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The evolution of international tax regime and the OECD Two-Pillar solution: Analysis from a developing country perspective

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Abstract: This paper explores the evolution of international taxation and the impact of the OECD Two-Pillar solution on developing countries. The agreement on the OECD (Organization of Economic Co-operation and Development) Two-Pillar solution reached in October 2021 is a major and radical change in the international taxation regime. This paper analyzes the evolution of international taxation from its initial mold, through its stages of development, and finally to the adoption of the Two-pillar solution by the OECD. It scrutinizes the influence exerted by economically advanced nations, while developing the design considerations of the present system of taxation. The research finds that the influence the developing countries exerted in the design of the present system of taxation was meager. The massive influx of digitization in the recent era has made the age-old system of taxation redundant. There have been various instances of multinational corporations resorting to various tax-avoidance measures, effectively using the loopholes of the current taxation system. Developing countries were most impacted by the tax-avoidance of large corporations, because it leads to reduced tax revenue in the hands of the government to undertake essential humanitarian and developmental activities. Developing countries also do not possess the expertise or leverage to deal with tax-avoidance of multinational firms. The findings suggest that the decision making process in the OECD is still being manipulated by the developed countries. The views from economically less-developed countries are not accommodated justifiably. The study also seeks to explore the impact of the Two-pillar solution and analyze what the future holds for developing countries with regard to the new system of taxation.

Keywords: OECD Two-Pillar solution; international tax; developing countries; Pillar 1; Pillar 2; Amount A; Amount B; Transfer pricing; Evolution

1. Introduction

The Corporate Income Tax (CIT) plays a very important part in the revenue generation of developing countries. The CIT in developing countries as a percentage of GDP (Gross Domestic Product) is much higher than that of developed countries (Burgers & Mosquera, 2021, p. 13). So, developing countries are more vulnerable than developed nations to any kind of tax avoidance by large corporations.

The evolution of the international tax system had been a long-drawn process spanning decades. It is clear from the historical realities that developed countries, predominantly the US, greatly influenced the development of the current system of taxation. During the colonialist period, decision-making powers were vested with the colonial powers, and the rules developed chiefly suited their needs.

The end of World War II led to the decline of colonialism around the globe. The proliferation of democracy, libertarian value systems, and globalization has increased the level and scope of participation of developing countries in the global decision-making process. Though the advanced economies still hold huge power potential to design global policies, developing countries were increasingly involved in bilateral forums and later the BEPS (Base Erosion and Profit Sharing) discussions leading to the OECD Two-Pillar solution on the digitization of the economy. The analysis is done on the past, present, and future aspects of international taxation from a developing country perspective.

International tax rules were influenced by the principle of PE (Permanent Establishment) for nearly a century. In the present age, the rapid digitalization of the economy has made the concept of PE less effective in determining tax revenue. Multinational corporations like Google, Amazon, Apple, and Facebook make large revenue from developing countries, but still save huge amounts in tax by placing their PE in tax havens, which tax at a very low rate. Once the OECD Two Pillar solution is introduced, the States are expected to gain access to more of this untapped tax revenue. The study analyzes the historical aspects in the development of the international tax regime. It aims to expose areas where less advanced countries failed to exert themselves

and the deficiencies of the existing system, with a view that past mistakes may not be repeated. It also proposes how developing countries could get a fair share of tax revenue out of the ongoing negotiations.

2. Evolution of International Taxation

When a business activity crosses national borders, the question arises of where the profits arising out of the activity are taxed. In principle, there are three possibilities to allocate taxing rights in different jurisdictions

- Source country – The countries where production takes place
- Residence country – The country where a company is deemed to reside
- Destination country – The country where actual sales take place

The "1920s compromise", reached at the League of Nations, put a solid foundation to the philosophical base of the current system of international taxation. Source countries (where production takes place) were given primary taxing rights to the "active" income of the business and residence countries (where the entity or person that ultimately owns the profit resides) were given the primary taxing rights to "passive" income, such as dividends, royalties, and interest (Devereux & Vella, 2015).

The 1920 deal gave importance to physical assets and production factors. Before the development of the internet, businesses were conducted via shops, factories, offices, or similar physical fixed bases within a country's geographical boundaries. This presence of physical assets and production factors in a country was called "Permanent Establishment" (PE). The 1920 deal institutionalized the concept of PE in international taxation (Sanghvi et al., 2019). The deal overlooked the markets where the goods are consumed. Since production factors were mostly situated in the advanced economies after the era of the industrial revolution across the 18th and 19th centuries, the deal naturally favored the economically advanced nations.

The system continued without much protest for a little less than a century. For most of the twentieth century, policymakers saw corporate tax avoidance as unproblematic or regarded the costs of curbing it as too high (Mason, 2020, p. 356). An OECD committee in 2005 concluded that the present tax rules are widely accepted and there is no alternate system presently which can act superior to the current rules. The committee recommended that no changes be made to the existing tax treaty rules (Sanghvi et al., 2019).

Though the system lasted, it was not without problems. There were problems of double taxation where a country would tax its residents on domestic and foreign earnings, simultaneously it would also tax foreign labor and capital on income earned within its borders (Christensen & Hearson, 2019, p. 1071). Due to many factors like sovereignty concerns and increased complexity among others, policy makers during the time were averse to multilateral solutions in international taxation, due to which bilateral treaties multiplied manifold by the end of the 20th century. Tax competition led to erosion of tax bases and a 'race to the bottom' (which refers to the downward trend of tax rates). Countries started giving tax incentives to attract capital, boost growth, and create employment opportunities for their citizens. Sovereign jurisdictions feared capital and labor to respond negatively to an increase in tax rates (Christensen & Hearson, 2019, pp. 1071-1072). This boosted the practice of profit-shifting of MNEs to low-tax jurisdictions or Tax havens.

This design choice of the international tax regime had the most severe impact on countries with weak economies. A study by Niels Johannesen, Thomas Torslov, and Ludwig Wier provided empirical evidence on the link between the tax aggressiveness of multinational firms and the economic development of their host countries. The work shows a high negative correlation between a country's development level and its exposure to multinational tax avoidance (Johannesen et al., 2020, pp. 24-25) . Owing to the reduced fiscal capacity of less developed countries, they are significantly more exposed to tax avoidance by multinational firms (Johannesen et al., 2020). Developing and low-income economies fared the worst in the evolving situation.

The Tax havens exploited the emerging tax regime by providing benefits like low taxes without physical relocation of people and goods and offered secrecy of assets from foreign tax authorities (Christensen & Hearson, 2019, p. 1072). The tax aggressiveness of Tax havens and the inherent capacity constraints put developing countries in a very vulnerable position in ensuring tax compliance.

2.1 Transfer Pricing and Arm's Length Principle

Transfer pricing refers to the price at which goods and services are exchanged between companies under common control. The OECD guidelines on transfer pricing initially published in 1995 represented consensus among mostly developed countries (UN Tax Committee's Subcommittee, 2011, p. 8). Transfer pricing procedures worldwide are currently dominated by the arm's length principle adapted from Article 9 of the OECD Model Convention. Arm's length principle states that the price charged in a transaction between two related entities should be the same as the price charged in a comparable transaction between two unrelated parties. Often the variables needed to fix a fair price are unavailable and usually, the methods used are unreliable and subjective (Mason, 2020, p. 360). Big companies largely misuse the arm's length principle by encouraging artificial profit shifting between the company's subsidiaries and divisions.

Developing countries mostly found it difficult to implement these guidelines in practice. Countries with less sophisticated tax systems risked unequal impact by the stringent enforcement of transfer pricing guidelines by the developed countries (UN Tax Committee's Subcommittee, 2011, p. 7). Though the theory of economics was important in arriving at the transfer pricing valuations, the market power of the US exerted a huge influence on the fair value of transfer pricing transactions.

The US effectively used its influence at the OECD and other avenues to effectively expand the acceptance of the arm's length principle and convince the rest of the world (Mason, 2020, p. 359). The US had lent a blind eye to the profit shifting by the US MNEs to sustain their competitive edge. Further, the 'check-the-box' regulations introduced by the US Treasury

Department in the late 1990s were contrarian to the Controlled Foreign Corporation (CFC)[1] rules and enabled US-parented companies to shift profits between foreign subsidiaries (Mason, 2020, p. 359).

2.2 Common Reporting Standard (CRS)

Common Reporting Standard (CRS) is a global standard for the automatic exchange of financial information among the member countries developed by OECD in 2014 or to get details of the financial assets held abroad by residents of member countries. This was a direct consequence of the implementation of a similar rule in the US called the Foreign Account Tax Compliance Act (FATCA) for closer monitoring of illicit money flow globally after the September 11 attack. The economic power of the US successfully and unilaterally applied FATCA through which it collected the foreign financial income of US taxpayers (Matsuoka, 2021, p. 16). The CRS was yet another example of how the world followed the US lead in financial decision-making.

CRS turned out to be inadequate for developing countries as it focussed only on wealthy individuals and private companies and not on public corporations. The US refused to not sign on CRS leading to a major information gap for developing countries because the majority of MNEs and data servers were located in the US. The developing countries also lacked the expertise in adhering to the technical standards required by the system (Kelsey et al., 2020, p. 117)

2.3 Era after the financial crisis of 2007-09

Table1 shows the important timelines in the run-up towards the OECD Two Pillar solution

Table 1. Timeline of the OECD Two Pillar solution.

Timeline	OECD Two Pillar solution
July 2013	Launch of BEPS Project[2]
October 2015	Recommendations consisting of 15 BEPS Action Plans[3]
July 2016	Establishing of IF[4]
October 2020	Release of Pillar One and Pillar Two Blueprints[5]
July 2021	Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy[6]
October 2021	136 countries in the IF have agrees to the Two-Pillar solution[7]

The financial crisis of 2007–2009 caused major shifts in global economic governance. It also forced reconsiderations in established paradigms of International Political Economy (IPE) (Christensen & Hearson, 2019, p. 1068). Thus, the crisis of 2007-09 led the state actors to contemplate more in a range of economic policy areas including tax policy.

Movements against the tax avoidance practices by MNEs gained steam in Europe around 2010. Even the general public, with less tax expertise, became aware of the tax-avoidance practices of the MNEs. Starbucks faced boycotts in the UK and Google faced protests in France when the tax avoidance practices of these MNEs were exposed (Matsuoka, 2021, p. 2). This resulted in the resident countries realizing that MNEs are avoiding taxes to unacceptable extents. OECD reversed its stand to acknowledge that the existing rules of international taxation are inadequate, and G20 working together with OECD decided to come out with new rules on international taxation (Sanghvi et al., 2019). The OECD's project of Harmful Tax Practices transformed into the discussion of the OECD BEPS (Base Erosion and Profit Shifting) project initiated in 2013. A move boosted by the public mood prevailed during that period to resolve complex international tax-avoidance issues (Matsuoka, 2021, p. 2). The BEPS project was thus formed to combat tax avoidance by international MNEs and the collective resistance against tax avoidance gave impetus to the BEPS project. Finally, policymaking in international taxation had gained some speed which was earlier slow and static (Christensen & Hearson, 2019).

Once the BEPS project had been initiated under the banner of OECD, the EU started to exert its influence more effectively than before. The EU strongly influenced the shaping of the Taxation and Substance topic of the BEPS project, aside from Action Plans Six and Seven (Matsuoka, 2021, p. 11) of the BEPS action plans. Powerful countries with strong economies continued to shape the character of rulemaking in the global tax regime.

The new international tax regime which included the tax administration, transparency, and certainty portion of the BEPS project and CRS system, was formulated based on certain power factors (Matsuoka, 2021). Predominantly were the interests of

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[1] **Controlled foreign corporation** (**CFC**) rules are features of an income tax system designed to limit artificial deferral of tax by using offshore low taxed entities. The rules are needed only with respect to income of an entity that is not currently taxed to the owners of the entity.

[2] https://www.oecd.org/tax/beps-oecd-engagement-with-stakeholders.htm

[3] https://www.oecd.org/ctp/beps-2015-final-reports.htm

[4] https://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project_23132612

[5] https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm

[6] https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf

[7] https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

the major economies to generate additional tax revenue and achieve better exchange of information in a way that benefits only the Global North.

Civil society groups and developing countries did attempt to move the tax debate from the OECD to the UN but couldn't succeed in doing so (Grinberg & Pauwelyn, 2015). During the same time, OECD made attempts to be more inclusive with the BEPS project being enlarged with more than 60 countries directly involved in technical groups and much more participating through regional structured dialogues.

The OECD came up with 15 BEPS action plans that were finalized as part of the BEPS project. BEPS Action plan 1 concluded that digitalization has indeed affected the economy and exacerbated tax avoidance, so the reform needs to go beyond BEPS issues. The remaining proposals and recommendations in BEPS made rules more complex than the already-complex practices found in OECD Model Tax Convention on Income and Capital. Tax authorities in developing countries usually lacked the resources to counteract strategies by MNEs to exploit the extreme complexity of rules proposed in BEPS 1.0 (Kelsey et al., 2020, pp. 64-85).

The importance of production factors has been reinforced in BEPS 1.0. BEPS Action plan 5 talks about substantial activity requirements. Action plan 8-10 realign transfer pricing profit allocations based on the activity that takes place. Tax treaties also give tax benefits to entities that undertake some co-commercial activities. Reallocation of global profits of MNEs to market jurisdictions was yet to be achieved.

Continued calls for inclusiveness culminated in the creation of Inclusive Framework (IF) when the talks entered the post-BEPS stage. The number of jurisdictions involved in the discussion reached to 137 countries by 2019 (Matsuoka, 2021, p. 12) The OECD estimated corporate tax avoidance is anywhere from USD 100-240 billion annually. OECD further acknowledges that developing countries are disproportionately affected due to the current tax regime, because they tend to rely more heavily on corporate income taxes than developed countries (OECD, 2021, p. 13)

IF was formed with the goal of involving interested countries under an "equal footing" criteria (Valderrama et al., 2021, p. 48). Even during the post-BEPS discussions, the exertion of US influence was visible. Pillar Two of the OECD IF Framework is quite similar and on the same lines as the GILTI (Global Intangible Low-Taxed Income) rules in the US (Matsuoka, 2021, p. 14). This reaffirmed the political and diplomatic power of the US to shape the discussions to align with its domestic rules, even when the Inclusive Framework (IF) was involved. Despite the creation of the Inclusive Framework, the discussions were dominated by perspectives and expertise of the Global North and were focused on the fundamental principles which were originally developed historically by the economically advanced nations (Kelsey et al., 2020, p. 5).

From 2005 to 2018 Amazon, Apple, Google, Facebook, and Microsoft spent half-million dollars in lobbying in Washington DC and Google alone spent 8 million pounds in lobbying EU institutions in 2019 (Kelsey et al., 2020, p. 134). The effect of corporate lobbying led the US to drag its heels in the OECD process and even a temporary withdrawal from the process in June 2020, citing the economic and health crisis, generated by Covid-19 (Kelsey et al., 2020, p. 138).

Following the inordinate delay in arriving at a deal at the OECD, several nations including France, India, Italy, and Turkey decided to apply unilateral Digital Services Taxes (DSTs) to plug tax leakage. The step was strongly opposed by the US. US Trade Representatives (USTR) initiated investigations under section 301 of the Trade Act 1972 against France (Office of the United States Trade Representative, 2019) and ten other countries under the guise of unfair trade practices. The USTR office held that these taxes discriminate against US companies and are inconsistent with international tax principles provoking retaliatory tariffs (Lawder, 2021). The US again, backed by its power of opinion, succeeded in bringing many of these countries back to OECD deliberations (Matsuoka, 2021, p. 18).

Onset of the Covid-19 pandemic strained the budgets of countries, both rich and poor alike. All countries needed more resources to fight the pandemic and prevent harsh economic fallouts (Mahapatra, 2021).

With the ascent of the Biden administration into power, the government needed to raise revenue in a desperate attempt to combat the economic downturn and push his massive $2 trillion-plus American Jobs plan to revitalize the nation's infrastructure and manufacturing sector. The new US Treasury secretary Janet Yellen pushed resolutely for the new tax regime (Hansen, 2021) which pulled out the OECD negotiations from a state of dormancy and indecision.

The new administration wanted to raise corporate tax rates from 21% to 28% (Davison, 2021) and GITLI (Global Intangible low-taxed Income) rates on income earned by foreign affiliates of US companies from patents, trademarks, copyrights, etc. (Amedeo, 2021) from 10.5% to 21%. Corporate lobbying has been strong against the proposed increase in corporate tax rates in the US (Marr & Fenton, 2021). If the US implemented high corporate taxes unilaterally, the US companies would lose their competitive advantage. So, the US desperately needed to bring the world along. The Biden administration has so far, at the point of writing this paper, failed to increase the US corporate taxes. But it found a much easier solution to tax foreign earnings of US companies by introducing a global minimum tax (Tankersley & Rappeport, 2021). The economic clout of the US revived and accelerated the OECD negotiations which were in the doldrums till 2020.

Many developing countries were keen on Pillar 1 or the revenue reallocation part, but not so keen on Pillar 2 or the minimum tax part of the negotiations. This was because most developing countries wanted more revenue reallocations to their jurisdictions, but they still needed ways to attract foreign capital to generate employment and faster economic growth. So, they were not generally inclined to give up their sovereign right to fix beneficial tax rates and woo foreign investors. The US which badly needed a global minimum tax to satisfy the Congress came up with an approach on Pillar 1 that was acceptable to the other countries as well, which accelerated the discussions (Deloitte, 2021, pp. 12-14).

The changes proposed by the US formed the basis of the political agreement by G7 nations on 5th June 2021 (Deloitte, 2021, p. 1). From the history of the evolution of the international taxation system, it was the powerful economies that always dictated

the terms. The economic and political power of the developed countries, predominantly the US persuaded the developing countries to fall in line.

3. Key aspects of the OECD Two-Pillar solution: A Developing country perspective

The basic aspects of the OECD Two-Pillar solution is given below.

Pillar 1

Amount A: The reallocation of 25% of residual profit (ie. profit above 10%) to market jurisdictions constitutes Amount A

Amount B: The simplification and streamlining of the arm's length principle to in-country baseline marketing and distribution activities constitutes Amount B

Tax Certainty: Dispute prevention and resolution mechanisms that will settle double taxation and all other issues related to Amount A in a mandatory and binding manner

Pillar 2

Global minimum tax: Large internationally operating businesses pay 15 percent tax, regardless of where they are headquartered or the jurisdictions in which they operate.

GloBE rules: A set of two interlocking rules (i) Income Inclusion Rule (IIR): It imposes a top-up tax in the parent jurisdiction if a constituent entity is taxed below the minimum rate in a market jurisdiction (ii) Undertaxed Payment Rule (UTPR): The market jurisdiction can impose a top-up tax if the parent jurisdiction fails to implement IIR.

In GloBE rules, priority is given to IIR

Subject to Tax Rule (STTR): A treaty-based rule which allows source countries to impose a minimum tax of 9% for certain high-risk payments such as royalties, interest payments, brokerage fees, rent, etc.

Figure 1 representation depicts the key outline of the new internationally applicable tax structure (OECD, 2021).

Pillar One	Pillar Two
Taxing rights over 25% of the residual profit of the largest and most profitable MNEs would be re-allocated to the jurisdictions where the customers and users of those MNEs are located	GloBE rules provide a global minimum tax of 15% on all MNEs with annual revenue over 750 million euros
Tax certainty through mandatory and binding dispute resolution, with an elective regime to accommodate certain low-capacity countries	Requirement for all jurisdictions that apply a nominal corporate income tax rate below 9% to interest, royalties and a defined set of other payments to implement the "Subject to Tax Rule" into their bilateral treaties with developing Inclusive Framework members when requested to, so that their tax treaties cannot be abused.
Removal and standstill of Digital Services Taxes and other relevant, similar measures	Carve-out to accommodate tax incentives for substantial business activities
The establishment of a simplified and streamlined approach to the application of the arm's length principle in specific circumstances, with a particular focus on the needs of low capacity countries.	

Figure 1. Features of OECD Pillar Two Solution.
Source: OECD (2021)

3.1 Revenue

The OECD has prescribed various ways in which the Two-Pillar solution would benefit developing countries. The most important and obvious benefit would be the increased revenue impact. OECD estimates that under Pillar One, taxing rights of more than USD 125 billion of profit could be reallocated to market jurisdictions each year and OECD claims that the tax gains would be larger in low-income countries. According to OECD, Global Minimum Tax of 15% would generate around USD 150 billion in new tax revenues globally per year (OECD, 2021, pp. 4-5). The gains for developing countries from the STTR rule which are described further down this article come in addition to the above.

The deal would mean DSTs (Digital Services Tax) implemented unilaterally by some countries to be dismantled and tax sovereignty curtailed for individual countries. An Impact Assessment conducted by OXFAM on the effect of Pillar 1 proposals has found that the net impact for developing countries even with a high reallocation percentage of 30% would be insignificant and the impact with a low reallocation percentage of 20% could be negative compared to a tax income of 3% DST could generate from these countries (OXFAM, 2021, p. 1). According to another study, a reallocation of USD 125 billion of tax profits, in terms of tax revenue only amounts to USD 10 billion, which is a very minuscule amount compared to the annual scale of corporate tax avoidance which ranges from USD 100-307 billion (South Centre, 2021, p. 1) .G-24 and ATAF (African Tax Administration

Forum) had campaigned for reallocation of total profits of MNE's (South Centre, 2021, p. 2) rather than residual profits, which would have generated much larger taxable income. Stephen E Shay, a researcher at the International Bureau of Fiscal Documentation (IBFD) argues that residual profit taxation is deceptive and there was no compelling reason to incorporate the feature into Pillar 1 (Shay, 2021). It's widely accepted among academic quarters that additional revenue impact to developing countries from Pillar 1 would be very low. Therefore, more in-depth studies and impact assessment is warranted before reaching a consensus solution on the technical elements of fixing the tax base and arriving at the reallocation percentage.

3.2 Participation in the decision-making process

OECD makes the case that the Inclusive Framework (IF) was largely made up of members from developing countries and they were active and effective during negotiations. The new rules will relieve excessive pressure from developing countries to provide generous tax incentives to attract foreign investment. The OECD IF initially discussed three model proposals which came from various sides of the spectrum, to address the issue of profit shifting. The first was the *User Participation* proposal supported by the US and the EU, the second was the *Significant Economic Presence* proposal which was proposed by India, and finally, the *Marketing Intangibles Proposal* put forward by the US (Chand, 20220, p. 18, 35). The different proposals were intertwined to form a Unified Approach to facilitate consensus. Mutually differing opinions including that of developing countries were extensively discussed while arriving at the present deal.

Nevertheless, major developing countries like Kenya, Nigeria, Pakistan, and Sri Lanka have refused to sign the deal and many developing countries like Argentina which backed the deal did so reluctantly (Financial Transparency Coalition, 2021). Reports suggest that developing nations are constantly put under pressure for consensus during deliberations. For example, the EU blacklisted Namibia from 2016 to 2018 as a non-cooperative territory for tax purposes because it did not heed OECD guidelines (Ehl, 2021). ATAF has stated during the negotiations that it is extremely challenging for developing countries to fully participate and some countries might commit to new rules without fully understanding the revenue and investment implications (Hearson, 2020, p. 4). The heavy influence of the OECD secretariat in the negotiations mostly favored the positions of the EU and other advanced nations (Financial Transparency Coalition, 2021). Many academics have pointed out that a deal brokered by the UN would have much better raised the concerns of developing countries and LDCs (Least developed Countries).

3.3 Comparison with UN Article 12B proposal

The gravity of discussions that happened in the OECD among the developed and developing nations resulted in a more commonly acceptable deal than the UN Article 12B proposal which was prominent among the proposed alternate arrangements. The OECD deal came through extensive discussions among the IF member countries spanning over 5 years, while the UN Article 12B was the handiwork of 25 tax experts working in their individual capacities, which would not have properly voiced the concerns of developing nations

Expert commentaries have pointed out the inconsistencies in the UN Article 12B proposal proposed by the UN, which is supposed to raise the concerns of developed countries. Article 12B offers simpler solutions compared to much more complex tax rules in the OECD proposal. For example, UN Article 12B gives taxing rights to jurisdictions where payments are made. In all possibilities, this could turn out detrimental to the interests of developing countries, because in many cases paying entities might not be present in the developing country. Nonetheless, a developing country might still house a variety of factors that could add value to the transaction like users and data. For example, in the case of online advertising services where the service provider and payer might be located in developed countries while the target audience could be located in developing countries (Mehta et al., 2021, p. 5). In cases like the above, developing countries will lose fair share of taxes, if only the paying jurisdiction is allocated the taxable income. The OECD Pillar 1 proposes separate nexus rules giving weightage to underlying factors such as users and location of data (Mehta et al., 2021, p. 4) thereby allocating a fair share of tax to developing countries. The UN proposal in comparison is vague in many aspects like B2C tax collection, Information Reporting, and Tax Registration of taxpayers (Chand, 2020). Overall, the UN Article 12B proposal is a very simple proposition which does not have much practical relevance and offers no credible alternative to the OECD deal.

3.4 Substance Carve-outs

The GloBE rules provide for substance-based carve-outs which is supposed to encourage investments with substance in developing countries. These carve-outs are proposed incentives given to MNEs for investment in employees or tangible assets in a country, which will be carved out from the original tax liability. It will encourage MNEs to locate their assets and employees in locations where there is real economic activity. OECD states the importance of substance carve-outs in allowing developing countries to continue to offer incentives to attract investments with real value (OECD, 2021, p. 68)

The carve-outs could also be misused by MNEs by hiring people in the name of R&D and by acquiring more tangible assets with an exclusive focus to lower the tax rate. It could also allow MNEs to pay less than 15% in existing tax havens where they already have several employees and tangible assets (Dey, 2021). A study by the EU Tax Observatory using limited data from 27 countries has found that at a 15% minimum tax rate, the total collectible minimum tax revenue is reduced by roughly 12% when substance-based carve-out is implemented. The research also found that the substance-based carve-outs have a substantially lesser impact at a 15% minimum tax rate than at a higher rate of 25% (Baraké, Neef, Chouc, & Zucman, 2021) . By and large, the substance carve-outs are justified because it curtails the artificial transfer of profits to low-tax jurisdictions (EU Tax Observatory, 2021, p. 2).

3.5 Multilateralism

Another important aspect of the OECD deal is the incorporation of multilateralism into the international tax regime. Taxing has long been accepted as a sovereign right of countries and is governed by a vast network of bilateral tax treaties. Owing to a variety of reasons, developing countries often ended up on the losing side due to their diminished bargaining power in a bilateral setup. A multilateral agreement would secure them credible access to their share of the global tax pie. The UN 12B agreement, on the other hand, supports the case of bilateralism and even in some cases tolerates unilateralism (Mehta et al., 2021, pp. 4,13). The developing countries have to find the right balance between accepting an MLI (Multilateral Instrument) and losing their sovereign rights at the negotiating table.

3.6 Subject to Tax Rule (STTR)

The Subject to Tax Rule (STTR) incorporated into the Pillar 2 proposal is supposed to be beneficial to develop countries in expanding their tax net. The minimum rate for STTR will be 9%. OECD publication on the Two-Pillar solution in October 2021 states that "the Subject to tax rule (STTR), prevents companies from avoiding tax on their profit earned in developing countries by making deductible payments such as interest or royalties that benefit from reduced withholding tax rates under tax treaties and which are not taxed (or taxed at a low rate) under the tax laws in the treaty partner; this will help developing countries protect their treaty networks from abuse through profit shifting to low tax jurisdictions" (OECD, 2021, p. 5). This allows source countries to apply a withholding tax when certain high-risk payments are made to low-tax jurisdictions like royalties for intangibles, interest payments, brokerage fees, rent, etc. The STTR rule thus curbs one of the most common methods MNEs shift profits out of developed countries. During further negotiations, developing countries must make sure that all base-eroding payments are covered under this rule.

3.7 Addressing capacity constraints of low-income countries

Poor countries often suffer from reduced fiscal capacities (Besley & Persson, 2013, p. 14) which limits their provisions for effective and efficient taxation. Profit shifting issues faced by developing countries may be due to less sophisticated reasons than those faced by developed countries. Capacity limitations aggravate the need for the adoption of simpler methods in international taxation, especially to protect the tax bases of developing countries (Waerzeggers et al., 2021). The OECD has designed ***Amount B*** in this vein for a "simplified and streamlined approach to the application of the arm-length principle to in-country baseline marketing and distribution activities" (OECD, 2021) in certain specific circumstances. Amount B focuses on the needs of low-capacity countries and is expected to bring more tax certainty to market jurisdictions by mitigating the uncertainty of the arms' length principle (Deloitte, 2021, p. 25).

At the same time, developing countries would lose their right to attract foreign investment by giving tax incentives. Low-income countries often lack the infrastructure, facilities, or even skilled workforce required to attract large companies, but would still need to forego their only policy option available, which is tax breaks. Structural inadequacies and administrative hassles considerably increase the tax compliance cost in developing nations (Kundt, 2017, pp. 18-20). Many governments still believe some form of tax competition should be allowed for developing countries to compete with countries with inherent economic advantages (Geiger & Sharon, 2021). African and Asian countries, till recently were announcing tax incentives to attract investment in key sectors. Kenya as recently as May 2021 announced an extensive tax exemption regime for Japanese investors (Gebre, 2021). Rwanda too in the recent past has expanded its tax regime to include a preferential corporate income tax rate of 0% for international companies (HKTDC Research, 2019). So, developing countries with huge capacity constraints would lose out if the value of economic incentives is fully eliminated.

3.8 Tax Rate

The accepted global minimum tax rate of 15% is considered too low by many tax activists. Since most developing countries have higher tax rates than developed countries, a lower minimum rate might not alter investor behavior to a great extent (Hearson, 2020, p. 9). The agreed rate of 15% is much lower than the global average CIT which is above 25% but is closer to tax rates offered by tax haven Ireland which offers a CIT rate of 12.5% (Moreno, 2021). Some experts have opined that the new rate would encourage a new 'race to the minimum', ATAF campaigned in the IF for a minimum effective rate of at least 20%, as most African countries had tax rates between 25-30% (ATAF Communication, 2021), which was not heeded.

At the same time, tax havens Ireland and Switzerland lobbied successfully in the IF to revise the text in the deal from 'at least 15%' to '15%', a very noteworthy concession (O'Carroll, 2021). The lower minimum tax rate also had the effect of pushing the STTR rate to 9%, which would have been ideally 10-15%, comparable with withholding rates in many developing country tax treaties (South Centre, 2021, p. 3). Therefore, the finally agreed global tax rate doesn't give much consolation to developing countries.

3.9 Tax certainty

While the element of tax certainty has been welcomed from many quarters, developing countries often draw red lines in involving themselves in long and binding tax disputes. During negotiations ATAF, G-24, and the UN tax committee, all had stated opposition to mandatory and binding arbitration (Hearson, 2020, p. 7). The US wanted the mandatory and binding dispute resolution aspects to be incorporated in the agreement and they succeeded in doing so. An elective option is provided in the deal

for countries with a small number of disputes not to get involved in mandatory dispute settlement processes which save effort and time.

Dispute resolution through arbitration is a resource-intensive process. There exist huge capability gaps between big MNEs and the developing countries and this may lead to an uneven playing field during binding arbitrations (Ovonji-Odida et al, 2020, p. 19). Thus, developing countries wanted to focus more on dispute prevention rather than resolution, a position that was not ceded in the final deal.

3.10 Threshold

The revenue threshold for companies to qualify under Pillar 1 rules is EUR 20 billion. A study conducted by the Oxford University Center for Business Taxation has found that using this threshold, the reallocation of profit under Pillar 1 affects only 78 of the world's largest companies. If the threshold is reduced from EUR 20 billion to EUR 750 million, the aggregate Amount A will be doubled and the number of companies affected will increase by a factor of 13 (Devereux & Simmler, 2021, p. 1). Though OECD maintains that gains would be insignificant if the threshold is reduced, this effectively reduces the tax base of developing countries, and could greatly impact small and least developed countries.

The GloBE rules exclude jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million. A lower threshold of EUR 250,000 is provided for low-income countries (GDP lower than EUR 40 billion) under Pillar to maximize the number of countries intended to receive tax benefits (OECD, 2021, p. 10). While this provision could increase the tax net, it could also de-incentivize companies from investing and marketing in low-income jurisdictions.

3.11 Exclusion of extractives

The exclusion of extractives from the deal has been incorporated taking into account the sensibilities of developing countries. In the case of extractives, mostly the developing countries are the producers and not market jurisdictions. Since the deal allocates more tax income to market jurisdictions, the exclusion of extractives favors developing countries in general.

4. What developing countries must do

Since consensus has been reached on the broad outlines of the deal, developing countries must focus their energies on the technical aspects of the final implementation. The OECD has promised technical support in all aspects of the implementation of the Two-Pillar solution (OECD, 2021, p. 15). During the implementation of BEPS 1.0, technical assistance from OECD has not been of much help. Developing countries are expected to enhance their technical capacities, not only for sound implementation of the project but also to have a fair deal while negotiating the crucial design considerations of the deal.

OECD has put across a highly ambitious timeline for the implementation of the project. It is the Global North that is pushing the deal at such an extraordinary pace. The US needs to convince Congress as the Biden administration goes for a hike in US domestic corporate tax rates and GILTI rates (Deloitte, 2021, p. 55:05). A European directive on Pillar 2 demands unanimity among EU members. So, the European Union (EU) was vouching to achieve some sort of unanimity as early as possible because implementation without a directive would result in functional bottlenecks (IBFD, 2021, p. 32:50) in the EU. Developed nations with more technical expertise tend to exploit the limitation of time to incorporate various measures beneficial to them. For example, a ten-year transition period with generous substance carve-outs was incorporated into the deal at the last moment (Laudage & Haldenwang, 2021) due to MNE lobbying supported by advanced countries. ATAF had already voiced concerns about the political and technical complexities involved in the deal and the pace of the process as early as 2020 (Hearson, 2020, p. 4). Developing countries must make sure that they need to accept the deal only after verifying and being convinced of all the political and technical intricacies. Help and advice from international NGOs and independent experts must be utilized whenever required.

Many aspects crucial to the developing countries have been put on hold to run at a slower pace. Amount B, an element favoring developing nations is put on a slower track (Deloitte, 2021, p. 14:50). UTPR too, which benefits developing countries could be possibly deferred and may become effective only in 2024,2025, or 2026 (Deloitte, 2021, p. 5). Experts have also questioned the possibility of Pillar 2 getting implemented earlier than Pillar 1, due to the undue influence of the advanced economies. Questions have been raised that this would create inequities between developing and developed countries (Griffith, 2021). It is imperative for the developing and low-income countries that the right provisions must be incorporated before the implementation of the deal in totality. Since Pillar 1 involves a Multilateral Instrument, it needs to be signed and ratified by members before implementation. The work on the Multilateral Convention (MLC) in Pillar 1 should be speed-tracked under the initiative of developing countries for timely implementation.

There is a clear lack of empirical evidence for analyzing tax distortions in developing countries. The data from advanced countries could be generalizable to some extent, but the same is not the case with developing countries. Still, accurate data is very essential for informed decisions on taxation (Kundt, 2017, p. 24). Developing countries have very diverse settings and establishments and the "one size fits all" approach might not be suitable for a good number of countries. Developing countries with unique needs must voice their concerns to secure specific concessions. Only if regional cooperation is intensified, area-specific issues can be brought into the negotiations.

Many developing countries have entered into tax agreements in large investment projects with MNEs which often contain tax incentives that are locked in fiscal stabilization clauses (Redhead et al., 2021). These provisions freeze fiscal terms from the beginning of the project for a defined period. So, the changes in tax laws may not apply to these projects. If developing countries

do not renegotiate these contracts, the untaxed income would be taxed in the residence countries of foreign investors under IIR. It is advisable that developing nations renegotiate these provisions to prevent the transfer of tax to parent jurisdictions.

5. Conclusion

An analysis of the history of the evolution of the international tax regimes clearly shows that developing countries never played an inclusive part in the development of the existing tax regime. The origin of concepts like PE can largely be traced back to the colonialist period when developing countries played a minimalist role in decision-making. The art of collective lobbying at international institutions was mastered by the western counties during the cold war and post-cold war period. During the BEPS negotiations, the OECD, G7, and EU have already developed into effective caucuses and mastered the art of effectively negotiating common positions while ATAF and G-24 have less experience in efficient caucusing (Hearson, 2020, p. 4).

The Two-Pillar solution reached by OECD has incorporated several provisions beneficial to the interests of developing countries. Developing countries with large economies like India and regional blocs of developing countries like ATAF played influential roles in the deliberations. Increased globalization, leanings toward liberal internationalism, and the role of non-profits gave a boost to the sensitivities of developing countries like never before. Despite increased contributions from developing nations, the negotiating table was far from equitable.

It was the US engagement that took the BEPS 2.0 negotiations out of the status-quo and drove towards a quick consensus. The appointment of Janet Yellen as Treasury Secretary and the desperation of the Biden administration to raise revenues provided the necessary push to the deal. Though the US had to cede some territory to developing nations, the US was the giant in the room making things tick.

Many developing countries were interested to take forward BEPS action plan 5 which concentrated on profit reallocation but did not intend to harmonize tax structures (Chand & Romanovska, 2020) as envisioned in Pillar 2. The Pillar 2 proposal came through the backdoor (Chand, 2020, p. 1,12) by the influence of the US. The US firmly pushed Pillar 2 while accepting a more accommodative stance on Pillar 1. Pillar 2 is strongly influenced by the reforms already adopted in the US (Hearson, 2020, p. 8) and the US pressure had finalized the package in a way that if developing countries wanted Pillar 1, they would need to accept Pillar 2.

The OECD has set ambitious timelines for the implementation of the plan. Both Pillar 1 and Pillar 2 are expected to come into effect by 2023. Challenging timelines again pressurize developing countries that run low on technical capacities. For a fairer outcome, developing countries are expected to improve their lobbying strategies and upgrade technical capabilities.

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