Draft Global Minimum Tax Bill

31 March 2024

Attention: The South African Revnue Services and National Treasury

Thank you for the opportunity to submit the following comments on the Global Minimum Tax Bill. This is a joint submission led by the Alternative Information Development Center (AIDC) and the Institute for Economic Justice (IEJ) and supported by Tax Justice Network Africa and #StopTheBleedimg Campaign.

This submission is in two parts:

I. Specific comments and proposals on the Draft Global Minimum Tax Bill ('the Bill'), as it relates to implementation of the Organisation for Economic Cooperation and Development (OECD)'s Global Anti-Base Erosion Model Rules ('GloBE rules' or 'Pillar Two'), and read with reference to the OECD's March 2022 Commentary and 2023 Administrative Guidance.
II. General comments and criticism on the provisions of the GloBE rules themselves, and proposals for alternatives.

In summary, this submission ultimately opposes the implementation of the OECD's GloBE rules for reasons outlined in Part II. However, should the Bill proceed we hope that our proposals in Part I help to inform the implementation of Pillar Two in a manner that mobilises the maximum amount of public resources possible within these confines.

Part I: Specific Comments on the Draft Global Minimum Tax Bill:

Approach to Implementation:

1. The Bill implements the OECD GloBE rules 'by reference'; the legislation does not copy the rules into domestic law wholesale but instead incorporates direct references to applicable and non-applicable Articles of the GloBE model rules. As stated in the Explanatory Memorandum, "this ambulatory treatment will ensure consistent application of the GloBE rules in line with the policy intention" as further updates or revisions to the GloBE Commentary or Administrative Guidance will automatically be applied in South Africa.

2. This approach compromises public oversight over South African tax policy. Future changes to the Commentary or Guidance will not pass through the legislative process because they are automatically applicable as per the Draft Bill. Given the complexity of the GloBE rules, as well as the notorious lack of transparency at the OECD and its Inclusive Framework platform, there is a very high risk of future revisions to these

documents in effect producing substantial changes to South African tax policy while bypassing public and parliamentary oversight processes.

3. Proposal: An approach where the bulk of the OECD GloBE rules are directly incorporated into the Bill would allow for maximum oversight, while any substantial revisions to the GloBE rules, Commentary, or Guidance could be introduced with the yearly Tax Laws Amendment Bill. Alternatively, the Draft Bill could include a transparency mechanism whereby both the Finance Standing Committee and the public are briefed on any relevant updates or revisions to these rules and their interpretation.

The Qualifying Domestic Minimum Top-Up Tax:

4. The implementation of the Domestic Minimum Top-Up Tax follows the necessary requirements to be considered a *Qualified* Domestic Minimum Top-Up Tax (QDMTT) under the OECD's Administrative Guidance.

5. At present, the threshold is multinational enterprises (MNEs) with a consolidated annual revenue of EUR 750mn (R15.4bn) for two consecutive fiscal years. In South Africa, only 17 MNEs, out of 243 that are headquartered in the country, fall above this threshold.[1] This is only 7.3%. This limits potential benefits to a relatively small number of very profitable foreign MNEs. The results can be seen in the February 2024 Budget Review, as the revenue from both the QMDTT *and* IRR amount to only R8bn in 2026.

6. South Africa has an urgent need for additional revenue, demonstrated by the growing burden of interest payments on public debt which have been the rationale for fiscal consolidation since 2020. These budgetary pressures have in turn placed essential public services under severe strain, and limited the levels of public investment in both economic development or urgent social support. Under these conditions, it is difficult to see why the Draft Bill has opted to leave the scope of the QDMTT unchanged, given that such a small number of MNEs are covered. We suspect that this is because of two concerns: the risk of losing the 'Qualified' status, and the fear of deterring foreign investment. We will address these in turn.

Would a lower threshold for the QDMTT risk losing its Qualified status?

7. Regarding the requirements of a QDMTT, the OECD's Administrative Guidance states the following:
In order to be considered functionally equivalent to the GloBE Rules, a minimum tax must be structured so that it is in line with the architecture of the GloBE Rules and does not systematically result in an incremental top-up tax for the jurisdiction that is less than what would have been determined under the GloBE Rules (pg 100)[2]

[1] Parliamentary Budget Office, Finance Standing Comittee Parliamentary Presentation.
[2] https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf

8. Crucially, section 118.2 states that a QDMTT designed in such a way that it "applies to groups that are not within the scope of the GloBE Rules does not produce outcomes that would cause the QDMTT to fail functional equivalence"[3]. In other words, while a *narrower* scope is not permitted, applying a *broader* scope than the GloBE rules is permissible. The Admninistrative Guidance explicitly mentions the case of a lower threshold for entities with a Ultimate Parent Entity (UPE) within the jurisdiction, as well as a lower threshold for domestic groups with no foreign subsidiaries as permissible examples. The Administrative Guidance does not make a clear determination on whether a lower threshold for domestic subsidiaries of foreign-owned subsidiaries is also considered to be functionally equivalent, but the implication of section 118.2 is that it is permissible.

Would a lower threshold for the QDMTT risk deterring investment?

9. It should first be noted that even a universally-applicable QDMTT would only bring the effective corporate tax rate up to 15%. This is equivalent to the tax benefit granted to companies operating in Special Economic Zones, and well below the statutory minimum rate of 27%. This would therefore primarily affect MNEs benefiting from tax incentives which bring their effective tax rate below 15%.

10. The effectiveness of tax incentives has long been disputed in the contexts of developing countries. In South Africa in particular, there is a strong argument to be made that the condition of basic infrastructure and socio-economic realities (such as unemployment and crime) are greater determinants of investment than the level of taxation compared to other jurisdictions. For example, a study by the ITUC showed that increasing government spending in the green economy, infrastructure and the care economy led to growth in employment and economic gwoth. The study found that "an extra 1% of GDP on infrastructure investment over five years would increase both employment and GDP levels by 12% on average."[4] We therefore do not consider a minimum tax rate of 15% on all MNEs to be a meaningful deterrent on investment.

11. Proposal: In both these respects, we, therefore, propose that the QDMTT threshold be lowered to a level that would ensure no multinational pays less than 15% tax in South Africa, bringing in revenue that could in turn stimulate real investment through reversing the decline of basic public services (notably healthcare and education) and key economic infrastructure (such as Eskom and Transnet).

The Undertaxed Payments Rule (UTPR)

12. The implementation of the UTPR is absent from this legislation. According to the Explanatory Memorandum provided: "Articles 2.4 to 2.6 of the GloBE Model Rules will not be applicable as they relate to the charging provisions of the Undertaxed Payments

[3] Ibid.
[4] https://www.ituc-csi.org/The-employment-effects-of-public-spending

Rule (UTPR)."

13. The UTPR is a secondary rule to the Income Inclusion Rule, which allows for SARS to deny deductions for certain cross-border payments in cases where these payments are made to low-tax jurisdictions that are not applying the GloBE rules. The African Tax Administration Forum has, along with other African states, argued that this should be the primary rule so as to provide 'source' jurisdictions a way in which to claw back some of the tax losses resulting from cross-border profit shifting. Sadly this debate was lost and the UTPR was implemented as a backstop to the Income Inclusion Rule (IIR).

14. Even though UTPR is secondary to the main IIR, South Africa is one of the early adopters of the GloBE rules and it is therefore foreseeable that there may be a period of a few years in which some 'residence' jurisdictions have not implemented the IIR. For example, the United States has faced significant legislative deadlock. Mauritius has also announced its intention to implement but has not yet done so. It is also possible that other residence jurisdictions choose not to apply the IIR at all, in which case this backstop measure can be applied in order to claw back a portion of the outflows made to low-tax jurisdictions.

15. Proposal: The OECD has stated that the UTPR may only take effect from 2025, but this does not mean that the relevant legislation cannot be drafted in the meantime. We recommend that the Draft Bill include provisions relating to the UTPR, so that it may become effective on 1 January 2025 without further delay.

Part II: General Comments:

16. While we submit the above comments on the implementation of the GloBE rules, we would like to clearly state that we have serious concerns about both the substance of the OECD's Two Pillar framework, and the process that informed its development. Because of these concerns, we ultimately do not recommend the implementation of the OECD GloBE model rules in South Africa. Our reasons are summarised below.

Revenue Potential

17. A significant amount of critical research and experts have stated that the OECD's Pillar Two will not bring sufficient revenue, especially for developing countries. A letter by Independent UN Tax experts criticised the OECDs two pillar framework for the meagre revenue it brings to Global South countries, while reducing their tax sovereignty and making them subject to binding dispute resolution procedures. This could in fact significantly reduce revenue and taxing rights of the Global South and have an impact on advancing and protecting human rights.

The UN experts stated that:

> *"We would like to reiterate that the Two Pillar solution, as it stands, would significantly undermine the revenue collection and taxing rights of low and*

middleincome countries. Lower levels of revenue collection in developing countries would weaken the States' capacity to fulfil their human rights obligations [...]"[5]

18. The 2024 Budget outlined a very low revenue estimate of R8bn following the implementation of Pillar Two. This estimate is deeply disappointing given the revenue required to expand and support basic services and public investment in South Africa. Moreover, it is a far cry from the promise made by the former finance minister, that the OECD minimum tax plan "effectively puts an end to the race to the bottom and to aggressive tax planning by major international companies".[6] According to the estimates cited by the OECD, the majority of studies support the claim that South Africa loses well in excess of R100bn to illicit financial flows of which commercial, tax-related outflows are the largest component.[7] Two important questions arise. (1) How was the R8bn estimate obtained? (2) Is this the amount of revenue that can be expected going forward?

19. If revenue estimates are accurate, this reaffirms the serious flaws in the GloBE rules as long pointed out by civil society, ATAF, and African countries in negotiations. The thresholds are too high, leaving only a few MNCs in scope. For those few countries left in-scope, the 15% rate is also far too low. It in fact risks legitimising 15% as a 'target' for corporate tax rates, prompting a global tax 'race to the minimum'.

Rule Order and Profit Shifting

20. Tax experts have highlighted how the GLoBE rule order gives the final right to tax undertaxed profits to the home countries of MNEs; the IIR is applied first by the jurisdiction where the Ultimate Parent Entity resides. As most of the impacted MNEs are headquartered in the Global North, the rules will benefit these countries more than Global South countries like South Africa.

21. The stated benefit of the OECD rules to countries like South Africa is that profit shifting at a global level will be disincentivised, as MNEs face the risk of under-taxed profits being taxed up to 15% in their ultimate residence jurisdiction through the application of the IIR even if they are able to successfully shift profits from source jurisdictions into tax havens. The benefit to source jurisdictions therefore relies on the premise that the 15% top-up tax on excess profits is sufficient to cause large MNEs to stop shifting profits altogether.

22. However, the failure to move to a truly unitary tax system leaves opportunities for profit shifting to continue. One can imagine a scenario where an MNE deems the 15% top-up tax on excess profit an 'acceptable' cost for avoiding a far greater 27%

[5] https://spcommreports.ohchr.org/TMResultsBase/DownLoadPublicCommunicationFile?gId=28676
[6] https://www.news24.com/fin24/opinion/mboweni-yellen-why-we-support-a-global-minimum-tax-rate-of-15-20210610
[7] https://www.oecd-ilibrary.org/sites/b5e31a5f-en/index.html?itemId=/content/component/b5e31a5f-en

corporate income tax in a source jurisdiction. This would perpetuate economic injustice and inequality, as the source jurisdiction would still not have any claim on its 'lost' tax revenue, with the shifted profits split between the MNE and the residence jurisdictions' additional tax revenue. If a jurisdiction where the UPE resides fails to adequately identify undertaxed profits along the ownership chain yet ostensibly applies the IIR, then profit shifting would also be able to continue as before unless another state in the MNE's ownership chain enters into a dispute process.

23. We do not believe that this is an acceptable compromise. The right of source jurisdictions to tax a share of the value created there is not an arbitrary principle; *where* profits are taxed matters. This is because the start of an economic value chain is generally where the greatest costs of this value chain are located, especially for activities in the extractive sector such as mining or gas extraction. It is in these source jurisdictions where non-renewable resources are permanently lost, where environmental damage is most pronounced, and where social and political conflict is driven by the so-called 'resource curse' - the phenomenon where activities such as mining crowd out other forms of economic development and in fact lead to under-development.

Transparency and Democratic Participation in a United Nations Alternative

24. Serious flaws in the GloBE rules are a result of a problematic and undemocratic process of development. The agreements put forward to the Inclusive Framework by the OECD were developed and negotiated outside of internationally recognised intergovernmental processes. It was negotiated by a few wealthy countries without the equal participation of developing countries and contributions from civil society. The Inclusive Framework has been widely criticised as being merely a platform for the OECD to rubber-stamp an agenda developed by member states and the Secretariat. Representatives from African states have reported undemocratic practices such as voluminous and technical proposals being distributed less than 24 hours before they are due for discussion, or diplomatic pressure being placed on states to approve proposals despite serious reservations - a consequence of the 'consensus-based' decision making process.[8]

25. Over 250 organisations, under the banner of Global Alliance for Tax Justice, stated that;

> "*A fair global deal is only possible in an open, fully inclusive and transparent intergovernmental process, in which the public and civil society can hold negotiators to account for proposals and decisions, and in which the draft agreements are open to public scrutiny. Such a process is only possible within*

[8] Examples may be found in this report: https://aidc.org.za/global-south-perspectives-on-international-tax-reform-report/

the framework of a UN based intergovernmental negotiation in which countries can participate as equals."[9]

26. Work is ongoing by the UN Ad Hoc Tax Convention Committee to develop a UN Framework for International Tax Cooperation. So far the process has been characterised by transparency, democratic participation and inclusiveness. It has already exceeded expectations and managed to reach unexpected compromises in its first meeting. This is a more suitable platform for international tax rules to be developed and decided, and we strongly urge that South Africa support this process.
27. In supporting and participating in ongoing UN Tax Ad Hoc meetings South Africa must speak with one voice. There needs to be more coordination between the Department of International Relations and Co-operation (DIRCO) and the National Treasury to ensure that South Africa's proposals are in line with the Africa Group. This is especially important given South Africa will host the G20 in 2025.

28. Proposal: The implementation of the OECD's rules in this Bill will act as a barrier to supporting a more impactful and just global tax reform agenda, as it not only legitimates the OECD's undemocratic processes and recognises it as *de facto* platform for international tax cooperation, but also leads to further complexity should a new UN tax framework be developed that supersedes the work of the OECD. We argue that the implementation of the OECD rules be put on hold until the UN Framework Convention on International Tax Cooperation has begun holding its sessions.

Summary of proposals:

29. The Qualifying Domestic Minimum Top-Up Tax should have a lower threshold to ensure all South African multinationals fall within its scope, thereby acting as a backstop on excessive tax incentives during a time of fiscal consolidation and ensuring that no multinational company pays less than 15% effective corporate income.
30. The Under-Taxed Payments Rule should be included in the Draft Bill so that it may be ready for implementation in January 2025.
31. The Treasury and Finance Committee should weigh up the benefits of this bill compared to the legitimation and credibility that it provides the OECD's Two Pillar plan. The Two Pillar plan was developed in a highly contested environment subject to diplomatic pressure and exclusionary practices by the OECD itself as well as the Global North states which constitute the core of its membership. We argue that its implementation be put on hold until a more democratic forum has been established in which to decide these issues.
32. This Bill and its impact should be considered in the context of the work towards a UN Tax Convention. The UN Tax Framework will give South Africa the chance to contribute towards a fairer international tax framework ensuring that all revenue efforts are linked to the importance of advancing human rights, expanding public goods and addressing climate change. Should this Bill be implemented, we urge that the

[9] https://globaltaxjustice.org/wp-content/uploads/2022/08/2021-10-08-Read-GATJs-statement-EN-PDF.pdf

government not consider it a barrier to supporting a new reform process under the United Nations.

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The submission is supported by:

- Alternative Information Development Center (AIDC)
- Institute for Economic Justice
- #StopTheBleeding Campaign
- Tax Justice Network Africa (TJNA)

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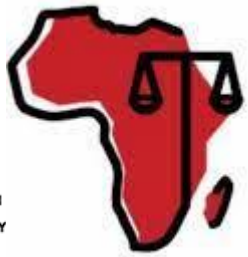

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