



# Globalization, digitalization & tax compliance: The Impact of the Recent OECD Two Pillar Solution on International Tax Compliance & its Impact on Unilateral DST measures.

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**14 DEC 2021.**

# Agenda Dashboard



- Review of the existing international taxation framework
- Weaknesses of the existing international taxation framework
- Unilateral Digital Service Tax (DST) measures
- OECD Two Pillar solution journey/ evolution
- OECD Two Pillar solution salient features
  - Pillar One - Taxation of digital economy
  - Pillar Two - Global minimum tax
- Critique of the OECD Two Pillar solution
- Kenya and Nigeria perspective
- Global perspective

# Review of the existing international tax framework



- Reliance on existence of factors of production in a jurisdiction for tax nexus to be established/ Physical presence
- Separate Entity concept/ principle
- Allocation of MNE profitability through ALP/ Transfer pricing rules

# Weaknesses of the existing intl taxation framework



- Inability to adequately tax digitalized economy due to lack of tax nexus
- New MNE business models negating separate entity principle
- Ineffective transfer pricing framework (ALP) to adequately allocate MNE profitability to market jurisdictions (profit shifting)
- Tax competition among different countries (race to bottom)
- Inability to neutralize effect of hybrid mismatch arrangements (arbitrage opportunities)

# Imposition of unilateral DST



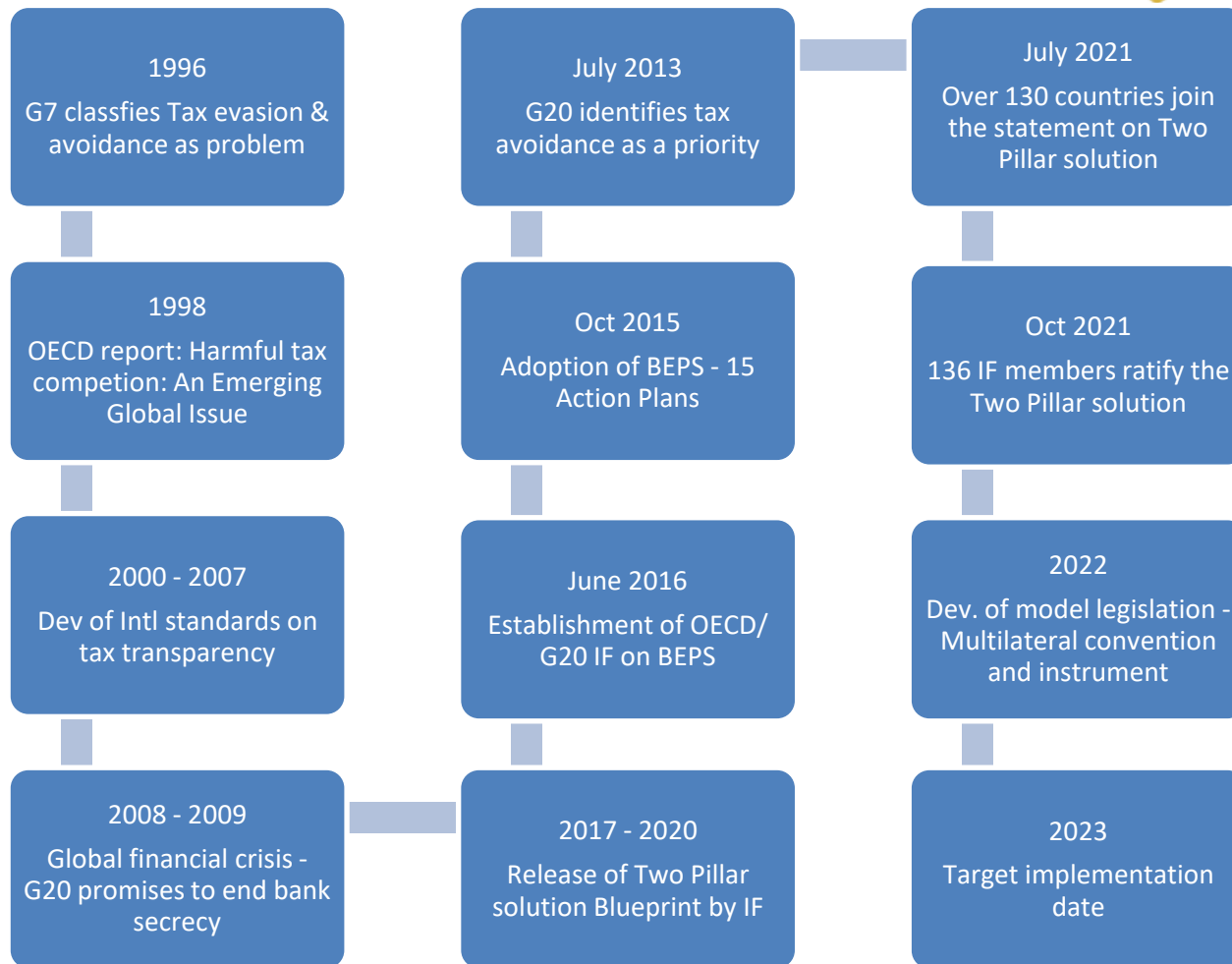
Country	Rate	Threshold	Effective date
France	3%	<ul style="list-style-type: none"><li>• Provision of digital interface</li><li>• Advertising services</li></ul>	1 Jan 2019 (later suspended until Dec 2020 to avoid US tariff retaliatory)
UK	2%	<ul style="list-style-type: none"><li>• Social media platforms</li><li>• Internet search engine</li><li>• Online marketplace</li></ul>	1 April 2020
Austria	5%	Online advertisements with domestic revenue of 25M euros	1 Jan 2020

# Imposition of unilateral DST



Country	Rate	Threshold	Effective date
India	2%	<ul style="list-style-type: none"><li>Digital services that includes e-commerce platforms (Equalization Levy)</li></ul>	March 2016
Nigeria	6% (IT) & 7.5% (VAT)	Significant Economic Presence (SEP)	February 2020
Kenya	1.5% of amount excluding VAT	No threshold	1 Jan 2021

# OECD Two Pillar solution journey/ evolution



# OECD Two Pillar solution salient features



- ❑ 136 out of 140 IF members ratified the agreement
- ❑ Unilateral DST measures to be abolished by 2023
- ❑ Pillar One - Taxation of digital economy (BEPS Action Plan 1)
  - ✓ Re - allocation of taxing rights to market jurisdictions
  - ✓ Establishment of Amount A and B
- ❑ Pillar Two - Global Minimum Tax (BEPS Action Plan 2 - 15)
  - ✓ Establishment of Global Minimum Tax at the rate of 15%

# OECD Pillar 1



## Amount A

- ❑ Deals with MNE's "residual profit for re – allocation to market jurisdictions (20% - 30% of MNE residual profit to be re – allocated to market jurisdictions)
- ❑ Residual profit – MNE's profitability in excess of 10%
- ❑ Taxing rights in excess of USD 125 billion expected to be re-allocated
- ❑ **Qualification criteria:**
- ❑ Global turnover greater than 20 billion Euros with profitability of 10% (revenue threshold to be reviewed downwards to 10 billion Euros in year 2030)
- ❑ For smaller jurisdictions with GDP lower than 40 billion Euros, nexus to be set at 250,000 Euros

# Re-allocation of Amount A



<b>Details</b>	<b>EUR Billion</b>
<b>Total Global MNE revenue (A)</b>	100
<b>PBT (B)</b>	30
<b>Profit/ sales (C )</b>	30%
<b>Profitability Threshold (D)</b>	10%
<b>Excess profitability (E) =C-D</b>	20%
<b>Residual profit re-allocated % (Assume 25%)</b>	25%
<b>Amount re-allocated (25% of 20 billion)</b>	5 billion EUR

# Amount B



- Deals with a fixed return for certain routine marketing and distribution activities to market jurisdictions
- Baseline ALP compensation to related party offering marketing & distribution services on behalf of MNE

# Pillar 2



2:08

**Global Minimum Tax Would 'End the Race to the Bottom,' Yellen Says**

# Pillar 2



**Secretary Janet Yellen**  @SecYellen · Jun 5, 2021



The G7 Finance Ministers have made a significant, unprecedented commitment today that provides tremendous momentum towards achieving a robust global minimum tax at a rate of at least 15%.



**Secretary Janet Yellen**  @SecYellen

That global minimum tax would end the race-to-the-bottom in corporate taxation, and ensure fairness for the middle class and working people in the U.S. and around the world.

2:35 PM · Jun 5, 2021



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# Pillar 2



- Establishes 15% Global Minimum Tax
- Applies to MNE with annual turnover above 750 million Euros
- Expected to generate at least USD 150 billion annually
- Aims to address the rest of BEPS Action Plan challenges
- Income Inclusion Rule (IIR) to tax MNE profit if constituent/ subsidiary is untaxed on some income
- Undertaxed Payment Rule (UTPR) aimed to limit deductions in some instances
- Subject To Tax Rules (STTR) – To allow source countries impose tax on some related party incomes e.g. royalties & interest payment

## Exclusions

- Financial services
- Extractive Industries
- International shipping line

# Critique of OECD Two Pillar solution



- Residual profit may not be sufficient for re - allocation
- Exclusion of MNE's with global turnover below 20 billion Euros
- Exclusion of MNE's with profitability below 10%
- Exclusion of MNE's deriving revenue below 1 million Euros from small market jurisdiction
- Global MT of 15% unlikely to curb profit shifting & tax competition effectively

# Kenya & Nigeria perspective



- Both countries declined ratifying the OECD Two Pillar solution citing weaknesses
- To maintain their form of DST for now until further notice
- Tax sovereignty
- International pressure

# Global perspective



- ❑ Cyprus Finance Minister proposes to increase C.I.T rate from 12.5% to 15%
- ❑ Republic of Ireland proposes to increase C.I.T rate from 12.5% to 15%

# Interactive Session

