PILLAR-TWO SOLUTION: HOW SHOULD CARIBBEAN SIDS RESPOND?

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1. INTRODUCTION

In 22-24 November 2022, a regional meeting organized by Caricom in collaboration with the Jamaican tax authorities and the OECD was held in Kingston, Jamaica. Several Caribbean jurisdictions participated, including Jamaica, Saint Kitts and Nevis, Saint Lucia, Barbados, Suriname, Guyana, Belize, Antigua and Barbuda, Turks, and Caicos and Curaçao. During one of the sessions the main challenges of the OECD Pillar-two solution for Caricom jurisdictions were discussed. The OECD's Pillar-two solution —the so-called GloBE rules or minimum tax –ensures that large multinational enterprises (MNEs) pay a minimum level of tax, aiming to solve the problem of tax avoidance by MNEs. The minimum effective corporate income tax rate is set at 15%. Qualifying subsidiaries of MNEs are often located in the Caribbean region in the context of international financial services. During the regional meeting in Jamaica, it became very clear that all the Caribbean jurisdictions face similar challenges due to the lack of capacity of well-trained professionals and the fact that their economies show little diversity by focusing mainly on tourism and the financial services sector. Indeed, the specific characteristics of the Small Island Developing States (SIDS) – in particular their small scale – generally have a negative impact on the economy of these jurisdictions. The consequences of the Pillar-two solution for the SIDS will be particularly interesting 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. Low taxes policy is key to Caribbean SIDS to attract investment they desperately need. Thus, Caribbean SIDS are extremely vulnerable in an economic and social way.

At the end of the regional meeting in Kingston, the Caribbean jurisdictions expressed the need for support from the OECD to better comprehend the pillars. Moreover, the Caribbean jurisdictions agreed to follow up upon new sessions in 2023 to discuss with OECD the necessary steps to implement the two pillars successfully.

Even though the Inclusive Framework members, such as Curaçao, are not obliged to adopt the GloBE rules due to the status of 'common approach', it is likely that most Caribbean SIDS will implement the complex rules of Pillar-two. This is especially worrisome as the Caribbean jurisdictions are already coping with limited resources to comply with the ongoing international standards set by the OECD and the EU. Therefore, how should Caribbean SIDS respond to these developments?

2. PILLAR-TWO IMPACT ON CARIBBEAN SIDS

Caribbean SIDS will probably consider increasing their effective tax rate to the minimum of 15%. While Caribbean jurisdictions will intend 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. A realistic option is to increase the tax burden to 15%, but only for subsidiaries of qualifying MNEs or introducing a local and qualifying 'top-up' tax (QDMTT) for situations where these subsidiaries are taxed below the effective 15%. As a result, additional levies will no longer take place elsewhere, but SIDS will collect the GloBE tax themselves.

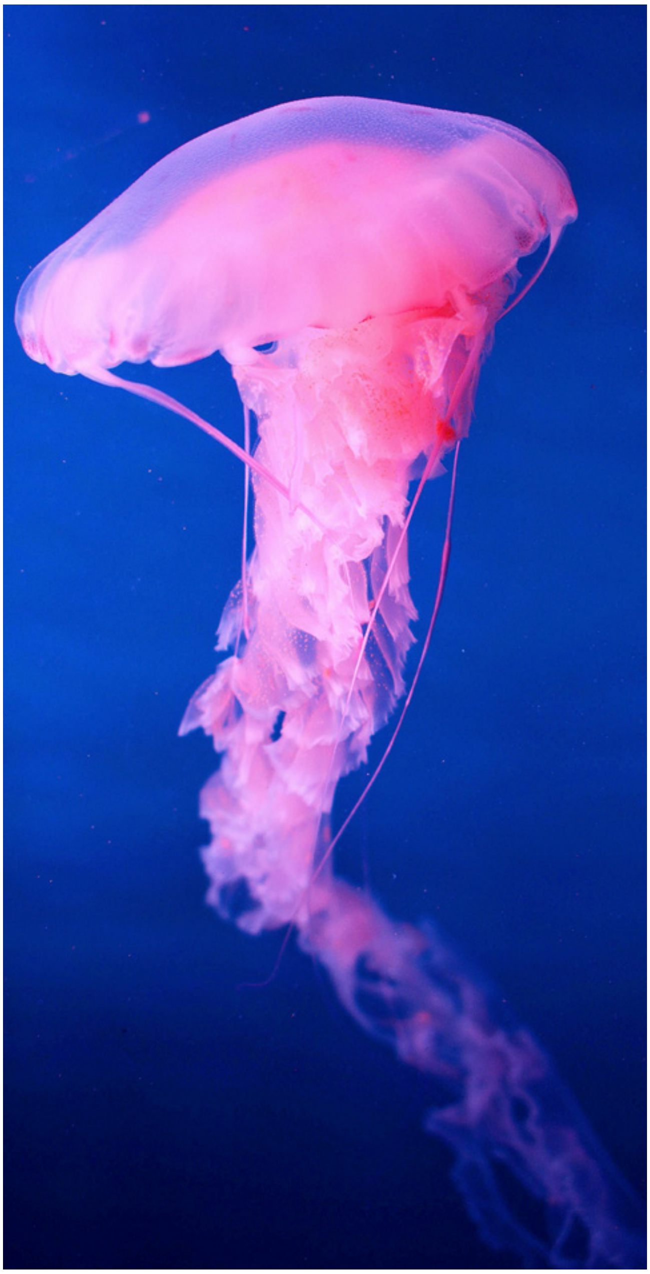
However, it is highly unlikely that Pillar-two will generate the promised additional global tax revenues, as already pointed out by Leopoldo Parada in his contribution "The OECD Global Tax Deal and Developing Countries: Where do we stand?". This is true, especially for the Caribbean SIDS. Qualifying MNEs rarely have their ultimate parent entity in a Caribbean jurisdiction. The annual turnover threshold of € 750 million is 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, and ultimately on the non-application of an Income Inclusion Rule (IIR). MNEs often do not have sufficient substance in Caribbean SIDS. Therefore, no significant tax income for these Caribbean jurisdictions will be expected while the very complex UTPR calculation will be a great challenge.

3. IMPLEMENTATION CHALLENGES

As mentioned already, SIDS participating in the Inclusive Framework of the BEPS-project have significant capacity and resource constraints to comply with the ongoing international standards set by the OECD and the EU. One must keep in mind that the underlying reason for SIDS to participate in the Inclusive Framework is mainly to be removed from the so-called blacklists and to show their commitment to cooperate internationally. However, adopting the Pillar-two solution will proof to be an additional challenge for the SIDS as the Pillar-two rules are very complex. A key question is whether the Caribbean SIDS have other options as they are facing the dilemma of endorsing a minimum effective corporate income tax of 15%. Implementing the complex QDMTT will proof to be an extra burdensome for tax administrators in the Caribbean SIDS. They must assess whether their respective tax administrations will be able to provide them with the requisite support so that they are able to apply the rules. The way out of this may be the bold Bermuda strategy.

4. THE BERMUDA PLAN AND OTHER STRATEGIES

On 8 August 2023, Bermuda announced that it is considering the implementation of a new corporate income tax regime. Bermuda seeks to incorporate an income tax that will qualify as a Covered Tax for purposes of the GloBE Rules, such that the Bermuda corporate income tax would mitigate the amount of Top-Up Tax payable to other jurisdictions with respect to profits earned in Bermuda. Bermuda intends to design a corporate income tax that includes features that will maintain the competitiveness and reputation for quality of Bermuda. Consistent with the GloBE Rules, the Bermuda corporate income tax will only apply to MNE Groups with revenues of € 750 million or more. By establishing a corporate income tax (CIT), Bermuda will certainly avoid the burdensome of analysing, understanding, and implementing the Pillar-two rules. Instead, it will focus on a simple and compliant CIT system while avoiding high administrative costs.



Apart from the Bermuda plan, it would be worth considering a cost/benefit analysis and reshaping the plan to attract foreign investors, by emphasising the advantages of expertise gathered over the years of providing international financial services. For example, Curaçao is now making a fresh start by designing and publishing its Tax Treaty Policy. The financial sector is a central pillar of the Curaçao economy and, worldwide, there has been a dramatic increase in the use of investment institutions for both private and institutional investors, but also for private equity. By concluding treaties with OECD-approved provisions for so-called Collective Investment Vehicles, Curaçao can contribute to preserving financial services in its territory. Furthermore, Curaçao intends to approach countries with which Curaçao has more intensive (trade) relations with a view to concluding a convention for the avoidance of double taxation, because such a convention will make it easier to capitalise on the relations between both countries, as well as both countries' regulations. It will also allow for a better division of double taxation accommodation. Thus, conventions may play an instrumental role in fostering economic relations between countries.

5. CLOSING REMARKS

The introduction of a global minimum tax rate will certainly make competing at tax rates below 15% more challenging. Even so, it is unlikely that the Caribbean SIDS will give up on tax related incentives. Caribbean SIDS should consider reviewing the whole set of corporate income tax incentives they offer, analysing the effectiveness of the corporate tax incentives under the GloBE rules and elaborating a strategic approach if the idea of a minimum tax is ultimately endorsed. In this regard, the introduction of a simple CIT, such as the one in Bermuda, appears as an option that deserves attention. Ultimately, such an option could lower the administrative costs associated to the OECD Pillar-two whilst reinforcing the competitive advantages of Caribbean SIDS, including marketing their financial services and strong banking infrastructure. Similarly, other options such as building a tax treaty network and entering bilateral investment treaties are also options to consider. In the overall, Caribbean SIDS should team up within the Inclusive Framework to advance their joint cause, as no island can stand up alone. For sure, there is still a lot to consider.

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