflict over taxation of certain activities and under taxation other businesses activities (Nersesyan 2021).

The League of Nations' "1920s compromise" established the basis for the present international taxation system. The "compromise" assigns the primary right to tax active business income to the "source" country, while passive income such as dividends, royalties, and interest to the "residence" country, where the entity or person that receives and ultimately owns the profit resides (Nersesyan 2021). Consequently, when the activities cross borders, certain factors must be considered including where the income should be taxed; the type of income that needs to be taxed (passive versus active); location of the income source; the residences of the parties involved; and most importantly, whether the activity has enough ties to the source country (or "nexus"), among others (Vann 1998).

Before the vast development of Information and Communication Technologies (ICTs), businesses were conducted by the usual "Brick and Motor" shops, factories or similarly physical fixed entity within a country's geographical boundaries. This presence of physical entity is called the "Permanent Establishment", and the concept was institutionalised in 1920s (Kurian 2022). Thus, "1920s deal" overlooked the markets where the goods are consumed, favouring developed economies as production units were mostly established in those countries during the 18th and 19th century industrial revolution. This model of international taxation faced little to no contestation throughout the 20th century with many policy makers deeming corporate tax avoidance as unproblematic or considered the costs of restraining it to be too expensive (Mason 2020).

Although this system continues to remain in practice, it faced its own challenges. One of the challenges faced was rise in double taxation treaties in 20th century due to sovereignty concerns and increased complexities associated with those, averting multilateral solutions in international taxation (Kurian 2022). This led to increase in tax competition leading to erosion of tax base as countries started giving tax incentives to attract capital to boost economic growth. Further, it allowed MNEs to boost the

practise of profit shifting by allocating to low tax jurisdiction or 'Tax Haven'. Johannesen, Thomas and Wier (2020) observe high negative correlation between MNEs tax avoidance and economic development implying the consequences of resource leakage especially for developing countries facing fiscal constraints.

With rapid spread of ICT applications across sectors in the 21st Century, profit shifting by MNEs to tax haven countries becomes easier due to increase in owning of intangible assets (i.e. valuable assets of business which have great mobility), providing opportunities to MNEs to further engage in tax avoidance. Ting and Gray (2019) noticed similar phenomenon of choosing locations for maximising tax avoidance very different from choosing locations with purpose of value creation. Thus, as digital economy continues to grow, more economic activity is going to shift to online platforms. Goods such as books, DVDs and music, which were once purchased as hard copies, are now available in online formats. Advanced digital technologies have greatly boosted cross-border supply of such services. For example, Netflix can streamline movies for its viewers without being physically located in the jurisdictions. Similarly, Airbnb does not need to own real estate to delivery its respective services (Ovonji-Odida, Grondona and Chowdhary 2022).

The inherent problems with international taxation rules coupled with digitalisation has led to huge amount of profit shifting and illicit financial flows to tax haven countries. During 1975-2019, there was a remarkable increase in profit shifted to tax heaven countries, with close to US$1 trillion (40 per cent of MNE profits) in 2019 alone (Wier and Zucman 2022). Also, there are evidences of misalignment between the locations where profits are reported and the location where economic activities occur, although reducing (OECD 2024). Median revenue per employee in investment hubs[4] are US$1,638,000 whereas in high-, middle- and low-income jurisdictions the same are US$ 504,000, US$ 210,000 and US$ 226,000 respectively. MNEs also report high share of profits (18 per cent), compared to share of employees (4 per cent) and tangible asset (12 per cent) in investment hubs. It is important to note that a variety of factors can be driving these figures, notably given the

significant economic turbulence in recent years due to pandemic but strongly indicate the incidence of BEPS behaviour (OECD 2024).

Two-Pillar Solution

The Two-Pillar solution developed by the OECD/G20 IF seeks to provide solution to the issues of taxation of highly globalised economy, particularly digital economy.[5] This framework often referred to as BEPS 2.0, consists of two distinct but interrelated pillars/components: Pillar One and Pillar Two. Pillar One seeks to ensure that a fair share of profits and taxing rights is allocated to market jurisdictions where MNEs generate revenue, regardless of their physical presence. Pillar Two aims to ensure that MNEs pay a minimum level of tax on their income thereby preventing profit shifting to low-tax jurisdictions. The key features of Two-Pillar solution are presented in Table 1.

The Two-Pillar solution represents a significant shift in international tax policies, particularly how profits are allocated and taxed in the context of digital economy. By reassigning taxing rights to market jurisdictions and introducing a global minimum tax, the OECD/ G20 IF aims to create a more equitable and stable international tax framework that addresses the challenges posed by digitalisation and profit shifting.

As per the outcome statement on the Two-Pillar Solution by OECD on 11 June 2023, over 50 jurisdictions have taken steps towards implementation of the global minimum tax framework under Pillar Two. However, despite intense negotiations and the extended deadlines of 30 June 2024, the OECD could not achieve consensus on Pillar One. The main hurdles have been geopolitical and economic disagreements among member countries of the OECD/G20 IF.[6] Further, which specific companies should fall under the new taxing rights and whether these rules could potentially discriminate against certain groups of companies, particularly those based in the United States, remained difficult ones. Moreover, disagreements on the technical details of the profit allocation and nexus rules are making it more difficult to reach a consensus agreement. The failure to secure global consensus would have significant implications for the international tax landscape as it leaves gaps in digital

Table 1: Features of Two-Pillar Solution

Pillar One (Reallocation of Taxing Rights)	Pillar Two (Global Minimum Tax)

• **Scope:** Applies to large MNEs with global revenues exceeding €20 billion and profitability above 10 per cent. The threshold may be adjusted to €10 billion based on implementation success (Amount A) post seven years of its implementation.
• **New Nexus Rule:** A special purpose nexus rule allows market jurisdictions to tax MNEs if they derive at least €1 million in revenue from that jurisdiction (or € 250,000 for smaller jurisdictions i.e., jurisdiction having GDP lower than € 40 billion).
• **Profit Allocation:** 25 per cent of the residual profit (defined as profit exceeding 10 per cent of revenue) will be allocated to the market jurisdictions with nexus using a revenue-based allocation key.
• **Revenue Sourcing:** Revenue will be sourced to the end-market jurisdictions where goods or services are consumed.
• **Removal of Digital Services Taxes (DSTs):** Countries are committed to not imposing new DSTs and to remove existing ones in alignment with the implementation of Pillar One.
• **Elimination of double taxation and Tax Certainty:** Double taxation of profits allocated to market jurisdictions will be relived using either the exemption or credit method. In scope MNEs will be benefit from dispute prevention and resolution mechanisms which will avoid double taxation for Amount A, including all issues related to Amount A (e.g. transfer pricing and business profits disputes).
	• **Global Anti-Base Erosion (GloBE) Rules:** These rules consist of two main components:
	    • **Income Inclusion Rule (IIR):** Imposes a top-up tax on the parent entity for low-tax income of its subsidiaries.
	    • **Undertaxed Payment Rule (UTPR):** Denies deductions or requires adjustments for payments made to low-taxed entities.
	• **Minimum Tax Rate:** A minimum effective tax rate of 15 per cent applies to MNEs with consolidated revenues exceeding €750 million. If an MNE's Effective Tax Rate (ETR) in any jurisdiction is below this threshold, it must pay a top-up tax to make up the difference.
	• **Subject to Tax Rule (STTR):** This rule allows source jurisdictions to impose limited taxation on certain high risk deductible payments such as (interest, dividends, royalties etc.) that are taxed below the minimum rate of 9 per cent.
	• **Implementation:** The GloBE rules are designed to be adopted by jurisdictions in a coordinated manner, allowing for flexibility in domestic law while ensuring consistency in outcomes.

Source: Author Compilation from (OECD 2021).

taxation regulation and creates an uncertain environment for MNEs operating in multiple jurisdictions.

Two-Pillar Solution in BRICS Countries

Apart from Ethiopia and Iran, all the other eight member countries of BRICS are member of the OECD/ G20 IF on BEPS as of 28th May 2024. As of 9 June 2023, all the BRICS countries that are part of OECD/G20 IF have agreed to 8th October 2021 Statement on Two-Pillar Solution. The ongoing work of OECD/ G20 IF is led by 24 Steering Group members. The original BRICS members are part of the steering group. China is the Deputy Chair with other four countries (Brazil, India, Russia and South Africa) being the BEPS associates. On 12 July 2023, the OECD published a Press Release and Outcome Statement following the 15th plenary meeting of the IF, which took place in Paris on 10-11 July 2023, and on 17 July 2023 a package of documents included: (i) agreed text for the Pillar Two STTR; (ii) the contents required in the Pillar Two GloBE Information Return; and (iii) further Pillar Two GloBE Administrative Guidance.[7] Among the BRICS members that are part of Two-Pillar jurisdictions, Russia has not approved the statement. South Africa and the UAE were the only BRICS members that have provided pathways towards implementation of Pillar Two solution.

South Africa in February 2024 Budget announced Pillar Two rules, in the form of an Income Inclusion Rule (IIR) and Domestic Minimum Top-up Tax (DMTT), which will come into force in South Africa for fiscal years starting on or after 1 January 2024.[8] The IIR applies to MNE's headquartered in South Africa with a consolidated turnover exceeding €750 million (approximately R15.3 billion). The top-up tax is payable to the South African Revenue Service (SARS) rather than the jurisdiction where the low tax rate applies, ensuring that South Africa retains tax revenue from its MNEs. DMTT complements the IIR by ensuring that MNEs operating in South Africa pay a minimum effective tax rate on their South African profits. The introduction of the DMTT is expected to secure additional tax revenue for South Africa, as it prevents the loss of potential tax revenue that would otherwise be collected under the IIR

in the parent company's jurisdiction. However, first tax returns under this framework would only be due by 30 June 2026 allowing time for businesses to adapt to the new regulations. The South Africa Budget 2024 also included an estimated revenue of R8 billion from the proposals in 2026-27 fiscal year, although no estimation details were provided and likely to be insignificant compared to total budget tax revenue.[9]

Ministry of Finance (MoF) of UAE announced that the Pillar Two rules will not be implemented in 2024. The MoF on 15th March 2024 launched a digital public consultation on the Pillar Two rules based on the OECD Model Rules. The goal of this consultation was to gather the views of stakeholders with respect to the potential policy design options to respond to the implementation of the GloBE Rules.[10] Qualified Domestic Minimum Top Up Tax (QDMTT) will be introduced in 2025.[11]

It is important to note that the effective average tax rate is between 18.59 per cent (Saudi Arabia) and 32.53 per cent (Brazil) which is higher than the global minimum tax rate of 15 per cent as mentioned under Pillar Two statement (OECD 2024). Thus, it is possible that implementation of Pillar Two among the BRICS countries may not generate additional tax revenue or altogether reduce the Corporate Income Tax (CIT) revenue compared to previous periods.

Table 2: Implementation Status of Pillar Two for BRICS countries

Country	Member of OECD/G20 IF on BEPS	Steering Group Member? If yes, role?	Pillar Two Status
Brazil	Yes	Yes, BEPS Associate	Draft Bill of Law for Income tax reform intended to be presented by 2025.
Russia	Yes	Yes, BEPS Associate	No public announcement for its implementation.
India	Yes	Yes, BEPS Associate	Announcement of a panel to be formed.
China	Yes	Yes, Deputy Chair	No public announcement for its implementation.

Continued...

Continued...

South Africa	Yes	Yes, BEPS Associate	Draft Legislation published on 21 Feb 2024 on draft GMT Bill and draft GMT administration Bill for public comment
UAE	Yes	No	MoF released GMT Public Consultation on March 15, 2024 to gather views of stakeholders w.r.t the potential policy design options for GloBE Rule implementation
Saudi Arabia	Yes	No	Pillar Two plan announced, however no date of draft legislation provided yet.
Egypt	Yes	No	No public announcement for its implementation.
Ethiopia	No	No	No public announcement for its implementation.
Iran	No	No	No public announcement for its implementation

Source: Compiled form Various Sources.

Challenges in Two-Pillar Solution Adoption

It is reasonably clear that not all countries are in consensus with Two-Pillar solution. Around 50 jurisdictions have shown commitment towards Pillar Two implementation, including three countries of BRICS (Brazil, South Africa, and UAE) have made public announcements of implementing Pillar Two. Some of the major observations are as follows:

- From the historical perspective, the negotiations and terms of international tax system has always been dictated by the developed economies. The OECD/G20 IF is no different. Once the OECD's harmful tax practices transformed into the OECD BEPS project in 2013, the EU started to exert its influence more effectively than before (Kurian 2022).

- Lower Middle-Income Countries (LMICs) have expressed frustration and concern about various inequities embedded in the OECD/ G20 IF deal leading to non-signing by Sri Lanka, Kenya, Nigeria and Pakistan. In fact, developing countries have been under constant pressure to sign the deal like in the case of Namibia which got blacklisted by EU from 2016 to 2018 as non-cooperative territory for tax purposes because it did not heed to the OECD guidelines (Kurian 2022).

- Double Edge sword by High Income Countries (HICs) as (i) failure of providing low cost, sufficient and sustainable financing to developing countries. In 2023, apart from five developed countries[12] meeting the ODA target of 0.7 per cent set by UN General Assembly (UNGA) in 1970, most of them fece short; (ii) Failure to cooperate with developing countries as the current Two-Pillar Solution greatly benefits the G7 and wealthier countries.

- There has been a failure by high-income countries to live up to their collective promises to double Domestic Resource Management (DRM) funding, while at the same time refusing to use the IF deal to close global loopholes in ways that meaningfully benefit DRM in the Global South.

Building on these discussions, we have further identified the issues based on 8th October 2021 Statement on Two-Pillar Solution on taxing the digital economy by OECD (see Table 3)

Table 3: Concerns Raised by Countries on Two-Pillar Solution

Pillar	Statement/Rule	Issues	Group/Country Raised Concern
One	Scope: applies to large MNE having more than €20 billion euros in average worldwide revenues and having profit before tax of at least 10 per cent.	• Too high a threshold to include many large taxpayers especially in LMICs. • African Tax Administration Forum (ATAF) calls for lowering the threshold.	Oxfam study on impact assessment of pillar one suggests that lowering the IF's overall revenue threshold from from €20 billion to €10 billion would double the revenue for Kenya, Nigeria, Argentina, and Mexico alone. (Jacobs 2022)
One	Countries should commit to not impose new Digital Service Taxes (DSTs) and to remove existing ones in order to align with the implementation of Pillar One.	Uncertainty around mandatory removal of DSTs which would increase CIT revenue	• For example, in Kenya, only 11 MNEs would meet the pillar one requirement, however there are currently 89 MNEs in Kenya that are subject to its current 1.5 per cent DST.[13] • Similarly in Nigeria, according to its federal inland revenue service, only six MNEs would be covered under pillar one in the €20 billion threshold.[14] • G24 referred to an IMF 2021 study on Digitalisation and Taxation in Asia, which showed that many countries may lose revenue under current pillar one structure. IMF estimates that with residual profit allocation, Vietnam could lose about 0.11 per cent of GDP due to profit reallocation of Japanese MNEs. In fact, it was noted that "high-income countries such as Australia, Japan, and Korea, as well as large markets such as China, gain revenue".

Continued...

Continued...

One	Rate of residual profits allocation i.e. 25 per cent of residual profits (defined as profit exceeding 10 per cent of revenue)	Less residual profits available for reallocation to end-market jurisdiction according to G24 and ATAF.	• G24 argued that less than 30 per cent of residual profit would not result in meaningful revenue. ATAF are demanding for minimum 35 per cent. According to Oxfam, at 30 per cent rate, limited gains for LMICs, earning additional revenue of $10 million per country with some countries generating only an additional $1 million per year. At 35 per cent, LMICs will generate significantly higher gain at $857 million per annum. • LMICs also criticising the definition of "routine profits" (10 percent of pre-tax profit) versus non-routine profits (all profit beyond an initial 10 percent), which protects the first 10 percent of corporate profits from being reallocated. • According to Oxfam, share of 20 per cent residual profit rate will lead to revenue loss for LMICs, possible losing of $230 million for poorer countries.
One and Two	Long lock-in period with limited window to review OECD/IFs statements.	As stated in statement, there is long lock in period and minimal scope of review	• The only aspect for pillar one which will be reviewed in seven years is the in scope MNEs expected threshold from €20 billion to €10 billion. • G24 demanded review of quantum of Amount A be at least 30 per cent and proposed a "profit escalator" mechanism where the greater the profit, the larger is the reallocation. However, the demand was ignored and has been removed from the scope of review.

Continued...

Continued...

Two	In Scope MNEs to be subject to the GloBE tax, they must meet a revenue threshold of €750 million or more.	Threshold is very high	• LMICs like Nigeria have shown their concern regarding € 750 million and have mentioned that the threshold of € 500 million will capture larger MNEs in their jurisdiction. (Devereux and Simmler 2021)
Two	The Global Minimum corporate tax rate of 15 per cent	Far lower than average existing rates in LMICs. In fact, some developed countries are reluctant to move forward on global minimum tax.	• Within the EU, there are several smaller low-tax countries like Estonia, Poland, and Hungary that are reluctant to move forward with a global minimum tax unless the EU places equal priority on advancing digital taxation reforms (pillar one and on a slower track). (McCarthy 2022) • In 2021, according to KPMG, the global average statutory corporate tax rate was 24 per cent. Also, for LMICs that heavily depend on higher corporate income tax rates for their source of revenue, it is a matter of concern. • ATAF had pushed for a minimum global corporate tax rate of 20 per cent, as African countries have an average corporate tax rate of 27.5 per cent.[15] • Another side is that developing countries may lose their right to attract foreign investments by giving up tax incentives, as these countries often have huge capacity constraints. Rwanda in the recent past has expanded its tax regime to include a preferential corporate income tax rate of 0 per cent for international companies. (Kurian 2022)

Continued...

Continued...

Two	Income Inclusion Rule (IIR) under GloBE which imposes a top-up tax on the parent entity for low-tax income of its subsidiaries (where tax benefits will accrue)	Additional tax revenue will largely go to high-income countries	• ATAF and other LMICs had advocated for flipping the order of priority so that source countries, rather than home countries, of MNEs were the first to benefit from any "under taxation" relative to the new global minimum (they demand the Undertaxed Profit Rule (UTPR) be given priority over IIR). However, IIR has been given priority. According to ATAF, it will only perpetuate the current imbalance in the allocation of taxing rights between residence and source countries.[16] • According to the Tax Justice Network, the current formula would provide G7 countries—home to only 10 per cent of the world's population—with 60 per cent of the new tax revenue generated under Pillar Two. Lowest-income countries and jurisdictions would only take home around three per cent of new tax revenues.[17] • In a nutshell, the "first claim" on taxing undertaxed income would be given to headquarter jurisdictions, which are mainly developed countries. Only if they refuse does source jurisdiction get the chance, which is highly unlikely. (Ovonji-Odida, Grondona and Chowdhary 2022)

Continued...

Continued...

One and Two	Lack of transparency and inclusion in the IF process.	Inability to assess or address the real potential revenue impacts of the deal on LMICs.	• Overall, there is great frustration in many LMICs and within civil societies that global tax governance continues to effectively remain in the domain of the OECD, instead of taking place within a universal, intergovernmental UN tax commission and/or via a formal UN Tax Convention. • Most of the African countries (52 per cent) and least developed countries (78 per cent) have not joined the framework till date, and those that have express deep concerns about the ability to meaningfully influence and engage on par with their high-income country counterparts.

Continued...

Continued...

One and Two	Mandatory arbitration of tax dispute (Dispute Resolution)	Track record of disadvantaging LMICs and favoring MNEs and high-income countries.	• The deal will lead to mandatory binding dispute resolution mechanism, which may put sovereign tax dispute in the hands of ad hoc international arbitrators (countries implemented include Argentina, Bolivia, Venezuela, Ecuador and Nigeria)[18] • Beyond well-known concerns about independence, impartiality, and representativeness among arbitrators, international arbitration procedures are typically conducted in secrecy. (Ovonji-Odida, Grondona and Chowdhary 2022) • Also, arbitration is often time consuming and expensive, which LMICs tax authorities will have to shift crucial resources from other development to dispute against top 100 MNEs which have huge resources. Thus, there exist a huge gap in capabilities in arbitration resources between developing countries and developed countries. • However, ATAF and African countries have succeeded in this dispute resolution mechanism being elective for most African countries, whereby the African country will only undergo the binding dispute resolution process if it elects to do so.[19]

Source: Author's Compilation from various sources.

Summary and Conclusion

Developing countries, especially the low-income countries, are facing multiple economic challenges such as rapid inflation, food insecurity, mounting debt, and geopolitical uncertainty. IMF estimates that low-income countries need an additional US$440 billion of financing through 2026 to put them back on a growth trajectory that converge with the advanced economies.[20] Robust tax collection can help countries mobilise resources for domestic financing. The OECD/G20 IF deal can be deemed a once-in-a-generation reform to increase domestic resource management for LMICs. The process began in 2013, but the final deal represents the lowest possible outcome for most of the jurisdictions. Not achieving consensus in the adoption of Pillar One among member jurisdictions and just over 50 jurisdictions planning to implement Pillar Two does not provide a healthy regime. As highlighted previously, the Pillar Two disproportionately benefits developed countries, as most in-Scope MNEs headquarters are in developed countries and OECD countries have better negotiation power in international tax matters.

The BRICS, comprising leading emerging markets and developing economies, accounting for nearly half of the world's population (46 per cent as of 2022), should provide a solution for Pillar Two, aligning with other developing countries priorities. In fact, IMF expects that the gap between G7 and BRICS is set to widen further due to robust economic growth, forecasting BRICS will account for 37.6 per cent of World GDP in PPP compared to G7 (28.2 per cent).[21]Thus, the BRICS (specifically BRICS tax heads) and ATAF should cooperate and provide alternative amendments or solutions to the Two-Pillar Solution for driving a better future deal in the realm of international taxation.

Some measures that should be considered for smoother adaptation for Two-Pillar Solution, especially for developing countries, are as follows

Sign Pillar One post amendments or else look for other international mechanisms to capture and redistribute revenues for development

Pillar One can work for developing countries if developed countries agree to give up their taxing rights and redistribute revenues to developing countries. As discussed, various impact assessments

reports suggest that profit reallocation with removal of DSTs may hurt developing countries resources further. Some of the amendments can be: (i) to reduce the In-Scope MNEs from €20 billion to €10 billion as suggested by Nigeria, (ii) increase the rate of residual profits by 35 per cent at least as suggested by Oxfam, (iii) increase the conditions that can be reviewed post seven years, (iv) allow developing countries to have certain unilateral measures for out-of-scope MNEs (like DSTs or equivalisation levy), and (v) Broaden the in-scope MNEs to include regulated financial services that are out of scope.

Comprehensive Review and appropriate impact assessment of Pillar Two

Developing countries need to call for a pragmatic approach of having a comprehensive review mechanism, as presently Pillar Two does not have review mechanisms. Countries that are yet to join Pillar Two need to put forward their condition of having a review mechanism in place before signing. As the Global South are emerging as key dominant market for the Global North MNEs, they can leverage this position to negotiate to meet these crucial key demands necessary for domestic resource management.

Although in 2023, the Effective Tax Rate (ETR) fell by one percentage point compared to the previous year, the average ETR across 90 jurisdictions remains to be 20.2 per cent which is 5 percentage points higher than what the global effective minimum tax rate is envisaged to be (OECD 2024). The global effective minimum tax rate should be revised to at least 20 per cent, allowing flexibility to lower and retain tax revenue share by LMICs to capture key economic markets and to move towards a convergent path of economic development.

A clear and comprehensive cost-benefit analysis that assesses revenue gain from other international taxation mechanisms, such as Article 12B of the UN Model Tax Convention and unilateral measures such as DSTs, may be undertaken. The assessment should account for different levels of residual profits (20 per cent, 25 per cent, 30 per cent and 35 per cent), consider in scope MNEs at different levels for both Amount A and Amount B, take different levels of minimum ETRs, and provide country wise cost-benefit analysis.

Shift the negotiation from OECD to UN[22]

For the sake of harmonising the international tax rule making system and to bring all countries to the same table, served by a neutral secretariat, it is essential that the longstanding G77 demand for a UN intergovernmental tax body be implemented. This will allow to reduce the influence exerted by OECD countries on reviewing the existing mechanisms in international taxation.

Endnotes

1 OECD (https://www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html)

2 OECD/ G20 IF on BEPS relates to tax planning strategies that MNEs use to exploit loopholes in tax rules to artificially shift profits to low or no-tax location as a way to avoid paying taxes

3 See OECD (2023)

4 Jurisdictions that attract an above-average share of global investments are referred to as 'investment hubs' i.e. countries whose FDI stock exceeds 150% of GDP.

5 See OECD (2021)

6 See Denton (2024)

7 See 11 July 2023 outcome statement on Two Pillar solution. (https://www.oecd.org/tax/beps/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.pdf)

8 Refer PWC Pillar Two country tracker (https://www.pwc.com/gx/en/services/tax/pillar-two-readiness/country-tracker.html)

9 See Warneke (2024)

10 See wts global, Pillar Two - Implementation Status Worldwide (https://wts.com/global/hot-topics/pillar-two/pillar-two-implementation-status-worldwide)

11 UAE together with the OECD hosted a Pillar Two Regional Forum where it was confirmed that the UAE won't implement Pillar Two rules in 2024. Instead, a QDMTT might be introduced.

12 These are Norway (1.09%), Luxembourg (0.99%), Sweden (0.91%), Germany (0.79%) and Denmark (0.74%). On average, DAC members only reached 0.37% GNI. The US, Japan and the UK recorded the largest increases in absolute terms. (Refer, https://devinit.org/what-we-do/news/new-aid-data-highlights-ongoing-global-challenges/)

13 Why Kenya and Nigeria haven't agreed to global corporate tax deal. (https://qz.com/africa/2082754/why-kenya-and-nigeria-havent-agreed-to-global-corporate-tax-deal)

[14] ibid.

[15] See Ndajiwo and Nyamudzanga (2021)

[16] ATAF communication (12 July 2023) on OECD OECD/G20 Inclusive Framework Releases Outcome Statement on the Two-Pillar Solution – What Does this Mean for Africa? (https://www.ataftax.org/oecd-g20-inclusive-framework-releases-outcome-statement-on-the-two-pillar-solution-what-does-this-mean-for-africa)

[17] See Cobham (2021)

[18] Refer Malamis and Cai (2021)

[19] Supra, pt 16.

[20] See IMF (2023)

[21] Refer Afota, et al. (2024)

[22] Progress has been made in this effort. The latest 16th BRICS summit 2024 (Kazan Declaration) welcome the UN General Assembly resolution 78/230 on Promotion of inclusive and effective international tax cooperation at the United Nations. BRICS (2024)

References

Afota, Amandine , Valentin Burban, Pavel Diev, Fabio Grieco, Théo Iberrakene, Karine Ishii, Margarita Lopez Forero, Quentin Paul, Frank Sammeth, and Cécile Valadier. 2024. "Expansion of BRICS: what are the potential consequences for the global economy?" *Banque de France Bulletin.*

BRICS. 2024. "Kazan Declaration." *16th BRICS Summit. Moscow*.

Cobham, A. 2021. "Is Today a Turning Point Against Corporate Tax Abuse?" *Tax Justice* 4.

Denton. 2024. "Pillar One deadline has passed: new Digital Services Taxes on the horizon?" https://www.dentons.com/en/insights/alerts/2024/july/8/pillar-one-deadline-has-passed-new-digital-services-taxes-on-the-horizon#:~:text=on%20the%20horizon-,Pillar%20One%20deadline%20has%20passed%3A%20new,Services%20Taxes%20on%20the%20horizon%3F&text=The%2.

DESA-FSDO. 2024. *Financing for Sustainable Development Report 2024*. UNDESA, 221.

Devereux, Michael P, and Martin Simmler. 2021. Who will pay Amount A? EconPol Policy Brief. https://oxfordtax.sbs.ox.ac.uk/article/who-will-pay-amount-a. .

IMF. 2023. "How Financing Can Boost Low-Income Countries' Resilience to Shocks." *IMF Blog*. https://www.imf.org/en/Blogs/Articles/2023/06/14/how-financing-can-boost-low-income-countries-resilience-to-shocks.

Jacobs, Didier. 2022. "The effect of the OECD's Pillar 1 proposal on developing countries-An impact assessment." *Oxfam America*.

Johannesen, Niels, Thomas T{\o}rsl{\o}v, and Ludvig Wier. 2020. "Are less developed countries more exposed to multinational tax avoidance? Method and evidence

from micro-data." *The World Bank Economic Review* (Oxford University Press) 34: 790-809.

Kurian, A. 2022. "The evolution of international tax regime and OECD two-pillar solution: Analysis from a developing country perspective." *Journal of Economics issues* 61-71. doi:https://doi.org/10.56388/ei220808.

Malamis, Spyridon E, and Qiang Cai. 2021. "International Tax Dispute Resolution in Light of Pillar One: New Challenges and Opportunities." *Bulletin for International Taxation* (International Bureau of Fiscal Documentation (IBFD)) 75: 94-107.

Mason, R. 2020. "The Transformation of International Tax." *American Journal of International Law*.

McCarthy, Julie. 2022. "A bad deal for development: Assessing the impacts of the new inclusive framework tax deal on low-and middle-income countries." BROOKINGS GLOBAL *Working Paper*. https://www.brookings.edu/articles/a-bad-deal-for-development-assessing-the-impacts-of-the-new-inclusive-framework-tax-deal-on-low-and-middle-income-countries/.

Ndajiwo, Mustapha, and Learnmore Nyamudzanga. 2021. "What Does the G7 Proposal on Taxation of the Digitalised Economy Mean for African Countries?" APRI.

Nersesyan, Narine. 2021. "The current international tax architecture: A short primer." *Corporate Income Taxes under Pressure* (IMF) 23.

OECD. 2024. *Corporate Tax Statistics*. Paris: OECD Publishing. doi:https://doi.org/10.1787/9c27d6e8-en.

OECD. 2023. "Revenue impact of international tax reform better than expected: OECD." OECD. https://www.oecd.org/en/about/news/press-releases/2023/01/revenue-impact-of-international-tax-reform-better-than-expected.html.

OECD. 2021. *Two-Pillar Solution ot Address the Tax Challenges Arising from the Digitalisation of the Economy*. OECD.

Ovonji-Odida, Irene, Veronica Grondona, and Abdul Muheet Chowdhary. 2022. "Two Pillar solution for taxing the digitalized economy: Policy implications and guidance for the Global South." *South Centre Research Paper*.

Sachs, Jeffrey D., Guillaume Lafortune, and Grayson Fuller. 2024. *Sustainable Development Report*. United Nation.

Ting, Antony, and Sidney J Gray. 2019. "The rise of the digital economy: Rethinking the taxation of multinational enterprises." Journal of International Business Studies (Springer) 50: 1656-1667.

UNDP. 2024. *Tax for Sustainable Development Goals Initiative*. United Nation.

Vann, Richard. 1998. "International Aspects of Income Tax." In *In Tax Law Design and Drafting,* by Victor Thuronyi, 718-810. Washington, DC: International Monetary Fund.

Warneke, David. 2024. *GloBE Pillar 2 rules to be implemented in South Africa*. 4 April. https://www.bdo.co.za/en-za/insights/2024/tax/globe-pillar-2-rules-to-be-implemented-in-south-africa.

Wier, Ludvig, and Gabriel Zucman. 2022. *Global profit shifting*, 1975–2019. Helsinki: UNU-WIDER. doi:https://doi.org/10.35188/UNU-WIDER/2022/254-6.

RIS Discussion Papers

Available at: http://www.ris.org.in/dicussion-paper

DP#298-2024 *Insolvency Laws and International Trade: A Perspective* by Amol Baxi

DP#297-2024 *Sittwe in Myanmar: Partnering for Clean and Green Energy* by Sujeet Samaddar

DP#296-2024 *AI Ethics for the Global South: Perspectives, Practicalities, and India's role* by Anupama Vijayakumar

DP#295-2024 *Seafarer's Well Being and Mitigation of Challenges in the Ecosystem* by Chander Shekhar

DP#294-2024 *India's Experience in Insolvency Laws: Learnings for the Global South* by Amol Baxi

DP#293-2024 *Equitable Development Transformation with Technology: Relevance of the Indian Experience for Global South* by Sachin Chaturvedi

DP#292-2024 *Trade and Environment: Tracking Environmental Provisions in Regional Trading Agreements (RTAs) to Make Appropriate Indian Stance* By Anshuman Gupta

DP#291-2024 *India's G20 Presidency as a Voice of Global South* by Sushil Kumar

DP#290-2024 *Analyzing India-Nepal Economic Integration: Status,Challenges and Way Forward* by Pankaj Vashisht

DP#289-2024 *SDG Gaps and Technology Needs in Developing Countries: Scope for Locally Agile Technology Ecosystems* by Sabyasachi Saha

DP#288-2023 *India's G20 Presidency as a Voice of Global South* by Sushil Kumar

DP#287-2023 *SDG Targets 2.2 and 4.2 Early Childhood Nutrition and Education: Bedrock of Life-long Equity by* Pramod Kumar Anand Krishna Kumar

DP#286-2023 *Financial Literacy across Different States of India: An Empirical Analysis by* Priyadarshi Dash & Rahul Ranjan

RIS A Think-Tank of Developing Countries

Research and Information System for Developing Countries (RIS) is a New Delhi-based autonomous policy research institute that specialises in issues related to international economic development, trade, investment and technology. RIS is envisioned as a forum for fostering effective policy dialogue and capacity-building among developing countries on global and regional economic issues.

The focus of the work programme of RIS is to promote South-South Cooperation and collaborate with developing countries in multilateral negotiations in various forums. RIS is engaged across inter-governmental processes of several regional economic cooperation initiatives. Through its intensive network of think tanks, RIS seeks to strengthen policy coherence on international economic issues and the development partnership canvas.

For more information about RIS and its work programme, please visit its website: www.ris.org.in

Research shaping the development agenda

RIS
Research and Information System for Developing Countries
विकासशील देशों की अनुसंधान एवं सूचना प्रणाली

Core IV-B, Fourth Floor, India Habitat Centre
Lodhi Road, New Delhi-110 003 India., Tel. 91-11-24682177-80
Fax: 91-11-24682173-74, Email: dgoffice@ris.org.in
Website: http://www.ris.org.in

/risindia @RIS_NewDelhi YouTube /RISNewDelhi