

Pillar-two solution and the impact on the Caribbean SIDS

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1. Introduction

The process of designing the OECD Pillar-two solution to address the tax challenges arising from the digitalisation of the economy is conducted through the Inclusive Framework. As per November 2021, a total of 137 IF-countries have joined the Pillar-two solution, including some countries from the Caribbean. The Global Anti-Base Erosion Model Rules (GloBE) ensure large multinational enterprises (MNEs) pay a minimum level of tax and aim to solve the problem of tax avoidance by MNEs.

The current discussion on the impact of the approach taken by the OECD and the EU primarily focuses on developed countries and, to a lesser extent, on developing countries. The lack of debate on the impact on [Small Island Developing States \(SIDS\)](#), especially Caribbean SIDS is striking. [Unlike the OECD](#), the United Nations (UN) define the small Caribbean islands as developing countries. The specific characteristics of the SIDS – in particular their small scale – generally have a negative impact on the economy of these jurisdictions. Outlining the impact of the Pillar-two solution on the SIDS is particularly relevant for the Caribbean SIDS such as Curaçao, Barbados, Bermuda, the British Virgin Islands, because the economic model of these Caribbean SIDS is mostly based on tax-related financial services. The SIDS are extremely vulnerable in an economic and social way. Moreover, the COVID pandemic has painfully exposed the socio-economic problems in the SIDS. SIDS participating in the Inclusive Framework of the BEPS-project are already coping with limited resources to comply with the ongoing international standards set by the OECD and the EU.

The aim of this blog is not to elaborate on the technical aspects of the Pillar-two proposal, but to flag the position of the Caribbean SIDS in the current debate.

2. Impact Pillar-Two solution on the Caribbean SIDS

The OECD suggests that the global minimum tax rate will have significant gains for all parties involved. According to OECD, [the implementation of Pillar-two will generate around USD 150 billion in additional global tax revenues annually.](#)

Nonetheless, the Pillar-two solution is unlikely to generate additional global tax revenues for the Caribbean SIDS. Neither will it have a substantial effect on the attractiveness of the Caribbean SIDS by foreign investors. First, qualifying MNEs rarely have their ultimate parent entity in a Caribbean jurisdiction. The annual turnover threshold of € 750 million is simply too high to affect most businesses operating in the Caribbean SIDS. Moreover, any additional taxation based on the so called 'Undertaxed Payments Rule' (UTPR) depends on the degree of substance present in the companies in those jurisdictions (in relation to the total substance in the group). MNEs often do not have sufficient substance in Caribbean SIDS. Therefore, no significant tax income for these Caribbean jurisdictions will be expected as the very complex UTPR calculation will be a great challenge. Furthermore, it is to be expected that the implementation of the so called 'Income Inclusion rule' (IIR) in Caribbean jurisdictions will not take place any time soon. In some cases, the IIR will already be applied in another jurisdiction within the group.

Qualifying subsidiaries of MNEs are often located in the Caribbean region in the context of international financial services. Although Curaçao, a member of the Inclusive Framework, does not qualify as a zero-tax or low-tax jurisdiction, it has favorable tax arrangements. As a result, a tax burden of less than 15% (effectively) will be achieved. Barbados, Bermuda, the British Virgin Islands, Cayman Islands, and the Dutch Caribbean islands Bonaire, Statia and Saba (BES) are zero-tax or low-tax jurisdictions. The implementation of the GloBE rules by one or more of these jurisdictions may lead to additional foreign taxation on the low-taxed Caribbean income.

The Caribbean SIDS have four options for responding to Pillar-two. First, SIDS can refrain from taking any action, leading to an additional levy of up to 15% by the country that has implemented the IIR and/or UTPR. Not introducing the GloBE rules should not cause any problems for the Caribbean jurisdictions that are part of the Inclusive Framework, because they are not obliged to adopt the GloBE rules due to the status of 'common approach'.

Second, Caribbean SIDS can opt to increase the effective tax rate to the minimum of 15%. While Caribbean jurisdictions will want to levy any top-up tax, it seems to me that zero tax or low-tax Caribbean jurisdictions will be reluctant to raise the corporate income tax rate. After all, in such a case, subsidiaries that are not part of a qualifying MNE will also be taxed at a higher profit tax rate.

The third option is to increase the tax burden to 15%, but only for subsidiaries of qualifying MNEs. The fourth option concerns the introduction of a local and qualifying 'top-up' tax for situations where these subsidiaries are taxed below the effective 15%. As a result, additional levies will no longer take place elsewhere through the IIR and/or UTPR. It seems to me that the SIDS should consider the latter option and thus collect the GloBE tax themselves. This way more substance in the Caribbean region will be encouraged. After all, when calculating the local qualifying top-up tax, the additional tax rate (15% minus the effective tax burden) will be multiplied by the GloBE income minus the so called 'substance-based income exclusion'. As a result, the more substance the subsidiaries have in a jurisdiction, the further the effective tax burden will fall below 15%, while the minimum tax levy is met.

It is likely that several non-taxed or low-taxed jurisdictions will choose the first option – at least for now – by not introducing new rules. These jurisdictions may be reluctant to implement the Pillar-two rules in the initial phase. It will provide jurisdictions some space to analyze how the absence of the GloBE rules and local top-up taxes can be embedded to the advantage of their future business climate.

3. Implementation challenges for SIDS

While developing countries (including SIDS) participate in the Inclusive Framework, they are in general not fully aware of the implications of their participation. [\[1\]](#) For instance, Curaçao registered for the Multilateral Instrument (MLI),[\[2\]](#) while Curaçao does not even have a tax treaty network.

Participating countries in the Inclusive Framework are invited to BEPS training and they receive capacity support in the implementation of the standards. However, it appears that most developing countries do not take these training courses. As a result, it remains difficult for the Inclusive Framework members to implement the minimum standards of BEPS. It should be noted that participation in a working group does not mean that developing countries actually (can) exert influence. Research shows, for example, that most members are fairly quiet participants. This is due to the pace and intensity of discussions, the culture of policy making, the cost of attending regular meetings in Paris, and the lack of timely translation of documents and meetings.[\[3\]](#) It can be argued that participating SIDS in the Inclusive Framework, but also the OECD, have not sufficiently realized how great the burden on the limited available capacity for implementation would be. The underlying reason for SIDS to participate in the Inclusive Framework is often only to be removed from the so-

called blacklists. These jurisdictions will therefore show little interest in the capacity building program.^[4]

4. Closing remarks

It is currently not clear to what extent the tax-related economy of the Caribbean SIDS will be impacted by the Pillar-two solution. Surely, the introduction of a global minimum tax rate will make competing at tax rates below 15% more difficult. Even so, it is not likely that the Caribbean SIDS will give up on tax related incentives. The position Caribbean SIDS should and most probably will take in the current debate is to look for other alternatives to attract foreign investors. Caribbean SIDS should still be able to market their services by emphasizing the advantages of expertise gathered over the years of providing international financial services, including a strong banking infrastructure. Building a tax treaty network and entering bilateral investment treaties are options to consider. At the same time, it should be noted that for some SIDS, like Curaçao, building a tax treaty network is a major challenge due to its constitutional structure. Attracting investors not covered by Pillar-two is an option to be considered. All in all, it will be fascinating to witness how the Pillar-two rules – if actually agreed and implemented on a worldwide scale – will influence the future development of the tax driven economy model of the Caribbean SIDS. For sure, the Pillar-two rules will not put an end to the global ‘unhealthy’ tax competition.

^[1] N. Sarfo & S. Johnston, ‘A Brave Bet: The Inclusive Framework’s High-Stakes Future’, *Tax Notes Int’l*, December 2021, p. 1326.

^[2] Y. Brauner, ‘Agreement? What Agreement? The 8 October 2021, OECD Statement in Perspective’, (editorial), *Intertax*, Vol. 50, (1), 2022, p. 2.

^[3] R. Christensen, M. Hearson & T. Randriamanalina, ‘At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations’, *ICTD Working Paper 115*, December 2020.

^[4] See also: M. Hearson, *Imposing Standards, the North-South Dimension to Global Tax Politics*, Cornell University Press, 2021.