A bad deal for development

Assessing the impacts of the new inclusive framework tax deal on low- and middle-income countries

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BROOKINGS GLOBAL
WORKING PAPER #174
MAY 2022

Center for
Sustainable
Development
at BROOKINGS

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MAY 2022
Brookings Global Working Paper #174
Brookings Center for Sustainable Development
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Acknowledgments
The author is deeply grateful to Alex Cobham, Ryan Gurule, Ian Gary, Homi Kharas, and John W. McArthur for their valuable comments.

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I. Overview

In October 2021, G20 leaders finalized a new global tax deal aimed at curbing tax avoidance by large multinational enterprises (MNEs). The deal, brokered by the Organization for Economic Cooperation and Development (OECD) and endorsed by 137 countries and jurisdictions (collectively this group is referred to as the *Inclusive Framework* or *IF*), represents the most significant global tax reform in decades.[1] Among other features, the "IF deal" introduces new taxing rights irrespective of an MNE's physical location, and a new global minimum corporate income tax of 15 percent on the largest MNEs.

The IF deal's primary goal is to prevent MNEs from taking advantage of gaps in international tax regimes that have enabled them to shift profits away from jurisdictions where they actually generate economic value to low or no tax jurisdictions. Multinational tax avoidance costs countries an estimated $500 billion per year, with the greatest relative intensity of losses occurring in low- and middle-income countries (LMICs).[2] Recent research suggests that approximately 40 percent of multinational profits are shifted to tax havens each year, which results in a net loss of around 10 percent of global corporate income tax revenue worldwide.[3] MNE tax avoidance may cost as much as 5-8 percent of GDP annually for LMICs like Guyana, Chad, Guinea, Zambia, and Pakistan, compared to .6-1 percent of GDP in annual losses for higher income countries like Germany and France.[4]

Negotiations over the IF deal took place in the context of a pandemic-driven global recession, which has dramatically reduced economic growth, increased poverty, strained public resources, and reduced the tax base, particularly in LMICs. For LMICs, the burden of pursuing COVID economic recovery comes in addition to navigating the fiscal challenges of climate crisis, a spiraling debt burden, faltering foreign aid, and more recently, inflation. In this context, the IF deal represented a critical opportunity to help

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[1] The IF deal emerged from a broader OECD Base Erosion and Profit Shifting (BEPS) process that initially focused on OECD member countries. Pressure to address LMICs' outsized reliance on corporate income tax and their exclusion from policy discussions led to the creation of the OECD/G20 Inclusive framework (IF), which now involves 141 countries and jurisdictions focused on reforming international and national tax systems to address tax avoidance and enhance tax cooperation.
[2] Alex Cobham and Petr Jansky,"Global distribution of revenue loss from corporate tax avoidance: re-estimation and country results," International Development, March 2018, https://onlinelibrary.wiley.com/doi/full/10.1002/jid.3348. For this paper, low- and middle-income countries (LMICs) refer to the most recent OECD Development Assistance Committee (DAC) list, which for 2022 categorizes low income countries as those with a GNI per capita of $1045 or less in 2020, and middle income as a GNI per capita of between $1,046-$4,095 (lower middle income) and $4096-$12695 (upper middle income), https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/DAC-List-of-ODA-Recipients-for-reporting-2022-23-flows.pdf.
[3]See *https://missingprofits.world*, a collective project to the University of California, Berkeley and University of Copenhagen. Estimates based on "The Missing Profits of Nations "by Thomas Tørsløv, Ludvig Wier and Gabriel Zucman, Updated 2018 estimates.
[4] Ibid Cobham and Jansky.

LMICs generate significant new resources to confront urgent development challenges by addressing the serious revenue drain of MNE tax avoidance. [5]

Unfortunately, that is not how the negotiations unfolded. While G7 countries have celebrated the IF deal as a breakthrough in "ending the race to the bottom in corporate taxation" worldwide, LMICs have expressed frustration and concern about various inequities embedded in this deal, with Kenya, Nigeria, Pakistan, and Sri Lanka refusing to sign on. Despite LMICs suffering disproportionately from multinational corporate tax avoidance, the net result of this largely G7 driven tax reform appears to be that it will overwhelmingly benefit only this handful of wealthy countries. Indeed, by approaching the IF deal as primarily a domestic policy opportunity, the G7 missed one of its most powerful near-term foreign policy tools to support the economic recovery and development in the Global South in the coming years.[6]

The failure of the IF deal to benefit domestic resource mobilization in LMICs is particularly concerning not only given the dire economic situation in these countries, but also in light of high income country promises at the Addis Ababa Action Summit in 2015 to "combat tax evasion as well as tax avoidance" as a means to help LMICs finance the Sustainable Development Goals (SDGs).[7] That 2015 summit gave rise to the *Addis Tax Initiative*, a multistakeholder effort to help LMICs get the financing, technical assistance, and global cooperation they need to strengthen domestic resource mobilization (DRM) and fund social and economic development. The result of that effort to date has been the failure of high-income countries to live up to their collective promises to double 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.[8]

This paper looks at the substance of the recent IF tax deal in terms of its likely impacts on LMICs and finds that there is not much to celebrate outside a handful of wealthy countries. It explores what LMICs had initially hoped to gain from the tax deal and where their asks and expectations ultimately failed to find resonance in the final IF deal. It places the tax deal in the broader context of financing for development trends in LMICs before and during COVID-19, with particular attention to specific commitments made by high-income countries to scale up support for DRM in recent years. Finally, it considers what opportunities exist for LMICs to address their unresolved global tax governance concerns going forward, both within and outside of the IF deal.

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[5] World Bank Press Release, Low-Income Country Debt Rises to Record $860 Billion in 2020, October 2021, https://www.worldbank.org/en/news/press-release/2021/10/11/low-income-country-debt-rises-to-record-860-billion-in-2020.

[6] IMF Blog, Corporate Tax Rates: How Low Can You Go, IMF, July 15, 2019, https://blogs.imf.org/2019/07/15/corporate-tax-rates-how-low-can-you-go/.

[7] Addis Ababa Action Agenda of the Third International Conference on Financing for Development, United Nations, July 2015, https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf.

[8] 2019 ATI Monitoring Report, December 2021, https://www.addistaxinitiative.net/resource/2019-ati-monitoring-report.

II. Overview of the new OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting

In October 2021, the G20/OECD Inclusive Framework's (IF) longstanding efforts to address global tax avoidance through its Base Erosion and Profit Shifting (BEPS) project culminated in the approval of new digital taxation rights and a new global anti-base erosion minimum tax on corporate profits. The IF deal comes on the heels of political outrage in many G7 countries over the challenges of taxing large tech companies like Apple, Facebook, and Google, thanks to longstanding loopholes in global tax rules that have enabled them to shift revenue and profits to low or no-tax countries and jurisdictions.

While global tax governance has long been a concern of G77 countries, it was largely ignored by G7 countries until the 2008 global financial crisis, and the "Panama Papers" tax scandals put tax havens and tax avoidance in the political spotlight. These events led to the G20 and OECD formally launching the BEPS process in 2013 with the core objective of addressing MNE tax avoidance and aggressive tax planning. By 2016, pressure for LMICs to have a seat at the table led the OECD to create the "Inclusive Framework/IF" whereby any interested countries/jurisdictions could collaborate with the OECD and G20 on BEPS efforts.

> *"BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity or to erode tax bases through deductible payments such as interest or royalties. Although some of the schemes used are illegal, most are not. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level."*
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> **OECD BEPS project description**

Prior to the recent IF deal, IF members used the BEPS process to agree on a 15 point action agenda on issues like country-by-country tax reporting, automatic exchange of tax information, clarification of arm's-length pricing rules, and other measures aimed at "improving the coherence of international tax rules and ensuring a more transparent tax environment."[9] This includes the introduction of a multilateral instrument that enables

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[9] OECD BEPS website.

signatory countries and jurisdictions to adopt these BEPS measures wholesale into their domestic legal environment irrespective of existing bilateral tax treaties and agreements. Since 2018 the IF has been exploring how to address the tax challenges posed by digitalization of the global economy, which led to the IF deal on a new collective approach to taxing large MNEs in late 2021.

Endorsed by 137 countries and jurisdictions, **the IF deal has two key pillars**: **Pillar one** establishes new taxing rights over a subset of large multinational companies (including ubiquitous digital giants like Amazon, Google, and Facebook), and **pillar two** establishes the base, rate, and approach for a new global minimum corporate tax (GloBE).[10]

Pillar one

Pillar one establishes the new rules for what level of economic (versus physical) presence in a country is required for an MNE to be subject to taxation, and on what basis taxable profits will be calculated and allocated among eligible jurisdictions. The primary goal of this rule is to address the highly digitalized nature of business in an increasingly digitalized world, where businesses with large customer bases are generating value in places where they have no physical presence. It creates new taxing rights for 25 percent of "residual profits" (profits in excess of 10 percent pre-tax revenues) for end-markets where goods and services are used/consumed. This new taxing right for "end market jurisdictions" is based on a set formula versus the prior arm's-length principle, which is viewed as more prone to abuse.[11] The OECD estimates that under pillar one, more than $125 billion of profit will be reallocated to "end market" countries and jurisdictions each year.[12]

What does this all mean in practice? Pillar one is a major departure from tax rules of the past century, which typically required businesses to have a physical presence in a country for that country to exercise taxation rights. In an increasingly digitized global economy where companies like Amazon, Google, or Alibaba are generating significant revenue (including from the consumer data they collect and sell) in end market countries where they often have no brick-and-mortar presence, pillar one allows these countries to capture a portion of that revenue for themselves.

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[10] OECD/G20 Base Erosion and Profit Shifting Project, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy," October 8, 2021, 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.

[11] The arm's length standard is the traditional approach to pricing transactions within MNEs in order to determine corporate tax payments in the home and source countries where the MNE operates. The standard requires that an MNE determine the price for intra-firm transactions based on the price that two unrelated parties would negotiate if they were engaged in the same/similar transactions under the same circumstances (OECD, 2010). When an MNE prices transactions between related entities using the arm's length principle, it is called the transfer price. The discretion and opacity involved in MNEs setting their own transfer prices presents real risks for abuse, which critics argue that a formula-based approach helps to mitigate. See for example Alexander Ezenagu, "Unitary Taxation of Multinationals: Implications for Sustainable Development," New Thinking on SDGs and International Law—Policy Brief No. 4, Center for International Governance Innovation, November 2019, https://www.cigionline.org/sites/default/files/documents/SDG%20PB%20no.4_0.pdf.

[12] OECD, "Tax Challenges Arising from the Digitalization of the Economy: Economic Impact Assessment, Webinar presentation," October 2020, https://www.oecd.org/tax/beps/economic-impact-assessment webinar-presentation-october-2020.pdf.

This new tax rule applies only to companies with more than 20 billion euro in averaged worldwide revenues and a before-tax profitability margin of at least 10 percent. In other words, if a company earns 20 billion euros in revenues and 3 billion euros in profits, the first 2 billion euros (10 percent of the revenues) are excluded from the rule. Of the remaining 1 billion euros in profits, 250 million (25 percent of the residual) is subject to taxation in end market jurisdictions (using a pre-agreed global reallocation formula). There is an intention to reduce this corporate revenue threshold under pillar one to 10 billion euros after seven years if implementation goes smoothly. Pillar one includes a special purpose rule that requires an MNE to generate at least 1 million euro in revenue for a market jurisdiction to qualify for residual profit reallocation (i.e., have a right to tax). There is a special rule, however, for LMICs with less than 40 billion euro in annual GDP, where the revenue threshold for these jurisdictions goes down to 250,000 euro in annual revenue.

While the scope of entities covered has moved beyond the original focus on digitalized businesses, this rule excludes financial services and extractive industries (e.g., minerals, oil, gas), and is expected to *only apply to around 100 multinationals worldwide*. Importantly, existing digital services taxes and similar measures must be repealed, and new ones banned from introduction, for all countries and jurisdictions that sign up to pillar one. The OECD estimates that under pillar one, more than $125 billion of profit will be reallocated to "end market" countries and jurisdictions each year.[13]

Pillar two

Pillar two establishes a global minimum rate of corporate taxation for MNEs of 15 percent and applies to all MNEs generating at least 750 million euro in consolidated revenues per annum. The OECD estimates that under pillar two, the GloBE tax will generate an additional $150 billion per annum in global tax revenues.[14] This global minimum tax works by allowing the headquarter country of MNEs to take the first cut at imposing a "top-up" tax on low-taxed income of constituent entities on a country-by-country basis. This is called the "income inclusion rule" or IIR and gives priority to the "top up" tax being paid at the level of the parent entity.[15] For example, imagine that parent company X books most of its profits in Barbados, with a current corporate income tax rate of 5.5 percent, while Company X's headquarters is located in the U.S. Under certain terms and conditions in pillar two, the U.S. has the right to demand a "top up" tax payment of 9.5 percent from Company X, so that Company X ultimately pays at total minimum effective tax rate of 15 percent. The IIR is meant to get at one of the most common and notorious forms of large MNE tax avoidance, as exemplified by Apple. In 2014, Apple booked most of its profits in the low tax jurisdiction of Ireland, which at the time had a corporate income tax rate of 12.5 percent. Apple then used additional tax loopholes in Ireland to avoid paying most of those taxes, and as a result, in 2014 had an effective European tax rate of 0.005 percent. The European Commission demanded that

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[13] OECD, "Tax Challenges Arising from the Digitalization of the Economy: Economic Impact Assessment, Webinar presentation," October 2020, https://www.oecd.org/tax/beps/economic-impact-assessment-webinar-presentation-october-2020.pdf.

[14] Ibid, OECD Economic Impact Assessment.

[15] OECD Explainer, "The Pillar Two Rules in a Nutshell," https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf.

Apple pay 13 billion euro in unpaid taxes, but based on the global tax rules at the time, the European General Court overturned the ruling in favor of Apple (and Ireland).

Pillar two also includes an "undertaxed payment rule" or UTPR, which limits the amounts of deductions that subsidiaries of a parent company can make to avoid paying this global minimum tax *somewhere* in the world. The UTPR is meant to be a backstop to the IIR, which gives an MNE's home country priority to collect any top-up tax. Under the UTPR, if the home country does not collect the top-up tax or the effective tax rate in the MNE's home country is lower than 15 percent, then other countries and jurisdictions where that MNE has subsidiaries can claim the top-up tax for themselves.

Finally, pillar two includes a "subject to tax rule" or STTR, which overrides tax treaty benefits for certain intra-group related party payments (e.g., royalties and interest payments) that are often shifted from LMICs to lower tax jurisdictions. The STTR will allow these source countries to apply a top up tax of up to 7.5-9 percent, if the equivalent rate is not imposed in the country or jurisdiction where the MNE has shifted this taxable income.[16] The STTR's upper rate of 9 percent is less than the overall GloBE rate of 15 percent, and its implementation relies on the cooperation of other tax havens to sign a new treaty.

Governments will still be able to set their own corporate tax rates well above the 15 percent global minimum rate under pillar two if they choose. What pillar two at least theoretically guarantees is that when MNEs choose to book their profits in low/no tax jurisdictions, they will be forced to "top up" their tax payments to their countries or jurisdictions of residence until the parent entity has paid a total effective tax rate of 15 percent. The OECD estimates that under pillar two, the GloBE tax will generate an additional $150 billion per annum in global tax revenues.[17]

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[16] Ryan Gurule, "Tremendous Opportunities and Legitimate Concern," FACT Coalition, October 5, 2021, https://thefactcoalition.org/tremendous-opportunities-and-legitimate-concerns/.
[17] Ibid, OECD Economic Impact Assessment.

The new IF Global Tax Deal at a glance[18]

	Pillar one	Pillar two
Headline	A portion of the largest and most profitable MNEs' profits will be re-allocated to jurisdictions where they have a market presence.	Creates a new global minimum corporate income tax of 15 percent for large MNEs.
Key Features	MNE profits **will be allocated to market jurisdictions irrespective of whether they have any physical presence** in those jurisdictions.	Includes the **Income Inclusion Rule** (IIR), which gives the home jurisdiction of the MNE's parent entity the first bite at imposing a top-up tax on the parent entity if its effective tax rate is less than 15 percent in other jurisdictions.
	The taxing rights allocate 25 percent of profits *in excess of 10 percent of revenue* to market jurisdictions. They do so **based on a formula, rather than the traditional arm's-length principle**.	Includes the **Undertaxed Payment Rule** (UTPR), which allows other jurisdictions where the MNE has subsidiaries to collect the top-up tax, if the home jurisdiction of the parent entity has not collected the top-up tax/has a lower than 15 percent effective tax rate.
	All existing digital services taxes and other similar measures **will be repealed** under the deal, and **no new digital taxes** will be allowed.	Includes a separate, treaty-based **Subject to Tax Rule** (STTR), which overrides treaty benefits for certain related-party payments (including interest and royalties) that are at high risk for MNE profit shifting. The STTR allows jurisdictions to charge a top-up tax where payments are being made to group members in lower tax jurisdictions with rates below 7.5-9 percent.
Scope	Pillar one will apply to MNEs with **greater than €20 billion in worldwide revenues** and a pre-tax profitability margin of at least 10 percent. The MNE revenue threshold will be reduced to €10 billion after seven years, contingent on successful implementation.	The IIR and UPTR will apply to MNEs with **€750 million or more in worldwide revenues**. It is unclear whether the STTR will also apply this threshold or include companies below €750 million in annual revenue.
Timeline	The IF originally aimed to finalize a new multilateral convention to implement pillar one in early 2022, with the goal of taking effect beginning in 2023. **Political challenges continue to delay approval in the U.S. and Europe**, with no clarity on when or whether deadlock will shift in favor of implementation.	The IF originally aimed to bring the pillar two rules into law in 2022, to be effective in 2023, although the effective date of the UTPR would be delayed until 2024. **Political challenges continue to delay approval in the U.S. and Europe** with no clarity on when or whether deadlock will shift in favor of implementation.

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[18] Data drawn from the OECD/G20 Base Erosion and Profit Shifting Project's "Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy," October 21, 2021, https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf and KPMG: BEPS Pillar One and Pillar Two, https://home.kpmg/xx/en/home/insights/2020/10/beps-2-0-pillar-one-and-pillar-two.html.

Next steps on implementation

One of the biggest criticisms by LMICs and private sector actors alike is that the two pillars are extremely technical and potentially too costly and complex to implement.[19] Of course, this is thanks in part to the highly complex tax avoidance structures that private sector actors have erected, and which these rules are trying to address. Details on both pillars remain subject to further planning, consultation, and adoption by IF members in 2022-2023. The IF's goal is to bring the majority of pillars one and two into effect beginning in 2023, subject to members bringing rules into law domestically and agreeing to relevant conventions in 2022 (which looks highly unlikely).[20] Importantly, IF members are not obligated to adopt the GloBE minimum tax rules under pillar two but must accept their implementation by other countries and jurisdictions.

In December 2021, the IF issued proposed model rules for implementing pillar two and in March 2022, they released a related commentary and proposed implementation framework.[21] Numerous key details remain to be worked out and agreed on, including the accounting standards and rules that will determine the profit base for pillars one and two, as well as the approach to dispute resolution under pillar one.

There are real political challenges to the IF deal's adoption in key OECD jurisdictions, for example, in the U.S., the measure faces opposition from Republicans and may require two-thirds of the Senate's approval to pass. Like the broader BEPS effort's Multilateral Instrument (MLI), implementing pillar one and parts of pillar two of the IF deal will require a new multilateral convention (MLC) to be agreed on by all parties in order to facilitate the necessary tax treaty changes without having to renegotiate thousands of existing bilateral tax treaties individually.

The MLC is likely to face the same challenges as the BEPS Multilateral Instrument, which the U.S. and several other key economic powerhouses such as Brazil refused to sign due to concerns that it may disproportionately target their countries' firms, or that renegotiating treaties bilaterally would result in more preferable terms.[22] While the IF can certainly proceed without U.S. approval, its impact will be severely limited given the outsized presence of U.S. firms in the initial cohort of MNEs implicated by pillars one and two.

EU tax laws require unanimous support from all 27 member countries, and there are several smaller low tax countries like Estonia, Poland, and Hungary, which have said they

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[19] See for example the Business at OECD/BIAC interest group's commentary on the IF deal, Doug Connelly, OECD's 'complex' minimum tax rules have 'major policy issues,' BIAC says, MNE Tax, January 7, 2022, https://mnetax.com/oecds-complex-minimum-tax-rules-have-major-policy-issues-biac-says-46604.
[20] The timeline for the UTPR portion of pillar 2 is set for implementation in 2024. See "Detailed review: OECD releases Model Rules on the Pillar Two Global Minimum Tax" Ernst and Young, December 22, 2021, https://taxnews.ey.com/news/2021-2299-detailed-review-oecd-releases-model-rules-on-the-pillar-two-global-minimum-tax.
[21] See "OECD releases detailed technical guidance on Pillar Two model rules for 15% global minimum tax," OECD, March 14, 2022, https://www.oecd.org/tax/beps/oecd-releases-detailed-technical-guidance-on-the-pillar-two-model-rules-for-15-%-global-minimum-tax.htm.
[22] Joseph Morley, "Why the MLI Will Have Limited Direct Impact on Base Erosion Profit Sharing," Northwestern Journal of International Law & Business, Volume 39 Issue 2, Winter 2019, https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1843&context=njilb.

are reluctant to move forward on the global minimum tax (pillar two, and the U.S. priority) unless the EU places equal priority on advancing digital taxation reforms (pillar one, and on a slower track). This ongoing deadlock, combined with ongoing debates in the European Parliament over a range of potential versions of the IF deal that could be implemented, have thrown the IF's fate in this region into question as well.

III. Concerns and critiques about the IF deal's impact on LMICs

Nearly all stakeholders involved seem to agree that the IF deal represents a real step forward in trying to reduce a "race to the bottom" in global tax competition and refashion MNE taxation to better reflect the places where they have real operations, sales, and personnel. Likewise, the idea of a global minimum corporate tax (set at the appropriate rate) seems to have wide appeal. By moving closer towards a formulaic method of allocating corporate taxes globally, rather than pretending that subsidiaries and affiliates are fully independent businesses, both critics and fans seem to agree on the IF deal's direction of travel away from traditional residence rules in an increasingly complex and digitized global economy.[23]

There are several of the IF deal's core elements, however, that LMICs find deeply concerning and in some cases, outright threatening to their ability to effectively tax MNEs if they sign up. For this reason, four IF countries—Kenya, Nigeria, Pakistan, and Sri Lanka—did not sign on to the deal last year, and many LMICs are being cautioned to reconsider implementing the deal.[24] It is worth noting that only 23 African states are among the 137 countries and jurisdictions set to implement this global deal—less than half of all the countries and jurisdictions on the continent.[25]

This hesitation to sign on comes in the context of LMICs being unable to access relevant data from the OECD to fully understand the economic and legal implications of each of the two pillars. As of April 2022, the OECD has yet to publish either a full impact analysis with country-level revenue estimates for each pillar, or the full country-by-country reporting dataset that would allow independent experts to conduct this analysis for them. In effect, LMICs are being asked to take a blind leap of faith by signing a legally binding agreement to give up certain taxing rights, in return for a highly uncertain—and potentially harmful—revenue outcome.

Despite this lack of data and relying solely on the draft proposals shared throughout the negotiations process, bodies like the G24 Intergovernmental Group on International Monetary Affairs and Development (G24) and civil society coalitions like the BEPS Monitoring Group have offered thoughtful and detailed critiques and asks on behalf of

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[23] Ruth Mason, "The Fine Print on the Global Tax Deal Domestic Politics Could Prevent Sweeping Reform," Foreign Affairs, November 8, 2021, https://www.foreignaffairs.com/articles/united-states/2021-11-08/fine-print-global-tax-deal.

[24] See for example a statement by the Global Alliance for Tax Justice, the leading global civil society coalition on tax justice concerns, upon the IF's adoption, "The OECD-led Tax Deal Will Only Deepen Inequalities Within and Between Countries, October 8, 2021, https://www.globaltaxjustice.org/en/latest/oecd-led-tax-deal-will-only-deepen-inequalities-within-and-between-countries.

[25] https://www.indepthnews.net/index.php/opinion/5028-the-global-corporate-tax-deal-an-african-perspective.

LMICs.[26] This is in addition to the direct interventions of middle-income countries like South Africa, Argentina, and India in G20 negotiations. Unfortunately, the vast majority of these recommendations were not reflected in the final IF deal. Below is a summary of key LMIC asks that did not ultimately translate into the final deal and remain serious outstanding concerns threatening their participation going forward.

The key concerns on the IF deal for LMICs relate to: (1) where tax benefits will accrue; (2) the current rate of global minimum tax; (3) the percentage of residual profits available for reallocation; (4) the scope of companies included; (5) the mandatory removal of digital taxes; (6) mandatory arbitration of tax disputes; and (7) lack of transparency in the IF negotiations process.

1. Where tax benefits accrue

The IRR aspect of pillar two ensures that the home country of an MNE is the primary beneficiary of any income that is not taxed to the effective rate of 15 percent. The African Tax Administrators Forum (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. This would have gone a long way towards addressing tax avoidance and enhancing domestic resource mobilization in LMICs but given the outsized influence of G7 leadership and specifically the U.S. and Europe's own determination to enhance domestic resource mobilization at home, this was never seriously considered.[27]

According to the Tax Justice Network, the current formula would provide G7 countries—home to only 10 percent of the world's population—with 60 percent of the new tax revenue generated under pillar two.[28] Lowest income countries and jurisdictions would only take home around three percent of new tax revenues.[29] Activists including the BEPS Monitoring Group had proposed a Minimum Effective Tax Rate (METR) that would not discriminate between home or source countries, instead the METR would "allocate profits that have been taxed below the agreed minimum effective tax rate among countries, using factors reflecting the MNE's real presence in each country (employees, physical assets, and sales to customers)."[30] Each country could then apply its own domestic tax rate to these apportioned undertaxed profits.[31]

Tax Justice Network's data suggests that compared to the GloBE, a METR approach would bring greater revenues to countries (i.e., per capita GDP below US$40,000), in

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[26] The G24 is a group of developing countries formally established by the G77 in 1971, which was deeply engaged in analyzing and commenting on the IF deal as it unfolded on behalf of LMICs.
[27] "A New Era of International Taxation Rules—What does this mean for Africa?" ATAF Communication, Oct 08, 2021, https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa.
[28] Alex Cobham, "Is today a turning point against corproate tax abuse?," https://taxjustice.net/2021/06/04/is-today-a-turning-point-against-corporate-tax-abuse/, Alex Cobham, June 2021.
[29] EU Tax Observatory, "Revenue Effects of the Global Minimum Tax: Country by Country estimates," October 2021, https://www.taxobservatory.eu/revenue-effects-of-the-global-minimum-tax-country-by-country-estimates/.
[30] Sol Picciotto, The METR, a Minimum Effective Tax Rate for multinationals, April 15, 2021, https://taxjustice.net/2021/04/15/the-metr-a-minimum-effective-tax-rate-for-multinationals/.
[31] Ibid.

addition to helping "level the playing field" between domestic and multinational enterprises by taxing both inbound and outbound investments.[32] In fact, a METR approach would also generate more revenue than the GloBE for higher income countries and jurisdictions at the lower rate of 15 percent that the IF ultimately settled on, and yet it was never seriously considered by G7 countries.[33] This gets to the larger reality that while LMICs were eventually invited to the IF table, the G7 never stopped approaching the IF deal almost exclusively as a domestic rather than a development and foreign policy opportunity, and may have ignored mutually beneficial alternatives like METR as a result.

2. Rate of global tax

The introduction of a new 15 percent effective global minimum tax rate has undoubtedly been the major headline emerging from the IF deal in the U.S. and Europe, with significant controversy in countries at all income levels about the rate. The Biden administration, seeking to raise corporate income taxes at home from 21 percent to 28 percent, was hoping to achieve a global minimum closer to 21 percent. Ireland, with a corporate income tax rate of 12.5 percent at the time of negotiations, ultimately held fast and succeeded in bringing IF stakeholders down to 15 percent as a condition for signing off on to the deal.

For LMICs, which tend to have higher corporate income tax rates and rely more heavily on this source of revenue, the new 15 percent baseline represents a big potential concern. What was meant to avoid a race to the bottom and create a new global floor may quickly become the new global ceiling, with countries racing downwards to converge at 15 percent to remain "competitive." The global average statutory corporate tax rate is 24 percent.[34] ATAF had been pushing for a minimum global rate of 20 percent, as African countries have an average corporate tax rate of 27.5 percent.[35] These countries expressed concern that anything below 20 percent would be ineffective at disincentivizing profit shifting away from the continent, as 15 percent is too close to the rate of many existing tax havens.

To be sure, this new minimum effective tax rate may aid significantly in reducing the appeal of traditional tax havens, which will no longer be able to offer their special blend of low tax/no tax and secrecy as a business model to companies and individuals seeking to reduce their tax burden below 15 percent. Yet by setting the rate so far below the global average, the unintended consequence may be substantial global downward

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32 Ibid.
33 Ibid, based on OECD Country by Country Reporting Data base.
34 See KPMG, historical corporate tax rate data for 2021, global average, https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html.
35 It is worth noting that effective tax rates are often far below the statutory and average levels. See Congressional Budget Office, "International Comparisons of Corporate Income Tax Rates," https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52419-internationaltaxratecomp.pdf and Ibid ATAF and Mustapha Ndajiwo and Learnmore Nyamudzanga, "What does the G7 Proposal on Taxation of the Digitalized Economies Mean for African Countries," African Policy Research Institute, September 3, 2021.

convergence and a resulting loss in the corporate tax base of many LMICs, which they can scarcely afford.

3. Rate of residual profits reallocated

As noted in the discussion of pillar one, only 25 percent of the residual profit (the "extra profit" that an MNE generates after an initial 10 percent that it keeps for itself) is available for reallocation to end-market jurisdictions. LMICs pushed for a larger share of residual profits to be available for reallocation, with the G24 arguing that anything less than 30 percent would not result in meaningful revenue for LMICs, and ATAF pushing for at least 35 percent as the minimum.[36] LMICs also criticized 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 under pillar one's formula.

Because the OECD decided not to do a full impact assessment of the final IF deal for public consultation before approving it, it is extremely difficult for any country or jurisdiction, particularly LMICs, to understand its likely impact on their economy. Towards the end of the IF process, however, Oxfam International hired Oxford Economics to develop an economic model that could at least give a general sense of order of magnitude of economic impact for various scenarios under pillar one for LMICs.[37]

At a residual profit reallocation share of 20 percent, Oxford Economics found that the net impact of pillar one was found to be potentially negative for LMICs, with a possible loss of around $230 million for poorer countries. At the higher 30 percent reallocation share of residual profits put forth by the G24, Oxfam estimates the impact on LMICs would not be significant—around $10 million in additional revenue per country, with some countries generating only an additional $1 million per year. Under this scenario, the costs of implementation might well run higher than any potential net gain. The ATAF's proposed share of 35 percent was shown to generate a more significant net gain for LMICs of $857 million per annum.[38] While Oxford did not run scenarios at a 25 percent residual allocation rate—the ultimate amount of residual profit available for reallocation in the final IF deal—the fact that 30 percent was already of questionable benefit suggests that the 25 percent amount will have trivial, if not negative revenue effects for many LMICs.

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[36] Ibid ATAF and "Comments of the G-24 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 first of July 2021," September 2021, https://www.g24.org/wp-content/uploads/2021/09/Comments-of-the-G24-on-the-IF-July-Statement.pdf.
[37] The impact of pillar one at various rates of residual profit allocation was compared to these same countries instead implementing a unilateral three percent digital services tax (the estimated current average). This is the option (an unilateral DST) that they would forgo if they implemented pillar one instead.
[38] Moreover, lowering the IF's overall revenue threshold for MNEs from 20 billion euro (the current amount under pillar one) to 10 billion euro would double the revenue for Kenya, Nigeria, Argentina, and Mexico alone. See Oxfam, "The Effect of the OECD's Pillar 1 proposal on developing countries-an impact assessment, " October 2021, https://www.oxfamamerica.org/explore/research-publications/the-effect-of-the-oecds-pillar-1-proposal-on-developing-countries/.

4. Scope of companies included

To be subject to pillar one, as mentioned, companies must have 20 billion euros in turnover and a 10 percent profitability margin, which means that only the 100 largest global MNEs will be included. Originally, the proposal—like pillar two, and also the current OECD Country-by-Country Reporting rules—included MNEs with a revenue threshold of 750 million euro or more in turnover.[39] Groups like ATAF had been pushing for a 250 million euro threshold, to include a broader set of what are still considered "large" taxpayers in LMICs. When the Biden administration entered negotiations, however, they successfully lobbied to raise the bar and significantly narrow the scope to include only the largest and ostensibly most profitable MNEs.

For pillar one, MNEs must also have at least one million euros of sales in a jurisdiction for it to qualify for reallocation of residual profits, although LMICs did win the concession that for countries with GDP of less than 40 billion euros, they only require 250,000 euro in sales to qualify. The challenge of course is that by adopting pillar one, many poorer countries will be abandoning a much simpler and easy to administer domestic digital services tax for a much more complex global rule that does not necessarily apply to as many companies, and therefore may not generate as much revenue (see digital services tax section below).

Under pillar two, to be subject to the GloBE tax, MNEs must meet a revenue threshold of 750 million Euro or more. LMICs like Nigeria have previously expressed concern that the revenue threshold of 750 million euro for Country-by-Country Reporting (CBCR)—a separate part of the BEPS agenda outside the IF deal—is overly exclusive, and a threshold of 500 million euros would, for example, capture many more of the large taxpayers in their jurisdiction.[40] As a result, uptake of CBCR in LMICs has been limited to date—not for lack of interest in the idea—but because its widespread inapplicability to their MNE tax base has made it much less useful. The same concern holds for pillar two, which may end up applying to too few enterprises at the current standard to make it worth the costs of implementation.

5. Elimination of existing/future digital taxes

As part of signing on to the IF, countries agree to eliminate any existing digital service taxes and forswear introducing any new ones, with the implication that they will generate as much or more revenue under pillar one of the IF deal. This unilateral elimination of existing digital services taxes is particularly concerning for LMICs, where it is not clear that they would actually get a significant share, if any, of digital taxes under pillar one, based on size, turnover, and profit requirements. For example, in Kenya, only 11 MNEs would meet the pillar one requirement of at least 20 billion euro in annual global revenue and a 10 percent pre-tax profit margin, however there are currently 89 MNEs in Kenya

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39 Michael Devereaux and Martin Simmler, "Who will pay Amount A?," Oxford University Center for Business Taxation, July 5, 2021, https://oxfordtax.sbs.ox.ac.uk/article/who-will-pay-amount-a.
40 "Tax Policy: How Inclusive Is The OECD's Inclusive Framework? Tax Notes Talk with Martin Hearson (International Center for Tax and Development) and Emmanuel Eze (Nigerian Inland Revenue Authority)," January 11, 2021, https://www.forbes.com/sites/taxnotes/2021/01/11/tax-policy-how-inclusive-is-the-oecds-inclusive-framework/?sh=587ee9ef65aa.

that are subject to its current 1.5 percent Digital Services Tax (DST).[41] MNEs like Uber and Booking.com would not qualify under pillar one for the IF tax in Kenya but are currently subject to its DST.

Revenue authorities worry about trading DSTs—a simpler, more broadly applicable tax that is currently working—for a narrower and more complex global approach with pillar one. As Kenya Revenue Authority Commissioner Terra Saidimu notes “a bird in hand is worth two in the bush” for countries like Kenya, given all the uncertainty about how much LMICs will ultimately benefit from the IF deal.[42] Likewise, in Nigeria, according to its federal inland revenue service, only six MNEs would be covered under pillar one according to the 20 million euro threshold.[43] India offers another example where abandoning its existing equalization levy rule for taxing digital businesses (effectively a DST) in favor of pillar one’s approach—focused only on a subset of the largest and most profitable global MNEs—would likely reduce the number of corporations captured by the tax scheme and undermine revenues.

The G24 expressed this concern in their comments several months before the IF deal was finalized, noting “if developing countries are expected to withdraw unilateral measures due to agreement on Pillars One and Two, then there should be sufficient revenue under Pillar One…”[44] The group refers to a 2021 IMF study on Digitalization and Taxation in Asia, which shows that many developing countries may lose revenue under pillar one as it is currently structured.[45] For example, the IMF estimates that under the final terms of pillar one, “with residual profits reallocated, Vietnam could lose about 0.11 percent of GDP in revenue, driven by the profit reallocation of Japanese MNEs…Similarly, emerging economies such as India, Indonesia, and Malaysia could lose about 0.01 percent of GDP in revenue or have a modest revenue gain.” This is nowhere near the transformational improvement in capturing digital tax revenue for LMICs required to justify the cost, risk, and complexity of forgoing DSTs in favor the IF deal’s approach. The report goes on to estimate that “high-income countries such as Australia, Japan, and Korea, as well as large markets such as China, gain revenue” under pillar one’s rules. It is worth noting that in April 2021, urged on by LMICs, the UN Tax Committee approved a new recommended approach to digital taxation in their model tax treaty rules through

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[41] https://qz.com/africa/2082754/why-kenya-and-nigeria-havent-agreed-to-global-corporate-tax-deal/.
[42]Carlos Mureithi, “Why Kenya and Nigeria Haven’t Agreed to the Global Corporate Tax Deal,” Quartz Africa, November 2021, https://qz.com/africa/2082754/why-kenya-and-nigeria-havent-agreed-to-global-corporate-tax-deal/.
[43] Ibid.
[44] Comments of the G24 Working Group On Tax Policy and International Tax Cooperation 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.
[45] Digitalization and taxation in Asia/prepared by a joint team from the IMF Asia-Pacific and Fiscal Affairs Departments, led by Era Dabla-Norris and Ruud de Mooij, September 2021, https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2021/09/13/Digitalization-and-Taxation-in-Asia-460120.

introducing Article 12B.[46] Article 12B offers an alternative approach to taxing cross-border digital revenue that any country can choose to incorporate into their bilateral tax treaties. Like the IF's pillar one, Article 12B would give market jurisdictions new taxing rights over digital tax revenue that is generated in their territory by non-resident MNEs. Unlike pillar one, however, there is no de minimus rule, which means that countries can apply the tax to all MNEs irrespective of their size. Article 12B is likely to become the preferred approach of LMICs in the near term unless and until the multilateral IF deal can demonstrate meaningful revenue benefits for them.

6. Mandatory arbitration of tax disputes

LMICs including Kenya and Nigeria are among those that have bristled at the IF's new mandatory binding dispute resolution mechanism, which, like investor state dispute settlement, may put sovereign tax disputes in the hands of ad hoc international arbitrators. As Sol Picciotto at the Institute for Development Studies notes, "Arbitrators will inevitably be drawn almost entirely from the members of the same club of specialists, dominated by developed countries, who have generally worked as both government officials and tax advisers."[47] Beyond well-known concerns about independence, impartiality, and representativeness among arbitrators, international arbitration procedures are typically conducted in secrecy.[48]

Likewise, arbitration is often lengthy and costly, which LMIC tax authorities must weigh in terms of redirecting scarce resources and human capacity towards fighting a potentially unwinnable battle with large MNEs or their home countries. During the IF negotiations, ATAF was successful in moderating the application of this mechanism to "developing economies" in the final deal, whereby certain low-income countries will be eligible for an elective binding dispute resolution mechanism, in instances where they have tended to have a low level of prior bilateral tax disputes.[49] This implies that "low risk" countries may get to opt out of mandatory arbitration, which would seem to unfairly disadvantage LMICs that have actively sought to defend their trade and investment interests internationally through bilateral disputes to date.

7. Lack of transparency and inclusion in the IF process

Overall, there is great frustration in many LMICs and within civil society that global tax governance continues to effectively remain the domain of the OECD, a relatively small

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[46] See Tax Treatment for Payment of Digital Services : New Article 12B—Income for Automated Digital Services, https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf and Anjana Haines, "This week in tax: Article 12B is ready for use in tax treaties," International Tax Review, April 29, 2021, https://www.internationaltaxreview.com/article/b1xtgtyg3ms0w9/this-week-in-tax-article-12b-is-ready-for-use-in-tax-treaties.

[47]Sol Picciotto "What Have We Learned About International Tax Disputes?" ICTD Summary Brief #7, https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/12781/ICTD_SB7.pdf.

[48] See, for example, J. Devaney, "An Independent Panel for the Scrutiny of Investment Arbitrators: an Idea Whose Time Has Come?," *The Law & Practice of International Courts and Tribunals*, *18*(3), 369-388, 2020, https://doi.org/10.1163/15718034-12341409.

[49]ATAF, "A new era of international taxation rules: What does this mean for Africa?" October 8, 2021. https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa.

and unrepresentative group of wealthier countries, instead of taking place within a universal, intergovernmental UN tax commission and/or via a formal UN Tax Convention. While the OECD Inclusive Framework technically allows all interested countries and jurisdictions to become members, there are fees and conditions associated with membership, and the travel/transaction costs of all the meetings, whether in Paris or virtually, are too much for many LMICs to manage. There is also an implicit G7/G20 homecourt advantage influencing the power dynamics in IF negotiations and decision-making, that a more truly universal forum such as the UN would be better placed to structurally mitigate against.

The majority of African countries (52 percent) and least developed countries (78 percent) have not joined the framework to date, and those that have express deep concerns about the ability to meaningfully influence and engage on par with their high-income country counterparts.[50] Logan Wort, ATAF Executive Secretary observed of the IF negotiations "the other day we received a document after 10 in the evening with a deadline for the next morning…You can sign away your taxing rights in your sleep if you receive a deadline like this. If this process is not careful about the pace, the number of meetings, deadlines, and the short notice to comment, it could lead to a de facto exclusion."[51]

Concerns have also been expressed about the need for a more open and participatory negotiations process where the public and civil society have a chance to analyze proposals and decisions and scrutinize draft agreements before final approval. Given that the OECD opted not to do their own impact assessment of pillars one and two to consider equity implications and economic risks for LMICs, this kind of public scrutiny and opportunity for independent analysis would have been that much more valuable to potentially influencing the ultimate outcome.

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[50] Acode and Global Financial Integrity, "OECD Global Tax Deal: Key Elements, Opportunities and Challenges," https://www.acode-u.org/uploadedFiles/OECD-Global-Tax-Deal.pdf and "ATAF tax's approach to simplifying the OECD's digitalization Proposal," Interview with Logan Wort, ATAF Communications, February 16, 2022.
[51] Ibid, ATAF Interview with Logan Wort.

Summary of core LMIC concerns with the IF deal/process

Issue	Problem
Where tax benefits will accrue	Additional tax revenue will largely go to high-income countries
The current rate of global minimum tax	Far lower than the average existing rate in LMICs
The percentage of residual profits available for reallocation	Too low to generate significant resources for LMICs
The scope of companies included	Too high a threshold to include many large taxpayers in LMICs
The mandatory removal of digital taxes	No certainty that they will replace or increase this revenue with the IF deal
Mandatory arbitration of tax disputes	Track record of disadvantaging LMICs and favoring MNEs and high-income countries
Lack of transparency in the IF negotiations process	Inability to assess or address the real potential revenue impacts of the deal on LMICs

IV. What now? Options to support DRM in LMICs going forward

The IF deal held special urgency for LMICs given that the COVID-19 pandemic dramatically increased internal financing pressures—particularly for health and social protection—at the same moment that their economies collapsed. Thanks to the pandemic-driven economic crisis, the World Bank estimates that nearly 100 million people fell back into extreme poverty (less than $2 a day) in 2021.[52] IMF researchers estimate that low-income countries will need an additional $450-550 billion until 2025 to step up their response to the pandemic and catch up with advanced economies' progress in terms of GDP growth.[53] Given the myriad challenges to financing for development in LMICs both pre- and post-pandemic, the pressure to improve domestic resource mobilization has never been higher.

The recent IF deal is a once in a generation reform that was years in the making and took a Herculean final diplomatic push by the new Biden administration to get over the line in October 2021. Like all multilateral agreements, the final deal represents the lowest common denominator of sorts, and no stakeholder emerged with everything that they wanted. In the IF deal's case, however, LMICs appear to have disproportionately lost out on any meaningful upside, at a moment when they could benefit from additional corporate income tax revenue far more than the wealthy countries this deal ultimately serves.

In a context where the political future of the IF deal is uncertain, LMICs must wait and watch whether the U.S. and Europe can manage to get the deal approved or it dies on the vine in the coming two years. In the meantime, LMICs would be wise to keep IF implementation at arm's length and hold back from participating, so long as the potential costs continue to outweigh the benefits. As they watch the IF's political fate unfold, below are several initial ideas on how LMICs might proceed to best advance their DRM interests in the meantime, focused on (1) changes to the IF deal and process, (2) domestic tax reforms, and (3) international tax governance and aid reforms.

1. Changes to the IF deal and process

Achieve G20 commitment to further equity-focused reforms of the IF deal

At this year's G20, the Indonesian chair could work to build consensus among stakeholders that the 2021 deal is an interim arrangement, as stakeholders identify a new two-year agenda focused on improvements to support LMICs. This would include

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[52] "Updated estimates of the impact of COVID-19 on global poverty: Turning the corner on the pandemic in 2021?," World Bank, June 24, 2021, https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty-turning-corner-pandemic-2021.
[53] Guillaume Chabert, Robert Gregory, and Gaelle Pierre, Funding the Recovery of Low Income Countries After Covid, IMF Blog, April 5, 2021, https://blogs.imf.org/2021/04/05/funding-the-recovery-of-low-income-countries-after-covid/.

revisiting issues such as the amount of residual profit available for reallocation under pillar one, and the size of MNEs (based on annual turnover) eligible for treatment under pillars one and two. Ideally these conversations would take place through a more inclusive structure, and at a pace that allows for meaningful participation of capacity constrained LMIC officials. As the G24 stressed in September 2021, without an increased reallocation of taxing rights to developing countries, the final deal "shall not be sustainable even in the medium run."[54]

LMICs could also push for a more thorough formal and transparent distributional analysis of the current IF deal, with particular attention to the equity impacts on LMICs.[55] This should include an analysis of alternative rate/allocation scenarios for each pillar under which LMICs could obtain significant additional revenue, while still preserving the general two pillar structure of the current deal. The assessment should also estimate the administration and implementation costs of the new IF deal for LMICs and compare this to the likely revenue generated. Ideally, this assessment would be done in partnership with the Addis Tax Initiative, to engage the group of core development partners currently involved in tax capacity-building in a dialogue about what implementing the IF deal costs versus what it will deliver.

Reframe the dispute settlement model from arbitration to the Mutual Agreement Procedure (MAP)

Instead of drawing on the typical Investor State Dispute Settlement (ISDS) model that involves private lawyers, significant time and expense and an implicit bias towards high income countries, the IF deal could reframe the model to resemble the Mutual Agreement Procedure (MAP) that is already present in many existing tax treaties.[56] MAP is currently the "go to" instrument for resolving international tax disputes, whenever one party to a tax treaty considers that tax administrations are acting in a way that will result in taxation not in accordance with existing treaties/conventions.[57] This approach dramatically minimizes costs (effectively just the in-kind cost of tax officials' time) and directly involves tax officials—rather than lawyers with potential conflicts of interest—as the competent authorities charged with resolving disagreements. [58]

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[54] Ibid, G24 Statement.
[55] Martin Guzman, "A global tax deal: A victory for whom?," Independent Commission for the Reform of International Tax Cooperation (ICRICT)/G24, October 7, 2021 (online webinar), https://www.youtube.com/watch?v=k0Nxrw0ZmIY.
[56] Primer on International Investment Treaties and Investor-State Dispute Settlement, Columbia Center on Sustainable Investment, January 2022, https://ccsi.columbia.edu/content/primer-international-investment-treaties-and-investor-state-dispute-settlement.
[57] United Nations launches MAP and Tax Dispute Resolution Handbook https://www.ey.com/en_gl/tax-alerts/united-nations-launches-map-and-tax-dispute-resolution-handbook.
[58] Statement by the South Centre on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy, October 2021, https://www.southcentre.int/wp-content/uploads/2021/10/SC-Statement-on-IF-Two-Pillar-Solution-13-Oct-2021.pdf.

2. Domestic tax reform

Introduce local minimum taxes, ideally at collectively agreed-upon regional rates

There is ample research suggesting that the introduction of a local minimum tax is associated with an increase in the average effective tax rate. The IMF argues that "setting a local floor on corporate taxation—at least at the local domestic level with moderate tax rates—can be a good option for countries looking to preserve revenue and prevent the erosion of their tax base without severely damaging corporate activity."[59] This is particularly true for lower income countries with weaker tax administration capacity to challenge the complex global tax maneuvering of large MNEs.
The new IF deal only triggers new "top-up" tax payments to LMICs under a narrow set of circumstances and is incredibly complex and likely costly to implement. For this reason, IMF researchers note that local minimum taxes could "provide a simpler alternative to the complex provisions of this [IF] proposal for a global minimum tax, which many low income and developing countries may not have the capacity to implement." [60]

Likewise, while LMICs may see some additional tax revenue from pillar one, it remains unclear if this amount will equal or exceed revenue from a more targeted and inclusive digital services tax. It therefore appears that LMICs would be best served to focus on ensuring a strong local minimum tax and holding on to/moving forward with introducing digital services taxes in the near term, while they wait to see how implementation of pillars one and two proceed. LMICs would be ill advised to abandon existing digital services taxes without a clear impact assessment demonstrating that they stand to gain substantially more revenue by signing up to implement the IF deal. If the IF evolves to include a larger number of MNEs, at a lower turnover threshold, and a higher level of residual profits available for reallocation, the benefits of moving forward with IF implementation would become much clearer and more compelling.

Political momentum for an improved/reformed IF deal could increase if LMICs abstain from implementing the current version of the deal in a collective fashion and agree on a common set of asks for a reformed IF deal. This would also require regional tax administrators ideally aligning on a collective local base erosion tax rate and approach to tax incentives, to avoid mutually harmful competition with neighboring countries over the coming few years. This is in the same spirit with which, for example, regional groupings such as Economic Community of West African States (ECOWAS) have previously approached attempting to harmonize fiscal regimes in the mining sector to avoid a race to the bottom.[61]

On the digital tax front, ATAF has already proposed a regional approach to drafting legislation on digital sales taxation, which they originally tabled in 2020 while IF negotiations were still underway and the outcomes (and potential benefits for African countries) uncertain. Moving forward with this approach appears to be the most prudent near-term option unless or until the IF deal's pillar one has been demonstrated to

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[59] Aqib Aslam and Maria Coelho, "Setting a lower limit on corporate taxation," IMF blog, June 9, 2021.
[60] Ibid.
[61] Philippe Hameau, Janice Feigher, Marc Robert and Chole Deydier (Norton Rose Fulbright), Mining Arbitration in Africa, June 9, 2021, https://globalarbitrationreview.com/guide/the-guide-mining-arbitrations/2nd-edition/article/mining-arbitration-in-africa.

achieve equal or greater impact than existing DST regimes.[62] More broadly, regional groupings of LMICs could develop common positions on international tax rules going forward, something that the AU is apparently considering and could strengthen LMIC influence in any new IF negotiations.[63]

Revisit existing tax incentives

The IF deal targets a subset of tax incentives related to corporate income tax—namely tax holidays, preferential tax rates, tax credits, investment allowances, and/or income exemptions.[64] These incentives, often used by LMICs to attract foreign investment (although often not to their ultimate economic benefit) will in theory become less attractive to MNEs under the IF's global minimum tax. This is because any tax incentives that bring the MNE's effective tax rate below 15 percent in a source country will require the MNE to remit the balance to the MNE's residence country. Because the MNE's residence country will potentially be able to do this calculation and collect a top-up tax *without notifying* the LMIC source country, many LMICs may end up forgoing potential additional revenue without even realizing it.

Some have pointed out that the inability to compete for foreign direct investment (FDI) based on corporate revenue-derived tax incentives may lead LMICs to offer tax incentives in other areas, such as Value Added Tax (VAT), customs duties, payroll taxes or mineral royalties.[65] A race to the bottom on non-corporate income-based tax incentives would be a hugely unfortunate unintended consequence of the IF deal for LMICs, and would result in them potentially forgoing some of their most predictable and easily administered tax revenue in the process. This makes it critical for LMICs to unilaterally tighten up their overall tax incentive regimes to ensure that they are capturing a full 15 percent of effective corporate income tax locally whenever possible.

3. International tax governance and aid reforms

Pursue the idea of a UN Tax Convention

One of the longstanding and most fundamental criticisms of global tax governance, which long precedes the IF deal, is the lack of a formal truly international forum to negotiate tax policy questions and agreements. The IF's challenges in engaging African countries and achieving a meaningful sense of G77 ownership more broadly are due to the OECD/G20 locus of decision-making and authority in global tax governance more broadly, and their outsized power in negotiations processes. The G77, the G24, the U.N. High Level Panel on International Financial Accountability, Transparency and

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[62] African Tax Administration Forum, 'ATAF publishes an approach to taxing the digital economy,' October 1, 2020, https://events.ataftax.org/index.php?page=documents&func=view&document_id=79.
[63] Orria Goni and Luckystar Miyandazi,"The global corporate tax deal - an African perspective," https://www.undp.org/blog/global-corporate-tax-deal-african-perspective.
[64] Thomas Lassourd, Howard Mann and Alexandra Readhead, The end of tax incentives: How will a global minimum tax affect tax incentives regimes in developing countries?, October 7, 2021, https://www.iisd.org/itn/en/2021/10/07/the-end-of-tax-incentives-how-will-a-global-minimum-tax-affect-tax-incentives-regimes-in-developing-countries-alexandra-readhead-thomas-lassourd-howard-mann/.
[65] Ibid and Didier Jacobs, "Is the Inclusive Framework tax deal in the interests of lower-income countries," International Center for Tax and Development, https://www.ictd.ac/blog/inclusive-framework-tax-deal-interests-lower-income-countries/?.

Integrity (FACTI) and global civil society are among the longstanding advocates for global tax agreements to be negotiated at a truly representative forum such as the United Nations, or for the establishment of a new, independent global tax institution with the power to enforce tax compliance.[66]

The European Network on Debt and Development (Eurodad) recently published a draft UN tax convention to build on post-IF deal frustration and momentum for deeper institutional reform on global taxation.[67] As the FACTI panel proposed, some hybrid form of UN/OECD Inclusive Framework entity could potentially form the basis of a new UN Tax Secretariat and thereby build off the strengths and momentum of the existing structure, while transitioning tax governance into a truly multilateral forum. The limited uptake of the IF so far by the majority of African countries and potential backlash from LMICs disappointed with the recent IF deal's failure to address many of their concerns may provide fresh energy behind the push for new institutional forms.

Look to other international mechanisms to capture and redistribute revenue for development

Given that the IF deal failed to deliver a major turbo boost in corporate tax revenue for LMICs during a particularly challenging moment for financing for development more broadly, these countries could consider reviving longstanding G20 debates about a potential financial markets tax. A financial markets tax in some form—whether on corporate stocks, as Gabriel Zucman proposes, or foreign exchange transactions, in the spirit of a traditional "Tobin Tax"—could generate significant new revenue for development in the range of $100-$200 billion per year, much of which could be redistributed to finance urgent health, climate, and SDG needs in LMICs.[68] A global financial markets tax has the benefit of being progressive and targeting a set of corporate stakeholders (and largely wealthy shareholders) that have huge impacts on LMIC economies but are often out of reach when it comes to LMIC taxing rights. Specifically, a tax on the market capitalization of large companies as Zucman proposes would have the virtue of taxing companies that are highly valuable even if they report minimal taxable income year on year.[69] A tax of this sort could therefore work in complement to the IF deal in its current or revised form, by capturing corporate

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[66] See Financial Transparency Coalition database on G77 statements in support of a new UN global tax body at https://financialtransparency.org/list-governments-supported-un-tax-body-one-table/; Gugulethu Resha, Strengthening Tax Cooperation with Africa for Sustainable Revenue Mobilisation, The South African Institute of International Affairs (SAIIA) Policy Briefing No 256, December 2021, https://saiia.org.za/research/strengthening-tax-cooperation-with-africa-for-sustainable-revenue-mobilisation/ and; Report of the High-Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI Panel), February 25, 2021, https://www.un.org/pga/75/2021/02/26/report-of-the-high-level-panel-on-international-financial-accountability-transparency-and-integrity-for-achieving-the-2030-agenda-facti-panel/ and; Global Alliance for Tax Justice, "Statement: The "deal of the rich" will not benefit developing countries," https://www.globaltaxjustice.org/sites/default/files/GATJ%20Statement%20on%20the%20G7-G20-OECD%20tax%20deal%20081021.pdf.

[67] Tove Maria Ryding, "Proposal for a United Nations Convention on Tax," Eurodad, March 2022 https://www.globaltaxjustice.org/sites/default/files/un-tax-convention-mar09-final_0.pdf.

[68] Pekanov, Atanas and Schratzenstaller, Margit, A Global Financial Transaction Tax - Theory, Practice and Potential Revenues (May 29, 2019), https://ssrn.com/abstract=3407855.

[69] Emmanuel Saez and Gabriel Zucman, A Wealth Tax on Corporations' Stock, University of California Berkeley, July 18, 2021, https://gabriel-zucman.eu/files/SaezZucman2021EP.pdf.

stakeholders that generate significant value but may not be meeting profit or size thresholds in their reporting.[70]

Increase funding commitments under Addis Tax Initiative, but recognize its limits

Given that wealthy countries have yet to live up to their 2015 commitments under the Addis Tax Initiative (ATI) to double tax capacity building assistance to LMICs, renewed donor support here can continue to strengthen the ability of LMIC revenue authorities to engage in IF negotiations as well as undertake local tax policy and administration reform. There is a problematic implicit theory of change, however, in the ATI Agenda, that it is important to call out in the context of the IF deal's failure to deliver for LMICs.

ATI is premised in part on the assumption that it is a lack of sufficient capacity (human, financial, and otherwise) that inhibits effective DRM in LMICs, including and especially in the highly complex area of MNE tax abuse. In the most recent ATI monitoring report on donor engagement, there is only a small section with several sentences devoted to global tax reform as it relates to addressing DRM challenges in LMICs.[71] The rest of the report reads like a gentle indictment of LMIC capacity, where the remedies for improving DRM are almost exclusively domestic.

At the same time, the impetus of high-income country support for the IF deal was an implicit admission that *even with their high capacity, comparatively well-resourced revenue authorities, they struggle to keep up with MNE tax abuse* in the current global tax architecture.[72] This suggests that no matter how much capacity is built within LMIC revenue authorities, they too will never be able to match the resources and sophistication underpinning MNE tax avoidance strategies, unless the fundamental global rules of the game are changed in ways that serve their interests.

Tax capacity building to support DRM in LMICs cannot make serious inroads in the absence of coordinated global tax reforms that explicitly target the most common forms of MNE abuse that affect them. It is equivalent to trying to use a bucket to dump water out of a sinking ship. By failing to fully fund the tax capacity building of LMIC revenue authorities, rich countries have handed them a tiny little bucket. At the same time, the IF deal demonstrates that rich countries are unwilling to change the global tax rules in ways that meaningfully address MNE tax avoidance in LMICs—and thereby also ignoring the gaping hole in the ship.

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70 Ibid Saez and Zucman.
71 Ibid, 2019 ATI Monitoring Report.
72 See for example Galen Hendricks and Seth Hanlon, Better Tax Enforcement Can Advance Fairness and Raise More Than $1 Trillion of Revenue, Center for American Progress, April 19, 2021, https://www.americanprogress.org/article/better-tax-enforcement-can-advance-fairness-raise-1-trillion-revenue/.

V. Conclusion: Reviving LMIC interests from the IF deal debacle

As low- and middle-income countries struggle to stay above water in an unrelenting wave of economic challenges—COVID, debt, climate crisis, and now inflation—conversations about financing for development have rightly focused on near term emergency relief. These measures include new Special Drawing Rights (SDR) issuances and SDR recycling mechanisms, debt suspension and renegotiation, and emergency loans from the IMF and multilateral development banks. These tools are critical to providing near term liquidity and helping "keep the lights on" while LMICs take stock of the enormous medium- and long-term economic challenges.

While aid, loans, and private sector investment all have an important role to play in helping get the SDGs back on track, these sources all have their limits and implementation challenges. Domestic resource mobilization remains the central tool for LMICs to sustainably finance their core development priorities in the coming years, and that means getting a handle on the billions of dollars in MNE tax avoidance that undermine their revenue base each year. To put in perspective, as of May 2022, the new IMF Resilience and Sustainability Trust (RST) had secured around $60 billion in donated SDR from high income countries, versus the estimated $213 billion per annum that MNE tax avoidance is estimated to cost LMICs. [73]

The IF deal initially seemed to present a perfectly timed, once in a generation opportunity to tackle the structural economic challenge of MNE tax avoidance for LMICs. Unfortunately, it ended up becoming a narrowly constructed vehicle to enhance domestic resource mobilization in G7 countries, and if implemented, may actually further *erode* LMICs' revenue base. As the IF deal runs up against steep and potentially fatal political challenges to implementation, LMICs would do well to keep their distance and refrain from taking steps to implement it themselves in the near term. This is especially true when it comes to eliminating existing or planned digital services taxes, as the U.S. and Europe have been pressuring them to do, including through the threat of potential sanctions.[74]

In a best-case scenario, the IF deal has helped to create a more permissive environment and momentum for LMICs to introduce their own more aggressive anti-avoidance measures, including revising their tax regimes to remove incentives and introducing minimum taxes with less threat of legal action (under ISDS for example) from MNEs or their home countries. Likewise, frustrations with the IF deal's substance and process seem to have galvanized momentum behind broader global tax reform, including a

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[73] See Ernesto Crivelli, Ruud De Mooij and Michael Keen, IMF Working Paper: Base Erosion and Profit Shifting in Developing Countries, 2015, https://www.imf.org/external/pubs/ft/wp/2015/wp15118.pdf and ONE.org's SDR Data Deep Dive at https://www.one.org/africa/issues/covid-19-tracker/explore-sdrs/.
[74] Kevin Pinner, "Global South Groups Decry Idea Of Sanctions For Digital Taxes," Law360, March 10, 2022. https://www.law360.com/tax-authority/articles/1472064/global-south-groups-decry-idea-of-sanctions-for-digital-taxes.

potential UN Convention and more equitable approaches to involving LMICs as equal stakeholders in tax governance debates.

Given the enormous fiscal and capacity constraints facing LMICs at this moment, their ability to seize momentum for more inclusive and equitable tax governance will require Addis Tax Initiative donors meeting and likely exceeding their 2015 commitments to fund tax capacity building and administration. These donors must also work harder to engage their foreign ministries and treasury departments on the foreign policy and development significance of future IF/global tax governance negotiations.

The current IF deal reflects G7 countries largely approaching the negotiations as winner take all, with domestic interests reigning supreme, instead of seeing the opportunity to harness MNEs to deliver substantial additional financing for development. This is not surprising, given how deeply siloed current conversations about development finance and LMIC economic recovery tend to be among core actors. Discussions about additional aid, loans, debt relief, and innovative financing to address economic crisis and recovery in LMICs too often take place without any reference to the potential role of domestic resource mobilization, and specifically, global tax governance reform. It is as if G20 donors, the IFIs, and the private sector have all implicitly agreed that the IF deal and the Addis Tax Initiative have checked that box and there is nothing more to be done for LMICs in this domain. As this paper and countless commentaries from LMIC stakeholders and civil society actors have demonstrated, that could not be further from the truth. Going forward, continued political debates about the merits and evolution of the IF deal cannot continue to take place in a vacuum. They must be deeply integrated into broader conversations about economic recovery, poverty reduction, and global fiscal support measures for the Global South.

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