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Pillar 2: QDMTT or Safe Harbour Domestic Minimum Top-Up Tax (SHDMTT)?

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The GloBE Model Rules have introduced the Qualified Domestic Minimum Top-Up Tax (QDMTT) into the ruleset of the international compromise on an effective minimum tax ("Pillar 2"). A QDMTT is defined as a domestic minimum tax that applies to local constituent entities of in-scope MNEs and produces outcomes that are consistent with the GloBE rules. A QDMTT does not turn off the levy of international top-up tax under the Income Inclusion Rule (IIR) or Untertaxed Profits Rule (UTPR), but it is creditable against such top-up tax. While a small amount of international top-up tax might occasionally still be levied, primarily because the QDMTT may rely on other – local – financial accounting standards for the purpose of the effective tax rate (ETR) calculation than the standards required by the GloBE jurisdiction(s), it can be expected that most – if not all – of the top-up tax will be collected by the low-tax jurisdiction itself if it adopts a QDMTT.

1. Benefits of adopting a QDMTT

The QDMTT need not be implemented as part of the internationally agreed "common approach" to Pillar 2. However, it is generally assumed that there exist strong incentives for its adoption, once a critical mass of countries will have implemented the GloBE Model Rules[1] – as will arguably be the case as of 2024[2]. It is also remarkable that the African Tax Administration Forum (ATAF) has recently published guidance for drafting domestic minimum top-up tax legislation, and in particular a QDMTT[3]. The reason for the presumed attractiveness of a QDMTT is that jurisdictions can benefit from it in several ways:

First and foremost, the QDMTT (at least almost) fully prevents the treasury transfer that would otherwise occur if an MNE earns excess profits in a low-tax jurisdiction with an ETR of local MNE profits below 15 %. In other words, the top-up tax is then essentially collected "at source" and not in the jurisdiction where a parent entity is domiciled, or in some UTPR jurisdiction. By contrast, if no QDMTT is adopted, the GloBE rules imply that low-taxed excess profits will be topped up in foreign jurisdictions. The QDMTT thereby reinforces the primary taxing rights of the jurisdiction were profits are "sourced" under traditional allocation rules. This effect is also the reason why capital-importing Global South countries with little or no presence of in-scope MNE headquarters were particularly keen on introducing the QDMTT into the GloBE ruleset[4]. In order to further enhance source country taxation rights, it was also agreed that a QDMTT shall not take into account foreign CFC taxes as covered taxes for the purpose of the ETR calculation, different from what applies in the context of the original GloBE minimum tax[5].

A second benefit, which is related to the first, is that the QDMTT takes the pressure off jurisdictions to reform or reduce domestic tax incentives[6]. Due to the implementation of GloBE by other countries, those incentives could be partially or fully absorbed by the international top-up tax – albeit to a different degree, depending on the type of incentive[7] – and thereby result in revenue losses without making the jurisdiction more attractive as an investment (or profit shifting) location. A QDMTT effectively acts as a domestic cap on tax incentives at 15 % of excess profits – only – for in-scope MNEs. It thereby prevents revenue leakage while preserving the effects of incentives to the greatest degree possible. Out-of-scope business entities can still fully avail themselves of all benefits. Without the QDMTT, the latter effect could only be achieved through a bifurcated system of tax incentives (as it has sometimes indeed been proposed in the inverse context of targeted anti-avoidance measures that could now be considered largely redundant – and thus excessive – for in-scope MNEs). And even such a system could not deliver the same type of bespoke ETR adjustments for in-scope MNEs with a range of different investment and profitability profiles, but would have to settle for the most common foreign investment pattern in the respective jurisdiction[8].

As has already been observed in literature[9], the QDMTT furthermore permits jurisdictions to continue to engage in tax competition for discrete investment projects until the floor of 15 % ETR on excess profits is reached. In the theoretical extreme, the Corporate Income Tax (CIT) could be fully substituted with the QDMTT for in-scope MNEs[10], even though this is unlikely to happen in practice – except possibly in case of (former) tax havens – due to political and legal constraints[11].

Finally, a QDMTT will provide MNEs with a safe harbour regarding the international top-up tax, and will thereby free MNEs from the compliance burden of additional ETR calculations for GloBE purposes, if the QDMTT design and its administration meet certain conditions (the Accounting Standard, the Consistency Standard, and the Administration Standard[12]). Obviously, the MNE will still incur the cost of having to comply with the local QDMTT. But reporting an eventual top-up tax liability only to local authorities can be preferable for several reasons. Most notably, it also fully turns off the subsidiary UTPR and thus the risk of having to deal with competing claims of, and parallel audits by, multiple tax authorities. Thereby, the overall costs of administering the GloBE are also reduced if QDMTTs are broadly adopted.

2. Drawbacks of adopting a QDMTT

However, upon a closer look, the QDMTT does have some drawbacks, too.

The QDMTT requires local tax authorities to assess and collect eventual top-up tax essentially in conformity with the GloBE Model Rules, Model Commentary and subsequent Administrative Guidance; otherwise, it will not be creditable against international top-up tax. The complexity of the ruleset to be applied[13], as well as the need to assess income on the basis of financial accounting standards, implies that a QDMTT jurisdictions has to make considerable investments in staff and training. Especially developing countries with no or little in-scope MNE headquarter presence – and thus little revenue incentive to implement the GloBE ruleset, anyways, for the levy of the *international* minimum tax – might consider this to be a significant burden on their limited tax administration capacities and enforcement resources[14]. In acknowledgement of such difficulties, it has been suggested that countries in such a position might refrain from auditing QDMTT taxpayers themselves, and could instead rely on the greater sophistication and capacities of typical IIR jurisdictions, especially ultimate parent entity (UPE) jurisdictions. The latter should be motivated, too, to police the proper calculation of the QDMTT liability, because it is creditable against their own IIR top-up tax claims[15]. However, it is far from certain that IIR jurisdictions will allocate significant resources accordingly, because any eventual positive revenue effects from determining the correct QDMTT liability would likely be negligible for them (see above). In any event, they will have very little incentive to do so once the QDMTT at issue qualifies for the QDMTT Safe Harbour[16]. Moreover, foreign tax authorities will find it difficult to properly assess the QDMTT liability if the latter is calculated on the basis of local accounting standards, as permitted by the GloBE Model Rules. In this case, compliance costs of affected MNEs would also increase, because they would have to carry out multiple ETR calculations based on different data points.

The local compliance and administrative costs of the QDMTT could nevertheless potentially be reduced to a considerable degree by applying the transitional CbCR Safe Harbour and future permanent safe harbours also within the QDMTT legal framework, as recommended in the Administrative Guidance of the Inclusive Framework[17]. However, significant efficiency gains from this solution would presuppose that the safe harbour thresholds are met by the great majority of in-scope MNEs. This, in turn, requires jurisdictions with tax incentive regimes that are susceptible to producing low-tax outcomes for GloBE purposes to either abolish, curb or reform those incentives. In a similar vein, jurisdictions with generally low (effective) tax rates would have to raise the general level of covered taxes to this effect. But this would clearly undermine some of the perceived advantages of the QDMTT, as described above, namely using it as a vehicle to maintain the current mix of incentives and continue to compete for real investment without a mere treasury transfer effect. Moreover, if “problematic” tax incentives continue to apply, this would not only preclude MNEs (and the tax administration) from benefitting from the CbCR Safe Harbour, but often lead to inefficient *double* compliance and administrative costs caused by now ineffective incentives: Often, the latter, too, imply significant costs in terms of reporting and monitoring, which then arise in addition to the costs of applying the counteracting QDMTT provisions[18].

If the local constituent entities of the MNE do not qualify for a CbCR Safe Harbour in the context of the QDMTT, this can result not only in increased compliance costs, but could also mean that the MNE can avail itself only to a lesser degree of temporary tax relief measures. The latter will usually result in deferred tax liabilities and will, as such, generally be treated as equivalent to covered taxes pursuant to the GloBE Model Rules. In the context of the CbCR Safe Harbour, this is ensured by using income tax expenses from financial accounts for the numerator of the ETR formula[19]. However, while no adjustments are required for safe harbour purposes, deferred tax expenses must eventually be recast at the lower minimum rate for the calculation of the QDMTT ETR, and certain liabilities will be “recaptured” if not paid within five years (cf. Art. 4.4 GloBE Model Rules).

Finally, the benefit of a QDMTT safe harbour will be available only once a – transitional and, eventually, permanent – peer review process has determined that the domestic minimum tax meets both, the requirements for a “qualifying” DMTT, and the corresponding safe harbour standards. Compliance with the latter further limits the policy choices that jurisdictions have with respect to the design of their domestic minimum tax.

In sum, the QDMTT comes at a relatively high compliance and administrative cost for both, MNEs and the jurisdictions that adopt it. These costs can be reduced, but only by significantly compromising the flexibility that the QDMTT provides regarding the maintenance of “problematic’” tax incentives, low tax-regimes, and international tax competition. A failure to do so may also cause collateral damage with respect to temporary tax relief measures. The QDMTT Safe Harbour is equally ambivalent.

3. The SHDMTT as a possible alternative

When jurisdictions weigh the benefits and disadvantages of introducing a QDMTT, the alternative need not be to keep the status quo, i.e. a national tax system without a domestic minimum tax or with traditional, non-qualifying domestic minimum taxes. It is suggested here that jurisdictions should also consider to adopt a different kind of domestic minimum tax: the Safe Harbour Domestic Minimum Top-Up Tax (SHDMTT).

The fundamental idea underlying the SHDMTT is to collect domestic top-up tax only to the extent necessary for in-scope MNEs to still benefit from one of the three CbCR Safe Harbour tests: the *de minimis* test, the routine profits test, or the ETR test[20]. To this effect, the SHDMTT should, first, be limited in scope to constituent entities of MNEs that come within the scope of GloBE. Second, it would be levied only from constituent entities of MNEs that meet neither the *de minimis* test nor the routine profits test. Third, the amount of SHDMTT top-up tax would be calculated as the amount needed – if any – to increase local covered taxes to the relevant safe harbour ETR test percentage (initially 15 %).

The SHDMTT would not be a qualified DMTT. As a consequence, it would not be creditable against international top-up tax. Instead it would be taken into account as covered tax for GloBE purposes – and as additional income tax expense under the CbCR Safe Harbour ETR test, which would therefore automatically be met. In comparison to the QDMTT, the SHDMTT approach might thus imply the need for somewhat higher domestic tax burdens in order to effectively turn off the collection of international top-up tax[21]. This is due to the fact that it needs to raise the (simplified) ETR on *overall* profits rather than ensure a minimum ETR on *excess* profits only, and also because the Safe Harbour ETR percentage increases to 16 % (17 %) as of 2025 (2026) under the agreed transitional regime. Domestic tax incentives or generally low rates could therefore be offset to a greater degree than under a QDMTT. However, this effect should normally be only moderate, because on the one hand, it fades out with increased profitability, and on the other, MNEs with low local profitability would not pay any minimum tax, anyways, due to meeting the routine profits test. For the latter category of MNEs, as well as for those with a small (*de minimis*) local footprint and for out-of-scope MNEs, the SHDMTT would produce exactly the same outcome as the QDMTT – their tax position would not be affected by the domestic minimum tax. Moreover, different from the QDMTT the SHDMTT would ensure that temporary tax relief measures remain fully effective, because deferred tax liabilities would always be taken into account in full and without temporal limits.

From a revenue perspective, the SHDMTT would prevent a treasury transfer effect and ensure that any minimum tax is only collected by the source country, no different than a QDMTT, and indeed with even greater certainty: As explained above, depending on the choice of the relevant financial accounting standard, the QDMTT might occasionally not reduce international top-up tax liabilities entirely to zero, as long as it has not been declared to be eligible for a QDMTT Safe Harbour through a peer review procedure. By contrast, the implementation of a SHDMTT would always lead to deemed international top-up tax liabilities of zero, because it guarantees that the MNE can avail itself of the CbCR Safe Harbour for GloBE purposes.

The SHDMTT would be as (relatively) easy to comply with, and administer, as the CBCR Safe

Harbour itself, because it builds entirely on this concept and establishes no additional requirements. MNEs could therefore use the same information that they already need to produce for meeting their CbCR obligations, and would not need any additional data points. This is clearly the greatest advantage for both businesses and the tax administration in comparison to a QDMTT.

Every country is, in principle, free to introduce a SHDMTT[22]. Different from the QDMTT, a jurisdiction would not have to undergo a peer review for the SHDMTT to have an effect on the international top-up tax. The SHDMTT would indeed immediately reduce the international top-up tax to zero, because the entry into effect of the CbCR Safe Harbour does not depend on a peer review, either, in contrast to the QDMTT Safe Harbour.

Currently, the GloBE Model Rules and Administrative Guidance do not even contemplate a prohibition of "related benefits" that would invalidate the muting effect of a SHDMTT on international top-up taxation. While a QDMTT liability will not block the collection of international top-up tax if it is linked to a reduction of other tax burdens (including relief for other than covered taxes), a grant of subsidies, or similar compensatory schemes, no such caveat applies for non-qualified domestic minimum top-up taxes. However, it is likely that the GloBE Administrative Guidance would be amended accordingly, should SHDMTTs actually be implemented by some jurisdictions.

Admittedly, the CbCR Safe Harbour on which the concept of the SHDMTT builds has so far been agreed only as a transitional measure. But considering its popularity within the business community and the increased likelihood of path dependence in a decision-making forum with over 140 member countries, it would come as a surprise if the CbCR Safe Harbour were to disappear after the transition period. The most likely development in the coming years is that CbCR standards will be tightened, and the CbCR Safe Harbour will be further refined to make it more robust, so as to become one of several permanent safe harbours. Governments contemplating a SHDMTT could therefore be confident that while a SHDMTT might need some amendments towards the end of the transition period, it would not become obsolete.

[1] See, e.g., IMF, International Corporate Tax Reform, 2023 (available at https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/02/06/International-Corporate-Tax-Reform-529240), p. 24.

[2] See Devereux et al., *Empirical evidence on the Global Minimum Tax: What is a critical mass and how large is the Substance-Based Income Exclusion*, Univ. Oxford SBS WP 2022-23 (available at https://oxfordtax.sbs.ox.ac.uk/files/wp22-23-devereux-paraknewitz-simmlerpdf).

[3] See ATAF Suggested Approach to Drafting Domestic Minimum Top-Up Tax Legislation, 2023 (available at https://events.ataftax.org/index.php?page=documents&func=view&document_id=191).

[4] See also OECD, Tax Incentives and the Global Minimum Corporate Tax, 2022 (available at https://www.oecd.org/publications/tax-incentives-and-the-global-minimum-corporate-tax-25d30b96-en.htm), para. 83.

[5] See Inclusive Framework on BEPS, *Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, February 2023 (available at https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf), para. 118.30.

[6] See also Bammens / Bettens, *The Potential Impact of Pillar Two on Tax Incentives*, 51 Intertax (2023) 155, at p. 165.

[7] For extensive analysis, see OECD, *Tax Incentives and the Global Minimum Corporate Tax*, 2022; Chand / Romanovska, *The impact of Pillar Two on Corporate Tax Incentives and Incentives post Pillar Two*, forthcoming (manuscript on file with author).

[8] See Englisch, *GloBE Rules and Tax Competition*, 50 Intertax (2022) 859, at pp. 865 et seq.

[9] See Devereux/Vella/Wardell-Burrus, *Pillar 2: Rule Order, Incentives, and Tax Competition*, 2022 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4009002), p. 8; Englisch, 50 Intertax (2022) 859, at pp. 865 et seq.

[10] See Devereux, *International Tax Competition and Coordination with a Global Minimum Tax*, 2022 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4335055), p. 24.

[11] See Englisch, 50 Intertax (2022) 859, at pp. 865 et seq.; Wardell-Burrus, *State Strategic Responses to the GloBE Rules*, Oxford Univ. SBS WP 22/21 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4291190), p. 25.

[12] For details, see Inclusive Framework on BEPS, *Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, July 2023 (available at https://www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf), chapter 5.

[13] See World Bank – O'Sullivan / Cebreiro Gómez, *The Global Minimum Tax: From Agreement to Implementation*, 2022 (available at https://openknowledge.worldbank.org/entities/publication/467fc434-f03b-5859-a456-1ea0757fddd3), p. 39.

[14] See Christians et al., *A Guide for Developing Countries on How to Understand and Adapt to the Global Minimum Tax*, 2022 (available at https://www.iisd.org/publications/guide/developing-countries-adapt-to-global-minimum-tax), p. 14.

[15] See Inclusive Framework on BEPS, Minimum Tax Implementation Handbook (Pillar Two), 2023 (available at https://www.oecd.org/tax/beps/minimum-tax-implementation-handbook-pillar-two.htm), para. 70; Wardell-Burrus, *Pillar Two and Developing Countries: The STTR and GloBE Implementation*, 51 Intertax (2023) 118, at p. 132.

[16] GloBE jurisdictions must recognize the decision taken by the Inclusive Framework, as part of the peer review process, on whether a particular QDMTT meets the requirements of the QDMTT Safe Harbour, see Inclusive Framework on BEPS, *Administrative Guidance*, July 2023, chapter 5 para. 9.

[17] See Inclusive Framework on BEPS, *Administrative Guidance*, February 2023, para. 118.45.

[18] See OECD, *Tax Incentives and the Global Minimum Corporate Tax*, 2022, para. 84.

[19] See Inclusive Framework on BEPS, *Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two)*, 2022 (available at https://www.oecd.org/tax/beps/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf), p. 7.

[20] For details, see Inclusive Framework on BEPS, *Safe Harbours and Penalty Relief*, 2022, p. 4 et seq.

[21] See also Inclusive Framework on BEPS, *Minimum Tax Implementation Handbook (Pillar Two)*, 2023, para. 67.

[22] In individual cases, a country might be barred from collecting SHDMTT top-up tax on grounds of fiscal stabilization clauses of investment contracts, or similar clauses in bilateral or multilateral investment treaties. Such constraints would similarly affect the collection of QDMTT top-up tax. As to possible solutions, see IMF, *International Corporate Tax Reform*, 2023, p. 25.

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