Submission on the 2024 Draft Global Minimum Tax Bill

07 October 2024

Attention:

Finance Standing Committee:

Chairperson: Mr MJ Maswanganyi (ANC)

Members: Alexander, Ms W (DA), Bateman, Mr AGBateman, Mr AG (DA), Beesley, Mr AD (Action SA), Gcaleka-Mazibuko, Ms NA (ANC), Hadebe, Mr N (IFP) Lekganyane, Mr MS (ANC) Makhubela, Ms LS (ANC), Maotwe, Ms OMC (EFF), Sekoati, Mr SC (ANC), Van Rooyen, Mr DD (MK)

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), supported by Tax Justice Network Africa (TJNA) and #StopTheBleeding Campaign. This follows our initial submission made to the National Treasury on 31 March 2024, and subsequent engagement in the 7 June workshop with the National Treasury and the South African Revenue Service.

This submission is in two parts:

I. Specific comments and proposals on the Draft Global Minimum Tax Bill ('the Bill'), as it relates to the 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.

4. <u>Response by National Treasury</u>
   Four reasons were given by the NT on why the incorporation by reference was chosen:
   - The approach was implemented by other countries.
   - It makes it easy for multinationals to comply, as they just need to learn one set of rules/no national deviations
   - The OECD is developing a peer review mechanism, to make sure each country's legislation meets the global standard. The approach is in line with the peer review mechanism.
   - To reduce the administrative cost for businesses.

5. Regarding the point on parliamentary and public oversight, Treasury responded by saying that changes to the OECD commentary will need to be reflected in the Tax Bills. If there are substantive changes to the commentary, then these will not go into effect until the next amendment bill is passed. This answer is somewhat confusing, as it runs contrary to the previous claim that changes to the commentary will automatically apply.

6. Despite the reasoning put forward by National Treasury, there are still some gaps. For instance, how does the ambulatory approach marry public oversight. Section 2 says rules will apply at times of most recent commentary. Will this commentary automatically apply? Or will it still need to go through the process for amendments for tax law? These are some question that still need to be clarified as the committee reviews the bill.

7. Lastly, the National Treasury argues that this ambulatory approach is simpler to understand and administer than the alternative of directly copying the OECD rules into legislation. We disagree with this argument on the basis that, if the OECD rules are directly implemented in legislation, then legislation would be the only authoritative source. The current proposed approach would require looking at the ambulatory legislation, assessing which sections of the OECD guidance it includes and excludes, and then looking for the appropriate version of the guidance from the OECD (keeping in mind that the OECD's latest version may not be applicable until the amendment bills have been passed, as per the response to point 5.) ?

The Qualifying Domestic Minimum Top-Up Tax:

8. 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.

9. 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 according to the University of Cape Town Tax Research Institute.[1] This is only 7.3%. According to the Treasury's assessment, the number is around 44, but this is still only 18%. 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* IIR amount to only R8bn in 2026, compared to the estimates of more than R50bn South Africa loses to tax-motivated illicit financial flows[2] and the R100bn lost to tax evasion each year.[3]

10. 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?

11. 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)[4]

12. 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"[5]. In other words, while a *narrower* scope is not permitted, applying a *broader* scope than the GloBE rules is permissible. The Administrative 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

---

[1] https://btpubs.co.uk/publication/?i=821333&article_id=4769897&view=articleBrowser

[2] https://www.oecd-ilibrary.org/taxation/assessing-tax-compliance-and-illicit-financial-flows-in-south-africa_e8c9ff5b-en

[3] https://www.moneyweb.co.za/news/south-africa/sars-to-crack-down-on-tax-avoidance-schemes/

[4] https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf

[5] Ibid.

functionally equivalent, but the implication of section 118.2 is that it is permissible.

Would a lower threshold for the QDMTT risk deterring investment?

13. 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%.

14. 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 growth. 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."[6] We therefore do not consider a minimum tax rate of 15% on all MNEs to be a meaningful deterrent on investment.

15. 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).

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

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

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 [...] "*[7]

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".[8] 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.[9] 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. Response by National Treasury: The Treasury has responded with uncertainty around whether the assessment that produced this estimate can be made public. It is crucial for the public and tax experts to be able to verify this estimate and obtain a clearer picture on the impacts of the GloBE rules.

20. 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'.

21. Finally, it is well known that the implementation of the OECD's GloBE rules is a very administratively complex task, requiring the dedicated work of numerous specialists and administrators. We question whether the administrative costs of implementing the GloBE rules have been taken into account, in comparison to the revenue benefits? In other words, what is the *net* estimated revenue benefit once the costs are deducted?

---

[7] https://spcommreports.ohchr.org/TMResultsBase/DownLoadPublicCommunicationFile?gId=28676

[8] https://www.news24.com/fin24/opinion/mboweni-yellen-why-we-support-a-global-minimum-tax-rate-of-15-20210610

[9] https://www.oecd-ilibrary.org/sites/b5e31a5f-en/index.html?itemId=/content/component/b5e31a5f-en

Rule Order and Profit Shifting

22. 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.

23. 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.

24. 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% 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.

25. 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

26. 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.[10]

27. 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 the framework of a UN based intergovernmental negotiation in which countries can participate as equals.*"[11]

28. The process towards a UN Tax Convention has been characterised by transparency, democratic participation and inclusiveness. It has already exceeded expectations and managed to reach unexpected compromises in the meetings to establish the Terms of Reference this year. 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.

29. 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, and that South Africa takes a leading role in making the UN Tax Convention into the authoritative body for global tax reform. This is especially important given South Africa will host the G20 in 2025.

30. 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 negotiations on the UN Framework Convention on International Tax Cooperation have reached an

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

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

advanced stage.

31. Response by National Treasury: The NT stated that: "all countries supported the UNTC process. Subsection 6 of this resolution says the UN could be complementary. Up until there is something substantive that will come up at the UNTC meetings in August, we will continue with this [OECD] process. If there will be a resolution that speaks to these issues, then we can come back and see. Until then, there is nothing more to discuss."

32. The African Group has played an important role in proposing a strong language to support human rights, combating illicit financial flows and taxing the wealthy. It has further highlighted that countries must support the UN as an inclusive and democratic forum for international tax cooperation. South Africa has, so far, played a limited role in the negotiations, supporting the outcomes and the position of the Africa Group but not taking the lead in doing so. There is a substantial difference between actively pushing for the UN Tax Convention to supercede the OECD, and "waiting and seeing" on the outcome of the negotiations. We call on the committee to ensure that South Africa takes a proactive approach to negotiations on international tax issues and, alongside the Africa Group, pushes for an ambitious UN Tax Convention that can supercede the work of the OECD. We also urge the committee to ensure that South Africa's participation in the OECD process does not preclude playing this active role.

Summary of proposals:

33. 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.

34. 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.

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

For more information contact Jaco Oelofsen - jaco@aidc.org.za and Zimbali Mncube - zimbali.mncube@iej.org.za

The submission is supported by:

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