*Marinela Stefanovska Petrovska**

INTRODUCING GLOBAL MINIMUM EFFECTIVE TAX RATE - CHALLENGES FOR THE MACEDONIAN TAX SYSTEM

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-Abstract-

This paper analyses the challenges for the Republic of North Macedonia, as a developing country, of the implementation at national level of the global minimum corporate tax rate introduced at the end of 2022 on a European level with the Council Directive on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (Pillar Two Directive). The Pillar Two Directive codifies in the EU law the OECD/G20 Two pillar solution to address the tax challenges arising from the digitalization of the economy. The global minimum tax is introduced through the global anti-base erosion rules (GloBE rules) which are an important shift in international taxation policy. These rules apply to both multinational enterprises (MNEs) and large-scale domestic groups with a combined group income of €750 million or more. GloBE rules are enforced in cases where the effective tax rate (ETR) of the MNEs and their constituent entities in a specific jurisdiction falls below 15%. In this case, a top-up tax is imposed to ensure that the ETR in each jurisdiction is brought up to 15%. The Directive outlines two mechanisms through which this top-up tax may be implemented: the income inclusion rule (IIR), which mandates a top-up tax on the ultimate parent entity (UPE) for all constituent entities with a jurisdictional ETR below 15%, and the undertaxed profit rule (UTPR), which serves as a safeguard when the UPE cannot be a subject to a qualifying IIR or if the parent entity is unable to collect top-up tax for other reasons. Additionally, the Directive offers the option to apply a qualified minimum domestic top-up tax (QMDTT), which is remitted to the Member State for the constituent entities situated within their jurisdiction in situations when those entities are subject to ETR within the respective jurisdiction that is lower than 15 %. This rule acts as a backstop for the UPE's overall liability for top-up tax. The Pillar Two and the designed GloBe rules constitute a mechanism that is expected to curtail tax competition in corporate income tax, concurrently ushering in the global minimum corporate tax rate of 15% and reducing the profit shifting and base erosion of the MNEs. This paper will present the theoretical framework governing the rules of Pillar Two, elucidate the core principles underpinning the Pillar Two Directive, and delve into the assessment of the minimum standard from the perspective of the Macedonian tax system. North Macedonia will be affected by the global minimum taxation initiative regardless of whether it responds with domestic implementation of GloBe rules or not. The internationally agreed standard gives the possibility for potential tax revenues for the hosting country of the in-scope MNEs on the one hand, and on the other for the participating jurisdiction where their constituent entities are located when the effective tax rate falls below 15 %.

Keywords: global minimum tax rate, GloBE rules, effective tax rate, income inclusion rule, undertaxed profit rule, qualified domestic top-up tax, top-up tax, BEPS, Macedonian tax system

* Marinela Stefanovska Petrovska, PhD Student, Ss. Cyril and Methodius University in Skopje, Iustinianus Primus Facultyy of Law,, bul. Goce Delcev 9b, 1000 Skopje, Republic of North Macedonia, e-mail: marinelastefanovska2309@gmail.com

I. INTRODUCTION

On October 8, 2021, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework on BEPS[1]) achieved consensus on a Statement outlining a Two-pillar solution to address tax challenges arising from the digitalization of the economy.[2] This landmark initiative was geared toward modernizing international tax regulations and practices and putting an end to tax practices of MNEs that allow them to shift profits to jurisdictions where they are subject to no or very low taxation. OECD put an effort into developing a set of international tax rules to ensure that MNEs pay a fair share of tax wherever they operate. The Pillar Two proposal seeks to encompass all incentive regimes that lower tax rates below 15%.[3] Accompanying the above-mentioned Statement is a comprehensive implementation plan that describes the work needed to implement the Two-pillar solution.

The global tax deal, as articulated in the Statement announced in October 2021, addresses today's tax challenges with two pillars that are distinct from each other.[4] The Two-pillar solution encompasses Pillar One and Pillar Two, which are set to oversee the global redistribution of profits for the largest and most lucrative MNEs, while also introducing a minimum tax rate of 15%. The two-pillar solution seeks to provide a multilateral solution to the practical problem of taxing highly digitalized businesses, for example the Silicon Six (Facebook, Apple, Amazon, Netflix, Google and Microsoft).[5]

Pillar One consists of two components (Amount A and Amount B). The two components of Pillar One can be thought of as reflecting the differing perspectives of the participants in the Inclusive Framework on what is wrong with the current rules of international tax.[6] Pillar One endeavors to achieve a fairer apportionment of taxing authority across nations concerning the profits generated by MNEs. Its objective is to streamline the allocation of a portion of MNE's profits to countries where they engage in sales and/or provide services, and where their customer base is located.

In contrast, Pillar Two represents a significant milestone in international tax agreements, aiming to institute a global minimum effective tax rate of 15% for MNEs with annual revenues reaching a minimum of 750,000,000 euros.

On December 14, 2021, Pillar Two Model Rules were developed by the OECD/G20 Inclusive Framework for BEPS[7], to meet the above-mentioned international tax policy objectives. The Pillar Two Model Rules were designed to facilitate the implementation of the minimum tax rate consistently and uniformly across all jurisdictions participating in the BEPS project.

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[1] BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. See more here for BEPS. As of 9 June 2023, 143 jurisdictions are part of Inclusive Framework on BEPS. See more here.

[2] OECD/G20 Base Erosion and Profit Shifting Project, 8 October 2021, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

[3] Suranjali Tandon, '*The Need for Global Minimum Tax: Assessing Pillar Two Reform*' [2022], Intertax, Volume 50, Issue 5.

[4] Reuven S. Avi-Yonah, Young Ran (Christine) Kim Karen Sam, '*A New Framework for Digital Taxation*' [2022], University of Michigan Law School, Volume 63, Number 2.

[5] Report by the South Centre Tax Initiative's Developing Country Expert Group, Irene Ovonji-Odida, Veronica Grondona, Samuel Victor Makwe, *Assessment of the two-pillar approach to address the tax challenges arising from the digitalization of the economy, An Outline of Positions Favourable to Developing Countries*, August 2020.

[6] Graeme S. Cooper, 'Building on the Rubble of Pillar One', [2021], Bulletin for International Taxation.

[7] OECD, 2021, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*: Inclusive Framework on BEPS, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.

A year later, the European Union demonstrated firm support for the global minimum tax reform by adopting the Pillar Two Directive.[8] The PillarTwo Directive was issued on 14 December 2022, implementing the OECD GloBE rules on a European level. The Pillar Two Directive aims to remove a substantial part of the advantages of shifting profits to jurisdictions with no or very low taxation. [9] The global minimum tax reform will level the playing field for businesses worldwide and will allow jurisdictions to better protect their tax bases.
Globalization has opened new ways for corporations to reduce their tax bills. As countries compete to attract investments, firms can move their activity to places that offer low tax rates. International tax competition and profit shifting have led to a large decline in effective corporate tax rates.[10]

II. OVERVIEW OF PILLAR TWO DIRECTIVE

This directive aims to establish a global minimum level of taxation for MNEs and large-scale domestic groups within the Union. The rationale behind the adoption of this Directive, as outlined in the preamble, is to prevent fragmentation within the internal market due to closely interlinked economies, emphasizing the critical need for a coherent and coordinated implementation of the global minimum tax reform.
The Directive set forth a unified approach to implementing minimum effective taxation on the European Union stage, thus expecting to reduce tax competition among countries in the area of corporate taxation. This initiative will neutralize the prevailing trend of lowering corporate tax rates, effectively eliminating the incentive for MNEs to shift profits toward jurisdictions with lower tax rates. Consequently, a level playing field will be established, ensuring fairness in the international tax landscape. At the same time, domestic tax bases will be safeguarded, enhancing the overall integrity of the taxation system.
The Directive came into force in 2022, obliging the member states to transpose it into their national legislation by the end of 2023. This means that laws, regulations, and administrative provisions necessary to comply with the Pillar Two Directive must be adopted by member states by the end of 31 December 2023. In the member states the Pillar Two Directive shall be effective as of January 1, 2024. Currently, member states are in the process of drafting their domestic tax legislation for the transposition of the Directive, with some even publishing draft legislation for consultation with other stakeholders.
Article 50 of the PillarTwo Directive gives a possibility for delayed application of the GloBe rules i.e. Member States in which no more than twelve UPEs of groups within the scope of this Directive are located may elect not to apply the IIR and the UTPR for six consecutive fiscal years beginning from 31 December 2023.[11]
The introduction of the global minimum tax rate within the Union is intended to join the efforts, establishing a unified framework to ensure consistent implementation across the member countries' internal economies. The Directive mirrors the content and structure of the Pillar Two Model Rules, aiming to achieve the highest degree of alignment with the global minimum rate rules at the level of the European Union. It applies to entities residing in member state countries, as well as non-resident entities affiliated with a parent entity situated in a member state.

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[8] Council Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (Pillar Two Directive) [2022] OJ L 328, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022L2523.
[9] Pillar Two Directive [2022] OJ L 328, preamble, par. 2.
[10] Clausing, Kimberly A. and Saez, Emmanuel and Zucman, Gabriel, Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals [2021] UCLA School of Law, Law-Econ Research Paper No. 20-12.
[11] Pillar Two Directive [2022] OJ L 328, article 50.

Furthermore, the Pillar Two Directive, unlike the work developed within the OECD/G20 framework, extends its application to large-scale domestic groups, with the overarching goal of preventing discrimination in both cross-border and domestic operations, while protecting fundamental freedoms.

Given that the Directive's objective is to establish a global minimum level of taxation in the Union, aligning with the common approach outlined in the OECD Pillar Two Model Rules, it is essential that the implementation thereof is integrated at the level of the Union. This ensures the prevention of fragmentation in the internal market during the process of implementation by the member states. Therefore, the principles of subsidiarity and proportionality are particularly complied with by the introduction of the global minimum rate of corporate income tax within the Union. Given that the objective of the Pillar Two Directive cannot be achieved by Member States acting unilaterally, the Union adopts measures by the principle of subsidiarity, as set out in Article 5 of the Treaty on European Union. Following the principle of proportionality, the Pillar Two Directive does not go beyond what is necessary to achieve this objective.[12]

Dealing with the corporate tax implications of digitalization and new business models is highly contentious, politically and intellectually.[13]

However, this paper attempts to explore the policy rationale and the mechanics behind the rules constituting the GloBE package and the global minimum tax.

The global minimum tax is meant to benefit the developing countries. This gain is expected to be twofold: First, the jurisdictions will increase the tax rates or introduce a QDMTT to ensure that the insufficiently taxed profits are taxed at the minimum tax rate. Failing this, the jurisdiction of the parent entity will collect the top-up tax, or it can be collected as a backstop by other jurisdiction(s) with subsidiaries. Second, Pillar Two is expected to reduce the incentive for MNEs to shift profits to no or low-tax jurisdictions. However, the rules are complicated and countries—particularly low-capacity ones—will need to consider implementation options as well as estimate potential revenue impacts.[14]

A minimum tax rate reduces the incentive for taxpayers to engage in profit shifting and establishes a fair ground for tax competition among jurisdictions. With respect to the latter, the GloBE proposal posits that global action is needed to stop a harmful race to the bottom on corporate taxes, which risks shifting the burden of taxes onto less mobile bases and may pose a particular risk for developing countries with small economies.[15]

i) System of a minimum level of corporate taxation

The Pillar II contains a complex set of overlapping and interconnected rules.[16] The Pillar Two Directive establishes common measures for the minimum effective taxation of MNE groups and large-scale domestic groups in the form of an **income inclusion rule (IIR)** by which a parent entity of an MNE group or a large-scale domestic group computes and pays its allocable share of top-up tax in respect of the low-taxed constituent entities of the group and an **undertaxed profit rule (UTPR)** by which a constituent entity of an MNE group has an

[12] Pillar Two Directive [2022] OJ L 328, preamble, para. 33.

[13] IMF (International Monetary Fund), *Corporate Taxation in the Global Economy*, [2019], Washington.

[14] David O'Sullivan, Ana Cebreiro Gómez, *The Global Minimum Tax, From Agreement to Implementation - Policy Considerations, Implementation Options, and Next Steps*, The World Bank, 2022.

[15] Vikram Chand, 'International Tax Competition in light of Pillar II of the OECD project on Digitalization', (Kluwer International Tax Blog, 14 May 2020) https://kluwertaxblog.com/2020/05/14/international-tax-competition-in-light-of-pillar-ii-of-the-oecd-project-on-digitalization/ accessed at 12.01.2024.

[16] Stewart Lipeles, John D. McDonald, Emily Berg, Ethan Kroll, and Julia Skubis Weber, 'Understanding the Real-World Consequences of Pillar II', [2022], International Tax Watch, https://www.bakermckenzie.com/-/media/files/people/kroll-ethan/ethan-kroll--taxes--september-2022.pdf?sc_lang=en&hash=5FBF5606092AFBA1A7C346FF67887ED0.

additional cash tax expense equal to its share of top-up tax that was not charged under the IIR in respect of the low-taxed constituent entities of the group.[17] The minimum effective taxation will be achieved based on those two interlocked rules (the IIR and the UTPR), commonly referred to as **GloBe rules**, which collectively ensure that MNEs are subject to a minimum corporate tax rate of 15%.
The GloBe rules introduce an additional amount of tax (a "top-up tax") which is collected each time that the effective tax rate of an MNE in a given jurisdiction is below 15%, i.e. the jurisdiction is considered to be low-taxed. [18]
Additionally, to allow Member States to benefit from the top-up tax revenues collected on the low-taxed constituent entities located in their territory, Member States should be able to elect to apply a **qualified domestic top-up tax system** (QDMTT)[19]. Through this rule, member states are exercising their right to tax source income that arose on their territory.
A crucial component of Pillar Two is the **subject to tax rule (STTR)**, a treaty-based rule that empowers source jurisdictions to levy restricted source taxation on intra-group covered income (such as interest, royalties, etc.) that is subject to tax below a minimum rate of 9%. STTR holds exceptional significance for developing members of the Inclusive Framework, as it safeguards their tax base and reinstates the taxing authority over that income to the source state in cases where such authority had been relinquished under the provisions of double tax treaties. This is different from the GloBE rules in that, instead of net income calculated annually, it applies as a withholding tax on each individual payment where the nominal rate is below 9% for a defined set of categories.[20]
The Pillar Two Directive applies to constituent entities situated within the Union, affiliated with either MNEs or domestic large-scale groups, meeting the criteria of an annual threshold of at least 750,000,000 EUR in its UPE's consolidated financial statements in at least 2 of the 4 fiscal years immediately preceding the tested fiscal year.[21] This threshold aligns with the one established in Council Directive 2011/16/EU[22], which relates to the filing of country-by-country reports.
A constituent entity is defined as an entity that is either a part of an MNE of a large-scale domestic group or any permanent establishment of a main entity.[23]
The calculation of the top-up tax is based on a fiscal year, and the 15% rate is globally recognized as an agreed-upon standard, reflecting a balance in corporate tax rates on global level.
To facilitate the efficient implementation of the Pillar Two Directive by member states, it is crucial to ensure a seamless flow of information from the MNEs to the tax administrations of the countries where the constituent entities are located. In this respect, while the primary responsibility to file a tax return for a top-up tax lies within the constituent entity in its jurisdiction, this obligation may be transferred to another constituent entity within the group after the appointment of the MNE. The MNE is responsible for calculating the effective tax rate of his constituent entities, while the tax obligation for paying the top-up tax is determined based on the information provided in the tax return form. Its accuracy is assessed according to the domestic rules governing tax return submission. In this way, the Pillar Two Directive enables access to comprehensive tax information for entities in participating jurisdictions, and

[17] Pillar Two Directive [2022] OJ L 328, art. 1(1).
[18] Pillar Two Directive [2022] OJ L 328, preamble, para. 5.
[19] Pillar Two Directive [2022] OJ L 3280, preamble, para. 13.
[20] Abdul Muheet Chowdhary and Sébastien Babou Diasso, 'Taxing Big Tech: Policy Options for Developing Countries', *Tax Cooperation Policy Brief, South Centre*, (December 2022).
[21] Pillar Two Directive [2022] OJ L 328, art. 2(1).
[22] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L 64.
[23] Pillar Two Directive [2022] OJ L 328, art. 3.

MNEs are obliged to provide detailed information on their profits and effective tax rates in each jurisdiction where they have constituent entities.
The introduction of the global minimum tax rate through the Directive raises the question of whether the European Union is operating within the boundaries of its competencies as stipulated in the primary legislation i.e. the founding treaties. This is particularly pertinent considering that the directives constitute a secondary legislation in the field of direct taxation. Therefore, a careful examination of the EU's authority in this matter, as delineated by primary legislation, is warranted to ascertain the legality and appropriateness of implementing the global minimum rate at the level of the Union.. In the past, most direct tax directives were adopted based on the internal market competence of Art. 115 Treaty of functioning of European Union.[24]
Concerning the competence to enact the global minimum rate of corporate tax, the Union, as outlined earlier, invokes Article 5 of the Treaty on the European Union. This article refers to the principles of subsidiarity and proportionality, emphasizing that in areas which do not exclusively fall within the competence of the Union, the Union should only act if the proposed actions cannot be fully achieved by the Member States, whether at the central or regional level and if a specific objective of the given action can be better attained at the Union level. The principle of proportionality further stipulates that the content and form of Union action should not exceed what is necessary to accomplish the goals of the Agreements.[25]

i. Income inclusion rule (IIR)

The IIR is a primary rule through which global minimum tax will be introduced in the home countries of MNEs by applying a top-up tax for the **ultimate parent entity (UPE).**
A UPE is considered an entity that holds a direct or indirectly controlling stake in another entity without being subject to control from another entity. This UPE, regarding his constituent entity situated in a member state or outside of the European Union, is obliged to calculate and remit a top-up tax for the fiscal year for the low-tax constituent entities located in jurisdictions other than its own.
The IIR rule also applies in cases where the **UPE is situated in a country classified as a low-tax jurisdiction**. In such instances, the UPE must compute top-up tax for itself, as well as for low-tax constituent entities of the group located within the same member state.
Additionally, the IIR rule extends to **an intermediate parent entity** situated in a member state, managed by an ultimate parent entity located in a third-country jurisdiction, or an ultimate parent entity designated as an excluded entity. In this scenario, the intermediate parent entity is responsible for calculating and paying the top-up tax for the fiscal year on behalf of the low-tax constituent entities located in other jurisdictions or those not subject to any jurisdiction. These entities, positioned hierarchically below the ultimate parent entity and situated within the Union, are obligated to apply the IIR rule, in proportion to their share in the top-up tax.
Furthermore, the IIR rule applies to **partially owned parent entities** concerning constituent entities originating from low-tax jurisdictions. This means that even partially owned parent entities are subject to the provisions of the IIR rule. Irrespective of whether the ultimate parent entity is located in a jurisdiction that implements the IIR rule, partially owned entities within the Union, which have more than 20% interest holders held by shareholders external to the group, will be subject to the IIR rule. The partially-owned parent entity means a constituent entity that owns, directly or indirectly, an ownership interest in another constituent entity of the same MNE group or large-scale domestic group, and for which more than 20 % of the ownership interest in its profits is held, directly or indirectly, by one or several persons that are

[24] Becker, Johannes and Englisch, Joachim, Implementing an international effective minimum tax in the EU (June 23, 2021). Available at SSRN: https://ssrn.com/abstract=3892160 or http://dx.doi.org/10.2139/ssrn.3892160.
[25] Consolidated version of The Treaty on European Union [2021] OJ C 326/13.

not constituent entities of that MNE group or large-scale domestic group and that does not qualify as an ultimate parent entity, a permanent establishment or an investment entity.[26]
The summary of the above-mentioned is that the parent entity of an MNE situated in one of the Member States is mandated to implement the IIR rule for its share of additional tax on any low-tax entity within the group. This applies regardless of whether the entity is located within or outside the Union i.e., the ultimate parent entity bears the responsibility of calculating and remitting the top-up tax for the low-taxed constituent entities that are part of the MNE.

ii. Undertaxed profit rule (UTPR)

If, for any reason, the country where the MNE is incorporated fails to implement the IIR or the GloBE rules, the UTPR rule comes into place and ensures payment of the minimum tax through denial of deduction or similar mechanism in all countries where MNE has presence e.g. when an MNE is located in a non-EU country where the global minimum rate is not imposed.
Under the UTPR, a constituent entity of the MNE is liable for an additional cash tax expense equal to the amount of the top-up tax that was not collected under the IIR rule for the low-taxed constituent entities within the group. In essence, the UTPR serves as a backstop mechanism to ensure that any tax shortfall resulting from low-taxed entities within the group is addressed by imposing an additional tax expense on the constituent entity. This helps maintain the effectiveness of the overall minimum tax framework.
In cases where the ultimate parent entity is situated in a third country where a qualified IIR rule is in place, constituent entities of the MNE should apply the UTPR rule to entities located in that third country. This applies when the jurisdiction is deemed low-taxed based on the effective tax rate of all constituent entities within that jurisdiction, including the ultimate parent entity.
The UTPR rule acts as a protective mechanism for the IIR rule, by redistributing any remaining amount of top-up tax if the entire amount of additional tax that applies to low-taxed entities cannot be collected from the parent entities through the application of the IIR rule.
According to the Directive, a transition period concerning the implementation of the UTPR is granted to allow third-country jurisdictions to apply the IIR in the first phase of implementation of the OECD Model Rules. The UTPR will apply for fiscal years starting on or after 31 December 2024.[27]

iii. Qualified domestic top-up tax

Both the GloBE rules under the Two Pillar Solution and the Pillar Two Directive allow for the potential introduction of a qualified domestic minimum top-up tax (QDMTT) by jurisdictions based on the GloBE mechanics, which eliminates any liability under GloBE rules, thereby safeguarding a jurisdiction's primary right of taxation over its income. This part holds particular significance for the Republic of North Macedonia, given its status as a developing country and a country that can benefit from source taxation. This rule applies first in the rule order concerning the GloBe rules, i.e. it stops the application of IIR and UTPR.
Introducing the top-up tax gives an opportunity for increasing tax revenues in countries where the effective tax rate, with the application of the Pillar Two Directive, falls below 15% for constituent entities within the MNE group. To enable member states to benefit from top-up tax revenues related to low-taxed constituent entities within their jurisdiction, they are granted the authority to incorporate the QDMTT rule into their domestic legislation. With the adoption of this rule, member states have the prerogative to collect the top-up tax in that member state. The calculation of the tax base according to the QMDTT i.e. qualified income or loss for the

[26] Pillar Two Directive [2022] OJ L 328, art. 3(22).
[27] Pillar Two Directive [2022] OJ L 328, preamble par.29.

constituent entities mirrors the methodology used to determine the top-up tax, as stipulated in the Directive, ensuring consistency in the application of the rule.
The implementation of the qualified domestic additional tax is at the discretion of the member states, allowing them to decide how to incorporate it into their domestic legislation. Pillar Two Directive is a binding legislation for the member states, , but they have the freedom to choose the form and methods to fulfil this obligation.

iv. Qualifying income or loss, effective tax rate and covered tax

The tax base for calculating the top-up tax, the effective tax rate, and the covered taxes are categories that are boarder than their scope according to the old-school corporate income tax system.
The Directive outlines a specific methodology for calculation of the effective tax rate, which is assessed at the jurisdictional level. This calculation is based on a defined set of rules for determining the tax base, referred to as "qualifying income or loss," as well as the taxes paid, known as "covered taxes." The initial step in calculating the effective tax rate is based on the financial accounts used for consolidation purposes. These accounts then undergo a series of adjustments, including reconciling time discrepancies, to mitigate any distortions between jurisdictions. ERT which is calculated on a jurisdictional level using a common tax base and common definition of covered taxes is the foundation of the global minimum tax rate that ensures a level playing field and puts a floor on tax competition. Importantly, Pillar Two rules rely primarily on financial (i.e., “book”) accounting data rather than tax accounting data. These book/tax differences mean that the Pillar Two rules account for timing differences by focusing on deferred tax assets which can include net operating losses and capital allowances.[28]
In practical terms, if ETR in a jurisdiction falls below 15 %, Pillar Two rules are triggered, and top-up tax must be paid by either the ultimate parent entity (under IIR rule), or by its constituent entity (under QDMTT). The calculations will be made by the ultimate parent entity of the group unless the group designates a different entity for this task.
The tax base for determining qualified income or loss is established through adjustments to the net profit or loss derived from financial accounting, under acceptable or approved financial accounting standards of the ultimate parent entity. This calculation can also be made based on other financial accounting standards, subject to conditions specified in the Directive. The qualified profit or loss is further adjusted in the manner prescribed in the Directive, including considerations for net tax costs, excluded dividends, and other specified adjustments.
As for "covered taxes", they refer to taxes as recorded in the financial accounts concerning the income or profit of constituent entities. This encompasses taxes on distributed profits, taxes imposed in lieu of income tax, as well as taxes imposed based on retained earnings. The covered taxes undergo adjustments under the procedures outlined in the Directive. This involves modifying the current tax expense, as determined in the financial accounting net profit or loss, concerning covered taxes for the fiscal year, adjusted for both additions and reductions in covered taxes, along with the total deferred tax adjustment, as determined in the Directive.

v. Excluded entities and carve-outs

Notably, the Directive does not extend to government entities, international organizations, pension funds, investment funds acting as ultimate parent entities, as well as non-profit organizations, including non-profit public health entities. The rationale here being that these types of entities are subject to domestic special tax regimes.

[28] Daniel Bunn, Sean Bray, 'The Latest on the Global Tax Agreement', (June 13, 2023), https://taxfoundation.org/blog/global-tax-agreement/, Accessed at: 12.01.2024.

The Directive incorporates specific provisions to address situations where the risks of erosion of the tax base and profit shifting are minimized. It introduces a "**substance-based income exclusion rule**" based on factors like employee costs and tangible asset value within a particular jurisdiction. This rule is designed to distinguish situations where MNEs or large-scale domestic groups engage in economic activities that necessitate a substantial presence in low-tax jurisdictions, where the risks of tax base erosion and profit shifting are notably reduced. Under this rule, companies will be able to exclude from the top-up tax an amount of income that is at 8 % of the value of tangible assets and 10 % of payroll.
A significant exception is the "**de minimis exclusion"** for MNEs or large-scale domestic groups with an average income below EUR 10,000,000 and an average qualified income or loss below EUR 1,000,000 in a jurisdiction. This exclusion is in place to strike a balance between the application of the global minimum rate and the administrative burden on jurisdictions. Entities meeting this exception will not be required to pay top-up tax if the effective tax rate is below the minimum effective tax rate of 15% in that jurisdiction.
The third exception refers to **MNEs with constituent entities in fewer than six jurisdictions**. For a five-year transition period, the less-taxed domestic activities of these MNEs will be exempt from the application of the global minimum rate rules. To maintain fairness at the domestic level, the income of large-scale domestic groups is also excluded during this transition period. The third exception grants member states the choice not to apply the rules of the global minimum tax rate if multiple MNEs are situated within their jurisdiction and only a small number of constituent entities of MNEs are located there. This option is provided to prevent an undue burden on the tax administrations of these member countries. They have the discretion not to implement the global minimum tax rate rules for a specified period, which they will communicate to the European Commission. However, these Member States must still facilitate the effective application of the Directive and the global minimum rate system for MNEs and domestic entities of large exchanges within the Union.
The fourth exception concerns the **maritime sector**, as income from this sector in most member countries is subject to specific taxation rules.

III. CHALLENGES FOR THE REPUBLIC OF NORTH MACEDONIA

As Morse argues, the mission of the BEPS project was “to save the corporate income tax”.[29] For developing countries, generally, net capital importing jurisdictions, saving corporate income tax seems relevant.[30] Indeed, the corporate income tax can be seen as “an instrument whereby source countries exercise their established right to tax all corporate income originating within their borders, including the income accruing to foreign-owned corporations operating in the country”.[31]

Concerning the global minimum tax deal, what would be the most optimal move for the Republic of North Macedonia: choosing to opt in or opting out?

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[29] Morse, Susan, 'Value Creation: A Standard in Search of a Process' [2018] Bulletin for International Taxation 72 (4/5), https://doi.org/10.59403/3dxa2wh.
[30] Sacchi, Andrea Riccardi, Implementing a (Global?) Minimum Corporate Income Tax: An Assessment from the Perspective of Developing Countries (August 6, 2020). Copenhagen Business School, CBS LAW Research Paper No. 20-15, Available at SSRN: https://ssrn.com/abstract=3668096.
[31] OECD. 1991. Taxing Profits in a Global Economy. Domestic and International Issues (Working Party No 2 on Tax Analysis and Tax Statistics of the Committee of Fiscal Affairs). Paris: OECD Publications.

North Macedonia is a candidate country for the EU and member of the Inclusive Framework since 2018 and as such should align its tax legislation to the international tax standards. The Republic of North Macedonia will be obliged to transpose the GloBE rules as stipulated in the Pillar Two Directive. Even before EU accession, North Macedonia has the option to implement the QDMTT into its domestic legislation. This would enable the collection of top-up tax from constituent entities of MNEs located within its territory, acting as a source state. However, implementing QDMTT has some challenges for the country, particularly concerning the existing nominal corporate tax rate of 10%. The increase in tax revenues resulting from QDMTT may positively impact the state's fiscal position. Yet, it's crucial to consider the potential drawbacks, particularly the additional compliance costs imposed on businesses, which may be viewed as a regressive step.

The corporate tax framework in the Republic of North Macedonia has historically featured a tax base with various incentives, coupled with a comparatively low corporate income tax rate. The above-mentioned leads us to the conclusion that the global minimum tax will affect the Republic of North Macedonia, irrespective of whether we enact domestic measures in response. Given its status as a developing nation, the adoption of GloBE rules opens up the possibility of generating additional tax revenues from the constituent entities situated in North Macedonia that form part of the in-scope MNEs. This potential arises when the effective tax rate of a specific entity at the jurisdictional level falls below 15%. With a nominal corporate tax rate of 10 % along with various tax incentives, the ETR in North Macedonia there is a strong possibility that it will fall below 15 %. There is a significant number of subsidiaries under our jurisdiction, that are part of the MNE group located in an EU country, which will fall under the scope of GloBe rules. If the parent company of the subsidiary is subject to the IIR rule, and the ETR of the subsidiary located in our territory is under 15 %, the parent entity will be liable to pay top–up tax in its home country i.e. North Macedonia in case there in a domestic QDMTT. The domestic minimum top-up tax must be in line with GloBE rules. The effect will be partially mitigated by implementing a carve-out rule for income generated from actual operations for subsidiaries operating within our jurisdiction.

This paper analyses the potential impact of GloBE rules on North Macedonia tax revenues based on the available data. For the calculation, the list of the 200 most successful companies published by Capital magazine for 2022/2023 was used, which contains data on companies' total revenues in our country.[32] In further analysis, it is determined which of the companies contained in the list are part of an MNE. Based on the annual financial reports and other financial information for MNEs for 2022, the entities that are part of an MNE that has consolidated revenues on a global level of over 750 million euros were determined. In further analysis, and based on the list contained in the above-mentioned magazine, it is determined which of the companies have revenues in the Republic of North Macedonia over 10,000,000 euros, as one of the eliminatory criteria for applying the GloBE rules.

Based on the research, it was determined that about 50 companies that are tax residents in the Republic of North Macedonia are part of MNE that fulfill the conditions for applying the GloBE rules. These Macedonian companies are in connection with GloBE rules and it is expected that they will be subject to the global minimum effective tax rate based on IIR or UDPR. This is in a scenario in which the Republic of North Macedonia remains status quo towards the GloBE rules.

The analysis gives us an insight that a higher percentage of Macedonian tax residents that could be subject to GloBE are from the automotive industry, as well as companies that are involved in the energy sector. (Table 1) Also, the analysis shows that the companies that are tax residents

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[32] Бизнис магазин Капитал, Special Edition, *Најголеми и најуспешни компании 2022/23 година*, 29 декември 2023.

in the Republic of North Macedonia and that are part of MNEs mostly come from Austria and Germany, both of them EU member states, that are obliged to implement GloBE rules in their domestic tax system. (Table 2)

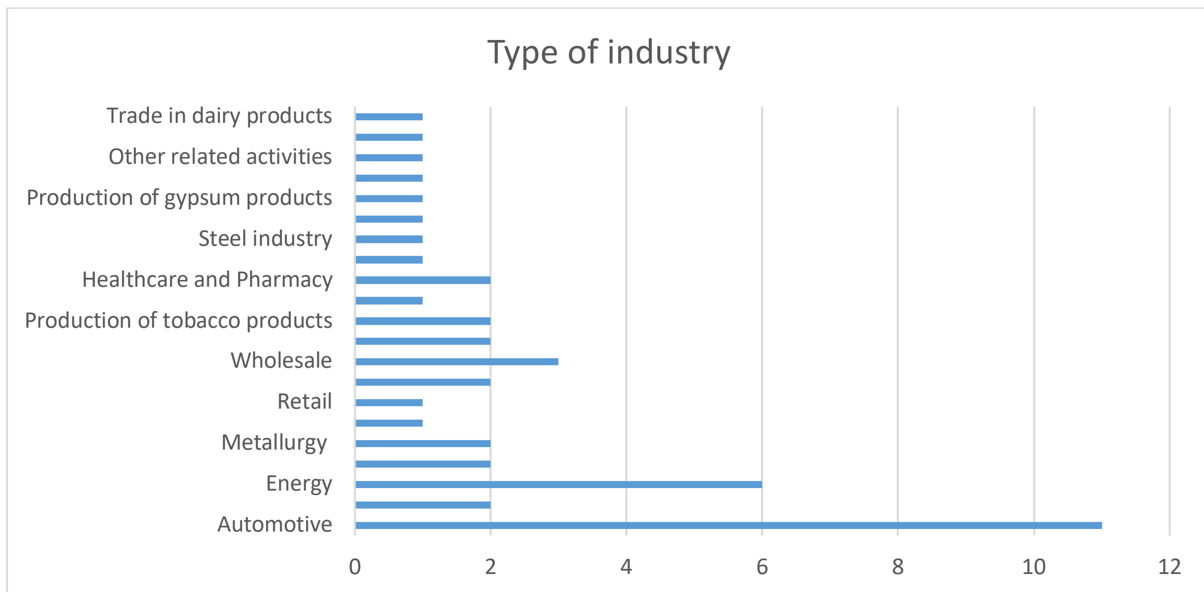

Table 1: Type of industries of Macedonian tax residents that are part of MNEs which are in-scope of GloBE rules.

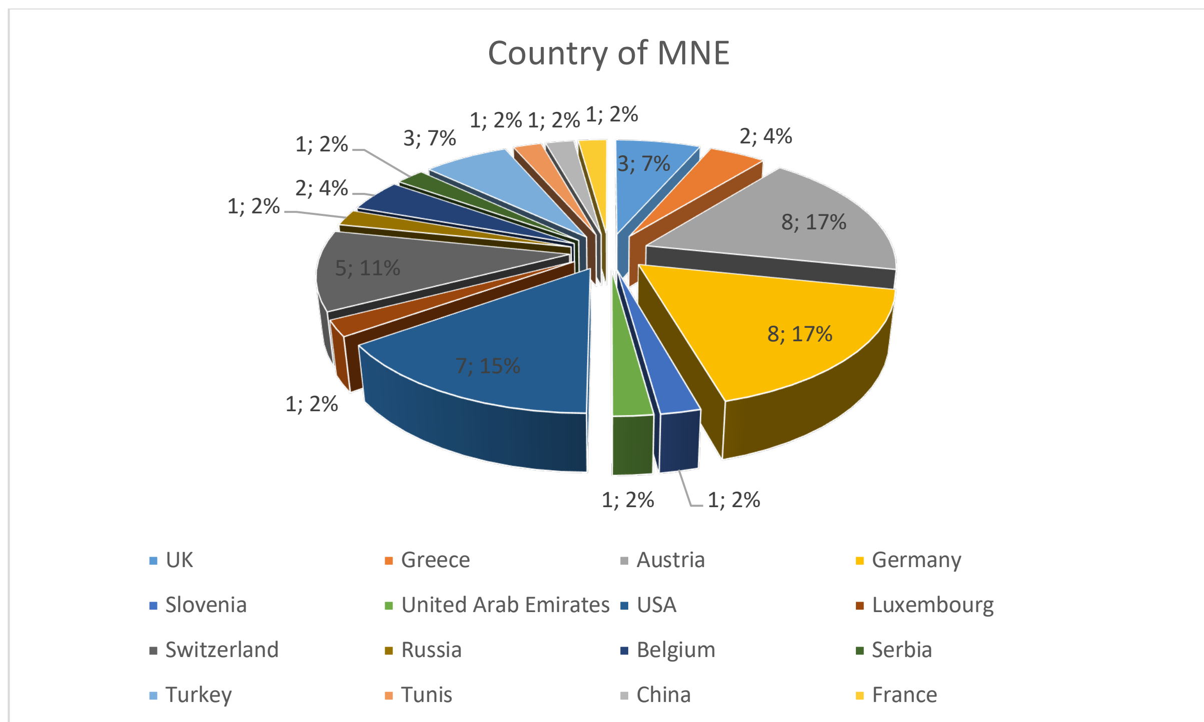

Table 2: Country of origin of MNEs in which Macedonian tax residents are part of the group

North Macedonia has implemented a series of tax measures aimed at attracting foreign direct investments. One such initiative includes the provision of tax reliefs, classified as state aid, specifically in the form of corporate income tax holidays spanning 10 years. Presumably, the introduction of GloBE rules will have an impact on these tax measures, potentially affecting

their efficacy. This is because tax incentives (especially income-based tax incentives) will likely lower the ERT of that subsidiary and this amount, indirectly will be transferred to another country as a top-up tax that will be paid in the resident country of the parent entity. These tax incentives were designed to attract investors but with the implementation of a global minimum tax rate, the benefits arising from them will be used/transferred to a specific country instead of the investor in the form of additional revenues from the top-up tax. This will ultimately impact the effectiveness of tax incentives.

In light of this, the Republic of North Macedonia must carefully assess the legislative strategy which will be adopted in executing the domestic tax system and estimate its broader implications on a domestic scale. This thorough examination is crucial in ensuring that the tax measures continue to serve their intended purpose amidst the evolving global tax regulations.

Given that the GloBE rules are expected to offset some of the benefits for investors of low effective tax rates at source, North Macedonia should reassess its domestic tax incentives because tax incentives are likely to lead to ETRs under 15%. For the Macedonian tax system, this international tax reform can trigger the right momentum to review and reform the corporate tax regime but firstly we must understand the challenges and opportunities evolving from GloBE rules.

As a general conclusion, North Macedonia would need to conduct a comprehensive assessment weighing the benefits of potential increased tax revenues against the potential drawbacks of added compliance costs for the tax administration and the taxpayers.

Estimating the impact of GloBE rules on domestic revenues for the Republic of North Macedonia can, to some extent, be done through country-by-country reports. However, for North Macedonia, this exercise is not currently possible as we have not yet incorporated this type of reporting into our domestic legislation. Additionally, any decision should align with the country's broader economic and development goals, taking into account the implications for its European integration aspirations. This would involve a thorough evaluation of the overall impact on the economy, businesses, and the fiscal landscape.

In determining the most optimal scenario, North Macedonia would need to conduct a comprehensive assessment weighing the benefits of increased tax revenues against the potential drawbacks of added compliance costs.

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