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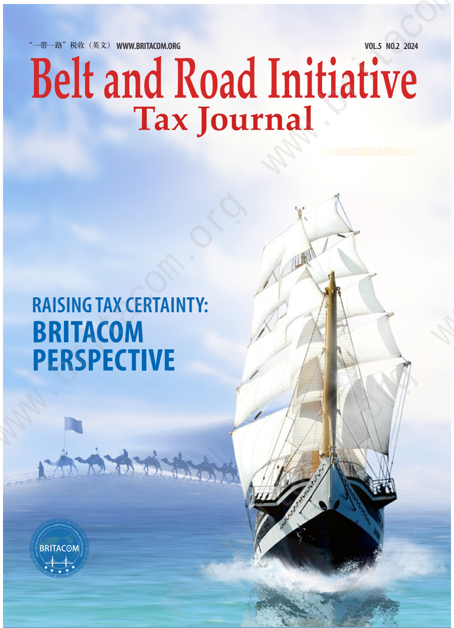
Belt and Road Initiative Tax Journal

RAISING TAX CERTAINTY:
BRITACOM PERSPECTIVE

BELT AND ROAD INITIATIVE TAX ADMINISTRATION COOPERATION MECHANISM
BRITACOM



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Joining Hands to Deepen Tax Administration Cooperation and Support High-Quality Development of the Belt and Road

—Speech at the Opening Ceremony of the Fifth BRITACOF

HU Jinglin

HU Jinglin
Commissioner
State Taxation Administration
the People's Republic of China

Today we gather at Hong Kong, China, a beautiful Pearl of the Orient, for discussions on tax administration cooperation and the Belt and Road development. On behalf of the State Taxation Administration (STA) of China, I would like to extend my warmest congratulations to the opening of the Fifth Belt and Road Initiative Tax Cooperation Forum (BRITACOF), and send my sincere greetings to all the distinguished guests attending the forum.

The vibrant South China Sea breeds abundant opportunities and robust momentum. As one of the most dynamic and competitive regions in the world, Hong Kong serves as a pivotal bridge connecting China and the world, and is emerging as an essential player and contributor in advancing the Belt and Road Initiative (BRI). Mr. Tam Tai-Pang, Commissioner of the Inland Revenue Department of the Hong Kong SAR, has been newly elected as Chair of the Council of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) as well as president of this BRITACOF. I believe that under his leadership and with concerted efforts of all parties, the BRITACOM will open up new prospects in the future.

The Silk Road advances with the times, and connects hearts and minds across mountains and seas. Since its introduction, the Belt and Road Initiative has weathered 11 years of evolution and seen numerous results yielded. Under the banner of the BRI, the BRITACOM has been in place for more than five years. Over these years, tax administrations, relevant international organizations, the business and the academia have rallied to the spirit of Silk Road and the vision of a community of shared future for mankind, implemented in full consensuses reached at past BRITACOFs to promote trade and investment liberalization and facilitation in the Belt and Road Initiative partner countries. By standing united and advancing hand in hand, we deepen exchanges, strengthen cooperation, and produce lasting achievements, painting a vivid scroll of shared prosperity that stretches across distance and navigates through challenges.

The Belt and Road development has embarked on a new journey, and tax cooperation is poised to reach new heights. At the Third Belt and Road Forum for International Cooperation in 2023, Chinese President Xi Jinping announced eight actions to support high-quality development of the Belt and Road, including strengthening the building of multilateral cooperation platforms in areas such as taxation. This not only fully acknowledges the active role of Chinese tax authorities, along with all parties, in promoting international tax exchanges and cooperation through the BRITACOM, but also embodies greater support and higher expectations for the BRITACOM. With the theme of "Deepening Tax Administration Cooperation for High-Quality Development of the Belt and Road," this BRITACOF focuses on practical discussions on new issues and developments in tax administration. These efforts are of great significance for building up synergy, enhancing capabilities, and fostering a tax environment characterized by mutual benefit and win-win cooperation. In this connection, I would like to share Chinese tax authorities' explorations and practices in strengthening tax administration and building efficient taxation.

Firstly, we have advanced law-based taxation to discipline the methods of tax governance. Adhering to the principle of taxation by law in all respects, we take proactive and sound steps to push forward legislation for taxes and revise laws governing tax administration, in a bid to refine the legal system for taxation. We collect taxes and fees in strict accordance with the law, ensuring standardized, fair, and just enforcement. We continually refine enforcement methods and strengthen full-process monitoring to better protect tax and fee payers' rights. We also actively raise tax law awareness, utilizing new technologies and media for targeted legal education, thereby fostering a positive environment of tax compliance and integrity across society and continuously improving taxpayers' compliance with tax laws.

Secondly, we have promoted digital-empowered taxation to elevate the efficiency of tax governance. In tune with the digital wave, we leverage vast data resources, sophisticated algorithms and computing power as core strengths and new quality productive forces for tax authorities, to enable more scientific, fine-tuned, and intelligent administration and governance for taxes and fees. Currently, we have largely built the main body of China Taxation Administration Information System Phase IV (CTAIS IV), more commonly known as the Golden Tax System and rolled out Fully Digitized Electronic Invoices nationwide. Additionally, we have launched several systems, including the new unified national e-Tax Service and the intelligent tax office platform. Building on this, we are advancing the intelligent and unit-specific collection of tax and fee information for businesses, individuals, and products, offering services like "targeted policy delivery" and pre-filled tax returns to provide more convenience for taxpayers. This also informs dynamic credit risk assessments and enables tax officials to provide differentiated, targeted services and supervision, continuously enhancing the quality and efficiency of tax enforcement.

Thirdly, we have advocated rigorous tax governance to prevent risks. We understand that tax governance cannot rely solely on information technology; ultimately, it depends on the commitment and responsibility of all tax officials. Therefore, we place accountability and strict tax governance at the forefront. We have established a comprehensive accountability mechanism where responsibilities are clearly defined for every task, everyone is accountable for their duty, failures are investigated, and accountability is enforced rigorously. We utilize various methods, including internal and external audits, supervision, assessments, inspections, incentives, and penalties. In particular, we embed internal control supervision rules into business processes, into job responsibilities, and into information systems. This ensures that concrete responsibilities and strict requirements are implemented for each official, each position, each task, and every link in the process. Our goal is to achieve integrated risk identification, prevention, and management across all processes of tax administration and internal management.

Fourthly, we have furthered coordinated tax governance to forge synergy. We actively strengthen efficient cooperation with various domestic departments in tax reform, tax and fee services, credit sharing, and combating tax-related violations. In particular, we have taken the initiative to establish cross-departmental information channels and set up regular data exchange and sharing mechanisms with 24 departments, continuously solidifying the foundation of tax governance. At the same time, we are integrating into global tax governance by deeply participating in the formulation of international tax rules, building a cross-border service brand named TaxExpress, and continuously expanding the network of tax treaties. To date, we have signed tax treaties with 114 jurisdictions, provid-

Hong Kong SAR Chief Executive John KC Lee talks with STA Commissioner HU Jinglin on 24 September 2024, during the 5th BRITACOF ing greater tax certainty for cross-border taxpayers. Through the mutual agreement procedure, we have helped relieve over RMB30 billion of international double taxation for taxpayers since 2013.

The fruitful results achieved through explorations and practices by Chinese tax authorities are not only the outcome of our continuous reform, innovation, and proactive efforts but also a reflection of the support and assistance provided by our counterparts across the world. At present, the world is undergoing profound changes unseen in a century, and fresh opportunities arise with new challenges. Recently, the Chinese government has made specific arrangements for deepening reform of fiscal and tax systems and promoting high-quality development of the Belt and Road. Chinese tax authorities will conscientiously implement the relevant plans and work for a tax system that promotes high-quality development, social equity, and a unified market. We will deepen tax administration reforms, further strengthen international tax exchange and cooperation, and focus on creating a market-oriented, law-based, and internationalized tax business environment. In doing so, we aim to contribute even more to enhancing global economic and tax governance.

The global economy is experiencing a bumpy recovery, but the trend toward peace, development, cooperation, and mutual benefit remains irreversible. Differences in tax systems and administration among countries have a significant impact on the liberalization and facilitation of cross-border trade and investment. Deepening tax administration cooperation is crucial for removing barriers to cross-border trade and investment, promoting inclusive global economic growth, and fostering high-quality joint efforts in building the Belt and Road Initiative. With this in mind, I would like to present three proposals:

Firstly, to strengthen the building of BRITACOM in an open and inclusive approach. The BRITACOM has become a significant propeller for multilateral tax cooperation. We need to uphold the spirit of the Silk Road, forge synergy for shared development, expand the "friend circle" of the BRITACOM, and enhance alignments in tax policies and tax administration, making the BRITACOM a world-class platform for international tax cooperation and bringing more fairness and rationality to global tax governance.

Secondly, to enhance capabilities of tax administration through mutual learning and exchanges. The BRITACOM has provided all parties with a practical platform for mutual learning, knowledge sharing and capacity building. We need to give full rein to this platform and elevate its efficacy through reform and opening up. We shall stick to the responsibilities of tax authorities and keep up with changes in international tax rules, and enhance exchanges and cooperation in training, research and capacity assessments under the framework of BRITACOM, so as to further build up capabilities of tax administration for all parties.

Thirdly, to support high-quality Belt and Road development with win-win cooperation. The Belt and Road Initiative is a path toward cooperation, hope and win-win results. Atop the real needs of BRI partners, we need to promote cooperation to a wider range, in a broader field and at a deeper level, to raise tax certainty, promote digital transformation of tax administration and improve the tax environment. By drawing on the strengths of all and integrating them in a coherent approach, we could jointly exert better performance of tax administration and contribute more and better strengths to high-quality development of the Belt and Road.

A traditional Chinese poem states: "With the sail piercing the clouds, we will mount the wind, break the waves, and traverse the vast, rolling sea." The STA is willing to work with all parties to confront challenges with shared solutions, forge ahead with joint efforts, and head for the future with common vision. By directing more efforts toward the same goal of deepening cooperation on tax administration, we will score new progress in the high-quality pursuit of the BRI, and make new contributions to the building of a community of shared future for mankind.

How to Create a Competitive Tax Environment:

An Exclusive Interview with Mr. Benjamin Chan, Commissioner of Inland Revenue, Government of the Hong Kong SAR, PRC

BRITJ Editorial Team

The tax system of the Hong Kong Special Administrative Region of the People's Republic of China (Hong Kong SAR) is well-known for its clarity, efficiency and compliance with international standards. The Government of the Hong Kong SAR is committed to providing a conducive business environment with strong competitiveness. Mr. Benjamin Chan, Commissioner of Inland Revenue of the Government of the Hong Kong SAR, shares with us in this interview the major facilitating measures in the tax field taken by the Hong Kong SAR in recent years and the implementation progress of OECD's Pillar Two Proposal in the Hong Kong SAR.

BRITJ: In the newly released *IMD World Competitiveness Yearbook 2024*, the Hong Kong SAR ranked fifth in the world. In the tax policy sub-factor, it improves from third to second place. What innovative measures has the Hong Kong SAR taken to create a competitive tax system?

Benjamin Chan: The Hong Kong SAR has long been renowned for its simple and transparent tax system. With a view to creating a conducive business environment with strong competitiveness and strengthening the Hong Kong SAR's status as an international financial centre, the Government of the Hong Kong SAR has introduced a number of facilitating measures in relation to taxation. The major measures implemented in recent years include the following:

(i) two-tiered profits tax rates regime, under which the profits tax rate for the first HKD2 million of profits is 8.25% (for corporations) and 7.5% (for unincorporated businesses) whilst profits above that amount is subject to the tax rate of 16.5% (for corporations) and 15% (for unincorporated businesses);

(ii) profits tax concessionary tax rate of 8.25% for all general reinsurance business of direct insurers, selected general insurance business of direct insurers and selected insurance brokerage business;

(iii) profits tax concessionary tax rate of 8.25% for qualifying shipping commercial principals (i.e. ship agents, ship managers and ship brokers);

(iv) profits tax concessionary tax rate of 0% for eligible family-owned investment holding vehicles managed by eligible single family offices in the Hong Kong SAR and family-owned special purpose entities; and

(v) tax certainty enhancement scheme for onshore gains from disposal of equity interests, under which the disposal gains are to be treated as capital in nature and not chargeable to profits tax if the investor entity concerned has held the equity interests in the investee entity for 24 consecutive months immediately before the disposal and those interests amount to at least 15% of total equity interests in the investee entity.

BRITJ: The Inland Revenue Department (IRD) has implemented voluntary e-filing from 2023. Could you tell us more about the e-filing? And what other technological advancements has the Hong Kong SAR made in tax administration in recent years?

Benjamin Chan: As a tax administration, the IRD has placed emphasis on the digitalisation of tax data and is actively promoting electronic filing (e-filing) of tax returns. In particular for profits tax returns, the IRD launched a fresh e-filing system in 2023 and invited enterprises to participate voluntarily. Having regard to the different resource capacities and readiness levels of enterprises, our plan is to implement mandatory e-filing of profits tax returns by phases, starting with large-scale multinational enterprises (MNEs) first and then progressing to small and medium-sized entities. Our ultimate goal is to achieve the full-scale implementation of mandatory e-filing by 2030.

One of the key enhancements featured in the new e-filing system for profits tax returns is to enable enterprises to e-file their tax returns together with financial statements and tax computations in inline eXtensible Business Reporting Language (iXBRL) format. iXBRL is the open international standard for business reporting, under which data in business reports can be tagged for identification by machine and human. The iXBRL filing requirement has been widely adopted for multiple compliance reporting purposes by various jurisdictions. The IRD is the first government agency of the Hong Kong SAR to embrace the functionalities of iXBRL technology in its reporting requirements. To facilitate enterprises to adapt to the new mode of tax return filing, the IRD has put in place various support measures, such as the provision of free conversion tools, publication of online materials, helpdesk, online webinars and outreaching training sessions.

Besides the e-filing initiative, the IRD is also keen to consolidate the use of advanced information technology with a view to improving efficiency and quality of services. Some recent examples are cited as follows:

(i) *Data analytics.* The IRD is seeking to adopt a wider use of data analytics to select cases for review or audit based on pre-set criteria. This helps reduce the reliance on manual analytical processes and focus on essential metrics and trend analysis for case selection.

(ii) *Blockchain network*. A permissioned blockchain network on the issue of an electronic version of Certificate of Resident Status will be rolled out by Q3 of 2025. Future applications including other cross-border information exchange would be explored. This may enhance audit trails and transparency in tax transactions.

(iii) *New tax portals.* The IRD plans to launch four new portals from 2025 to 2027.

(a) Individual Tax Portal: This portal will replace the existing eTAX System with enhanced functionalities for individual taxpayers. It allows taxpayers to submit returns and make payments electronically, track their application results, and receive notifications, thereby significantly reducing the administrative burden and processing time.

(b) Business Tax Portal: This portal is designed for businesses, enabling them to submit their profits tax returns online, view their e-filed tax returns and tax assessments issued, lodge objections and claims, and communicate with the IRD on other tax-related matters. It also provides a channel for e-filing of tax returns for employers, and conducts matters relating to stamp duty and business registration.

(c) Tax Representative Portal: This portal is designed specifically for tax professionals and service providers, enabling them to conduct electronic transactions on behalf of both individuals and businesses. It will provide tax representatives and service providers with tools to manage multiple clients efficiently.

(d) Pillar Two Portal: This portal is designed to facilitate the submission of top-up tax notifications and returns by in-scope MNE groups for the purposes of the Global Anti-Base Erosion (GloBE) rules and the Hong Kong minimum top-up tax (HKMTT), issue of top-up tax assessments and communication between the MNE groups and the IRD. The backend function of the portal will also enable the Hong Kong SAR to exchange GloBE Information Returns with other jurisdictions through the OECD's Common Transmission System.

BRITJ: On 28 February 2024, the Financial Secretary of the Hong Kong SAR announced the 2024-25 Budget. Could you please briefly introduce some key tax measures contained in the Budget?

Benjamin Chan: The key tax measures announced in the 2024-25 Budget include a one-off reduction of profits tax, salaries tax and tax under personal assessment for the year of assessment 2023/24 by 100%, subject to a ceiling of HKD3,000 per case. There will be two enhancement measures for deduction of expenses under profits tax, namely the new tax deduction for expenses incurred in reinstating the condition of the leased premises to their original condition and the removal of time limit for claiming industrial and commercial building allowances. In addition, we will further enhance the preferential tax regimes for related funds, single family offices and carried interest with a view to attracting more funds and family offices with potential to establish a presence in the Hong Kong SAR.

To boost public revenue, we propose to implement a two-tiered standard rates regime for salaries tax and tax under personal assessment starting from the year of assessment 2024/25. In calculating the amount of tax for taxpayers whose net income (before deduction of allowances) exceeds HKD5 million and whose salaries tax or tax under personal assessment is to be charged at a standard rate, the first HKD5 million of their net income will continue to be subject to the standard rate of 15% while the portion of their net income exceeding HKD5 million will be subject to the standard rate of 16%. We also propose to resume the collection of the hotel accommodation tax at a rate of 3% with effect from 1 January 2025.

BRITJ: The Hong Kong SAR plans to apply the global minimum tax on in-scope MNE groups and implement the HKMTT from 2025 onwards. Would you please brief us on the implementation progress of Pillar Two in the Hong Kong SAR?

Benjamin Chan: As an international financial centre and a responsible member of the international community, the Hong Kong SAR has all along been supportive of international efforts to enhance tax transparency and combat tax evasion. In the 2024-25 Budget, the Financial Secretary announced that the Hong Kong SAR will apply the global minimum tax rate of 15% in accordance with the GloBE rules, and impose the HKMTT on MNE groups with annual consolidated group revenue of at least EUR750 million starting from 2025.

To take forward the initiatives, the Government of the Hong Kong SAR conducted a three-month consultation exercise from December 2023 to March 2024 to gauge public views on the implementation of the global minimum tax and the HKMTT, as well as corresponding changes to the tax administration regime in the Hong Kong SAR. The Government has largely taken on board the respondents' views and is now finalising the legislative proposals for implementing the initiatives, with the aim of introducing the relevant amendment bill into the Legislative Council by January 2025. Concurrently, the IRD is developing the Pillar Two Portal to facilitate MNE groups' compliance with the GloBE rules and the HKMTT, including filing obligations and other related matters.

BRITJ: For all we know, the Hong Kong SAR's low, simple and competitive tax system has attracted a lot of investors globally to settle down. What impacts do you think the Pillar Two will have on MNEs in the Hong Kong SAR? Are there any tax measures to mitigate these effects?

Benjamin Chan: In the Hong Kong SAR, the global minimum tax and the HKMTT will only apply to in-scope MNEs (i.e. those with consolidated annual revenue of at least EUR750 million which operate in the Hong Kong SAR). The vast majority of corporate taxpayers, including purely domestic groups as well as small and medium-sized enterprises, will generally not be affected. The initiatives will put a floor on tax competition over corporate income. With a more level playing field in terms of taxation, it is anticipated that the Hong Kong SAR will be able to reinforce its competitive advantages.

We will preserve the simplicity, certainty, transparency and fairness of our tax system and maintain the territorial principle of taxation.

The Government of the Hong Kong SAR will ensure that the global minimum tax and the HKMTT are administered in a way that facilitates compliance of the in-scope taxpayers and reduces compliance burden. The business facilitating measures include:

(i) aligning the design of the HKMTT, including the scope and tax rate, with that of the global minimum tax to ensure simplicity of the regime;

(ii) allowing an in-scope MNE group to flexibly decide on how the HKMTT payable is allocated among the group's constituent entities in the Hong Kong SAR;

(iii) providing for safe harbours in the framework to relieve compliance burden and enhance tax certainty; and

(iv) requiring an in-scope MNE group to only furnish a single top-up tax return for the purpose of both the global minimum tax and the HKMTT to minimise compliance burden.

BRITJ: This year marks the fifth anniversary of the unveiling of the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area (GBA). What opportunities does the GBA bring to the Hong Kong SAR?

Benjamin Chan: The Government of the Hong Kong SAR attaches great importance to the GBA and its role in our future. More than a key national strategy, it is the obvious entry point for the Hong Kong SAR to integrate into the country's national development.

The development of the GBA will inject new impetus to the pillar industries of the Hong Kong SAR and support their diversification into areas with good potential, thereby strengthening the city's position as global financial, transportation and trade centres as well as an international aviation hub.

The development of the GBA also encompasses further improving the connectivity between the Hong Kong SAR and other cities in the region. The Hong Kong-Zhuhai-Macao Bridge and the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link, both commencing operation in 2018, have substantially shortened the commute time between the Hong Kong SAR and other parts of the GBA. Such large-scale cross-boundary infrastructures, combined with the ongoing efforts to streamline and simplify customs procedures between the Hong Kong SAR and the mainland, will facilitate the flow of people and goods within the region and bring about great convenience to the people of the Hong Kong SAR.

Furthermore, the development of the GBA enables the talents in the Hong Kong SAR, including young people, to participate in the advancement of the mainland's economy and seize opportunities in such areas as employment, entrepreneurship, internship and cultural exchange.

Recently, the finance and taxation departments of Guangdong Province, Shenzhen City, the Hong Kong SAR and the Macao SAR have entered into a Memorandum of Understanding (MoU) for promoting the coordination of tax administration and services in the GBA. The deepened tax cooperation in the GBA can enhance GBA's tax competitiveness and create a more favourable business environment, thus enhancing the development of the GBA.

To seize the opportunities of the GBA, the Government of the Hong Kong SAR will continue to liaise proactively with its Guangdong and Macao counterparts and relevant ministries of the Central Government for introducing more measures to facilitate connectivity, and the flow of people, goods and capital, as well as promote complementary economic development in the GBA.

BRITJ: What are worth promoting and learning from for the Belt and Road jurisdictions in the process of creating a competitive tax system in the Hong Kong SAR?

Benjamin Chan: In recent years, we have made active efforts in the following aspects, which can be used as a reference for the Belt and Road jurisdictions.

➢ *Tax transparency*

Tax transparency is a vital element of a robust tax system. Increasing tax transparency will improve understanding and foster trust between the tax administration and taxpayers. The benefits of tax transparency will contribute to a better compliance environment, providing long-term benefits for taxpayers and the economy. To provide for tax transparency, the IRD has promulgated guidance on new tax issues, illustrative examples and FAQs. Furthermore, we have delivered latest tax information or updates at seminars, conferences and meetings with tax profession and business sectors.

➢ *Client-focused approach*

Relationship management is another focus of the Hong Kong SAR's tax administration. To strengthen the working relationship between the IRD and the taxpayers as well as their tax representatives, the same assessing officers or teams will generally be assigned to handle tax files of the same enterprise or group of enterprises. In addition, there will be regular engagements with taxpayers to discuss the tax and compliance issues relating to the taxpayer; to alert taxpayers to any new or forthcoming tax developments that may concern the taxpayer; and to understand any change to the taxpayer's operation that may have tax implication.

➢ *Tax disputes mechanism*

Given the growing complexity of tax system, it is unavoidable that disputes over the application of the tax laws may occasionally occur. The Hong Kong SAR has established a comprehensive dispute resolution mechanism whereby a taxpayer who disagrees with the IRD's assessment may lodge an objection or appeal to the Commissioner, the Board of Review (which is an independent tax tribunal) or even the courts in accordance with statutory requirements. In addition to the established mechanism, the IRD also places emphasis on the efficiency in processing taxpayers' objections. We have prescribed the target response time for the objections in our performance pledge. We also take the view that litigation is not the only way to resolve disputes. In most objection cases, the IRD has been able to resolve tax disputes by way of settlement through direct negotiation with taxpayers or their tax representatives.

➢ *Leverage on information technology for tax administration*

The IRD leverages technology to improve the efficacy and efficiency of our services and to streamline tax filing processes so as to facilitate compliance and provide seamless and business-friendly experiences for taxpayers. For example, in order to handle general enquiries from the public efficiently, the IRD has launched on its website a real-time interactive service, a Chatbot named "Iris", since April 2021. "Iris" provides round-the-clock instant service in answering general enquiries relating to tax on individuals. In addition, with the Faster Payment System (FPS) in place since 2018, taxpayers can simply scan the FPS QR code on the bills issued by the IRD using supporting mobile applications of banks or stored value facilities and arrange payment of relevant taxes and fees in a convenient way.

➢ *Building extensive tax treaty network*

The Government of the Hong Kong SAR is committed to expanding the double taxation agreements (DTAs) network to provide enhanced certainty and predictability over tax liabilities arising from cross-border activities, with particular focus on the Belt and Road jurisdictions, thereby creating a favourable tax environment for businesses, and strengthening economic ties with the Belt and Road jurisdictions. By reducing the risks of double taxation and providing clearer tax rules, the DTAs make it more attractive for businesses and investors to engage in cross-border activities. This can encourage foreign direct investment and economic growth. DTAs help strengthen economic ties between the Hong Kong SAR and the Belt and Road jurisdictions by fostering a more predictable and transparent tax environment, thus bringing about deeper economic cooperation and collaboration.

➢ *Participation in international tax platform*

The Hong Kong SAR has been actively participating in the activities of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), including attending the Belt and Road Initiative Tax Administration Cooperation Forums (BRITACOFs), seminars, roundtable meeting, tax administration theme day events, training programmes organised by the BRITACOM/Belt and Road Initiative Tax Administration Capacity Enhancement Group. The valuable experiences and good practices which we have learnt from other jurisdictions serve as useful references for our work on further optimising our tax system.

BRITJ: The 5th BRITACOF took place in the Hong Kong SAR on 24-26 September 2024. What impressed you most as the host?

Benjamin Chan: The 5th BRITACOF has well served as an excellent platform for the exchange of knowledge and expertise in tax administration. It is inspiring to see around 500 tax officials and experts from various backgrounds came together and shared their expertise and experience. We have heard from prominent tax officials and experts about successful reforms, best practices as well as challenges faced by different jurisdictions.

As the host of the 5th BRITACOF, we are glad that a number of tax professionals in the Hong Kong SAR have had the opportunity to share their expert knowledge and experience in, among others, the promotion of tax administration digitalisation through coordination between tax authorities and enterprises and the optimisation of tax administration measures in the financial sector. And of course we all also benefit from the world-class sharing by other speakers and panelists.

The knowledge and insights gained from the Forum are invaluable to all of us in our endeavours to improve our tax systems and enhance the quality and capacity of our tax administrations, which are vital to economic development in our respective jurisdictions.

The fruitful discussions among participants demonstrated a shared commitment to strengthening tax administration cooperation and collaboration. We have reached consensus on deepening tax administration cooperation of the Belt and Road jurisdictions in the coming years and achieved significant outcomes which can serve as a foundation for future collaboration.

Practices and Experience in Expediting Transfer Pricing Dispute Resolution

Transfer Pricing and Dispute Resolution Branch, International Tax and Relations Division, Inland Revenue Authority of Singapore

Abstract: Tax certainty is of paramount importance for businesses. It fosters a stable environment for investment and growth. The Inland Revenue Authority of Singapore (IRAS) seeks to create an environment that provides tax certainty to businesses from both domestic and international tax perspectives, thereby promoting economic growth.

Keywords: Tax certainty; Transfer pricing; Dispute resolution; Mutual Agreement Procedure

INLAND REVENUE AUTHORITY OF SINGAPORE

Transfer Pricing and Dispute Resolution Branch
International Tax and Relations Division
Inland Revenue Authority of Singapore

1. Introduction

1.1 Evolving Business Models and Environment

Businesses today operate in a highly globalised environment where interconnected markets and international trade significantly increase cross-border transactions and activities. At the same time, business models continually evolve with new ways of doing business, such as increased use of Artificial Intelligence or having business transactions through the Metaverse. The COVID-19 pandemic has also accelerated the pace of digitalisation and technological changes.

Jurisdictions will need to continually assess the relevance and applicability of existing tax rules to keep up with the rapidly evolving business landscape and to address new and more complex business models. It is also important for multinational enterprise (MNE) groups to keep abreast of international developments and to have adequate contemporaneous documentation to support business decisions that may be subject to scrutiny by tax authorities in future. The increased scrutiny of MNE groups' cross-border operations and transfer pricing policies to counter base erosion and profit shifting is expected to continue.

1.2 Tax Certainty for Businesses

While "change is the only constant," it is important to provide businesses with tax certainty to operate and thrive. In a volatile, uncertain, complex and ambiguous environment, stability and predictability in the global tax landscape are even more critical. The lack of clarity on tax rules and regulations may raise concerns about potential tax disputes and affect businesses' investment decisions in a jurisdiction. If tax disputes materialise, businesses could be embroiled in an extended and costly process with tax administrations, which in turn affects their business operations, financial viability and willingness to invest further in a jurisdiction. Resolving tax disputes also takes up resources in tax administrations that could be better utilised to develop new policies for economic growth.

1.3 Tax Certainty Promotes Economic Growth

As recognised by G20 Ministers, maintaining and enhancing tax certainty benefits both taxpayers and tax administrations, and is crucial for promoting investment, job creation and economic growth. Enhancing tax certainty is also one of the main priorities of the OECD Forum on Tax Administration, a forum through which tax administrators share knowledge, undertake research and develop innovative ideas to enhance tax administration globally. The 2015 Report on BEPS Action 14: Making Dispute Resolution Mechanisms More Effective (BEPS Action 14 Report) contains a commitment by jurisdictions to implement a minimum standard that ensures a timely, effective and efficient resolution of treaty-related disputes. The importance of tax certainty in contributing to a growth-friendly tax environment is also acknowledged by the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), where "Raising Tax Certainty" is one of the focus areas under the *Nur-Sultan Action Plan (2022-2024)*, which had been built on the *Wuzhen Action Plan (2019-2021)* Final Reports.

1.4 Dispute Resolution and Prevention Mechanisms in Singapore

As Singapore is a small and open economy with limited natural resources, the Inland Revenue Authority of Singapore (IRAS) recognises that a fair and transparent tax system is crucial for fostering economic growth and ensuring that businesses expand and invest in Singapore. IRAS has therefore taken efforts to create an environment that provides tax certainty to businesses both from a domestic and an international tax perspective. In the international context, IRAS has implemented dispute resolution mechanisms such as mutual agreement procedure (MAP) and arbitration, as well as dispute prevention mechanisms such as advance pricing arrangement (APA) and International Compliance Assurance Programme (ICAP). On the domestic front, taxpayers may pursue domestic litigation to resolve their tax disputes and IRAS has introduced several domestic cooperative compliance measures to provide more clarity and certainty to taxpayers.

This article will cover IRAS' practices and experience with regard to transfer pricing MAP and provide an overview of alternative dispute resolution mechanisms and dispute prevention mechanisms adopted by IRAS.

2. IRAS' Administrative Procedures for Transfer Pricing MAP

2.1 IRAS' Transfer Pricing MAP Administration

Singapore has a comprehensive tax treaty network of around 100 treaty partners. All of Singapore's comprehensive tax treaties contain the MAP article which allows a Singapore resident taxpayer to request for IRAS' assistance to resolve cross-border tax disputes by entering into discussions with a foreign tax authority, or for IRAS to provide advance tax certainty through APA.

MAP is a dispute resolution facility that provides taxpayers the opportunity to present their dispute to the competent authorities and allow the competent authorities to come together to discuss and agree on an outcome that seeks to resolve or minimise the double taxation suffered by the taxpayer. MAP provides an amicable way for IRAS and the relevant foreign competent authority to agree on the transfer pricing for their taxpayers' related party transactions for past years to eliminate double taxation arising from transfer pricing adjustments. Where the agreed MAP outcome between IRAS and the relevant foreign competent authority is accepted by the relevant taxpayers, it is binding on the relevant parties. In the following section we will introduce how MAP is implemented in Singapore.

In Singapore, MAP is available to:

• Taxpayers who are Singapore tax residents; and

• Taxpayers who are not Singapore tax residents but have a branch in Singapore. However, such applications must be submitted by taxpayers in the jurisdiction where they are tax residents and with which Singapore has a tax treaty.

2.2 IRAS' 4 - Step Transfer Pricing MAP Process

IRAS has set out the MAP process and timeline for taxpayers to engage IRAS in its electronic tax guide (e-Tax Guide) on transfer pricing guidelines. For each step of IRAS' 4-step transfer pricing MAP process, IRAS has also clarified the expectations and actions required of the taxpayers, as well as the follow-up actions to be undertaken by IRAS.

Under step 1 on submission of MAP application, once the taxpayer has decided on taking the MAP route to resolve the double taxation, the taxpayer should proceed to submit its MAP application to IRAS within the time limit specified in the MAP article of the relevant tax treaty. The taxpayer should also concurrently submit the MAP application to the other foreign competent authority. IRAS has also listed the information and documentation that taxpayer is required to submit, so that IRAS can evaluate the issues more efficiently and tailor the dispute resolution approach accordingly. In order to streamline and simplify the MAP application process, IRAS has recently done away with the need for pre-filing meetings. This is expected to reduce the time and resources required by taxpayers in the MAP process.

Under step 2 on evaluation of the MAP application, IRAS may seek clarification on the MAP application by requesting additional information from the taxpayer or by holding discussions with them. Following the preliminary review, if the MAP application is accepted, IRAS will issue letters of acceptance to both the taxpayer and the relevant foreign competent authority. If IRAS rejects the application, for instance, if the MAP application is not made within the time limit specified in the relevant tax treaty, it will notify the taxpayer and the relevant foreign competent authority in writing together with the reasons.

Under step 3 on the detailed review and negotiation upon acceptance of the MAP application, IRAS may again seek further clarification or information from the taxpayer, hold discussions with the taxpayer, or conduct site visits to the taxpayer's premises, which involve interviewing the taxpayer's key personnel. IRAS may also conduct joint fact-finding exercises with the foreign competent authority to ensure that the competent authorities have a common understanding of the case facts. This approach will also help to save time and resources for the taxpayer.

IRAS will update the taxpayer on the progress and the outcome of the competent authorities' negotiations. After every competent authorities' negotiation, IRAS will arrange a debrief meeting with the taxpayer to share updates from the discussion, and identify areas where further clarification is required to assist the competent authorities to progress future discussion. In line with the BEPS Action 14 minimum standard requirement, IRAS aims to resolve a MAP case within 24 months from receiving the taxpayer's complete application.

Under step 4 on implementation of the MAP outcome, once an outcome is reached between IRAS and the relevant foreign competent authority, IRAS will discuss the details and implementation of the agreement with the taxpayer. The taxpayer will have to decide whether the agreed outcome is acceptable.

2.3 Resourcing of the MAP Function

As highlighted in the BEPS Action 14 Report, it is important for tax authorities to ensure adequacy of their MAP function, in terms of personnel and training, so as to resolve MAP cases in a timely and effective manner. Singapore's MAP function is well-staffed, consisting of a total of seven competent authorities, along with nine staffs handling transfer pricing MAP cases and APA cases, and six staffs handling treaty MAP cases and other areas related to tax treaty matters. Regarding training, new staffs in the MAP function participate in an in-house transfer pricing training programme, conducted by tax specialists within the MAP function, covering both procedural and technical aspects. In terms of soft skills such as negotiation, new staffs receive on-the-job trainings to learn from experienced staffs and also engage in external training programmes. Staffs in the MAP function also regularly attend technical training programmes offered by various organisations, e.g. the Tax Academy of Singapore, and the Vienna University of Economics and Business (WU).

For better accountability, there will be a specific case manager assigned to each transfer pricing MAP case to oversee progress and ensure adherence to timelines. The cases are also assigned to case managers by jurisdiction, MNE groups and industry, where applicable, to enhance the case managers' knowledge and understanding of transfer pricing practices of the jurisdictions and MNE groups under their charge as well as to develop the case managers' specialisation in specific industries.

3. IRAS' Experience and Interactions with Competent Authorities and Taxpayers for Transfer Pricing MAP

3.1 Effective Communication and Trust between Competent Authorities

MAP is an avenue to resolve transfer pricing issues through negotiation and cooperation between competent authorities. Therefore, it is important for IRAS to promote clear and open communication with other competent authorities to identify key issues and address differences quickly.

IRAS has a good working relationship with its counterparts and has built mutual trust with them over the years. This strong foundation and cooperation that IRAS has established with the foreign competent authorities over the years has enabled IRAS to resolve cross-border issues in a mutually acceptable manner. While IRAS and foreign competent authorities may hold differing views on certain issues, the competent authorities would strive to bridge the gap in views and find mutually acceptable solutions in order to provide relief for double taxation and tax certainty to taxpayers.

In respect of MAP, the jurisdiction that has made the audit adjustment would first provide the position paper to the other jurisdiction, explaining the basis of the audit adjustment and the views of the competent authority. The other competent authority would then provide a response paper to share its views. If the exchange of position papers does not resolve the MAP, the competent authorities will arrange for a meeting to discuss the MAP case further. Even if the competent authorities require more time for their review, IRAS and the foreign competent authority may still arrange discussions to exchange preliminary views on the MAP case and to highlight the key areas of concern and focus. This will facilitate subsequent discussions and shorten the duration in reaching a MAP outcome.

3.2 Taxpayers' Engagement and Cooperation

While taxpayers are not directly involved in the negotiation process, the cooperation and commitment of taxpayers are essential to the success of the MAP process. As stated in the IRAS transfer pricing guidelines, taxpayers should:

• Act in good faith throughout the process;

• Comply with all the requirements pertaining to the application processes;

• Provide access to all relevant documentation, including transfer pricing documentation;

• Be forthcoming in providing complete and reliable information and good quality analysis (including actual examples) relating to the MAP;

• Adhere to all the stipulated timelines when providing any clarification, information and analysis that may be requested by IRAS and the relevant foreign competent authorities;

• Update IRAS on all information that they have provided to or received from the relevant foreign competent authorities on a timely basis; and

• Provide the same set of information to IRAS and the relevant foreign competent authorities.

3.3 Use of Technology

IRAS has also leveraged digital technologies to improve efficiency of dispute resolution. The silver lining to the COVID-19 pandemic is the accelerated adoption of video conferencing facilities for meetings. As compared with face-to-face meetings, it is easier to organise virtual meetings between competent authorities. Hence, virtual meetings can be held more frequently, thereby expediting dispute resolution. Furthermore, most, if not all, tax authorities are using emails over traditional mailing options to facilitate more efficient and convenient communication. The same applies to the interactions between IRAS and taxpayers, where virtual meeting tools have resulted in faster communication and clarification with taxpayers.

That said, based on IRAS' experience, face-to-face meetings may be more effective in building trust and closer relationships with fellow competent authorities. In discussing complex cases, a face-to-face meeting with competent authorities may also be more useful in achieving a quicker resolution.

3.4 Sharing of the Best Practices and Peer Reviews

Despite the existing dispute prevention and resolution mechanisms, it is not sufficient for jurisdictions to operate in isolation. Discussions at various international forums are useful for tax authorities to stay informed about the latest trends or developments and ensure that their tax dispute prevention and resolution mechanisms remain robust.

Singapore is an active member of the OECD Forum on Tax Administration-Mutual Agreement Procedures (FTA-MAP forum), which ensures that jurisdictions implement the BEPS Action 14 minimum standard with respect to resolution of treaty-related disputes and be subject to peer reviews on their dispute resolution mechanisms. The FTA-MAP forum, which consists of representatives from competent authorities, also provides an avenue for tax authorities to discuss challenges encountered in resolving MAP disputes and to collaborate on improving existing dispute resolution mechanisms. As part of our commitment to the Action 14 minimum standard, Singapore strives to resolve its MAP cases within an average period of 24 months. Singapore has completed both Stage

1 and Stage 2 peer reviews and was assessed to meet the minimum standards in December 2017 and March 2020 respectively.

In addition to the FTA-MAP forum, Singapore actively participates in and contributes to the FTA Tax Certainty Focus Groups, which relates to APA best practices, multilateral APAs/MAPs, and benchmarking. Through these Focus Groups, Singapore contributes its views and learns from the experience of other jurisdictions, and shapes the guidance eventually developed to enhance tax certainty for taxpayers.

Singapore is also an Observer of the BRITACOM and participates in its Raising Tax Certainty Task Force by speaking at seminars, contributing articles to the *Belt and Road Initiative Tax Journal* (BRITJ) and sharing insights on Singapore's practices through questionnaires and surveys. Regionally, Singapore is a member of the Study Group on Asia-Pacific Tax Administration and Research (SGATAR) and ASEAN Forum on Taxation. Through these forums and work groups, Singapore exchanges views and learns from other jurisdictions to promote tax certainty for taxpayers.

4. Alternative Dispute Resolution Mechanisms

4.1 Arbitration

Under the MAP process detailed above, jurisdictions may not be able to reach an agreement or achieve full elimination of double taxation for taxpayers, or they may be unable to do so in a timely manner. Arbitration provides an alternative dispute resolution mechanism for taxpayers, where unresolved issues may be submitted to an arbitration panel for resolution, if the taxpayer requests in writing to do so. The decision reached by the arbitration panel helps to resolve issues that may otherwise hinder agreement between competent authorities in deadlocked MAP cases.

Singapore opted for the mandatory binding arbitration provisions to be included in our tax treaties upon signing the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) in 2017. Although this was a non-mandatory provision under the MLI, Singapore believes that it will be beneficial for taxpayers to provide more certainty and timeliness in resolving cross-border disputes.

4.2 Domestic Litigation

The MAP does not preclude taxpayers of other remedies available under their respective domestic tax law. Businesses retain the option to seek legal remedies in the jurisdiction where the transfer pricing adjustment is made.

Taxpayers should inform IRAS and the relevant foreign competent authorities if the matter

is adjudicated through any legal or judicial proceedings while the MAP process is still ongoing. The competent authorities will then discuss and decide if the MAP process should be continued, ceased or suspended.

Where the matter has been subjected to litigation and determination by the Singapore tribunals and courts, IRAS is unlikely to amend the transfer pricing adjustments that depart from the determination by the Singapore tribunals and courts.

5. Dispute Prevention

5.1 APA

When it comes to tax disputes and double taxation, prevention is better than cure. Both taxpayers and tax administrations can save time, efforts and resources by preventing tax disputes from arising in the first place. Dispute resolution processes can be very time-consuming, costly and resource intensive for taxpayers and tax administrations. Dispute resolution typically arises when taxpayers are subject to audit adjustments and suffering from additional taxes, or sometimes penalties. In this regard, to minimise the resources expended on dealing with audit queries and appealing audit adjustments, IRAS encourages taxpayers to apply for APAs to obtain early tax certainty on the pricing of their related party transactions, which will in turn reduce tax disputes.

IRAS is seeing an increased focus from businesses on dispute prevention, fuelled by taxpayers' desire for early tax certainty. To a certain extent, this is a result of improved maturity in jurisdictions' APA programmes as well.

There are three types of APAs available in Singapore: unilateral, bilateral and multilateral. IRAS has a preference to enter into bilateral or multilateral APAs as they provide the most tax certainty to taxpayers since the agreements are also binding on the foreign tax authority.

Similar to the MAP, IRAS' good working relationship and open communication with the foreign competent authorities, as well as the cooperation and commitment from taxpayers are critical to the successful conclusion of APAs.

5.2 ICAP

ICAP is a voluntary risk assessment and assurance programme to facilitate cooperative multilateral engagements between MNE groups and tax administrations where they have activities. This is mainly driven by the growing complexity of business models and inter-relatedness of trans-national transactions. It is designed to provide an efficient, effective and coordinated approach to provide MNE groups with multilateral tax certainty with respect to certain of their activities and transactions, thereby reducing the number of tax disputes.

Singapore is one of the signatories to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (as amended by a Protocol in 2010), which is the multilateral instrument that provides a legal basis for various forms of mutual assistance such as ICAP. Singapore has been a member of the ICAP Steering Group since March 2021, as part of our commitment to providing tax certainty to taxpayers. Under ICAP, IRAS will work together with MNE groups and other participating tax administrations to reach a mutual understanding of the tax risk presenting in certain activities and transactions carried out by an MNE group.

5.3 Domestic Cooperative Compliance

IRAS enhances its communication and engagements with taxpayers to engender trust and strengthen compliance. IRAS values an open relationship built on trust and encourages taxpayers to come forward early in partnership with us to discuss new business models or business restructuring activities to avoid future transfer pricing controversies. To minimise ambiguities in the interpretation of tax rules and facilitate compliance among taxpayers, IRAS regularly provides guidance to clarify tax rules and publishes its technical positions on the website, along with detailed e-Tax Guides, to provide a clear and consistent interpretation of tax laws.

IRAS also conducts seminars or workshops as part of the wider taxpayer service and outreach strategy to educate taxpayers and engages in regular dialogues with the business community. Additionally, through taxpayers' feedback and inquiries regarding the interpretation or application of tax rules, IRAS can collaboratively develop new rules or policies together with taxpayers. Such regular engagements and consultations enable IRAS to take into account taxpayers' concerns in the design of the rules, ensuring greater clarity and thereby providing tax certainty.

IRAS also manages other domestic programmes designed to provide tax certainty. For instance, IRAS engages its large corporations, who are likely to face more complex tax issues, through the Enhanced Taxpayer Relationship ("ETR") programme.

IRAS also offers the Advance Ruling System for Income Tax and Goods and Services Tax ("GST") where IRAS will provide its interpretation of how a specific tax provision would apply to a specific business arrangement faced by a business.

In 2022, IRAS introduced the Tax Governance Framework ("TGF"), and Tax Risk Management and Control Framework for Corporate Income Tax ("CTRM"), in addition to the existing Assisted Compliance Assurance Programme ("ACAP") for GST. These are voluntary compliance initiatives that taxpayers can apply for to demonstrate their adherence to sound tax governance policy and practices, as well as a round and robust tax risks management framework.

6. Conclusion

Dispute resolution and prevention are essential in preserving taxpayers' trust in the tax system. While Singapore has introduced numerous initiatives and mechanisms to provide tax certainty to taxpayers, IRAS recognises that the tax landscape is constantly evolving. IRAS will continue its efforts to ensure that its dispute prevention and resolution mechanisms remain effective and efficient in providing tax certainty for taxpayers.

Tax administrations need to collaborate based on mutual trust and close cooperation to provide the much-needed tax certainty for taxpayers. This may be achieved by providing upfront certainty to businesses via dispute prevention mechanisms such as APA to prevent lengthy transfer pricing audits and associated penalty payments. Nevertheless, in the event that disputes do arise and double taxation occurs due to transfer pricing adjustments, tax administrations should strive to resolve the disputes in a timely manner.

In the light of changing and evolving international tax developments, it is important for all tax administrations to build up their technical and administrative capabilities to address increasingly complex international tax issues and provide tax certainty for taxpayers. Consequently, we believe that tax administrations should continue to engage with their counterparts and share best practices on dispute prevention and resolution mechanisms through bilateral engagements and various international forums, including the BRITACOM.

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Nigeria's Efforts in Harmonizing Tax Laws for Greater Certainty

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Abstract: This paper highlights Nigeria's efforts in harmonizing tax laws in order to achieve greater certainty in its tax system. The research examines the current tax landscape in Nigeria, pointing out the complexities and inconsistencies that have hindered tax administration and compliance. This article also emphasizes the initiatives undertaken by the Nigerian government to harmonize tax laws, including the establishment of the National Tax Policy and the review of existing tax legislation. The impact of these efforts on tax certainty is highlighted, and areas for further improvement are identified. The research findings suggest that, while progress has been made, more needs to be done to achieve a cohesive and coherent tax system that promotes economic growth and development. This article recommends a comprehensive approach to tax reform, involving stakeholder engagement, legislative simplification and the adoption of international best practices.

Keywords: Tax certainty; Tax harmonization; Transparency in tax administration; Global standards; Tax reform

1. Introduction

Tax certainty is an important pillar for economic growth, playing a critical role in shaping the investment landscape of any country. For nations like Nigeria, where the need for foreign direct investment (FDI) is paramount for economic diversification and sustainable development, a predictable and transparent tax environment is essential. Investors seek assurance that the tax framework will remain stable and equitable, thereby allowing them to plan their business strategies with a sense of confidence and predictability.

Historically, Nigeria has faced significant challenges in achieving tax certainty due to a combination of factors including multiplicity of tax laws, inconsistency in the enforcement of tax laws, complexity in legislation, lengthy court procedures, unclear drafting and frequent legislative and policy changes.[1] In October 2010, Pricewaterhouse Coopers listed 50 top tax issues[2] faced by Nigeria as it marked its 50th anniversary. These issues tend to create concerns among investors and businesses, particularly for international corporations seeking stable markets for expansion.[3]

However, in recent years, Nigeria has indeed been working on several tax reforms to enhance tax certainty and align its tax environment with global standards. By improving the predictability of its tax regime, aligning its tax policies with global best practices and fostering a transparent, stable and fair tax environment, Nigeria is increasingly creating a more conducive environment for investment, economic growth and development.

This article explores the current status of tax certainty in Nigeria, the strategies and initiatives that Nigeria has implemented to enhance tax certainty, and examines the progress made, the challenges faced and the opportunities available to create a more predictable tax regime that benefits both investors and the broader economy.

2. Understanding Tax Certainty

2.1 Key Components and Impact of Tax Certainty

Tax certainty refers to the clarity and predictability of tax laws and regulations, ensuring that taxpayers understand their obligations and the consequences of non-compliance. It encompasses several key components[4]:

➢ Predictable Tax Rules: Clear and stable tax laws enable businesses to make informed financial decisions and long-term investment plans without the fear of sudden changes in tax rates or regulations.

➢ Transparent Administration: Effective tax administration processes involve consistent enforcement and clear communication from tax authorities, allowing taxpayers to navigate the system with confidence.

➢ Limited Ambiguity: Tax laws should be drafted in a way that minimizes ambiguity, ensuring that both taxpayers and tax authorities have a common understanding of their interpretation. This clarity helps reduce disputes and fosters a cooperative relationship between the government and taxpayers.

Globally, tax certainty is recognized as a fundamental driver of economic stability and growth. Organizations like the OECD emphasize its importance in creating an environment conducive to investment and trade. Countries with high levels of tax certainty often experience increased FDI and a more robust business climate, as investors are more likely to commit resources when they can anticipate their tax liabilities with confidence.[5]

2.2 Impact of Tax Uncertainty on Investment

Tax uncertainty significantly affects a country's investment climate, with far-reaching implications for both FDI and domestic business operations.[6] Understanding these impacts is important for developing strategies to enhance tax certainty and attract investment.

1 Eddy E., Dan M., & Wisdom O. (2017). *Issues and Challenges Inherent in the Nigerian Tax System,* https://www.researchgate.net/profile/Daniel-Edori/publication/321650051_Issues_and_Challenges_Inherent_in_the_Nigerian_Tax_System/links/5b741ba745851546c9080336/Issues-and-Challenges-Inherent-in-the-Nigerian-Tax-System.pdf.

2 PricewaterhouseCoopers (2010). *Nigeria @ 50: Top 50 Tax Issues*, https://www.pwc.com/ng/en/pdf/nigeria-top-50-tax-issues.pdf.

3 Micah L. C., Ebere C. & Umobong A. A. (2012). Tax System in Nigeria—Challenges and the Way Forward. *Research Journal of Finance and Accounting* 5, pp.1-10.

4 IMF & OECD (2017). *Tax Certainty: IMF/OECD Report for the G20 Finance Ministers*, https://www.imf.org/external/np/g20/pdf/2017/031817.pdf.

5 *Supra note 4.*

6 *Supra note 4.*

2.2.1 Effects on FDI

➢ Deterrence of Investment: Foreign investors often seek stable environment where they can predict their tax liabilities. Tax uncertainty can deter potential investors who may choose to invest in countries with more predictable tax regimes. The fear of unexpected tax liabilities or sudden policy changes makes a jurisdiction less attractive compared with other emerging markets.[7]

➢ Increased Cost of Compliance: Multinational enterprises (MNEs) operating in a country without tax certainty will likely face higher compliance costs due to the need for legal and tax advisory services to navigate the complex and changing tax landscape. These added costs can diminish the overall return on investment, leading companies to reconsider their commitments to that market.[8]

➢ Risk Aversion: Investors typically prefer to avoid risks associated with tax disputes and ambiguity. When faced with uncertainty, companies may delay investment decisions or limit their commitments, opting instead to allocate resources to countries with clearer tax frameworks. This behavior ultimately stifles economic growth and development.[9]

2.2.2 Influence on domestic business

➢ Impact on Local Enterprises: Domestic businesses, particularly small and medium-sized enterprises (SMEs), are especially vulnerable to tax uncertainty. Without the resources to engage in complex tax planning or dispute resolution, these companies may struggle to comply with tax obligations, leading to increased anxiety and reluctance to invest in expansion or innovation.[10]

➢ Reduced Entrepreneurial Activity: There are a number of factors that can hinder the path of entrepreneurship development and related research literature highlighted the fact that taxes are one of the most important barriers for entrepreneurs.[11] A lack of tax certainty can stifle entrepreneurship as potential startups may hesitate to launch their ventures due to fears of unexpected tax liabilities or regulatory changes. This reluctance can hinder job creation and economic dynamism.[12]

➢ Heightened Tax Disputes: Increased ambiguity in tax laws leads to more frequent disputes between businesses and tax authorities.[13] The resulting conflict not only consumes time and resources but also fosters a climate of mistrust, discouraging collaborative efforts between taxpayers and the government.[14]

2.2.3 Challenges for startups and SMEs

➢ Resource Limitations: Startups and SMEs often operate with limited financial and human resources, making it challenging for them to navigate complex tax systems. Tax un-

7 *Supra note 4.*

8 Ecovis (2024). *Tax Complexity for Multinational Companies: Increasingly Complex Regulations*, https://www.ecovis.com/global/tax-complexity-for-multinational-companies-increasingly-complex-regulations/.

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10 *Supra note 9.*

11 Rusu V. D. & Dornean A. (2023). Do Tax Rates Matter for Entrepreneurial Motivations? An Empirical Approach. *Scientific Annals of Economics and Business* 2, pp.277-299. Retrieved from https://doi.org/10.47743/saeb-2023-0025.

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certainty exacerbates these challenges, resulting in potential non-compliance and missed growth opportunities.[15]

➢ Innovation Stifling: The unpredictability of tax policies can stifle innovation, as businesses may prioritize compliance over investment in research and development.[16] This dynamic can hinder the emergence of new ideas and technologies essential for economic progress.

➢ Exit of Businesses: In extreme cases, persistent tax uncertainty can lead to the exit of businesses from the market, as companies choose to relocate to more stable environments.[17] Such exits can result in job losses and a reduction in economic activity, further damaging a country's investment landscape.

In summary, tax uncertainty poses a significant barrier to investment, affecting both foreign and domestic businesses. Addressing these challenges is important for creating a more conducive environment that fosters confidence, drives economic growth and encourages investment in various sectors of the economy.

3. Challenges to Tax Certainty in Nigeria

Nigeria's tax system is characterized by a mix of federal, state and local taxes. The Federal Inland Revenue Service (FIRS) administers the centrally collectible taxes for the federation. Key taxes include Corporate Income Tax (CIT), Petroleum Profits Tax (PPT), Value Added Tax (VAT), Tertiary Education Tax (TET), Capital Gains Tax (CGT), Stamp Duties (SD), Personal Income Tax (PIT), Withholding Tax (WHT), Nigeria Police Trust Fund Levy, National Information Technology Development Levy (NITDL) and various excise duties. While the framework is designed to facilitate revenue generation for government projects and services, it faces significant challenges that impact tax certainty. Some of the challenges that have been identified include the following:

3.1 Frequent Policy Changes

One of the most pressing issues is the tendency for rapid changes in tax laws and policies. Frequent amendments can create confusion among businesses, making it difficult for them to stay compliant and effectively plan for the future. For instance, annual Finance Acts introduce new provisions, which can disrupt established business models.[18]

3.2 Ambiguities in Tax Laws

Many tax laws in Nigeria contain vague language, leaving room for varied interpretations. This lack of clarity can lead to disputes between taxpayers and tax authorities, as businesses may not fully understand their obligations. Such ambiguities hinder compliance and increase the risk of audits and penalties, further eroding investor confidence.[19]

3.3 Inconsistent Tax Enforcement

The enforcement of tax laws can vary significantly across different states in Nigeria. This inconsistency leads to a fragmented tax landscape where businesses operating in multiple jurisdictions face different compliance requirements and administrative practices. Such disparities can complicate operations for both local and foreign

15 Dom R., Prichard W. & Custers A. (2022). *Innovations in Tax Compliance: Building Trust, Navigating Politics, and Tailoring Reform*, https://issuu.com/world.bank.publications/docs/9781464817557/s/15149210.

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companies, deterring investment and fostering frustration among taxpayers.[20]

3.4 Limited Awareness and Resources

Many businesses, particularly SMEs, lack the necessary resources and expertise to navigate Nigeria's complex tax environment. This limitation often results in unintentional non-compliance, increasing the burden on these businesses and contributing to the overall perception of tax uncertainty.

3.5 Unsatisfactory Tax Dispute Resolution

The mechanisms for resolving tax disputes in Nigeria can be lengthy and cumbersome sometimes, further exacerbating uncertainties for businesses.[21] Delays in obtaining rulings or clarifications from tax authorities can create a risk-averse environment where businesses are hesitant to engage in new ventures or expand their operations.

Addressing these issues will not only benefit investors and businesses, but also strengthen the overall economic framework, fostering a more resilient and diversified economy.

4. Efforts to Enhance Tax Certainty in Nigeria

Recognizing the adverse impact of tax uncertainty on investment and economic growth, Nigeria has undertaken several initiatives aimed at improving its tax environment. These efforts, while still evolving, mark important steps toward enhancing tax certainty and making the country more attractive to both domestic and foreign investors. Among the many efforts are the following steps taken to enhance tax certainty in Nigeria.

4.1 Creating Tax Certainty by Means of the Finance Act (2019–2023)

The introduction of the annual Finance Act is one major effort to enhance tax certainty in Nigeria. It allows for periodic adjustments to tax laws, reflecting changes in the economic environment and addressing emerging tax issues to align them with the nation's evolving economic realities, provide clarity, remove outdated provisions, address ambiguities in tax legislation, and enhance tax certainty. This has been the trend since 2019. The Finance Acts, for example, have introduced changes to the Corporate Income Tax Act, Petroleum Profit Tax Act, Personal Income Tax Act (PITA), Value Added Tax Act, Capital Gains Tax Act (CGTA), Stamp Duties Act, Customs, Excise, Tariffs, etc. (Consolidation) Act, Tertiary Education Trust Fund (Establishment) Act, Industrial Development (Income Tax Relief) Act, Finance (Control and Management) Act, Police Trust Fund Act, Nigeria Export Processing Zones Act, and National Agency for Science and Engineering Infrastructure Act.

Led by the Presidential Committee on Fiscal Policy and Tax Reforms in Nigeria, a comprehensive review of existing tax legislation is presently being undertaken, focusing on simplifying complex tax provisions and removing outdated or ambiguous expressions.

4.2 Harmonization of Federal and State Taxes

Efforts to harmonize tax administration between state and federal authorities aim to address issues related to double taxation and overlapping tax jurisdictions. One of the key initiatives is the Nigeria Tax Bill 2024, which aims to simplify

20 Ierkwagh K., Imbwaseh R. N. & Yagba J. F. T. (2020). The Legal Regime for Tax Enforcement in Nigeria: An Appraisal. *International Journal of Law* 5, pp.346-353. Retrieved from https://www.lawjournals.org/assets/archives/2020/vol6issue5/6-5-60-933.pdf.

21 Andersen Tax (2019). *Tax Dispute Resolution in Nigeria: Challenges and Practical Steps*, https://www.mondaq.com/nigeria/tax-authorities/798522/tax-dispute-resolution-in-nigeria-challenges-and-practical-steps.

the tax system by consolidating various tax laws into a single framework.[22] This bill is part of government's broader agenda to create a more transparent and robust economy.[23] Streamlining these processes helps eliminate conflicts and inconsistencies that could lead to uncertainty for taxpayers.

4.3 Digitalization and Automation of Tax Collection

Technological innovation is playing a vital role in enhancing tax certainty in Nigeria. The introduction of e-filing platforms, e-payment systems and automated tax assessments has helped to significantly streamline tax administration, and reduce delays, errors and inconsistencies that have traditionally plagued the system. The introduction of platforms such as the Integrated Tax Administration System (ITAS) and, more recently, the TaxPro Max by the FIRS is among the most notable efforts. The online platforms allow taxpayers to file returns, make payments and access their tax records more easily, making compliance more straightforward for businesses of all sizes. The use of technology in tax collection also helps to increase transparency. By reducing the reliance on manual processes, digital platforms minimize the risk of human error, reduce opportunities for fraud, and improve the accuracy of tax assessments. For foreign investors, this digital transformation provides a more secure and predictable framework for understanding and fulfilling their tax obligations in Nigeria.

Moreover, the implementation of digital tax solutions supports the government's efforts to broaden the tax base by improving the capture of informal businesses and ensuring that more entities comply with their tax obligations. By increasing revenue through better compliance, Nigeria can further stabilize its fiscal environment, thereby increasing predictability in its tax policies.

4.4 Clarification of Tax Holidays and Investment Incentive Programs

Recent reforms have sought to make Nigeria's tax incentive structure more transparent and accessible. By clearly outlining the eligibility criteria, duration and benefits of tax incentives for sectors such as agriculture, mining, renewable energy, manufacturing and technology, the government aims to attract investment and reduce uncertainty for businesses seeking to benefit from these incentives. These programs offer temporary relief from corporate income taxes and customs duties, providing greater tax predictability for businesses seeking to invest in these emerging industries.

4.5 Implementation of Tax Administration Diagnostic Assessment Tool (TADAT)

The TADAT, developed by the International Monetary Fund (IMF), has been implemented by the Nigerian government to assess and improve the effectiveness of tax administration. By identifying gaps and enhancing processes, TADAT supports greater transparency, accountability and predictability in Nigeria's tax system.

4.6 Double Taxation Agreements (DTAs)

Nigeria has also sought to improve tax certainty for MNEs by negotiating DTAs with key trading partners. DTAs provide clearer tax treatment for cross-border transactions, reducing the risk of double taxation and helping businesses understand their tax obligations when engaging in international trade.

It is worthy to note that Nigeria has expanded its network of DTAs to include agreements with countries in Europe, Asia and Africa. These agreements offer MNEs greater clarity regarding tax liabilities on income earned from cross-border operations, enhancing investor confidence and reducing tax disputes related to international transactions.

22 Atoyebi A. A. (2024). Nigeria Tax Bill 2024: A Comprehensive Framework for Taxation. *BusinessDay*, October 10.

23 Awujoola A. (2024). *Nigeria: Considerations from Nigeria's Tax Reform Efforts*, https://www.wts.com.

4.7 Implementation of Mutual Agreement Procedure (MAP)

As part of its commitment to improving tax certainty, Nigeria has been implementing the MAP provisions in its DTAs. MAP allows taxpayers to resolve disputes arising from the interpretation or application of tax treaties between Nigeria and other countries, providing a more structured and timely method for dispute resolution.[24]

4.8 Multilateral Instrument (MLI) on Tax Treaty Arrangements

Nigeria signed the MLI to modify its tax treaties under the OECD's BEPS framework.[25] The MLI allows Nigeria to modernize and enhance its tax treaties with various countries, reducing instances of double taxation and ensuring that the tax rules are consistent with global best practices, thereby improving tax certainty for MNEs.

4.9 Taxpayer Education and Public Engagement

Regular stakeholder consultations between the government, tax authorities and businesses help shape tax policy reforms that address taxpayers' concerns. Furthermore, the annual Finance Act review process includes public hearings where stakeholders can provide input, which improves the alignment of tax policies with business realities. The FIRS has also launched taxpayer education campaigns aimed at improving awareness and understanding of tax laws.[26] By equipping taxpayers with the knowledge they need to comply with tax regulations, these campaigns help reduce misunderstandings and the risk of non-compliance, contributing to greater tax certainty.

4.10 Development of a Transfer Pricing Framework

To address tax base erosion and profit shifting by MNEs, Nigeria introduced transfer pricing regulations in 2012, aligning them with the OECD guidelines. These regulations provide clear guidelines for the pricing of transactions between related parties. They were updated in 2018 to tighten compliance requirements and provide clearer guidance on documentation and penalties. Nigeria's adoption of a comprehensive transfer pricing regime represents another important step toward enhancing tax certainty, especially for MNEs.[27] By aligning with international standards, Nigeria has reduced the potential for disputes related to cross-border pricing practices, giving businesses greater confidence in their tax planning strategies.

4.11 Tax Appeal Tribunals (TAT)

Efforts have also been made to strengthen the TAT system, which provides taxpayers with an avenue for resolving tax disputes outside of the regular court system.[28] By enhancing the efficiency and accessibility of tax tribunals, Nigeria seeks to provide businesses with a faster and more reliable mechanism for addressing tax disputes. These efforts help reduce the uncertainty associated with prolonged tax litigation in regular courts, enabling businesses to resolve their issues more quickly and focus on their operations.

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24 Federal Inland Revenue Service (2023). *Nigeria Mutual Agreement Procedure (MAP) Guidelines: 2023 Update*, https://old.firs.gov.ng/wp-content/uploads/2023/07/Nigeria-MAP-Guidelines_2023_update-final4193341963.pdf.

25 PricewaterhouseCoopers (2017). *Implications of OECD Multilateral Instrument (MLI) on Tax Treaties*, https://www.pwc.com/ng/en/assets/pdf/implications-of-oecd-mli.pdf.

26 Busola Aro (2022). *FIRS Signs MoU with NTA, FRCN to Commence Nationwide Tax Education*, https://www.thecable.ng/firs-signs-mou-with-nta-frcn-to-commence-nationwide-tax-education/.

27 PricewaterhouseCoopers (2018). *Nigeria's New Transfer Pricing Regulation (Part 1 of 2)*, https://www.pwc.com/ng/en/assets/pdf/new-tp-regulation-prt1.pdf.

28 Oniyangi B. (2020). *An Overview of the Tax Appeal Tribunal (TAT)*, https://thenigerialawyer.com/an-overview-of-the-tax-appeal-tribunal-tat/.

4.12 Establishment of a Taxpayer Service Department

FIRS has set up a Taxpayer Advocacy Department to assist taxpayers with resolving issues and navigating complex tax matters. The department provides guidance and helps address disputes, thereby fostering a more taxpayer-friendly environment and enhancing tax certainty.

4.13 Customs Modernization and Trade Facilitation Program

Part of the efforts of the Nigerian government to enhance tax certainty involve the automation and simplification of customs processes to improve import and export procedures, reduce delays and enhance compliance. The clearer framework for customs duties, excise taxes and other trade-related levies help reduce tax-related uncertainties for businesses involved in international trade.

4.14 Establishment of the Nigerian Investment Promotion Commission (NIPC) One-Stop Investment Center

The NIPC has set up a one-stop investment center to streamline the processes for setting up operations in Nigeria, including tax registration and compliance. This center helps both local and foreign investors navigate tax-related issues efficiently, reducing bureaucratic delays and confusion.

4.15 International Collaboration and Compliance with Global Standards

Nigeria's engagement with international tax bodies and its commitment to global tax standards are key strategies for enhancing tax certainty. Through its active participation in the OECD's Base Erosion and Profit Shifting (BEPS) initiative, Nigeria has taken steps to combat tax avoidance by MNEs. This initiative promotes fair taxation and transparency, which is essential for building trust with international investors.

By adopting global minimum standards and best practices in areas such as transfer pricing, country-by-country reporting and automatic exchange of tax information, Nigeria demonstrates its commitment to creating a tax environment that aligns with the expectations of the global investment community.

Additionally, Nigeria's involvement in the West African Tax Administration Forum (WATAF) and its collaboration with BRITACOM play an important role in aligning its tax policies with both regional and global standards. These partnerships enable Nigeria to benefit from knowledge-sharing, technical assistance and capacity-building, thereby further enhancing the predictability and efficiency of its tax system.

4.16 Use of Circulars and Guidelines to Clarify Tax Provisions

FIRS circulars play a significant role in enhancing tax certainty by providing clear, consistent and accessible guidance on tax law interpretation, helping businesses to better understand their tax obligations and reducing the risk of arbitrary assessments,[29] thereby supporting compliance, reducing disputes and fostering a favorable tax environment.

5. Conclusion and the Path Forward

These above-mentioned initiatives mark significant steps toward improving tax certainty in Nigeria. The global business environment demands a tax system that is consistent, easy to navigate and adaptable to changing international standards. Nigeria's ongoing efforts to reform its tax policies, including digitalization, simplification of tax legislation and efforts to reduce tax disputes, are commendable but must be expanded to ensure long-term success. Implementing policies that provide clear tax guidance, stable incentives and streamlined dispute resolution mechanisms will increase investor confidence

29 Udoma U. & Osagie B. (2021). *FIRS Issues Information Circulars on Provisions of Tax Laws Amended by the Finance Act 2020*, https://www.mondaq.com/nigeria/sales-taxes-vat-gst/1090720/firs-issues-information-circulars-on-provisions-of-tax-laws-amended-by-the-finance-act-2020.

and drive economic growth.

In conclusion, enhancing tax certainty is more than just a technical reform. It is a strategic imperative for Nigeria's development. A predictable tax system will serve as the foundation for sustainable growth, enabling businesses to thrive and the government to achieve its fiscal objectives. Through the implementation of the outlined reforms, Nigeria can build a tax regime that is fair, efficient and conducive to the economic progress of its people. The path ahead may present challenges, but with the right policies in place, Nigeria is well-positioned to become a leading tax administration model within Africa and the global economy.

The next steps involve consistent monitoring, evaluation and adaptation to ensure that Nigeria's tax policies remain relevant, competitive and responsive to the dynamic needs of the global economic landscape. With ongoing commitment to reform, Nigeria can achieve tax certainty and unlock its full economic potential.

By further enhancing clarity, predictability and fairness in the tax system, Nigeria can create a more stable environment for businesses, boosting investor confidence and promoting long-term economic growth.

Going forward, Nigeria must strengthen the institutional capacity of its tax authorities, ensuring that tax officials have the necessary tools and training to effectively manage modern tax administration challenges. Collaboration between the government and the private sector, as well as continuous stakeholder engagement, will create a tax environment built on trust and mutual understanding. Additionally, aligning with international tax standards through frameworks like the OECD's BEPS initiative will reinforce Nigeria's reputation as a reliable partner in global tax affairs.

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The Gabonese Experience in Improving Tax Certainty

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Abstract: Taking into consideration the utmost importance of tax certainty in creating a tax environment in favor of sustainable development and inclusive growth of Gabon, the author outlines several measures taken by the Gabonese government to improve tax certainty of the country. Efforts have been made in a number of aspects, such as at the level of the General Tax Code, in the Special Investment Zones, at the conventional level, at the bilateral level and at the community level, which have led to significant progresses.

Keywords: Tax certainty; Tax policy; Tax attractiveness; Special Investment Zones; Inclusive growth

Gabon, like many other countries in the world, places particular emphasis on improving tax certainty. Indeed, for the exploitation of its many raw materials (oil, manganese, wood, gold, etc.), the government has adopted a tax policy based on broadening the tax base. Several measures have been taken over the last 14 years to improve the tax attractiveness of the territory through laws, regulations and agreements that guarantee investors a secure return on investment. In this article, we will present the efforts made each year at the level of the General Tax Code (GTC), in the Special Investment Zones (SIZs), at the conventional level, at the bilateral level and at the community level.

1. At the Level of the General Tax Code

The GTC brings together the essential tax laws adopted by the Gabonese Republic. In this respect, it constitutes the common law in tax matters in Gabon because any company not benefiting from a special tax regime is governed by the provisions of the GTC. Article 2 of this Code provides for this purpose that:

"The basis, rate and methods of collection of taxes of all kinds are the domain of the law.

The rules of basis, liquidation and collection of taxes, duties and charges referred to in this Code are applicable subject to the provisions of international conventions duly ratified by Gabon and published in the *Official Journal of the Republic*."

Given their importance in establishing the Government's tax policy, the provisions of the GTC constitute the primary source of tax measures voted on each year by parliament. Indeed, each year, the tax services, through the Directorate of Legislation and Litigation (DLL), revisit the tax measures in force to ensure their clarity and easy application by operational services. In this context, several tax provisions will be rewritten or amended so that they are well understood by both the agents of the Tax Administration and taxpayers. These rewrites and amendments may concern the tax base or basis, the liquidation or calculation of the tax to be paid, the methods of recovery or control, or even the provisions relating to litigation.

It should also be noted that several amendments to the tax texts in force are the result of questions from taxpayers or employers about the difficulties encountered in understanding or applying certain provisions of the GTC. This is part of the ongoing dialogue that the Tax Administration maintains with taxpayers, either individually or through the organizations of which they are members.

2. In the Special Investment Zones

The SIZs were created by the Government to be real attractive zones for investors and thus constituted real poles of economic development. Article 3 of Law No. 036/2018 of February 8, 2019 regulating SIZs provides that:

"The special investment zone is a specific area of the national territory, customs or not, specially developed, created to allow the realization of industrial, commercial, agricultural, technological, tourist, research and educational activities as well as services. It covers a terrestrial, lagoon or maritime geographical area within which investors have obtained one of the approvals provided for by this law benefiting or not from a privileged regime."

Article 4 of the same law specifies that:

"The SIZ may consist of one or more categories of zones, including:

- a Privileged Economic Zone (PEZ);
- an Industrial Zone (IZ);
- a Privileged Industrial Zone (PIZ);
- a Commercial Zone (CZ);
- a Special Zone for the Promotion of Education and Technological Research (SZ-PETR);
- a High Productivity Agricultural Zone (HPAZ);
- a Zone of Entrepreneurial Excellence (ZEE);
- a Zone of Tourist Interest (ZTI); and
- a Service Zone (SZ)."

Of all these forms of SIZ, only the PEZ of NKOK, located around 30 kilometers from the capital, Libreville, has experienced real development with the setup of more than 100 companies operating in fields as varied as wood processing, drug production, drinking water production, etc.

In terms of taxation, Article 67 of Law No. 036/2018 cited above provides that:

"Investors admitted to the privileged SIZ regime benefit from:

- exemption from withholding tax of 20% on payments to non-resident service providers and permanent establishments established in Gabon and belonging to a company whose headquarters (parent company) are abroad, SIZ Affiliated Companies and SIZ Subcontractors, the Development and Management Body, its subcontractors and its affiliated companies;
- total exemption from corporate tax or industrial and commercial profits tax for the first ten years from the first sale of the company, including the minimum tax. From the eleventh year following the first sale, companies admitted to the Special Investment Zone regime will be subject to corporate tax or industrial and commercial profits tax at the rate of 10% for the five years following the initial ten-year exemption period;
- exemption from value added tax (VAT) for a period of twenty-five years from the date of obtaining admission approval, only for

sales made within the Special Investment Zone and for export. In the event of a VAT credit, this will be subject to reimbursement at the latest within thirty days of its request;
- exemption from all withholding taxes, for a period of twenty-five years from the first sale of the company; and
- exemption from land taxes on built and unbuilt properties, for a period of twenty-five years from their registration in the Land Conservation and Mortgages Register."

These tax benefits can only be lost if the beneficiary company has had its approval granted to it to set up in the zone withdrawn, in accordance with the provisions of Articles 50 to 53 of the law. This is not an easy decision.

Indeed, approval can be withdrawn in the event of a violation of the provisions of the law, its implementing decrees, the provisions of the SIZ specifications or any other legal or regulatory provision in force to which the law does not expressly derogate.

The approval may in particular be withdrawn if the Investor:
- has ceased to exercise an economic or industrial activity in the SIZ;
- has not complied with its investment program;
- has used resources attached to the SIZ for a purpose other than the transformation of said resources in the SIZ; and
- has lost, under the applicable legislative and regulatory provisions, a license or other permit required to exercise its activity in the SIZ.

The Administrative Authority[1], after having carried out an investigation, communicates the results to the company and to the Development and Management Body[2]. The company is formally notified to take the necessary measures to put an end to the situation created by its failure.

In the absence of a response within 30 days from the date of receipt of the formal notice, the Planning and Management Body may propose to the Administrative Authority the decision to withdraw the approval. This is notified to the Investor by means of an extrajudicial act.

Decisions to withdraw approvals may be appealed to the competent courts within 60 days from the date of notification.

3. At the Conventional Level

As part of the exploitation of its raw materials, the State has signed a certain number of agreements with large multinational companies. The purpose of these agreements, among other things, is to grant the companies concerned special tax regimes, accompanied, in almost all cases, by tax stabilization clauses. In general, a specific article inserted in the agreement will provide that the rates and methods of assessment and collection of the taxes listed in a previous article are stabilized for the entire duration of the Agreement. Consequently, for the entire duration of the Agreement, neither the Company nor its shareholders may be subject to taxes, duties, taxes and contributions of any kind, the creation of which would result from a legislative or regulatory text subsequent to the entry into force of the Agreement.

4. At the Bilateral Level

Gabon has signed double taxation avoidance agreements with several countries. These conventions have, among other things, the mission of providing legal security to individuals and legal entities of Gabon and the other State party in matters of prevention of double taxation and providing the mechanisms for resolving possible cases of double taxation.

1 Administrative Authority: geographical and functional grouping of all the administrations and services of the State involved in the process of creation, supervision, control and management of the operation of companies established in the SIZ.

2 Development and Management Body: private law entity in charge of the development, extension and management of a SIZ.

For example, Article 24 — *Elimination of double taxation in the area of income, wealth and inheritance taxes,* of the agreement signed with France, provides in its (1)(a) that "With regard to France, double taxation shall be eliminated as follows: income arising in Gabon and taxable or taxable only in that State in accordance with the provisions of this Agreement shall be taken into account for the calculation of French tax when its beneficiary is a resident of France and it is not exempt from corporate tax under French domestic legislation. In this case, Gabonese tax is not deductible from this income, but the beneficiary is entitled to a tax credit deductible from French tax."

On the other hand, points (2)(a) and (b) of the same article provide, with regard to Gabon, that "double taxation shall be eliminated as follows:

- (a) when, in accordance with the provisions of the Convention, a resident of Gabon is taxable in France on elements of his income or fortune not referred to in subparagraph (b), these elements of income or fortune shall be exempt from tax in Gabon.
- (b) when a resident of Gabon receives income taxable in France in accordance with the provisions of Articles 10, 11 and 12, Gabon shall grant, on the tax he receives on this income, a deduction equal to the tax paid in France on this same income. The amount of the deduction granted may not exceed that of the Gabonese tax relating to this income."

It emerges from this article that while France has chosen the tax credit mechanism to compensate for the double taxation suffered by its residents due to having paid tax in Gabon on income taxable in France, Gabon has chosen the exemption and deduction mechanisms when a Gabonese resident has been taxed in France on income taxable in Gabon.

Furthermore, Article 27, which deals with the *Mutual Agreement Procedure*, provides in point (1) that "Where a person considers that the measures taken by one or more Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of one of the Contracting States concerned.

The case must be presented within three years from the first notification of the measure resulting in taxation not in accordance with the provisions of the Convention." Points (2) and (3) specify that the competent authority shall endeavor, if the complaint appears to it to be justified and if it is not itself able to provide a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting States, with a view to avoiding taxation not in accordance with this Convention. The agreement shall be applied notwithstanding the time limits provided for in the domestic law of the Contracting States.

The competent authorities of the Contracting States shall endeavor, by mutual agreement, to resolve any difficulties or dispel any doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in this Convention.

5. At the Community Level

Gabon is a member state of the Economic and Monetary Community of Central Africa, in French "Communauté Economique et Monétaire de l'Afrique Centrale" (CEMAC). As such, it is subject to compliance with community provisions (regulations and directives), like all other member states. Thus, in terms of VAT, the tax regime adopted by Gabon complies with Directive No. 1/99/CEMAC-028-CM-03 of 17 December 1999 on the Harmonization of the Legislation of the Member States in the Field of VAT and Excise Duty. Article 21-1) of this directive provides, for example, that

"The rates of value added tax are as follows:

- general rate: a range between 15% and 18% applicable to all taxable transactions excluding transactions subject to the zero rate; and
- zero rate, applicable to exports, their accessories and international transport. The zero rate applies only to exports that have been the subject of a declaration endorsed by the

customs services."

As long as this directive is in force, exports will always be taxed in Gabon at the zero rate. Imports and deliveries of goods and services on the domestic market may never bear a rate higher than 18%.

Similarly, in terms of income tax, Gabon is required to comply with the provisions of Directive No. 01/04-UEAC-177 of July 30, 2004. Article 1 of this directive provides:

"A single annual tax on the income of natural persons is established. This tax, known as personal income tax, abbreviated as 'PIT', is levied on the taxpayer's overall net income.

This overall net income is made up of the total net income from the following categories:

- profits from industrial, commercial and craft activities;
- profits from non-commercial professions and similar income;
- profits from agricultural operations;
- property income;
- salaries, wages, allowances, emoluments, pensions and life annuities;
- income from movable capital; and
- capital gains made by individuals and similar persons."

This article of the directive has been transposed identically by the provisions of Article 73 of the GTC. According to this article,

"A single annual tax on the income of individuals is created.

This tax, known as personal income tax, abbreviated to 'IRPP', is levied on the taxpayer's overall net income.

This overall net income is made up, subject to the provisions specific to certain categories of income, of the total net income of the following categories:

- property income;
- salaries, wages, allowances, emoluments, pensions and life annuities;
- income from movable capital;
- capital gains realized by individuals and similar persons;
- profits from industrial, commercial and craft activities;
- profits from non-commercial professions and similar income; and
- profits from agricultural exploitation."

It is clear from the examples taken above that CEMAC plays an important role in maintaining the tax security of its member countries.

6. Conclusion

In short, it is clear from the points developed above that Gabon has understood that tax certainty is a key element in creating a tax environment conducive to its development and that it is in its interest and that of businesses to reduce tax uncertainty as much as possible. This is why tax security in Gabon is ensured by both national and international standards. These standards protect investors against frequent and sudden changes in tax rules, new tax rules with retroactive effect, a considerable gap between national and community or international standards, etc. These efforts have started to bear fruit on NKOK's PEZ, but several informed observers of the Gabonese economy wonder about the benefits of this tax certainty in terms of tax revenue. In other words, the tax certainty that Gabon, like many developing countries, provides to multinational companies that exploit its natural resources enables it to generate inclusive growth.

An Overview of Advice and Guidance Issued by the Australian Taxation Office to Achieve Tax Certainty:

With a Focus on Taxation Rulings

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Abstract: This article provides an overview of advice and guidance on income tax matters issued by the Australian Taxation Office, including but not limited to taxation rulings, as a contributor to tax certainty. The form and nature of that guidance have evolved over the years. Australia has had for many years a statutory regime to define and regulate binding rulings, and in addition, the system has also evolved into informal guidance that has been developed as a matter of administrative practice. The Australian approach to advice and guidance is largely shaped by the broader features of the Australian tax system, and in particular, the self-assessment regime, which places an increased burden on taxpayers.

Keywords: Taxation rulings; Advice and guidance; Tax certainty; Tax administration

1. Introduction

The purpose of this article is to provide an overview of advice and guidance issued by the Australian Taxation Office (ATO), including but not limited to taxation rulings, as a contributor to tax certainty.

Tax certainty is a fundamental objective which all tax systems strive to achieve. Australia's self-assessment environment provides a greater burden and responsibility on taxpayers to ensure that tax returns are lodged correctly.

Tax certainty requires multiple inputs at various points in the tax system: from policy design to law design to administration and compliance. This article describes the diverse range of advice and guidance issued by the ATO in respect of Australian income tax law.

Adam Smith, in his book *The Wealth of Nations* in 1776, identified certainty as a key objective of a good tax system: "The tax which each individual is bound to pay ought to be certain, and not arbitrary."[1]

The OECD declares that "Tax certainty calls for clear and simple rules and regulations that minimise disputes."[2]

The ATO comments on tax certainty as follows:

"The Law Design and Practice Group serves the community, government, and clients by ensuring the tax and superannuation laws are informed, understood, administered and applied with confidence and integrity. It is respected and trusted as the authoritative voice of the Commissioner on matters of law and revenue analysis. The group works collaboratively with Treasury and other agencies in supporting government outcomes and leading the ATO's work on design of new policies and law; providing certainty through interpretation of the law and publication of guidance to support taxpayers in getting it right the first time; and is committed to understanding the drivers of disputes — litigating only the right cases, using insights to prevent disputes and ensuring earlier resolution where disputes do happen."[3]

2. Australia's Tax System

Advice and guidance issued by the ATO are influenced by various features of the Australian tax system.

2.1 Self-assessment

Australia's income tax system is a self-assessment system. The primary aim of the self-assessment is to collect revenue with minimum administration and compliance costs. When self-assessment was introduced, the responsibility for applying taxation laws increasingly shifted to the taxpayer.

The self-assessment system means:

- The ATO accepts the information taxpayers provide is complete and accurate.
- The information provided will be reviewed if the ATO has reason to think otherwise.
- The responsibility is on taxpayers to ensure their tax return and other tax forms comply with taxation laws.
- The ATO assumes taxpayers complete their tax returns and other forms in good faith and accepts the information provided as being true and correct.[4]

The lodgement of a return by a self-assessment taxpayer results in a deemed assessment being made by the Commissioner of Taxation[5]: the Commissioner is taken to have made an assessment of the relevant taxable income and of the tax payable, being those respective amounts as specified in the return, and the assessment is deemed to have been served on the taxpayer.

2.2 Review Period

The law provides the ATO with a period where it may increase or decrease the amount of tax payable by way of amended assessment.

The amendment period is four years from the date of lodgement for most business taxpayers. There is no such time limit in the event of fraud or evasion.

2.3 Objections and Appeal

Taxpayers can object to tax assessments and amended assessments. Such objections are initially determined by the ATO, and if a taxpayer is dissatisfied with the objection decision, the taxpayer can appeal to the Administrative Appeals Tribunal or the Federal Court.

1 Adam Smith (1776). *An Inquiry into the Nature and Causes of the Wealth of Nations*. London: W. Strahan and T. Cadell. Part II: On Taxes.

2 IMF/OECD (2018). *Update on Tax Certainty*, https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/tax-administration/tax-certainty-update-oecd-imf-report-g20-finance-ministers-july-2018.pdf.

3 *The ATO Executive*, https://www.transparency.gov.au/publications/treasury/australian-taxation-office/australian-taxation-office-annual-report-2023-24/part-1-%E2%80%93-overview/the-ato-executive.

4 Australian Taxation Office (2024). *Self-assessment and the Taxpayer*, https://www.ato.gov.au/individuals-and-families/your-tax-return/self-assessment-and-the-taxpayer.

5 Section 166A, Income Tax Assessment Act 1936.

2.4 Audit Approach

The ATO runs extensive taxpayer engagement and compliance activities, including specifically developed and funded programmes, such as the Tax Avoidance Taskforce. The overriding principle of the ATO, especially for the large market, is to build and maintain community confidence that taxpayers are paying the right amount of tax, based on a "justified trust" model.

Justified trust is an OECD concept under which the ATO seeks objective evidence that would lead a reasonable person to conclude a particular taxpayer paid the right amount of tax. This is a higher level of assurance than confirming certain risks do not arise. The ATO tailors the assurance approach based on the profile of a taxpayer, and focuses on four key areas:

1) Understanding a taxpayer's tax governance framework;

2) Identifying tax risks flagged to the market;

3) Understanding significant and new transactions; and

4) Understanding why the accounting and tax results vary.[6]

3. Evolution of Taxation Rulings in Australia

3.1 Three-Stage History of Taxation Rulings

In 1975, a seminal review of the Australian tax system, the Asprey Report, noted:

"22.73 When requested by a taxpayer, the Taxation Office now gives advance rulings on the application of specific provisions of the law to a proposed transaction where full details of the contemplated transaction are supplied. The ruling is normally given on the understanding that it is not legally binding on the Commissioner. There is considerable merit in placing advance rulings by the Commissioner on a formalised basis binding him to the decision given. Rulings of this nature would clearly be of benefit to the taxpayer concerned and it is therefore reasonable that the cost of providing the service should be met by him rather than by the general body of taxpayers."

This is the genesis for what eventually became the binding ruling system.

In 2001, the Australian National Audit Office (ANAO) undertook a performance audit titled "The Australian Taxation Office's Administration of Taxation Rulings" (hereinafter referred to as "ANAO Report").[7] This report provides a helpful history of taxation rulings in Australia, separated into three periods:

- 1975–1989: The formation of the taxation rulings system;
- 1990–1992: Introduction of public and private rulings; and
- 1993–2001: Developments in the taxation rulings system.

The ANAO Report also includes a useful timeline diagram (see Figure 1) which shows the evolution of the taxation rulings system[8].

3.2 1990-1992 Reforms

A 13 December 1990 statement by the then Treasurer stated that in connection with self-assessment:

"The Commissioner of Taxation would continue to issue rulings. Taxpayers would be able to seek private rulings, which would be binding on the Commissioner. A request for ruling could be made before, with or after payment of the tax liability. Taxpayers could self assess or self amend on the basis of a ruling, and would have the right to object to, such a ruling.

General Taxation Rulings would also be issued by the Commissioner, along the lines of the current rulings system. Such rulings would

6 Australian Taxation Office (2021). *Large Business Justified Trust*, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/large-business/justified-trust.

7 Australian National Audit Office (2021). *The Australian Taxation Office's Administration of Taxation Rulings,* https://www.anao.gov.au/sites/default/files/anao_report_2001-2002_03.pdf, p.173.

8 Australian National Audit Office (2021). *The Australian Taxation Office's Administration of Taxation Rulings,* https://www.anao.gov.au/sites/default/files/anao_report_2001-2002_03.pdf, p.174.

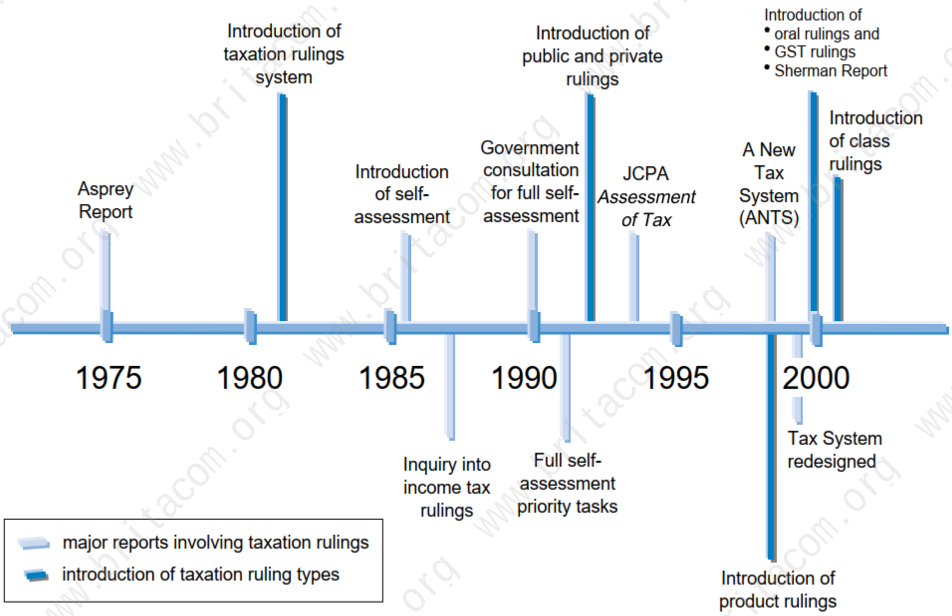

Figure 1. Major reports into the Australian Taxation Office with specific reference to taxation rulings and introduction of types of taxation rulings
Source: ANAO analysis.

also be binding on the Commissioner. Where a taxpayer disagreed with the application of a Taxation Ruling to their particular circumstance, they would be able to seek a private ruling and could then object to that ruling. Taxpayers failing to take rulings into account in determining taxable income could be liable to penalty following audit."

In 1992 and further to the above announcement, amendments were made to Australian tax law[9] "to improve existing self assessment arrangements". The relevant Explanatory Memorandum stated:

"Among other things, amendments proposed by the Bill will provide for a system of binding and, in some cases, reviewable taxation rulings. These amendments will affect:

- Public Rulings — rulings issued by the Commissioner for the information of the public generally; or
- Private Rulings — rulings given to individual taxpayers about their own particular tax affairs.

...

A ruling will be binding on the Commissioner if the ruling can be said to be favourable to a person. A ruling about a matter can be said to be favourable if the way in which the tax law would apply to a person in relation to that matter is different to the way the ruling stated that law would apply and the tax payable under an assessment or an amount of withholding tax would, because of the difference, be more than it would have been if the ruling had been correct. The ruling will be binding in the sense that the tax payable or the withholding tax is not to be greater than it would be if the ruling applied. A taxpayer will be able to self assess in line with the ruling. If the Commissioner was to make an assessment involving that matter, he will be compelled by the law to act in accordance with the favourable ruling."

3.3 2004-2005 Reforms

In 2004, Treasury undertook a "Review of Aspects of Income Tax Self Assessment"

9 Taxation Laws Amendment (Self-Assessment) Act 1992.

(hereinafter referred to as "2004 Review"). The purpose of the 2004 Review was to determine whether the self-assessment arrangements struck the right balance between protecting the rights of taxpayers and protecting the revenue for the benefit of the Australian community.

The 2004 Review discusses various aspects of the self-assessment system such as amendment periods, penalty and interest charges, and recommendations regarding ATO advice and guidance.

In response to the recommendations made in the 2004 Review, the Government introduced Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005, which replaced the existing regime and forms the basis for the current law dealing with public and private rulings.

By way of background[10], the Government stated:

"4.2 Before self assessment, taxpayers provided the ATO with relevant information and the ATO applied the law to assess their liabilities accordingly. Where taxpayers provided all relevant information, errors of fact could be corrected by the ATO but mistakes of law could not be. Under that system, the majority of risk and the cost of mistakes of law by the ATO were borne by all taxpayers. Self assessment relieved the ATO of the obligation to examine returns lodged by taxpayers and allowed the ATO to amend errors of calculation, mistakes of fact and mistakes of law after processing the initial assessment and collecting the tax payable or paying a refund. In some circumstances, returns may be re-opened many years after the original assessment. In this way, the introduction of self assessment shifted the balance of risk and uncertainty towards taxpayers. The change to self assessment meant that the ATO's resources could be used more efficiently, allowing more revenue to be collected for the same administrative cost.

4.3 Under self assessment, taxpayers may be uncertain about how the law applies to their circumstances. Uncertainty exposes taxpayers to costs (such as a requirement to pay additional tax, penalties and interest, or the costs of professional advice and litigation) if a shortfall is detected by the ATO. Uncertainty may have implications for taxpayer perceptions about the fairness of the tax system and consequently may affect the level of voluntary compliance by taxpayers. Finally, uncertainty about the tax consequences of a proposed transaction may have adverse economic implications, as taxpayers may be unwilling to enter into economically beneficial transactions if they are not able to obtain assurance about their taxation consequences."

The object of the new law was to provide improved ways for taxpayers to find out the Commissioner's view about how certain laws apply to them, so that the risks of uncertainty in a self-assessment environment are reduced.

The new provisions made public, private and oral rulings legally binding on the Commissioner where taxpayers rely on rulings that apply to them. The relevant Explanatory Memorandum states:

"3.24 A ruling applies to a taxpayer if the taxpayer is a member of the class to whom the ruling applies (in the case of a public ruling), or it is given in response to an application (in the case of a private or oral ruling) and the facts, assumptions or conditions set out in the ruling are met…

3.26 If a taxpayer acts (or has acted, or omits to act) in the way stated, a ruling that applies to a taxpayer binds the Commissioner and the Commissioner must not apply the provision in a way that is inconsistent with the ruling. However, if the scheme is not implemented in the way set out in the ruling, or material facts were omitted from the ruling application, or misleadingly or inaccurately stated, the ruling does not bind the Commissioner."

4. Current State

The key types of current ATO advice and guidance in Australia are listed in Figure 2.

Most forms of ATO advice and guidance

10 Refer to Regulation Impact Statement, Explanatory Memorandum to the 1992 Act.

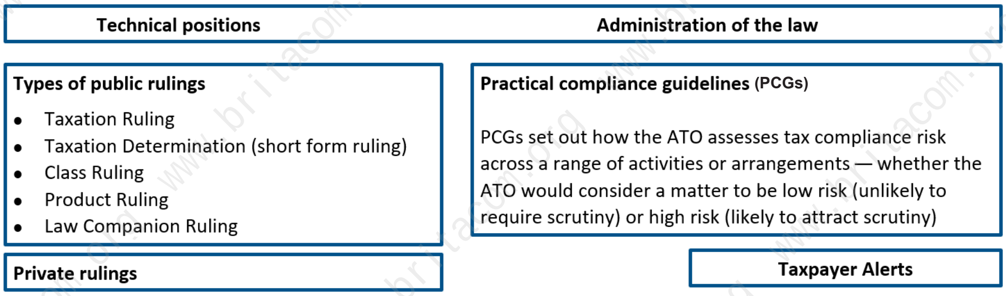

Figure 2. Key types of current ATO advice and guidance
Source: Author, based on the Australian Taxation Office.

are initially published in draft, with a comment or consultation period. In addition, there is a considerable amount of informal, webpage commentary and guidance issued by the ATO.

4.1 Key Aspects of the Private Rulings and Public Rulings

Some key aspects of the private rulings and public rulings are summarised in Table 1.

Table 1: Key aspects of the private rulings and public rulings

	Private Rulings	Public Rulings
Definition	Written expression of the Commissioner's opinion that sets out how a tax provision applies in relation to a specific scheme or circumstance, for particular income years	Written expression of the Commissioner's opinion that sets out how a tax provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes
Application	Applies to a taxpayer if it is given in response to a private ruling application and the facts, assumptions or conditions set out in the ruling or accompanying documents are met. Usually the private ruling applies only to the entity in respect of whom the application was made. Edited versions of private rulings are published, with client identifiers and other facts removed. The edited versions of written binding advice can't be relied on by taxpayers	Applies to an entity if the entity is a member of the class to whom the public ruling applies and the entity's circumstances come within the circumstances addressed in the public ruling. Specific types of public rulings include: A **class ruling** is a type of public ruling which explains how a relevant provision of the tax law is applied to a specific class of participants for a particular scheme. For example, a class ruling may be sought in relation to some public market transactions (takeovers, restructures, etc). A **product ruling** is a type of public ruling applicable to participants (or potential participants) and which deals with the tax consequences of an arrangement, provided it is carried out as described in the ruling. A **law companion ruling** expresses the Commissioner's view on how recently enacted law applies to a class of taxpayers, or to taxpayers generally
Fee	There is no fee payable by the taxpayer / applicant	
Binding aspect	Binds the Commissioner if the private ruling applies to the taxpayer and the taxpayer relies on the private ruling. Commissioner must not apply the provision covered by the private ruling in a way that is inconsistent with the private ruling to the taxpayer's detriment	Binds the Commissioner if the public ruling applies to the entity and the entity relies on it. An entity relies on a public ruling by acting (or omitting to act) in accordance with the public ruling. An entity does not need to know of the existence of a public ruling in order to rely on it

Date of effect	Applies for the specified period, so long as the law to which it relates remains in force. If no time is specified, the ruling applies from when it is made until the end of the income year or accounting period in which it started to apply	Binds the Commissioner from the time the public ruling is published, or from the earlier or later time as specified in the ruling. Applies for the specified period, so long as the law to which it relates remains in force
Law is re-enacted or remade	Where the law is re-enacted or remade, the ruling continues to apply. If the law is repealed or amended to have a different effect, the ruling ceases to apply	
Timing	Where the Commissioner has not made the ruling (nor declined to rule) within 60 days of the application being lodged, the taxpayer may give a notice to the Commissioner to make the private ruling. A taxpayer may lodge an objection if the Commissioner has failed to make a private ruling (or declined to rule) within 30 days after being given such a notice	Not applicable
Penalties	A private and public ruling (applied correctly) will protect taxpayers from having to pay any underpaid tax, penalty, or interest in respect of the matters covered by the ruling	
What if the ruling is incorrect?	The effect of a ruling binding the Commissioner is that there is no tax shortfall even if the ruling is incorrect. The false or misleading statement penalty and interest charges are not applied in these circumstances	

Source: Author, based on the Australian Taxation Office.

Following the issue of a private ruling, the normal practice as a matter of transparency is that the ruling is de-identified and edited, after which it is published as an "edited version of private advice". Taxpayers who are not the applicant for the private ruling cannot rely on an edited version of private advice: it provides no protection to such third parties with respect to underpaid tax, penalty, or interest. As a matter of practice, tax advisers and taxpayers will search the publicly available database of edited versions of private advice to obtain a non-binding indication of how the ATO has ruled in other similar matters.

4.2 Other Advice and Guidance

There is a wide range of other advice and guidance products issued by the ATO.

4.2.1 Law Companion Rulings

ATO Law Companion Rulings (LCRs)[11] describe how the ATO will apply new laws once enacted. Taxpayers who rely on these rulings in good faith will generally not be subject to underpaid tax, penalties or interest if the guideline does not correctly state how a relevant provision applies to the taxpayer.

Once finalised, LCRs are binding advice. They express the ATO interpretation of the laws it administers and the ATO opinion of how a provision of tax law applies to taxpayers generally, rather than to specific circumstances of a particular taxpayer.

LCRs are usually finalised as a public ruling and the protection elements are the same. Accordingly, if applied correctly it will protect taxpayers from having to pay any underpaid tax, penalty, or interest in respect of the matters covered by the ruling.

4.2.2 Taxation Determinations

Taxation Determinations (TDs) are a short form public ruling, dealing with a specific issue. In recent years, the number of TDs has reduced

11 Australian Taxation Office (2023). *How We Apply the Law*, https://www.ato.gov.au/businesses-and-organisations/trusts/in-detail/managed-investment-trusts/managed-investment-trusts-overview/how-we-apply-the-law.

and is now typically used as a means of communicating annual updates, for example, where certain thresholds are annually indexed.

4.2.3 Practical compliance guidelines

The ATO also issues practical compliance guidelines (PCGs)[12] which provide broad law administration guidance, addressing the practical implications of tax laws and outlining the ATO's administrative approach. For example, they might set out:

- how the ATO assesses tax compliance risk across a range of activities or arrangements in relation to a certain area of the law — where the ATO would consider an activity or arrangement low risk (unlikely to require scrutiny) and where the ATO might consider an activity or arrangement high risk (likely to attract scrutiny); and
- a practical compliance solution where tax laws are creating a heavy administrative or compliance burden, or where the tax law might be uncertain in its application.

A PCG typically describes an ATO compliance approach without necessarily giving a technical view of the relevant matter.

The ATO considers that PCGs can provide taxpayers with additional certainty and compliance savings, and allow the ATO to direct compliance resources to higher risk areas of the law.

PCGs do not provide the same level of protection as public and private rulings. If applied correctly, it will not protect the taxpayer from having to pay any underpaid tax, but they will be protected from penalty and interest.

4.2.4 Decision Impact Statements

Decision Impact Statements (DISs) are issued following certain court decisions, providing the ATO's view of the decision and whether there is any impact on existing advice or guidance.

4.2.5 Practice Statement Law Administration

Practice Statement Law Administration (PSLA) is published as a guide to ATO staff. However, such documents are also published to provide taxpayers with an understanding of the ATO's approach to the application of certain laws.

4.2.6 Taxpayer alerts

In addition, the ATO issues taxpayer alerts[13] to warn taxpayers of ATO concerns about new or emerging higher risk tax arrangements or issues that the ATO has under risk assessment. The ATO's aim is to share concerns early to help taxpayers make informed decisions about their tax affairs.

Similar to PCGs, taxpayer alerts do not provide the same level of protection as public and private rulings. If applied correctly, it will not protect the taxpayer from having to pay any underpaid tax, but they will be protected from penalty and interest.

4.2.7 Other guidance

In prior years, the ATO used to issue "ATO Interpretative Decisions" or ATOIDs. These were typically short (1-3 pages), addressing a specific technical issue. For example, in 2010, more than 200 ATOIDs were published. ATOIDs have not been published since 2016.

4.2.8 Website guidance

Further, the ATO provides a wide range of other written advice in the form of manuals, booklets, schedules, fact sheets, press releases and Interpretative Decisions. A considerable amount of this advice is available on the ATO webpage. The ATO webpage guidance is easily accessible and simplifies areas of tax law through concise wording, tables and/or examples. Often the ATO webpage guidance will refer to a binding taxation ruling. Advice provided through these mechanisms is not legally binding, however, some advice is treated as administratively binding, meaning the ATO will not apply penalties or interest if the advice is wrong, while other advice will only provide protection from penalties.

12 Australian Taxation Office (2018). *Practical Compliance Guidelines*, https://www.ato.gov.au/about-ato/ato-advice-and-guidance/ato-guidance-products/practical-compliance-guidelines.

13 Australian Taxation Office (2015). *Taxpayer Alerts*, https://www.ato.gov.au/about-ato/ato-advice-and-guidance/ato-guidance-products/taxpayer-alerts.

The Purpose of Tax Policy: Economic Growth

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Abstract: This article posits that the purpose of tax policy should be to drive economic growth, on the theory that investment leads to employment, which leads to taxation, which leads to development. In virtually all circumstances, economic growth is a prerequisite for revenue growth. The article calls on tax administrations to renew a focus on growth as the purpose of tax policy, discusses the dangers of "degrowth" and reviews the role of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) in raising the level of knowledge and skills of tax administrations.

Keywords: Tax policy; Taxation; Revenues; Tax administration; Incentives; Growth; Development; Investment; Employment; BRITACOM

1. The Importance of Growth

What is the purpose of taxation? The answer is clear: to provide adequate revenues that governments need for necessary functions of government. In the words of an opinion in a famous decision of the U.S. Supreme Court, "[t]axes are what we pay for civilized society." (Holmes, 1927) Taxes provide a continuing source of revenue. Governments use these revenues to promote economic development and social progress.

This seemingly simple question on the purpose of taxation, however, quickly raises other and equally important questions. First, how do governments determine the levels of taxation that will best meet their needs? As tax revenues provide funding for the essential functions of government, tax rates are ideally geared to accomplish that goal; most countries cannot rely on high levels of government debt to finance regular government operations without risking high inflation or other deleterious economic consequences. Second, how should policymakers determine which tax policy is the best?

The answer to these questions should determine both the scope and contours of tax policy and the design of the tax system. This article posits that, most broadly, the purpose of tax policy should be to drive economic growth, using a simple formula: Investment leads to employment, which leads to taxation, which leads to development. Increase in tax revenues, which also means in government's ability to fund essential functions, depends on profitable businesses employing workers and on investors, domestic or foreign, placing funds into those businesses or starting new businesses. In virtually all circumstances, therefore, economic growth is a prerequisite for revenue growth.

Too often, discussions on tax policy miss this most important element. Rather than simply adjusting the level of tax rates in response to economic conditions (or worse, to favor certain types of economic activity over others), a focus on growth shifts policymakers' priority to basic questions like how to design a tax system to promote the economic growth that itself drives higher revenue.

China, of course, has been one of the most prominent examples of rapid economic growth and eradication of poverty (Zhu, 2012). Other nations seek to follow this path, but they need assistance in doing so and encouragement to stay the course even in difficult times with demanding fiscal pressures. Through the Belt and Road Initiative, China seeks to develop closer ties with other developing countries around the world so that other nations may embark on the path of development and economic growth.

Indeed, other countries around the world including Bangladesh, Ethiopia, Mongolia, and Vietnam have enjoyed regular and sustained GDP growth (McKinsey & Company, 2022; Ventura, 2024). Still others, including Indonesia and Kenya, have taken bold steps in developing broader growth strategies, including diversifying the economy and moving up the value chain.

A focus on growth works. African countries highlight the trend. Even though overall African growth fell to 3.2% in 2023, the African Development Bank expects real GDP growth of 3.8% in 2024 and 4.2% in 2025 — higher than the global rate and second only to Asia (African Development Bank, 2024).

Considering Kenya, which the IMF expects will pass Angola to become the fourth largest economy in sub-Saharan Africa in 2024 and which is building that growth on the foundation of a very diverse economy not reliant on one dominant sector. Ethiopia, which had an economy smaller than Kenya in 2020, is also on a growth push and is expected to overtake Nigeria in 2026 (IMF, 2024). Many African countries already enjoy fast growth: the ADB forecasts that countries including Niger, Libya, Rwanda, Côte d'Ivoire, Ethiopia, Benin, Djibouti, Tanzania, Togo, and Uganda will all have growth at or above 6% (African Development Bank, 2024).

Yet despite some countries' progress, there is also a note of caution in the current international economy which reaffirms the need for policymakers to focus on growth. The UN Trade and Development Agency recently warned of "further growth deceleration" (UNCTAD, 2024). And while the agency urged "concerted multilateral action and a balanced policy mix," nations must also look to their domestic economic conditions for strategies to build growth. As economic growth slows, the importance of growth as the essential imperative of tax policy rises, because without it, revenues will fall and governments will not have the resources they need for development.

To this end, investments in infrastructure, both physical and social (such as education, healthcare, and gender equality) contribute strongly to growth. Frequently, however, they are necessary but not sufficient conditions if governments also make other policy choices, such as overexpansion of fiscal stimulus, without considering the effect on growth and a country's overall fiscal posture. The question then becomes how to avoid stifling economic growth even if countries make those necessary investments in physical and human capital.

For many countries, tax incentives have long been pivotal in attracting investment. Yet as reforms progress, policymakers must consider how to design incentives that encourage productive investment while avoiding distortions, ensuring they contribute positively to sustainable development as part of an overall strategy for growth. To assist this process, governments should understand how tax policy influences investors' decisions, particularly as companies face a maze of tax regulations in a rapidly shifting environment.

Governments must also prioritize practical considerations. Companies must understand the impact of tax policies, ensure compliance, and optimize tax strategies across diverse jurisdictions. For their part, businesses generally favor broad-based and easily administered taxes. Simplifying invoicing and tax collection fosters efficiency and promotes investment. In contrast, unpredictability or uncertainty in a tax regime can deter investment, underscoring the importance of clarity and stability in tax frameworks to maintain investor confidence and stimulate economic growth.

2. The Argument for Degrowth—a Danger to Economies

Some, in sharp contrast to this focus on growth, actually argue against growth and even for "degrowth" (Marquis, 2024; Saito, 2024). But this strategy is extremely shortsighted. First, degrowth ignores the plight of the poor, who need economic growth to lift them from poverty and provide the revenues governments can use to meet the UN Sustainable Development Goals. Second, global problems such as climate change cannot be solved by reducing economic growth but rather only from further investments in the new technologies, ranging from renewable energy to carbon capture and storage, that will deliver true emissions reductions towards net zero. This is a sharp retort to those who argue that the challenge of climate change requires degrowth. Third, reducing economic growth will quite simply lower tax revenues that governments need. The challenges of an aging population and other demographic pressures in many countries, the energy transition, and the need to service both internal and external debt without resorting to inflation all require an appropriate level of government revenues, which can only come from increasing, rather than decreasing, economic growth.

While governments should therefore easily dismiss the call for degrowth, economists continue to debate appropriate strategies to achieve economic growth. In an important recent paper, for instance, Rodrik and Stiglitz argue in response to lower economic growth from what they see as the decline of export-led industrialization that growth strategies should focus on "the green transition and labor-absorbing services" and posit that "sustained rapid growth, in turn, requires structural transformation." (Rodrik and Stiglitz, 2024)

Rodrik and Stiglitz wisely do not argue against economic growth, though one may question their conclusion that the era of export-led growth is over. Certainly many developing countries are increasing their exports in industries of all types. Latin America, for instance, is expected to expand its share of global agricultural exports by 17 percent over the next decade (FAO, 2023), while global merchandise trade continues to grow (2.6% in 2024 and 3.2% in 2025), albeit at lower levels than in the previous decade (WTO, 2024). One must also acknowledge that measuring economic growth, particularly for intangible goods including intellectual property or even services which form an increasingly important part of many developing countries' economies, can be difficult, yet it is vital to measure these types of economic activity to determine whether an economy is in fact experiencing growth (Roser, 2021).

Despite these challenges, a focus on growth as the underpinning of a tax system remains essential, and one can agree with the essential point of Rodrik and Stiglitz on the importance of a strategy for growth requiring structural transformation. But this is not merely a matter for economic policymakers. Tax policy must play a part in the development of that strategy; without it, the strategy risks missing its purpose precisely because governments need revenues from taxation to assist their own economic development, maintain a strong fiscal policy giving fiscal space to policymakers, protect their people, and promote social progress. For many countries, a structural transformation of tax policy will need to accompany the implementation of a strategy for growth. In short, a wise system of taxation built with this emphasis on growth can assist a country's development and attract significant foreign investment; an inefficient or ineffective tax system can hold a country back from achieving its full potential. Tax systems should therefore be designed to promote economic growth no matter what form of revenue mix forms the basis of a country's tax receipts.

Here again, tax policy becomes paramount, for unwise policy can deter sustainable economic growth in countries that might otherwise be primed for it. This is true no matter what strategy a country has developed for economic growth, for instance export-led manufacturing as in the Republic of Korea and other East Asian countries, a focus on increasing domestic demand as in Indonesia, Thailand, and other large developing countries, or highlighting specific economic sectors such as extractive industries or tourism. In each case, unwise tax policy can serve to limit or even reduce growth. As McKinsey & Company writes, "[m]eaningful economic growth is a marathon, not a sprint." Using that analogy, tax policy is among the parameters that countries running this marathon should regularly check.

3. What Factors Contribute to a Tax System Designed to Promote Economic Growth?

It is important to underscore that tax policy is not merely a question of determining tax rates. Excessively high tax rates discourage both domestic and foreign investment; excessively low rates mean that governments miss opportunities for revenue that can promote development. Setting rates appropriately is essential (and often challenging) but will depend on domestic circumstances. Rather, the more significant question is how a tax system is designed and the goals it seeks. Poor or corrupt tax administration, for instance, discourages foreign investment as surely as high rates do.

As a series of general principles, tax systems that promote economic growth are systems that are fair to all taxpayers; predictable in their effects to drive investment and ensure both domestic and foreign taxpayers understand their obligations; understandable to promote very high levels of compliance; and simple for revenue authorities to administer, to reduce opportunities for corruption and support fairness and predictability in the overall system.

Beyond avoiding degrowth, however, other alternatives to a focus on growth may be tempting but ultimately miss the mark. For instance, technology can produce growth — but technological advances of themselves do not replace the need for countries to focus on growth as an economic imperative. Greater adoption of AI, as an example, may improve productivity, which is a component of growth, but it cannot be a substitute for sustainable, broad-based growth. If anything, the usual pattern on the effects of the adoption of technology in many developing countries is the reverse: it is growth that opens the way for greater adoption of new technologies in a virtuous cycle, for instance in agriculture as countries become richer.

Similarly, while domestic resource mobilization is important, by itself it is insufficient to drive growth. The IMF's International Group of Twenty-Four on International Monetary Affairs and Development recently discussed the "crucial" role of Domestic Resource Mobilization for "funding sustainable development, particularly in light of decreasing overseas development assistance and private market financing." (IMF, 2024)

Without question, developing countries should seek to close the "tax gap" as an essential part of building a system that is fair to all taxpayers and repositioning it for growth. But by definition, if private market financing is declining, a system that should attract investment is not functioning as it should. Capital goes where it can seek higher returns. National governments, therefore, are far better advised to address ways to increase the attractiveness of their own domestic economies, including their tax systems, to encourage investment than simply to raise rates in the unlikely expectation that revenues will increase.

There are important steps that countries should take even while focusing on growth: improve transparency in tax systems (and digitise them), make tax administration fairer and more predictable, and bring more businesses into the formal economy where they will pay tax. For instance, African countries including South Africa, Mozambique, and Zambia have made important reforms in these areas. But those steps cannot obscure the reality that growth should be the heart of tax policy.

4. The Role of the BRITACOM

In all this, the work of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) is essential. The BRITACOM brings together jurisdictions with historic trading ties in a new, cooperative mechanism, in which consultation and discussion will help jurisdictions develop wise tax policy to promote sustainable economic growth based on increased foreign and domestic investment.

The BRITACOM has helped developing countries modernize their tax systems and optimize them for economic growth by promoting reforms involving tax regimes in a range of industries including extractive industries, agriculture, and many others. In short, this work is geared to develop systems that are fair and predictable while also promoting economic growth. Further, the BRITACOM has promoted the concept that these systemic issues require attention at the highest levels of national policy-making.

Along with this, the key insight that led to the establishment of BRITACOM and informs its work is raising the level of knowledge and skills among tax administrations, which in itself contributes to economic development, by helping countries to administer tax systems designed to promote economic growth.

Tax administration is too often neglected as an important aspect of a nation's overall tax system. In this context as well, the role of BRITACOM in the work of tax administration is essential. Beyond its efforts in promoting the Belt and Road Initiative and in helping countries to participate more effectively in it, perhaps most of all, it seeks to raise the level of knowledge and skills among national tax administrations by promoting cooperation among tax admin-

istrations. In this way, BRITACOM has a truly global impact. International Tax and Investment Center (ITIC) is proud to be one of the selected non-governmental organizations invited to actively participate in the workings of the BRITACOM.

5. Conclusion

There is simply no way to achieve the Sustainable Development Goals without real, sustained economic growth that lifts people out of poverty, increases gender equality, builds national education and health systems, provides funding for addressing climate change, and underpins strong domestic fiscal systems. Indeed, in this period as the global economy braces for an era of slower growth that attention to tax policy must rise, not fall, in national councils. Collaboration and partnerships between government and the private sector can aid governments in developing tax policy that promotes growth.

Just as tax policy is therefore essential to economic growth, economic growth is the fundamental purpose of tax policy. Policymakers, economists, and government leaders must both build a strategy for growth in partnership with tax authorities and continually ask as a fundamental question whether a particular regulation or tax policy will promote or discourage economic growth.

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Central Bank Digital Currencies and Their Use by Tax Administrations

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Abstract: Central Bank Digital Currencies (CBDCs) may offer transformative opportunities for tax policy and administration, particularly if features like programmability and enhanced transparency are implemented. Automating fiscal transfers could streamline government payments and reduce administrative burdens, while programmable tax enforcement could simplify compliance and recovery processes. Limited privacy capabilities may help address tax evasion and illicit financial flows by creating a transparent and traceable audit trail. However, implementing CBDCs involves balancing these benefits with challenges such as privacy protection and data security. Wide adoption requires a secure and trusted digital currency system that safeguards personal and financial information, preventing unauthorized access and cyberattacks. Additionally, CBDCs present risks like disintermediation and "digital dollarization", which requires careful design to mitigate. Cross-border use of CBDCs could reduce transaction costs and promote economic integration among Belt and Road Initiative (BRI) jurisdictions, but coordination on standards is essential to prevent regulatory competition. CBDCs have the potential to reshape financial and tax systems, being thus important to explore their design and governance.

Keywords: Central Bank Digital Currencies (CBDCs); Tax policy and compliance; Transparency; Programmability

1. Central Bank Digital Currencies: Opportunities for BRI Jurisdictions

In the last decade, the use of cryptocurrencies has increasingly penetrated the financial systems of jurisdictions around the globe, challenging the monetary sovereignty of central banks. This trend has created new risks due to the lack of sufficient regulation and control in many jurisdictions, alongside the volatility, pseudo-anonymous nature and, hence, potential for illicit financial activities and tax evasion. In their attempt to embrace this innovation, central banks of many jurisdictions consider the possibility of issuing their own digital money, which would become an alternative to cryptocurrencies subject to adequate control by the monetary authorities without being associated with the above risks.[1]

The concept of Central Bank Digital Currency (CBDC) is not without dispute and may refer to a wide range of realities. The most common could be the digital form of fiat money issued by a central bank; or the negative definition "digital form of central bank money that is different from balances in traditional reserve or settlement accounts".[2] According to the definition of the Bank of International Settlements (BIS), a CBDC "is a digital payment instrument, denominated in the national unit of account, that is a direct liability of the central bank".[3] Central banks can consider issuing two forms of CBDCs, retail and wholesale ones. Retail CBDCs (also known as general purpose or universally available CBDCs) constitute the type of CBDCs accessible to the general public as a direct claim on the central bank, similar to cash, thereby modifying the traditional two-tier monetary system where other forms of digital retail money

1 Cf. R. de Bonis & G. Ferrero (2022). *Technological Progress and Institutional Adaptations: the Case of the Central Bank Digital Currency (CBDC)*, https://www.bancaditalia.it/pubblicazioni/qef/2022-0690/QEF_690_22.pdf?language_id=1, p.17; PwC(2023). *PwC Global CBDC Index and Stablecoin Overview 2023*, https://www.pwc.com/gx/en/financial-services/pdf/pwc-global-cbdc-index-and-stablecoin-overview-2023.pdf, p.4; The use of CBDCs in a scenario which a cryptocurrency or stablecoin has substantial circulation was analyzed by: the Bank of Canada, cf. Raphael Auer, Giulio Cornelli & Jon Frost(2020). *Rise of the Central Bank Digital Currencies: Drivers, Approaches and Technologies*. BIS Papers No 880, BIS Monetary and Economic Department, https://www.bis.org/publ/work880.pdf, p. 26; and the safeguard of the trust in the national currency "vis-à-vis proliferation of crypto asset is another important motivation for introducing CBDC" is one of the motivations for issuance of CBDCs for India, cf. Reserve Bank of India (2022). *Concept Note on Central Bank Digital Currency*, https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/CONCEPTNOTEACB531172E0B4DFC9A6E506C2C24FFB6.PDF, pp. 20, 21.

2 BIS (2018). *Committee on Payments and Market Infrastructures and Markets Committee, Central Bank Digital Currencies*, https://www.bis.org/cpmi/publ/d174.pdf, p.4; M. Appendino, O. Bespalova, et al.(2023). *Crypto Assets and CBDCs in Latin America and the Caribbean: Opportunities and Risks*. Working paper WP/23/37, International Monetary Fund, p. 4.

3 Cf. joint report by the Bank for International Settlements, Bank of Canada, European Central Bank, et al. (2020). *Central Bank Digital Currencies: Foundational Principles and Core Features*, https://www.bis.org/publ/othp33.pdf, p. 3.

represent a claim on intermediaries.[4] Wholesale CBDCs are used by banks and other financial institutions, typically holding reserve deposits with a central bank, for interbank payments and securities transactions.[5] Additionally, the taxonomy of CBDCs makes a distinction between token-based and account-based CBDCs. The first category relies on wallet technologies and does not depend on a central agency and allowing for peer-to-peer transactions, which makes it similar to cash. The second category can be held within an account either in a public or a private financial institution, which is in charge of settling payments upon request.[6] Cryptocurrencies and CBDCs share certain similarities, as both exist in digital form and can be based on the blockchain technology. However, there is a number of principal characteristics that make CBDCs different from other cryptocurrencies. First, unlike cryptocurrencies, CBDCs are issued and regulated by central banks, which gives them control over the digital currency's creation, supply and monetary policy. Moreover, CBDCs represent a direct claim on the central bank without involvement of a private financial institution, which also makes them different from other cashless payment instruments (e.g., e-money and card payments).[7] Second, the design of CBDCs must ensure their recognition as legal tender[8] within a specific territory while cryptocurrencies are not recognized as a legitimate medium of exchange for goods and services in most of the jurisdictions. [9] Third, as a direct central bank liability, CBDCs are expressed in the same unit of account as the currency they issue, and their status as legal tender makes them stabler than crypto assets. It is noteworthy that crypto assets can be designed to maintain a stable value and pegged to a fiat currency or backed by stable assets, as is the case with stable coins and the so-called synthetic CBDCs which makes them less volatile than most of cryptocurrencies.[10] However, this feature might be also attributed to some stablecoins and synthetic CBDCs, neither of them being CBDCs.[11] Fourth, the use of CBDCs is specific to particular jurisdictions or monetary unions (e.g., in Eurozone and Eastern Caribbean Currency Union) and subject to the decisions and regulations of those central banks. In general, cryptocurrencies can be used in cross-border exchange. CBDCs have the potential to be used to facilitate cross-border transactions and offer some benefits compared with the traditional payment methods, e.g.,

4 BIS (2021), *Annual Economic Report*, https://www.bis.org/publ/arpdf/ar2021e.pdf, pp. 72, 92.

5 World Economic Forum (2021). *Digital Currency Governance Consortium, White Paper Series, Compendium Report*, https://www3.weforum.org/docs/WEF_Digital_Currency_Governance_Consortium_White_Paper_Series_2021.pdf, p. 13.

6 Lilas Demmou & Quentin Sagot (2021). *Central Bank Digital Currencies and Payments: A Review of Domestic and International Implications*. Economics Department Working Papers No. 1655, OECD, https://one.oecd.org/document/ECO/WKP(2021)6/En/pdf, p. 8.

7 Anneke Kosse & Ilaria Mattei (2023). *Making Headway — Results of the 2022 BIS Survey on Central Bank Digital Currencies and Crypto*. BIS Papers No. 136, BIS Monetary and Economic Department, https://www.bis.org/publ/bppdf/bispap136.pdf, p. 2.

8 For the purposes of this paper, the assumption is that jurisdictions recognize CBDC as legal tender and amend the central bank laws and other related legislation accordingly to ensure financial integrity.

9 By the moment of writing this article, the authors were aware about two countries, that have recognized bitcoin as legal tender, El Salvador and Central African Republic. Additionally, some states such as Switzerland accept bitcoin as the medium of exchange, including the possibility of paying taxes.

10 World Economic Forum (2023). *How are CBDCs Different from Cryptocurrencies and Stablecoins?*, https://www.weforum.org/agenda/2023/11/cbdcs-how-different-cryptocurrency-stablecoin/; European Central Bank (2018). *What is Bitcoin*?, https://www.ecb.europa.eu/ecb-and-you/explainers/tell-me/html/what-is-bitcoin.en.html.

11 R. de Bonis & G. Ferrero (2022). *Technological Progress and Institutional Adaptations: the Case of the Central Bank Digital Currency (CBDC)*, https://www.bancaditalia.it/pubblicazioni/qef/2022-0690/QEF_690_22.pdf?language_id=1, p. 8.

faster, cheaper and more efficient transactions, enhanced transparency, which follows from the pilot projects Inthaton-LionRock2, Jura, Dunbar and Bridge.[12] Finally, central banks have a higher degree of control over CBDCs than cryptocurrencies, as they can design the former with a limited degree of privacy, and impose regulation framework and identity verification requirements to prevent illegal activities.[13] These characteristics of digital money enable central banks to use innovative technologies to achieve certain aims not only in the field of monetary policy, but also in related areas that involve other governmental departments including the tax administration and achieving sustainable development goals. The use of more or less features may influence the adoption of CBDCs by the public, e.g., the less protection of privacy, the lower the acceptance may be.[14]

Currently, a significant number of jurisdictions, including China, Australia, the United Kingdom, Switzerland, Kazakhstan, Russia and India, nations in Latin America and the Caribbean (LAC), and several African countries, are conducting research or have launched digital money pilot projects, or exploring the potential of digital currencies,[15] with three out of four live retail CBDCs in the world circulating in the Latin America and Caribbean region (The Bahamas, the Eastern Caribbean and Jamaica). The key motivations for central banks' engagement in CBDC projects are mostly related to promoting financial inclusion, increasing the efficiency and safety of the domestic payments systems,[16] and their interest is caused by the opportunities of obtaining a number of benefits, which include, among other things, reduction of informality and provision of a mechanism for distributing funds to hard-to-reach individuals. Other possible benefits of CBDCs include reduction of cash economy and direct costs associated with physical cash, improving resilience and safety of payment systems, promoting openness and competition between private payments providers, further simplifying the financial system and fostering innovation, supporting monetary sovereignty and financial stability, and so on.[17] In addition, some of the developing economies,

12 Borten Bech, Codruta Boar, et al. (2022). *Using CBDCs Across Border: Lessons from Practical Experiments*, https://www.bis.org/publ/othp51.pdf.

13 However, the current regulatory framework of cryptocurrencies is constantly developing, leaving less possibilities to use cryptocurrencies for tax evasion and other illegal activities.

14 See Reserve Bank of India (2022). *Concept Note on Central Bank Digital Currency*, https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/CONCEPTNOTEACB531172E0B4DFC9A6E506C2C24FFB6.PDF, pp. 20, 21. See also the outcomes of the research: Syngjoo Choi et al. (2023). *Central Bank Digital Currency and Privacy: A Randomized Survey Experiment*. BIS Working Papers No. 1147, https://www.bis.org/publ/work1147.pdf, p. 29.

15 According to the BIS survey, 80 central banks out of those 86 that responded are engaged in the work on CBDCs. See Anneke Kosse & Ilaria Mattei (2023). *Making headway — Results of the 2022 BIS Survey on Central Bank Digital Currencies and Crypto*. BIS Papers No. 136, BIS Monetary and Economic Department, https://www.bis.org/publ/bppdf/bispap136.pdf, p. 2; PwC (2023). *PwC Global CBDC Index and Stablecoin Overview 2023*, https://www.pwc.com/gx/en/financial-services/pdf/pwc-global-cbdc-index-and-stablecoin-overview-2023.pdf, p. 4; *Today's Central Bank Digital Currencies Status*, https://cbdctracker.org/.

16 Christian Barontini & Henry Holden (2019). *Proceeding with Caution — a Survey on Central Bank Digital Currency*. Monetary and Economic Department, BIS Papers No. 101, https://www.bis.org/publ/bppdf/bispap101.pdf, pp. 3 and ff; Codruta Boar, Henry Holden & Amber Wadsworth (2020). *Impending Arrival — A Sequel to the Survey on Central Bank Digital Currency*. Monetary and Economic Department, BIS Papers No. 107, https://www.bis.org/publ/bppdf/bispap107.pdf, pp. 4 and ff; Viviana Alfonso, Steven Kamin & Fabrizio Zampolli (2022). *Central Bank Digital Currencies (CBDCs) in Latin America and Caribbean*. BIS Working Papers No. 989, BIS Representative Office for the Americas, Monetary and Economic Department, https://www.bis.org/publ/work989.pdf, p. 7.

17 Viviana Alfonso, Steven Kamin & Fabrizio Zampolli (2022). *Central Bank Digital Currencies (CBDCs) in Latin America and Caribbean*. BIS Working Papers No. 989, BIS Representative Office for the Americas, Monetary and Economic Department, https://www.bis.org/publ/work989.pdf.

including India and Russia, which have recently launched CBDC pilot projects, aim at promoting innovation per se with regard to payment systems and cross-border remittances.[18]

2. CBDCs and Tax Policy

Although CBDCs primarily aim to achieve monetary policy objectives, their features such as programmability and possibility to design with limited privacy can positively impact tax policy and administration. Programmability allows CBDCs to be tailored with specific rules that can automate fiscal transfers, thus improving financial inclusion and reducing the administrative burden. Additionally, the limited privacy of CBDC transactions enhances transparency and traceability, making it easier to detect and prevent tax evasion and illicit financial flows. Chapter 2 below outlines key considerations regarding the use of CBDCs to achieve tax policy objectives in the BRI jurisdictions.

2.1 Programmability and Fiscal Transfers

Several benefits associated with the use of CBDCs by tax administrations are related to their programmability, which can facilitate payments with specific purposes from the governments, including payment of targeted benefits and facilitating fiscal transfers, such as making digital transfers to certain categories of people that expire after a set date or allow only certain purchases with the received digital money.[19] CBDCs can also facilitate the payment of taxes, by allowing the immediate recovery through automatic enforcement, as is currently practiced in China, and may be implemented in jurisdictions such as Singapore and Jamaica in the future.[20] These features would also be beneficial to recovering the proceeds of criminal activities and illicit financial flows. In cross-border situations, the use of CBDCs may facilitate paying taxes such as the withholding taxes.[21] Adoption of CBDC can bring additional benefits in the area of VAT/GST by transforming the compliance and collection of this tax. In particular, the use of the programmability feature of blockchain-based CBDCs can streamline the VAT/GST registration, refunds computation

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18 Reserve Bank of India (2022). *Concept Note on Central Bank Digital Currency*, https://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1218#CP76. For countries like Russia and Belarus, facing international sanctions, facilitation of cross-border remittances is one of the key considerations when implementing CBDCs. (Digital rubble, Bank of Russia, available at: https://cbr.ru/fintech/dr/, accessed on: The Concept of the Belarusian Digital Ruble, National Bank of the Republic of Belarus, https://www.nbrb.by/payment/digital_ruble/concept.pdf, p. 8; Dmitriy Zayats (2024). The Development of a Platform for the Digital Ruble has Begun in Belarus, *Economic Journal*, https://neg.by/novosti/otkrytj/v-belarusi-nachalas-razrabotka-platformy-dlya-tsifrovogo-rublya/.)

19 Cf. joint report by the Bank for International Settlements, Bank of Canada, European Central Bank, et al. (2021). *Central Bank Digital Currencies: System Design and Interoperability*, https://www.bis.org/publ/othp42_system_design.pdf, pp. 8, 9.

20 Cf. Angelo Contrino & Stefano Maria Ronco (2023). Cashless society and Central Bank Digital Currencies: Tax Aspects and Taxpayer Protection, p. 6; Ashley Lannquist & Brandon Tan (2023). *Central Bank Digital Currency's Role in Promoting Financial Inclusion*. IMF Fintech Notes, p. 12; Monetary Authority of Singapore (2021). *A Retail Central Bank Digital Currency: Economic Considerations in the Singapore Context*, https://www.mas.gov.sg/-/media/MAS/EPG/Monographs-or-Information-Paper/A-retail-CBDC---Economic-Considerations-in-the-Singapore-Context.pdf, p. 19; and PwC (2023). *PwC Global CBDC Index and Stablecoin Overview 2023*, https://www.pwc.com/gx/en/financial-services/pdf/pwc-global-cbdc-index-and-stablecoin-overview-2023.pdf, p. 20.

21 Mentioning the general benefits that the blockchain can bring to withholding taxes, cf. Jeffrey Owens & Julia de Jong (2017). *Taxation on the Blockchain: Opportunities and Challenges*. Tax Notes International, pp. 606, 609; and Jeffrey Owens & Sabina Hodžić (2022). Policy Note: Blockchain Technology: Potential for Digital Tax Administration. *Intertax*, pp. 815; Angelo Contrino & Stefano Maria Ronco (2023). Cashless Society and Central Bank Digital Currencies: Tax Aspects and Taxpayer Protection. *International Tax Studies 6*, p. 6.

and claims, improve VAT collection through the split payment system. Furthermore, they can enhance transmitting the transaction details to tax authorities similar to real-time reporting and e-invoicing, potentially reducing the reliance on the latter.[22] In addition, the CBDCs may also be programmed to have the necessary real-time features be used to design a progressive VAT, i.e. a VAT that taxes all consumption at a single rate, whose revenue gives rise to a compensation subsidy that is paid in real time at the moment of the purchase.[23] This could contribute to the development of more efficient and fairer VAT/GST systems.

The CBDCs' programmability could also be used by the private sector, e.g., by programming repayments due in case certain conditions are met. This possibility may require the redesign of the taxation of certain transactions, particularly in jurisdictions that levy taxes on financing transactions or guarantees.

Moreover, CBDCs with offline functionality could have become relevant for the BRI jurisdictions under the conditions of emergency caused, for example, by natural disasters or the COVID-19 pandemic, when governments struggled with distributing relief payments in a timely and efficient manner due to limited access to the Internet. [24] It should nonetheless be noted that it is generally referred that the CBDCs shall be considered complementary means of payment and fast payment systems.[25] The European Central Bank has also expressed the view that cash transactions are desirable specially in case of lack of electricity or natural disasters.[26]

The adoption of CBDCs may strengthen the link between tax and fiscal policy by, for example, enabling the imposition of a more effective levy directly on bank account balances, functioning as a wealth tax on bank deposits, which could be used as a policy tool to reduce inflation.[27]

It would be also possible for the tax authorities to verify the business reasons of payments and link payments to invoices through the use of CBDCs and other technology. A simpler solution could be to allow the tax deductibility of payments made using traceable CBDCs.[28]

In addition, CBDCs may be used to exercise social control over populations through the use of programmability features, e.g., by programing CBDCs of certain taxpayers in breach of their tax obligations not to allow them to pay for and, thus, enjoy certain non-basic public services.[29]

However, coordination between jurisdic-

22 Michi Kakebayashi (2023). *The Potential of Central Bank Digital Currency for Transforming Public Finance: A Focus on VAT Systems*, http://dx.doi.org/10.2139/ssrn.4449562, pp. 29-42; Sreema Seeram (2022). *Whether Tax Programmable Elements Built into CBDC Enhance Efficiency in Tax Assessment and Collection?*, Master thesis, University of Amsterdam, pp. 12-21.

23 Rita de la Feria & Artur Swistak (2023). *Designing a Progressive VAT*. Working paper WP/24/78, International Monetary Fund, pp. 15 and ff.

24 Viviana Alfonso, Steven Kamin & Fabrizio Zampolli (2022). *Central Bank Digital Currencies (CBDCs) in Latin America and Caribbean*. BIS Working Papers No. 989, BIS Representative Office for the Americas, Monetary and Economic Department, https://www.bis.org/publ/work989.pdf, p. 19.

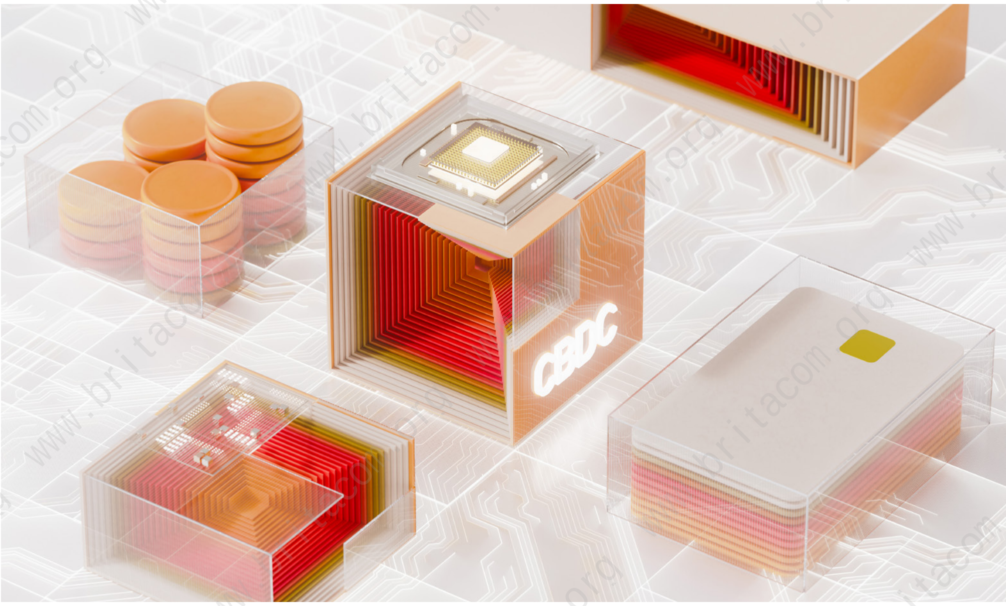
25 *Supra note 3*, p. 10; Anneke Kosse & Ilaria Mattei (2023). *Making headway — Results of the 2022 BIS Survey on Central Bank Digital Currencies and Crypto*. BIS Papers No. 136, BIS Monetary and Economic Department, https://www.bis.org/publ/bppdf/bispap136.pdf, p. 8.

26 Angelo Contrino & Stefano Maria Ronco (2023). Cashless Society and Central Bank Digital Currencies: Tax Aspects and Taxpayer Protection. *International Tax Studies 6*, p. 3.

27 *Supra note 26*, p. 6.

28 *Supra note 26*, p. 6; Luisa Scarcella (2021). The Implications of Adopting a European Central Bank Digital Currency: a Tax Policy Perspective. *EC Tax Review 4*, pp. 180 and ff.

29 *Supra note 26*, p. 7.



tions shall be nonetheless established, not only to set standards but also to avoid a race to the bottom in CBDC's standards and reduce the risk of "digital dollarization" or "cryptoization" of the economy.[30]

2.2 Possible Application by Tax Administrations to Tackle Illicit Financial Activities and Policy Considerations

The outlined characteristics of CBDCs can make them a mechanism to combat various forms of illicit financial activities, such as tax evasion and money laundering, which may be facilitated by the use of crypto assets. This would complement the exchange of tax-related information on crypto assets through the standards developed by the OECD.[31] Although CBDCs may not be the holy grail to fight illicit financial activities as private crypto assets can still be used in criminal activities, they can nonetheless play a role on this fight. CBDCs can effectively compete with private crypto assets and become the preferred digital asset for the general public due to their stability. By offering CBDCs, jurisdictions may curb the flight to private crypto assets by innovation seeking investors with lower risk appetites, thereby keeping the crypto assets market smaller and, as such, more volatile, weakening any store of value function that these assets may be perceived to have. This would reduce the use of crypto assets for criminal activities. At the same time, when crypto assets have a market value, it becomes easier to detect payments related to crypto asset transactions in cases where the payments deviate from market values and situations that are indicative of possible underlying criminal activities.

CBDCs could achieve this goal through increased transparency and traceability of transactions carried out in CBDC. Hence, their better

30 I.e. "the official or 'de facto' adoption of an alternative currency in place of the official domestic one". Cf. International Monetary Fund (2023). *Cryptoassets and CBDCs in Latin America and the Caribbean: Opportunities and Risks*. Working paper WP/23/37, p. 15.

31 OECD (2022). Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard, https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.htm.

visibility to tax administrations create a robust and immutable audit trail to detect discrepancies and track funds, and enhance real-time reporting enabling tax administrations to receive more accurate and timely information on the income and expenses, thereby reducing the opportunities for tax evasion strategies for taxpayers. However, there are several factors that might hinder CBDCs' ability to address illicit activities, which should be carefully considered when designing them.

First, it is crucial to strike a balance between data privacy and the prevention of illicit activities. On one hand, privacy constitutes a fundamental right that allows individuals and companies to maintain control over their financial information and transactions and to prevent potential abuse of power by authorities, which leads governments to implement robust data privacy regulations aimed at protecting the confidentiality and integrity of data. The fact that the use of CBDCs implies collection of sensitive data inevitably raises concerns about concentration of such information in the hands of governments. On the other hand, the potential anonymity of transactions conducted with CBDCs can reduce the ability of tax administrations to track illicit activities and detect anomalies, which poses the risks similar to those associated with the use of cryptocurrencies. A possible solution could involve developing CBDCs that allow for varying levels of privacy a user can have depending on the amount of a wallet and identification and KYC requirements that was embedded, for example, in the design of the Chinese digital Yuan (e-CNY)[32] or Bahamas' "Sand Dollar".[33] Nonetheless, some jurisdictions might consider providing tax administrations with full control over CBDC wallets. For example, the upcoming amendments of the Russian Tax Code imply the obligation of the digital ruble operator platform to inform the Russian tax authorities about the balances of CBDC wallets and transactions with them.[34]

Second, wide adoption of CBDCs requires strong data security framework to safeguard personal and financial information (e.g., personal and transaction identifiers, account balances)

32 One of the defining principles of the Chinese e-CNY is so called "managed anonymity", which implies dividing the wallets into several levels according to the KYC level. Opening a wallet allowing a single-transaction limit of 2,000 RMB requires only a phone number, while expanding the limit would need additional identifiable information such as a photo or an ID number. However, opening an e-CNY wallet requires less KYC information in comparison with the nine elements needed to open a bank account (Changchun Mu (2022). Balancing Privacy and Security: Theory and Practice of the E-CNY's Managed Anonymity, People's Bank of China, http://www.pbc.gov.cn/en/3688006/4706656/4696666/2022110110364344083.pdf, pp. 3-4. While the Chinese data protection laws prohibit sharing personally identifiable information with external parties, including the People's Bank of China, it is acknowledged that e-CNY has been designed to provide a higher level of visibility and control over transactions in comparison with cash operations (Eli MacKinnon, Lexicon (2024). 'Controllable Anonymity' or 'Managed Anonymity' and China's Digital Yuan, Stanford University, https://digichina.stanford.edu/work/lexicon-controllable-anonymity-or-managed-anonymity-and-chinas-digital-yuan/.)

33 The CBDC system introduced by the Bahamas' Central Bank implies three wallet levels a user can have. A basic wallet, which is restricted to a $500 balance and $1,500 in monthly transactions, requires only an email or a phone number. The second wallet level is limited to $5,000 of balance and $10,000 of monthly transactions; its use requires providing a government ID photo. The third level wallet with a holding limit of $8,000 to $1,000,000 and unlimited transactions requires businesses to provide their license and tax filings. In case of DCash, the Eastern Caribbean Currency Union CBDC, the information on transactions is only available to the financial institutions if one of the parties involved in a transaction is this financial institution's client; the Central Bank can anonymously observe the wallets amounts and transaction information without obtaining access to the personal data of their users.

34 Draft Federal Law No. 384598-8 "On Amendments to Parts One and Two of the Tax Code of the Russian Federation", https://static.consultant.ru/obj/file/doc/fz_210623-384598.pdf, p. 15.

from unauthorized access, breaches and cyberattacks, which is important for maintaining trust between the users and governments. For example, the Bahamas' Central Bank established a special unit to monitor cyber risks, while all financial institutions authorized to use the Sand Dollar are subject to third party cybersecurity assessments before receiving approval to integrate the platform with their custom applications.

Finally, enhancing tax compliance, Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) and combating tax evasion require limiting the cash economy. This could be achieved by developing digital infrastructure, promoting digital literacy and amending legislation to encourage individuals and businesses to extend the use of CBDCs. Such reforms can include amending tax policies to provide incentives for the use of electronic payments. In particular, Colombian and Mexican businesses can deduct cash payments only below certain threshold, while Argentina and Uruguay guarantee VAT rebates for card payments.[35] Additionally, it is important to ensure that tax legislation recognizes CBDCs as medium of payment and includes transactions carried out in CBDCs within the taxable base.[36] Failure to provide specific tax treatment and guidance regarding CBDCs may give rise to unintended tax consequences, such as applying the same tax treatment to crypto assets and CBDC transactions.

3. Further Considerations of Adopting CBDCs

3.1 CBDCs and Digital Divide

Even though financial inclusion constitutes one of the key drivers of central banks' engagement in CBDC projects in developing economies, there are still significant problems due to a large informal sector, widespread use of cash, limited access to the Internet, and a relatively large proportion of the population that do not own bank accounts. Although promoting financial inclusion was one of the key motivators of introducing the Nigerian CBDC eNaira, the deficit of supporting infrastructure such as widespread and stable internet access, as well as low level of digital literacy have become the barriers to its adoption.[37] For example, in 2021, less than 50% of Latin America and the Caribbean's population had fixed broadband internet connection, and only 9.9% had high-quality fiber connection at home. The proportion of the Internet coverage of the rural population is around 40%, urban population — 71% .[38] Governments can make CBDCs more accessible by investing in projects aimed at developing digital infrastructure and by adopting CBDCs with an "offline"

35 Anne Brockmeyer & Magaly Sáenz Somarriba (2022). *Electronic Payment Technology and Tax Compliance, Evidence from Uruguay's Financial Inclusion Reform*. Policy Research Working Paper 9947, World Bank group, p. 32.

36 For example, introduction of the digital ruble pilot in Russia was accompanied by the immediate amendment of tax legislation to cover transactions with a new CBDC (Draft Federal Law No. 384598-8 "On Amendments to Parts One and Two of the Tax Code of the Russian Federation", https://static.consultant.ru/obj/file/doc/fz_210623-384598.pdf).

37 Jookyung Ree (2023). *Nigeria's eNaira, One Year After*, IMF, https://www.imf.org/en/Publications/WP/Issues/2023/05/16/Nigerias-eNaira-One-Year-After-533487, p. 4; Adekemi Omotubora & Same Naira (2024). More Possibilities! Assessing the Legal Status of the eNaira and Its Potential for Privacy and Inclusion. *Journal of African Law 2*, https://www.cambridge.org/core/journals/journal-of-african-law/article/same-naira-more-possibilities-assessing-the-legal-status-of-the-enaira-and-its-potential-for-privacy-and-inclusion/19189464219A6786DE28C68B5E28D67D, pp. 1-18, at p. 15; Tuhu Nugraga (2023). *Why Did CBDC Fail in Nigeria? Valuable Lessons for Developing Counties*, https://moderndiplomacy.eu/2023/10/22/why-did-cbdc-fail-in-nigeria-valuable-lessons-for-developing-countries/.

38 Franz Drees-Gross & Pepe Zhang (2021). *How to Boost Digital Access in Latin America*, https://www.weforum.org/agenda/2021/08/how-to-boost-digital-access-in-latin-america/.

option. Additionally, digital money can complement other initiatives designed to promote financial inclusion, such as providing subsidies to private banks to involve unbanked people.

3.2 The CBDCs' Impact on Monetary and Fiscal Policies

Although CBDCs are considered as a new transmission channel of the monetary policy,[39] their issuance is inherently associated with a number of risks. These are related to posing challenges for financial stability and creating the possible negative impact to the financial markets structure.[40] In particular, the use of CBDCs may create disintermediation for banks[41] and threaten the monetary stability by facilitating the "digital dollarization" of the economy.[42] In addition, the use of CBDCs to facilitate direct fiscal stimulus through monetary channels[43] may blur the distinction between fiscal and tax policy and thus harm monetary policy independence[44] and exacerbate risks associated with "helicopter money", possibly raising concerns about the appropriateness of involving the central bank in credit allocation,[45] and resulting in a reduction in the profitability of commercial banks.[46] To avoid these risks, the BIS, together with a group of central banks, developed three foundational principles that CBDCs should respect: i) do not harm[47]; ii) ensure coexistence[48]; and iii) promote innovation and efficiency[49].

3.3 Governance Issues Raised by Cryptocurrencies

One of the opportunities offered by the adoption of CBDCs is the potential to mitigate the risks raised by the widespread use and decentralized nature of cryptocurrencies. From the monetary and financial policy stability perspective, the rise of cryptocurrencies may have

39 J. Temperini, C. D'Ippoliti & L. Gobbi, et al. (2024). Is the Time Ripe for Helicopter Money? Growth Impact and Financial Stability Risks of Outright Monetary Transfers. *Structural Change and Economic Dynamics*, pp. 24-36, at p. 30, 34; Ulrich Bindseil (2020). *Tiered CBDC and the financial system*. Working Paper No. 2351, European Central Bank, https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2351~c8c18bbd60.en.pdf, p. 6.

40 See, for example, J. Meaning, B. Dyson, J. Barker, et al. (2018). *Broadening Narrow Money: Monetary Policy with a Central Bank Digital Currency*. Staff Working Paper No. 724, Bank of England, https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/broadening-narrow-money-monetary-policy-with-a-central-bank-digital-currency.pdf, pp. 25-26; Young Sik Kim & Ohik Kwon (2023). Central Bank Digital Currency, Credit Supply, and Financial Stability. *Journal of Money, Credit and Banking 1*, pp. 297-320.

41 Blurring the difference between the central bank's and commercial banks' functions and reducing demand for bank deposits that constitute one of the key sources of funding for banks.

42 *Supra note 3*, pp. 7, 8; *supra note 19*, p. 14 and ff.

43 Ulrich Bindseil (2020). *Tiered CBDC and the Financial System*. Working Paper No. 2351, European Central Bank, https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2351~c8c18bbd60.en.pdf, pp. 6-7.

44 *Supra note 3*, pp. 7, 8; *supra note 19*, p. 14 and ff.

45 Hongyi Chen & Pierre L. Siklos (2022). Central Bank Digital Currency: A Review and Some Macro-financial Implications, *Journal of Financial Stability*, https://www.sciencedirect.com/science/article/pii/S1572308922000146#fn7, p. 4.

46 J. Temperini, C. D'Ippoliti & L. Gobbi, et al. (2024). Is the Time Ripe for Helicopter Money? Growth Impact and Financial Stability Risks of Outright Monetary Transfers. *Structural Change and Economic Dynamics*, pp. 24-36, at p. 33-34.

47 "New forms of money supplied by the central bank should continue supporting the fulfilment of public policy objectives and should not interfere with or impede a central bank's ability to carry out its mandate for monetary and financial stability." *Supra note 3*, p. 10.

48 "Central banks have a mandate for stability and proceed cautiously in new territory. Different types of central bank money — new (CBDC) and existing (cash, reserve or settlement accounts) — should complement one another and coexist with robust private money (eg. commercial bank accounts) to support public policy objectives." *idem ibidem*.

49 "There is a role for the public and private sectors in the supply of payment services to create a safe, efficient and accessible system." *idem ibidem*.

damaging consequences as they may: i) undermine the monetary policy of the governments or central banks, by, e.g., bypassing anti-inflation measures or exchange regulations; ii) cause disintermediation and reduce the credit availability; iii) lead to the "cryptoization" of the economy, i.e. the official or "de facto" adoption of alternative assets in place of the official domestic currency; and iv) pose risks by neglecting consumer protection. From the economic perspective, cryptocurrencies may contribute to a stronger informal sector, as tax authorities often lack the means to capture transactions carried out in cryptos. Furthermore, from the criminal law perspective, cryptocurrencies can be used for money laundering and avoiding AML/CTF compliance. Finally, from the tax perspective, crypto may be used to circumvent exchange of information regulations and facilitate tax fraud.[50]

The design of CBDCs, involving features such as programmable payments and a limited degree of privacy, as well as the potential expansion of CBDC payments substituting other cryptocurrencies to facilitate payments, can contribute to minimizing the above-mentioned exposure. Even though CBDCs may pose similar risks in certain cases, such as disintermediation, it seems that addressing these challenges would be easier.[51]

4. Concluding Remarks

The development of new digital instruments, such as CBDCs, is a logical outcome of central banks' attempts to reduce the risk of losing monetary sovereignty, adapt to the changing circumstances, and strengthen monetary control in response to the widespread use of cryptocurrencies and the potential risks they may pose. Indeed, the issuance of CBDCs is associated with numerous benefits, including the reduction of the informal economy, promotion of digital inclusion, the ability to tackle illicit financial flows and facilitate fiscal transfers, and the development of a more efficient and secure payment system.

In the context of the globalization of the world economy and investment flows, as well as the growing significance of the BRI, which already includes more than 150 jurisdictions with different economic and political conditions,[52] the importance of cross-border remittances is growing. This necessitates a reduction in the cost of such transfers and ensuring the integration and interoperability of various payment systems. In this context, CBDCs provide opportunities for enhancing cross-border payments, strengthening cooperation within the BRI, and increasing the potential of the initiative.

Amidst a multipolar race for global economic and technological leadership, China's adoption of a well-developed central bank digital currency serves as a key factor in enhancing the country's competitive advantage, increasing its influence on the global arena, and strengthening the role of the Yuan as a currency for international payments. With many BRI jurisdictions conducting research and development on CBDCs, and some already launching pilot projects and operating them to address various monetary and fiscal needs, it seems timely to establish international standards in the area of CBDCs.

50 Cf. Reserve Bank of India (2022). *Concept Note on Central Bank Digital Currency*, https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/CONCEPTNOTEACB531172E0B4DFC9A6E506C2C24FFB6.PDF, pp. 7, 20 and 21; International Monetary Fund (2023). *Cryptoassets and CBDCs in Latin America and the Caribbean: Opportunities and Risks.* Working paper WP/23/37, p. 15.

51 *Supra note 3*, pp. 8, 9; Reserve Bank of India (2022). *Concept Note on Central Bank Digital Currency*, https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/CONCEPTNOTEACB531172E0B4DFC9A6E506C2C24FFB6.PDF, pp. 22 and ff.; Board of Governors of the Federal Reserve System (2022). *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*, https://www.federalreserve.gov/publications/files/money-and-payments-20220120.pdf, pp. 18-20.

52 Countries of the Belt and Road Initiative (BRI), Green Finance and Development Center, https://greenfdc.org/countries-of-the-belt-and-road-initiative-bri/.

Comparison of OECD and UN Processes on International Tax Cooperation

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Abstract: From the formation of the OECD, its work on taxation was driven by the member states, responding to the requirements of industrialised economies. However, during the work on the BEPS action plan leading to the final reports in 2015, a limited number of developing country representatives participated in the technical working groups, aiming to ensure that the outcomes conformed to the needs of developing countries. Developing countries considered that the OECD procedures were not giving sufficient opportunity for countries to participate in the standard setting process. The countries that were required to implement the standards needed a mechanism for participating in setting up the process of implementation, and this led to the creation of the BEPS Inclusive Framework. Participation of non-OECD countries in decision-making was still limited, and many developing countries were not members of the Inclusive Framework.

The African group of nations at the UN considered that inclusive international tax policy instruments should be developed through a global, transparent forum which can be provided by the UN. The UN Resolution of 22 November 2022 called for discussions on developing an international tax cooperation framework to be agreed through a UN inter-governmental process. The Terms of Reference of 15 August 2024 clarified that a Framework Convention should establish a system of governance for inclusive international tax cooperation. It should establish an inclusive, fair, and transparent international tax system for sustainable development and strengthening of domestic resource mobilisation.

Keywords: UN; OECD; International taxation; Tax cooperation; Inclusive Framework; Tax policy; Domestic resource mobilisation

1. Introduction

International tax cooperation is required to mitigate the effects of the application of different national tax systems on the income of international enterprises and individuals. The application of taxing rights by the home and the host country, in the absence of any international agreements on taxation, would risk causing double taxation of income. International agreements are needed to ensure relief from double taxation and to allocate taxing rights between the contracting states. Double taxation agreements can be concluded by two states, without wider international agreement, but the development of model tax agreements by international organisations has helped to guide and standardise bilateral tax agreements.

In addition to provisions for relief of double taxation, international agreements can improve other aspects of taxation, for example, by providing for the exchange of tax information, cooperation in tax collection and more tax transparency. Countries also need to agree on procedures to follow when one country adjusts the transfer pricing of transactions between related parties, which in the absence of international guidelines could lead to double taxation. Recently international cooperation has been directed towards combating base erosion and profit shifting, usually by international enterprises exploiting differences between national tax rules. As the interpretation of provisions of double taxation agreements can often lead to tax disputes, these agreements also contain provisions for dispute resolution. Double taxation agreements therefore provide for a mutual agreement procedure under which the competent authorities of the contracting states endeavour to resolve disputed issues by mutual agreement.

2. Role of the OECD

2.1 Development of the OECD Model Tax Convention

The Organisation for Economic Co-operation and Development (OECD) was established in 1948 as the Organisation for European Economic Co-operation (OEEC). As the role of the organisation broadened, 20 countries signed the Convention on the OECD on 14 December 1960, and membership was extended to non-European states. Since then, the membership has increased to 38 countries.[1]

The OECD's main tax policy body is the Committee on Fiscal Affairs (CFA). The CFA brings together senior officials from all OECD member governments and other leading nations, as well as observers from international organisations who play an active role in formulating tax policies and set the OECD work programme on taxation. The CFA aims to enable OECD and partner (i.e. non-member) governments to improve the design and operation of their national tax systems and increase the level of cooperation among them in the area of taxation. The detailed work of the CFA is carried out by working parties which consist of experts from participating country governments. Each working party concentrates on a specific area, for example, Working Party 6 has focused on transfer pricing. The work of the CFA is mostly undertaken by government officials and the OECD Secretariat, but there is also frequent consultation with representatives of business and trade unions and co-operation with other international and regional tax organisations.

In the early 20th century, the industrialised countries encountered problems in relation to pricing between a parent company and its foreign affiliates, subsidiaries and branches. This gave rise to a need for international guidance on transfer pricing. Eventually the OECD issued guidelines on transfer pricing in 1979 and those guidelines have further developed since then.

The OECD Model Tax Convention arose from previous League of Nations models that were based on treaties between European countries. The OECD produced a Model Tax Convention in 1963. The OECD Model has been used as a basic document of reference for the

1 OECD (2024). *Members and Partners*, https://www.oecd.org/en/about/members-partners.html.

negotiation and interpretation of tax treaties. It has been an important document helping countries to increase certainty and predictability; and assisting in the prevention of tax avoidance and evasion.

The OECD has also worked on tax transparency and exchange of tax information through the Global Forum on Transparency and Exchange of Information for Tax Purposes.[2] Peer reviews are carried out to assess the progress of member jurisdictions of the Forum on transparency issues such as registers of beneficial ownership. There is also a Forum for Harmful Tax Practices that examines aspects of national tax legislation that may be exploited by taxpayers for avoidance purposes.

2.2 Creation of the OECD's Inclusive Framework

The action plan on base erosion and profit shifting (BEPS) was a joint initiative between the OECD and the G20. Final reports in relation to the BEPS actions were issued in 2015 and the project then entered the next phase which was implementation of the agreed actions. The OECD and G20 decided that four of the areas covered by the action plan were to become minimum standards. These standards relate to combating harmful tax practices and the spontaneous exchange of information on advance tax rulings; the inclusion of abuse clauses in double taxation agreements; implementation of country-by-country reporting; and improved dispute resolution mechanisms. For implementation of the standards and to adequately address the BEPS issues, the OECD considered that as many countries as possible needed to participate in the project and begin the implementation process.

During the work on the BEPS action plan leading to the final reports in 2015, a limited number of developing country representatives participated in the BEPS technical working groups, aiming to ensure that the outcomes from the project were in line with the needs of developing countries. However, most developing countries were not fully involved in the BEPS process at that stage. These included some G20 members that were not members of the OECD. The OECD permitted some developing countries and organisations such as the African Tax Administration Forum (ATAF) to observe the negotiations and to provide some input into the proceedings, but the views of the OECD and G20 countries carried the most weight in OECD discussions.

The OECD wanted the BEPS standards to be implemented globally but was not giving sufficient opportunity for countries to participate in the standard setting process. The countries that were required to implement the standards needed a mechanism for participating in establishing the process of implementation. This issue led to the creation of the Inclusive Framework.

Delegates representing more than 80 countries participated in a meeting held on 30 June and 1 July 2016 to take forward the Inclusive Framework on base erosion and profit shifting. The countries involved in the Inclusive Framework were given an opportunity to participate in decision-making and to provide input into the formulation of international tax rules.

The participating countries began to work on standard setting on the remaining issues under BEPS in areas such as transfer pricing and interest deductibility. Practical guidance was developed to support global implementation of BEPS recommendations, with a focus on implementing the four minimum standards on BEPS issues. A peer review process was set up to assess compliance with the minimum standards.

Although this mechanism existed for involvement of developing countries, there was concern amongst many developing countries that the BEPS process did not address the specific challenges for many countries. A large number of countries were not yet members of the Inclusive Framework and more countries needed to be engaged in the work to reduce

2 See https://web-archive.oecd.org/tax/transparency/who-we-are/index.htm for more detail.

their vulnerability to base erosion and increase their ability to respond to it effectively.

In recent years the Inclusive Framework has been involved in developing the two-pillar approach to taxation of the digital economy. During the discussions on Pillar One and Pillar Two, there was significant participation from regional entities such as ATAF and from the larger developing countries. However, many developing countries still had difficulty in participation owing to lack of time and resources, language problems or travel restriction especially during the pandemic.

Since the initial meeting, the membership of the Inclusive Framework has grown from 82 to over 145 countries and jurisdictions, including 14 observer organisations. The ongoing work is led by a 24-country Steering Group. The intention is that member countries should participate on an equal footing and each member country is committed to implementing the BEPS package of minimum standards.

2.3 Cooperation with Other International Organisations

There is currently some cooperation on tax issues between the international organisations. On 19 April 2016 the OECD, International Monetary Fund, World Bank and United Nations (UN) announced the creation of the Platform for Collaboration on Tax (PCT).[3] The Platform aims to intensify cooperation and hold regular consultations on the design and implementation of international tax standards. The Platform also aims to strengthen capacity building support; develop joint guidance on tax; and facilitate information sharing on operational and knowledge activities. The PCT is concerned with providing greater capacity support to developing countries and will give them greater influence in the design of rules and standards for international taxation.

Tax Inspectors Without Borders (TIWB)[4] is a joint initiative by the OECD and the UN Development Programme (UNDP) supporting developing countries with capacity building programmes to improve domestic resource mobilisation. TIWB works by placing technical experts to tax administrations in developing country; such experts, who are usually serving tax officials from both developed and developing countries, work directly on taxpayer issues and give practical assistance. While the work is often in dealing with the tax affairs of multinational enterprises, their role is to strengthen overall capacity in specific areas, such as audit, criminal investigation, transfer pricing, etc. The work of TIWB is in line with the UNDP goal of working in partnership with countries to build integrated systems that use taxation as an important tool in advancing the 2030 Agenda of Sustainable Development. TIWB is also involved with programmes on digitalising tax administrations and with the use of information obtained from country-by-country reports.

2.4 Reasons for Dissatisfaction from Developing Countries

Over the years the developing countries became dissatisfied with their lack of influence on the international tax agenda. They have been unable to make their voices heard enough in the discussions at the OECD; and have had little influence on the decisions reached. This is partly due to their late involvement in consideration of the issues, and the lack of resources of smaller developing countries that prevented them from adequately assessing the options. The developing countries have not been content with some of the OECD decisions, for example, the percentage of profits allocated to market jurisdictions under Amount A of Pillar One or the 15% tax rate established for the global minimum tax.

The measures agreed in the original BEPS action plan were established before the creation of the Inclusive Framework and developing

3 See Platform for Collaboration on Tax (https://www.tax-platform.org/) for further information.

4 OECD. *Tax Inspectors Without Borders Is Sending Expert Tax Auditors to Assistance-Requesting Host Administrations in Order to Build Audit Capacity Around the World!*, https://www.tiwb.org/.

countries consider that the agreed measures served the interest of participant countries only. Countries that want to join the Global Forum or the Inclusive Framework must meet the previously formulated requirements, but this conflicts with the principle of universal participation and with the criterion that all states must be involved in drawing up the agenda. The actual participation and thus the influence of a number of non-OECD member countries remain very limited.

3. Role of the UN Tax Committee in International Tax Cooperation

3.1 Formation of UN Tax Committee

With the aim of encouraging the conclusion of double tax agreements by developing countries, in 1968 the UN set up the Ad Hoc Committee of Experts on Tax Treaties between Developed and Developing Countries (hereinafter referred to as "Group of Experts"), consisting of tax officials and experts.[5] In the years from 1968 to 1977, this committee established the guidelines in the Manual for the Negotiation of Tax Treaties between Developed and Developing Countries. In 1980 the UN published the United Nations Model Double Taxation Convention between Developed and Developing Countries.

From 1980 the Group of Experts was renamed the Ad Hoc Group of Experts on International Cooperation in Tax Matters, and was composed of members from developed and developing countries.[6] In the 1990s the international tax landscape was changed by the emergence of new financial instruments, transfer pricing mechanisms, globalisation and the growth of tax havens. The Group of Experts therefore set up a focus group in 1997 to consider revising the UN Model Tax Convention. This led to the publication of the updated version of the UN Model in 2001.

In 2004 the group was again renamed and became the Committee of Experts on International Cooperation in Tax Matters. A further update of the UN Model was launched on 15 March 2012. Compared with the OECD Model Tax Convention,[7] the UN Model generally aims to ensure that greater taxing rights are allocated by a treaty to the country that is the source of the income. For example, the UN Model contains a wide definition of a permanent establishment in Article 5 and allows a greater share of tax to be allocated to the source country in respect of dividends, interests, royalties, capital gains and other income. Article 9 (associated enterprises) of the UN Model reflects the provisions of the OECD Model on transfer pricing adjustments but has an additional provision that denies a corresponding adjustment in certain circumstances.

Other products of the UN Tax Committee's work include the UN Practical Transfer Pricing Manual; the UN Dispute Resolution Manual; the Manual for negotiation of Tax Treaties; and the Carbon Tax Handbook and the Handbook on Taxation of extractive industries.[8] A new Health Tax Manual is in preparation and will be published soon.

3.2 Achievements of the UN Tax Committee

The UN Tax Committee has been characterised by transparent proceedings, with the participation of country observers and civil society members in meetings. Compared with other UN bodies there has been easier and faster decision-making because members are acting in their personal capacity and do not need to go to their governments for approval. Proceedings

5 Formed by Resolution 1273 (XLIII) of the Economic and Social Council of the UN (ECOSOC) in 1967.

6 The Group consisted of 25 experts in tax policy and tax administration nominated by governments, 10 from developed countries and 15 from developing countries.

7 Here refers to the OECD Model Tax Convention on Income and on Capital.

8 United Nations (2017). *United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries*, https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook_2017.pdf.

are also facilitated by the relatively small size of the Tax Committee, and the decision-making is based on the majority view, with respect for minority viewpoints.

However, a consequence of members acting in their personal capacity is that their decisions do not represent the official views of their governments. The Committee represents the views of its individual members, though the members do represent a wide geographical distribution. As the Committee meets twice per year it lacks the seamless continuity of many inter-governmental bodies. The term of each Committee is limited in time, which can restrict the scope and continuity of their work.

As decisions of the Committee are taken by a majority, the members do not need to reach a consensus before a decision is taken. On many issues there can be strong minority views. These are respected and taken into account, but this method of reaching conclusions can be confusing for stakeholders who want to use the output from the Committee.

Achievements of the Tax Committee in recent years include Article 12A on fees for technical services; Article 12B on income from automated digital services; and the work on capital gains on indirect transfers of assets. In the last few years, the number of meetings of subcommittees and participation by developing country members have increased greatly, with more inclusive agenda setting.

4. UN Work on International Tax Cooperation Framework

4.1 Resolution on International Tax Cooperation Framework

On 22 November 2022 the United Nations General Assembly's finance committee voted unanimously to begin discussions on international taxation standards. The UN Resolution called for discussions on developing an international tax cooperation framework that is agreed through a UN inter-governmental process. The Resolution was proposed by the African group of nations which considered that inclusive international tax instruments should be developed through a global, transparent forum which can be provided by the UN.

The Resolution could be seen as challenging the efforts by the OECD to develop a two-pillar approach to taxation of the digital economy including a global minimum tax. Developing countries have long taken the view that while the OECD has tried to develop consensus, after 10 years of the BEPS process to reform international tax rules, the more global, inclusive and transparent forum was the UN. The message from developing countries was that normative discussions should be held at the UN and the OECD should play a supporting role. They considered that strengthening role of the UN in designing tax standards was the best way to increase inclusiveness and this could be done through an international cooperation framework.

4.2 Report of the UN Secretary General

The UN Resolution on effective and inclusive international tax cooperation called for discussions on developing an international tax cooperation framework to be agreed through a UN inter-governmental process. The General Assembly requested the Secretary General to prepare a report analysing the existing international tax arrangements, identifying additional options, and setting out the possible next steps. The Secretariat invited Member States and other stakeholders to provide written inputs, and more than 80 submissions were received.

An advance unedited report released by the UN Secretary General on 8 August 2023 considered the promotion of inclusive and effective international tax cooperation at the UN. A final version of the report was made available to the UN General Assembly. The report outlined the next steps to be taken by the UN on commencing discussions on international tax cooperation.

The Secretary General's report noted that the international tax system should take into account the sovereign equality of all Member States under the UN Charter. International tax cooperation should consider the different needs, priorities, and capacities of all countries. As required by the Addis Ababa Action Agenda, inclusive international tax cooperation requires participation by all countries in developing the rules that will apply to them. The most important elements in international cooperation were identified as participation, agenda-setting, decision-making, and implementation, including monitoring and tax dispute resolution.

The report sets out three general approaches for the next stage of inter-governmental discussions at the UN. The first option would be a legally binding treaty or standard multilateral convention covering a wide range of tax issues. The second option could be a framework convention in the form of a legally binding multilateral instrument, which would establish an overall system of international tax governance. This framework convention would set out the basic principles of future international tax cooperation, its objectives, and the key principles and governance structure for cooperation. The third option would be the development of a non-binding multilateral agenda providing for coordinated action, at the international or bilateral level, on improving tax standards. This third option would establish principles of international tax cooperation, but these principles would not be enforced by legal commitments.

4.3 Resolution on the Framework Convention

Following the delivery of the report from the Secretary General, the General Assembly adopted UN Resolution A/C.2/78/L.18/Rev.1 of 15 November 2023[9] on the promotion of inclusive and effective tax cooperation. A total of 125 countries voted in favour of the Resolution, 48 voted against and 9 abstained. Under the Resolution the UN commenced the process of setting up a Framework Convention on tax. The Framework Convention could ensure that the UN is the main body for decision-making on international tax rules.

Under the Resolution the member states of the UN decided to establish an open-ended, ad hoc inter-governmental committee to draft the terms of reference for the UN Framework Convention on international tax cooperation. The committee would invite input from international organisations and civil society and aim to finalise its work by August 2024. The bureau of the ad hoc inter-governmental committee was to consist of no more than 20 members, elected on the basis of balanced geographical representation.

The Resolution requested the ad hoc committee to take into account the priorities and capacities of all countries, in particular developing countries, and to consider the need for sustainable development. The text emphasised the interaction of international taxation with other important economic, social and environmental policy areas. The committee was requested to consider the flexibility required by the tax system to achieve equitable results as the technology and business models evolved. The committee was also requested to consider the work of other relevant forums; and take account of the existing tools and expertise available.

The Resolution requested the ad hoc committee, in addition to drafting the Framework Convention, to consider developing protocols on specific priority issues, such as measures to combat tax-related illicit financial flows and measures to tax the income from the provision of cross-border services in the digitalised global economy. The committee was requested to submit a report to the 79th Session of the UN General Assembly with the draft terms of reference for a UN Framework Convention on tax.

The Resolution recognised the work of the Addis Tax Initiative in coordinating action to strengthen the capacity of developing countries and reduce the gaps in provision of development finance. It also noted the work of the African Union in promoting international cooperation to fight illicit financial flows, which are draining financial resources from Africa and impacting economic development.

9 UN (2023). *Promotion of Inclusive and Effective International Tax Cooperation at the United Nations*, https://documents.un.org/doc/undoc/ltd/n23/356/75/pdf/n2335675.pdf.

4.4 Terms of Reference of the UN Framework Convention for Tax Cooperation

At the second session of the Ad Hoc Committee to Draft Terms of Reference for a United Nations Framework Convention on International Tax Cooperation, held from 29 July to 16 August 2024, the Terms of Reference for a UN Tax Convention were adopted by 110 votes to 8, with some abstentions.

The Terms of Reference dated 15 August 2024 clarified that the Framework Convention should include a clear statement of its objectives, establishing a system of governance for inclusive international tax cooperation that can respond to existing and future challenges. It should establish an inclusive, fair, and transparent international tax system for sustainable development, addressing issues around the strengthening of domestic resource mobilisation.

The Terms of Reference noted that efforts to achieve the objectives of the Framework Convention should fully consider the different needs and capacities of all countries, including developing countries; recognise the sovereign right of every member state to decide its tax policy and practice; contribute to achieving sustainable development by ensuring fairness in allocation of taxing rights; and provide for rules that are simple and easy to administer.

The Framework Convention would include commitments on the fair allocation of taxing rights and fair taxation of multinationals; address tax evasion and avoidance by high-net worth individuals; contribute to the achievement of sustainable development; ensure effective mutual administrative assistance in tax matters, including transparency and exchange of information for tax purposes; address tax-related illicit financial flows, tax avoidance, tax evasion and harmful tax practices; and provide for effective prevention and resolution of tax disputes.

The Framework Convention would include provisions for support to member states in their efforts to build capacity on relevant international tax practice and to ensure that they have adequate capacity to participate effectively in international tax cooperation.

There will be protocols which are separate legally binding instruments, under the Framework Convention, to implement the Convention. Each party to the Convention would have the option whether or not to become a party to a protocol on any important tax issues. There would be two early protocols, one addressing taxation of income derived from the provision of cross-border services in the digitalised and globalised economy and the other one on another important international tax issue to be decided later. Protocols could also be considered to address tax cooperation on environmental challenges; exchange of information for tax purposes; mutual administrative assistance on tax matters; and harmful tax practices.

The Framework Convention is to be drawn up by a member-state-led negotiating committee, meeting in 2025, 2026 and 2027 for at least three sessions per year. This committee would submit the final text of the Framework Convention and of the two early protocols to the General Assembly for its consideration in the first quarter of the 82nd Session.

The bureau of the inter-governmental negotiating committee would consist of a chair, 18 vice-chairs and a rapporteur, who would be elected on the basis of geographical representation. International organisations, civil society and other relevant stakeholders would be able to contribute to the work of the inter-governmental negotiating committee. The committee would take into consideration the work of other relevant forums, considering potential synergies and the existing tools available from institutions involved in international tax cooperation.

5. The Future of International Tax Cooperation

The UN may be able to achieve inclusiveness in a true sense, to an extent that was not possible for the BEPS Inclusive Framework. The OECD's Inclusive Framework was not fully inclusive because many developing countries were not part of the framework. Even those developing countries that were part of the Inclusive Framework were hampered by their lack of resources and often complained that there was insufficient time for them to consider and respond to proposals from the OECD. Although they could participate in some discussions, the developed countries remained the driving force in bringing forward tax policy proposals.

By contrast, in the UN, there is very wide membership and all countries can have a role in agenda setting and participate in a transparent decision-making process. The UN can allow sufficient time for countries to consider proposals and take a position. Countries will be able to decide whether to participate or not. A broad view of many observers, including from civil society and business, recognise that work at the UN level overcomes the perceived "democratic deficit" in OECD centred work. On the other hand, many of the same observers recognise that the OECD's extensive technical expertise is not matched elsewhere.

The aspirations regarding inclusiveness in norm setting may be achieved through the process of inter-governmental discussions under UN umbrella. The decision on the agenda for discussions, and which topics are to have priority, would no longer be a prerogative of the OECD, but all member countries of the UN would participate in setting the agenda. The smaller developing countries will be given a chance to consider and take a view on the topics being discussed and be better able to participate meaningfully than in the agenda of the Inclusive Framework. They could therefore participate in norm setting and implementation of important changes such as the allocation of taxing rights through consensus.

The use of a majority decision instead of a consensus would give rise to problems in relation to the actual implementation of proposals from the UN. It will be difficult to decide and enforce minimum standards without a consensus. The UN will face similar problems to the OECD in relation to some countries that decide not to implement proposals, despite the broader participation in discussion. The sovereignty of countries needs to be respected; however, it is likely that this work will face similar tensions to those that have applied to other aspects of tax work at the UN.

Since it is largely the OECD countries that will be exporters of capital in the foreseeable future, and in receipt of active and passive income flows from developing countries, an approach that does not cater to their needs will most likely have limited impact. An important factor in this respect will be the position of upper-middle-income countries such as Malaysia, Kenya, etc., some of which are already major capital exporters, while others are beginning to see resident firms looking for investment opportunities abroad. The jurisdictions within the Belt and Road Initiative (BRI) are probably the largest group of such countries.

Globalisation is being questioned in many OECD countries due to the rise of populism, increased protectionism and reordering of supply chains in the aftermath of the pandemic. In this context, the impact of these broader trends could increase the importance of alternative sources of capital for many developing countries. Trade and investment flows between BRI jurisdictions, and from such jurisdictions to the rest of the developing world, which are already on the rise, could increase significantly. This would result in a consequent rise in the importance on tax and regulatory relationships between them. This is especially true in the case of consumer facing and digitised economy businesses, where the bulk of consumers are located in developing countries.

The UN process could thus benefit a subset of like-minded countries and could be considered a success if it helps to establish the principles of an updated tax relationship between developing countries. This could particularly be the case of such relationships between upper-middle-income and lower-middle-income developing countries. Such countries will most likely be more interested in a balanced approach between source- and residence-based taxation rights and it is possible that they will see the UN-led process to be a viable alternative to the complex arrangements under the Inclusive Framework process.

The Impact of Pillar Two on In-Scope Taxpayers and Their Responses

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Abstract: The OECD's Pillar Two initiative aims to establish a global minimum tax rate of 15% to prevent a "race to the bottom" in corporate taxation. The GloBE Rules, which include the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR), introduce significant complexity for both taxpayers and tax administrations. Taxpayers must invest in new processes and systems to comply with the rules, which results in higher compliance costs for taxpayers and increased administrative burdens for tax authorities. The impact of the Top-Up Tax on the cash and profit positions of in-scope taxpayers varies depending on factors such as the jurisdictional mix of the MNE and the specific tax benefits available in different jurisdictions. While the Top Up Tax generally leads to a higher effective tax burden, some jurisdictions have enacted legislation to mitigate its impact, potentially resulting in tax benefits for certain MNEs.

Keywords: GloBE Rules; Pillar Two; Level playing field; Complexity

1. Introduction

The OECD's Pillar Two aims to establish a global minimum tax rate of 15% to curb what many have referred to as the "race to the bottom." The approach to achieve this are the OECD Model Rules or GloBE Rules (Global Anti Base Erosion)[1] which consist of an Income Inclusion Rule (IIR) and an Undertaxed Payments Rule (UTPR) and are designed for multinational enterprises (MNEs) with revenue of at least EUR750 million per

1 OECD (2021).Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), https://www.oecd-ilibrary.org/docserver/782bac33-en.pdf?expires=1729825232&id=id&accname=guest&checksum=F4710ED752ACD5524BFA43F164AD741A.

annum.[2] The GloBE Rules were picked up by some countries and transferred into their domestic law,[3] but most notably inspired the European Union (EU) to issue a respective Directive,[4] obligating EU member states to introduce an IIR into their domestic tax law as of 1 January 2024 (and a UTPR with one year delay). To understand the impact of this Pillar Two on taxpayers in scope, it is important to dive a little bit deeper into the mechanics of the GloBE Rules.

2. How the GloBE Rules Work

As described above the GloBE Rules mostly consist of a main component, the IIR and a supporting concept, the UTPR.[5] The rules apply to MNEs with a revenue of more than EUR750 million per annum, and are designed to be primarily applied at the level of the parent entity (IIR). In principle, the parent entity must calculate the respective effective tax rate for each jurisdiction in which it operates through so-called constituent entities (legal entities or permanent establishments). To do so, it first must calculate the tax base for each jurisdiction (so-called GloBE income or loss). The GloBE income or loss is the Financial Accounting Net Income — which means that the starting point for the GloBE income is the book income. The idea behind was to create a globally mostly consistent tax base for the GloBE Rules. Having said so, the GloBE income or loss is in a second step adjusted for items which usually are exempt from tax or excluded, such as certain dividends, capital gains or specific policy disallowed expenses. The tax that now must be compared with the GloBE income or loss is called the Covered Tax. It is the current tax as accrued in the financial net income for the respective jurisdiction. Because the current tax is due on the applicable domestic tax base — which in most cases deviates from the Financial Accounting Net Income — the GloBE Rules use an approach which per se leads to a distortion of the effective tax rate: e.g. the financial net income might be higher than the domestic tax base because the Financial Accounting rules might allow to amortize certain expenses (such as R&D expenses) whilst the applicable domestic taw law does not allow to do so; in this case, the effective tax rate would come out lower in the year of the amortization, but end up to be higher in the following years. Under financial accounting rules these distortions are called temporary differences for which so-called deferred taxes must be recognized. The deferred taxes reflect future tax benefits or tax expenses. The GloBE Rules do not fully follow the concept of deferred taxes but allow to include a so-called deferred tax adjustment amount in the covered taxes. This deferred tax adjustment amount deviates significantly from the deferred taxes under financial accounting rules. If the covered taxes come out lower than 15% of the GloBE income or loss for the respective jurisdiction, a Top-Up Tax must be paid by the parent entity corresponding to the percentage gap between the effective tax rate and 15%. The parent entity is allowed to deduct a substance-based-carve-out from the GloBE tax base — this carve-out is a specific percentage of payroll and tangible assets that relate to the respective jurisdiction. Because the Top-Up Tax will end up in the pockets of the country of residence of the parent entity, countries are allowed to introduce so-called qualifying domestic top up taxes (QDMTTs). These QDMTTs will elevate domestic taxation levels in a way that the

2 The GloBE Rules are complemented by a subject-to-tax-rule (STTR), which constitutes a treaty-based rule that protects the right of developing Inclusive Framework members to tax certain intra-group payments, where these are subject to a nominal corporate income tax that is below the minimum rate; see the respective report of the Inclusive Framework on BEPS dated July 17, 2023.

3 31 countries by beginning of August 2024, including the countries of the European Union; see https://www.pwc.com/gx/en/tax/international-tax-planning/pillar-two/pwc-pillar-two-country-tracker-summary-v2.pdf.

4 Council Directive (EU) 2022/2523 of 15 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

5 The STTR will not be in focus of this analysis.

IIR will not trigger any Top-Up Tax outside of the respective jurisdiction and thus allow the previously low-taxed jurisdiction to "harvest" the additional tax. For a transitional period, some safe harbor rules apply.

The UTPR allows a country to increase taxes on a resident constituent entity. If that entity is part of a larger multinational group that pays less than the proposed a UTPR would apply additional tax on a subsidiary of a multinational that has low-taxed profits outside the jurisdiction applying the UTPR global minimum tax of 15% in another jurisdiction. In other words, the UTPR applies additional tax on a subsidiary of an MNE that has low-taxed profits outside the jurisdiction applying the UTPR. In this way, the UTPR targets MNEs whose parent entities are resident in a country that does not implement the GloBE Rules. The UTPR will not only apply to low-taxed subsidiaries, but includes a low-taxed parent entity, too. The UTPR acts as a backstop enforcement of the GloBE Rules and is designed to ensure that no country will stay outside of the potential reach of the GloBE Rules (provided that some countries play along and implement the GloBE Rules).[6]

3. Complexity and Administration

It is apparent that the GloBE Rules create a new level of complexity, both for taxpayers and tax administrations. Taxpayers have to incest heavily in new processes and systems — the significant adjustments to the financial accounting net income or loss, the adjustments to the current income and especially the adjusted deferred tax amount introduce a new layer of "GloBE-books" on top of the financial books and the domestic tax books. Many of the adjustments can and must be reflected in respective IT systems — a manual (not system based) approach will not be sustainable for more than one tax period. Some of the required adjustments cannot even be programmed in a support system. Most prominently, deferred tax liabilities can only be included in covered taxes when they are "paid within a period of five years."[7] First of all, deferred tax liabilities usually are not being paid, because they result out of temporary differences between the financial and the tax books; these differences disappear over time, e.g., because of different depreciation timetables for book and tax. Secondly, the prognosis, that the GloBE Rules require taxpayers to apply in this case, is practically impossible. The reason is simple: there are not only two or three deferred tax liabilities but literally thousands, potentially hundreds of thousands. For financial accounting purposes, deferred taxes are calculated on an account basis, e.g., for the account for machinery. This means in this example, the account comprises and the deferred tax on it is the result of many assets — on an asset-by-asset basis, there can be a deferred tax liability or a deferred tax asset. The five-year prognosis can only be applied on this item by item basis.[8] Because of the extreme complexity and the particularities of the rules, taxpayers will be faced with significantly higher compliance cost — and this will also be the case for tax administrations, which have to build up expertise not only for the GloBE Rules, but also starting with the underlying financial accounting rules.[9]

6 But see below on the relieve the OECD granted in 2023 regarding the application of the UTPR with respect to (mostly) the US.

7 Art. 4.4.4 of the GloBE Model Rules.

8 The OECD realized this impossibility and tried to heal it with administrative guidance issued June 2024, http://www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-june-2024.pdf. The Guidance is well spirited but largely replaces one complexity with another one. It very well underlines that the Model Rules contain many difficulties and might have been issued too fast, given their global reach and complexity.

9 Michael P. Devereux (and others) elaborated on the downside effects of the extreme complexity of the GloBE Rules, International Tax Competition and Coordination with a Global Minimum Tax, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4335055.

4. Cash and Profitability Impact

The impact of the Top-Up Tax on the cash and profit position of in-scope taxpayers depends on a variety of factors. It starts with the jurisdictional mix of the MNE — e.g., in which countries the parent entity is resident and in which countries the MNE operates through constituent entities (see more on this in the next chapter "level playing field"). It seems obvious that in any case the Top-Up Tax will only lead to a higher effective tax burden or at least the same effective tax burden than before. Having said so, there are cases in which the introduction of the Top-Up Tax leads to a tax benefit for an MNE. This is the case in some jurisdictions which enacted legislation to counter the negative impact of the Top-Up Tax for taxpayers doing business in their jurisdiction, especially headquarter-business. One example is Bermuda, which introduced a corporate income tax (CIT) taking effect in 2025. The Bermuda CIT includes an economic transition adjustment (ETA), which allows Bermuda entities at the end of 2023 to mark up their intangible assets to their estimated market value as of 30 September 2023. Most of these assets had a zero-tax basis and can now be amortized over 10 years for tax purposes.[10] This creates the recognition of a deferred tax asset (DTA) which is included as additional income in the Financial Accounts of the Bermuda entity. There are other options the new Bermuda regime offers to Bermuda entities which as well generate a benefit to the Financial Accounts and there are other countries which offer similar options to resident entities to Bermuda.[11]

The cases in which Pillar Two leads to less tax expense are certainly a transitional phenomenon. In most cases, the tax cash out and tax expense will be higher than before, in some cases even significantly higher. This will be the case for taxpayers with constituent entities in low tax jurisdictions and a respective high profitability in these entities — or in jurisdictions which are not per se low tax but offer certain investment tax benefits, such as renewable energy tax credits. It remains to be seen if this additional tax burden will stick around or if MNEs will react and rearrange their business setup in a different way by using new incentives, subsidies and benefits offered by jurisdictions as a response to the shifting competitive environment (see next chapters).

5. Level Playing Field (Deterring Economic Competition)

One of the goals of the GloBE Rules was to achieve a level playing field, i.e., leveling the effects of low taxation and jurisdictional tax competition on economic competition. This goal has not been achieved. First, the majority of jurisdictions have not implemented or indicated to implement the GloBE Rules, including economically important and powerful countries. MNEs with a parent entity resident in these countries do not have to apply the IIR on the level of the parent entity. For them, the impact of the GloBE Rules is only relevant in the jurisdictions which have implemented the GloBE Rules —this can lead to the result that all or at least most of the financial net income of these MNEs will not be subject to Top-Up tax. In contrast, MNEs with parent entity being resident in one of the EU member countries are subject to the Top-Up Tax in all jurisdictions they are present in via a constituent entity. And the UTPR (see above) does not change this for the time being: this apparent competitive distortion is sanctioned by the OECD which delayed the application of the UTPR from 2025 to 2026 for countries with a statutory corporate tax rate above 20%.[12] Because the US statutory tax rate

10 Martin A (2024). Sullivan. Gain and Little Pain from New Bermuda Corporate Tax, 114 *Tax Notes International*, p. 503.

11 Mindy Herzfeld (2024). The Next Phase of Pillar Two Implementation: Creative Competition, 114 *Tax Notes International*, P. 1727.

12 The transitional UTPR Safe Harbor introduce in Sec. 5.2 of the second set of administrative guidance issued by the Inclusive Framework on BEPS in July 2023, https:// www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf.

is 21%, this transitional safe harbor should shield US multinationals from the UTPR through the end of 2025. Thus, the impact of Pillar Two on taxpayers in countries which implemented the rules as they stand is a competitive disadvantage, while taxpayers in countries such as the US are not fully impacted by the GloBE Rules and taxpayers in "smart" jurisdictions such as Bermuda even continue to harvest tax benefits. A level playing field looks different.

6. Allocation Decisions

We have seen that the GloBE Rules do not achieve a level playing field. It is obvious that as long as not all jurisdictions have implemented these rules and some jurisdictions actively try to design their tax rules in a way to counter any negative impact from the IIR, taxpayers will reflect these particularities within their allocation decisions, i.e. decision in which jurisdiction to invest by e.g. building a new factory or R&D hub.

Even within the GloBE Rules there is one element which can heavily influence allocation decisions. The so-called substance-based income exclusion[13] allows for a reduction of the tax base to which the Top-Up Tax is applied. This reduction is calculated based on the eligible payroll costs within the jurisdiction, as defined by the OECD's Pillar Two proposal, and the eligible tangible assets, which encompass the value of property, plant and equipment, natural resources, and lessee's right-of-use assets situated within the jurisdiction of the relevant entity. This reduction means that wherever employees are employed and "real" (tangible) investments are made a lower tax rate can still be applied without the Top-Up Tax taking away the corresponding advantage. Thus, a factory — which is usually a heavy tangible investment and requires a lot of payroll — can still benefit from tax holidays or other tax incentives. The tax planning will have to reflect the mechanism of the substance-based carve-out to ensure that benefits can be fully harvested, but this is a mere mathematical exercise. From the perspective of countries such as Germany, which still are materially relying on their traditional domestic industrial base, this component of the GloBE Rules might have a negative impact. Rules (the GloBE Rules) which were meant to tackle "unfair" tax competition undertaken via low-substance entities and via low tax jurisdictions all of a sudden might inspire tax competition among jurisdictions to focus on high-substance activities and with this much more harm the industrialized countries losing tangible investments and jobs.[14]

7. Competition for Investments

The GloBE Rules change the way jurisdictions compete for investments. A low tax rate or a specific tax benefit alone will in most cases not continue to do the deal, i.e. attract inbound investment. This is because the Top-Up Tax will likely elevate the effective tax burden to at least 15%. Jurisdictions that do want to attract inbound investments have a couple of options to adapt to this new environment.[15]

First, tax incentives for tangible investments can still work out because of the substance-based carve-out of the GloBE Rules.

Second, tax credits, which are refundable, will not lower the covered taxes but are taken into account as part of the GloBE Income. In this way, it is less likely that these refundable tax credits will lower the effective tax rate below the threshold of 15%. The OECD pivoted to accommodate many of the US tax systems tax credits as refundable, even though they are not refundable in the very meaning of the

13 Article 5.3 of the GloBE Model Rules, also referred to as substance-based carve-out.

14 See Michael P. Devereux and John Vella (2023). The Impact of the Global Minimum Tax on Tax Competition, 15 *World Tax Journal* 3, pp. 323-378.

15 Please also see footnote of 14.

word but can only be transferred (sold) to other taxpayers.[16]

Third, other non-tax related subsidies or benefits are becoming more important. These benefits can be cash grants or cash subsidies. Such cash benefits will increase the GloBE Income, but have no impact on the covered taxes because they are mostly treated as tax exempt income items. Higher income and no corresponding tax burden will lead to a lower effective tax rate and thus might bring a benefiting constituent entity within a Top-Up Tax position. Still, it is pure mathematics that a cash benefit is less likely to lead to a low tax position than a corresponding tax benefit (comparable to the effect of refundable tax credits). Other non-cash benefits will gain importance, too. This could be awarding specific certificates or permits, visa for inbound delegates, preferable personal income tax treatments for inbound delegates, etc. In any case, jurisdictions will try to replace tax benefits they offered in the past and can't offer any longer by other incentives to remain competitive within the global landscape.

For developing countries, the competition has become tougher due to the GloBE Rules. Most of them lack the economic ability to attract investments using direct subsidies or instruments such as refundable tax credits.[17] Because other typical location factors, such as infrastructure, logistics, and skilled and highly educated workforce, are in many developing countries not on the same level than in other (developed) jurisdictions, with the GloBE Rules these jurisdictions have lost an effective tool to develop their economies without getting much in return. This, too, might explain why developing countries have started to focus more on the work of the UN in the field of international tax cooperation.[18]

8. How Multinational Enterprises can Deal with the New Situation

For MNEs, the first challenge is to establish new processes and a supporting digital infrastructure to cope with the compliance challenges of the GloBE Rules. It is not possible to apply the GloBE Rules "manually" (i.e. using mostly Excel work-papers for the calculations) for any MNE with substantial operations and business in more than a dozen countries — at least not for longer than the first year of the rules' effectiveness. MNEs might either enlarge their existing tax accounting systems to have an extra layer for the GloBE adjustments or implement an extra tax ledger solely for GloBE purposes in their ERP system. The latter approach is extremely costly and will therefore only be used by very few MNEs. Even then MNEs with operations in more than just a few jurisdictions will complement their system landscape with specific GloBE tools as they are offered by some providers already. The better solution is that these tools integrate the interplay between QDMTTs and the Top-Up Tax at the parent entity level which is an extra layer of complexity because the QDMTTs can (and are allowed to) deviate from the GloBE Rules in some respects. MNEs therefore might first apply the GloBE Rules for all their jurisdictions centrally, in a second step will hand over the jurisdictional calculation to the respective jurisdictions which do have to comply with a QDMTT and have them make the respective domestic adjustments to get the adjusted jurisdictional calculation back to integrate it in the Global Information Return (GIR)

16 So-called "Marketable Transferable Tax Credits," as described by the Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf.

17 Błażej Kuźniacki & Edwin Visser (2024). *Tax and Non-Tax-Related Challenges of Pillar 2 for Non-Advanced Economies, Tax Notes Online*, https:www.taxnotes.com/special-reports/oecd-pillar-2-global-minimum-tax/tax-and-non-tax-related-challenges-pillar-2-non-advanced-economies/2024/05/03/7jg9l.

18 For an overview, see the ICC comments on the zero draft terms of reference for the UN tax framework convention, https://iccwbo.org/news-publications/news/icc-comments-on-zero-draft-terms-of-reference-for-un-tax-framework-convention/.

required by the GloBE Rules.

Apart from the compliance challenge, MNEs will have to review their structural setup and re-align their tax planning within the context of GloBE Rules. A low statutory tax rate loses its attractiveness if not enough substance can be provided to benefit from the substance-based carve-out. In contrast, MNEs will start looking for tax benefits in the form of qualified refundable tax credits or shift their attention to other non-tax related incentives. A more aggressive move would focus on escaping from the reach of the GloBE Rules by moving the parent entity (or other activities) to a jurisdiction which did not implement the GloBE Rules so far (and doesn't plan to do so) and benefits from the transitional UTPR Safe Harbor. In this way the application of the UTPR in respect of the transferred activities could be avoided for the years 2025 and 2026. Such a transaction would trigger significant cost and create a lot of publicity and will therefore most likely be a rather rare exception.

9. How Belt and Road Jurisdictions Can React to the New Situation

None of the member jurisdictions of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) has implemented the GloBE Rules as of 1 January 2024. Slovakia is the only member country that implemented a QDMTT as of 1 January 2024.[19] Given the complexity of the GloBE Rules this is not a surprising fact and taxpayers resident in the BRITACOM member jurisdictions should be thankful for the respective administrative relief. Meanwhile, with almost all of the EU member states (and some others like Canada, South Korea, Australia and Japan) having implemented the GloBE Rules as of 1 January 2024, MNEs being resident in BRITACOM member jurisdictions will have to deal with the IIR in these jurisdictions — even though they will mostly not be low-taxed.[20] And starting from 2025 (or 2026 depending on the facts), the UTPR might target low-taxed activities of these MNEs even outside of the EU member states. Plus, if a BRITACOM member jurisdiction decides to attract investments by giving tax incentives, this benefit might be "taxed" away by EU member states applying the GloBE Rules.

In this regard it seems appropriate to at least implement a QDMTT to avoid other countries "stealing" the tax. A ">15%" Corporate Income Tax Rate alone will not do the deal because of the different computational basis for the QDMTT — Adjusted Financial Accounting Net Income as the tax base and the definition of Covered Taxes as explained above; even with rates above 20% adjustments could lead to a GloBE tax rate of below 15% and trigger a respective Top-Up Tax.

However, to implement the IIR and the UTPR should be carefully considered. The UN started a discussion in 2022,[21] and decided in December 2023 to develop a Framework Convention for International Tax Cooperation.[22] The respective Draft Terms of Reference (TOR) have been developed by a UN-member-state-led intergovernmental committee which decided on 16 August 2024, to present the Draft TOR to the UN General Assembly for adoption in September 2024.[23] The Draft TOR target the same

19 On 8 December 2023 the Slovak parliament approved the wording of the Law on Slovak Domestic Top-up Tax, applicable for accounting periods starting after 31 December 2023; the UAE implemented a corporate income tax for periods starting on or after 1 June 2023 — but this CIT does not qualify as a QDMTT even though it might effectively lead to a similar tax burden.

20 And therefore safeguarded by a transitional safe harbor rule as referred to in Art. 32 Council Directive (EU) 2022/2523 of 15 December 2022.

21 Resolution 77/244 of the UN General Assembly; the resulting report — "Promotion of Inclusive and Effective International Tax Cooperation at the United Nations" — was published in July 2023 (A/78/235).

22 UN General Assembly Resolution 78/230.

23 Mindy Herzfeld in Tax Notes International online on the process and content, https://www.taxnotes.com/tax-notes-today-international/harmonization/dissecting-u.n-multilateral-convention-process/2024/09/09/7l5mm.

aspects which have been in scope of the OECD BEPS project and the GloBE Rules. Given the fact that it seems unlikely that the US is implementing the GloBE Rules and considering the democratically questionable process of how the EU converted the OECD GloBE Rules into a directive and opened a door for future OECD decisions (e.g., administrative guidance) directly influencing the EU law and EU member states' domestic law, there is no need to rush for the BRITACOM member jurisdictions. They can take a backseat and observe how their European competitors will suffer from the GloBE Rules while themselves actively engaging in the UN process.

In any case BRITACOM member jurisdictions need to use the right tools from the tax-incentive- and other-benefits-toolbox if they want to inspire domestic investments. Tax holidays or other tax benefits might be taken away by third countries applying respective GloBE Rules. Refundable/transferable tax credits seem to work better, but they are much more costly for the country awarding them to taxpayers. Giving tax certainty to taxpayers and other "softer" factors, such as good taxpayer service or audit relief, do not have an impact on the GloBE Rules and will therefore be a good way to compete with other locations for investments. Non-tax related benefits, such as cash grants or non-cash benefits, e.g., permits, work-visa, etc., will also gain more importance in the competition for investments and growth.

In any case BRITACOM member jurisdictions need to at least train parts of their tax administrations in Financial Accounting Rules and the GloBE Rules so that they gain a holistic understanding of the impacts of the development on their country and can better decide whether to implement a QDMMT or not or how to design tax-benefits/investment-benefits the best way to make them "GloBE-safe."

10. Summary

The OECD's Pillar Two initiative aims to establish a global minimum tax rate of 15% to prevent a "race to the bottom" in corporate taxation. The GloBE Rules, which include the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR), target MNEs with annual revenues of at least EUR750 million. These rules have been adopted by some countries and inspired the European Union to issue a directive requiring member states to implement the GloBE Rules by 1 January 2024.

The GloBE Rules introduce significant complexity for both taxpayers and tax administrations. Taxpayers must invest in new processes and systems to comply with the rules, which require adjustments to financial accounting net income or loss, current income, and deferred tax amounts. This complexity results in higher compliance costs for taxpayers and increased administrative burdens for tax authorities.

The impact of the Top-Up Tax on the cash and profit positions of in-scope taxpayers varies depending on factors such as the jurisdictional mix of the MNE and the specific tax benefits available in different jurisdictions. While the Top-Up Tax generally leads to a higher effective tax burden, some jurisdictions have enacted legislation to mitigate its impact, potentially resulting in tax benefits for certain MNEs.

The GloBE Rules have not achieved a level playing field, as not all jurisdictions have implemented them. This creates competitive disadvantages for taxpayers in countries that have adopted the rules, while those in jurisdictions that have not adopted the rules are not fully impacted. Additionally, some jurisdictions, such as Bermuda, continue to offer tax benefits that counter the goals of the GloBE Rules.

In conclusion, while the GloBE Rules aim to address issues of tax competition and ensure a minimum level of taxation for MNEs, their implementation has introduced significant complexity and compliance costs. The uneven adoption of the rules across jurisdictions has also led to competitive disparities, highlighting the challenges of achieving a truly level playing field in global taxation. Both MNEs and the BRITACOM member jurisdictions need to understand the new landscape to respond to it appropriately and to find the best individual set-up.

The Implementation of the Global Minimum Tax in Italy

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Abstract: Global Minimum Tax marks a new era in the international landscape setting out a new paradigm, i.e. the GloBE Rules, which are intended to apply, as a general rule, starting from fiscal year 2024. To date, the implementation of GloBE Rules in the OECD/G20 Inclusive Framework jurisdictions appears to be a work in progress.

As far as Italy is concerned, GloBE Rules have been implemented into the Italian tax framework with Legislative Decree No. 209 dated 27 December 2023, followed by T-CbCR SH Decree and QDMTT Decree in 2024. The implementation process will be completed, though, only once all the supplementary Ministry decrees are issued.

GloBE Rules implementation process shows Italy's strong will to enact legislation as aligned as possible to the OECD Pillar Two Model Rules and Council Directive (EU) 2022/2523. It is reasonable to expect that forthcoming supplementary Ministry decrees will follow the same approach.

As pursuant to the Italian GloBE Rules, IIR and QDMTT are effective starting from fiscal year 2024, in-scope MNEs headquartered or operating in Italy and large-scale groups are now required to deal with their application (subject to Transitional Safe Harbours).

Keywords: Pillar Two; GloBE; Safe Harbours rules; QDMTT; Italy; Legislative Decree 209/2023

1. Introduction

To further address challenges arising from digitalisation and globalisation on taxation of international business income and improve the fairness of tax systems, following up on Base Erosion and Profit Shifting (BEPS) project, over 140 OECD/G20 Inclusive Framework (IF) jurisdictions joined a two-pillar solution (hereinafter referred to as "Two-Pillar Solution") to reform the international taxation rules and ensure that multinational enterprises (MNEs) pay a fair share of tax wherever they operate and generate profits.[1]

The Two-Pillar Solution consists of: (i) Pillar One: a set of rules aimed at reallocating taxing rights amongst market jurisdictions and (ii) Pillar Two: a set of rules aimed at ensuring that certain multinational enterprises are subject to an overall minimum level of taxation.

The Two-Pillar Solution highlights the ineffectiveness of the measures previously conceived at the international level as well as those adopted independently by single countries to address the tax ramifications of the digital economy. This clearly surfaces from the "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" that reads as follows:

"[t]he Multilateral Convention (MLC) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC. The modality for the removal of existing Digital Services Taxes and other relevant similar measures will be appropriately coordinated."

As far as Pillar Two (Global Minimum Tax) is concerned, it will have a major impact on in-scope multinational enterprises and large-scale groups. Pillar Two marks a new era in the international landscape setting out a new paradigm, i.e. the Global Anti-Base Erosion (GloBE) Rules, which are intended to apply, as a general rule,

1 See OECD (2020). *Tax Challenges Arising from Digitalisation — Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, https://doi.org/10.1787/abb4c3d1-en.

starting from fiscal year 2024.

Implementing the Global Minimum Tax will not be an easy task for the IF jurisdictions as they will have to create a new set of rules that fits within their existing tax framework and ensure consistency with the OECD Pillar Two Model Rules. Indeed, being a global project, Pillar Two can only succeed if OECD Pillar Two Model Rules are implemented and applied consistently by the IF jurisdictions.

8 October 2021 marked an important date in the Pillar Two project since on that date OECD/G20 IF members agreed on a common approach.

On 14 December 2021, the OECD/G20 IF approved the OECD Pillar Two Model Rules, providing detailed rules aimed at assisting the IF in the implementation of the landmark international tax system reform concerned. On 20 December 2021, the OECD Secretariat published the OECD Pillar Two Model Rules.[2]

Following the issuance of the OECD Pillar Two Model Rules, the OECD kept working to produce detailed guidance to ease the implementation process and the interpretation of OECD Pillar Two Model Rules. Reference is made to, among others, OECD's Commentary to the GloBE Rules, the Illustrative Examples, Guidance on Safe Harbours and Penalty Relief, and Administrative Guidance.[3]

At European Union level, to achieve consistency among Member States in the implementation of OECD Pillar Two Model Rules, on 14 December 2022, the Council enacted the Council Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (hereinafter referred to as "Directive"). The Directive entered into force on 23 December (i.e. the day after its publication in the *Official Journal of the European Union*). The Directive was to be implemented by the Member States into their domestic law by 31 December 2023.[4]

As far as Italy is concerned, Pillar Two (Global Minimum Tax) implementation process started with a public consultation on Legislative Decree Implementing Global Minimum Taxation Directive launched on 12 September 2023.

On 23 October 2023, the Decree was preliminary approved by the Council of Ministers; final approval was obtained on 20 December 2023.

On 27 December 2023, Italy translated the provisions of the Directive into its domestic law with Legislative Decree No. 209/2023 "Attuazione della riforma fiscale in materia di fiscalità internazionale" which includes *inter alia* Pillar Two provisions.

On 28 December 2023, the Decree was published in the *Official Gazette* and became effective starting from 29 December 2023.[5]

2 OECD (2021). *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, https://doi.org/10.1787/782bac33-en.

3 *Ex multis,* OECD (2024). *Tax Challenges Arising from the Digitalisation of the Economy — Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023): Inclusive Framework on BEPS*, https://doi.org/10.1787/b849f926-en; OECD (2024). *Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two) Examples*, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf; OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, 2 February 2023, 17 July 2023 and 18 December 2023; OECD (2024). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, http://www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-june-2024.pdf.

4 Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

5 Legislative Decree No. 209 of 27 December 2023, Official Gazette — General Series, Year 164, No. 301 issued on 28 December 2023.

Following the enactment of the Decree, the Ministry of Finance issued two Decrees that deal with Pillar Two Transitional Safe Harbours and Domestic Minimum Top-up Tax, respectively. The said decrees provide detailed rules on the above-mentioned aspects with the view to enlarging the scope of Italian GloBE Rules and aligning them with the most recent developments in the OECD's works.

2. The Implementation of the Global Minimum Tax in the Italian Framework

2.1 Legislative Decree No. 209 Issued on 27 December 2023

The provisions of the Directive have been implemented by Italy with the Legislative Decree No. 209/2023 (hereinafter referred to as "Decree").

The approach pursued by Italy in implementing GloBE Rules into its tax framework is to create a domestic set of rules aligned to the greatest extent possible to the OECD Pillar Two Model Rules and the OECD's works publicly available. As it will be explained below, though, GloBE Rules implementation process is subject to the boundaries set out by the Constitution law. Furthermore, Italian law-making process makes it quite hard, if not impossible, to keep up with the pace of the OECD's works; the issuance of Ministry decrees as a way to speed up the implementation process and incorporate the latest developments in the OECD's works, although useful, does not appear to be sufficient given the number and length of the reports and guidance issued by OECD over time.

A direct and open-ended reference to OECD reports and guidance is not allowed by the Italian law. Such "soft law" instruments can only become binding for Italian taxpayer if and to the extent that their contents are included in a law or a Ministry decree which, again, would require the fulfilment of a lengthy law-making process.

Notwithstanding that, to ensure consistency with the OECD principles and to provide a greater degree of detail, when translating the Directive's provisions into its domestic tax law, Italy incorporated some of the most important guidance provided by the OECD (OECD Commentary and OECD Administrative Guidance) up to the date of enactment of the Decree.[6]

Italian GloBE Rules set forth in the Decree appear, thus, aligned with the Directive and the OECD Model Rules. As a matter of fact, the structure and functioning of the Income Inclusion Rule (IIR), UTPR and Qualified Domestic Minimum Top-up Tax (QDMTT) governed by the provisions of the Decree appear consistent with the Directive and the OECD Model Rules.

The importance of OECD guidance in the interpretation of the GloBE Rules set forth in the Decree is confirmed by Article 9(3) of the Decree that requires domestic GloBE Rules to be interpreted and applied in the light of OECD Commentary and Administrative Guidance, which, in turn, ensures that GloBE Rules set forth in the Decree are applied in a consistent and coordinated manner and mitigate the risk of diverging interpretation.

Article 9(3) of the Decree endorses the "ambulatory approach" as it requires interpreting the provision of the Decree in the light of any further OECD guidance included in the OECD Commentary and Administrative Guidance. As a result, when interpreting the Italian

6 The Italian Ministry of Economy and Finance, *Presentazione dello Schema di Decreto Legislativo*, clarified that one of the key aims of the Decree is to design Italian GloBE Rules as closely aligned as possible with the Directive, the OECD Model Rules and guidance (set forth in the OECD Commentary and in the Administrative Guidance). See I. Giuliano & L. Ceresi (2024). Implementation of the Global Minimum Tax in Italy and EU Directive Proposals: Does This Approach Effectively Pave the Way for the Establishment of a More Sustainable Tax System?. 64 *European Taxation* 4.

GloBE Rules set forth in the Decree, attention should be given to the latest version of the OECD Commentary and Administrative Guidance.

Changes to the OECD Commentary and Administrative Guidance become, thus, relevant under Article 9(3) of the Decree to interpret the Italian GloBE Rules set forth in the Decree. However, Article 9(3) of the Decree cannot be construed as to make OECD Commentary and Administrative Guidance binding instruments under the Italian law, nor to allow the OECD Commentary and Administrative Guidance to introduce new rules that are not included in the Decree.

Preparatory works and the explanatory memorandum to the Decree provide further guidance in the interpretation of the Italian GloBE Rules. Consistently with the above-described approach, the said guidance is aligned with the OECD guidance.

Although the Decree closely follows the content and structure of the OECD Model Rules, some differences do exist. For example, as opposed to the OECD Model Rules, the IIR under the Italian GloBE Rules applies also to the ultimate parent entity (UPE) and its low-taxed subsidiaries located in Italy.[7] Furthermore, the subjective scope of the Italian rules (and the Directive) is broader than the OECD Model Rules as the Italian rules also cover large-scale domestic groups.

2.2 Transitional CbCR Safe Harbours Decree

On 21 May 2024, the Italian Ministry of Finance published a decree (hereinafter referred to as "T-CbCR SH Decree") implementing in the Italian law the Transitional Safe Harbours. The T-CbCR SH Decree reflects the content of OECD reports: (i) the administrative guidance of December 2022[8] and (ii) the administrative guidance of December 2023.[9]

Transitional Safe Harbours are of the utmost importance for in-scope multinational enterprises and large-scale domestic groups as they can push back the application of the full GloBE Rules and free them not just from an additional tax burden but most of all from cumbersome compliance duties and complex calculations. Given the importance of the Transitional Safe Harbours, detailed rules were needed to ensure certainty on such an important matter.

Indeed, prior to the issuance of the T-CbCR SH Decree, in-scope MNEs and large-scale domestic groups assessed the applicability of Safe Harbours rules with respect to their entities by making reference to the conditions set forth in the OECD reports that, as mentioned before, are not binding for Italian tax purposes.

As a result of the issuance of the T-CbCR SH Decree, in-scope MNEs and large-scale domestic groups can now rely on a set of binding rules fully aligned with OECD principles.

Even though the T-CbCR SH Decree is substantially in line with the OECD report on the topic, there are some peculiarities that are still worth highlighting.

First off, the T-CbCR SH Decree states that, in calculating the Net Unrealized Fair Value Losses, groups only have to take into account variations in the value of participations accounted for with the fair value accounting method.

Indeed, the objective scope of the rule for Net Unrealized Fair Value Losses and the strictly related concept of changes in fair value of participations (contained in Art. 3.2.1(c) of the OECD Pillar Two Model Rules) have not

7 See Art. 2.1.6 of the OECD Model Rules.

8 OECD (2022). *Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two)*, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf.

9 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-december-2023.pdf.

been interpreted in a homogenous fashion by the countries that have implemented the GloBE Rules.

Some countries[10] have taken the position that variations in the value of participations must be disregarded for Pillar Two purposes regardless of the fact that such participations are accounted for with fair value or cost accounting methods. On the contrary, Italy has taken the position that such variations have to be neutralised for Pillar Two purposes (both for GloBE calculations and for T-CbCR SH purposes) only when they refer to participations for which a fair value accounting method has been applied.

Another important feature of the T-CbCR SH Decree is that it already contains the anti-hybrid provisions contained in the Administrative Guidance issued on 18 December 2023.

2.3 QDMTT Decree

On 1 July 2024, the Italian Ministry of Finance issued a decree implementing in the Italian law named the QDMTT (*imposta minima nazionale*) (hereinafter referred to as "QDMTT Decree").

Italy chose to introduce a QDMTT to preserve its tax base and to avoid that its domestic income is subject to a top-up tax in other jurisdictions through the application of their GloBE Rules.

The QDMTT applies to entities located in Italy belonging to in-scope MNEs and Italian large-scale domestic groups. It ensures that those entities are subject to a minimum level of taxation on their excess (low-taxed) profit derived in its territory; QDMTT on excess (low-taxed) profit derived by the said entities stays, thus, in Italy.

The QDMTT takes precedence over (domestic) IIR and UTPR. It applies regardless of the fact that the in-scope MNEs and large-scale domestic groups meet the conditions for the initial phase of international activity exclusion.[11]

The QDMTT also ensures that Italian tax incentives granted to entities located in Italy belonging to in-scope MNEs and large-scale domestic groups do not result in an excess (low-taxed) profit subject to the top-up tax imposed by other jurisdictions.[12] Indeed, any excess (low-taxed) profit resulting from the use of an Italian tax incentive by a relevant entity would be caught by the QDMTT. This prevents that a tax incentive may lower the Italian tax base and increase the tax base of another jurisdiction as a consequence of the application of the local GloBE Rules.

The QDMTT is designed to meet the conditions set out by the OECD to (i) be deemed as a qualified domestic minimum top-up tax and (ii) to qualify as a QDMTT Safe Harbours.[13,14] The QDMTT complies with the QDMTT Accounting Standard, the Consistency Standard, and the Administration Standard set forth by the OECD Administrative Guidance issued on 17

10 One of them being the United Kingdom.

11 Art. 18(6) Decree.

12 Law No. 160 of 27 October 2023 delegating to the Government the revision of the system of tax incentives for companies makes no mention of Council Directive (EU) 2022/2523 of 14 December 2022 (Legge Delega) that calls for a revision and rationalisation of the existing tax incentives for companies in line with object and purposes of the Directive and GloBE Rules. To date, however, no comprehensive and consistent revision of the Italian tax incentive system took place. Absent a comprehensive revision of the Italian tax incentive system, QDMTT appears to be suitable means to preserve the Italian tax base.

13 OECD (2023). Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), 2 February 2023 and 17 July 2023.

14 OECD (2022). Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two), pp.5, par. 8: "[*a*] *QDMTT Safe Harbour would eliminate the need for an MNE to perform an additional GloBE calculation in addition to the QDMTT calculation required under local law*".

July 2023.[15] Furthermore, QDMTT is also in line with guidance provided by the OECD Administrative Guidance issued on 17 July 2023[16] regarding currency. The status of the QDMTT under the OECD's standards depends on a decision from the OECD. The OECD will have, thus, to confirm that the QDMTT characterises as a qualified domestic minimum top-up tax and qualifies as a QDMTT Safe Harbours. To date, there are no indications which lead to the conclusion that the QDMTT could fail such a test.

The structure and functioning of the QDMTT are aligned to those of the GloBE Rules. Differences are due to the specific features and aim of the QDMTT that aims at taxing the excess profit derived in Italy by entities located in Italy and belonging to in-scope MNEs and large-scale domestic groups.[17]

The QDMTT applies to entities belonging to in-scope MNEs and large-scale domestic groups located in Italy. That includes investment entities, minority-owned constituent entities (MOCEs), joint ventures (JVs) and stateless entities established under Italian law. The calculation of the QDMTT for MOCEs, JVs and investment entities must be carried out separately.

The QDMTT applies to the excess (low-taxed) profit derived by entities located in Italy belonging to in-scope MNEs and Italian large-scale domestic groups, regardless of the holding percentage held, directly or indirectly, by the UPE.

The entities located in Italy belonging to in-scope MNEs and Italian large-scale domestic groups, other than the investment entities, are jointly and severally liable for the payment of the QDMTT. In-scope MNEs and large-scale domestic groups are free to identify the entity located in Italy that will be responsible for the payment of the QDMTT vis-à-vis the Italian tax authorities. Intra-group payments relating to the allocation of the QDMTT burden are tax neutral.

Although, as it has already been highlighted above and as one could have been expected, the Italian QDMTT provisions are in line with the GloBE Rules, there are some peculiarities that are worth highlighting.

First off, in principle, the source of data may differ from the one used in the computation of the IIR. Indeed, the data shall be primarily taken from the statutory individual financial accounts of the entities and not from the consolidation reporting package. Certain exception may, however, apply to this rule.

Secondly, the kind of tested entities for QDMTT purposes might go up to seven, being:

a) Joint Venture not party to a JV Group;
b) JV Groups;
c) Investment Entity;
d) Insurance Investment Entity;
e) MOCE not party to an MOCE Group;
f) MOCE; and
g) Stateless Entities set up under the laws of Italy.

Finally, Italy has provided for a rule that allows to tax, under the QDMTT, stateless entities.

3. Conclusion

The process of implementation of the Global Minimum Tax in Italy reached an advanced stage. The enactment of the Legislative

15 See Art. 18(2) and (3) Decree.

16 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023*, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf. Chapter 5.1, par. 31.

17 Art. 18(1) Decree governs the QDMTT. It makes direct reference to the ordinary GloBE Rules and provides for certain derogatory rules to accommodate specific features of the QDMTT. For instance, allocation rules provided for by the ordinary GloBE Rules on CFC, transparent entities, permanent establishment and dividends, do not apply to the QDMTT to prevent that taxes paid outside the Italian territory affect the QDMTT. Another difference between QDMTT and ordinary GloBE Rules is that QDMTT applies regardless of the inclusion ratio.

Decree No. 209/2023 marks a significant step in the implementation process. The Legislative Decree No. 209/2023 translates into the Italian law the provisions of the Council Directive (EU) 2022/2523 and, at the same time, includes (some of) the OECD guidance available on the date of its enactment.

It can be seen that Italian approach on the implementation of GloBE Rules is to render the Italian GloBE Rules as aligned as possible to the OECD principles.

The importance of the existing and further OECD principles in the interpretation of the Italian GloBE Rules is explicitly confirmed by Legislative Decree No. 209/2023. Moreover, Ministry decrees provide detailed rules on specific aspects, integrating the Italian GloBE Rules and ensuring certainty.

Two Ministry decrees (i.e. the T-CbCR SH Decree and the QDMTT Decree) have been issued so far and more will be issued in the near future. That increases the consistency and coherence of the Italian GloBE Rules with the OECD Model Rules and OECD principles.

It is important to point out, though, that a full alignment between the Italian GloBE Rules and the OECD principles is hard to reach as the pace of OECD's works cannot be matched by the Italian law-making process. The same goes for Ministry decrees and Italian tax authorities' statements of practice. That may leave room for discrepancies and diverging interpretation and application of the GloBE Rules.

Global Minimum Tax will have a major impact on relevant MNEs and large-scale groups. The burden for both tax administrations and MNEs (and large-scale groups) will be significant and will require in-scope MNEs to set up advanced monitoring and compliance systems. GloBE Rules are quite complex and significantly increase compliance burdens for MNE Groups (and large-scale groups) regardless of the fact that they result in an additional tax burden (and, thus, an increase in the Italian tax revenues).

Selected Challenges in the Implementation of Pillar Two in Brazil

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Abstract: This article examines the challenges Brazil may face in implementing Pillar Two, particularly in terms of its integration with Brazil's existing tax framework and constitutional considerations. The study explores how Brazil's existing Worldwide Income Taxation (WWIT) system interacts with the Global Anti-Base Erosion (GloBE) Rules, as well as conflicts with the Brazilian National Tax Code, and implications for the country's constitutional principles.

Keywords: Pillar Two; GloBE Rules; IIR; UTPR; QDMTT; Minimum Tax; Brazil

1. Introduction

Pillar Two introduces a global minimum tax to ensure that large multinational enterprise (MNE) groups pay a minimum level of tax of 15% in every jurisdiction they have operations.[1] The minimum tax is achieved through the Global Anti-Base Erosion (GloBE) Rules,[2] which include two main rules: the Income Inclusion Rule (IIR) and the Undertaxed Payments

1 OECD (2020). *Cover Statement by the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two*, para. 7. https://www.oecd-ilibrary.org/sites/abb4c3d1-en/1/1/3/index.html?itemId=/content/publication/abb4c3d1-en&_csp_=e7df02b7273c00f57848cd6d74af0543&itemIGO=oecd&itemContentType=book#intro-d7e1221.

2 OECD (2021). *Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en; OECD (2022). *Tax Challenges Arising from the Digitalisation of the Economy — Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-the-digitalisation-of-the-economy-commentary-to-the-global-anti-base-erosion-model-rules-pillar-two-first-edition_1e0e9cd8-en.

Rule (UTPR). The IIR requires the ultimate parent entity (UPE) of a group to pay a top-up tax if the Effective Tax Rate (ETR) of the Constituent Entities (CEs) in a jurisdiction falls below 15% in its residence jurisdiction, while the UTPR acts as a backstop to the IIR, requiring the jurisdictions of CEs of the group to deny deductions, or take similar actions,[3] to collect any remaining top-up tax from other low-taxed CEs not subjected to an IIR.

Jurisdictions may also implement a Qualified Domestic Minimum Top-Up Tax (QDMTT), to prioritize collecting the top-up tax domestically. These rules are supplemented by a treaty-based Subject-to-Tax Rule (STTR), allowing source states to impose a top-up tax on certain intra-group payments taxed below 9%.[4] While several jurisdictions have started implementing Pillar Two, Brazil is still developing its rules and discussing their compatibility with its existing tax system.[5]

Despite a nominal corporate income tax rate of 34% (including the Brazilian corporate income tax — IRPJ, and Brazilian social contribution on net income — CSLL), the particularities of Brazil's domestic tax system could result in an ETR below 15%. Considering the potential impact of GloBE on Brazilian companies, as well as its membership in the Inclusive Framework and its commitment to the global tax deal, Brazil is expected to react to Pillar Two. The first significant reaction occurred in October 2024, when Brazil introduced a QDMTT (referred to as Additional CSLL).[6] However, the extent to which it will implement the IIR and UTPR remains uncertain. This paper explores selected challenges that Brazil may face in implementing Pillar Two, including potential conflicts with its legal framework and constitutional issues.

2. Integrating GloBE with Brazil's Existing Tax System

2.1 Coordination with the Brazilian WWIT Legislation

A significant challenge for Brazil in implementing the IIR and UTPR lies in coordinating these rules with its existing Worldwide Income Taxation (WWIT) system, outlined in Law No. 12,973/2014,[7] also known as the Brazilian Controlled Foreign Company (CFC) regime.[8] Under this system, Brazilian corporations must include profits from foreign-controlled and certain associated companies in their corporate

3 According to Article 2.4.1 of the GloBE Model Rules, the UTPR may take the form of an adjustment that is "equivalent" to a denial of a deduction. While the Rules do not prescribe the mechanism by which the adjustment must be made, the GloBE Model Rules Commentary on Article 2.4.1., para. 47, mention that the UTPR could take the form of a top-up tax ("the UTPR could take the form of an additional Tax levied directly on a resident taxpayer in an amount equal to the allocated UTPR Top-Up Tax Amount").

4 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Subject to Tax Rule (Pillar Two): Inclusive Framework on BEPS* and OECD (2023). *Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule.* The STTR will not be discussed in this article. On the idea, *see* B.F. Liotti (2024). The Subject-to-tax Rule under Pillar Two. 16 *World Tax Journal* 1.

5 *See* the Comments of the Brazilian Internal Revenue Service at Valor Econômico (2024). *Brasil só aplicará taxa mínima global de 15% em 2025 ou 2026*, https://valor.globo.com/opiniao/assis-moreira/coluna/brasil-so-aplicara-taxa-minima-global-de-15percent-em-2025-ou-2026.ghtml.

6 Provisional Measure 1,262 of 3 October 2024.

7 For a comprehensive analysis, *see* L.E. Schoueri & G. Galdino (2020). Controlled Foreign Company Legislation in Brazil. *Controlled Foreign Company Legislation* (G. Kofler et al. eds.). Amsterdam: IBFD.

8 P. Rosenblatt & R. Torres Pimenta Cabral (2017). Regime de transparência fiscal na tributação dos lucros auferidos no exterior (CFC Rules): lacunas e conflitos no direito Brasileiro. 2 *Revista de Direito Internacional* 14; and S.A. Rocha (2016). *Tributação dos lucros auferidos por coligadas e controladas no exterior*. (2nd ed.). São Paulo: Quartier Latin.

income tax base[9] annually, regardless of effective distribution or the existence of abuse.[10]

Given that GloBE introduces rules on taxation of foreign CEs of an MNE group, Brazil needs to coordinate these with its WWIT legislation, which already addresses the taxation of controlled and associated companies abroad. In fact, the Brazilian regime is broader in scope than the GloBE Rules, taxing foreign profits at rates often higher than the 15% minimum tax rate under Pillar Two, and without applying exclusions, such as the "Substance-based Income Exclusion" (SBIE) offered by the GloBE Rules.

Despite their operational differences, the simultaneous application of the Brazilian WWIT and the GloBE Rules can lead to overlaps, causing potential double taxation of profits of foreign companies and increased compliance burdens for Brazilian companies.[11] Double taxation may arise from the GloBE's treatment of taxes paid under CFC regimes and the unique nature of the Brazilian WWIT legislation, which is not a "CFC rule" as traditionally understood.[12] That is, GloBE classifies taxes paid under CFC Tax Regimes as "covered taxes" for the calculation of the ETR in the CFC jurisdiction (rather than in the jurisdiction applying the CFC rule).[13] Consequently, if the Brazilian regime is not classified as a CFC Tax Regime under GloBE, taxes paid in Brazil may not be included as "covered taxes," leading to double taxation of CFC profits and triggering the IIR or UTPR in other jurisdictions.

GloBE provides an autonomous and broad concept of "Controlled Foreign Companies Tax Regime",[14] which could qualify the Brazilian rules as a CFC Tax Regime for its purposes. However, this classification may be contingent on the jurisdiction applying the IIR or the UTPR. For these jurisdictions, recognizing the Brazilian regime as a CFC Tax Regime may be undesirable, as the broad scope of the Brazilian regime may reduce the amount of top-up tax that the jurisdiction could impose under GloBE. This recognition in relation to associated companies may pose even greater challenges, since these are not typically taxed under CFC rules.

Considering the challenges associated with the simultaneous application of these two regimes, the adoption of GloBE in Brazil presents an opportunity for the country to reconsider its WWIT regime and implement a more typical CFC rule. This will mitigate the risk of double taxation of the profits of foreign companies and alleviate the burden of additional tax compliance, which might otherwise discourage investment and hinder Brazilian companies from expanding overseas.

9 Article 77 of Law No. 12,973 of 13 May 2014.

10 Profits from associated companies subject to regular taxation, i.e. those not located in tax havens or non-haven jurisdictions with preferential tax regimes, are only taxed upon distribution. However, in all the other cases — involving controlled companies in tax havens, controlled companies not situated in tax havens or associated companies in tax havens — immediate taxation applies in Brazil under Law No. 12,973/2014, irrespective of distribution.

11 Even though, as raised by L.A. de Andrade (2023). As Regras Recomendadas pelo Pillar Two e a sua Relação com o Ordenamento Jurídico Brasileiro. *Revista Direito Tributário Internacional Atual* No.12., year 6, p. 162, it is possible for a company to be subject to one of the regimes and not be subject to the other, given their different scope.

12 For example, following the six building blocks for the design of effective CFC rules provided in OECD (2015). *Designing Effective Controlled Foreign Company Rules, Action 3 — 2015 Final Report*. OECD/G20 Base Erosion and Profit Shifting Project.

13 Article 4.3.2(c) of the GloBE Model Rules. However, it is important to note that these CFC taxes allocated to a domestic CE (the CFC) will be excluded from the QDMTT calculation, meaning that the QDMTT takes priority over the CFC taxes, as explained in OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two).* OECD/G20 Inclusive Framework on BEPS, paras 118.28-118.30 (hereinafter referred to as February 2023 Administrative Guidance).

14 Article 10.1. of the GloBE Model Rules.

2.2 Compatibility with the Brazilian National Tax Code

The adoption of GloBE Rules may conflict with Brazil's National Tax Code,[15] especially regarding the definitions of "income"[16] and "taxable person." According to Article 43 of the National Tax Code, the taxable event for income tax is the *acquisition of economic or legal availability* of income and of earnings of any nature. Thus, taxation requires not only the *acquisition* of income, but also the *availability* of such income,[17] meaning mere existence of wealth is not sufficient for taxation.[18]

The requirement for availability is closely linked to the ability-to-pay principle,[19] where income will be considered available when the taxpayer can make use of it, including to pay taxes.[20] The availability of the income indicates the taxpayer's ability to pay taxes. Moreover, this requirement is also connected to the principle of net income,[21] under which income taxation should only affect income that is actually available for the tax payment. This means that expenses incurred to generate the income should be considered within the respective assessment period.[22] "Available income", therefore, refers to income capable of paying taxes, net of expenses deemed essential.[23]

The National Tax Code further specifies that "taxpayer" for income tax purposes is the holder of the availability, while a "liable person" may be designated by law to withhold or pay the tax. This stems from Article 121 of the National Tax Code, which states that the person obligated to pay the tax is either the "taxpayer" — when there is a personal and direct relationship with the taxable event — or the "liable person" — a third party with an obligation that arises from an express provision of law.[24] Nevertheless, for the responsibility for paying the tax to be assigned to the liable person, there must be a connection between this person and the taxable event.[25]

15 BR: Law No. 5,172 of 25 October 1966 (Brazilian National Tax Code).

16 On the definition of income, *see* e.g., L.E. Schoueri (2010). O mito do lucro real na passagem da disponibilidade jurídica para a disponibilidade econômica in *Controvérsias Jurídico-Contábeis* (R. Q. Mosquera and A. B. Lopes eds., vol. 1). São Paulo: Dialética; K. Holmes (2000). *The concept of income. A multi-disciplinary analysis*. Amsterdam: IBFD; R. M. de Oliveira (2008). Fundamentos do imposto de renda. São Paulo: Quartier Latin; and G. Lemke (1998). *Imposto de Renda — os conceitos de renda e de disponibilidade econômica e jurídica*. São Paulo: Dialética.

17 Schoueri, *Ibid.*, pp. 246-248.

18 As explained by L.E. Schoueri (2019). Considerações acerca da disponibilidade da renda: renda disponível é renda líquida in *Direito tributário: princípio da realização no Imposto sobre a Renda — estudos em homenagem a Ricardo Mariz de Oliveira*. (F.A. Zilveti et al, org.). São Paulo: IBDT, p. 24, it is sufficient for there to be an indisputable right to this inflow, even if it does not materialize.

19 L.E. Schoueri (2003). Imposto de Renda e os Lucros Auferidos no Exterior in *Grandes Questões Atuais do Direito Tributátio.* (V.O. Rocha coord, vol. 7). São Paulo: Dialética, p. 323. This principle is enshrined in Article 145, paragraph 1 of the Brazilian Federal Constitution.

20 *Ibid.*

21 On the principle of net income, *see* e.g., Schoueri, *supra* n. 18; R.T. Santos (2019). O Princípio da Renda Líquida. *Revista Fórum de Direito Tributário — RFDT*, 17, No. 101, pp. 61-75; R.M. de Oliveira (1998). Princípios fundamentais do imposto de renda in *Direito Tributário — estudos em homenagem a Brandão Machado*. (L.E. Schoueri and F.A. Zilveti coord.). São Paulo: Dialética; J.A.L. Gonçalves (1997). *Imposto sobre a Renda. Pressupostos Constitucionais*. Mateiros Editores, p. 179; J. Hennrichs (2010). Leistungsfähigkeit — objektives Nettoprinzip — Rückstellung, in *Festschrift für Joachim Lang zum 70 Geburtstag* (K. Tipke et al. eds.). Otto Schmidt, pp. 237-254; and K. Tipke (1993).2 *Die Steuerrechtsordnun*,. Otto Schmidt, p. 591.

22 Oliveira, *Ibid.*, p. 224.

23 Schoueri, *supra* n. 18, p. 26.

24 L.E. Schoueri (2022). *Direito Tributário.* (11th ed.). São Paulo: Saraiva, p. 620.

25 Article 128 of the National Tax Code.

The GloBE Rules, however, would allow Brazil to tax income earned by a foreign taxpayer that lacks any personal or objective connection with the jurisdiction applying the rules,[26] based solely on the fact that such income was under-taxed. That is, under the IIR, Brazil (as the UPE jurisdiction) would be allowed to tax income earned by a foreign low-taxed CE — the taxpayer — regardless of any distribution to the Brazilian UPE, which would be only the person liable to pay the tax. Similarly, under the UTPR, Brazil would be allowed to tax income earned by a foreign low-taxed CE — the taxpayer — that has not been remitted to Brazil, and the Brazilian CE would be the person liable for the tax payment.

Thus, the adoption of the GloBE Rules presents a twofold challenge for Brazil. First, these rules would enable taxation in Brazil to occur without any remittance or distribution to the Brazilian entity, potentially conflicting with the availability requirement for income tax purposes outlined in the National Tax Code. Second, these rules designate the low-taxed CE as the taxpayer for its purposes, while assigning the liability to pay the top-up tax on its income to another entity, which would act merely as a third-party collecting agent.

Applying these rules in Brazil would mean taxing income accrued in a foreign jurisdiction, by a foreign taxpayer (the low-taxed CE), while the Brazilian entity would serve as a collecting agent, being the person liable for paying the tax (and not the taxpayer) in Brazil. This would occur even though the Brazilian entity is not directly involved in the taxable event and lacks a clear connection to the income or the taxable event.[27]

For the IIR, legislation might choose to designate the Brazilian UPE as the taxpayer for the purposes and justify the additional taxation based on the control relationship between the Brazilian UPE and the foreign low-taxed CE. This approach, however, may raise questions about whether the income of the foreign low-taxed CE can be considered legally or economically available for taxation in Brazil, in line with the National Tax Code. The mere existence of a control relationship, or the fact that the income was under-taxed in another jurisdiction, may not suffice to establish legal or economic availability for taxation in Brazil.

The situation is even more complex regarding the UTPR, as it would enable taxation irrespective of a control relationship between the Brazilian CE and the foreign low-taxed CE,[28] making it more difficult to argue that the profits earned by the foreign affiliate are available to the Brazilian company. Moreover, the UTPR raises further concerns regarding its compatibility with the National Tax Code, particularly because it allows UTPR jurisdictions to deny deductions of otherwise deductible expenses of domestic CEs in an amount sufficient to result in that entity incurring an additional cash tax expense equal to the top-up tax amount allocated to

26 P.G.L. Schoueri & R.A. Galendi Júnior (2022). *Who is the "Taxpayer" for the IIR and Why it does Matter*, https://kluwertaxblog.com/2022/08/16/who-is-the-taxpayer-for-the-iir-and-why-it-does-matter/.

27 This rationale stems from the operation of the GloBE Rules, which separates the ETR and top-up tax calculation from the mechanism for collecting the top-up tax into different steps. As R.A. Galendi Júnior (2023). *The Justification and Structure of the GloBE Model Rules*, https://kups.ub.uni-koeln.de/71906/2/RAGJ%20-%20Thesis%20KUPS.pdf, p. 192 explains, the GloBE Model Rules are special "in the sense that they first assign the GloBE Income and Covered Taxes to the CEs, in order to calculate a Top-Up Tax, and, in a subsequent step, they allocate a taxing right to another jurisdiction, based on a charging rule, applied on another CE. Ultimately, a jurisdiction will have the right to tax income that is allocated, under the GloBE Model Rules, to a CE located in another jurisdiction. From a systematic perspective, the person earning the income (the low-taxed CE) is not the tax debtor of the resulting tax claim, which extends to another person — a Parent Entity in the case of the IIR, or another CE in case of the UTPR."

28 *See* Andrade, *supra* n. 11, pp. 181-182.

that jurisdiction.[29] Such mechanism contradicts Brazil's principle of net income, which ensures the taxpayer's right to deduct essential expenses incurred to obtain the taxable income.[30] Consequently, the denial of deduction under the UTPR may contravene this principle and raise concerns about its compatibility with the Brazilian legislation.[31]

Nonetheless, it is important to note that the GloBE Rules provide some flexibility in this regard. The jurisdiction implementing the UTPR may opt not to use the deduction denial mechanism but instead apply "an equivalent adjustment under domestic law", which "could take the form of an additional tax levied directly on a resident taxpayer."[32] If Brazil decides to implement a "top-up tax" on its domestic companies to collect the UTPR related to other CEs of the group, this potential violation of the principle of net income could be mitigated. However, such an approach may still raise concerns, as discussed in relation to the IIR.

3. Constitutional Challenges

3.1 QDMTT and UTPR Potential Conflicts with the Equality Principle

Implementing the GloBE Rules, specifically the QDMTT and UTPR, may conflict with Brazil's Federal Constitution,[33] particularly regarding the equality principle outlined in Articles 5 and 150, II of the Constitution.

The QDMTT is designed to ensure low-tax jurisdictions have the primary right to tax companies located within their territory. While the OECD has stipulated that the QDMTT must be implemented in a manner consistent with the design of the GloBE Rules and produce similar outcomes,[34] it provides various options for the design of some specific features of the QDMTT.[35] For example, although the QDMTT is primarily intended to apply to MNE groups that meet a EUR750 million revenue threshold, the OECD allows jurisdictions to apply a QDMTT to purely domestic groups or groups that do not trigger such revenue threshold.[36]

As Brazil has recently introduced a QDMTT to prevent other jurisdictions from imposing top-up taxes on Brazilian CEs taxed below 15%,[37] and chose to apply it only to in-scope domestic companies, this may lead to different tax treatments compared with domestic companies under similar circumstances that fall outside Pillar Two's scope, potentially violating the constitutionally guaranteed equality principle. To avoid this violation, any difference in treatment must be justified based on some valid constitutional parameter.

In Brazil, the ability-to-pay principle, outlined in Article 145(1) of the Federal Constitution, is a parameter serving as a differentiation

29 Article 2.4.1 of the GloBE Model Rules.

30 R.L. Torres (2007). *Tratado de Direito Constitucional Financeiro e Tributário — Os Tributos na Constituição, vol. IV*. Renovar, pp. 128-129. Also, L.E. Schoueri & G. Galdino (2018). Dedutibilidade de Despesas com Atividades Ilícitas in *Tributação do Ilícito.* (P.A. Adamy and A.M.F. Neto coord.). Malheiros, p. 151.

31 For a comprehensive analysis of these potential violations, *see* Andrade, *supra* n. 11, pp. 182-206.

32 GloBE Model Rules Commentary on Article 2.4.1., paras 46-47.

33 For the English version of the Brazilian Federal Constitution, see https://www.stf.jus.br/arquivo/cms/legislacaoCons tituicao/anexo/Brazil_Federal_Constitution_EC_125.pdf.

34 These are referred to as the "guiding principles." *See* February 2023 Administrative Guidance, *supra* n. 13, at p. 99, para. 5.

35 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-the-digitalisation-of-the-economy-consolidated-commentary-to-the-global-anti-base-erosion-model-rules-2023_b849f926-en.

36 February 2023 Administrative Guidance, *supra* n. 13, para. 11 and para. 118.2.

37 For a comprehensive analysis of the QDMTT, *see* R.A. Galendi Jr. (2023). The Single Top-Up Tax Principle: Justification, Content and Functions upon the Design of QDMTTs. 15 *World Tax Journal* 4.

factor to measure the equality or inequality of taxpayers. This principle mandates unequal treatment to those who are unequal, according to their ability to bear the tax burden. While it might be argued that the differential treatment arising from the QDMTT could be justified under the ability-to-pay principle, such justification becomes problematic if both Brazilian entities have similar economic capacities. Simply distinguishing entities based on their affiliation with an MNE group falling under Pillar Two's scope may not be sufficient to establish a valid constitutional basis. Differentiating taxpayers' ability-to-pay solely on an international basis, rather than considering the inherent characteristics of the local company for taxation purposes, may not align with the justifiable criteria set forth in the Federal Constitution.

To avoid violating the equality principle, Brazil could adopt a QDMTT that applies to all companies, both within and outside the scope of GloBE, as allowed by the OECD. This approach, however, may be undesirable as it tends to increase the tax burden and impact the country's competitiveness. Additionally, applying a QDMTT regardless of revenue thresholds could raise concerns about violating Article 179 of the Federal Constitution, which grants differentiated legal treatment to small and medium-sized businesses to support their development.

Similar concerns arise regarding the UTPR, which allows jurisdictions to deny deductions for otherwise deductible expenses of their domestic companies instead of adopting a top-up tax. If Brazil chooses to implement this mechanism, it may also violate the equality principle. Denying a deduction for a Brazilian company could result in disparate tax treatment compared with domestic companies with similar economic capacities that fall outside the scope of Pillar Two. As asserted regarding the QDMTT, this differential treatment may not be justified by differences in taxpayers' ability to pay, infringing upon the provisions of the Federal Constitution.

3.2 The Impact on Tax Incentives

Pillar Two's introduction of a global minimum tax aims to reduce tax competition, which could affect existing tax incentives in Brazil that are not considered in the ETR calculation under the GloBE Rules.[38] These include, for example, the presumed profit regime, which is a simplified optional method for calculating the Brazilian corporate income taxes for certain businesses, interest on equity deductions (*Juros sobre o Capital Próprio*),[39] the treatment conferred to goodwill in corporate reorganizations,[40] and tax incentives aimed at fostering regional development within Brazil, such as those targeting enterprises established in the Manaus Free Trade Zone,[41] companies located in the regions covered by SUDAM (Superintendence for Devel-

38 On the idea of the impact of GloBE on tax incentives, *see* OECD (2022). *Tax Incentives and the Global Minimum Corporate Tax: Reconsidering Tax Incentives after the GloBE Rules,* https://www.oecd.org/en/publications/tax-incentives-and-the-global-minimum-corporate-tax_25d30b96-en.html; UNCTAD (2022). *World Investment Report 2022: International Tax Reforms and Sustainable Investment,* https://investmentpolicy.unctad.org/publications/1263/world-investment-report-2022-international-tax-reforms-and-sustainable-investment; and B.F. Liotti, J.W. Ndubai, R. Wamuyu, I. Lazarov & J. Owens (2022). The Treatment of Tax Incentives under Pillar Two. 29 *Transnational Corporations Journal* (2).

39 Article 9 of Law No. 9,249 of 26 December 1995. *See* on the matter, L. E. Schoueri (2012). Juros sobre capital próprio: natureza jurídica e forma de apuração diante da "Nova Contabilidade" in *Controvérsias Jurídico-Contábeis (Aproximações e Distanciamentos)* (R.Q. Mosquera and A.B. Lopes org., vol. 3). São Paulo: Dialética, pp. 169-193.

40 On the idea, see L.E. Schoueri (2012). Ágio em Reorganizações Societárias (Aspectos Tributários). São Paulo: Dialética.

41 The Manaus Free Trade Zone (ZFM) is a free import and export trade area where special fiscal incentives apply with the aim of creating an industrial, commercial agricultural centre in the Amazon Region that allows its development (Article 1 of Decree-law No. 288 of 28 February 1967). Over the years, several tax incentives have been granted to companies established in the ZFM, which are to remain in effect until 2073 (Article 1 of Law No. 14,788 of 28 December 2023).

opment of the Amazon — North Region) and SUDENE (Superintendence for Development of the Northeastern Region).[42]

Nullifying these incentives solely for in-scope companies due to GloBE's application, while allowing other domestic companies with similar economic capacities not subject to GloBE to continue benefitting from them could lead to unequal treatment, violating the equality principle.

Moreover, nullifying incentives designed to reduce regional inequalities, which are constitutionally guaranteed, such as those for the Manaus Free Trade Zone (protected until 2073 by the Federal Constitution),[43] could be challenged as unconstitutional. According to the Federal Constitution, the Federal Government is allowed to grant tax incentives aimed at promoting socio-economic development balance among different regions in Brazil,[44] and reducing regional inequalities is one of the fundamental objectives of the Federal Republic and a guiding principle of the economic and financial order.[45]

In this context, the nullification of certain incentives due to the application of the QDMTT carries the risk of being challenged as unconstitutional. Nevertheless, it must be noted that the impact may be reduced by specific provisions of the GloBE Rules, such as the SBIE, a formulaic carve-out that excludes a fixed return on payroll and tangible assets costs from the GloBE Rules application.[46] As such, MNEs that rely on labor and tangible asset-intensive activities are likely to benefit the most from the carve-out, meaning that incentives granted to these companies might be less affected by the GloBE Rules. This can be the case, for example, of the tax incentives aimed at fostering regional development within Brazil, such as those targeting companies located in the regions covered by SUDAM and SUDENE, which are typically granted to companies that rely on labour and tangible asset-intensive activities and, as such, are likely to benefit from the SBIE.

Due to the potential impact GloBE may have on the existing incentives granted by Brazil, the country has already signalled its intention to convert the regional incentives granted to companies located in the regions covered by the SUDAM and SUDENE into a financial credits classifiable as Qualified Refundable Tax Credits, which are adjusted in the ETR calculation and may be less affected by the minimum tax.[47]

4. Conclusion

The implementation of the GloBE Rules presents significant challenges for Brazil, particularly in aligning them with the country's existing tax framework and constitutional principles. While the GloBE Rules aim to establish a global minimum tax rate of 15%, potential conflicts arise due to Brazil's unique tax system.

Brazil must address potential overlaps between the GloBE Rules and its existing WWIT regime to prevent double taxation and avoid increased compliance burdens on domestic companies. Furthermore, the adoption of the GloBE Rules requires careful consideration of Brazil's National Tax Code definitions to ensure compliance and maintain the integrity of its income tax principles.

Constitutionally, the implementation of the QDMTT and UTPR could challenge Brazil's commitment to the equality principle, especially when these rules result in unequal treatment of companies that cannot be justified by their ability to pay. Similarly, the potential nullification of existing tax incentives due to the GloBE Rules could violate constitutional norms, particularly for incentives aimed at promoting regional de-

42 Provisional Measure No. 2,199-14 of 24 August 2001.

43 Articles 40, 92 and 92-A of the Transitional Constitutional Provisions Act.

44 Article 151, I of the Brazilian Federal Constitution.

45 Article 3, III of the Brazilian Federal Constitution.

46 GloBE Model Rules Commentary on Article 5.3., para. 25.

47 Article 36 of the Provisional Measure 1,262 of 3 October 2024.

velopment.

Despite these challenges, non-adoption of the GloBE Rules by Brazil does not imply that Brazilian entities will remain unaffected. This is because GloBE introduces a set of "fiscal fail-safes"[48] whereby if one jurisdiction refrains from taxation, another automatically steps in and taxes. This mechanism is dictated by the configuration of GloBE's charging rules (QDMTT, IIR and UTPR), which operate as an "interconnected series of on/off switches."[49] As elucidated by Galendi, "the main switch is the IIR, which can be "switched off" by a QDMTT. The UTPR is only "switched on" if neither a QDMTT nor an IIR applies."[50] This means that, if the CEs of an MNE group falling within the scope of the GloBE Rules have an ETR below 15%, their profits will be subject to the top-up tax somewhere, whether through the QDMTT, the IIR or the UTPR.

Therefore, even if it is concluded that Brazil cannot implement the GloBE Rules due to violations of constitutional norms and principles, it does not imply that the profits of the entities that would have been affected by the application of the GloBE in Brazil will remain untaxed elsewhere. Another jurisdiction, governed by a different charging rule (either the IIR or the UTPR), may impose taxes instead. Brazilian courts have not addressed this type of assertion, which essentially suggests that, despite potential constitutional violations, it may be more advantageous for Brazil to enforce taxation itself rather than allowing another jurisdiction to do so. While rejecting GloBE might result in a loss of revenue for Brazil, it is unlikely that the courts would support such reasoning without stronger justification, given the potential conflict with established constitutional principles.

Consequently, Brazil faces the critical task of carefully balancing its implementation of Pillar Two to align with global tax standards while respecting its domestic legal and constitutional framework.

48 R. Mason (2022). *A Wrench in GLOBE's Diabolical Machinery,* https://www.taxnotes.com/special-reports/digital-economy/wrench-globes-diabolical-machinery/2022/09/16/7f3pt.

49 A. Christians & T. D. Magalhães (2022). Undertaxed Profits and the Use-It-or-Lose-It Principle. *Tax Notes International*, https://www.taxnotes.com/featured-analysis/undertaxed-profits-and-use-it-or-lose-it-principle/2022/11/04/7f9n0

50 Galendi, *supra* n. 27, p. 201.

Is Qualified Refundable Tax Credit So Appealing?

— The Nature and the Mechanism of QRTC under Pillar Two

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Abstract: The concept of the Qualified Refundable Tax Credit (QRTC) is a novel tax term under the OECD's Pillar Two framework, with unique characteristics that require further examination. While some jurisdictions have already adopted treatments for QRTC, their implications remain underexplored. This article delves into QRTC qualitatively and quantitatively. On one hand, the research examines the interplay between QRTC and existing tax accounting standards, focusing on government grants and income treatment. On the other hand, through quantitative analysis, this article reveals that in general QRTC can offer a more favourable tax outcome for multinational enterprises (MNEs) subject to certain conditions. However, QRTC may not be beneficial universally, as certain scenarios may diminish its advantageous — such as in the case of companies undergoing mergers and acquisitions (M&A) or facing a significant recession. The findings suggest that current accounting standards are insufficient for addressing the unique characteristics of QRTC, necessitating potential improvement to tax and accounting regulations. This approach highlights the distinctive features of QRTC and reveals potential tax competition with respect to QRTC. Practical recommendations for policymakers and businesses are provided to help navigate the complexities of the post-Pillar Two tax landscape.

Keywords: Global minimum tax; Pillar Two; QRTC; Tax credits; GloBE income

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1. Introduction

1.1 General Introduction

The OECD continues to play a crucial role in international tax cooperation, where the OECD Model Tax Convention[1] sets templates for international tax treaties and the Base Erosion and Profit Shifting (BEPS) project addresses the emergence of digitalisation issues and other fundamental transformative changes in the real world. In the post-BEPS tax landscape, a Two-Pillar solution was introduced to tackle the allocation of taxing rights as well as the minimum tax rate.[2] "Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to 'tax back' where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation."[3]

However, Pillar Two and the OECD's previous efforts to counter tax competition are not identical from certain perspectives. The current system — Pillar Two — is aimed at reducing tax competition not only in both harmful cases but also in legitimate ones.[4] Countries are also compelled to consider the costs and benefits of cooperation and competition and join the strategic game states play on the bilateral and multilateral levels.[5] Although the fiscal fail-safe of Pillar Two will result in a reduction in traditional corporate income tax competition, Pillar Two does not eliminate the conditions for tax competition.[6] The main reason for such an issue lies in the fact that new Global Anti-Base Erosion (GloBE) Rules introduce a variety of incentives and carve-outs.

The Pillar Two framework represents not only a revolution in the international taxation landscape but also an evolution of current tax accounting rules. To enhance the Pillar Two framework, some preferential treatments are inserted in the GloBE Rules. The five-step approach for calculating the top-up tax occupies a central role in determining the top-up tax. Above all, the core accounting-related issue is determining the jurisdictional effective tax rate (ETR). Deviating from the traditional statutory tax rate, the ETR is a measure of the exact tax burden of a company.

Tax incentives are the most common means to influence the companies' behaviour and the macroeconomy. In the interim, the incentives tangle with the ETR. Some countries even live up to the well-known tax incentives "tax havens". However, the issues are addressed in the BEPS project. The purpose also influences the design of the Pillar Two framework. The global minimum tax rate is set at 15%, thereby establishing a tax rate floor that limits potential tax incentives. The introduction of Pillar Two will incur changes in the existing market of tax

1 OECD (2017). *Model Tax Convention on Income and on Capital 2017 (Full Version)*, https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en.

2 OECD (2020). *Tax Challenges Arising from Digitalisation — Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint_abb4c3d1-en.

3 OECD (2020). *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

4 Avi-Yonah R. & Kim Y. R. (2022). Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax. 43 *Michigan Journal of International Law* 3, pp. 505-556.

5 Dagan T. (2018). *International Tax Policy: Between Competition and Cooperation (Introduction)*, https://papers.ssrn.com/abstract=3232139.

6 Chen J. & Chow W. (2023). Global Minimum Tax Reform and the Future of Tax Competition, 77 *Bulletin for International Taxation* 8, pp.308-319.

incentives offered in different jurisdictions.[7] The introduction of the Pillar Two rules may also harm the availability of tax incentives as a tool for both developed and developing countries to attract investment.[8] Therefore, dealing with the tax incentives under the Pillar Two rules is significant. The issue also relates to the aim of Pillar Two regarding tax competition.

1.2 Qualified Refundable Tax Credits and Non-tax Subsidies as ETR Denominators

Among the tax incentives, the Pillar Two rules defined a new term "Qualified Refundable Tax Credit (QRTC)". As stated in Article 10.1 of the Pillar Two rules, a QRTC is treated as income for purposes of the GloBE rules, which means the credit is taken into account in the denominator of the ETR computation and is not treated as reducing a constituent entity's taxes in the year the refund or credit is claimed.[9] Furthermore, the administrative guidance also clarified the definition of income and provided specific rules on the treatment.[10]

Identifying QRTC is important, for the treatment of such tax incentives is in the "special treatment" in Article 3.2.4.[11] The effect of such rules will be discussed in detail in Chapter 2. According to this definition, QRTC will thus slightly decrease the ETR. Based on such rules, jurisdictions are believed to have a stronger incentive to adopt QRTCs and non-tax subsidies to attract investment.

Recent developments should help address the international tax competition that has contributed to a proliferation of tax incentives. The preference for non-tax subsidies over equivalent tax subsidies could also result in distortions and welfare losses.[12] As a remaining scope for tax competition in the post-Pillar Two environment, the QRTC remains to be attractive.

1.3 Research Question

Based on the existing literature and studies, the mechanism and application of the GloBE Rules are thoroughly discussed. However, the relationship between QRTC and the GloBE rules remains to be explored in depth. Moreover, the QRTC should be viewed from a broader perspective. Therefore, this article aims to examine the compatibility between QRTC and the existing accounting rules. Notably, this mechanism shall be discussed quantitatively, aiming to examine the characteristics of QRTC under different scenarios: whether QRTC is more favourable than other tax credits under Pillar Two.

2. Tax Credit and Its Relationship with the Current Accounting Standard

2.1 Tax Credits under Pillar Two

As mentioned in Chapter 1, tax incentives are widely employed around the world. One of the major perspectives of tax incentives is to balance effective investment promotion and public revenue which varies among different countries.

7 O'Sullivan D. & Gómez A. C. (2022). The Global Minimum Tax: from Agreement to Implementation — Policy Considerations, Implementation Options, and Next Steps. World Bank; IMF (2023). *International Corporate Tax Reform*. IMF Policy Paper No. 2023/001.

8 Titus A. (2022). Pillar Two and African Countries: What Should Their Response Be? The Case for a Regional One. 50 *Intertax* 10, pp.711-720.

9 OECD (2021). *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd-ilibrary.org/content/publication/782bac33-en.

10 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-june-2024.pdf.

11 OECD (2021). *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*, (supra note 9).

12 Chen & Chow (supra note 6).

Countries frequently use income tax incentives to promote private-sector activities that advance important national objectives, such as research and development (R&D), green energy, and low-income housing.[13] Under the new Pillar Two framework, the design of tax incentives will be influenced by GloBE rules for the ETR which lies at the centre of calculation.

GloBE rules provide some tax incentives other than QRTCs which this article will discuss. The tax competition is one of the aims to be addressed by Pillar Two. Consequently, traditional tax competition will be eliminated while some tax competition room remains to be discussed. The material scope of the rules is the biggest carve-out: Multinational enterprises (MNEs) with a consolidated group revenue less of EUR750 million will be excluded from GloBE rules, namely the small and medium enterprises (SMEs). Moreover, as indicated in GloBE rules, government entities, international organisations, non-profit organisations, and pension funds are precluded. The shipping income is also exempted from the GloBE rules.[14] Jurisdictional approach will blend the high-taxed and low-taxed locations, allowing room for tax planning.[15] Furthermore, the GloBE rules state that the tax benefit that offsets the impact of the rules is prohibited. Beyond these provisions, QRTC distinguishes itself from the established rules. As stated in the administrative guidance, the treatment of tax credits under the GloBE rules is important because they can impose a significant impact on the jurisdictional ETR calculation depending upon whether they are treated as GloBE income or a reduction to covered taxes.[16]

Income-based and expenditure-based tax incentives are two major sorts. On one hand, the income-based incentives such as full exemption will straightforwardly influence the jurisdictional ETR and thus be recaptured by the top-up tax.[17] On the other hand, expenditure-based incentives such as tax allowance or accelerated depreciation will encounter different treatments. The core idea is the calculation of ETR. If the jurisdictional ETR is more than 15%, no top-up tax will be imposed.[18] However, usually when the tax credit being categorised as an expenditure-based incentive, the nature of the incentives matters.

2.2 The Current Accounting Standards with Respect to the Tax Incentive

The face value of a QRTC will be treated as GloBE income of the recipient constituent entity in the year such entitlement accrues.[19] The idea is grounded in the accounting principle of International Accounting Standard (IAS) 20 (Accounting for Government Grants and Disclosure of Government Assistance) and IAS 12 (Income Taxes).[20] It should also be concluded that a QRTC shall be distinguished from Standard Interpretations Committee (SIC) 10 (Gov-

13 Merrill P R, Russo K, Junge A, et al (2023). *Where Credit Is Due: Treatment of Tax Credits Under Pillar 2*, https://www.taxnotes.com/special-reports/credits/where-credit-due-treatment-tax-credits-under-pillar-2/2023/03/17/7g743#sec-6-1-2-4-1.

14 OECD (2021). *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)* (supra note 9). Article 1.5.1 and Article 3.3.

15 Chen & Chow (supra note 6).

16 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)* (supra note 10).

17 Assuming no SBIE and other related deduction exist.

18 Bammens N. & Bettens D. (2023). The Potential Impact of Pillar Two on Tax Incentives. 51 *Intertax* 2, pp.155-169.

19 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Consolidated Commentary to the Global Anti-Base Erosion Model Rules*, https://www.oecd-ilibrary.org/content/publication/b849f926-en.

20 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules*, (supra note 10).

ernment Assistance — No Specific Relation to Operating Activities).

Besides the IAS mentioned above, it is also worthy to mention International Financial Reporting Standards (IFRS) 15 (Revenue from Contracts with Customers). It replaces former revenue recognition standards (IAS 11 — Construction Contracts, IAS 18 — Revenue) and most of other revenue recognition guidance. It indicates the characteristics of the "revenue" by introducing a five-step model. Pillar Two did not differentiate different kinds of revenue though. The nature of the tax credits cannot be included in IFRS 15 as normal revenue from the business activity.

Regarding the current accounting rules, the current IFRS usually treats tax credits as a deduction of tax expenses, which frequently results in a lower ETR. According to the current tax standards, all the tax issues shall be included in the scope of IAS 12.[21] IAS 12 regarding the government grant has nothing to do with tax credits or investment tax credits. Besides, IAS 20 shall be applicable in this for government grants. Per this accounting rule, government assistance is an action by the government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.[22] However, IAS 20 will not address the government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss or are determined or limited based on income tax liability.[23] This dilemma is significant because QRTCs are not covered by any of the current accounting standards.

This article will delve into the nature of the accounting standards, the income approach shall prevail in calculating the government grants because income and other taxes are both expenses. It is logical to deal with government grants, which are the extension of fiscal policies, in profit or loss. Therefore, it can be concluded from this argument that the Pillar Two framework also adopts this approach. "The treatment of QRTC is somewhat like the income approach. Moreover, for investment tax credits, there are no specific accounting rules on this kind of credit under IFRS.[24] If an entity determines that it has an investment tax credit, the entity should adopt an accounting policy and apply it consistently to all similar arrangements."[25]

In a short summary, tax credits do not receive uniform treatment under existing standards. QRTCs therefore bring about a new definition. Chapter 3 will further discuss the examples of QRTCs, and the mechanism of QRTCs will be moreover discussed in a quantitative way below.

3. The Quantitative Illustration of QRTCs

The existing accounting rules failed to stipulate clear instructions on the QRTCs. However, this beneficial treatment — the deemed "government grant" — is already reflected in certain existing tax laws. Moreover, this article examines the nature of QRTCs to explore how QRTCs will be implemented in different scenarios.

3.1 The Existing Laws as the Starting Point

Under several international tax standards, multinational enterprises are generally better off when they receive non-tax subsidies instead of equivalent tax benefits.[26] Instead of deducting

21 IFRS (2022). *IAS 12 Income Taxes*, https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2022/issued/part-a/ias-12-income-taxes.pdf?bypass=on.

22 Buschhüter M. & Striegel A. (2011). *IAS 20 — Accounting for Government Grants and Disclosure of Government Assistance*, http://link.springer.com/10.1007/978-3-8349-6633-9_22.

23 Supra note 22.

24 KPMG (2024). *Handbook: Tax credits*, https://kpmg.com/us/en/frv/reference-library/2024/handbook-tax-credits.html.

25 Merrill P R, Russo K, Junge A, et al (2023). *Where Credit Is Due: Treatment of Tax Credits Under Pillar 2* (supra note 13).

the tax payable directly, QRTCs provided by the government become appealing.

The UK has already implemented this type of instrument that is qualified as QRTC.[27] QRTCs are incentives for certain activities delivered through the tax system. QRTCs offset spending on these activities on a "dollar-for-dollar" basis through the reduction of taxes, with any excess over taxes due paid back in cash to the taxpayer.[28] EU indicates that "It seems that tax preferences that allow for an additional deduction from the tax base and could not lead to a refund of tax due are not a tax credit and therefore cannot be considered as a refundable or a non-refundable tax credit."[29]

Under this exisiting legislation, the UK government has determined that its Research and Development Expenditure Credit (RDEC) will be treated as an addition to income rather than a tax reduction when calculating the ETR.[30] RDEC is determined by the amount spent on eligible R&D activities and is treated similarly to a government grant. RDEC will be calculated in pre-tax profit, but the actual tax payments will be net of the RDEC.

3.2 Quantitative Illustration: How Will QRTCs Affect the Tax Due

QRTC will impact the financial statement in specific ways as stipulated in the GloBE income[31] of Article 3.2.4 and the adjusted covered tax[32] of Article 4.1.2 and Article 4.1.3. Treated as income, QRTC is usually more favourably backed by Pillar Two model rules. Entirely, QRTC introduces a comprehensive effect on the calculation.

This article includes a brief example to demonstrate the consequences of QRTCs and non-QRTCs. Following Devereux and Vella's work, this article continues to define "T" as the adjusted covered tax, "P" as GloBE income, "H" as the tax credit, "M" as the minimal tax rate, and "C" as the substance-based income exclusion (SBIE).[33] This article assumes T, H, and P are all greater than 0. The calculation has no practical significance if these parameters are negative.

Therefore, the tax burdens under non-QRTCs and QRTCs situations are illustrated as follows, where e_N and e_Q depict the ETRs of each scenario.[34] Obviously, e_N and e_Q are both less than 1 since the tax rate cannot be larger than 100%. This article will now calculate tax burden under different situations. We hereby derive T_N and T_Q.

$$T_N = T - H + (M - e_N)(P - C)$$

$$\text{Where } e_N = \frac{T-H}{P}$$

$$T_Q = T - H + (M - e_Q)(P + H - C)$$

$$\text{Where } e_Q = \frac{T}{P+H}$$

When $T_N - T_Q = \left[(1-M) - (1-e_Q)\frac{C}{P}\right]H > 0$, QRTCs are more favourable than non-QRTCs for MNEs. This article aims to explore when

26 Noked N (2020). From Tax Competition to Subsidy Competition. 42 *University of Pennsylvania Journal of International Law* 2, pp.445-485.

27 UK (2023). *UK legislation: Finance (No.2)*, https://www.legislation.gov.uk/ukpga/2023/30/section/148.

28 OECD (2023). *Tax Challenges Arising from the Digitalisation of the Economy — Consolidated Commentary to the Global Anti-Base Erosion Model Rules* (supra note 19).

29 European Commission(2023). Frequently Asked Questions on the Pillar 2 Directive.

30 HMRC (2022). *OECD Pillar 2 Consultation on Implementation*, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045663/11Jan_2022_Pillar_2_Consultation_.pdf.

31 OECD (2021). *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)* (supra note 9).

32 Supra note 31.

33 Devereux M & Vella J (2023). The Impact of the Global Minimum Tax on Tax Competition, 15 *World Tax Journal* 3, pp.278-323.

34 ETRs are supposed to be below 15%. Otherwise, no top-up tax shall be levied.

QRTC is more beneficial and how various factors may influence this issue.

Now this article defines such gap between different tax treatments as a multi-variable function of P, H, C, and T. Specifically, the function will be *f (P,H,C,T)* where four typical financial variables are treated as independent variables. This calculation assumes M equals 15%, which is the minimal tax rate agreed upon by the community. By substituting and rearranging the function, it implies that:

$$f(P,H,C,T) = 0.85P(P+H) - C(P+H-T) > 0$$

This function aims to examine QRTCs are more favourable under which conditions. For all MNEs, GloBE income should be positive. This article also discusses this question only when the tax credits apply. So, P and H are both greater than 0 in practice. Therefore, in an extreme scenario, assuming no SBIE is present (i.e., when C=0), *f (P,H,T)*>0. This result indicates that the function is positive, suggesting that QRTCs are more favourable than non-QRTCs under such condition.

In practice, C>0 is a more reasonable situation where tangibles and payrolls both exist. This article therefore checks the value of *f (P,H,C,T)* determined by these independent variables. To gain a clearer insight into the partial effects that indicate whether these financial data are converging or diverging, this article calculates the first-order partial derivatives of each independent variable.[35] It implies the partial effects of each variable, as shown in the equations below.

$$\frac{\partial}{\partial P} f(P,H,C,T) = 1.7P + (0.85H - C) \quad (1)$$

$$\frac{\partial}{\partial H} f(P,H,C,T) = 0.85P - C \quad (2)$$

$$\frac{\partial}{\partial C} f(P,H,C,T) = -P + T - H \quad (3)$$

$$\frac{\partial}{\partial T} f(P,H,C,T) = C \quad (4)$$

3.3 Analysis Based on the Derivatives

The GloBE income serves as the starting point and centre of our analysis. As shown in equation (1): if a company earns more income, the effect of P is inherently tied to the income itself. Thus, for this first-order derivative analysis, this article can conclude that as long as 1.7P+0.85H–C>0, the equation will be positive. It means that as P increases, the benefit of QRTCs over non-QRTCs is larger. Usually, P is much larger than other financial indicators. Consequently, the company may benefit from the QRTCs compared with non-QRTCs in most cases. It indicates the larger the GloBE income of a company, the more benefit of QRTCs will be achieved. Larger MNEs are more likely to have QRTCs and will benefit more from it.

This article now dives into the second-order derivate. By substituting and rearranging this function, this article can get:

$$\frac{\partial^2}{\partial P^2} f(P,H,C,T) = 1.7$$

The positive constant 1.7 suggests that the incremental benefits will be acceleratingly larger when the GloBE income increases. When the income increases, the effect of the quadratic term may dominate, especially in the cases where P is large. From equation (1), this article can also conclude mathematically that when $P = \frac{C-0.85H}{1.7}$, the function gets the minimum, $\frac{3.4C(T-H)-(0.85H-C)^2}{3.4}$. It suggests that except for extreme circumstances, QRTCs will constantly be more beneficial.

Apart from equation (1), all other three equations are linear, indicating the marginal changes of the individuals are influenced by other factors beyond their own amount.

From equations (2) and (4), the function demonstrates a positive relationship with both H and T. The larger, which indicates that larger tax credits or adjusted covered taxes, leads to greater benefits. However, in equation (2), the higher

35 The detailed derivation process can be requested from the author's email.

tax credit may result in a negative value when the SBIE is proportionally very high compared to the GloBE income.

In equation(3), –P+T–H will always yield a negative value because e_N or e_Q are both constrained to be less than 1. This implies that the larger SBIE will reduce the advantage of QRTC, highlighting the reverse but complicated relationship of QRTC with SBIE.

Based on the analysis above, only under the extreme cases — specifically, when the adjusted covered tax is sufficiently small — the SBIE is significantly large, the QRTC may have some adverse effects. Otherwise, the QRTC is more generally favourable than the non-QRTC. To better explain this situation, the next section will exemplify the circumstances intuitively.

3.4 The Illustration of the Results

QRTC generally gives rise to a more beneficial outcome under the Pillar Two Framework. According to the research result of this article, one of the significant findings is that larger MNEs may benefit a lot from the QRTCs. Nevertheless, this article also mentioned that the QRTC may not be beneficial under certain circumstances. To illustrate, this article may assume a large MNE that only earns minimal profit while the SBIE is large enough. In this case, QRTCs will not be advantageous as the non-QRTCs. This article introduces two possible situations of such issue.

One of the possible circumstances is "shortly after the mergers and acquisitions (M&A) activity". In this scenario, the MNEs that are subjected to top-up tax shall have a large amount of SBIE for the current year. The large amount of SBIE is because of the M&A activities resulting in the large tangibles and payrolls. However, the income of a certain year is highly possible to be low because of the re-organisation. Should the subsidies provided by the government can be classified as QRTCs under certain circumstances, the treatment may not benefit a company compared with non-QRTC treatment. Under such circumstances, the tax credits under Pillar Two are not favourable.

Another possible circumstance is the "enterprises in recession". Enterprises of this type had already progressed through the first three stages of corporate decline and had reached the critical fourth stage in the industry life cycle in a boarder horizon.[36] Burdened with heavy tangibles and payrolls, the company receives negligible income. The cash refund in this kind qualified as QRTC. However, it will also increase the tax burden supplemented by the top-up tax.

This research could also be explained by sector. Asset-intensive industries and labour-intensive industries in a perfect competitive market are more likely to be affected. Especially the heavy industry is susceptible to this "adverse effect", where the external bulk commodity price is fluctuating together with its high tangibles internally. These kinds of MNEs are more fragile exposing to the QRTC than other industries. Under extreme cases, QRTCs cannot guarantee a better situation for the companies.

4. Conclusion

Recent international tax reforms provide an advantage to non-tax subsidies over economically equivalent tax benefits. Under several international tax standards, multinational enterprises are generally better off when they receive non-tax subsidies instead of equivalent tax benefits where QRTC will be treated as GloBE income.[37] The focus of this term is "they are refundable within 4 years" concerning the policy design. The treatment of QRTC lies somewhere between that of income and government grant.

4.1 The Nature of QRTC

Based on the definition of QRTC and the case of RDEC, a QRTC is a government subsidy that is provided in cash or equivalent form to

36 Industry life cycle analysis is an analysis framework to understand the various stages of development an industry goes through over time. There are four stages in the industry life cycle: introduction, growth, maturity, and decline.

37 Noked (supra note 26).

the extent the taxpayer has insufficient tax liability to use the full amount of the credit, that is, it is refundable. Besides, the timing of 4 years and the exclusions under an imputation credit regime. Moreover, the Commentary to Model Rules requires that credits are in substance, and not merely in form, likely to be refunded. Although this article discusses QRTCs under the framework of tax incentives, no relevant existing accounting rules can be found. QRTC shares more similarities with the government grant by cash, which requires a cash refund within 4 years.

The goal of the Pillar Two system is to eliminate tax competition, though there is some disagreement on this matter. Racing to the bottom for each jurisdiction will be alleviated. Nevertheless, to compete in the post-Pillar Two era, countries can develop new incentives (in particular, expenditure-based regimes) and classify them as QRTCs and/or convert their most affected incentives to fit them under the QRTC umbrella.[38] Therefore QRTCs may serve as a tool to sustain the tax competition.

The influence of QRTC and non-QRTC is not linear nor intuitive. This study finds that QRTC is not favourable than non-QRTC in certain situations. Overall, the greater income of an MNE, the more advantageous situation under this treatment will achieve. SBIE shows adverse effect on the impact of the QRTC tax benefit, while various factors and their interrelationships also matter.

4.2 Academic and Practical Implications

For academic implications, this article advanced research on the mechanism of the tax credit to incremental changes analysis of the different factors. This paper fills in the gap of Pillar Two research where QRTC lies in the centre of ETR calculation and tax competition. In future, the strong relationship between QRTCs and SBIE remains to be discussed. With the implementation of Pillar Two, more exploration and exploitation will emerge. The abundancy of Pillar Two data will also add on this research perspective.

The practical implications are also significant and multi-faceted. Firstly, our research concludes that existing accounting rules are not fully applicable to QRTCs. The newly introduced concept is not yet compatible with the current rules despite its adoption in some jurisdictions. Therefore, new definitions or revisions regarding the accounting standard should be welcomed. Secondly, the research implies suggestions for both policy makers and MNEs. However, under extreme situations such as "shortly after the M&A activity" or "large company in recession"

38 Vikram C. & Kinga R (2024). The Impact of Pillar Two on Corporate Tax Incentives and Incentives Post Pillar Two: The Potential Rise of Tax Credits and Subsidies. 6 *International Tax Studies* 9, p.56.

as mentioned in the paper, MNEs may be given the right not to opt for the QRTCs. Firms can further utilise QRTC in a rational and compliant manner. Otherwise, the lower ETR shall harm the enterprises. Moreover, each jurisdiction may modify the current tax incentive regulations to meet the Pillar Two requirements, taking into consideration of this complex interplay among different indicators. There exists no one-size-fits-all approach for policy makers. The macroeconomy and microeconomy jointly influence the effectiveness of tax policies. However, without prejudice to the idea, the governments are required to be prepared with more fiscal cash flow on a "dollar-for-dollar" basis through the reduction of taxes. Tax authorities are expected to face tax competition in the Pillar Two era positively.

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A Diagrammatic Overview of the Mechanism of Amount A of Pillar One

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Abstract: Pillar One of the G20/OECD Two-Pillar Solution to address the tax challenges arising from the digitalisation of the economy (commonly termed Base Erosion and Profit Shifting 2.0 or "BEPS 2.0") is complex. This complexity is exacerbated by having only two official languages of English and French for international treaties such as "the Multilateral Convention to Implement Amount A of Pillar One" (MLC). This article provides a diagrammatic overview of Pillar One's allocation mechanism in the hope of promoting better understanding of the mechanism of Amount A and encouraging academic discussion. As key elements of Amount A such as the Marketing and Distribution Safe-harbour (MDSH) remain under negotiation at the time of writing and there are many details, the diagrams and numbers of this article are not meant to be comprehensive but illustrative.

Keywords: Amount A; Pillar One; Base Erosion and Profit Shifting; MLC; International taxation; Digital tax

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1. Background

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that multinational enterprises (MNEs) use to exploit gaps or mismatches in tax rules, especially those between countries, to artificially shift profits to low- or no-tax locations as a way to avoid paying tax. The G20 had tasked the Organisation for Economic Co-operation and Development (OECD) to study and deal with the issue of BEPS by MNEs. Starting in 2013, the OECD-led BEPS project aims to equip governments with rules and instruments to address tax avoidance, ensuring that profits should be taxed where economic activities take place and where value is created. This is accompanied by concerted efforts to strengthen international cooperation in tax matters, to stamp out harmful tax practices and combat tax avoidance. The first set of BEPS Actions reports was published in 2015, commonly termed "BEPS 1.0".

To ensure a consistent and coordinated implementation of the BEPS recommendations and to make the project more inclusive, OECD/G20 subsequently broadened its BEPS discussion to include more jurisdictions through a platform called the Inclusive Framework on BEPS.

It was felt that BEPS Actions reports completed in 2015 did not adequately address the challenges of the digital economy. Therefore, the OECD continued work and in October 2021, the Inclusive Framework on BEPS released the BEPS 2.0 "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy".[1]

Pillar One seeks to reallocate some profits (Amount A) to where the markets (i.e. the customers) are (market jurisdictions). With respect to a share of the profits of large MNEs operating in their markets, "The Multilateral Convention to Implement Amount A of Pillar One"[2] (MLC) introduces a 3-tier tax certainty framework (scope certainty, advance certainty, and comprehensive certainty), along with an enhanced tax certainty process with mandatory binding dispute resolution for disputes related to Amount A, and seeks to prohibit Digital Service Taxes (DSTs) and other relevant similar measures. The other part of Pillar One is Amount B, which will be incorporated into the OECD Transfer Pricing Guidelines and provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity countries.

Pillar Two seeks to ensure a minimum tax rate of 15% for in-scope MNEs in each jurisdiction where they operate. If an in-scope MNE has an effective tax rate (ETR) of less than 15% in any jurisdiction at the group level, other jurisdictions can collect the difference of up to 15%. Pillar Two also includes a Subject-to-Tax Rule (STTR). STTR allows a jurisdiction (A) to impose additional tax of up to 9% on certain payments (such as interest and royalty) that an entity in jurisdiction A makes to related entities in another jurisdiction (B), if the total tax burden on that payment in jurisdictions A and B is less than 9%.

2. Mechanism of Amount A

This article illustrates the allocation mechanism of Amount A of Pillar One following the 4 steps.

Step 1: Determine If an MNE Group Is in Scope

1) Group revenue and profitability test: Is the annual global revenue of an MNE group above EUR20 billion, and the pre-tax profit

1 OECD (2021). *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy — 8 October 2021*, https://www.oecd.org/en/about/news/announcements/2021/10/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.html.

2 OECD (2023). *The Multilateral Convention to Implement Amount A of Pillar One*, https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf.

margin[3] greater than 10%?[4]

2) Exceptional segmentation rule: Even where an MNE group does not meet those thresholds (e.g. profitability below 10%), if one of its disclosed segments in the consolidated financial statements is on a standalone basis, the segment would be in scope.

3) Limited exclusions: Scope exclusions apply to specific industries (extractives, regulated financial services, and defence) and "autonomous domestic businesses".[5]

The intent of the "autonomous domestic businesses jurisdiction" exception is to exclude predominantly domestic business operations from the Amount A regime. To qualify, revenues sourced to a jurisdiction must be between 95% and 105% of the entity financial accounting revenues (third-party revenues), i.e. mostly transactions within that jurisdiction rather than transacting with the third parties offshore. In addition, cross-border intra-group revenues and the cross-border intra-group expenses cannot exceed 15% of the total revenues and expenses.

Figure 1 is a diagrammatic illustration of step 1.

Step 2: Identify Eligible Market Jurisdictions

1) Revenue sourcing rules: MNE reve-

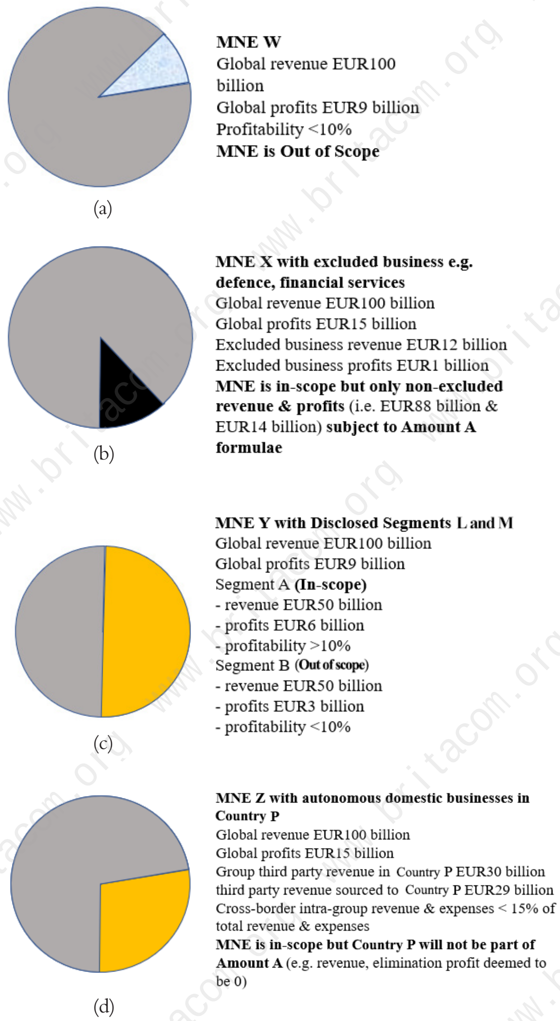

Figure 1. Schematic of determining if an MNE group is in scope

Note: In Figure 1(d), elimination profit (or loss) is similar to GloBE income in the GloBE model rules of Pillar Two. Financial accounting profit or loss is the starting point for the computation of the elimination profit and is subject to similar adjustments as in GloBE, such as excluding: (i) current and deferred income tax expense (or income); (ii) dividends or other similar distributions; (iii) gains or losses arising from certain specified transactions; (iv) expenses related to payments considered illegal by the jurisdictions of the ultimate parent entity, the group entity that made the payment or the group entity that incurred the expenses; and (v) expenses or fines exceeding EUR50,000 (for details, see Annex B Section 4 of the MLC) .

3 "Pre-tax profit margin" means the adjusted profit before tax of an MNE group for a period (calculated pursuant to Annex B Section 2(1) in the MLC as though the MNE group was a covered group and without taking into account relevant net losses) divided by the adjusted revenues of that group for the period.

4 Except for those MNE groups that fail to meet the criteria in two periods immediately preceding the current period, their pre-tax profit margin is greater than 10% in at least two of the four periods immediately preceding the current period, and the pre-tax profit margin in terms of the MNE group adjusted profit before tax and the group adjusted revenues over the five periods ending in the current period is greater than 10%.

5 The criteria in "Section 5 — Autonomous Domestic Business Exemption" of the MLC are that: (i) cross-border intra-group revenues and expenses of group entities located in that jurisdiction should not exceed 15% of the total revenues or expenses, respectively, of those group entities; and (ii) third-party revenues booked by group entities in that jurisdiction (after eliminating intra-group transactions) also being substantially all sourced to that jurisdiction, i.e., being between 95% and 105% of the total third-party revenues of those group entities.

nues are sourced to market jurisdictions through specific sourcing rules.

2) Nexus test based on revenue: Determining whether a market jurisdiction is entitled to tax the profit of Amount A through a quantitative threshold (i.e. sourced revenue above EUR1 million, reduced to EUR250,000 for jurisdictions with GDP below EUR40 billion), regardless of physical presence of the MNE.

Figure 2 is a diagrammatic illustration of step 2.

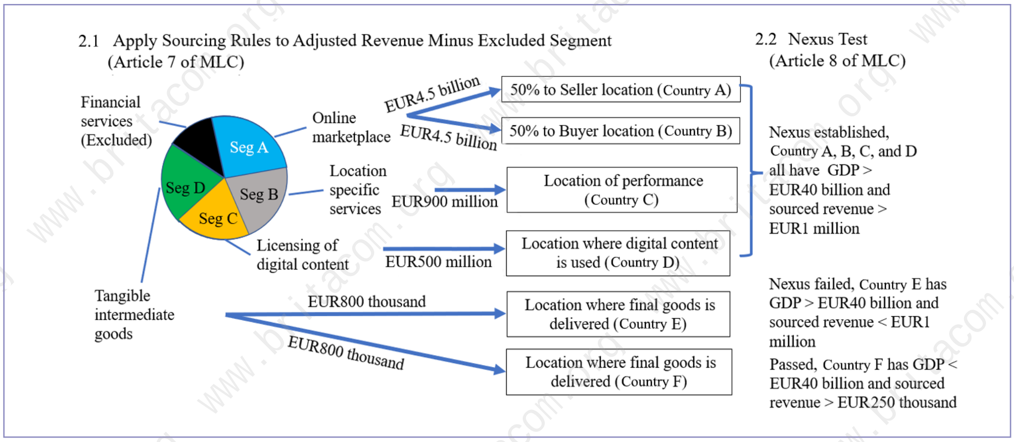

Figure 2. Schematic of identifying eligible market jurisdictions

Note: "Adjusted Revenues" means the revenues, exclusive of VAT and other consumption taxes that are reported in the consolidated financial statements of an MNE group, modified by: (i) excluding certain distributions from specified equity interests and gains or losses from disposal of such equity interests, and allocating revenue related to certain equity interests evenly among the period in which the disposition occurs and the four subsequent periods; (ii) excluding revenue derived by an excluded entity; (iii) adjusted for any prior period adjustment; and (iv) including the MNE group's share of revenue derived from a joint venture proportionate to its share of profits or losses from the joint venture (for details, see Article 2(c) of the MLC) .

Step 3: Calculate and Allocate a Portion of Excess Profit

1) Determine relevant group profit: The starting point is the profit reported in the consolidated financial statements of the MNE, and then apply a limited number of book-to-tax adjustments and take into consideration any prior losses incurred by the MNE.

2) Allocate a portion of excess profit to markets: Apply a formula to identify 25% of the MNE's profit in excess of 10% of the MNE's revenue, and allocate this defined portion of excess profit to market jurisdictions using a revenue-based allocation key.

3) Adjust for double counting: The allocated profit is adjusted downwards to prevent "double counting in instances where a market jurisdiction could otherwise tax the excess profit of the MNE twice", i.e. the Marketing and Distribution Safe Harbour Adjustment (MDSH).

The MDSH is an adjustment that reduces Amount A allocated to eligible market jurisdictions. The calculation can be expressed as:

MDSH adjustment = Min {Article 5(1)(a) allocation, [Max (0, group adjusted elimination profit − Max (group elimination threshold RoDP × jurisdictional DP, 3% of group adjusted revenue sourced to that jurisdiction))] × 25% (35% or 90%)} .

In summary, MDSH adjustment represents the amount of excess profit which has already been taxed in the concerned market jurisdiction and hence a portion of it should be used to deduct Amount A allocated to the market jurisdiction according to the rule in Article 5(1)(a) of MLC.

The excess profit shall be determined by the total profit taxed in the jurisdiction (group adjusted elimination profit) minus an estimated routine profit, not lower than zero. The total profit shall be a profit booked in that jurisdiction (Annex B, Section 4 of MLC) plus an adjustment considering the withholding tax collected by the jurisdiction (Annex B, Section 6 of MLC). The routine profit shall be estimated on the basis of return on depreciation and payroll (RoDP) or return on adjusted revenue multiplied by a percentage reflecting the intensity of marketing and distribution function.

In particular, the "routine profits" is the greater of: (i) group elimination threshold RoDP (10% × group adjusted revenue / group sum of RoDP) times jurisdiction's DP; and (ii) 3% of group adjusted revenue sourced to that jurisdiction. The percentage is 90% for a jurisdiction with low depreciation and payroll,[6] 25% for a lower-income jurisdiction[7] and 35% otherwise (Article 5(2)(d) of MLC).

Figure 3 is a diagrammatic illustration of step 3.

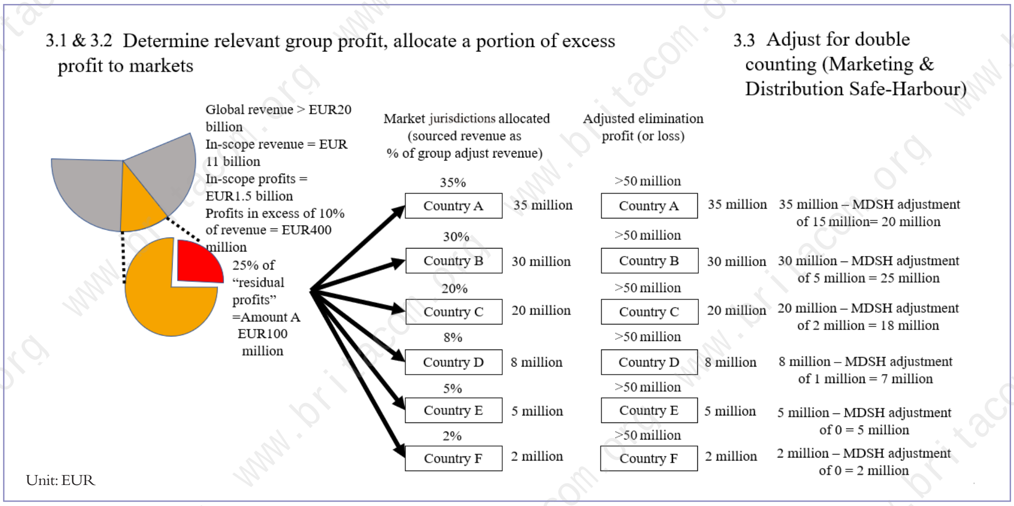

Figure 3. Schematic of calculating and allocating a portion of excess profit

Note: In this example, assume that Countries A, B, C and D all have MDSH adjustments and Countries E and F have MDSH adjustment of 0.

Step 4: Eliminate Double Taxation

1) Determine relevant jurisdictional profit (and RoDP): MNE firstly calculates its profit in each jurisdiction by summing the accounting profit (or loss) of each entity in the jurisdiction and making several book-to-tax adjustments. It then calculates its depreciation and payroll in each jurisdiction on a similar basis, and expresses the jurisdictional profitability as an RoDP.

2) Allocate obligation to relieve double taxation to jurisdictions: A tiered approach based on the RoDP of each jurisdiction is used to allocate the obligation to relieve double taxation at the jurisdictional level, with those obligations being allocated firstly to the jurisdictions with the highest RoDP (i.e. typically those with high levels of intangible asset ownership).

3) Identify relief entities within a jurisdiction: Specific rules apply to identify within each relieving jurisdiction the entities of the MNE that will be entitled to claim relief from double taxation.

Figure 4 is a diagrammatic illustration of step 4.

6 A jurisdiction is of "low depreciation and payroll" for a covered group in a period means a jurisdiction in which the ratio of jurisdictional depreciation and payroll to the adjusted revenues sourced to the jurisdiction (see Article 6) is less than 75% of the ratio of the sum of the accounting depreciation and accounting payroll of the covered group (determined under Annex B Section 5 of MLC) to the adjusted revenues for the covered group.

7 A jurisdiction is a lower-income jurisdiction as defined by the World Bank as a low-income economy or as a lower-middle-income economy by reference to gross national income per capita using the World Bank Atlas method for the most recent World Bank determination period that ends in the period immediately preceding the period.

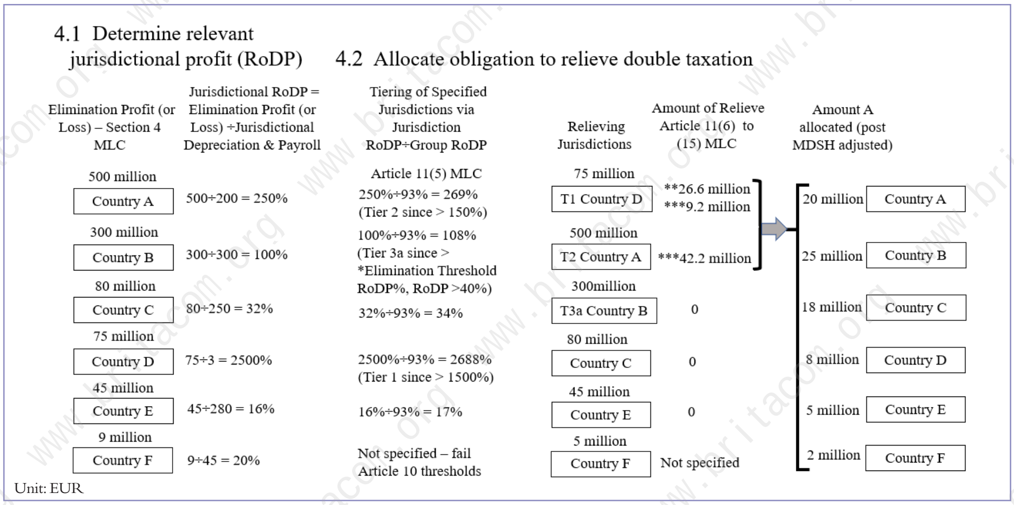

Figure 4. Schematic of eliminating double taxation

Note: *Elimination Threshold RoDP = (11×10%)÷1.078 = 102%.

**Apply Article 11(6) to (8): 1500% threshold means Country D RoDP drops to 1613%, means reducing 75 to 48.4 = 26.6.

***Apply Article 11(9) to (10): Country D T2 excess profit (i.e. above 150%) = 75-26.6-4.5 =43.9; Country A T2 excess profit = 500-300 = 200.

Allocate remaining Amount A proportionately: Country D gets (43.9÷243.9)×(78-26.6) = 9.2; Country A gets the remainder i.e. 78-26.6-9.2 =42.2.

In this example, Country E is a specified jurisdiction as it is part of the smallest number of jurisdictions with respect to which the sum of elimination profit (or loss) of those jurisdictions totals at least 95% of the sum of elimination profit (or loss) for all jurisdictions for the period (sum of elimination profits would be <95% without Country E or F but priority is given to Country E as the jurisdiction with higher elimination profit than Country F) and further assume that Country F fails all the other thresholds under Article 10(a) of MLC.

In terms of tiering, Country D is within Tier 1 since it has an adjusted jurisdictional RoDP (2500%) greater than 1500% of the group RoDP (computed to be 1009 ÷ 1078= 93%) and greater than 40%; Country A is within Tier 2 since it has an adjusted jurisdictional RoDP (250%) that is greater than 150% of the group RoDP (93%) and greater than 40%; Country B is a specified jurisdiction within Tier 3a as its adjusted jurisdictional RoDP (100%) is greater than the elimination threshold RoDP (computed to be 102%[8]) and greater than 40%. But since the amount that needs to be relieved is already covered by Country D and Country A, there is no allocation to Country B to provide relief (for details, see Article 11(5) of MLC).

3. Conclusion

The OECD Secretary-General's Tax Report to the G20 Finance Ministers and Central Bank Governors in July 2024 updated that Inclusive Framework members secured "near full consensus" on Amount A MLC. Further, the report noted broad support for Amount B with some remaining issues for a small number of Inclusive Framework members to be resolved in order to unlock the adoption of the Amount A MLC. The Biden Administration sought for Amount B to be made mandatory as a precondition for proceeding with Amount A. However, at the time of publication, the advent of a second Trump Administration has increased the uncertainty as to whether Amount A will proceed as President-elect Donald Trump's choice of Treasury Secretary may not be as supportive of BEPS 2.0 as Secretary Yellen had been. Regardless, the great amount of work that the OECD and Inclusive Framework on BEPS have done in getting to the draft Amount A MLC has unquestionably advanced the thinking and formulation of international rules on profit allocation.

8 Determined by multiplying the covered group's adjusted revenues for the period by 10% and dividing the product by the sum of the accounting depreciation and accounting payroll of the covered group, see Article 2(n) General Definitions in MLC.

Digitalization in Taxation: Hungarian Practice

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Digitalization has been one of the most important developments in the recent decades, which has also brought revolutionary changes in tax administration. This paper mainly introduces the practice of the National Tax and Customs Administration (NTCA) of Hungary in its digitization process from the following aspects.

1. Taxpayer Registration

As of 31 December 2022, there were a total of 2,064,332 persons, organizations and entities with tax numbers in Hungary. They engage in some form of independent economic and business activities based on the registry of the NTCA. Among them are:

• 800,459 economic operators: all organizations performing domestic economic activities belong to this group, including companies, civil organizations, cooperatives, even state agencies and municipal authorities carrying out business activities and foreign persons without a domestic business settlement (location);

• 576,930 individual entrepreneurs; and

• 686,943 individuals (without individual entrepreneur status).

Hungarian tax numbers are 11-digit identifiers (8-digit base number, a one-digit VAT code and a 2-digit area code: "12345678-X-YY"). For intra-Community (EU) trade purposes the NTCA creates the EU VAT version from the 8-digit base number by adding an "HU" prefix ("HU12345678") upon the request of the taxpayers who (which) wish to engage in cross-border commerce in the EU.

1.1 Domestic Persons

1.1.1 Private individuals

Virtually every Hungarian private individual (approximately 9.7 million domestic citizens), with the exception of a few very old individuals who never had any taxable income, has a tax identification (tax ID) number (with a tangible tax card), assigned to natural persons at birth since 2006 (a 10-digit number starting with number 8). Only private individuals can have a tax ID.

The tax ID of private individuals (natural persons) is different from the tax number of independent participants in the economy. A private person may have both a tax ID (by nature) and a tax number (with respect to his/her independent economic activities) simultaneously.

Anyone who wishes to pursue independent business activities as an individual entrepreneur (and take advantage of the related tax opportunities) may register directly at the NTCA since mid-2020 and get his/her (11-digit) tax number. It is however also possible for a private individual to engage in economic activities as an independent actor without being an individual entrepreneur: those are, among others, individual farmers, freelancers, lessors and those performing various tasks, jobs based on assignments.

1.1.2 Legal entities and other organizations

When legal entities (companies, cooperatives, foundations, civil organizations etc.) are being established at state agencies (company court, regular court, etc.), the state agency (court) requests a (11-digit) tax number from the NTCA for the entity being created (single window method). During the process the founder may choose between the available options regarding direct and indirect taxes.

1.2 Foreign Persons

If foreign individuals work (or gain any taxable income) in Hungary, they shall also request a tax identification number (and a tax card) from the NTCA: either the individual himself/herself or as in most cases the domestic employer requests the tax ID on behalf of the employee (during the mandatory process of notifying the tax agency of the employment). Their tax IDs are the same 10-digit numbers (starting with number 8) as the ones assigned to Hungarian individuals.

Foreign natural persons who wish to pursue economic activities in an independent form can register themselves as individual entrepreneurs the same way as Hungarian individuals and obtain their tax number. However, they may also request a tax number without individual entrepreneurship from the NTCA. In this regard there is no difference between foreigners who have just arrived in Hungary and those with permanent residence status or Hungarian citizenship.

Legal entities with headquarters abroad shall register their branch (branches) in the Company Register (Company Court) of Hungary if they intend to pursue regular economic activities domestically. For the purposes of taxation, branches shall be treated the same way as domestic companies i.e., they shall apply for a tax number.

2. Ways of Administering Tax Matters and Maintaining Contact with the NTCA

2.1 Mandatory Electronic Administration (from 2018)

First of all, it is important to point out that those considered to be an "economic operator" (an entity engaged in business activity) shall manage their public administration matters (including taxation) electronically and maintain a proper electronic channel with state authorities (besides the NTCA) since the E-Administration Act of Hungary came into effect in 2018. This former act was replaced by the Act on the Digital State and Digital Services in 2024 but the basic rule of mandatory e-administration for a great variety of persons and organizations has not changed ever since. By definition, domestic companies, cooperatives, private pension and private healthcare funds, foundations, associations, civil organizations, and even individual entrepreneurs are subject to mandatory e-administration.

This means that such persons and organizations may only manage their tax affairs electronically, they shall keep in touch with the state tax agency primarily this way, and they may only handle their tax matters in a paper-based way, by post or in person (through their representatives at a client office) in certain cases expressly authorized by law (e.g., an inspection on the premises, an interview of employees).

Therefore, the representative (or one of the representatives) of a legal entity (or other organization) subject to mandatory electronic communication (administration) shall create a Company Gate Access (with an official electronic mailbox for receiving letters from state agencies and municipal authorities) on behalf of the domestic entity using the appropriate government platform (tarhely.gov.hu). However, this is only possible if the representative himself or herself otherwise has access to electronic administration. Respectively the natural person setting up the Company Gate Access shall be the chief executive officer (CEO) in the case of a company, the chairman of the board of trustees in the case of a foundation, the president in the case of an association, etc.

A private individual managing his or her own tax matters shall identify himself/herself when logging in for electronic administration, which was most often done with the Client Gate Access (username and password), currently with Client Gate Plus Access or Digital Citizenship Access (DAP). The latter two identification methods also require a temporary code generated by an application on smart gadgets (mobile phone/tablet) besides the username and password. Previously other identification methods were also available (e.g., general ID card with an electronic identifier chip, video technology for facial identification) but those are no longer available after 20 (due to their low utilization by individuals and due to the fact that it overall complicated the system of identification unnecessarily).

2.2 Electronic Administration by Choice and Other Ways of Contact

Private individuals with only a tax ID, individuals with only a tax number (not registered as individual entrepreneurs) and foreign legal entities (organizations) are not obliged to manage their tax matters electronically, which means both personal and paper-based administration are open to them. At the same time, it is generally recommended for private persons to also use electronic administration.

Electronic administration is not mandatory for foreign businesses and other foreign organizations, and under current Hungarian law Company Gate Access cannot be set up for foreign entities. If a foreign entity nevertheless wishes to manage its tax affairs electronically, this can only be done through its representatives registered with the state tax agency and the representatives shall have personal access to electronic administration: currently the Client Gate Plus Access and for individuals listed in the central personal data and address register of Hungary the Digital Citizenship Access is also available.

2.3 Current and Future Changes in Electronic Administration and Taxpayer Identification

There are significant changes introduced in electronic administration in Hungary: as already mentioned above, the Client Gate Access ceases to exist after 15 January 2025 as its simple username/password scheme has long been outdated as a secure online identification method (along with phasing out other e-identification schemes such as using the general ID card with a microchip, partial encoded phone identification and video technology/facial identification mentioned above in 2.1 and 2.2). Private individuals shall switch to the more secure and up-to-date two-step identification methods: Client Gate Plus Access or Digital Citizenship Access (available only for individuals listed in the central personal data and address register of Hungary). It also affects the foreign individuals not listed in the central personal data and address register of Hungary who currently use a Client Gate Access to electronic administration: they also need to switch to Client Gate Plus.

These changes have an even bigger impact on Hungarian citizens and on other individuals listed in the central personal data and address register of Hungary: according to government plans the already available Digital Citizenship (DAP) will gradually become the dominant tool of digital administration for them during 2025. The new DAP scheme will become more than just an identification method (compared with the Client Gate/Client Gate Plus Access), it is an integrated, life event-based (marriage, childbirth, real estate/car purchase etc.) tool for managing public administration matters more easily, thoroughly, transparently and faster.

However, these changes will not affect the rules of representation before the NTCA that are discussed in detail below.

3. Representation in Tax Matters Before the NTCA

3.1 Representation of Domestic Organizations and Legal Entities

By definition legal entities, business associations and other non-natural persons can only act through their representatives. Since the majority of domestic organizations as mentioned above in 2.1 shall use electronic administration, their representatives acting on their behalf shall also have access to electronic administration.

To handle tax matters of an organization the representatives either use the Company Gate Access of the given organization or their own (personal) Client Gate Plus/Digital Citizenship Access. In addition to legal representatives there are other persons can act as permanent representative, including: an adult member or employee who proves his or her right to representation (a branch of a foreign company can also be represented by an employee of the foreign parent company); in-house legal adviser; attorney-at law, law firm, European Community lawyer; registered tax expert, tax consultant, auditor or accountant; representative, employee or member of an accounting or tax consulting firm; and in matters related to environmental protection product fees and excise

The professional representatives (accountant, lawyer, etc.) listed above refer to professionals under Hungarian law. Therefore, a Hungarian organization cannot be permanently represented by an attorney-at-law, a tax consultant or an accountant operating under foreign law.

It is however possible to represent legal entities based on case-by-case mandates but in that case the certificate of the mandate (power of attorney) shall be submitted to the NTCA for each separate procedure or act (e.g., attaching it to the tax return or other standardized form).

3.2 Representing Foreign Legal Entities

Foreign legal entities not established in Hungary may be represented on a permanent basis by the persons listed in point 3.1 above if they notify the NTCA of their right to representation. Legal representatives, such as CEOs, shall also attach an extract from the founding document of their organization with an authentic Hungarian or English translation as there is no other source the NTCA can use to verify their right to representation.

In addition, Hungarian law also offers some particular options and rules of representation for foreign organizations and legal entities:

• In value added tax (VAT) refund cases, according to the VAT Act, a taxpayer not established in the country may also be represented by a foreign natural person, legal entity or other organization before the NTCA. The document certifying the right to representation shall also be attached to the standardized form;

• A domestic branch (registered at the Company Court of Hungary) of a foreign company acts as a tax agent for the foreign enterprise in connection with its domestic economic activity if the foreign enterprise is obliged to establish a domestic branch for its economic activities (or otherwise it has one);

• A financial representative can be appointed by a foreign company that is not obliged to set up a business establishment in connection with its domestic economic activities in Hungary. Financial representatives can be only certain types of domestic companies with adequate subscribed capital and in addition to managing tax matters (e.g., submitting tax returns) on behalf of the foreign business entity, a financial representative has joint liability for paying the tax at the same time.

Tax returns and other standardized forms (data reporting and notification about changes) may also be submitted by an ad hoc representative (based on a case-by-case mandate) on behalf of a foreign legal entity. It is however important to highlight that representatives who wish to act on behalf of organizations and legal entities on online platforms of the NTCA (e.g., ONYA, described below in Chapter 4) shall be either legal representatives (CEOs, presidents etc.) or individuals with a permanent mandate to do so (ad hoc/case-by-case representatives cannot access the profile and data of those organizations and entities on those online platforms).

3.3 Representation of Private Persons

Regarding both domestic and foreign individuals we can speak of permanent representation: in addition to legal representatives (e.g. parent-child, guardian-the adult under guardianship), a private person may be represented on the basis of a permanent mandate either by those listed in title 3.3 (mostly professional representatives like accountants, tax consultants etc.) or by another non-professional private individual as well.

Individuals can also be represented on a case-by-case basis (in one tax case or procedural act) by another (professional or non-professional) individual.

Apparently if a foreign private individual wishes to represent another private person the representative shall be present in our registry

(NTCA taxpayer database) with at least a Hungarian tax identification number (tax ID).

4. Instruments, Procedures and Systems Supporting Tax Administration

4.1. Online Platforms Supporting Taxpayer Registration, Handling the Changes in the Taxation of Taxpayers and Maintaining Contact

In addition to our website (at "nav.gov.hu") the NTCA maintains separate online platforms for information and administrative purposes. One is the Customer Portal (at "ugyfelportal.nav.gov.hu") where taxpayers can check their current tax account balance, their basic personal data managed by the NTCA, issues of representation, they may also view and download both the previously submitted tax returns, forms and all the documents they have received from the state tax agency (going back years). Private individual taxpayers can also check their insurance status and they may also pay taxes with a bank card on this platform.

The Online Form-Filling Application (Hungarian acronym: "ONYA" at "onya.nav.gov.hu") also supports taxpayers by containing online versions of some, typically shorter and simpler data sheets and tax returns so taxpayers do not need to download and install the standard form filling software on their desktop computer to submit those forms. The NTCA has been working on transforming and moving the vast majority of our forms and tax returns to this online platform, which no longer requires taxpayers to install the form-filling software on their desktop.

4.2 Tools and Procedures for VAT

VAT-related tools and procedures mainly include the following:

4.2.1 Online Cash Registers

Online cash registers were first introduced in 2013, which provide the NTCA with real-time data on receipts. For a few years taxpayers have been able to request their monthly turnover per cash register from the NTCA (by submitting a request form). Since 2022 any taxpayer may download the NTCA data collected from online cash registers of the taxpayer to the accounting software or enterprise resource planning system through a machine-to-machine connection (interface). There are already reforms underway concerning receipts: the introduction of electronic receipts in 2024 and the gradual transition from conventional cash registers to software- and application-based issuance of receipts (e-receipts).

4.2.2 The Electronic Public Road Trade System

The Electronic Public Road Trade System (Hungarian acronym: "EKAER" at "ekaer.nav.gov.hu") is a significant and at the same time unique innovation from 2014: certain transactions between businesses (first domestic sales subject to VAT, intra-Community sales and other intra-Community movements of products) involving delivery (transportation) are subject to reporting to the NTCA. The reporting obligation has contributed significantly to the reduction of VAT evasion and VAT fraud. The reporting obligation used to apply to all kinds of transported goods, but currently only "risky products" (from a VAT perspective such as clothing items, food stuffs, some construction materials and chemicals) are subject to reporting.

4.2.3 Online Invoice System

The Online Invoice System (at "onlineszamla.nav.gov.hu") has been in operation since 2018 collecting a significant amount of data on the invoices issued domestically (the ones under Hungarian VAT rules). Data reporting automatically takes place immediately after an invoice is finalized, which implies that billing (invoice) softwares and Online Invoice Systems in the market shall all be suitable for establishing and maintaining direct data connection to the NTCA.

4.2.4 eVAT Platform

With the help of online cash registers, the Online Invoice System and our customs databases (on imports from outside the EU and on exports from Hungary to non-EU countries) almost all the VAT payable and deductible can be assessed for each VAT subject. Draft VAT returns can be compiled from the data. Since 2024 the online eVAT platform (at "eafa.nav.gov.hu") has been in operation where taxpayers can amend, correct (if necessary) and modify the drafts and accept those on the online platform (which qualifies as a valid submitted tax return).

4.2.5 Instruments and systems based on EU law

As a member of the EU, Hungary also uses tools and systems based on EU law with regard to VAT:

• The One-stop-shop/single window (OSS) system has simplified reporting VAT duties and tax payment in intra-Community distance sale of goods and supply of services (to non-taxable persons or special status VAT subjects e.g. taxpayers with VAT exemption): the seller does not have to register (require a tax number) in the other Member State where the transaction is completed (and where the seller shall fulfill its VAT obligations). Instead, the seller may submit VAT returns and pay taxes in any Member State (besides Hungary) through the OSS system.

• Using the standardized 'A60' data sheet VAT subjects report their intra-Community business-to-business transactions.

• The website of the EU Commission (VIES system) makes it possible for VAT subjects to check each other's EU tax (VAT) numbers.

With regard to the audit of taxpayers the risk analyst department of the NTCA publishes its guidelines every year defining the criteria how VAT subjects are selected for audit that year. More recently the state tax authority also sends notifications to VAT subjects (so VAT returns can be submitted on time) on the basis of the prediction model based on statistics and the past behavior of the particular taxpayer.

4.3 Personal Income Tax and Digitalization

Payers and employers submit monthly tax returns on personal incomes while financial institutions, investment companies and other organizations also provide data on the income of private individuals. This data supply is used when compiling personal income tax (PIT) return drafts for private individuals (the "ePIT" or "eSZJA" system "eszja.nav.gov.hu") every year. Taxpayers can amend (typically with the data on income gained from other private persons), correct and modify the drafts if necessary and then accept (submit) the drafts (that will become valid finalized PIT returns).

4.4 Corporate Income Tax and Digitalization

In corporate income tax (CIT) there are no plans for a separate online platform for draft tax returns as it would not be practical, given that the bookkeeping of businesses is unique and personalized in many respects, so self-assessment continues to prevail in corporate income tax.

Since the introduction of electronic audit (e-audit) in 2018 the NTCA sends the documents created during an audit to the taxpayer's electronic memory space (storage) and the taxpayer may also electronically submit all the documents (even those not created in an electronic form originally) required for the tax audit to the NTCA. The e-audit method itself covers all kinds of audits but it is particularly useful in the revision of corporate income tax because regarding CIT there are no additional NTCA databases like those supporting VAT (Online Invoice system, online cash registers) or PIT (databases behind the "ePIT" aka "eSZJA" system which are put together from the data provided by payers and employers).

5. Conclusions

Digitalization in taxation and in tax administration has definitely helped decreasing the workload of the NTCA, more precisely it provides the opportunity for our management to shift human resources to the fields and the tasks that cannot be done without human involvement and the assistance of our colleagues. Due to this there have been significant restructurings in the workforce of the NTCA. There are always considerations regarding which tax procedures can and should be automated and to what extent.

Other significant benefits of digitalization are the reduction of the tax gap, eliminating most of the informal economy, the increase in state tax revenues, the facilitation of risk assessment and tax audits and ultimately an easier, a more client-friendly way of managing tax matters.

4-5 July 2024
The Event on the Development of the BRITAs

From 4 to 5 July, the BRITACOM successfully held an event on the development of the BRITAs. Representatives from five Belt and Road Initiative Tax Academies (BRITAs): BRITA•Astana, BRITA•Beijing, BRITA•Macao, BRITA•Riyadh and BRITA•Yangzhou, attend the event. Meanwhile, tax administrations of Algeria, Uruguay, and other jurisdictions, as well as international organizations such as the Inter-American Center of Tax Administrations (CIAT), the Asian Development Bank (ADB), and the United Nations Development Programme (UNDP), and representatives from BRITACEG experts and embassies based in China, participated in the event either on-site or online.

August 2024
Improving the BRITACEG Curriculum System

By August 2024, BRITACEG experts have reviewed and enhanced all 65 courses within the curriculum system, which includes 4 themes, 8 topics, and 27 sub-topics. The course content has been updated and expanded to incorporate the latest trends in international taxation, making the curriculum more scientific and up-to-date. Furthermore, BRITACEG has provided English subtitles for online courses to improve trainee understanding.

6 September 2024
BRITA•Macao (Hengqin Campus) Officially Established

On 6 September, Guangdong Provincial Tax Service, State Taxation Administration (STA) of China and the Financial Services Bureau of Government of the Macao Special Administrative Region of China signed a Memorandum of Cooperation, marking the official establishment of the BRITA•Macao (Hengqin Campus) in the Guangdong-Macao In-Depth Cooperation Zone in Hengqin, Guangdong, China. Tax and fiscal officials from nine jurisdictions, including the Mainland of China, Macao SAR of China, Angola, Brazil, and Cape Verde, attended the signing ceremony to witness this significant milestone.

24-26 September 2024
The 5th BRITACOF Convened in Hong Kong, China

The 5th Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF), themed “Deepening Tax Administration Cooperation for High-Quality Belt and Road Development”, was successfully held in Hong Kong, China on 24-26 September. The event brought together more than 500 participants, including heads of tax administrations from nearly 50 tax jurisdictions, representatives from 13 international organizations, and more than 40 prominent global enterprises, both physically and virtually.

Hosted by the Inland Revenue Department of Hong Kong SAR, China, the three-day event included Council Meetings and plenary sessions. Participants engaged in in-depth exchanges on topics such as improving tax environment, enhancing tax administration capacity and promoting tax administration cooperation along the Belt and Road. Nine major outcomes were announced during the event.

September 2024
Maldives Inland Revenue Authority Joined the BRITACOM as a New Member

During the 5th BRITACOF, the Maldives Inland Revenue Authority was approved to join BRITACOM as a Council Member Tax Administration. With this addition, BRITACOM now has 37 members and 30 observers, establishing itself as an important multilateral tax cooperation platform in the international tax arena under the Belt and Road Initiative.

September 2024
BRITA•Algiers Officially Established

The establishment of the BRITA•Algiers was officially announced at the 5th BRITACOF. BRITA•Algiers is dedicated to providing training programs in French and Arabic to tax officials from African countries. The number of BRITAs has now increased to six, located in Yangzhou (China), Beijing (China), Macao (China), Astana (Kazakhstan), Riyadh (Saudi Arabia) and Algiers (Algeria).

September 2024
Nur-sultan Action Plan (2022-2024) Successfully Concluded

The *Nur-Sultan Action Plan (2022-2024)* was successfully concluded during the 5th BRITACOF, marked by releasing a series of reports including the *Report of the Task Force on Raising Tax Certainty (2022-2024), Report of the Task Force on Promoting Tax Administration Digitalization (2022-2024),* and *Report of the Task Force on Improving Tax Environment (2022-2024)*, introducing the background and scope of the corresponding themes, analyzing the overall situation based on the questionnaires, sharing good practices and advanced experiences, and putting forward suggestions for future development. The *Report on the Work of the BRITACEG (2022-2024)* and *the Video Showcasing the Training Achievements of the BRITACEG (2022-2024)* were also released during the 5th BRITACOF, providing a comprehensive picture of the development and progress of the BRITACEG over the past three years.

6 November 2024
The Eighth Tax Administration Theme Day

In early November 2024, the eighth Tax Administration Theme Day was co-hosted by the National Tax and Customs Administration of Hungary (NTCA) and the BRITACOM Secretariat via a virtual seminar and an online exhibition on a dedicated webpage, attracting over 150 representatives from BRITACOM Member Tax Administrations, Observers, the Advisory Board and business entities.

24-30 November 2024
Seminar on Tax Administration and Digitalization

From 24 to 30 November 2024, the Seminar on Tax Administration and Digitalization hosted by the BRITACEG was successfully held at BRITA·Yangzhou. The seminar attracted 27 tax officials from 11 jurisdictions, including Mongolia, Maldives, Georgia, Sierra Leone, Bangladesh, Thailand, Saudi Arabia, Uzbekistan, Vietnam, Hong Kong of China, and Macao of China. Focusing on the theme of tax administration and digitalization, the seminar set up courses on optimization and improvement of tax administration system, development and practice of digitalization of tax administration, and application of big data, and organized the participants to go to the Jiangsu Smart Taxation Experience Center, and the taxpayer service hall of Guangling District, Yangzhou City, for on-site teaching.

Contributions Invited

Dear readers and writers,

We highly appreciate your contribution to the *Belt and Road Initiative Tax Journal* (BRITJ), and look forward to your continuous support in the future.

As an official journal sponsored by China Taxation Magazine House in collaboration with the BRITACOM Secretariat, BRITJ is committed to serving as a platform for communication and cooperation among tax administrators, academia, tax practitioners and other stakeholders around the world, and providing strong theoretical support and international reference for tax reform and administration among the Belt and Road jurisdictions.

Given your expertise and reputation in the tax arena, we sincerely invite you to contribute papers to the journal on such themes as tax issues concerning the Belt and Road Initiative, the latest development and reform of tax system and tax administration as well as hot topics in the field of international taxation. Papers written in English with less than 5,000 words and sent in a WORD format would be highly appreciated.

Papers can be sent to britj@britacom.org. For more information, please visit our website: www.britacom.org.

Kind regards,

Editorial Department
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