

OECD/G20 Base Erosion and Profit Shifting Project

**Tax Challenges Arising from the  
Digitalisation of the Economy –  
Administrative Guidance on the Global Anti-  
Base Erosion Model Rules (Pillar Two)**

Inclusive Framework on BEPS

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

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# Abbreviations and acronyms

<b>CbCR</b>	Country-by-Country Reporting
<b>CFC</b>	Controlled Foreign Company
<b>CIT</b>	Corporate Income Tax
<b>ETR</b>	Effective Tax Rate
<b>FANIL</b>	Financial Accounting Net Income or Loss
<b>GAAP</b>	Generally Accepted Accounting Principles
<b>GILTI</b>	Global Intangible Low-Taxed Income
<b>GloBE</b>	Global Anti-Base Erosion
<b>IFRS</b>	International Financial Reporting Standards
<b>IIR</b>	Income Inclusion Rule
<b>Inclusive Framework</b>	OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting
<b>JV</b>	Joint Venture
<b>LTCE</b>	Low-Taxed Constituent Entity
<b>MNE</b>	Multinational Enterprise
<b>MOCE</b>	Minority Owned Constituent Entity
<b>OCI</b>	Other Comprehensive Income
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>PE</b>	Permanent Establishment
<b>POPE</b>	Partially-Owned Parent Entity
<b>QDMTT</b>	Qualified Domestic Minimum Top-up Tax
<b>QRTC</b>	Qualified Refundable Tax Credit
<b>UPE</b>	Ultimate Parent Entity

# Executive summary

## Background

1. In October 2021 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework) agreed a two-pillar solution to reform the international tax framework in response to the challenges of digitalisation of the economy. As part of the October Statement, Inclusive Framework members agreed to a co-ordinated system of Global anti-Base Erosion (GloBE) rules that are designed to ensure large multinational enterprises pay a minimum level of tax on the income arising in each jurisdiction where they operate. In the October Statement, it was agreed that the *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (the “GloBE Model Rules”) (OECD, 2021<sup>[1]</sup>) (agreed by the Inclusive Framework and published in December 2021) and the *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), First Edition: Inclusive Framework on BEPS (the “Commentary”)* (OECD, 2022<sup>[2]</sup>) (agreed by the Inclusive Framework and published in March 2022) would have the status of a common approach. Under this common approach, jurisdictions are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the agreed outcomes. The common approach also means that Inclusive Framework members accept the application of the GloBE rules applied by other members, including agreement as to rule order and the application of any agreed safe harbours.

2. The GloBE Rules were approved and released by the Inclusive Framework on 20 December 2021. The GloBE Rules consist of an interlocking and coordinated system of rules which are designed to be implemented into the domestic law of each jurisdiction and operate together to ensure large MNE Groups are subject to a minimum effective tax rate of 15% on any excess profits arising in each jurisdiction where they operate. Consistent with the intention of the Inclusive Framework, the GloBE Rules (including the IIR and UTPR) are designed so that the imposition of top-up tax in accordance with those rules will be compatible with the provisions of the United Nations Model Double Taxation Convention between Developed and Developing Countries (the “UN Model Double Tax Convention”) (UN, 2021<sup>[3]</sup>) and the *Model Tax Convention on Income and on Capital: Condensed Version 2017*, (the “OECD Model Tax Convention”) (OECD, 2017<sup>[3]</sup>).

3. The Commentary to the GloBE Model Rules was approved and released by the Inclusive Framework on 14 March 2022, together with a set of detailed examples that illustrate the application of the rules to certain fact patterns. The Commentary clarifies the interpretation and operation of the provisions in the GloBE Model Rules and includes some examples illustrating how the rules apply to specific fact patterns. The Commentary is intended to promote a consistent and common interpretation of the GloBE Model Rules in order to provide certainty for MNE Groups and to facilitate coordinated outcomes under the rules. Although the Commentary is detailed and comprehensive, it does not provide guidance on every aspect of the GloBE Model Rules and, in certain cases, the Commentary specifically identifies issues that will require further consideration and development as part of the GloBE Implementation Framework.

## Agreed Administrative Guidance

4. Against this background, Inclusive Framework members have agreed, under Article 8.3 of the GloBE Rules, that an implementing jurisdiction will “apply the GloBE Rules consistent with Agreed Administrative Guidance, subject to any requirements of domestic law.” Agreed Administrative Guidance is defined in Article 10.1 as guidance issued by the Inclusive Framework on either “the interpretation or administration of the GloBE Rules”. Administrative Guidance is expected to play an important role in promoting certainty under the GloBE Rules by clarifying the interpretation of the GloBE Rules and by providing guidance to tax administrations on how to apply the GloBE Rules. Because Agreed Administrative Guidance will also reflect the Inclusive Framework’s common understanding of how the GloBE Rules should be interpreted and applied, such guidance will play an important role in ensuring coordinated outcomes under the GloBE Rules and providing a level playing field for MNE Groups.

5. In many cases, the nature and type of guidance that may be required will not be known until Inclusive Framework members have begun the implementation process and the need for further guidance on the application of the rules may only emerge after the rules are in effect. Accordingly, administrative guidance will be needed on an ongoing basis to address those issues as they arise.

6. The definition of Agreed Administrative Guidance in Article 10.1 of the GloBE Rules envisions that the Inclusive Framework may issue guidance on both the interpretation and the operation of the rules. Interpretive guidance provides for consistent and common interpretation of the GloBE Rules that will provide certainty for MNE Groups and facilitate coordinated and transparent outcomes under the rules. It supplements or replaces paragraphs in the Commentary or explains how to apply the language of the rules to particular fact patterns. Operational guidance sets out administrative procedures tax administrations may use to apply the rules and may include guidance on the use of administrative simplifications that result in equivalent outcomes as those provided under the GloBE Rules while avoiding undue compliance and administration costs.

## 2023 Administrative Guidance

7. The items of Administrative Guidance set out in this document address a wide range of issues that Inclusive Framework members have identified as the issues most in need of immediate clarification and simplification for stakeholders. The Administrative Guidance will be incorporated into a revised version of the Commentary that will be released later this year (and replaces the original version of the Commentary issued in March 2022). The examples included in the Administrative Guidance will be incorporated into a revised set of detailed examples that will be released alongside the revised Commentary. The Inclusive Framework will continue to consider Administrative Guidance priorities on an ongoing basis, where more clarity is required, with the aim of releasing guidance throughout the year as soon as it is agreed so that the Inclusive Framework members can meet their implementation schedule.

# 1 Scope

## 1.1. Rebasing monetary thresholds in the GloBE Rules [AG22.04.T18]

### 1.1.1. Introduction

1. The GloBE Rules contain several monetary thresholds expressed in Euros (EUR). While many jurisdictions may implement the GloBE Rules based on these amounts denominated in EUR, some jurisdictions may choose to implement the rules with these amounts in denominated in local currency. To ensure a coordinated application of the rules and consistency across jurisdictions, harmonised foreign exchange translation rules in relation to these thresholds are required.

2. This guidance does not seek to deal with the foreign currency translation of amounts other than for the purposes of rebasing the relevant thresholds on a yearly basis in the domestic law of an implementing jurisdiction. Guidance addressing foreign currency translation for the purposes of taxpayers undertaking calculations as part of compliance with the GloBE Rules will be dealt with in subsequent guidance.

### 1.1.2. Issues to be considered

3. Where monetary thresholds in the GloBE Rules are expressed in domestic legislation in a non-EUR denominated currency, the Commentary provides that these thresholds will need to be rebased annually to ensure a co-ordinated and consistent application and scope of the GloBE Rules across jurisdictions.

4. The GloBE Rules contain the following monetary thresholds:
- a. Articles 1.1, 1.2, and 6.1.1 – which refer to revenue included in the Consolidated Financial Statements equal to or greater than EUR 750 million.
  - b. Article 3.1.3 – which refers to permanent differences in excess of EUR 1 million.
  - c. Articles 4.6.1 and 4.6.4 – which refer to an aggregate decrease of less (Article 4.6.1) or more (Article 4.6.4) than EUR 1 million in the Adjusted Covered Taxes.
  - d. Articles 5.5.1(a) and (b) – which refer to Average GloBE Revenue of less than EUR 10 million and Average GloBE Income or Loss of less than EUR 1 million.
  - e. Article 9.3.2 – which refers to the sum of the Net Book Values of Tangible Assets not exceeding EUR 50 million.
  - f. Article 10.1, “Material Competitive Distortion” – which refers to an aggregate variation of greater than EUR 75 million in a Fiscal Year.
  - g. Article 10.1, “Policy Disallowed Expenses” – which refers to expenses accrued by the Constituent Entity for fines and penalties that equal or exceed EUR 50 000.



5. Where the aforementioned thresholds are expressed in domestic legislation in a non-EUR currency, the amounts will need to be rebased to ensure a coordinated application of the GloBE Rules as well as consistency in the thresholds used by different jurisdictions on an ongoing basis. To ensure equivalency with the EUR denominated amounts as well as across jurisdictions, the thresholds should be rebased as of the same date and using equivalent current exchange rates. Those rebased thresholds should apply consistently for the reporting Fiscal Year starting as of (or with a start date that is set by reference to) a common date following the rebasing, such as 1 January (including a Fiscal Year with a start date such as the Sunday nearest to 1 January).

6. Greater certainty is provided when the applicable monetary thresholds are known to MNE groups prior to the commencement of the relevant Fiscal Year and jurisdictions should rebase the local currency thresholds provided in their domestic legislation based on an exchange rate that is available at the beginning of a Fiscal Year at the latest. Therefore, the rebasing of the relevant thresholds should be undertaken with reference to the average foreign exchange rate for the December month immediately prior to the commencement of the relevant calendar year.

7. Where the relevant Article is a threshold that references previous Fiscal Years (i.e. Article 1.1), the foreign exchange rate for each individual year will be based on the average foreign exchange rate for December of calendar year immediately preceding the calendar year in which such previous Fiscal Year starts rather than a single exchange rate applied for the purposes of all the relevant Fiscal Years.

8. The applicable average foreign exchange rate will be determined by the foreign exchange reference rates as quoted by the European Central Bank (ECB). As of November 2022, the Euro foreign exchange reference rates are provided for 31 currencies (Australian dollar, Brazilian real, Bulgarian lev, Canadian dollar, Chinese yuan renminbi, Croatian kuna, Czech koruna, Danish krone, Hong Kong dollar, Hungarian forint, Icelandic krona, Indian rupee, Indonesian rupiah, Israeli shekel, Japanese yen, Malaysian ringgit, Mexican peso, New Zealand dollar, Norwegian krone, Philippine peso, Polish zloty, Pound sterling, Romanian leu, Singapore dollar, South African rand, South Korean won, Swedish krona, Swiss franc, Thai baht, Turkish lira and the US dollar). Where the ECB does not provide a foreign exchange reference rate for the local currency of a jurisdiction, or the jurisdiction faces legal or practical impediments to using such exchange rate when setting their own monetary thresholds under domestic legislation, the average foreign exchange rate will be determined by that quoted by the jurisdiction's Central Bank.

### 1.1.3. Guidance

9. The following guidance **in bold** will be inserted in paragraph 19 of the Introduction to the Commentary of the GloBE Rules:

19. For those jurisdictions that introduce the GloBE Rules into their legislation using local currency thresholds other than Euros, the preferred approach would be for those jurisdictions to use a consistent methodology to rebase the thresholds in their local currency. Application of a consistent rebasing rule will minimise differences between the local currency thresholds used by different jurisdictions. **Therefore, jurisdictions should rebase their non-Euro denominated thresholds annually, based on the average foreign exchange rate for the month of December determined by the foreign exchange reference rates as quoted by the European Central Bank (ECB) and apply the rebased thresholds to any Fiscal Year that starts on (or by reference to) any day of the following calendar year. Where the local currency of the jurisdiction is not quoted in the foreign exchange reference rates of the ECB or the jurisdiction faces legal or practical impediments to using such exchange rate when setting their own monetary thresholds under domestic legislation, the jurisdiction should rebase their non-Euro denominated thresholds based on the average foreign exchange rate for the month of December as quoted by the jurisdiction's Central Bank.**

10. The following guidance will be inserted after paragraph 19 of the Introduction to the Commentary of the GloBE Rules:

19.1 The rebasing rule described above only applies for the purposes of rebasing the following thresholds in the domestic legislation of an implementing jurisdiction and not for the purposes of translating amounts from the Consolidated Financial Statements to the relevant currency that the threshold is denominated in domestic legislation:

- a. Articles 1.1, 1.2, and 6.1.1 – which refer to revenue included in the Consolidated Financial Statements equal to or greater than EUR 750 million.
- b. Article 3.1.3 – which refers to permanent differences in excess of EUR 1 million.
- c. Articles 4.6.1 and 4.6.4 – which refer to an aggregate decrease of less (Article 4.6.1) or more (Article 4.6.4) than EUR 1 million in the Adjusted Covered Taxes.
- d. Articles 5.5.1(a) and (b) – which refer to Average GloBE Revenue of less than EUR 10 million and Average GloBE Income or Loss of less than EUR 1 million.
- e. Article 9.3.2 – which refers to the sum of the Net Book Values of Tangible Assets not exceeding EUR 50 million.
- f. Article 10.1, “Material Competitive Distortion” – which refers to an aggregate variation of greater than EUR 75 million in a Fiscal Year.
- g. Article 10.1, “Policy Disallowed Expenses” – which refers to expenses accrued by the Constituent Entity for fines and penalties that equal or exceed EUR 50 000.

19.2 Where the relevant Article is a threshold that references previous Fiscal Years, the foreign exchange rate for each individual year for the purposes of determining the relevant threshold translated into local currency will be based on the average foreign exchange rate for December of the calendar year immediately preceding the calendar year in which such previous Fiscal Year starts and not a single foreign exchange rate applied for the purposes of all the relevant Fiscal Years. For example, Article 1.1 sets out that the GloBE Rules apply to Constituent Entities that are members of an MNE Group that has annual revenue of EUR 750 million or more in the Consolidated Financial Statements of the Ultimate Parent Entity (UPE) in at least two of the four Fiscal Years immediately preceding the tested Fiscal Year. Assuming the tested Fiscal Year is 2026 and the jurisdiction expresses the threshold in local currency, then for the purposes determining whether the MNE Group’s revenues exceeded the threshold, the MNE Group’s revenues would need to exceed the threshold in two of the four years based on the annually translated rates outlined below, rather than applying a single foreign exchange rate to all the Fiscal Years in question:

- a. For the 2022 Fiscal Year – EUR 750 million translated into local currency based on the average foreign exchange rate for the month of December 2021 determined by the foreign exchange reference rates as quoted by the ECB.
- b. For the 2023 Fiscal Year – EUR 750 million translated into local currency based on the average foreign exchange rate for the month of December 2022 determined by the foreign exchange reference rates as quoted by the ECB.
- c. For the 2024 Fiscal Year – EUR 750 million translated into local currency based on the average foreign exchange rate for the month of December 2023 determined by the foreign exchange reference rates as quoted by the ECB.
- d. For the 2025 Fiscal Year – EUR 750 million translated into local currency based on the average foreign exchange rate for the month of December 2024 determined by the foreign exchange reference rates as quoted by the ECB.

## 1.2. Deemed consolidation test [AG22.04.T3]

### 1.2.1. Introduction

1. This section provides guidance on the deemed consolidation test found in paragraph (d) of the definition of Consolidated Financial Statements and in paragraph (b) of the definition of Controlling Interests. The deemed consolidation test is applied where the GloBE Rules depend on a determination that is based on a Group or Entity's financial statements or financial accounts and the relevant Group or Entity does not prepare Consolidated Financial Statements using an Authorized Financial Accounting Standard.

2. The deemed consolidation test is incorporated into paragraph (d) of the definition of Consolidated Financial Statements. This paragraph provides that where the Ultimate Parent Entity does not prepare financial statements described in the paragraphs (a) to (c) of that definition:

... the Consolidated Financial Statements of the Ultimate Parent Entity are those that would have been prepared if such Entity were required to prepare such statements in accordance with an Authorised Financial Accounting Standard that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions.

3. The definition of Consolidated Financial Statements (and, by extension, the deemed consolidation test) is relevant to the operation of a number of provisions of the GloBE Rules. For example, the composition of a Group, as defined by Article 1.2.2, relies on the definition of Consolidated Financial Statements because it is based on an accounting consolidation test. If Consolidated Financial Statements do not exist in accordance with paragraphs (a) to (c) of the definition, a Group may still exist under the GloBE Rules because of the deemed consolidation test of paragraph (d).

4. The deemed consolidation test also forms part of paragraph (b) of the definition of Controlling Interests. Under paragraph (b) a Controlling Interest includes any Ownership Interest in an Entity such that the interest holder:

... would have been required to consolidate the assets, liabilities, income, expenses and cash flows of the Entity on a line-by-line basis if the interest holder had prepared Consolidated Financial Statements.

5. The definition of Controlling Interest is particularly relevant to the definition of Ultimate Parent Entity, in Article 1.4.1. An Ultimate Parent Entity includes an Entity that owns directly or indirectly a Controlling Interest in any other Entity and at the same time is not owned with a Controlling Interest, directly or indirectly, by another Entity. Thus, the deemed consolidation test means that an Ultimate Parent Entity also includes an Entity that would have been required to consolidate the assets, liabilities, income, expenses and cash flows of another Entity on a line-by-line basis if the first-mentioned Entity had prepared Consolidated Financial Statements.

6. Entity is defined in Article 10.1 as any legal person (other than a natural person). Under the law of many jurisdictions, the General Government is, or is treated as, a legal person. Thus, the General Government of a jurisdiction could be considered part of an MNE Group if it holds Controlling Interests in an enterprise that is not an Excluded Entity.

### 1.2.2. Issues to be considered

7. The deemed consolidation test is drafted in conditional terms. It is only triggered where there are no Consolidated Financial Statements prepared in respect of the relevant entity or group of entities.

8. Stakeholders have asked whether the deemed consolidation test requires consolidation on a line-by-line basis of an Entity that is majority-owned where that Entity's income and expenses are not included on a line-by-line basis in the owner's Consolidated Financial Statements because the relevant accounting standard does not require such consolidation. As illustrated in the examples attached to this guidance, this question could arise where an Investment Entity has a controlling interest in an investee company and is required to reflect the performance of that entity in its financial statements based on changes in the fair value of its investment.

9. Stakeholders have asked whether the definition of Entity is intended to include General Government.

### **1.2.3. Guidance**

10. The following guidance will be included as part of the Commentary to the definition of Consolidated Financial Statements in Article 10.1:

#### *Consolidated Financial Statements*

##### **Paragraph (d)**

8.1 Paragraph (d) of the definition of Consolidated Financial Statements is a deemed consolidation test that applies where the UPE does not, in fact, prepare financial statements in accordance with an Authorised Financial Accounting Standard. The deemed consolidation test typically applies where the GloBE Rules depend on a determination derived from a Group or Entity's financial statements or financial accounts and the relevant Group or Entity does not prepare Consolidated Financial Statements using an Authorized Financial Accounting Standard. The GloBE Rules rely on the accounting consolidation rules to determine whether a Group exists. However, in some cases, a parent entity does not consolidate its subsidiaries because there is no statute or regulation that requires it to prepare Consolidated Financial Statements in accordance with IFRS or a local GAAP (e.g. a privately and family-owned multinational corporation). Nothing prevents the GloBE Rules to apply to these cases because, under the deemed consolidation test, even if the group does not have Consolidated Financial Statements, it would be required to prepare them if the application of the accounting standard was compulsory in accordance with a law or regulations. The test does not change the content of the accounting standard but rather asks whether a consolidation group would have existed if the application of the standard was compulsory.

8.2 The deemed consolidation test requires preparation of a set of Consolidated Financial Statements based on an Authorized Financial Accounting Standard that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions. The MNE Group may choose among the Authorized Financial Accounting Standards applicable in the UPE's location. This deemed set of Consolidated Financial Statements is then used for the purposes of applying other parts of the GloBE Rules, for example in determining whether an MNE Group meets the revenue threshold test in Article 1.1 or whether an Entity should be treated as a Constituent Entity of an MNE Group. Further, the Authorised Financial Accounting Standard used to prepare the deemed set of Consolidated Financial Statements is generally used to determine Financial Accounting Net Income or Loss and Adjusted Covered Taxes of Constituent Entities.

8.3 The deemed consolidation test does not, however, modify the rules to be applied under that Authorised Financial Accounting Standard and therefore does not alter the outcomes of applying the standard. Specifically, it does not require an Entity to consolidate the assets, liabilities, income, expenses, and cash flows of another Entity on a line-by-line basis where the Authorised Financial

Accounting Standard does not require such consolidation. For example, if the Authorized Financial Accounting Standard permits an Entity that qualifies as an investment entity under criteria specified in the accounting standard to reflect certain of its investments (including majority ownership interests in other Entities) in the financial statements based on the fair value of those investments, the deemed consolidation test will not require instead that those investments be consolidated on a line-by-line basis. Accordingly, an Entity that qualifies as an investment entity under an Authorized Financial Accounting Standard and prepares a financial statement that reflects investments at fair value pursuant to that accounting standard cannot be required to prepare a financial statement under the deemed consolidation test that consolidates the investments on a line-by-line basis. Likewise, an Entity that qualifies as an investment entity under the relevant accounting standard may prepare a Consolidated Financial Statement that reflects investments at fair value under the deemed consolidation test and cannot be required to prepare a financial statement that consolidates the investments on a line-by-line basis.

8.4 The operation of the deemed consolidation test is illustrated in Examples 10.1-1 through 10.1-4.

#### ***Interaction with Article 1.2.2(b)***

8.5 The definition of a Group in Article 1.2.2(b) includes Entities that are excluded from the Consolidated Financial Statements of an Ultimate Parent Entity solely on size or materiality grounds or on the grounds that the Entity is held for sale. This principle also applies with respect to each paragraph of the Consolidated Financial Statements definition. Thus, if either the Consolidated Financial Statements or the deemed Consolidated Financial Statements prepared in accordance with an Authorized Financial Accounting Standard would exclude an Entity solely on the basis that it is immaterial or held for sale, that Entity is nonetheless part of the Group pursuant to Article 1.2.2(b).

11. The following guidance will be included as part of the Commentary to the definition of Controlling Interests in Article 10.1:

#### *Controlling Interest*

##### ***Paragraph (b)***

8.6 Paragraph (b) of the definition of Controlling Interests is a deemed consolidation test that leverages the consolidation rules under the financial accounting standard used in the preparation of the UPE's Consolidated Financial Statements. It provides that one Entity with an Ownership Interest in another Entity is treated as holding a Controlling Interest in that Entity where the interest holder would be required to be consolidated with that other Entity if it had prepared Consolidated Financial Statements and thus ties into the deemed consolidation test set out in paragraph (d) of the definition of Consolidated Financial Statements. Accordingly, the deemed Consolidated Financial Statements in paragraph (b) of the Controlling Interests definition are those that the Entity would have prepared using an Authorized Financial Accounting Standard that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions. As discussed in the Commentary on paragraph (d) of the definition of Consolidated Financial Statements, the deemed consolidation test does not modify the standards or alter the outcomes that are provided for under the relevant accounting standard. Similarly, it does not treat a holder of an Ownership Interest as holding a Controlling Interest in an Entity where the relevant accounting standard would not require consolidation of the assets, liabilities, income, expenses, and cash flows of another Entity on a line-by-line basis. The operation of the deemed consolidation test is illustrated in Examples 10.1-1 through 10.1-4.

### ***Interaction with Article 1.2.2(b)***

8.7 The definition of a Group in Article 1.2.2(b) includes Entities that are excluded from the Consolidated Financial Statements of an Ultimate Parent Entity solely on size or materiality grounds or on the grounds that the Entity is held for sale. This principle also applies with respect to each paragraph of the Consolidated Financial Statements definition. Thus, if either the Consolidated Financial Statements or the deemed Consolidated Financial Statements prepared in accordance with an Authorized Financial Accounting Standard would exclude an Entity solely on the basis that it is immaterial or held for sale, that Entity is nonetheless part of the Group pursuant to Article 1.2.2(b).

12. The following guidance will be included as part of the Commentary to the definition of Entity in Article 10.1:

#### *Entity*

17.1 The term Entity shall not include central, state, or local government or their administration or agencies that carry out government functions.

### **1.2.4. Examples**

13. The following examples will be included in the GloBE Model Rules Examples.

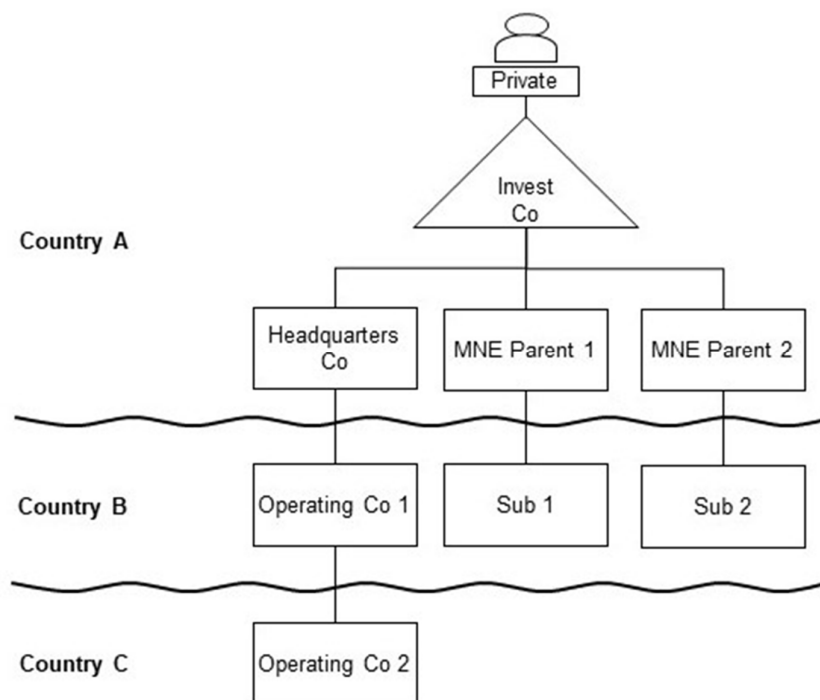
#### *Example 10.1-1*

#### ***Privately held entity not required and not preparing financial statements***

1. This example illustrates the deemed consolidation test found in paragraph (d) of the definition of Consolidated Financial Statements and paragraph (b) of the definition of Controlling Interest in Article 10.1 with regards to a privately held entity that is not required and does not prepare financial statements.

2. Invest Co is a private company located in Country A that is not required to, and does not, prepare financial statements for any other purpose. Invest Co is not, however, an investment entity under IFRS 10. Invest Co owns (directly or indirectly) all the Ownership Interests of Headquarters Co, Operating Co 1 and Operating Co 2. Headquarters Co, which is located in Country A, issued debt instruments that are traded on a public securities exchange and it is required by the securities regulatory body in Country A to prepare financial statements in accordance with IFRS, the Authorized Financial Accounting Standard in Country A. Invest Co also owns all of the Ownership Interests of MNE Parent 1, MNE Parent 2, Sub 1, and Sub 2, none of which are required to prepare financial statements for any purpose. A diagram illustrating the holding structure and the location of the entities is set out below.

Figure 1.1. Holding structure



Source: OECD

3. In this case, Invest Co is considered to hold the Controlling Interests of Headquarters Co, Operating Co 1, Operating Co 2, MNE Parent 1, Sub 1, MNE Parent 2, and Sub 2 because if it had prepared financial statements under IFRS, the Acceptable Financial Accounting Standard in its jurisdiction, Invest Co would have been required to consolidate its financial results with the financial results of those Entities on a line-by-line basis. The fact that Headquarters Co prepares Consolidated Financial Statements that do not include Invest Co does not affect the analysis under paragraph (b) of the definition of Controlling Interests with respect to Invest Co.

4. Paragraph (d) of the definition of Consolidated Financial Statements is triggered because Invest Co did not prepare financial statements in accordance with an Authorised Financial Accounting Standard. Invest Co's Consolidated Financial Statements are those that it would have been required to prepare under IFRS, the Authorised Financial Accounting Standard in Country A. Accordingly, the MNE Group includes Invest Co, Headquarters Co, Operating Co 1, Operating Co 2, MNE Parent 1, Sub 1, MNE Parent 2, and Sub 2.

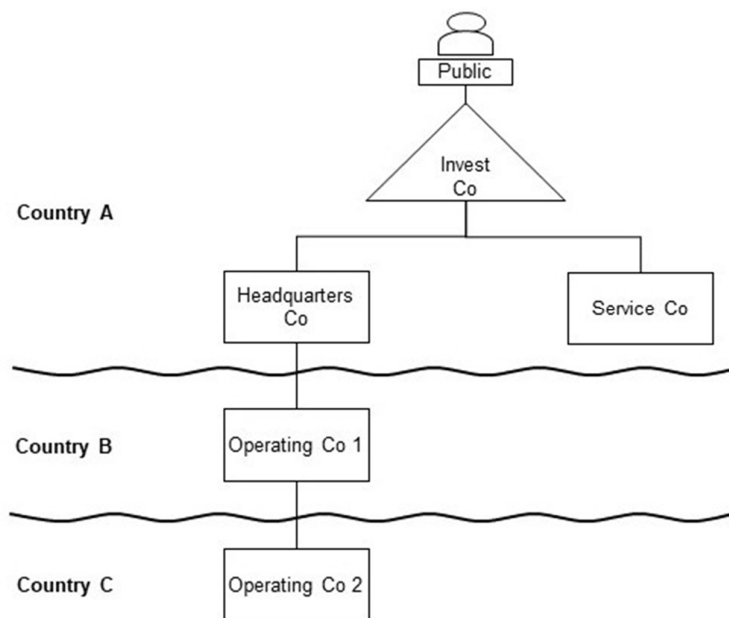
#### Example 10.1-2

##### **Investment entity not required to consolidate investments**

1. This example illustrates the deemed consolidation test found in paragraph (d) of the definition of Consolidated Financial Statements and paragraph (b) of the definition of Controlling Interest in Article 10.1 with regards to an investment entity that is not required to consolidate investments.

2. Invest Co is an Investment Fund that is established and tax resident in Country A. Invest Co issues shares to the market which are traded on a public stock exchange in Country A. The law of Country A requires Invest Co to prepare financial statements in accordance with International Financial Reporting Standards (IFRS). Invest Co owns all of the outstanding shares of Service Co and Headquarters Co. Service Co provides accounting and other investment services to Invest Co and is tax resident in Country A. Headquarters Co actively manages the day-to-day business operations of Operating Co 1 and Operating Co 2 and is tax resident in Country A. Headquarters Co owns 100% (directly or indirectly) of the shares of Operating Co 1, which is tax resident in Country B, and Operating Co 2, which is tax resident in Country C. A diagram illustrating the holding structure and the location of the entities is set out below.

Figure 1.2. Holding structure



Source: OECD

3. Invest Co is an investment entity under IFRS 10. Invest Co prepares Consolidated Financial Statements that consolidate the financial results of Invest Co and Service Co on a line-by-line basis. However, Invest Co is not required to consolidate Headquarters Co, Operating Co 1, and Operating Co 2 on a line-by-line basis, notwithstanding that it owns all of their outstanding shares (directly or indirectly). Rather, pursuant to IFRS 10, Invest Co is required to reflect the performance of these investments in its financial statements under the fair value method. Headquarters Co, which is not an investment entity under IFRS 10, prepares Consolidated Financial Statements in accordance with IFRS that consolidate the financial results of Headquarters Co, Operating Co 1, and Operating Co 2 on a line-by-line basis.

4. In this case, Invest Co holds the Controlling Interests of Service Co because it is required to consolidate the financial results of Service Co with its own financial results under IFRS, which is an Authorised Financial Accounting Standard that is an Acceptable Financial Accounting Standard. Invest Co does not hold the Controlling Interests of Headquarters Co, Operating Co 1, and Operating Co 2 because Invest Co is not required to consolidate the financial results of such Entities under the



Authorised Financial Accounting Standard used in preparing its Consolidated Financial Statements, i.e. IFRS. Similarly, paragraph (d) of the definition of Consolidated Financial Statements is not triggered in this situation because Invest Co prepares financial statements that are described in paragraph (a) of the definition, i.e. Consolidated Financial Statements prepared under IFRS that consolidate the financial results of Entities in which it holds a Controlling Interest (Service Co).

*Example 10.1-3*

***Investment Entity does not prepare financial statements***

1. This example illustrates the deemed consolidation test found in paragraph (d) of the definition of Consolidated Financial Statements and paragraph (b) of the definition of Controlling Interest in Article 10.1 with regards to an investment entity that is not required and does not prepare financial statements.
2. The facts are the same as Example 10.1-2, except that Invest Co is not required to, and does not, prepare financial statements for any other purpose.
3. In this case, Invest Co is considered to hold the Controlling Interests of Service Co in accordance with paragraph (b) of the definition of Controlling Interests because it would have been required to consolidate the financial results of Service Co on a line-by-line basis with its own financial results if it had prepared Consolidated Financial Statements pursuant to IFRS. However, Invest Co is not considered to hold the Controlling Interests of Headquarters Co Operating Co 1 and Operating Co 2 because it would not have been required to consolidate the financial results of those Entities on a line-by-line basis with its own financial results if it had prepared Consolidated Financial Statements pursuant to IFRS.
4. Similarly, paragraph (d) of the definition of Consolidated Financial Statements is triggered with respect to Invest Co. Under paragraph (d) of the definition of Consolidated Financial Statements, Invest Co's Consolidated Financial Statements are those that would have been required if it were required to prepare Consolidated Financial Statements, for example by law or by a regulatory body, under an Authorised Financial Accounting Standard that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions. Under IFRS, the standard applicable in Invest Co's jurisdiction, Invest Co would be required to consolidate the financial results of Service Co. However, under IFRS 10, Invest Co would not be required to consolidate the financial results of Headquarters Co, Operating Co 1, and Operating Co 2.

*Example 10.1-4*

***Non-investment entity does not prepare financial statements***

1. This example illustrates the deemed consolidation test found in paragraph (d) of the definition of Consolidated Financial Statements and paragraph (b) of the definition of Controlling Interest in Article 10.1 with regards to a non-investment entity that is not required to and does not prepare financial statements.
2. The facts are the same as Example 10.1-2, except that Headquarters Co is not required to, and does not, prepare financial statements that include the financial results of Operating Co 1 and Operating Co 2 for any other purpose.
3. In this case, Headquarters Co is considered to hold the Controlling Interests of Operating Co 1 and Operating Co 2 in accordance with paragraph (b) of the definition of Controlling Interests because it would have been required to consolidate the financial results of those Entities on a line-

by-line basis with its own financial results if it had prepared Consolidated Financial Statements pursuant to IFRS.

4. Similarly, paragraph (d) of the definition of Consolidated Financial Statements is triggered with respect to Headquarters Co. Under paragraph (d) of the definition of Consolidated Financial Statements, Headquarters Co's Consolidated Financial Statements are those that would have been required if it were required to prepare Consolidated Financial Statements, for example by law or by a regulatory body, under an Authorised Financial Accounting Standard that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions. Under IFRS, the standard applicable in Headquarters Co's jurisdiction, Headquarters Co would be required to consolidate the financial results of Headquarters Co, Operating Co 1, and Operating Co 2. As in Example 10.1 – 1, Invest Co is not deemed to hold the Controlling Interests of Headquarters Co, Operating Co 1, and Operating Co 2 for the reasons explained above. If there were another Authorised Financial Accounting Standard in Headquarter Co's jurisdiction in addition to IFRS, and if such other standard would not have required consolidation (after taking into account adjustments for any Material Competitive Distortions when applying standards other than Acceptable Financial Accounting Standards) under the facts described, Headquarter Co can rely on the alternative Authorised Financial Accounting Standard to not consolidate its subsidiaries for purposes of the GloBE Rules. Under these circumstances, paragraph (d) does not require Headquarter Co to prepare Consolidated Financial Statements under IFRS and therefore Headquarter Co will not be treated as the UPE of an MNE Group for GloBE purposes.

### 1.3. Consolidated deferred tax amounts [AG22.04.T3]

#### 1.3.1. Introduction

1. The GloBE Rules require Constituent Entities to calculate their GloBE Income or Loss and Covered Taxes in a jurisdiction based on the financial accounts used in the preparation of the UPE's Consolidated Financial Statements. This Administrative Guidance clarifies which financial accounts should be used for the purposes of the GloBE Rules and, in particular, the financial accounts that should be used in the calculation of Deferred Tax.

2. Chapter 3 of the Model Rules contains the rules for calculating GloBE Income or Loss. Article 3.1 determines which financial statements should be used to compute the net income or loss for a Constituent Entity. Article 3.1.2 sets out that the Financial Accounting Net Income or Loss for a Constituent Entity should be based on "the net income or loss determined for a Constituent Entity ... in preparing Consolidated Financial Statements of the Ultimate Parent Entity". The Commentary to Article 3.1.2 clarifies that:

[i]tems of income and expense, other than those attributable to purchase accounting, that are reflected in the consolidated accounts, rather than a Constituent Entity's separate accounts, may be taken into account in computing the Constituent Entity's Financial Accounting Net Income or Loss and GloBE Income or Loss only to the extent they can be reliably and consistently traced to the relevant Entity (e.g. stock-based compensation).

3. Chapter 4 of the Model Rules contains the rules for calculating Adjusted Covered Taxes. Article 4.1.1 provides that the calculation of Adjusted Covered Taxes for a Constituent Entity starts with the current tax expense accrued in its Financial Accounting Net Income or Loss, as defined in Article 3.1, with respect to Covered Taxes. This cross-reference to Article 3.1 means that the current tax expense taken into account in the calculation of Adjusted Covered Taxes should be based on the same financial accounts used to calculate GloBE Income or Loss. Generally, the relevant financial accounts are those used to determine the net income or loss of the Constituent Entity for purposes of preparing the UPE's Consolidated Financial Statements. However, in the case of a Constituent Entity that computes its Financial Accounting Net Income or Loss pursuant to Article 3.1.3, the relevant financial accounts are the ones used to compute that Constituent Entity's Financial Accounting Net Income or Loss.

4. However, some stakeholders have requested clarification on whether the same principle applies to the calculation of deferred taxes. In particular, these stakeholders note that, under Article 4.4.1, the calculation of the Deferred Tax Adjustment Amount for a Constituent Entity is equal to the deferred tax expense accrued in its financial accounts. The wording in Article 4.4.1 could be interpreted as taking the deferred tax expense accrued in the individual financial accounts of the Constituent Entity in question rather than the amount accrued in the Financial Accounting Net Income or Loss as is the case in Article 4.1.1.

#### 1.3.2. Issue to be considered

5. Stakeholders have asked whether deferred tax expense with respect to a Constituent Entity recorded in the MNE Group's consolidated financial accounts are included in the calculation of the Deferred Tax Adjustment Amount for that Constituent Entity.

#### 1.3.3. Guidance

6. Some MNE Groups record the deferred tax expense with respect to a Constituent Entity in the financial accounts used for preparing the consolidated financial statements, rather than the financial accounts of individual Constituent Entities. If the deferred tax expense were limited to the amount accrued

in the financial accounts of the individual Constituent Entities, these MNE Groups would not be able to include the deferred tax expense associated with the GloBE Income or Loss of a Fiscal Year in the ETR computation for that year.

7. The wording in 4.4.1 was not intended to limit the deferred tax expense to amounts recorded as such in the financial accounts of the Constituent Entity because this would mean the denominator and numerator of the ETR calculation would not be calculated on the same basis. Thus, if the individual financial accounts of the Constituent Entity do not contain its deferred tax expense, whether due to an internal accounting practice of the MNE Group or pursuant to the Accepted Financial Accounting Standard used to prepare its financial accounts, the deferred tax expense with respect to the Constituent Entity recorded in the MNE Group's consolidated financial accounts is included in the calculation of the Total Deferred Tax Adjustment Amount for that Constituent Entity.

8. To clarify, the following guidance will be included after paragraph 71 of the Commentary to Article 4.4.1:

71.1 For the purposes of Article 4.4.1, references to the deferred tax expense accrued in the financial accounts of a Constituent Entity must be interpreted as the deferred tax expense accrued in the Financial Accounting Net Income or Loss for that Constituent Entity in line with Article 4.1.1 and the principles of Article 3.1.2. In the case of income and expense attributable to a Constituent Entity that are reflected only in the consolidated financial accounts, Article 3.1.2 requires tracing of those items of income and expense to the relevant Constituent Entity. Similarly deferred tax expenses recorded in the Constituent Entity's financial accounts and any deferred tax expenses in respect of that Constituent Entity recorded exclusively in the MNE Group's consolidated financial accounts shall be included in the calculation of the Total Deferred Tax Adjustment Amount for that Constituent Entity and must be taken into account in computing the Adjusted Covered Taxes of that Constituent Entity. This principle applies also in the case of a Constituent Entity that computes its Financial Accounting Net Income or Loss pursuant to Article 3.1.3.

71.2 If the individual financial accounts of the Constituent Entity do not contain its deferred tax expenses in accordance with the Acceptable Financial Accounting Standard used to prepare its financial accounts, the deferred tax expenses recorded in the MNE Group's consolidated financial accounts with respect to the Constituent Entity, other than those attributable to purchase accounting or excluded items of income or expenses, are included in the calculation of the Total Deferred Tax Adjustment Amount for that Constituent Entity and must be taken into account in computing the Adjusted Covered Taxes of that Constituent Entity.

71.3 The numerator (Adjusted Covered Taxes) and denominator (GloBE Income or Loss) of the GloBE ETR computation should be determined consistently using the same accounting standard. The deferred tax expenses taken into account under this principle are those attributable to timing differences between the accounting standard used to determine the GloBE Income or Loss and the local taxable income and any deferred tax expense in respect of a Constituent Entity shall only be taken into account under this principle to the extent such expense relates to amounts included in the GloBE Income or Loss computation.

## 1.4. Sovereign wealth funds and the definition of Ultimate Parent Entity [AG22.04.T5]

### 1.4.1. Introduction

1. This section provides guidance on the definition of Ultimate Parent Entity in Article 1.4.1(a) as it applies to a Governmental Entity to which paragraph (b)(ii) of the definition of Governmental Entity in Article 10.1 applies. For ease of reference, this is referred to as a sovereign wealth fund that qualifies as a Governmental Entity under Article 10.1.

#### *Sovereign wealth funds*

2. The definition of Governmental Entity is set out in Article 10.1. The term Governmental Entity includes an Entity that is wholly-owned by a government that has the principal purpose of managing or investing that government's or jurisdiction's assets through the making and holding of investments, asset management, and related investment activities for the government's or jurisdiction's assets, so long as it does not carry on a trade or business. To qualify as Governmental Entities, such Entities must also be accountable to the government, provide annual information reporting to the government, and their assets must vest with the government upon dissolution and any distributions of earnings must be made to the government. Governmental Entities of this nature are typically referred to as sovereign wealth funds.

3. Sovereign wealth funds are commonly established by governments to hold and manage their investments for the jurisdiction's future fiscal needs, stabilising the jurisdiction's balance of payments, and to strike an appropriate balance between domestic consumption and savings. They hold or manage the assets on behalf of the government or jurisdiction. In addition, governments may hold or manage their investments through a sovereign wealth fund rather than directly by the government itself in order to reduce or eliminate potential conflicts between the government's role as an investor and a business regulator. A sovereign wealth fund is thus akin to an investment company or an asset management company, wholly-owned by the government, that consolidates the government's investment activities. It is unlike the headquarters company of a conglomerate business.

#### *UPE definition*

4. The definition of Ultimate Parent Entity in Article 1.4.1(a) is the reference point for identifying all the Entities that are part of the same Group. The definition is also relevant to the operation of other parts of the GloBE Rules, such as the application of rule priority in Chapter 2 and the determination of the financial accounting standard to be used in the computation of the GloBE Income or Loss of the Constituent Entities under Chapter 3.

5. A UPE includes an Entity that:

- (i) owns directly or indirectly a Controlling Interest in any other Entity; and
- (ii) is not owned, with a Controlling Interest, directly or indirectly by another Entity.

6. Article 10.1 provides that one Entity holds a Controlling Interest in another if the interest holder consolidates the financial results of that other Entity on a line-by-line basis under an Acceptable Financial Accounting Standard (or would be required to consolidate the financial results of that Entity if the interest holder had been required to prepare Consolidated Financial Statements). The UPE, together with all the Entities in which it holds a Controlling Interest, form a Group for the purposes of the GloBE rules. As the Entity at the top of the ownership chain, the UPE holds Controlling Interests in all the other Group Entities but there is no other Entity in the Group that holds a Controlling Interest in the UPE.

*Application of UPE definition to sovereign wealth funds*

7. A key feature of the UPE definition is the requirement that the UPE consolidates its financial results with the other members of the Group. Although a central, state, or local government or their administration or agencies that carry out government functions (the government) may in some instances prepare consolidated financial statements, the government nonetheless cannot be an Entity and thus would not be a UPE.

8. Sovereign wealth funds may have different approaches to consolidation – some may not consolidate, while some may consolidate:

- (i) Some may not consolidate as they are investment entities. Under certain Authorised Financial Accounting Standards, an investment entity is allowed to account for its investments based on changes in their fair value rather than through consolidation. Investment entities that qualify for this treatment under the relevant accounting standard are exempted from consolidation on a line-by-line basis and will not be treated as the UPE of a Group because they do not have a Controlling Interest in their controlled investment subsidiaries.
- (ii) Some may consolidate because their Authorised Financial Accounting Standards do not have an exception to the consolidation requirement for investment entities or the sovereign wealth funds do not meet all the conditions of an investment entity as set out in the relevant accounting standard that allows fair value accounting by investment entities. Fair value accounting by investment entities is a relatively recent development in financial accounting and may not be available under all Authorised Financial Accounting Standards. The standards that do allow fair value accounting by investment entities, such as IFRS and US GAAP, generally define an investment entity as an entity whose purpose is to make investments for capital appreciation, investment income, or both and provide further detailed guidance to determine whether an entity qualifies as an investment entity. To qualify as an investment entity under these Authorised Financial Accounting Standards (e.g. IFRS 10), the Entity must meet certain conditions, including having an exit strategy documenting how it plans to realise capital appreciation from substantially all of its equity investments and non-financial assets. In particular, the Entity must identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments.

9. IF members have noted that some sovereign wealth funds that qualify as Governmental Entities may not qualify as investment entities under certain Authorised Financial Accounting Standards as they are not eligible to apply fair value accounting to their investments under those financial accounting standards. This may be due to the specific application of a local accounting standard or because the fund does not meet the requirement for having an exit strategy because its investment strategy may involve holding its investments for the longer term with no definite exit time frame for certain of its investments. Accordingly, although in all other material respects these sovereign wealth funds function like investment entities, they may be treated as the UPE of an MNE Group because they do not meet the requirements of the accounting standard to be able to apply the fair value method to their investments. This could bring indirectly held government-owned Groups that do not otherwise meet the EUR 750 million consolidated revenue threshold on a separate basis within the scope of the GloBE Rules merely because they are held and consolidated by a sovereign wealth fund, rather than held directly by the government. Stated differently, these indirectly-held, government-owned MNE Groups would not have been treated as a single MNE Group for purposes of the GloBE Rules had they been held directly by the government because is not an Entity and thus cannot be a UPE under the GloBE Rules.

### 1.4.2. Issue to be considered

10. Entities held by a government through a sovereign wealth fund that qualifies as a Governmental Entity under Article 10.1 are treated as a single MNE Group, whereas Entities held directly by the government would not be treated as a single MNE Group. This does not give full effect to the intended policy of treating a sovereign wealth fund that qualifies as a Governmental Entity under Article 10.1 in the same way as the government under the GloBE Rules. Hence, the issue to be considered is whether a sovereign wealth fund that meets the definition of a Governmental Entity in Article 10.1 should be treated as a UPE for the purposes of Article 1.4.1.

### 1.4.3. Guidance

11. The following guidance will be included after paragraph 36 of the Commentary to the definition of Ultimate Parent Entity in Article 1.4.1:

#### *Sovereign wealth fund that qualifies as Governmental Entity is not a UPE*

36.1 Governmental Entities are Excluded Entities under the GloBE Rules. As explained in the Commentary to the definition of Governmental Entity, they are excluded from the charge to GloBE tax because they are sovereign entities that are not typically subject to tax in their own jurisdiction and often benefit from exclusions from taxation under foreign law or tax treaties. The term Governmental Entity includes an Entity that is wholly-owned directly or indirectly by a government and that has the principal purpose of managing or investing that government's or jurisdiction's assets through the making and holding of investments, asset management, and related investment activities for the government's or jurisdiction's assets, so long as it does not carry on a trade or business. To qualify as a Governmental Entity, such Entities must also be accountable to the government, provide annual information reporting to the government, and its assets must vest with the government upon dissolution and any distributions of earnings must be made to the government. Governmental Entities of this nature are typically referred to as sovereign wealth funds. These conditions ensure that Governmental Entities are appropriately treated like the government and excluded from the charge to tax under the GloBE Rules.

36.2 Generally, an Excluded Entity can be the UPE of an MNE Group if it holds a Controlling Interest in another Entity. Whether an interest is a Controlling Interest depends on whether the holder would be required to consolidate the assets, liabilities, income, expenses and cash flows (the financial results) of the Entity on a line-by-line basis under an Acceptable Financial Accounting Standard. Governments are typically not required to consolidate the financial results of non-Governmental Entities that they own on a line-by-line basis.

36.3 As mentioned in paragraph 30 of the Commentary to Article 10, the condition in paragraph (b)(ii) of the definition of Governmental Entity is intended to include Entities such as sovereign wealth funds (including those incorporated as companies). Sovereign wealth funds are commonly established by governments to hold and manage their investments for the jurisdiction's future fiscal needs, stabilising the jurisdiction's balance of payments, and to strike an appropriate balance between domestic consumption and savings. They hold or manage the assets on behalf of the government or jurisdiction. In addition, governments may choose to hold or manage their investments through a sovereign wealth fund rather than directly by the government itself in order to reduce or eliminate potential conflicts between the government's role as an investor and a business regulator. A sovereign wealth fund is thus akin to an investment company or an asset management company, wholly-owned by the government, that consolidates the government's investment activities. It is unlike the headquarters company of a conglomerate business.

36.4 When a sovereign wealth fund does not qualify as an investment entity under the Authorised Financial Accounting Standard in the jurisdiction (for instance, a sovereign wealth fund could be a long-term investor with no definite exit time frame for certain of its investments and thus does not meet the definition of an investment entity) or this Authorised Financial Accounting Standard does not have an exception to the consolidation requirement for similar investment entities, the sovereign wealth fund could be required to consolidate on a line-by-line basis the financial results of all of the Entities in which it has a controlling Ownership Interest. As a consequence, MNE Groups that would not meet the EUR 750 million threshold on their own could be treated as part of a larger MNE Group that is within the scope of the GloBE Rules merely because they were owned by the government through a sovereign wealth fund rather than directly by the central, state, or local government or their administration or agencies that carry out government functions (the government). This outcome would be inconsistent with the intended policy outcomes of the GloBE Rules because a sovereign wealth fund that qualifies as a Governmental Entity under Article 10.1 is intended to receive equivalent treatment to that of the government and the separate MNE Groups would not have been considered as a single MNE Group for purposes of the GloBE Rules if they had been held directly by the government. To clarify that the UPE and Group definitions in Chapter 1 were not intended to produce this result, the Inclusive Framework has agreed that a sovereign wealth fund that meets the definition of a Governmental Entity in Article 10.1 (i.e. a Governmental Entity to which paragraph (b)(ii) of the definition of Governmental Entity in Article 10.1 applies) will not be considered to be a UPE and will not be considered part of an MNE Group. Further, a sovereign wealth fund that meets the definition of a Governmental Entity in Article 10.1 will not be considered to own a Controlling Interest in any Entity in which it has an Ownership Interest, and accordingly whether any such Entity is the UPE of an MNE Group is determined without regard to any Ownership Interest held by the sovereign wealth fund.

12. The following guidance will be included after paragraph 24 of the Commentary to the definition of Group in Article 1.2.2:

24.1 See Commentary to the definition of UPE in Article 1.4.1 in the case of Entities owned by a sovereign wealth fund that qualifies as a Governmental Entity.

13. The following guidance will be included at the end of the Commentary to the definition of Controlling Interest in Article 10.1:

See Commentary to the definition of UPE in Article 1.4.1 in the case of Ownership Interests held by a sovereign wealth fund that qualifies as a Governmental Entity.



## 1.5. Clarifying the definition of ‘Excluded Entity’ (Article 1.5.2) [AG22.04.T13]

### 1.5.1. Introduction

1. Entities that meet the definition of Excluded Entities are excluded from the GloBE Rules under Article 1.1.3. Article 1.5.1 lists the types of Entities that are Excluded Entities.

2. Article 1.5.2 extends of the definition of an Excluded Entity in Article 1.5.1 to cover Entities owned by an Excluded Entity. Article 1.5.2 recognises that Excluded Entities may be required, for regulatory or commercial reasons, to hold assets or carry out specific functions through separate controlled entities. Under paragraph 1.5.2(a), where an entity is at least 95% owned, either directly or indirectly, by an Excluded Entity or Entities, that entity will also be considered an Excluded Entity, if the entity:

- i. operates exclusively or almost exclusively to hold assets or invest funds for the benefit of the Excluded Entity or Entities; or
- ii. only carries out activities that are ancillary to those carried out by the Excluded Entity or Entities.

3. Further, under paragraph 1.5.2(b) where an Entity is at least 85% owned, either directly or indirectly, by an Excluded Entity or Entities, that Entity will also be considered an Excluded Entity, provided that substantially all the Entity’s GloBE income is composed of Excluded Dividends or Excluded Equity Gains or Losses that are excluded from GloBE Income in accordance with paragraphs 3.2.1(b) or (c).

### 1.5.2. Issue to be considered

4. Several stakeholders have requested further clarity in relation to the application of paragraph 1.5.2(a).

5. The first issue is in relation to the interaction between subparagraphs 1.5.2(a)(i) and (ii). The provisions, when interpreted strictly, may prevent an entity from falling within the definition of Excluded Entity, where it only undertakes activities that consist of the holding of assets or investment of funds for the benefit of an Excluded Entity **and** carries out activities that are ancillary to those carried out by the relevant Excluded Entity. This is due to the use of the terms ‘exclusively or almost exclusively’ and ‘only’ in subparagraphs 1.5.2(a)(i) and (ii). The Commentary should be made clear that where all of the activities undertaken by the Entity fall within the scope of subparagraph 1.5.2(a)(i) and (ii), it should be considered an Excluded Entity.

6. The second issue relates to providing clarity around the application of paragraph 1.5.2(a) to Entities owned by an Excluded Entity (directly or through a chain of Excluded Entities) listed in Article 1.5.1 (other than a Pension Services Entity), where the first-mentioned Entities borrow from third parties and apply the funds to making direct acquisitions of assets (including operating entities). The question relates to whether such Entities are holding assets or investing funds for the benefit of the Excluded Entity or are considered to be carrying on ancillary activities. To avoid differing interpretations of ‘holding of assets or investment of funds’ and ‘ancillary’ activities, the Commentary should make clear that borrowing funds and making direct acquisitions of assets falls within the meaning of ‘holding of assets or investment of funds’ and is not considered ‘ancillary’. Further, where the finance entity undertakes both the ‘holding of assets or investment of funds’ and ‘ancillary’ activities for the benefit of an Excluded Entity it will fall within the scope of paragraph 1.5.2(a).

7. The third issue is whether the activities undertaken by a Permanent Establishment of the Main Entity tested under Article 1.5.2 are also taken into account for purposes of the testing the Main Entity and if met, whether such Permanent Establishment is also an Excluded ‘Entity’ in accordance with Article 1.5.2.

### 1.5.3. Guidance

8. The following guidance will be inserted after paragraph 43 of the Commentary to Article 1.5.2:
- 43.1 Where an Entity meets the definition of an Excluded Entity under Article 1.5.2 based on the totality of the activities of the Entity, including the activities of all of its PEs, the activities undertaken by the PE are not considered separate when applying the Activities Test or for determining whether “substantially all of the Entity’s income is Excluded Dividends or Excluded Equity Gain or Loss” for the purposes of Article 1.5.2. Further, where the Entity meets the definition of an Excluded Entity, the entirety of its activities, including those undertaken by its PE(s), are excluded from the GloBE Rules.
9. The bold and underlined text will be added to paragraph 53 of the Commentary to Article 1.5.2:
53. Subparagraph (i) requires that the Entity operates “exclusively or almost exclusively to hold assets or invest funds.” The words “exclusively or almost exclusively” denote a facts and circumstances test that requires all or almost all of the Entity’s activities to be related to holding assets or investing funds. Except as provided in paragraph 54.1, the Entity must not actively carry out activities other than holding assets or investing funds in order to be an Excluded Entity under paragraph (a). For example, subparagraph (i) could apply to a sovereign wealth fund owned by a government (in case it does not already meet the definition of a Governmental Entity under Article 10.1) that is holding assets and investing funds for the benefit of the government, but it would not extend to an airline company owned by the government, because an airline’s activities go beyond holding assets and investing funds. Subparagraph (i) also requires that the assets are held or funds invested “for the benefit of the Excluded Entity”. **For example, an Excluded Entity listed in Article 1.5.1 may have a wholly owned subsidiary which borrows funds from third parties to make direct acquisitions of assets (including Ownership Interests in operating companies). Where this is the case, the borrowing and acquisition should be treated as holding assets and investing funds for the benefit of its Excluded Entity parent.** This condition has to be read in conjunction with the other conditions of this Article, including the condition that the assets must be held or the funds invested for the benefit of the Excluded Entity or Entities.
10. The following guidance will be inserted after paragraph 54 of the Commentary to Article 1.5.2:
- 54.1 Further, an Entity should not be considered to fail the Activities Test in paragraph 1.5.2(a) where the aggregate of its activities falls within the combined scope of subparagraphs (i) and (ii). Accordingly, an Entity that carries out ancillary activities and the remainder of its activities are to exclusively or almost exclusively hold assets or invest funds for the benefit of the Excluded Entity or Entities will satisfy the Activities Test.

## 1.6. Meaning of “ancillary” for Non-Profit Organisations

### 1.6.1. Introduction

1. Non-Profit Organisations (NPO) are Excluded Entities under Article 1.5.1(c). NPOs often carry-on limited trading activities to raise funds for their charitable activities. For example, universities may operate a conference centre or accommodation in order to generate funds for their educational activities. These activities are typically structured through a trading subsidiary to limit the NPO’s exposure to risk from commercial activities, among other commercial and legal reasons. In many jurisdictions, the profit of such entities is not subject to tax, either due to an exemption or a tax deduction for dividends (paid to the NPO-Parent Entity) because the dividend is treated similarly to a charitable donation.

2. These trading subsidiaries will not be Non-Profit Organisations as defined in Chapter 10 of the Model Rules because their income and assets are available to be distributed to their shareholder. They may not always be considered Excluded Entities under Article 1.5.2 because their activities go beyond holding assets or investing funds and there may be questions about whether those activities are ancillary to those carried out by the Non-Profit Organisation. In these circumstances these trading subsidiaries may be considered Constituent Entities of the MNE Group.

3. The revenue of Excluded Entities is included in the consolidated revenue for the purposes of determining whether the MNE Group’s revenue meets the EUR 750 million threshold. This means that the revenue of large NPOs could result in the MNE Group being in scope of the GloBE Rules even though the revenue of the Constituent Entities from the trading activities is significantly below the threshold. The subsidiaries conducting these trading activities would not be in scope of the GloBE Rules if they were not owned by the NPO.

4. This could result in Top-up Tax being payable on the subsidiary’s profits under the GloBE Rules. This could occur where the subsidiary does not pay tax either because it is exempt or is entitled to a tax deduction for the distribution of the profits to the NPO. This reflects that the profits are raised to generate funds for the NPO and charitable donations are typically tax deductible. This means that the profits will not be subject to income tax if the profits are fully distributed to the NPO.

5. However, under many Authorised Accounting standards:

- the income of the subsidiary is recognised in the Entity’s Financial Accounting Net Income or Loss; and
- The dividend from the subsidiary to the NPO-Parent Entity is treated as a distribution and is not an expense.

6. This means the profits of the trading subsidiary will be included in the entity’s GloBE Income (or Loss). Where these profits are exempt, or the dividend is treated as a deductible dividend, there will be a permanent difference which could result in Top-up Tax being payable.

7. In other cases, the subsidiary may be subject to a high level of tax in the jurisdiction but would need to undertake the burden of preparing a GloBE Information Return to demonstrate that no Top-up Tax was due.

8. The Inclusive Framework has agreed that the GloBE Rules were not generally intended to impose top up taxes on the commercial fundraising activities of NPOs carried out through the NPOs’ directly or indirectly wholly-owned subsidiaries, where these trading activities are solely performed to raise funds for the benefit of the NPO and the revenues from these activities would be below the revenue threshold at which trading activities generally become subject to the GloBE Rules.

9. As such, a bright-line test has been developed to simplify the application of subparagraph 1.5.2(a)(ii) when determining whether an entity only carries out activities that are ancillary to those carried

out by the NPO. Where the revenues of all Group Entities, excluding revenue derived by the NPO or Excluded Entities under subparagraph 1.5.2(a)(i), paragraph 1.5.2(b) or subparagraph 1.5.2(a)(ii) but for the application of this test, is less than EUR 750 million (adjusted as provided under Article 1.1.2 if the Fiscal Year is a period other than 12 months) or 25% of the revenue of the MNE Group (if lower), the activities of all Group Entities that are 100% owned (i.e. ownership interests held directly or indirectly) of the NPO (and do not fall within the scope of subparagraphs 1.5.2(a)(i) or (ii), or paragraph 1.5.2(b) independently) will be considered ancillary, and therefore those entities will be Excluded Entities under subparagraph 1.5.2(a)(ii). Where any entity is not 100% owned (directly or indirectly) by NPOs, it will not be eligible to apply this bright-line test.

10. Where such revenue equals or exceeds 25% of MNE revenue or EUR 750 million, all Group Entities that are subsidiaries of an NPO that do not meet the requirements of subparagraphs 1.5.2(a)(i) or (ii), or paragraph 1.5.2(b) independently will not be considered Excluded Entities and will thus be subject to the GloBE Rules and potential Top-Up Tax.

11. In determining the revenue of an Entity for the purposes of this administrative bright-line test, this guidance should be read in line with the guidance issued for “Clarifying the Definition of Excluded Entity in Article 1.5.2”. Under that guidance, the activities undertaken by a permanent establishment of an entity are taken into account in determining whether the entity meets the requirements of Article 1.5.2. As the activities are not considered separate, neither is the revenue derived by the entity for the purposes of determining whether this administrative bright-line test applies.

12. Central, state, or local government or their administration or agencies that carry out government functions are not considered an Entity under the GloBE Rules and cannot be treated as the UPE of an MNE Group, and their revenues would not be considered to belong to any MNE Groups. Governmental Entities could be considered the UPE of an MNE Group and members of an MNE Group that includes a Governmental Entity could be subject to the GloBE Rules if the MNE Group meets the EUR 750 million revenue threshold. However, a Governmental Entity that meets the definition of an NPO will be eligible to benefit from this guidance.

### **1.6.2. Guidance**

13. In order to avoid unintentional Top-up Tax and administrative burden on certain trading operations conducted by entities held directly or indirectly by NPOs, the following guidance will be inserted after paragraph 54 of the Commentary to Article 1.5.2:

54.1 Non-profit Organisations may set up wholly-owned subsidiaries to undertake commercial activities to raise funds for the charitable activities of the parent Non-profit Organisation. Under some Authorised Financial Accounting Standards, Non-profit Organisations are required to prepare consolidated financial statements and thus they are more likely to be the UPE of the MNE Group as compared with the other types of Excluded Entities. As the revenue of Non-profit Organisations is not excluded from the GloBE revenue threshold, smaller trading operations of subsidiaries of Non-profit Organisations that are ultimately for the purpose of funding that entity’s charitable activities may become subject to the GloBE Rules and/or potentially subject to Top-Up Tax.

54.2 To assist Non-profit Organisations with managing compliance with the GloBE Rules, the Inclusive Framework has agreed to a bright-line test to determine the ‘ancillary’ activities of 100% owned subsidiaries of Non-profit Organisations. For the purpose of determining whether activities are ancillary to those carried out by Non-profit Organisations for the purposes of subparagraph 1.5.2(a)(ii), the activities of an entity where 100% of the value is owned directly or indirectly by the Non-profit Organisation or by Non-profit Organisations will be deemed to be ancillary if the aggregate revenue of all Group Entities (excluding revenue derived by the Non-profit Organisation or by an Entity that is an Excluded Entity under subparagraph 1.5.2(a)(i) or paragraph 1.5.2(b), or that would

be an Excluded Entity under subparagraph 1.5.2(a)(ii) but for the application of this bright-line test)), is less than EUR 750 million (adjusted as provided under Article 1.1.2 if the Fiscal Year is a period other than 12 months) or 25% of the revenue of the MNE Group (if lower) for the Fiscal Period. The application of this deeming does not have regard to, and is not affected by, the actual activities carried out by such subsidiary entities.

54.3 Where the aggregate revenue of all Group Entities (excluding revenue derived by the Non-profit Organisation or Excluded Entities under subparagraph 1.5.2(a)(i), paragraph 1.5.2(b) or subparagraph 1.5.2(a)(ii) but for the application of this bright-line test), equals or exceeds 25% of the revenue of the MNE Group or EUR 750 million for the Fiscal Period, all the relevant subsidiaries that fail to meet the requirements of subparagraph 1.5.2(a)(i), subparagraph 1.5.2(a)(ii) or paragraph 1.5.2(b), independent of this deeming, will not be Excluded Entities under Article 1.5.2.

54.4 The definition of Non-profit Organisation does not depend on the status of its funder. An organisation funded by government may fall within the definition of Governmental Entity and Non-profit Organisation. Where a Governmental Entity meets the definition of a Non-profit Organisation, it is treated as a Non-profit Organisation as well as a Governmental Entity under GloBE rules, and it could apply this guidance in respect of the ancillary income of its subsidiaries. Examples of Governmental Entities that could benefit from this guidance may include government-owned educational entities, research institutions and hospitals, as well as other government-owned healthcare providers.

# 2 Income & taxes

## 2.1. Intra-group transactions accounted at cost

### 2.1.1. Introduction

1. Article 6.3.1 aims at aligning the GloBE values (i.e. gain or loss on disposition at seller's side and GloBE carrying value at buyer's side) to the accounting values, where the latter generally reflect the fair market value of the asset and liabilities at the time of disposition. It is premised on the assumption that intra-group transactions are accounted for at fair value on a separate entity basis and then adjusted to eliminate intra-group income in consolidation. However, some MNE Groups account for intra-group transactions at cost, meaning the selling member does not recognise income, gain or loss on the transaction and the buying member records an asset in its financial accounts at the selling member's cost.

2. The computation of a Constituent Entity's GloBE Income or Loss begins with its Financial Accounting Net Income or Loss. Article 3.2.3 generally requires MNE Groups to apply the Arm's Length Principle to cross-border intra-group transactions in order to protect the integrity of jurisdictional blending. Without Article 3.2.3, MNE Groups could shift income from one jurisdiction to another by simply recording transactions in their financial accounts at below-market prices. Thus, an MNE Group that records intra-group transactions at the disposing Constituent Entity's carrying value must apply Article 3.2.3 for purposes of determining the income of the disposing Constituent Entity.

3. The guidance set out below confirms the application of Article 3.2.3 to a disposing Constituent Entity in transactions under Article 6.3.1 and notes that further work will be undertaken by the Inclusive Framework to address potential double taxation issues without imposing undue compliance burdens.

### 2.1.2. Guidance

4. The following guidance will be included in the Commentary to Article 6.3.1 after paragraph 73:

73.1 In a transaction between Constituent Entities of an MNE Group that is described in Article 6.3.1, the GloBE Income or Loss of the disposing Constituent Entity is determined in accordance with Article 3.2.3. The arm's length principle under Article 3.2.3 applies irrespective of whether the MNE Group accounts for transactions between Constituent Entities at the disposing Constituent Entity's carrying value rather than based on fair value. The Inclusive Framework will develop further guidance, including possible simplifications, for an acquiring Constituent Entity to avoid any possible double taxation attributable to the MNE Group's accounting for intra-group transactions.

## 2.2. Excluded Equity Gains or Loss and hedges of investments in foreign operations [AG22.04.T8]

### 2.2.1. Introduction

1. The definition of Excluded Equity Gain or Loss in Article 10.1 is relevant to Article 3.2, which sets out the adjustments to the Financial Accounting Net Income or Loss that are required in the computation of each Constituent Entity's GloBE Income or Loss.
2. Article 3.2.1(c), in particular, adjusts a Constituent Entity's Financial Accounting Net Income or Loss by the amount of Excluded Equity Gain or Loss. The term is defined in Article 10.1 as the gain, profit or loss included in the Financial Accounting Net Income or Loss of the Constituent Entity arising from:
  - a. gains and losses from changes in fair value of an Ownership Interest, except for a Portfolio Shareholding;
  - b. profit or loss in respect of an Ownership Interest included under the equity method of accounting; and
  - c. gains and losses from disposition of an Ownership Interest, except for a disposition of a Portfolio Shareholding.
3. Gains and losses excluded under Article 3.2.1(c) are those arising from the disposition of an Ownership Interest in any Entity where the MNE Group holds, in the aggregate, 10% or more of the Ownership Interests at the time of the transfer that are included in the Financial Accounting Net Income or Loss. As many jurisdictions fully or partially exempt from the tax base gains and losses arising from the disposition of shares or other Ownership Interests, this adjustment brings the GloBE Income or Loss computation more into line with taxable income by excluding gains or losses on such dispositions that are included in the financial accounting income. Moreover, some but not all jurisdictions also exclude gains or losses from transactions that hedge the currency risk associated with these Ownership Interests.

### 2.2.2. Issue to be considered

4. MNE Groups commonly hedge foreign currency risks arising from their net investments in foreign operations where the Entity's activities are conducted in a currency other than the functional currency of the parent entity. The hedged risk, in particular, is the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any Parent Entity (UPE, Intermediate Parent Entity or Partially-Owned Parent Entity) of that foreign operation. A derivative or non-derivative instrument in the currency of the foreign operation is generally designated as a hedging instrument in a hedge of the net investment in the foreign operation. Therefore, gain or loss in the value of the Ownership Interest (in the foreign operation) based on the foreign exchange movement between the functional currency of the Parent Entity and the functional currency of the foreign operation should be offset (in whole or in part) by an opposite gain or loss in the value of the derivative or non-derivative instrument.
5. The Commentary to Art. 3.2.1 (paragraph 57) anticipates that the GloBE Implementation Framework would consider providing Agreed Administrative Guidance on the extent to which gains and losses on hedging instruments may be treated as Excluded Equity Gains or Losses.
6. Under Acceptable Financial Accounting Standards (e.g. IFRS), gains or losses on hedging instruments that are determined to be an effective hedge of the net investment are recognised in other comprehensive income at the level of the Consolidated Financial Statements. At an entity level, on the other hand, the Parent Entity may report the hedging instrument denominated in the functional currency of the foreign operation and may be required to account for currency fluctuations in its income statement. This entity-level treatment could result in large foreign exchange items from net investment hedges in the

profit and loss statement and such gains or losses would also be included in the GloBE Income or Loss computation. Jurisdictions often have rules that exempt profit and loss items attributable to net investment hedges from tax.

7. The treatment of a net investment hedge for GloBE purposes should be aligned with the treatment of the equity investment it is hedging. This means that gains or losses from instruments that hedge the risk in Ownership Interests that give rise to Excluded Equity Gain or Loss would also qualify as Excluded Equity Gain or Loss for the purposes of Article 3.2.1(c). However, where domestic tax rules do not exempt the gain or loss from the net investment hedge, excluding such gains or losses from the computation of GloBE Income or Loss could be disadvantageous. Any Covered Taxes on such hedging gains would also need to be excluded from Adjusted Covered Taxes under Article 4.1.3 (a). Accordingly, the Inclusive Framework has determined that treatment of net investment hedges as Excluded Equity Gain or Loss should be at the election of the MNE Group.

### **2.2.3. Guidance**

8. The following guidance will replace paragraph 57 of the Commentary to Art. 3.2.1:

57.1. MNE Groups commonly hedge foreign currency movements in Ownership Interests in Constituent Entities. The hedged risk, in particular, is the foreign currency exposure arising between the functional currency of the Constituent Entity in which a Parent Entity holds an Ownership Interest and the functional currency of the Parent Entity. Under Acceptable Financial Accounting Standards, foreign exchange gains or losses on hedging instruments that are determined to be an effective hedge of the currency risk attributable to a net investment in a foreign operation (a net investment hedge) are recognised in other comprehensive income at the level of the Consolidated Financial Statements.

57.2. The treatment of a net investment hedge should follow the treatment of the investment it is hedging. Therefore, a Filing Constituent Entity may make a Five-Year Election to treat foreign exchange gains or losses reflected in a Constituent Entity's Financial Accounting Net Income or Loss as also an Excluded Equity Gain or Loss for the purposes of Article 3.2.1(c) to the extent that:

- (a) such foreign exchange gains or losses are attributable to hedging instruments that hedge the currency risk in Ownership Interests other than Portfolio Shareholdings;
- (b) such gain or loss is recognised in other comprehensive income at the level of the Consolidated Financial Statements; and
- (c) the hedging instrument is considered an effective hedge under the Authorised Financial Accounting Standard used in the preparation of the Consolidated Financial Statements.

As a consequence, any taxes arising on the foreign exchange gains described in the preceding sentence shall be treated as a reduction to Covered Taxes under Article 4.1.3 (a).

57.3 The rule set out in the previous paragraph relies heavily on the treatment of a hedging transaction in the Consolidated Financial Statements. Paragraph (a) distinguishes between hedges that are reported in the profit and loss of the Consolidated Financial Statements and those that are reported in other comprehensive income. Gains and losses from hedges reported in the profit and loss statement are properly taken into account in the computation of GloBE Income or Loss. The excluded gains and losses are those that relate to the net investments in a foreign operation reflected in the other comprehensive income because gains or losses from disposition of those net investments would be Excluded Equity Gains and Losses. Paragraph (b) limits the scope of the rule to transactions that are considered effective hedges under the accounting standard used to prepare the Consolidated Financial Statements.



57.4 The net investment hedge may be issued by a Constituent Entity that performs a treasury or finance function for the MNE Group (the issuing Constituent Entity) and that does not itself hold the Ownership Interest that is being hedged. This Constituent Entity may transfer the economic and accounting effect of the hedge to the Constituent Entity that holds the Ownership Interest through intercompany loans or other instruments. Consequently, if the hedging instrument is held by an issuing Constituent Entity that transfers the effect of the hedge to the Constituent Entity that holds the hedged Ownership Interest through intercompany loans or other instrument, the foreign exchange gain or loss on the net investment hedge shall be treated as an Excluded Equity Gain or Loss under Article 3.2.1(c) of the Constituent Entity that holds the Ownership Interest and no adjustment shall be made to the GloBE Income or Loss of the issuing Constituent Entity.

#### **2.2.4. Examples**

9. The following examples will be included in the GloBE Model Rules Examples.

##### *Example 3.2.1(c)-1*

1. This example illustrates how to allocate the Excluded Equity Gains or Loss on hedging instruments that hedge the currency risk in Ownership Interests other than Portfolio Shareholdings in cases where the hedging instrument is issued by a Constituent Entity (the issuing Constituent Entity) other than the Constituent Entity that holds the hedged Ownership Interest.
2. Group A prepares its Consolidated Financial Statements in US Dollars while Group B prepares its Consolidated Financial Statements in Euro. Group A acquires Group B, which becomes Subgroup B, and enters into an external loan denominated in Euro to hedge the fluctuations in the value of assets and liabilities of the newly acquired Group B that arise from translating those assets and liabilities from Euro to US Dollars for its Consolidated Financial Statements. The loan is considered an effective hedge under the Authorised Financial Accounting Standard used in the preparation of the Consolidated Financial Statements of Group A, which continue to be prepared in US Dollars after the acquisition.
3. As the loan is designated in the Consolidated Financial Statements of Group A as a net investment hedge against the investment in the newly acquired Group B, any currency fluctuations on the loan are reflected in the Other Comprehensive Income (OCI) rather than in the Income Statement. This ensures that foreign exchange movements between the value of the Euro and Dollar do not affect the financial results for Subgroup B in Group A's Consolidated Financial Statements.
4. The loan was entered into by TC Co, a Constituent Entity of Group A located in Country A that performs treasury functions for Group A. The investment in the newly acquired Group B, however, is held by Subgroup B Hold Co, a separate Constituent Entity of Group A that is located in Country B. The functional currency of both TC Co and Subgroup B Hold Co is the US Dollar and both Countries A and B have a 25% CIT rate.
5. The financial accounts of the former Group B Entities are maintained in Euro and translated to US Dollars for consolidation. Net investment hedge accounting is not available in the entity accounts of TC Co because TC Co does not have foreign exchange exposure in respect of Subgroup B so from the entity perspective the external loan is not a hedge. Consequently, currency fluctuations on the loan are reflected in the Income Statement in its financial accounts. To avoid large currency fluctuations on the external loan affecting taxable profits, TC Co (lender) and Subgroup B Hold Co (borrower) enter into an intra-group loan denominated in Euro for the same value of the external loan taken out by TC Co. Any currency fluctuations in the external loan will therefore be offset by equal and opposite fluctuations in the intra-group loan ensuring that there is no net income or loss in respect of the external loan included in either TC Co's financial accounts or

its taxable profit. From Subgroup B Hold Co's perspective, the currency fluctuations on the intragroup loan are included in its financial accounts. This is because net investment hedge accounting is not available in its entity accounts because its financial investment in Subgroup B is measured at cost and does not reflect movements in the value of the ownership interests attributable to currency fluctuations. The movement on the intra-group loan is consequently not hedging any currency movement in the Income Statement from an entity perspective. However, under Country B's tax laws, the currency fluctuations on the intra-group loan are not included in taxable profits on the basis that they relate to a loan used to hedge Subgroup B Hold Co's investment in the newly acquired Subgroup B. The intragroup loan therefore prevents the external loan affecting the taxable profit of Group A, when there is no net income from the overall arrangement from the consolidated perspective.

6. In Year 1, TC Co and Subgroup B, including Subgroup B Hold Co, have USD 1 000 of profit each before any foreign currency fluctuations are considered. Due to foreign currency fluctuations, however, the value of the Euro denominated external loan increases by USD 100 so that it gives rise to an expense of USD 100 for TC Co. In the Consolidated Financial Statements of Group A, this USD 100 is reflected in the OCI (and therefore it is not included in the profits). The same currency fluctuation applies on the intra-group loan so that the impact on the profit and loss statement of TC Co determined based on its entity accounts (without regard to consolidation adjustments) is neutralised (i.e. the USD 100 expense on the external loan is offset by the USD 100 income arising from the intra-group loan). Under the tax laws of jurisdiction B, the USD 100 expense arising from the intra-group loan is reflected in Subgroup B Hold Co's financial accounts but is excluded from the computation of its taxable profits. Therefore, USD 250 of tax (= USD 1 000 x 25% CIT) is paid both in Jurisdictions A and B, irrespective of the fact that the overall accounting profit of TC Co is USD 1 000 while the accounting profit of Subgroup B is 900 (= USD 1 000 Subgroup B profit – USD 100 Subgroup B Hold Co expense arising from intra-group loan).

7. As currency fluctuations are reflected in the OCI and the external loan is considered an effective hedge under the Authorised Financial Accounting Standard used in the preparation of the Consolidated Financial Statements of Group A, the USD 100 expense of TC Co is an Excluded Equity Gain or Loss for the purposes of Article 3.2.1 (c). As TC Co does not hold the investment in Subgroup B, however, the USD 100 expense is actually excluded from the GloBE Income or Loss of Subgroup B Hold Co. Therefore, TC Co has GloBE Income of USD 1 000 and a GloBE ETR of 25% (= 250 Adjusted Covered Taxes / USD 1 000 GloBE Income) in Year 1. Subgroup B also has GloBE Income of USD 1 000 (= USD 900 accounting profit + USD 100 Excluded Equity Loss) and a GloBE ETR of 25% (= 250 Adjusted Covered Taxes / USD 1 000 GloBE Income) in Year 1.

## 2.3. Excluded Dividends – Asymmetric treatment of dividends and distributions [AG22.04.T10]

### 2.3.1. Introduction

1. This section provides guidance on the definition of Excluded Dividends and Ownership Interest in Article 10.1. The definition is relevant to Article 3.2, which sets out the adjustments to the Financial Accounting Net Income or Loss that are required in the computation of each Constituent Entity's GloBE Income or Loss.
2. Article 3.2.1(b) adjusts a Constituent Entity's Financial Accounting Net Income or Loss by the amount of any Excluded Dividends. The term is defined in Article 10.1 to mean dividends or other distributions received or accrued in respect of an Ownership Interest, except for:
  - a. a Short-term Portfolio Shareholding, and
  - b. an Ownership Interest in an Investment Entity that is subject to an election under Article 7.6.
3. Ownership Interest, defined in Article 10.1, means any equity interest that carries rights to the profits, capital or reserves of an Entity, including the profits, capital or reserves of a Main Entity's Permanent Establishment(s). Equity interest is referred to in paragraph 85 of the Commentary as an interest that is accounted for as equity under the financial accounting standard used in the preparation of the Consolidated Financial Statements.
4. "Dividends or other distributions" (hereafter distributions) are undefined within the Model Rules. Paragraph 2 of the Commentary for Article 10.1 notes that where a common accounting term is undefined it should be interpreted consistent with the meaning given to them in financial accounting standards and guidance.

### 2.3.2. Issue to be considered

5. There is a concern raised by stakeholders that MNE Groups subject to the GloBE Rules may attempt to rely on the accounting treatment of certain financial instruments and the broad definition of Excluded Dividend, to artificially increase the Effective Tax Rate of the MNE Group for a jurisdiction for the purposes of Article 5.1.
6. This is achieved as follows:
  - A Constituent Entity issues a financial instrument to another Constituent Entity, which may be located in the same jurisdiction. The financial instrument is treated as equity of the issuer for local tax purposes and distributions made in respect thereof are not deductible. In contrast, the financial instrument is treated as debt (a liability) by the issuer under the Acceptable Financial Accounting Standard. The issuer accounts for each payment in respect of that financial instrument as an expense for accounting purposes, which effectively reduces its Financial Accounting Net Income (or increases its Financial Accounting Net Loss) by the amount of the payment.
  - The Constituent Entity holding the financial instrument treats it as an Ownership Interest and the payment received as an Excluded Dividend. Receipt of the payment is excluded from the holder's income for local tax purposes.
7. If the financial instrument were treated consistently by the issuer and holder for accounting purposes, it would have no effect on the Effective Tax Rate (ETR) computed for the jurisdiction under the GloBE Rules when both are located in the same jurisdiction. For example, if the instrument were treated as debt by both for purposes of computing GloBE Income or Loss, the issuer would be entitled to a expense for the payment and the holder would include the payment in income. Thus, payments in respect of the

instrument would have no net effect on the GloBE Income computed for the jurisdiction. Similarly, if the instrument were treated as equity by both the issuer and the holder, there would be no change in the GloBE Income for the jurisdiction. However, by treating the financial instrument as debt of the issuer and equity for the holder, the issuer's financial accounting expense is not offset by a corresponding amount of income to the holder. This asymmetric accounting treatment would produce, in effect, a Deduction / No Inclusion outcome under the GloBE Rules that artificially reduces the GloBE Income and increases the ETR for the jurisdiction. A similar result would obtain for the MNE Group where the issuer and holder are in different jurisdictions.

8. A common example of such an instrument that may give effect to this outcome would be redeemable preference shares. Depending on the terms of the shares, they can often be treated as a liability for the issuer under Acceptable Financial Accounting Standards (e.g. a redeemable preference shares or convertible note), while the same accounting standard allows for a different classification of the instrument from the holder's perspective (i.e. equity treatment).

9. In certain situations where there is a mismatch between the accounting treatment of the issuer of an instrument and the holder that gives rise to such issues, Article 3.2.7 excludes the expense from the issuing Constituent Entity's Financial Accounting Net Income or Loss. However, given the definition of Low-Tax Entity and High-Tax Counterparty in Article 10.1, Article 3.2.7 is not triggered in circumstances where the issuer and the holder are residents of the same tax jurisdiction.

10. A similar outcome could potentially apply in circumstances where a Constituent Entity issues a compound financial instrument. Compound financial instruments are non-derivative financial instruments that, from the issuer's perspective, contain both a liability and an equity component, such as a convertible bond. Under IFRS and US GAAP, the issuing entity must separately identify the liability and equity components of the compound financial instrument and treat each accordingly in the financial statements.

11. Where this is the case, it could be asserted that, from the holder's perspective, the relevant interest is both equity and debt under the Acceptable Financial Accounting Standard. The definition of Excluded Dividend requires the underlying interest be equity in nature but does not explicitly prevent instruments that are considered both equity and debt in nature from falling within scope. Under this assertion, any distribution, regardless of whether it is considered an expense (i.e. liability) or a reduction in equity, may still be in respect of the instrument that is equity under the Acceptable Financial Accounting Standard and therefore potentially be considered an Excluded Dividend.

12. To preserve the integrity of the GloBE Rules and ensure consistent outcomes, it should be expected that Constituent Entities in an MNE Group subject to the same Acceptable Financial Accounting Standard consistently apply the relevant standard uniformly to all instruments to prevent asymmetrical outcomes. Further, it should be made clear that for a dividend or distribution made in respect of a compound financial instrument, only the amount that relates to the equity portion of the instrument is intended to fall within scope of the definition of Excluded Dividend. That is, coupon or interest payments paid on a compound financial instrument, which are considered a liability for the issuer, should not be treated by the holder as an Excluded Dividend under Article 3.2.1(b) of the GloBE Rules.

### 2.3.3. Guidance

13. The bold and underlined text below will be added to the end of paragraph 37 of the Commentary to Article 3.2.1(b):

37. Excluded Dividends are defined in Article 10.1 as dividends or other distributions received or accrued in respect of an Ownership Interest, except for a Short-term Portfolio Shareholding and an Ownership Interest in an Investment Entity subject to an election under Article 7.6. The exception that applies to these two categories of Ownership Interest is further described below. **Further, where a dividend or other distribution is received or accrued in respect of an Ownership**

**Interest which is a compound financial instrument (i.e. having both equity and liability components under the Acceptable Financial Accounting Standard), only the amounts received or accrued in respect of the equity component of the Ownership Interest shall be treated as an Excluded Dividend.**

14. The bold and underlined text below will be added to the end of paragraph 85 of the Commentary to the meaning of Ownership Interest in Art. 10.1:

85. The definition uses the term equity interest to distinguish between an Ownership Interest and other rights to the profits, capital, or reserves of an Entity, such as profit-sharing agreements with employees that do not carry any equity rights to the Entity or creditors rights to compel sale certain assets to satisfy an obligation of the Entity that is in default. An equity interest is an interest that is accounted for as equity under the financial accounting standard used in the preparation of the Consolidated Financial Statements. Similarly, whether a Constituent Entity is the owner of an equity interest, e.g. shares of stock that have been loaned to another person in connection with a short sale or stock sold with a repurchase obligation, is determined based on the accounting treatment of the interest in the Consolidated Financial Statements. **A financial instrument issued by one Constituent Entity and held by another Constituent Entity in the same MNE Group must be classified as debt or equity consistently for both the issuer and holder and accounted for accordingly in the computation of their GloBE Income or Loss. To the extent the Constituent Entities have classified the instrument differently under the relevant accounting standard(s), the classification adopted by the issuer should be applied by the issuer and the holder for GloBE purposes. Aligning the classification of the instrument ensures that no amount in respect of a financial instrument shall be treated as an Excluded Dividend to the extent that another Constituent Entity in the same MNE Group that issued the instrument treats the payment as an expense in the computation of its GloBE Income or Loss. To the extent the issuer classifies the relevant instrument as a debt for accounting purposes, the MNE Group will still need to consider the application of Article 3.2.7.**

## 2.4. Treatment of debt releases

### 2.4.1. Introduction

1. As the financial accounts are used as a starting point for determining the GloBE Income or Loss, permanent differences are likely to arise between the taxable income of a Constituent Entity in the jurisdiction where it is located and its GloBE Income or Loss. Article 3.2 adjusts the Financial Accounting Net Income or Loss for certain book to tax differences that are common in Inclusive Framework jurisdictions to determine the GloBE Income or Loss for a Constituent Entity. While the number of adjustments has been kept at a minimum to minimise complexity, the adjustments set out in Article 3.2 reflect cases that are sufficiently material and widely accepted in Inclusive Framework jurisdictions. However, Article 3.2.1 does not include an adjustment for income within Financial Accounting Net Income or Loss (FANIL) arising from debt releases.

2. “Debt release” refers to a situation where an amount owing by an entity is waived or forgiven by the creditor without being repaid in full and with the debtor being freed or released from any further obligation to pay the amount. Under many Authorised Financial Accounting Standards, debt releases typically result in the amount released being considered income of the debtor.

3. However, it is common in Inclusive Framework jurisdictions that the tax rules do not tax or require adjustments to tax attributes for some or all of the amount of debt released. Further, in some Inclusive Framework jurisdictions, these rules do not distinguish between related and third-party debt releases

4. Where a debtor is subject to a debt release and the relevant jurisdiction has tax rules similar to those above, the debt release would result in either a temporary (where it reduces tax attributes) or permanent (where it is not subject to tax) difference for local tax purposes.

5. Where there is a reduction in tax attributes for the debtor due to a debt release, there would likely be a corresponding increase in Adjusted Covered Taxes under Article 4.4.1 because the reduction in tax attributes would result in a change in the deferred tax asset or a deferred tax liability on those attributes and therefore a charge to the income statement. This would prevent or reduce additional Top-up Tax. However, this is only the case to the extent that the tax attributes reduced under local law correspond to the tax attributes taken into account under the GloBE Rules.

6. To the extent that the debt release results in the debt release amount, either in full or in part, not being subject to tax under local tax law, Top-up Tax liabilities arising for entities within the scope of the GloBE Rules. In such circumstances, the debt release would increase GloBE Income for those entities with no corresponding increase in Adjusted Covered Taxes, potentially resulting in significant amounts of Top-up Tax where the amounts released are substantial.

7. It should also be noted that it is common in Inclusive Framework jurisdictions to provide companies in financial distress and that are no longer able to support existing capital structures with corporate rescue procedures under corporate law to support reorganisation measures and securing the survival of the company. These procedures often include negotiations between the distressed company as the debtor and its creditors on deleveraging the company’s capital structure and typically involve the release, or conversion into equity, of debt. These procedures are often supervised or must be confirmed by a court in the jurisdiction of the company. Such procedures are not necessarily required for debt releases to occur (i.e. the debt can be released and the relevant tax laws apply without the requirement to undertaken court supervised procedures) and typically are not used in relation to related-party debt releases.

### 2.4.2. Issues to be considered

8. Under the model GloBE Rules, significant Top-up Tax liabilities could arise for MNE Groups where a Constituent Entity has had a debt released. While this liability would reflect accounting income, it could

materially reduce the effectiveness of both domestic tax and corporate law procedures and consequently defeat the policy objective of using the tax system to assist financially distressed entities that have released or forgiven by creditors by imposing Top-Up Tax due to the debt release.

### *Scope*

9. To minimise the scope for tax planning, the scope of an adjustment for debt release must be limited to corporate rescue scenarios that can be defined on legal facts as opposed to requiring subjectivity. In addition, the scope must be limited so as not to introduce tax planning opportunities for MNE Groups using related-party financing structures.

10. The relief given in relation to debt releases only applies in circumstances where the relevant procedure is:

- a. undertaken under statutorily provided insolvency or bankruptcy proceedings, that are supervised by a court or other judicial body in the relevant jurisdiction or where an independent insolvency administrator is appointed;
- b. where the creditor to the debt release is a third-party and it is reasonable to conclude that the debtor would be insolvent within 12 months but for the release of the third-party debts under an arrangement. Where this is the case, relief will apply to both third-party and related-party debts released, provided the debt release of any related-party debt is undertaken as part of the same arrangement as the release of the third-party debt; or
- c. where the creditor to the debt release is a third-party and, immediately before the debt release, the debtor's liabilities are in excess of the fair market value of its assets. Where this is the case and the requirements in paragraphs (a) and (b) are not met, relief will apply to third-party debts but only to the extent of the lesser of (i) the excess of the debtor's liabilities over the fair market value of its assets (determined immediately before the debt release), or (ii) the reduction in the debtor's attributes under the tax laws of the debtor's jurisdiction resulting from the debt release.

11. Limiting any debt release exemption to these circumstances ensures that only genuine actions that are likely to be significant in size and fundamental to the survival of the company fall within scope, meaning the suggested adjustment should always be material.

12. Where the above-mentioned circumstances apply, the entire amount of the debt release within scope of the relief is excluded from the computation of GloBE Income or Loss under Article 3.2.1. In circumstance where a jurisdiction requires a reduction in the tax attributes of any entity, the deferred tax expense associated with the reduction of those tax attributes is also excluded from the computation of Adjusted Covered Taxes under Article 4.4.1.

13. In accordance with the GloBE Rules, any current tax expense (where part of the debt release is subject to tax) should be included in the current tax expense of the entity and any deferred tax expense associated with the reduction of tax attributes should be included in the computation of Adjusted Covered Taxes under Article 4.4.1.

14. The guidance issued below relates solely to the debtor to a debt release. The Inclusive Framework will consider whether further guidance in relation to the creditor as necessary.

### **2.4.3. Guidance**

15. The following paragraphs will be included after paragraph 86 of the Commentary to Article 3.2.1:

*Additional adjustments to determine GloBE Income or Loss*

***Debt releases under prescribed circumstances***

86.1 The Inclusive Framework has agreed that the amount of a debt release included in the Financial Accounting Net Income or Loss shall be excluded from the computation of a Constituent Entity's GloBE Income or Loss, where the Filing Constituent Entity elects to do so and the debt release:

- (a) is undertaken under statutorily provided insolvency or bankruptcy proceedings, that are supervised by a court or other judicial body in the relevant jurisdiction or where an independent insolvency administrator is appointed. Where this is the case, both third-party and related-party debts released as part of the same arrangement will be excluded from the computation of GloBE Income or Loss;
- (b) arises pursuant to an arrangement where one or more creditors is a person not connected with the debtor (i.e. third-party debt) and it is reasonable to conclude that the debtor would be insolvent within 12 months but for the release of the third-party debts released under the arrangement. Where this is the case, both third-party and related-party debts released as part of the same arrangement will be excluded from the computation of GloBE Income or Loss; or
- (c) occurs when the debtor's liabilities are in excess of the fair market value of its assets determined immediately before the debt release. An amount will only be excluded with respect to debts owed to a creditor that is a person that is not connected with the debtor and only to the extent of the lesser of (i) the excess of the debtor's liabilities over the fair market value of its assets determined immediately before the debt release, or (ii) the reduction in the debtor's attributes under the tax laws of the debtor's jurisdiction resulting from the debt release. Paragraph 86.1(c) only applies in circumstances where paragraphs 86.1(a) or (b) do not apply.

86.2 Where the debtor is not subject to tax on this income under domestic tax law, absent the relief provided in the preceding paragraph, Top-up Tax liabilities could arise for MNE Groups, which may undermine the tax and corporate law policy measures designed to support entities that are insolvent or subject to financial distress. However, where the parties to a debt release are members of the same MNE group, planning opportunities would arise if the impact of the transaction on each party's GloBE Income or Loss was recognised. Only allowing adjustments to the GloBE Income or Loss computation of a Constituent Entity in the circumstances mentioned above is intended to ensure that only genuine cases of insolvency that are material in size and fundamental to the survival of the Constituent Entity fall within scope.

86.3 Accordingly, where the circumstances fall within scope of paragraph 86.1(a), (b) or (c), income from the debt release in the FANIL, any current tax expense and any related deferred tax expense (arising from a reduction in domestic tax attributes) in relation to the debt release shall be excluded from the borrowing Constituent Entity's GloBE Income or Loss and Adjusted Covered Taxes, respectively. However, this treatment will only apply in circumstances where the Filing Constituent Entity elects to do so. Further, in the case of debt subject to paragraph 81.6(c), the abovementioned treatment only applies to the proportion of the debt released that is eligible for relief.

86.4 Where a debt release falls within scope of paragraph 86.1(a) or (b), amounts in relation to both related-party and third-party debts released will be excluded from the computation of a Constituent Entity's GloBE Income or Loss. However, where a debt released falls within scope of paragraph 86.1(c), only amounts in relation to debts owed to a creditor that is a person that is not



connected with the debtor will be excluded from the computation of a Constituent Entity's GloBE Income or Loss. Further, the amount to be excluded from the computation of a Constituent Entity's GloBE Income or Loss under paragraph 86.1(c) is the lower of the amount of the reduction in the debtor's tax attributes under local tax law (including tax attributes that are not included in Covered Taxes for GloBE purposes, e.g. foreign tax credits) or the amount required to make the entity solvent on a net asset basis (i.e. the difference between its liabilities and the fair market value of its assets).

86.5 A "statutorily provided insolvency or bankruptcy proceeding... supervised by a court or other judicial body", for the purposes of 86.1(a) is defined as any procedure provided under the domestic law of a jurisdiction to support companies in financial distress in reorganising and secure their survival or ensure their orderly winding up that is supervised or must be confirmed by a Court or other judicial body. "The appointment of an independent insolvency administrator" extends the scope of the adjustment to situations where an independent administrator is appointed to control the Constituent Entity. In some jurisdictions, while this process is determined by domestic legislation, it is not supervised or confirmed by a court or judicial body. Only debts legally waived after the administrator is appointed will fall within scope of the adjustment. Further, the exemption outlined in 81.6(a) will apply regardless of whether the creditor is 'connected with' the debtor or not.

86.6 In the instance described in paragraph 86.1(b) or (c), the creditor will be considered to not be "connected with" the debtor, if the relationship between the two entities does not meet the test set out in Article 5(8) of the OECD Model Tax Convention (OECD, 2017<sup>[3]</sup>).

86.7 Whether it is reasonable to conclude the debtor would be insolvent within 12 months but for the release of the aggregate amount of any relevant third-party debt under an arrangement should be based on the opinion of a qualified independent party. "Insolvency" in this context refers to its common meaning of "an entity that cannot pay all its debts, as and when they become due and payable", rather than a strict balance sheet test. In determining whether the entity would be insolvent but for the release on any third-party debt, the qualified independent party should exclude any debt owed to a creditor that is "connected with" the debtor. In order to fulfil this requirement, the Constituent Entity will be required to have sought external professional advice from a qualified independent party. Notwithstanding the requirement that the scope of 86.1(b) requires testing of solvency based on third-party only debt, to the extent that related-party debts are also released under the same arrangement, the related-party debts will also receive the benefit of the adjustments outlined in paragraph 86.3 above. An "arrangement" refers to its ordinary meaning, but should involve a negotiation and agreement between the debtor and the creditor/s. While it is not necessary that all the relevant debts forgiven are part of a single legal agreement, the relevant debt releases should be objectively viewed as being undertaken as part of a single arrangement or plan to ensure the solvency of the debtor.

## 2.5. Accrued Pension Expenses [AG22.04.T1]

### 2.5.1. Introduction

1. This section provides guidance on the definition of Accrued Pension Expense in Article 10.1, which is relevant to the Adjustments under Article 3.2 to determine GloBE Income or Loss. As the financial accounts are used as a starting point for determining the GloBE Income or Loss, permanent differences are likely to arise between the taxable income of a Constituent Entity in the jurisdiction where it is located and its GloBE Income or Loss. Article 3.2 adjusts the Financial Accounting Net Income or Loss for certain book to tax differences that are common in IF jurisdictions.

2. Article 3.2.1 (i) adjusts a Constituent Entity's Financial Accounting Net Income or Loss for Accrued Pension Expense. The term "Accrued Pension Expense" is defined in Article 10.1 as "*the difference between the amount of pension liability expense included in the Financial Accounting Net Income or Loss and the amount contributed to a Pension Fund for the Fiscal Year.*"

3. Financial accounting standards sometimes differ in their treatment of pension expenses associated with defined benefit pension plans. In general, the company makes contributions to another entity, often a trust, and the other entity invests the contributions to earn income that, along with the original contributions, will fund the payments to pensioners when they become eligible. The earnings of the pension fund reduce the contributions that the company must make to fund its employees' retirement benefits. In some cases, the pension plan earnings could exceed the company's total liability and the excess would ultimately be returned to the company. In either case, however, the company's net expense will be equal to the contributions because to the extent earnings reduce the need for contributions, they offset pension liabilities. For example, if a company's pension liability for an employee upon retirement is 100 and it contributes 60 that earns 40 of income over the employee's career, the company's net cash expense is 60. If instead, the pension plan earned only 30 of income, the company would need to contribute an additional 10 to satisfy its pension liability.

4. The earnings of the pension fund are typically reflected in the Other Comprehensive Income (OCI) section of the company's balance sheet under financial accounting standards. The earnings may be recycled through the profit and loss statement, in whole or in part, depending upon the financial accounting standard. These differences in the financial accounting standards would result in different amounts of Financial Accounting Net Income or Loss under different Authorised Financial Accounting Standards. However, Article 3.2.1(i) ensures that the pension expenses of a company are equal to its net contributions (i.e. its contributions less any earnings of the pension plan refunded to the company) irrespective of the accounting standard it applies to compute its GloBE Income or Loss.

5. Stakeholders have requested clarification on the application and scope of Article 3.2.1(i) and the related consequences on the determination of Adjusted Covered Taxes, including:

- whether Article 3.2.1(i) applies to company pension schemes wherein payments are made directly to pension recipients, rather than to a pension fund;
- whether an Adjustment under Article 3.2.1 (i) is necessary in cases of pension income or surplus (i.e. where the earnings of the pension fund for the period exceed the accrued pension expense for the period and the net earnings are included in the profit and loss statement); and
- the treatment of deferred tax assets (DTAs) or deferred tax liabilities (DTL) associated with pension expenses.

### 2.5.2. Issues to be considered

#### *Scope of Accrued Pension Expense Adjustment*

6. The definition of Accrued Pension Expenses specifically refers to amounts contributed to a Pension Fund. Paragraph 85 of the Commentary also states that pension liabilities are allowed as expenses in the GloBE Income or Loss computation to the extent of contributions to a Pension Fund during the Fiscal Year.

7. By focusing on Pension Funds, the definition of Accrued Pension Expense could be interpreted to disallow an expense for company pension schemes wherein the company makes payments directly to pension recipients. Disallowing such expenses would create an unjustified difference between contributions to a Pension Fund and direct payments to pension recipients.

#### *Treatment of pension income*

8. The definition of Accrued Pension Expense refers to pension liability expense. In this connection stakeholders have asked for clarification if the reference to “pension liability expense” means that the adjustment only applies when there is an accrued expense in the Financial Accounting Net Income or Loss, because the pension scheme is in deficit, or whether this adjustment should also apply when there is the net pension income recognised in the profit and loss statement for the Fiscal Year as a result of the scheme being in surplus.

### 2.5.3. Guidance

#### *Scope of Accrued Pension Expense Adjustment*

9. In view of the intended policy outcome of the adjustment under Article 3.2.1 (i), the adjustment should only apply in the case of pension expenses that are provided through a Pension Fund.

10. Paragraphs 85 and 86 of the Commentary to Article 3.2.1 (i) are revised to read as follows:

85. Pension liabilities are allowed as expenses in the computation of GloBE Income or Loss to the extent of contributions to a Pension Fund during the Fiscal Year. Calculating the annual expense for pension liabilities based on contributions to a Pension Fund has two benefits. First, the timing rule for deducting pension liabilities under local tax rules is commonly based on the timing of contributions and consequently, will better align the timing of *pension expense attributable to Pension Funds* from a GloBE Rules perspective with the effect on local tax liability. Second, it avoids complications and potential competitiveness concerns that would arise under some Acceptable Financial Accounting Standards that reflect some of the effects of pension accounting solely in the OCI. *However, Article 3.2.1(i) only applies to the pension expenses of pension plans that are provided through a Pension Fund. Thus, pension expenses that are accrued for direct pension payments to former employees are not subject to Article 3.2.1(i) and should be taken into account under the GloBE Rules at the same time and in the same amount as they are accrued as an expense in the computation of Financial Accounting Net Income or Loss.*

#### *Treatment of pension income*

86. While perhaps unusual, it is possible for the Pension Fund earnings to exceed the pension expense for the Fiscal Year, with the surplus included as income in the profit and loss statement. That surplus, or net income, should be excluded from the GloBE Income or Loss computation to the extent that it is retained by the Pension Fund. Conversely, in cases where the surplus is distributed to the MNE Group, it should be added back to the GloBE Income or Loss computation in the Fiscal

Year of the distribution. There may also be instances where the overall scheme is in a surplus, rather than deficit, due to unexpectedly high performance of the assets held by the scheme. The adjustment under Article 3.2.1(i) is intended to exclude the entire difference between the amounts included in the Financial Accounting Net Income and Loss for the year and the amounts contributed to the Pension Fund. The adjustment should ensure that the amounts contributed to the pension scheme are the only pension expense amounts included in the computation of GloBE Income or Loss, so that the treatment of pension expenses under the GloBE Rules corresponds to the timing of deduction of pension expenses for Corporate Income Tax purposes. Accordingly, Article 3.2.1(i) also applies in situations where there is a pension surplus or pension income recognised in the Financial Accounting Net Income or Loss. The italicized language below will be inserted into a revised paragraph 86 of the Commentary to Article 3.2.1(i):

86.1 The adjustment for Accrued Pension Expense required by Article 3.2.1(i) depends upon whether the Constituent Entity's Financial Accounting Net Income or Loss includes an accrued pension expense or pension income with respect to a Pension Fund. In the case of an accrued pension expense, the adjustment is equal to the difference between (a) the amount contributed to a Pension Fund and (b) the amount accrued as an expense with respect to that Pension Fund in the computation of Financial Accounting Net Income or Loss during the Fiscal Year. The adjustment to Financial Accounting Net Income or Loss for this difference will be a positive amount (increasing income) if the amount accrued as an expense in the financial accounts exceeds the contributions for the year. It will be a negative amount (reducing income) in Fiscal Years in which the contributions exceed the expense accrued in the financial accounts. In the case of accrued pension income, the adjustment would be calculated as the sum of the pension income and the amount of pension contributions, if any, during the Fiscal Year. In this case, the adjustment will be a negative amount. This adjustment will also apply when the Pension Fund is in surplus as well as when it is in deficit or liability position. The formula to determine the adjustment (positive or negative) to Financial Accounting Income or Loss for the Accrued Pension Expense is as follows:

*GloBE Adjustment = (Accrued Income or Expense for fiscal year + contribution for fiscal year) x (-1)*

*Where*

- *Accrued income is expressed as a positive amount*
- *Accrued expense is expressed as a negative amount*
- *Contribution is expressed as a positive amount*

*In cases where the Pension Fund is in surplus and the surplus (net income) is distributed to a Constituent Entity, that surplus will be included in the computation of the Constituent Entity's GloBE Income or Loss in the Fiscal Year of the distribution.*

#### **2.5.4. Examples**

11. The following examples will be included in the GloBE Model Rules Examples.

##### *Example 3.2.1(i)-1*

##### ***Accrued Pension Expense Adjustment***

1. This example illustrates the adjustment to a Constituent Entity's Financial Accounting Net Income or Loss for Accrued Pension Expenses under Article 3.2.1(i).
2. A Co is located in Country A, which implemented the GloBE Rules. A Co is a Constituent Entity of ABC Group, which is in scope of the GloBE Rules. A Co established a pension fund in Country A for its employees, which operates exclusively to administer and provide retirement

benefits to the employees of A Co. Country A imposes a 15% corporate income tax (CIT) and under the local tax rules of Country A deductions for pension liabilities are allowed in the taxable Year in which the amount is contributed to a pension fund or, in the case of pension benefits that are not administered through a pension fund, when paid to pension beneficiaries.

3. In Year 1, A Co has income of EUR 100 and accrues pension expenses for accounting purposes of 20. In Year 2, A Co has income of EUR 100 and effects a contribution of EUR 15 to its pension fund.

4. In Year 1, A Co has taxable income of EUR 100, which results in a tax liability of EUR 15. For Country A tax purposes, the accrual of pension expenses for accounting purposes is disregarded as no contribution is made to the pension fund. A Co created a deferred tax asset of EUR 3 (= EUR 20 x 15%) because the EUR 20 pension liability is not deductible for tax purposes until it is contributed and the carrying value of the liability for accounting purposes exceeds that of the liability for tax purposes by EUR 20. The timing difference will be resolved when the EUR 20 is contributed to the pension fund. Because of the deferred tax asset created for financial accounting purposes, A Co's income tax expense for Year 1 is 12 (= EUR 15 – EUR 3), which produces an ETR for accounting purposes of 15% (= EUR 12 income tax expense / EUR 80 pre-tax income).

5. In Year 1, A Co has Financial Accounting Net Income or Loss of EUR 68 (= EUR 100 income – EUR 20 pension expense – 12 income tax).

6. For GloBE purposes, pension liabilities are only allowed as expenses in the computation of GloBE Income or Loss to the extent of contributions to a Pension Fund during the fiscal Year. Under Article 3.2.1(i), A Co's Financial Accounting Net Income or Loss must be adjusted according to the following formula:

$$\text{GloBE Adjustment} = (\text{Accrued Income or Expense for fiscal Year} + \text{payment for fiscal Year}) \times (-1)$$

Where

- *Accrued income is expressed as a positive amount*
- *Accrued expense is expressed as a negative amount*
- *Payment is expressed as a positive amount*

7. The GloBE Adjustment for Year 1 is EUR +20 (= (EUR -20) + (0) x (-1)), which results in a GloBE Income of EUR 100 (= EUR 68 FANIL + 20 pension adjustment + 12 income tax). Although A Co created a deferred tax asset of 3 for accounting purposes, the creation of that asset is ignored for purposes of determining A Co's Adjusted Covered Taxes as there is no longer a temporary difference between the local tax position and GloBE Income after the GloBE adjustment under Article 3.2.1(i). Thus, the ABC Group's GloBE ETR for Country A is 15% (= 15 Adjusted Covered Taxes / 100 GloBE Income). Tables illustrating the numerical results of this example for Year 1 are set out below.

Income	Accrued Pension Expense	Contributions to Pension Fund	Taxable Income	Tax Liability
EUR 100	EUR 20	EUR 0	EUR 100	EUR 15

Deferred Tax Asset	Tax Expense	FANIL	GloBE Adjustment	GloBE Income
EUR 3	EUR 12	EUR 68	EUR 20	EUR 100

8. In Year 2, A Co has pre-tax income of EUR 100 and pays EUR 15 to its pension fund, but accrues 0 pension expense in its financial accounts. A Co also reduces its deferred tax asset in respect of pension expenses from 3 to 0.75 giving rise to a deferred tax expense of 2.25. For local

tax purposes A Co has taxable income of EUR 85 as the contribution of EUR 15 to the pension fund is allowed as a deduction from taxable income, which results in a local tax liability of EUR 12.75. A Co's Financial Accounting Net Income or Loss is 85 (= EUR 100 income – EUR 12.75 of current tax expense – EUR 2.25 of deferred tax expense). Under Article 3.2.1(i), the pension expense has to be adjusted according to the formula set out above. This results in an adjustment to A Co's Financial Accounting Net Income or Loss of EUR -15 ((EUR 0 + EUR 15) x (-1)), which in turn results in GloBE Income of EUR 85 (= EUR 85 FANIL -15 pension adjustment + 12.75 income tax + 2.25 deferred tax expense). Although A Co reduced its deferred tax asset by 2.25 for accounting purposes, the movement in that asset is ignored for purposes of determining A Co's Adjusted Covered Taxes. Thus, the ABC Group's GloBE ETR for Country A is 15% (EUR 12.75 Adjusted Covered Taxes / EUR 85 GloBE Income). Tables illustrating the numerical results of this example for Year 2 are set out below.

Income	Accrued Pension Expense	Contributions to Pension Fund	Taxable Income	Tax Liability
EUR 100	EUR 0	EUR 15	EUR 85	EUR 12.75

Deferred Tax Asset	Tax Expense	FANIL	GloBE Adjustment	GloBE Income
EUR 0.75	EUR 15	EUR 85	EUR (- 15)	EUR 85

#### Example 3.2.1(i)-2

##### **Accrued Pension Expense Adjustment**

1. The facts are the same as in Example 3.2.1(i)-1, except that
  - a. in Year 3, A Co has 100 of income,
  - b. the pension plan earns EUR 40,
  - c. A Co's pension liabilities for the Year are EUR 10, and
  - d. A Co reduced its deferred tax asset by 0.75.
2. The deferred tax asset reverses because the income earned by the pension plan has meant that A Co no longer needs to make the further EUR 5 of cash contributions based on the pension expense calculated in Year 1, as a result there are no future tax deductions, given tax deductions are based on cash contributions in this jurisdiction. A Co's Financial Accounting Net Income or Loss for Year 3 includes the net pension surplus of EUR 30 as income. No deferred tax is reflected on the pension surplus for accounting purposes so there is just the deferred tax expense of EUR 0.75 arising from the reversal of the existing deferred tax asset.
3. In Year 3, the net pension income of EUR 30 for accounting purposes is not taken into account by A Co for Country A tax purposes, and thus A Co's taxable income is EUR 100 and tax liability is EUR 15. A Co's Financial Accounting Net Income or Loss is EUR 114.25 (= EUR 100 income + EUR 30 pension income – EUR 15 income tax – EUR 0.75 deferred tax expense).
4. Article 3.2.1(i) also applies in situations where there is a pension surplus or pension income recognised in the Financial Accounting Net Income or Loss. Article 3.2.1(i) requires an Accrued Pension Expense Adjustment of A Co's Financial Accounting Income or Loss in Year 3 according to the following formula:

$$\text{GloBE Adjustment} = (\text{Accrued Income or Expense for fiscal Year} + \text{payment for fiscal Year}) \times (-1)$$

Where

- Accrued income is expressed as a positive amount
- Accrued expense is expressed as a negative amount
- Payment is expressed as a positive amount

5. The GloBE Adjustment for Year 3 is EUR -30 (EUR 30 + EUR 0 x (-1)), which results in a GloBE Income of EUR 100 (= EUR 114.25 FANIL – 30 adjustment + 15 income tax + 0.75 deferred tax expense). Although A Co reduced its deferred tax asset for accounting purposes, the movement in that asset is ignored for purposes of determining A Co's Adjusted Covered Taxes. Thus, the ABC Group's GloBE ETR for Country A is 15% (EUR 15 Adjusted Covered Taxes / EUR 100 GloBE Income). Tables illustrating the numerical results of this example for Year 3 are set out below.

Income	Accrued Pension Expense	Net Pension Surplus	Taxable Income	Tax Liability
EUR 100	EUR 0	EUR 30	EUR 100	EUR 15

Deferred Tax Asset	Tax Expense	FANIL	GloBE Adjustment	GloBE Income
EUR 0	EUR 15.75	EUR 114.25	EUR (- 30)	EUR 100

## 2.6. Covered Taxes on deemed distributions (Article 4.3.2(e)) [AG22.04.T11]

1. Under Article 4.3.2(e), taxes paid in respect of dividends or other distributions from a Constituent Entity are allocated to the Constituent Entity that made the distribution (referred to in the article as the distributing Constituent Entity).

2. Questions have been raised as to whether Article 4.3.2(e) applies to deemed distributions. To confirm that it does and to align the wording more closely with paragraph 37 of the Commentary to Article 3.2.1(b) (which deals with Excluded Dividends), paragraph 60 the Commentary to Article 4.3.2(e) will be revised to include the bold and underlined text and will read as follows:

60.1 Paragraph (e) allocates taxes arising in connection with distributions **in respect of Ownership Interests** between Constituent Entities. This includes withholding tax and net basis taxes incurred by direct Constituent Entity-owners on distributions by Constituent Entities in respect of their stock which are allocated to the distributing Constituent Entity. Withholding taxes are imposed under the laws of the distributing Constituent Entity and are collected at the source, but the income tax is the legal liability of the Constituent Entity-owner. The rule applies to Taxes with respect to any type of distribution with respect to an Ownership Interest in the distributing Constituent Entity. Thus, the rule also applies to Taxes in respect of a distribution that does not meet the definition of a dividend for tax purposes in the recipient jurisdiction **but is made in respect of an Ownership Interest in a Constituent Entity under the financial accounting standard used in the preparation of the Consolidated Financial Statements.**

**60.2 Paragraph (e) also applies to Covered Taxes incurred by a Constituent Entity-owner in respect of deemed distributions where the underlying interest is treated as an equity interest for tax purposes in the jurisdiction imposing the tax and for financial accounting purposes. Covered Taxes incurred in respect of deemed distributions include taxes (other than CFC taxes) that a jurisdiction imposes on a shareholder in connection with undistributed earnings or capital of an Entity in which it holds an Ownership Interest, such as consent dividends.**



## 2.7. Excess Negative Tax Carry-forward guidance (Art 4.1.5 & 5.2.1) [AG22.04.T6]

### 2.7.1. Introduction

1. The GloBE Rules impose tax liability on certain MNE Groups when they earn Excess Profits from operations in a jurisdiction and those profits are taxed below the Minimum Rate. In determining the Effective Tax Rate (ETR) of operations in a jurisdiction, the GloBE Rules take into account current tax expenses as well as deferred tax expenses. Article 4.4 contains specific rules for determining the amount of deferred tax expense that is taken into account in the computation of Adjusted Covered Taxes.

2. Absent safeguards, there may be instances in which deferred tax expense can shield permanent differences from GloBE tax liability. This is illustrated in the following example.

3. Example. Assume that the GloBE Income determined for a jurisdiction for the year is zero, there is a tax loss for the year of 100 due to depreciation in excess of an asset's cost under local tax rules, and that loss can be carried forward for local tax purposes. The MNE Group would create a DTA of 15 under Article 4.4.1. In the following year, if there were 100 of GloBE Income and 100 of income for tax purposes, there would be no current tax due to the loss carry-forward and 15 of Adjusted Covered Taxes due to the reversal of the DTA. This would produce an ETR of 15% and no Top-up Tax, which is the same result in terms of Top-up Tax as deducting the depreciation expense in excess of cost from GloBE Income in the year.

4. The GloBE Rules have two features that counteract the effect described in the example above.

5. The first is in Article 4.1.5. This article effectively imposes a current Additional Top-up Tax equal to the portion of the loss carry-forward DTA attributable to the permanent difference. The amount of Additional Top-up Tax determined under Article 4.1.5 is the maximum amount that the permanent difference could reduce the Top-up Tax in a subsequent year. The DTA attributable to the permanent difference, however, may actually result in a much smaller reduction or no reduction at all in the Top-up Tax determined in a subsequent year, depending upon the amount of income in the subsequent year and the rate at which that income is taxed.

6. Continuing with the example above, if the income in the second year were 200 and taxed at a 30% rate, the current tax expense alone would be sufficient to reach an ETR of 15%. Thus, no Top-up Tax is avoided by virtue of the DTA that was generated in connection with a permanent difference.

7. The second feature of the GloBE Rules that counteracts the effect described above arises from the computation of the Top-up Tax Percentage under Article 5.2.1. If there is GloBE Income in a jurisdiction, the interaction of a permanent difference with deferred tax accounting may cause the ETR for the jurisdiction to be a negative percentage. When that negative percentage is subtracted from the Minimum Rate, the Top-up Tax Percentage will be an amount in excess of the Minimum Rate. And the effect of multiplying that excess percentage over the Minimum Rate by the GloBE Income for the Fiscal Year is similar to the effect of Article 4.1.5. It would result in an additional amount of Top-up Tax equal to the maximum amount that the permanent difference could reduce the Top-up Tax in another Fiscal Year. However, under the GloBE Rules, the Top-up Tax Percentage is multiplied by the Excess Profits, not the GloBE Income. The Substance-based Income Exclusion has an outsized effect under these circumstances because it not only shields that amount of GloBE Income from taxation at the Minimum Rate, it also by extension shields a proportionate amount of the permanent difference from Top-up Tax under the GloBE Rules.

### 2.7.2. Reason for guidance

8. As explained above, Articles 4.1.5 and 5.2.1 prevent the mechanism devised to address timing difference from becoming an instrument that eliminates permanent differences and are necessary to

preserve the integrity of the GloBE Rules. Nevertheless, Article 4.1.5 imposes tax in a Fiscal Year in which the MNE Group has no GloBE Income and neither rule takes into account the actual results in the year that the loss DTA attributable to the permanent difference is utilised. The Inclusive Framework has agreed that jurisdictions shall adopt an administrative procedure, described below, in relation to the determination of total Adjusted Covered Taxes for a jurisdiction for a Fiscal Year.

9. The administrative procedure set out below describes a methodology by which an MNE Group carries forward any Excess Negative Tax Expense determined for a Fiscal Year and reduces Adjusted Covered Taxes in a subsequent Fiscal Year (or Years) in which the MNE Group has GloBE Income for the jurisdiction. The administrative procedure is elective where Article 4.1.5 applies and mandatory where Article 5.2.1 applies. When an MNE Group determines the Total Deferred Tax Adjustment Amount of its Constituent Entities in a jurisdiction based on this methodology, Article 4.1.5 will not apply by its terms. Moreover, if the GloBE Income for the jurisdiction is a positive amount, there will not be a negative ETR when the administrative simplification is applied.

10. In addition, paragraphs 19 through 21 of the existing Commentary to Article 4.1.5 is drafted in such a way as to imply that Article 4.1.5 is limited to situations where there is a loss for local tax purposes. However, Article 4.1.5 applies in any case where the Adjusted Covered Taxes are less than zero and less than the Expected Adjusted Covered Taxes. Therefore, those paragraphs need to be revised for accuracy.

### **2.7.3. Guidance**

11. Paragraph 19 of the Commentary to Article 4.1.5 will be revised to read as follows:

19. Article 4.1.5 provides a special rule that applies in limited circumstances when there is no GloBE Income in a jurisdiction for the Fiscal Year and the MNE Group computes a negative amount of Adjusted Covered Taxes for the jurisdiction and there is a permanent difference between the local taxable income and the GloBE Income. This fact pattern may occur when the local tax rules in the Constituent Entity's jurisdiction grant a deduction from income that is in excess of the amount that would be allowed for financial accounting purposes and where that difference between GloBE and local tax rules will not reverse over time. Examples of items that could give rise to permanent differences include notional interest deductions or a deduction that is in excess of economic cost (i.e. a super deduction). Permanent differences may also arise where a jurisdiction exempts an item of income or gain that is included in GloBE Income or Loss in a Fiscal Year where the Constituent Entity still has an overall economic loss for the year. However, the generation of a GloBE Loss Deferred Tax Asset under Article 4.5 will not result in Top-up Tax under Article 4.1.5 because, when elected, Article 4.5 applies in lieu of Article 4.4.

12. The following sentence will be inserted at the beginning of Paragraph 20 of the Commentary to Article 4.1.5:

20. Although Article 4.1.5 may apply in other scenarios, the most common fact pattern in which Article 4.1.5 will apply is where there is a tax loss that is greater than the amount of loss recognised for GloBE purposes.

13. The first sentence of Paragraph 21 of the Commentary to Article 4.1.5 is revised to read as follows:

21. In situations where the local tax loss is greater than the loss that has been recorded for GloBE purposes in a Fiscal Year, an Additional Current Top-up Tax charge will typically arise because the additional tax loss results from a deduction for a non-economic loss or similar permanent difference between the local tax base and GloBE Income or Loss.

14. The following guidance will be included after paragraph 21 of the Commentary to Article 4.1.5:

### *Carry-forward of Excess Negative Tax Expense*

21.1 The total Adjusted Covered Taxes determined by an MNE Group for a jurisdiction may be less than zero for a variety of reasons. In many cases, the negative Adjusted Covered Taxes amount will correspond to the amount of the GloBE Loss for the jurisdiction. However, when there are permanent differences in the computation of taxable income or loss and GloBE Income or Loss, the negative Adjusted Covered Taxes determined for a jurisdiction that has a GloBE Loss may be less than the expected Adjusted Covered Taxes on the GloBE Loss, i.e. less than 15% of the GloBE Loss. In some cases, permanent differences may produce disparities in the negative Adjusted Covered Taxes and negative tax expense for a jurisdiction that has GloBE Income for the year.

21.2 When there are negative Adjusted Covered Taxes in a Fiscal Year in which there is also a GloBE Loss, the MNE Group must pay an Additional Top-up Tax pursuant to Article 4.1.5 to the extent that the negative Adjusted Taxes are less than 15% of the GloBE Loss determined for the year. The amount of negative tax expense attributable to permanent differences is not determined under Article 4.1.5 based on a comparison of the different items of income or expense taken into account in computing the GloBE Loss and the tax loss. Instead, Article 4.1.5 determines the aggregate amount of negative tax expense attributable to permanent differences based on the difference between the Expected Adjusted Covered Taxes Amount (i.e. the GloBE Loss multiplied by the Minimum Rate) and the Adjusted Covered Taxes determined for the jurisdiction.

21.3 When there are negative Adjusted Covered Taxes in a Fiscal Year in which there is GloBE Income for the jurisdiction, the Top-up Tax Percentage for a jurisdiction will exceed the Minimum Rate. Much like the conditions that activate Article 4.1.5, the negative Adjusted Covered Taxes that cause this result are attributable to permanent differences in the computation of GloBE Income or Loss and the taxable income or loss.

21.4 The Inclusive Framework considered a methodology that would require MNE Groups to identify the permanent differences that created the scenarios described above and adjust the deferred tax assets and liabilities for GloBE purposes to eliminate the effect of the permanent difference. However, the Inclusive Framework concluded that this approach would be impractical and overly burdensome for both MNE Groups and tax administrations. Nonetheless, the Inclusive Framework considers that the GloBE Rules should also provide an administrative procedure that will allow MNE Groups to avoid Additional Top-up Tax under Article 4.1.5 in the year in which it has a GloBE Loss and Top-up Tax Percentages in excess of the Minimum Rate under Article 5.2.1. Accordingly, the Inclusive Framework has agreed that in cases where Article 4.1.5 applies, a MNE Group may apply the Excess Negative Tax Expense administrative procedure described below. In cases where the Top-up Tax Percentages are excess of the Minimum Rate under Article 5.2.1, a MNE Group must apply the Excess Negative Tax Expense administrative procedure described below. The Excess Negative Tax Expense Carry-forward arising under the administrative procedure is a GloBE tax attribute of the MNE Group that is retained until it is used in full irrespective of whether the Constituent Entities in the jurisdiction are disposed. The Inclusive Framework considered eliminating the attribute to the extent it was attributable to a permanent difference in certain circumstances, for example when it was included in a loss carry-forward DTA, after all the Constituent Entities in the relevant jurisdiction were disposed. However, the Inclusive Framework concluded that a more targeted rule would add significant complexity and potential for disputes over the nature and make-up of the remaining Excess Negative Tax Expense Carry-forward. Furthermore, eliminating the attribute in these circumstances would be inappropriate in cases where the deferred tax assets and liabilities of a Constituent Entity whose tax position created the Excess Negative Tax Expense Carry-forward is transferred to another MNE Group that is within scope of the GloBE Rules, if the local tax rules permit the item that gave rise to the Article 4.1.5 adjustment amount to be taken into account for local tax purposes by the acquiring MNE Group. Accordingly,

the Inclusive Framework determined that the need for simplicity and certainty in the application of Article 4.1.5 outweighed any potential benefits that might arise from additional precision in this respect.

21.5 An MNE Group that elects or is required to apply the Excess Negative Tax Expense administrative procedure shall exclude the Excess Negative Tax Expense from its aggregate Adjusted Covered Taxes computed for the Fiscal Year and establish an Excess Negative Tax Expense Carry-forward. The Excess Negative Tax Expense for a Fiscal Year in which the MNE Group realizes no GloBE Income for the jurisdiction is equal to the amount computed under Article 4.1.5 for that Fiscal Year. The Excess Negative Tax Expense for a Fiscal Year in which the MNE Group realizes positive GloBE Income for the jurisdiction is equal to the negative Adjusted Covered Taxes for that Fiscal Year. In each subsequent Fiscal Year in which the MNE Group has positive GloBE Income and Adjusted Covered Taxes for the jurisdiction, the MNE Group shall decrease (but not below zero) the aggregate Adjusted Covered Taxes by the remaining balance of the Excess Negative Tax Expense Carry-forward. Then, the MNE Group shall reduce the balance of the Excess Negative Tax Expense Carry-forward by the same amount. Under the Excess Negative Tax Expense administrative procedure, the Excess Negative Tax Expense attributable to an amount of a loss that is carried back and applied against income for prior taxable years for domestic tax purposes must be taken into account under Article 4.1.5 currently and cannot be included in the Excess Negative Tax Expense Carry-forward. See also the Commentary to Article 4.6.1 related to the treatment of loss carrybacks under the GloBE Rules.

21.6 When an MNE Group applies the Excess Negative Tax Expense administrative procedure, the negative amount of Adjusted Covered Taxes will not be less than the Expected Covered Taxes Amount under Article 4.1.5 when the MNE Group has a GloBE Loss or the ETR will not be less than zero when it has GloBE Income in a jurisdiction. Accordingly, when a Constituent Entity applies this administrative procedure, the MNE Group will not be subject to tax under the GloBE Rules due to an Additional Top-up Tax Amount under Article 4.1.5 or compute a Top-up Tax Percentage for a jurisdiction that exceeds the Minimum Rate.

21.7 Use of the Excess Negative Tax Expense administrative procedure under Article 4.1.5 for a jurisdiction is an annual election. An MNE Group makes the election by applying the administrative procedure to the computation of aggregate Adjusted Covered Taxes for the jurisdiction in the year in which the MNE Group has Excess Negative Tax Expense and using the resulting Adjusted Covered Taxes in the computation of the jurisdictional ETR. When elected, the Excess Negative Tax Expense Carry-forward must be utilised in all relevant subsequent computations of the jurisdictional ETR.

21.8 Should an MNE Group dispose of one or more Constituent Entities in a jurisdiction in which it has made the annual election described in the previous paragraph, the Excess Negative Tax Expense Carry-forward shall remain an attribute of the transferor group. The MNE Group shall maintain a record of the outstanding balance of the carry-forward. If the MNE Group disposes of all Constituent Entities in a jurisdiction and re-acquires or establishes Constituent Entities in that jurisdiction in a subsequent Fiscal Year, the balance of the Excess Negative Tax Expense Carry-forward shall be taken into account in determining the Adjusted Covered Taxes for the jurisdiction beginning with such Fiscal Year.

15. The following guidance will be included after paragraph 15 of the Commentary to Article 5.2.1:

15.1 The Top-up Tax Percentage for a jurisdiction can in some circumstances exceed the Minimum Rate. This can occur when the MNE Group's operations in a jurisdiction are profitable for GloBE purposes, i.e. the jurisdiction has GloBE Income, but the MNE Group determines a negative amount of Adjusted Covered Taxes for the jurisdiction. Applying the formula in Article 5.2.1 to a jurisdiction with a negative jurisdictional ETR results in a Top-up Tax Percentage in excess of the

Minimum Rate. For instance, assume a jurisdiction where the ETR is -4%, the Top-up Tax Percentage is equal to 19% (= 15% - (-4%)).

15.2 When the Top-up Tax Percentage exceeds the Minimum Rate due to a negative amount of Adjusted Covered taxes, the Inclusive Framework has agreed that an MNE Group shall apply the Negative Tax Expense administrative procedure described below. The rationale justifying Negative Tax Expense administrative procedure set out in the Commentary to Article 4.1.5 apply equally in the context of Article 5.2.1. However, the procedure is mandatory under Article 5.2.1 to ensure that the Substance-based Income Exclusion for the Fiscal Year eliminates only the Top-up Tax attributable to the GloBE Income that the exclusion removed from Excess Profits and does not also eliminate the Top-up Tax attributable to the permanent difference that caused the excess negative tax expense.

15.3 An MNE Group that applies the Negative Tax Expense administrative procedure shall exclude the Negative Tax Expense from its aggregate Adjusted Covered Taxes computed for the Fiscal Year and establish an Excess Negative Tax Expense Carry-forward. The Negative Tax Expense for a Fiscal Year in which the MNE Group has a Top-up Tax Percentage for a jurisdiction that exceeds the Minimum Rate due to negative Adjusted Covered Taxes is equal to the amount of negative Adjusted Covered Taxes. For instance, if a MNE Group has GloBE Income of 100 in a jurisdiction and Adjusted Covered Taxes of -5, the Negative Tax Expense is -5.

15.4 The Excess Negative Tax Expense Carry-forward must be utilised in all relevant subsequent computations of the jurisdictional ETR.

15.5 Should a MNE Group dispose of one or more Constituent Entities in a jurisdiction in which it has applied the Negative Tax Expense administrative procedure, the Negative Tax Expense shall remain an attribute of the transferor group. The MNE Group shall maintain a record of the outstanding balance of the carry-forward. If the MNE Group disposes of all Constituent Entities in a jurisdiction and re-acquires or establishes Constituent Entities in that jurisdiction in a subsequent Fiscal Year, the balance of the Excess Negative Tax Expense Carry-forward shall be taken into account in determining the Adjusted Covered Taxes for the jurisdiction beginning with such Fiscal Year.

#### **2.7.4. Examples**

16. The following examples will be included in the GloBE Model Rules Examples.

##### *Example 4.1.5 – 5*

##### **Excess Negative Tax Expense administrative procedure**

1. This example illustrates the Excess Negative Tax Expense administrative procedure under Article 4.1.5.

2. A MNE Group operating in jurisdiction X incurs a GloBE Loss of (100) in Year 1. However, under the domestic tax law of jurisdiction X, the MNE Group records a net operating loss of (300) in Year 1. The Expected Adjusted Covered Tax Amount for jurisdiction X is (15) and the actual Adjusted Covered Taxes are (45). The MNE Group elects to apply the Excess Negative Tax Expense administrative procedure and does not pay any Top-up Tax in Year 1. An Excess Negative Tax Expense carry-forward of 30 is established.

3. In Year 2 the MNE Group earns GloBE Income of 300 in jurisdiction X and applies its full net operating loss of 300 to offset the income for domestic tax purposes. For GloBE purposes, the deferred tax asset of (45) that was recorded in Year 1 will reverse due to usage of the loss carry-

forward. However, because the Excess Negative Tax Expense administrative procedure was elected in Year 1, the Adjusted Covered Taxes for jurisdiction X are reduced by the Excess Negative Tax Expense carry-forward of 30 in Year 2. As a result, Adjusted Covered Taxes for Year 2 are equal to 15 and the ETR is 5% ( $= 15 \text{ Adjusted Covered Taxes} / 300 \text{ GloBE Income}$ ). The jurisdictional Top-up Tax Percentage is 10% ( $= 15\% \text{ Minimum Rate} - 5\% \text{ ETR}$ ) and Top-up Tax of 30 will apply in Year 2.

*Example 5.2.1 – 1*

***Excess Negative Tax Expense administrative procedure***

1. This example illustrates the Excess Negative Tax Expense administrative procedure under Article 5.2.1.
2. A MNE Group operating in jurisdiction X earns GloBE Income of 200 in Year 1. However, under the domestic tax law of jurisdiction X, the MNE Group records a net operating loss of (100) in Year 1. The MNE Group records a deferred tax asset of 15 due to the tax loss and thus negative tax expense of 15. The MNE Group is required to apply the Excess Negative Tax Expense administrative procedure in Year 1. Accordingly, Adjusted Covered Taxes are 0 after removal of the Negative Tax Expense, the ETR is 0% and Top-up Tax of 30 ( $= 200 \text{ GloBE Income} \times (15\% - 0\%)$ ) is applicable in Year 1. An Excess Negative Tax Expense Carry-forward of 15 is established.
3. In Year 2, the MNE Group earns GloBE Income of 100 and does not pay any jurisdiction X tax due to its 100 net operating loss carry-forward in jurisdiction X. When the net operating loss carry-forward is used, the deferred tax asset of 15 recorded with respect to such net operating loss reverses. This tentatively results in Adjusted Covered Taxes of 15. However, because the Negative Tax Expense administrative procedure was applied in Year 1, the Excess Negative Tax Expense Carry-forward is applied in Year 2 and Adjusted Covered Taxes for Year 2 are 0. As a result, the ETR for the jurisdiction is 0% and Top-up Tax of 15 ( $= 100 \text{ GloBE Income} \times (15\% \text{ Minimum Rate} - 0\% \text{ ETR})$ ) is applicable with respect to jurisdiction X in Year 2.

## 2.8. Loss-making Parent Entities of CFCs

### 2.8.1. Introduction

1. Some jurisdictions with CFC Tax Regimes provide for the taxation of the CFC income by including such income in the domestic taxable income of the taxpayer. Generally, under such regimes a taxpayer may use foreign tax credits (FTCs) to offset the tax imposed on some or all of the foreign source income brought into charge under the CFC regime, but such FTCs generally cannot offset domestic source income of the taxpayer. Under such regimes, when there is foreign source income brought into charge under a CFC regime or otherwise and in the same year there is a domestic source loss, the domestic source loss is used to offset the foreign source income. In such a scenario the FTCs that would have otherwise offset the foreign source income are either lost or carried forward, depending upon the rules of the domestic tax regime. In such a scenario, if the domestic tax regime did not blend foreign source income and the domestic source loss, the taxpayer could have potentially offset the foreign source income with FTCs and carried-forward a loss to offset domestic source income in future years.

2. Many jurisdictions with such systems provide relief such that the system is not at a significant disadvantage to one that exempts foreign source income. Relief can be provided in various manners, including a recapture mechanism that will allow a taxpayer to treat subsequently earned domestic source income as foreign source income, up to the amount of the prior year(s) domestic source loss. This provides for approximately the same result as though the taxpayer had carried forward a domestic source loss, essentially compensating for the reduction of the loss that would have otherwise been generated in the prior year if FTCs had been allowed to offset the foreign source income.

### 2.8.2. Issues to be considered

3. Under the GloBE Rules, if there is a domestic loss in a jurisdiction, the GloBE Income or Loss will generally be negative due to the loss regardless of whether such jurisdiction taxes foreign source income. If such a jurisdiction permits tax on foreign source income to be offset with FTCs in a year with a domestic loss, a loss will generally be generated under domestic rules that can be carried-forward. The GloBE Rules would permit the deferred tax asset associated with this loss to be carried-forward and used as an addition to Adjusted Covered Taxes in a subsequent year when the loss is used to offset domestic taxable income.

4. On the other hand, if for example, the jurisdiction requires the domestic loss to first offset foreign source income before FTCs are used, no loss or a reduced loss will be generated compared to the first scenario. Jurisdictions with rules such as this generally permit future domestic source income to be recharacterized as foreign source, up to the amount of the prior year(s) domestic source loss, to allow the use of FTCs in lieu of the loss that was not generated. Under Article 4.4.1(e), deferred tax assets with respect to FTC carry-forwards are not taken into account in the computation of Adjusted Covered Taxes. Accordingly, when FTC carry-forwards are used to offset tax on domestic source income in future years, absent a clarification, Top-up Tax could arise in this second scenario, even though the economics are the same as the scenario where a loss carry-forward has been provided for.

5. Take for example a taxpayer in jurisdiction A that has one CFC in jurisdiction B. Jurisdiction A has a 17.5% tax rate and jurisdiction B has a 20% tax rate. For the purpose of this example, it can be assumed that the domestic tax base exactly matches the GloBE base in all jurisdictions. In Year 1 the taxpayer incurs a loss of (100) in jurisdiction A and generates income of 100 in jurisdiction B. The CFC pays tax of 20 in jurisdiction B. Jurisdiction A does not require the domestic loss to be offset against the CFC inclusion from jurisdiction B. Accordingly a loss of (100) is generated and carried forward in Jurisdiction A. No tax is due on the CFC inclusion from jurisdiction B because the 20 FTC with respect to jurisdiction B fully offsets the 17.5 CFC tax liability. Under the GloBE Rules a DTA of 15 is carried-forward due to the loss carry-

forward and may be added to Adjusted Covered Taxes in a future Fiscal Year when the loss carry-forward is used for domestic tax purposes.

6. Now take the same facts as above, but assume that jurisdiction A requires the income from jurisdiction B to offset the jurisdiction A loss before the use of any FTCs. No loss is generated in this fact pattern and the 20 of unused FTCs are carried forward. In a subsequent year when income is earned in jurisdiction A, the jurisdiction permits up to 100 (i.e. the domestic source loss) to be re-sourced as foreign to allow the use of FTCs against such income. Unused FTCs of 17.5 from the loss year are applied and no tax is paid in jurisdiction A. Because the deferred tax expense resulting from the reversal of a DTA by reason of the use of an FTC carry-forwards is not taken into account as an addition to Adjusted Covered Taxes, Top-up Tax of 15 would be due with respect to Jurisdiction A in the subsequent year when income of 100 is earned. In the first example, while the economics are the same, no Top-up Tax would be due since the use of the loss carry-forward would cause 15 to be added to Adjusted Covered Taxes when the DTA associated with such loss carry-forward reverses.

7. Where a jurisdiction has provided for this second option of treating domestic source income in future years as foreign source in an amount equal to the domestic loss that was offset by the CFC or other foreign source income, the GloBE Rules should not disadvantage this methodology as compared to jurisdictions that provide for a loss carry-forward.

### **2.8.3. Guidance**

8. This guidance ensures certain outcomes are functionally equivalent under the GloBE Rules regardless of whether a jurisdiction permits a loss carry-forward or FTC carry-forward (or equivalent mechanism) when there is a domestic source loss and foreign source income in the same year.

9. In order to produce functionally equivalent outcomes, the GloBE Rules should give effect to tax attributes that are provided for in lieu of a loss carry-forward when there is a domestic source loss and foreign source income in the same year. However, functional equivalence demands that any outcome delivered under the domestic tax rules is not a more generous outcome for the taxpayer than the outcome that would be provided for if a loss carry-forward had been generated (i.e. a DTA recast at the Minimum Rate).

10. This guidance provides a substitute or replacement for the loss DTA that would have otherwise been generated in the year of the domestic loss and ensures that such replacement is no more generous to the taxpayer than the GloBE DTA associated with the loss that would have otherwise been generated and carried-forward.

11. It should be noted that some jurisdictions have rules that operate in the same manner with respect to domestic losses offset by income arising through Permanent Establishments. . The Inclusive Framework will consider the case for extending the mechanism described in the previous paragraph in the context of Permanent Establishments to provide for similar outcomes recognizing that some differences in mechanisms may be necessary given certain differences between the two contexts.

12. Although this guidance is intended to achieve parity of outcomes between systems that do and do not result in a domestic loss carry-forward, Implementing Jurisdictions may modify their existing CFC Tax Regimes to provide for similar outcomes under the GloBE Rules as if a loss carry-forward had been generated in the year of the domestic loss without such modification being considered a benefit related to the GloBE Rules that could prevent the Implementing Jurisdiction from being considered to have adopted a Qualifying IIR or Qualifying UTPR.

13. The following guidance will be inserted after paragraph 82 of the Commentary to Article 4.4.1(e):

82.1. However, there are circumstances where it is inappropriate for an amount of deferred tax expense with respect to the generation and use of tax credits to be excluded from the Total Deferred



Tax Adjustment Amount for a Constituent Entity for the Fiscal Year. This is the case where a jurisdiction taxes foreign source income and under the domestic tax rules of the jurisdiction, a Constituent Entity may use foreign tax credits to reduce domestic tax on income in a subsequent year after a domestic source loss has offset foreign source income. In such cases, without a specific exemption, the Constituent Entity's ETR may be lowered as the use of the foreign tax credit carry-forward is excluded from the Constituent Entity's Adjusted Covered Taxes. This result would occur notwithstanding the fact that the Constituent Entity will generate a smaller deferred tax asset in respect of a loss carry-forward because the domestic tax loss offset the foreign source income. Had the foreign source income not offset the domestic tax loss, the full amount of the tax loss would have been reflected in the Constituent Entity's deferred tax asset and therefore would be included in Covered Taxes when used by the Constituent Entity in future Fiscal Years.

82.2. To address this issue, Article 4.4.1(e) shall not apply in the case of a Substitute Loss Carry-forward DTA. For this purpose, a Substitute Loss Carry-forward DTA arises where all of the following apply:

- a. the jurisdiction requires that foreign source income offset domestic source losses before foreign tax credits may be applied against tax imposed on foreign source income;
- b. the Constituent Entity has a domestic tax loss that is fully or partially offset by foreign source income; and
- c. the domestic tax regime allows foreign tax credits to be used to offset a tax liability in a subsequent year in relation to income that is included in the computation of the Constituent Entity's GloBE Income or Loss.

Where all of the above requirements are met, the deferred tax expense attributable to the Substitute Loss Carry-forward DTA shall be included in the Constituent Entity's Total Deferred Tax Adjustment Amount in the Fiscal Year that it arises and in the Fiscal Year (or Years) it reverses, but only to the extent the foreign tax credit that gave rise to the Substitute Loss Carry-forward DTA is used to offset tax liability on income included in the Constituent Entity's GloBE Income or Loss. The amount of a Substitute Loss Carry-forward DTA is equal to lesser of (i) the amount of the foreign tax credit in respect of the foreign source income inclusion that the domestic tax regime allows to be carried forward from the year in which the Constituent Entity had a tax loss (before taking into account any foreign source income) to a subsequent year; and (ii) the amount of the Constituent Entity's tax loss for the tax year (before taking into account any foreign source income) multiplied by the applicable domestic tax rate. The Substitute Loss Carry-forward DTA is subject to the exclusion in Article 4.4.1(a) and must be recast at the Minimum Rate in accordance with the formula set out in the Commentary under Article 9.1.1.

82.3. Certain CFC Tax Regimes do not allow foreign tax credit carry-forwards but provide for equivalent results through a loss recapture mechanism that similarly allows excess foreign tax credits arising in a subsequent year to offset the domestic tax liability on the domestic source income that has been re-sourced as foreign source income. Provided this loss recapture mechanism does not provide for an outcome that is more generous than the outcome that would be provided for if a loss carry-forward had been generated (i.e. a DTA recast at the Minimum Rate), then equivalent adjustments shall be made as necessary to recognise the effect of this mechanism on Adjusted Covered Taxes. To ensure equivalent outcomes under the GloBE Rules, the amount of a Constituent Entity's tax loss for a tax year that is subject to a recapture mechanism is treated as giving rise to a Substitute Loss Carry-forward DTA arising in the year of the tax loss and reversing as the tax loss is recaptured, but only to the extent the recapture mechanism increases the foreign tax credit used to offset tax liability on income included in the Constituent Entity's GloBE Income or Loss.

82.4. Although this guidance is intended to achieve parity of outcomes between systems that do and do not result in a domestic loss carry-forward, Implementing Jurisdictions may modify their existing CFC Tax Regimes or other domestic tax laws to provide for similar outcomes under the GloBE Rules as if a loss carry-forward had been generated in the year of the domestic loss without such modification being considered a benefit related to the GloBE Rules that could prevent the Implementing Jurisdiction from being considered to have adopted a Qualifying IIR or Qualifying UTPR or necessarily preventing any resulting CFC Tax from being treated as a Covered Tax.

## 2.8.4. Examples

### Example 4.4.1(e) - 1

1. The ABC MNE Group owns 100% of Constituent Entity A in Jurisdiction Z. Constituent Entity A is the only Constituent Entity of the MNE Group in Jurisdiction Z. Jurisdiction Z imposes a 17.5% corporate income tax and taxes the worldwide income of Constituent Entity A through a CFC Tax Regime. Constituent Entity A owns 100% of Constituent Entity B which is located in Jurisdiction Y. Jurisdiction Y imposes a 20% corporate income tax. The income of Constituent Entity B is taken into account in the Jurisdiction Z taxable income of Constituent Entity A as foreign source income brought into charge under the Jurisdiction Z CFC Tax Regime. Jurisdiction Z permits a foreign tax credit to offset Jurisdiction Z tax on foreign source income. With the exception of the CFC Tax Regime in Jurisdiction Z, the tax bases of Jurisdiction Z and Jurisdiction Y are the same as the GloBE tax base.

2. In Year 1, Constituent Entity A incurs a Jurisdiction Z loss of (100) and Constituent Entity B earns jurisdiction Y income of 100. Constituent Entity B pays jurisdiction Y tax of 20 in Year 1. Constituent Entity A pays no Jurisdiction Z tax because it has no jurisdiction Z taxable income. No loss carry-forward is generated in Jurisdiction Z because the domestic loss has been offset by foreign source income. A foreign tax credit carry-forward in Jurisdiction Z is established for the unused foreign tax credits resulting from the Jurisdiction Y tax paid in Year 1. A Substitute Loss Carry-forward DTA of 15, which is equal to the foreign tax credits carried-forward, recast at the Minimum Rate, is generated and carried-forward.

3. In Year 2 Constituent Entity A earns Jurisdiction Z income of 100 and Constituent Entity B earns no income or loss in Jurisdiction Y. The laws of Jurisdiction Z permit the use of carried-forward foreign tax credits to offset the 100 of domestic source income since no loss carry-forward was generated in Year 1. When these foreign tax credits are applied, the Substitute Loss Carry-forward DTA reverses and is treated as an addition to Adjusted Covered Taxes. Accordingly, Adjusted Covered Taxes for Year 2 in Jurisdiction Z are 15 and no Top-up Tax is applicable. This is the same result as if a loss carry-forward had been generated with respect to the Jurisdiction Z loss in Year 1 and then carried-forward and applied in Year 2.

Year 1	Foreign Source	Domestic Source	Total
Constituent Entity A Income (Loss)	100	(100)	0
FTC Generated/ (Used)	20	0	20
Loss Generated/ (Used)	0	0	0
FTC Carry-forward	20	0	20
Jurisdiction Z Tax (17.5%)	-	-	0
Jurisdiction Z GloBE Income (Loss)		(100)	
Jurisdiction Z GloBE Adjusted Covered Taxes		(15)	

Year 2	Foreign Source	Domestic Source	Total
Constituent Entity A Income (Loss)	0	100	100
FTC Generated/ (Used)	0	(17.5)	(17.5)
Loss Generated/ (Used)	0	0	0
FTC carry-forward	2.5	0	2.5
Jurisdiction Z Tax (17.5%)	-	-	0
Jurisdiction Z GloBE Income (Loss)		100	
Jurisdiction Z GloBE Adjusted Covered Taxes		15	

*Example 4.4.1(e) - 2*

1. The ABC MNE Group owns 100% of Constituent Entity A in Jurisdiction Z. Constituent Entity A is the only Constituent Entity of the MNE Group in Jurisdiction Z. Jurisdiction Z imposes a 17.5% corporate income tax and taxes the worldwide income of Constituent Entity A through a CFC Tax Regime. Jurisdiction Z requires that foreign source income offset domestic source losses before foreign tax credits may be applied against tax imposed on foreign source income. Constituent Entity A owns 100% of Constituent Entity B which is located in Jurisdiction Y. Jurisdiction Y imposes a 30% corporate income tax. The income of Constituent Entity B is taken into account in the Jurisdiction Z taxable income of Constituent Entity A as foreign source income brought into charge under the Jurisdiction Z CFC Tax Regime. In lieu of providing a loss carry-forward for a domestic source loss in a year with foreign source income, Jurisdiction Z permits the recharacterization of domestic source income as foreign source in subsequent tax years so that, over time, the appropriate amount of foreign source income is taken into account when foreign source income is offset by a domestic source loss in a given year. The maximum amount of recharacterization under this rule is the amount of domestic loss that has been offset by foreign source income. Jurisdiction Z does not allow foreign tax credit carry-forwards but, through the recharacterization mechanism, provides for equivalent results that are not more generous than the outcome that would be provided for if a loss carry-forward had been generated. With the exception of the CFC Tax Regime in Jurisdiction Z, the tax bases of Jurisdiction Z and Jurisdiction Y are the same as the GloBE tax base.
2. In Year 1 Constituent Entity A incurs a Jurisdiction Z loss of (100) and Constituent Entity B earns Jurisdiction Y income of 100. Constituent Entity B pays Jurisdiction Y tax of 30 in Year 1. Constituent Entity A pays no Jurisdiction Z tax because it has no Jurisdiction Z taxable income. No loss carry-forward is generated in Jurisdiction Z because the domestic loss has been offset by foreign source income. However, as a result of the domestic loss of 100 offsetting 100 of foreign source income in Year 1, 100 of domestic source income will be recaptured and recharacterized in future tax years as foreign source income to permit the use of foreign tax credits.
3. In this example, the amount of Constituent Entity A's Substitute Loss Carry-forward DTA is equal to the amount of the tax loss of (100) that is subject to recapture under the Jurisdiction Z tax regime multiplied by the applicable domestic tax rate of 17.5%, and recast at the 15% Minimum Rate. This results in a Substitute Loss Carry-forward DTA of 15 generated in Year 1.
4. In Year 2 Constituent Entity A earns Jurisdiction Z income of 100 and Constituent Entity B earns jurisdiction Y income of 200. Prior to taking into account any foreign tax credits, Constituent Entity A's Jurisdiction Z tax liability is 52.5 (= 300 x 17.5%). Constituent Entity B pays 60 of jurisdiction B tax, 35 of which are allowed as a foreign tax credit in Jurisdiction Z to offset the Jurisdiction Z tax on the 200 income of Constituent Entity B. In addition, for Jurisdiction Z tax purposes, Constituent Entity A's domestic source income of 100 is recharacterized as foreign source, thereby allowing an additional 17.5 of foreign tax credits to be used. Accordingly, no

Jurisdiction Z tax is paid in Year 2. However, when the domestic source income is recharacterized as foreign source and the 17.5 of foreign tax credits are used to offset the Jurisdiction Z tax on the recharacterized income, the GloBE Rules require the Substitute Loss Carry-forward DTA to reverse and result in an addition of 15 to Jurisdiction Z Adjusted Covered Taxes for Year 2. Accordingly, Adjusted Covered Taxes in Jurisdiction Z for Year 2 are 15 and there is no Top-up Tax with respect to Jurisdiction Z in Year 2. This is the same result as if Jurisdiction Z permitted the generation of a loss in Year 1 with respect to the domestic source loss that could be carried forward and applied in Year 2.

5. Note that the addition to Adjusted Covered Taxes to reflect the reversal of the Substitute Loss Carry-forward DTA is limited to the amount of additional foreign tax credits used by reason of the recharacterization in the year of the recharacterization. Accordingly, if the recharacterization of domestic source income as foreign source income in Year 2 did not result in any additional foreign tax credits being allowed in Jurisdiction Z in Year 2, the reversal of the Substitute Loss Carry-forward DTA would not result in an addition to Jurisdiction Z Adjusted Covered Taxes in Year 2.

Year 1	Foreign Source	Domestic Source	Total
Constituent Entity A Income (Loss)	100	(100)	0
FTC Generated/ (Used)	30	0	30
Loss Generated/ (Used)	0	0	0
FTC Carry-forward	0	0	0
<u>Jurisdiction Z Tax (17.5%)</u>	=	=	<u>0</u>
<u>Jurisdiction Z GloBE Income (Loss)</u>		<u>(100)</u>	
<u>Jurisdiction Z GloBE Adjusted Covered Taxes</u>		<u>(15)</u>	

Year 2	Foreign Source	Domestic Source	Total
Constituent Entity A Income (Loss)	200	100	300
FTC Generated/ (Used)	(35)	(17.5)	(52.5) (60 FTC limited to 17.5% tax rate)
Loss Generated/ (Used)	0	0	0
FTC Carry-forward	0	0	0
<u>Jurisdiction Z Tax (17.5%)</u>	=	=	<u>0</u>
<u>Jurisdiction Z GloBE Income (Loss)</u>		<u>100</u>	
<u>Jurisdiction Z GloBE Adjusted Covered Taxes</u>		<u>15</u>	

## 2.9. Equity Gain or loss inclusion election and Qualified Flow-Through tax benefits

### 2.9.1. Introduction

#### *Exclusion of gains, profits and losses arising from certain Ownership Interests (Article 3.2.1(c))*

1. Article 3.2.1(c) excludes gains, profits or losses attributable to certain Ownership Interests from GloBE Income or Loss. Specifically, Article 3.2.1(c) excludes:
  - a. Gains and losses from changes in fair value of an Ownership Interest, except for a Portfolio Shareholding;
  - b. Profit or loss in respect of an Ownership Interest included under the equity method of accounting; and
  - c. Gains and losses from disposition of an Ownership Interest, except for the disposition of a Portfolio Shareholding.
2. The exclusion applies irrespective of whether the relevant gain, profit, or loss, or a portion thereof, is included in the owner's taxable income computation under the laws of the jurisdiction in which the owner is located. Thus, if a partnership that is accounted for by its owner under the equity method is treated as a Tax Transparent Entity in the owner's tax jurisdiction, such that the income or loss of the partnership is included in the taxable income of the Constituent-Entity Owner, the annual income or loss is nevertheless removed from the owner's GloBE Income or Loss computation. Similarly, gains and losses on the disposition of an Ownership Interest other than a Portfolio Shareholding and changes in the carrying value of an Ownership Interest other than a Portfolio Shareholding due to fair value accounting or impairment are removed from the owner's GloBE Income or Loss computation irrespective of whether they are included in the owner's taxable income computation.

#### *Exclusion of current tax expense in respect of excluded income (Article 4.1.3(a))*

3. Article 4.1.3(a) reduces Covered Taxes by "the amount of current tax expense with respect to income excluded from the computation of GloBE Income or Loss under Chapter 3." The exclusion of the current tax expense on items of excluded income is designed to ensure symmetry in the GloBE ETR computation such that the only taxes taken into account in the numerator (Adjusted Covered Taxes) are taxes imposed upon items that were included in the denominator (GloBE Income). Without the adjustment under Article 4.1.3(a), the GloBE ETR could potentially be overstated due to the inclusion of tax expense relating to items of income that are excluded from GloBE Income or Loss.
4. For example, consider a Constituent Entity that owns a minority interest in a Tax Transparent Entity that is accounted for using the equity method for financial accounting purposes. Because income from the Ownership Interest in the Tax Transparent Entity is accounted for using the equity method of accounting, that income will be excluded from the Constituent Entity-owner's GloBE Income or Loss. Unless the tax expense associated with the Ownership Interest is excluded from current tax expense, it will overstate the Entity's ETR on its GloBE income.

#### *Symmetry is needed in the case of an Excluded Equity Loss*

5. While Article 3.2.1(c) applies to exclude both income and losses arising from an equity method investment, Article 4.1.3(a) refers to "income excluded from the computation of GloBE Income or Loss" but does not explicitly refer to an excluded loss. Unless there is a symmetry between the numerator and

denominator of the ETR fraction, Excluded Equity Losses that are deductible for local tax purposes will potentially understate the GloBE ETR computation and may produce a Top-up Tax liability in an otherwise high-tax jurisdiction. This concern is illustrated in the following example.

6. Consider again a Constituent Entity that owns a minority interest in a Tax Transparent Entity that is accounted for using the equity method and is subject to net basis taxation on its share of the Tax Transparent Entity's net profit or loss. In a year in which the Tax Transparent Entity has a net loss, the Constituent Entity will reduce its taxable income by its share of the Tax Transparent Entity's net loss, which in turn will reduce the Constituent Entity's tax liability. However, the Constituent Entity's share of the Tax Transparent Entity's loss is not included in the computation of its GloBE Income or Loss. Absent an adjustment, the GloBE ETR of the Constituent Entity will be lower than the applicable tax rate in the jurisdiction given that the tax loss has reduced the current tax expense but has not reduced the GloBE Income. If this asymmetry causes the ETR to fall below the Minimum Rate, the MNE Group will incur a Top-up Tax solely due to holding a non-controlling investment that produces a loss in a given Fiscal Year.

7. This example illustrates the need for symmetry in the numerator and denominator of the ETR computation where losses in respect of equity investments are taken into account for local tax purposes but not under the GloBE Rules. The needed symmetry could be achieved in two different ways.

8. One approach would be to increase the Adjusted Covered Taxes to compensate for the reduction in current taxes caused by the loss. This approach suffers from several deficiencies. The first problem is that the amount by which the loss reduced current taxes is somewhat speculative because it is not readily determinable from the financial accounts or the tax return and would need to be estimated based on an agreed methodology. In developing an agreed methodology, Working Party 11 would need to decide whether, or in what circumstances, the tax effect of the loss should be re-cast at the Minimum Rate. Finally, there will likely be differences between the timing and amount of local tax loss and the accounting loss, for example due to accelerated depreciation or super deductions, which require consideration of how and to what extent these differences would require additional adjustments.

9. A simpler and more robust way of achieving symmetry is to allow the MNE Group to elect to include the gains, profits, and losses from equity investments in the computation of GloBE Income or Loss and to take into account the corresponding current and deferred tax expenses or benefits. Symmetry is achieved by including both domestic tax consequences of the gain, profit or loss in the numerator (change in income tax expense due to the taxable income increase or reduction for domestic purposes) and the associated accounting gain, profit, or loss in the denominator (the GloBE Income or Loss) of the ETR computation. This option eliminates many of the complexities associated with the first approach, because it does not provide credit for a hypothetical tax that will never be paid and eliminates the question as to what rate should be used to estimate this hypothetical tax. In addition, unlike the first approach, this option leverages the financial accounting income or loss for purposes of adjusting the denominator. This further safeguards against inappropriate inclusions of permanent differences between the GloBE tax base and local tax base via the election.

#### *Flow through tax credits generally*

10. Tax credits may flow through a Tax Transparent Entity. Because tax credits generally reduce Covered Taxes, these credits will also affect the ETR of an investor in a Tax Transparent Entity. The character of a tax credit does not change simply because the holder of the credit has derived it through a Tax Transparent Entity. For example, a Qualified Refundable Tax Credit (QRTC) derived through a Tax Transparent Entity that is accounted for under the equity method is treated as income in computing the investor's GloBE Income or Loss and a non-QRTC or non-refundable credit reduces the investor's Adjusted Covered Taxes. This general principle applies with respect to tax credits derived through Tax Transparent Entities regardless of how the MNE Group accounts for the Ownership Interest. Thus, this treatment applies also to Ownership Interests in Tax Transparent Entities that are consolidated (i.e.

Constituent Entities), accounted for under the equity method, or fall below the threshold for applying equity method accounting.

#### *Qualified Flow-through Tax Benefits*

11. The Inclusive Framework has determined that a special rule will apply to Qualified Flow-through Tax Benefits. These are tax credits (other than Qualified Refundable Tax Credits) and the tax benefits of losses that flow to an investor as a return of (rather than a return on) the investor's investment. Qualified Flow-through Tax Benefits, are allowed as a positive amount in the owner's Adjusted Covered Taxes. For instance, if the Qualified Flow-through Tax Benefit was treated for financial accounting purposes as reducing tax expense, the Qualified Flow-through Tax Benefit shall be added to the Adjusted Covered Taxes to the extent necessary to offset the reduction to financial accounting tax expense. The special treatment of Qualified Flow-through Tax Benefits is designed to ensure the neutrality of certain tax equity structures where such non-refundable tax credits are an essential element of the investment return. Accordingly, this special treatment only applies:

- a. where, at the time of the investment, the investor's expected return on the Ownership Interest would not be positive in the absence of the expected non-refundable credits; and
- b. to the extent the Qualified Flow-through Tax Benefits constitute a return of all or part of the investor's investment.

12. The MNE Group will need to maintain records to verify that tax benefits that flow through the partnership are Qualified Flow-through Tax Benefits and provide any information on Qualified Flow-through Tax Benefits required by the GloBE Information Return.

#### **2.9.2. Guidance**

13. The guidance set out below provides for an Equity Investment Inclusion Election that can be made with respect to a jurisdiction that includes profit, gain or loss with respect to an equity investment in the domestic tax base. The guidance sets out the circumstances in which an election can be made and the effect of that election. However, certain aspects and implications of the election are not covered in this guidance. Accordingly, the Inclusive Framework will consider providing further guidance, including guidance related to the treatment of dispositions of Ownership Interests subject to the Equity Investment Inclusion Election, adjustments required by the guidance in the context of different financial accounting standards, and the interaction of this election with other aspects of the GloBE Rules.

14. Under the guidance set out below the owner's investment in the Qualified Ownership Interest serves as the cap on the amount of tax credits and tax benefit of losses that flow through to the owner that can be treated as Qualified Flow-through Tax Benefits. The Inclusive Framework will provide further guidance on how this limitation applies in each Fiscal Year that the investment is held and where the investment gives rise to a Qualified Refundable Tax Credit or produces income, including where the owner is subject to tax on the income. This further guidance will take into account the applicable accounting treatment applied to the tax benefits that flow through a Qualified Ownership Interest and preserve the integrity of the GloBE Rules and the outcomes provided under the guidance. The guidance set out below also provides for the treatment of Qualified Flow-through Tax Benefits in respect of the holder of a Qualified Ownership Interest. The Inclusive Framework will further consider providing further guidance on the consistent treatment of Qualified Flow-through Tax Benefits by other parties to the tax equity investment structures.

15. The Inclusive Framework will also consider providing further guidance on the application of the Model Rules that would prevent artificial structuring that generates or shifts artificial losses among or to Constituent Entities of an MNE Group, including exploring rules to prevent an MNE Group from using a reorganisation to shift artificial losses into a jurisdiction to shelter low-taxed income.

16. The following additional guidance will be inserted after paragraph 57 of the Commentary to Article 3.2.1(c):

*Equity Investment Inclusion Election*

57.1 Many of the income items excluded from a Constituent Entity's computation of GloBE Income or Loss will relate to returns, including dividends and gains, on share or equity investments. Such items often benefit from full or partial exemption regimes, however, these and other excluded income items may be subject to Covered Taxes in certain jurisdictions or circumstances. In such cases, an adjustment may be necessary to prevent understatement of the MNE Group's Effective Tax Rate when losses from such investments reduce the total amount of tax in a jurisdiction for a Fiscal Year. Allowing for such an adjustment ensures that the computation of the MNE Group's Effective Tax Rate in the relevant jurisdiction is not distorted by the excluded income or loss, or the tax expense or benefit associated with such item. To neutralize the impact of a loss (as well as a gain) with respect to an equity investment that is included in the domestic tax base in a jurisdiction, a Filing Constituent Entity may make an Equity Investment Inclusion Election. Absent this election, no adjustment attributable to such losses shall be made to the ETR computation.

57.2 An Equity Investment Inclusion Election applies on a jurisdictional basis to all Ownership Interests (other than a Portfolio Shareholding) owned by Constituent Entities located in the jurisdiction with respect to which the election is made. An Equity Investment Inclusion Election is a Five-Year Election, except that it cannot be revoked with respect to an Ownership Interest if a loss with respect to that Ownership interest has been taken into account in the computation of the GloBE Income or Loss during the period in which the Equity Investment Inclusion Election was in effect. When an Equity Investment Inclusion Election is made, an owner of an Ownership Interest other than a Qualified Ownership Interest under paragraph 57.8:

- a. includes in its GloBE Income or Loss the accounting gain, profit, or loss (adjusted as required by the provisions of Article 3.2 other than Article 3.2.1(c)) with respect to any:
  - i. fair value gains and losses and impairments on that Ownership Interest where the owner is taxable on a mark-to-market basis or on the impairment (and the tax consequences of the mark-to-market movements or impairments on Ownership Interest are reflected in Income tax expense) or the owner is taxable on a realization basis and the Income tax expense includes deferred tax expense on the mark to market movement or impairments on the Ownership Interest
  - ii. profit and loss attributable to that Ownership Interest where the interest is in a Tax Transparent Entity and the owner accounts for the interest using the equity method; and
  - iii. the dispositions of that Ownership Interest which give rise to gains or losses that are included in the owner's domestic taxable income, excluding any gain fully offset, and the proportionate share of any gain partially offset, by any deduction or other similar relief particular to the type of gain (such as a participation exemption directly attributable to the disposition of the Ownership Interest); and
- b. notwithstanding Articles 4.1.3(a) and 4.4.1(a), includes all current and deferred tax expense or benefits associated with these items in the computation of its Adjusted Covered Taxes subject to the relevant provisions of the GloBE Rules.



### *Treatment of tax credits derived through a Tax Transparent Entity*

57.3 The direct or indirect owner of an Ownership Interest in a Tax Transparent Entity shall treat any tax credits that flow through the Tax Transparent Entity in accordance with the ordinary requirements of the GloBE Rules based on the character of the credit received. For example, in the case of a Qualified Refundable Tax Credit (QRTC), the amount of the credit that flows through a Tax Transparent Entity to an owner shall be treated as income in the owner's GloBE Income or Loss. On the other hand, a non-QRTC or a non-refundable tax credit that flows through a Tax Transparent Entity to the owner shall not be treated as GloBE Income but rather as a reduction to Adjusted Covered Taxes of the owner (unless such credit is a Qualified Flow-through Tax Benefit as described further below).

### *Treatment of Qualified Flow-through Tax Benefits of Qualified Ownership Interests*

57.4 An owner that is subject to an Equity Investment Inclusion Election shall apply the treatment described in paragraphs 57.5 through 57.7 to Qualified Flow-through Tax Benefits that flow through a Qualified Ownership Interest. The treatment provided in paragraph 57.2 does not apply to a Qualified Ownership Interest; accordingly, where income flows through a Qualified Ownership Interest, the owner's GloBE Income or Loss is not increased to reflect such income and the owner's Covered Taxes are reduced by the amount of any tax expense with respect to such income. Similarly, where losses flow through a Qualified Ownership Interest the owner's GloBE Income or Loss is not reduced to reflect such loss and, to the extent provided in paragraph 57.5, the amount of any tax benefit of the owner with respect to such loss is effectively excluded from the owner's Adjusted Covered Taxes through being treated as a positive amount in the Adjusted Covered Taxes of the owner.

57.5 Qualified Flow-through Tax Benefits will be allowed as a positive amount in the Adjusted Covered Taxes of the direct owner of a Qualified Ownership Interest or an indirect owner of such an interest through a chain of Tax Transparent Entities that are not Constituent Entities of the MNE Group of a Qualified Ownership Interest to the extent the Qualified Flow-through Tax Benefit was treated for financial accounting purposes as reducing tax expense. A Qualified Flow-through Tax Benefit is any amount described in paragraph 57.6(a) or (b) (other than a Qualified Refundable Tax Credit) that flows through a Qualified Ownership Interest to the extent it reduces the owner's investment in the Qualified Ownership Interest pursuant to paragraph 57.6.

57.6 An owner's investment in a Qualified Ownership Interest is treated as being reduced by receipts with respect to the Qualified Ownership Interest of any of the following types:

- (a) The amount of tax credits that have flowed through to the owner;
- (b) The amount of any tax-deductible losses that have flowed through to the owner multiplied by the statutory tax rate applicable to the owner;
- (c) The amount of any distributions (including a return of capital) to the owner; and
- (d) The amount of proceeds from a sale of all or part of the Qualified Ownership Interest.

This rule shall in no circumstances cause the owner's investment to be less than zero, and accordingly no amount shall be treated as reducing the investment to the extent it would reduce the investment below zero.

57.7 Any of the items described in paragraphs 57.6(a) through (d) that flow through or are received in respect of the Qualified Ownership Interest after the owner's investment has been reduced to zero pursuant to paragraph 57.6 shall be treated as a negative amount in the owner's Adjusted Covered Taxes. However, an item described in paragraph 57.6(c) or (d) or a Qualified Refundable Tax Credit,

shall be treated as a negative amount in the owner's Adjusted Covered Taxes only to the extent of the amount of any Qualified Flow-through Tax Benefits that flowed through the Qualified Ownership Interest and that were treated as a positive amount in the owner's Adjusted Covered Taxes.

57.8 A Qualified Ownership Interest is an Ownership Interest in a Tax Transparent Entity where the assets, liabilities, income, expenses, and cash flows of the Tax Transparent Entity are not consolidated on a line-by-line basis in the Consolidated Financial Statements of the MNE Group and the total return with respect to that Ownership Interest (including distributions and benefits of tax losses and Qualified Refundable Tax Credits derived through the Tax Transparent Entity, but excluding tax credits other than Qualified Refundable Tax Credits) is expected to be less than the total amount invested by the owner of the Ownership Interest such that a portion of the investment will be returned in the form of tax credits other than Qualified Refundable Tax Credits. The determination of the expected total return is made at the time the investment is entered into and is based on facts and circumstances, including the terms of the investment.

## 2.10. Allocation of taxes arising under a Blended CFC Tax Regimes [AG22.04.T17]

### 2.10.1. Introduction

1. Article 4.3.2(c) of the GloBE Rules requires taxes imposed under a Controlled Foreign Company Tax Regime (CFC Tax Regime) to be allocated from the Constituent Entity-owner that is subject to the CFC tax to the Constituent Entity through which the CFC income has arisen. Because CFC Tax Regimes apply in respect of income earned through a foreign company, Article 4.3.2(c) allocates tax arising in one jurisdiction to a Constituent Entity in another jurisdiction. This ensures that taxes are matched with the income on which they arise for purposes of the jurisdictional ETR computations. Article 4.3.2(c) does not provide for a specific method for allocating these CFC taxes. The guidance in the Commentary provides that the CFC tax shall be allocated to each CFC based on the Constituent Entity-owner's share of the underlying income.

2. The allocation of CFC taxes under Article 4.3.2(c) is likely to be relatively straightforward when a Constituent Entity-owner holds only one CFC or when CFC tax is computed on a standalone basis. The exercise of identifying which CFC tax relates to what CFC becomes more complex, however, when the CFC tax arises under a Blended CFC Tax Regime. A Blended CFC Tax Regime is one in which the tax charge under the CFC Tax Regime is computed based on a blend of income, losses and / or creditable taxes of multiple CFCs whose Ownership Interests are held by a Constituent Entity-owner (or multiple Constituent Entity-owners that file a single tax return). Tracing the CFC tax to a specific Constituent Entity becomes significantly more complex because the CFC tax is not generated by the inclusion of income and taking into account the taxes from a specific CFC, but rather by all CFCs.

3. These Blended CFC Tax Regimes are designed not to tax low-tax outcomes in respect of a particular entity or jurisdiction but to ensure aggregate foreign income that is beneficially owned by a taxpayer through a CFC is subject to a minimum level of tax.

4. The US Global Intangible Low-Taxed Income (GILTI) regime is an example of a Blended CFC Tax Regime. The GILTI rules aggregate income, losses, and taxes of all CFCs owned by a US shareholder to determine whether that shareholder's share of the income derived through CFCs is subject to tax at a minimum rate. The GILTI regime was designed to test the global aggregate CFC income of the US shareholder and then impose an additional tax should the globally blended ETR be below 13.125% in a given tax year, as computed under US tax principles. This document provides guidance on the allocation of CFC taxes under Article 4.3.2(c) when such CFC taxes are generated under a Blended CFC Tax Regime.

5. In its October 2021 Statement, the Inclusive Framework agreed that consideration would be given to the considerations under which GILTI will co-exist with the GloBE Rules in order to ensure a level playing field. The Inclusive Framework has agreed that GILTI, in its current form, meets the definition of a CFC Tax Regime under the GloBE Rules and must be treated as such. However, given the status of GILTI as a Blended CFC Tax Regime and the urgent need for guidance on the allocation of GILTI taxes under Article 4.3.2(c), the Inclusive Framework has agreed a simplified allocation that can be applied to Blended CFC Tax Regimes, including GILTI, for a limited time period. Whether to allow a special allocation methodology for Blended CFC Tax Regimes after that limited time period will be assessed by the Inclusive Framework.

6. The guidance set out below allocates CFC tax incurred under a Blended CFC Tax Regime to Entities located in jurisdictions in which the GloBE Jurisdictional ETR is below the Applicable Rate for the Blended CFC Tax Regime. The Applicable Rate means the rate at which foreign taxes on CFC income generally fully offset the CFC tax through the tax credit mechanism applicable to the CFC Tax Regime. The effect of such an allocation formula is that Constituent Entities with lower Covered Taxes under the

GloBE Rules and larger amounts of income as computed under the Blended CFC Tax Regime will attract the largest amount of Blended CFC Tax Regime taxes. This result is administrable and logically allocates the tax incurred under a Blended CFC Tax Regime to the Constituent Entities which have the most significant downward impact on the aggregate ETR of the CFC shareholder under the Blended CFC Tax Regime.

### **2.10.2. Issues to be considered**

7. This document provides guidance on the allocation of GILTI taxes and taxes arising under other Blended CFC Tax Regimes under Article 4.3.2(c).

### **2.10.3. Guidance**

8. The following guidance will be included after paragraph 58 of the Commentary to Article 4.3.2.

58.1 To improve tax certainty and administrability of the GloBE Rules in the first years of application, a special allocation methodology has been developed for Blended CFC Tax Regimes on a time-limited basis. This methodology allocates Allocable Blended CFC Taxes to low-tax jurisdictions.

58.2 A Blended CFC Tax Regime is a CFC Tax Regime that aggregates income, losses, and creditable taxes of all the CFCs for the purposes of calculating the shareholder's tax liability under the regime and that has an Applicable Rate of less than 15%. For the purposes of this special allocation methodology, a Blended CFC Tax Regime does not include a regime that takes into account a group's domestic income (although a Blended CFC Tax Regime may allow losses incurred by the domestic shareholder of the CFC to reduce the CFC income inclusion).

58.3 Allocable Blended CFC Tax shall be allocated from a Constituent Entity-owner to a Constituent Entity under Article 4.3.2(c) in accordance with the formula set out below for Fiscal Years that begin on or before 31 December 2025 but not including a Fiscal Year that ends after 30 June 2027. Allocable Blended CFC Tax is the amount of tax charge incurred by the Constituent Entity-owner under the Blended CFC Tax Regime. For instance, in the case of GILTI, the Allocable Blended CFC Tax can be determined from the US shareholder's US federal income tax return and in the absence of a domestic loss is equal to the amount of GILTI (reduced by the GILTI deduction) multiplied by 21%, less the foreign tax credit allowed in the GILTI basket.

#### **Blended CFC Tax Allocated to an Entity:**

$$\frac{\text{Blended CFC Allocation Key}}{\text{Sum of All Blended CFC Allocation Keys}} \times \text{Allocable Blended CFC Tax}$$

#### **Blended CFC Allocation Key:**

$$\text{Attributable Income of Entity} \times (\text{Applicable Rate} - \text{GloBE Jurisdictional ETR})$$

58.4 Attributable Income of the Entity means the Constituent Entity-owner's proportionate share of the income, of the CFC (or relevant part of the income of a CFC that is comprised of more than one Constituent Entity) in the jurisdiction in which the Entity is located as determined under the Blended CFC Tax Regime. For instance, in the case of GILTI the Attributable Income of the Entity can be determined from the US shareholder's US federal income tax return and is equal to the US shareholder's share of the tested income (without reduction for foreign income taxes) of the Constituent Entity (which may be a CFC or a tested unit of the CFC).

58.5 Applicable Rate means the threshold for low taxation under the Blended CFC Tax Regime (i.e. the minimum rate at which foreign taxes on CFC income generally fully offsets the CFC tax). For instance, in the case of GILTI the Applicable Rate is 13.125%.

58.6 GloBE Jurisdictional ETR means the Effective Tax Rate for a jurisdiction as computed under Article 5.1 without regard to any Covered Taxes under a CFC Tax Regime. If the GloBE Jurisdictional ETR equals or exceeds the Applicable Rate or the Minimum Rate, the Blended CFC Allocation Key for the Constituent Entity will be treated as zero. Further, income tax expense attributable to the Qualified Domestic Minimum Top-up Tax of a jurisdiction will be included in the computation of the GloBE Jurisdictional ETR for that jurisdiction under this paragraph. A Qualified Domestic Minimum Top-up Tax is taken into account in determining the GloBE Jurisdictional ETR only if the Blended CFC Tax Regime allows a foreign tax credit for the QDMTT on the same terms as any other creditable Covered Tax.

58.7 To the extent the income of non-Constituent Entities is subject to the Blended CFC Tax Regime, an amount of CFC tax imposed under the Blended CFC Tax Regime must be allocated to such non-Constituent Entities to ensure such tax is properly excluded from Covered Taxes for GloBE purposes. Accordingly, such non-Constituent Entities should also be included in the allocation formula set out in paragraph 58.3. Any Blended CFC Tax Regime tax allocated to such non-Constituent Entities shall be excluded from Covered Taxes. If the non-Constituent Entity is located in a jurisdiction in which the MNE Group does not compute a jurisdictional ETR under Article 5.1 (for instance, because the MNE Group has no Constituent Entities in the jurisdiction), the GloBE Jurisdictional ETR will be computed based on the aggregate income and taxes shown in the financial accounts of all non-Constituent Entities in the jurisdiction.

#### **2.10.4. Examples**

##### *Example 4.3.2-1*

1. An MNE Group with a UPE in jurisdiction X is subject to a Blended CFC Tax Regime imposed by jurisdiction X. Under the jurisdiction X Blended CFC Tax Regime, shareholders of CFCs aggregate their proportionate share of the income and taxes of all CFCs in which they hold an Ownership Interest. The foreign effective tax rate must be 13.125% in order to generate sufficient foreign tax credits to prevent the imposition of a CFC charge under this Blended CFC Tax Regime. This is without reference to impacts of any foreign tax credit limitation formulas applicable in jurisdiction X.
2. The UPE owns CFCs in jurisdictions A (A Co), B (B Co), and C (C Co). For the Fiscal Year, A Co generates 100 of Attributable Income, B Co generates 50 of Attributable Income, and C Co generates 25 of Attributable Income. The UPE owns 100% of each CFC and all of each CFC's income is Attributable Income of the Entity.
3. The GloBE Jurisdictional ETR for the jurisdictions are as follows:
  - a. jurisdiction A: 10%,
  - b. jurisdiction B 20%, and
  - c. jurisdiction C 5%.
4. Under the Blended CFC Tax Regime, the UPE incurs 20 of tax, which must be allocated to the CFCs.

5. The Blended CFC Allocation Key for each CFC is computed as set out below:

Entity	Allocation Key Computation (Attributable Income of Entity x (Applicable Rate – GloBE Jurisdictional ETR))	Blended CFC Allocation Key (Result of Allocation Key Computation)
A Co	100 x (13.125% - 10%)	3.125
B Co	50 x (13.125% - 20%)	No Allocation
C Co	25 x (13.125% - 5%)	2.031
<u>Sum of All Blended Allocation Keys</u>		<u>5.156</u>

6. The 20 of Blended CFC Tax Regime tax is then allocated as follows:

Entity	Allocation Amount Computation (Blended CFC Allocation Key / Sum of All Blended CFC Allocation Keys) x Allocable Blended CFC Tax)	Blended CFC Tax Allocated (Result of Allocation Amount Computation)
A Co	(3.125 / 5.156) x 20	12.12
B Co	No Allocation	No Allocation
C Co	(2.031 / 5.156) x 20	7.88
<u>Total Blended CFC Tax Allocated</u>		<u>20.00</u>

#### Example 4.3.2-2

1. The facts are the same as Example 4.3.2-1, however, there are two Entities in Jurisdiction A. Entity A1 Co is a non-Constituent Entity and Entity A2 Co is a Constituent Entity. A1 Co earns 100 of total income and 25 of that income is Attributable Income of the Entity. A2 Co earns 75 of income, all of which is Attributable Income of the Entity.

2. The Blended CFC Allocation Key is computed as set out below:

Entity	Allocation Key Computation (Attributable Income of Entity x (Applicable Rate – GloBE Jurisdictional ETR))	Blended CFC Allocation Key (Result of Allocation Key Computation)
A1 Co	25 x (13.125% - 10%)	0.781
A2 Co	75 x (13.125% - 10%)	2.344
B Co	50 x (13.125% - 20%)	No Allocation
C Co	25 x (13.125% - 5%)	2.031
<u>Total Allocation Key</u>		<u>5.156</u>

3. The 20 of Blended CFC Tax Regime tax is then allocated as follows:

Entity	Allocation Amount Computation (Blended CFC Allocation Key / Sum of All Blended CFC Allocation Keys) x Allocable Blended CFC Tax)	Blended CFC Tax Allocated (Result of Allocation Amount Computation)
A1 Co	(0.781 / 5.156) x 20*	Excluded Because A1 Co is a Non-Constituent Entity*
A2 Co	(2.344 / 5.156) x 20	9.09
B Co	No Allocation	No Allocation
C Co	(2.031 / 5.156) x 20	7.88
<u>Total Blended CFC Tax Allocated</u>		<u>16.97*</u>

\*3.03 of Blended CFC Tax is attributable to A1 Co ((0.781 / 5.156) x 20) and is not included in Adjusted Covered Taxes of the MNE Group because A1 Co is not a Constituent Entity.

# 3 Application of GloBE Rules to insurance companies

## 3.1. Application of Article 7.6 to Insurance Investment Entities [AG22.04.T11]

1. Chapter 7 of the GloBE Rules contains a series of special rules applicable to Investment Entities and Insurance Investment Entities. The general rule in Article 7.4 requires such Entities to apply the GloBE Rules to such Entities on a stand-alone basis. In other words, each Entity computes its own ETR and Top-up Tax based on its GloBE Income or Loss, Adjusted Covered Taxes, and Substance-based Income Exclusion. The Article allows Entities located in the same jurisdiction to be combined for this purpose.
2. Article 7.5 provides for an election to treat an Investment Entity or an Insurance Investment Entity as a Tax Transparent Entity. Article 7.5 was created to address comments submitted by the insurance industry that described a timing and location mismatch between insurance expenses and the investment income that funded the insurance liabilities. Insurance companies are often subject to tax regimes that require them to include gains and losses on their investment entities on a mark-to-market basis and that allow a deduction for increases in insurance reserves. Without the Article 7.5 election, the insurance company would have GloBE losses from its insurance expenses and the Investment Entity would have Top-up Tax on its fair value gains. Under those circumstances, it made sense to align the tax and GloBE treatment through a tax transparency election.
3. Article 7.6 provides an elective method to account for income earned through Investment Entities. The Taxable Distribution Method reduces the exposure to Top-up Tax to the extent that the Investment Entity makes distributions of its income within a four-year period that are taxable in the hands of the recipients at or above the Minimum Rate.
4. The purpose of Article 7.5 with respect to Insurance Investment Entities is to bring the income to the jurisdiction in which it is currently taxed after taking into account the related expenses. However, there are cases where this Article cannot apply because Insurance Investment Entities are not subject to a mark-to-market or similar tax regime in certain jurisdictions. Nonetheless, the insurance company may be taxed on the difference between investment income and insurance liabilities on a different basis, including when the investment income is received. For these cases, an election to Article 7.6 can achieve a similar result in terms of conformity with the local tax treatment of the investment income and related expenses.
5. Currently, Article 7.6 covers Investment Entities only and not Insurance Investment Entities. To better conform to the treatment of income earned through Insurance Investment Entities, it is therefore proposed that Insurance Investment Entities can make an election to use the Taxable Distribution Method in Article 7.6.
6. In addition, Article 7.6.1 requires a reasonable expectation that the Constituent Entity-owner will be subject to tax on distributions at rate that equals or exceeds the Minimum Rate. Under Article 7.1.1 and Article 7.2.1, the reasonable expectation test takes into account taxes paid by the entity and the shareholder. The Inclusive Framework has determined that an election under Article 7.6 should be

available where the taxes paid by the shareholder and the Investment Entity or Insurance Investment Entity, in the aggregate, are reasonably expected to equal or exceed the Minimum Rate.

7. Finally, the Inclusive Framework will give further consideration to the treatment of Investment Entities and Insurance Investment Entities under Articles 7.6 and consider simplifications and further clarifications of the rules in that article.

8. The following paragraph will replace paragraph 99 of the Commentary to Article 7.6:

99. Article 7.6 provides another alternative to the treatment of Investment Entities under Article 7.4. This alternative, the Taxable Distribution Method, reduces the exposure to Top-up Tax of income earned through an Investment Entity to the extent that the Investment Entity makes distributions of its income within a four-year period that are taxable in the hands of the recipients at or above the Minimum Rate. The Inclusive Framework has agreed that the election under Article 7.6.1 shall be available to Insurance Investment Entities. Accordingly, the term “Investment Entity” in Article 7.6 and the related Commentary shall be interpreted to include an Insurance Investment Entity.

9. To clarify the eligibility requirement of Article 7.6.1, the following sentence will be added after the second sentence of paragraph 100 of the Commentary to Article 7.6:

100. (...) Taxes arising on distributions as well as taxes incurred by the Investment Entity in respect of income distributed to a Constituent Entity-owner are taken into account in determining whether the Constituent Entity-owner is reasonably expected to be subject to tax at a rate that equals or exceeds the Minimum Rate.

10. Furthermore, in order to provide for a definition of deemed distributions in the context of Article 7.6, the following sentence will be added to paragraph 102 of the Commentary to Article 7.6:

102. (...) For the purposes of Art. 7.6, a deemed distribution includes the income of an Investment Entity for a Fiscal Year to the extent that it is not distributed but under domestic tax law is considered to be realised at the level of the Constituent Entity-owner and subject to taxation at that level in the same Fiscal Year.

11. In addition, the following sentence will replace the first sentence of paragraph 103 of the Commentary to Article 7.6:

103. A Constituent Entity-owner that is itself an Investment Entity, i.e. an intermediate Investment Entity, does not include the distribution in its GloBE Income or Loss in order to preserve the tax neutrality of Investment Entities.



### 3.2. Exclusion of Insurance Investment Entities from the definition of Intermediate Parent Entity and Partially-Owned Parent Entity [AG22.04.T11]

1. The definition of Intermediate Parent Entity excludes from being an Intermediate Parent Entity the following Constituent Entities: Ultimate Parent Entity, Partially-Owned Parent Entity, Permanent Establishment, or Investment Entity. Investment Entities are excluded from this definition in order to preserve the tax neutrality of the Investment Entity vis-à-vis any minority-interest holders. The same rationale applies to Insurance Investment Entities. It is therefore proposed to also exclude Insurance Investment Entities from the definition of Intermediate Parent Entity. In order to do so, paragraph 14 the Commentary to Article 2.1.2 will be revised to include the bold and underlined text and will read as follows:

14. Article 2.1.2 provides the rules for application of the IIR by an Intermediate Parent Entity. An Intermediate Parent Entity is defined in Article 10.1 as a Constituent Entity (other than a UPE, POPE, PE or Investment Entity) that owns (directly or indirectly) an Ownership Interest in another Constituent Entity in the same MNE Group. Investment Entities (i.e. an Investment Fund or a Real Estate Investment Vehicle and certain subsidiaries of such entities as set out in the Article 10 definition) are excluded from the definition of Intermediate Parent Entity and Parent Entity in order to preserve the tax neutrality of the Investment Entity vis-à-vis any minority-interest holders. **The same applies to Insurance Investment Entities and therefore these are also excluded from the definition of Intermediate Parent Entity.** The treatment of Investment Entities **and Insurance Investment Entities** is discussed in more detail in the Commentary to Article 7.4 to Article 7.6. To avoid difficult factual determinations and disputes as to whether the Ownership Interests in LTCEs are held by the PE or the Main Entity, PEs are not treated as Parent Entities under the GloBE Rules. In this context, Ownership Interests in an LTCE that are held through a PE are treated, instead, as held by the Main Entity.

2. The definition of Partially-Owned Parent Entity has the same deficiency. Accordingly, it is also proposed to exclude Insurance Investment Entities from the definition of Partially-Owned Parent Entity. In order to do so, paragraph 7 of the Commentary to Chapter 2 will be revised to include the bold and underlined text and will read as follows:

7. Articles 2.1.4 to 2.1.5 apply to so-called “split-ownership structures”, where some of the LTCEs have a significant (i.e. more than 20%) minority interest holder outside the MNE Group. In this case, the GloBE Rules depart from the top-down approach and instead require a POPE to apply the IIR notwithstanding that it is in a lower-tier of the ownership chain. **A POPE is a Constituent Entity that directly or indirectly owns an Ownership Interest in another Constituent Entity of the same MNE Group and has more than 20% of its own Ownership Interests held by persons that are not Constituent Entities of the same MNE Group. However, a POPE does not include a UPE, a Permanent Establishment, an Investment Entity or an Insurance Investment Entity.**

### 3.3. Restricted Tier One Capital (Article 3.2.10) [AG22.04.T11]

1. Article 3.2.10 provides a set of rules that essentially treats Additional Tier One Capital (which banks are required to issue pursuant to prudential regulatory requirements) in the same manner as a debt instrument. Distributions on Additional Tier One Capital are treated as expenses of the issuer and income of the holder in the computation of GloBE Income or Loss. Insurance companies are required to issue similar instruments, known as Restricted Tier One Capital, under prudential regulatory requirements, such as Solvency II regulations. Restricted Tier One Capital is contingent convertible subordinated debt and includes a contractual trigger to convert to equity on specified events. In some jurisdictions Restricted Tier One Capital is treated as equity for financial accounting purposes, but coupons are deductible for tax purposes. This treatment is identical to Additional Tier One Capital in the banking sector in such jurisdictions.

2. In order to provide similar treatment to similar instruments issued by insurance businesses, it is proposed that Article 3.2.10 apply also to Restricted Tier One Capital. Accordingly, the bold and underlined text will be added to paragraph 142 of the Commentary to Article 3.2.10 to read as follows:

142. Article 3.2.10 provides a special rule for the treatment of Additional Tier One Capital, which is defined in Article 10.1 as an instrument issued by a Constituent Entity pursuant to prudential regulatory requirements applicable to the banking sector that is convertible to equity or written down if a pre-specified trigger event occurs and that has other features which are designed to aid loss absorbency in the event of a financial crisis. This type of capital is commonly referred to in financial markets as Additional Tier One Capital. **Prudential regulatory requirements in the insurance sector often require Constituent Entities to issue instruments with the same characteristics. In the insurance sector, this type of capital is commonly referred to as Restricted Tier One Capital. Because of their similar characteristics and purpose, the Inclusive Framework has agreed that Article 3.2.10 shall also apply to Restricted Tier One Capital. This is defined as an instrument issued by a Constituent Entity pursuant to prudential regulatory requirements applicable to the insurance sector that is convertible to equity or written down if a pre-specified trigger event occurs and that has other features which are designed to aid loss absorbency in the event of a financial crisis.**

### 3.4. Liabilities related to Excluded Dividends and Excluded Equity Gain or Loss from securities held on behalf of policyholders (Article 3.2.1(b) and Article 3.2.1(c)) [AG22.04.T11]

#### 3.4.1. Excluded Dividends

1. Insurance companies often hold investments in equities on behalf of the policyholders. Under these types of contracts, the insurance company is obligated to pay all earnings from the investment to the policyholders less an investment management fee. This is referred to as unit linked insurance. From an accounting perspective, the insurance company's income from dividends is reduced by the expense in respect of the increase in liabilities to the policyholders (insurance liability). Hence, the insurance company will have no net Financial Accounting Net Income or Loss on these dividends, except for its investment management fee.

2. Many of these equities will be long-term shareholdings even though they are held on trading account. Therefore, the dividends will often qualify as Excluded Dividends notwithstanding that they are included in taxable income for local tax purposes. Because of the accounting treatment as set out in the previous paragraph, this could lead to a distortive mismatch where the income is excluded from the computation of GloBE Income or Loss, but the insurance liability not. This would effectively decrease the GloBE Income (if any) of the insurance company and increase its ETR.

3. Given the close relationship between the dividends and the insurance liability, it is proposed to include the bold and underlined text below at the end of paragraph 36 of the Commentary to Article 3.2.1(b) to read as follows:

36. Article 3.2.1(b) adjusts a Constituent Entity's Financial Accounting Net Income or Loss by reducing that Net Income (or increasing the Loss) by the amount of any Excluded Dividends received during the Fiscal Year. In general terms, Excluded Dividends are dividends or other distributions paid on shares or other equity interests where (i) the MNE Group holds 10% or more of the Ownership Interests in the issuer or (ii) the Constituent Entity has held full economic ownership of the Ownership Interest for a period of 12 months or more. Paragraph (b) is intended to provide for a broad exemption for dividends that aligns with the operation and scope of participation exemptions in many IF jurisdictions and covers both substantial and long terms shareholdings, while, at the same time, ensuring that the exclusion does not provide unintended benefits for dividend income received by a Constituent Entity as part of its trading activity. **Where a movement in an insurance company's reserves economically matches an Excluded Dividend (net of the investment management fee) from a security held on behalf of a policyholder (for example, unit linked insurance), the movement in the insurance reserves is not allowed as an expense in the computation of GloBE Income or Loss.**

4. In addition, it is proposed to include the bold and underlined text below at the end of paragraph 45 of the Commentary to Article 3.2.1(b) to read as follows:

45. In relation to Short-term Portfolio Shareholdings, the dividend income is not included in the adjustment for Excluded Dividends and thus would be included in the GloBE Income or Loss. Any Taxes paid under local law in respect of those dividends would be included in the Adjusted Covered Taxes (the numerator) of the ETR calculation under Article 4.1.1. The treatment of dividends on Short-term Portfolio Shareholdings applies equally to dividends on stock in domestic and foreign corporations. Including dividends on Short-term Portfolio Shareholdings in the GloBE Income or Loss eliminates the need to exclude the related expenses and the need for rules to determine the scope and amount of those related expenses. Although local tax rules typically disallow deductions for expenses associated with income that is excluded from taxable income, for simplicity, the GloBE Rules do not disallow expenses related to Excluded Dividends **(except that**

**movements in insurance reserves related to Excluded Dividends from securities held on behalf of policyholders (for example, unit linked insurance) are not allowed as a deduction in the computation of GloBE Income or Loss** and therefore rules to determine the scope and amount of those related expenses are unnecessary.

#### **3.4.2. Excluded Equity Gain or Loss**

5. For the same reasons as set out above under Excluded Dividends, it is also agreed that expenses related to Excluded Equity Gains or Losses from unit linked insurance must be excluded. Accordingly, the following bold and highlighted text is added to the last sentence of paragraph 54 of the Commentary to Article 3.2.1(c):

54. (...) However, gains and losses from the disposition of a Portfolio Shareholding are included in the GloBE Income or Loss. **For simplicity, the GloBE Rules do not disallow expenses related to Excluded Equity Gains or Losses in the computation of GloBE Income or Loss (except the expenses from movements in insurance reserves related to Excluded Equity Gains or Losses from securities held on behalf of policyholders (for example, unit linked insurance) are not allowed as a deduction in the computation of GloBE Income or Loss).**

### 3.5. Simplification for Short-term Portfolio Shareholdings (Article 3.2.1(b)) [AG22.04.T11]

1. Under the rules for Excluded Dividends, there is an exception for dividends from Short-term Portfolio Shareholdings. A Short-term Portfolio Shareholding is a Portfolio Shareholding that has been held for less than one year at the time a dividend is distributed. These dividends are included in the GloBE Income or Loss.

2. Insurance companies and other stakeholders indicate that the requirements to differentiate Short-term Portfolio Shareholdings from other (long-term) Portfolio Shareholdings are burdensome. As a matter of administrative simplification, it is therefore proposed that MNE Groups can for each Constituent Entity elect to include dividends from all their Portfolio Shareholdings (including long-term Portfolio Shareholdings) in their GloBE Income or Loss computation. Any type of Constituent Entity of an MNE Group can make this election, whether they are insurance companies or not. It is however expected that mostly insurance companies would elect. This election would be a Five-Year Election and should be made at the level of the Constituent Entity.

3. An MNE Group that elected to include all dividends from Portfolio Shareholdings in its computation of GloBE Income or Loss would not need to adjust for movements in insurance reserves that are related to securities held on behalf of policyholders. Consequently, this proposal could also be a simpler alternative to the Excluded Dividend provision as discussed above.

4. Accordingly, the bold and underlined text will be included at the end of paragraph 45 of the Commentary to Article 3.2.1(b):

45. In relation to Short-term Portfolio Shareholdings, the dividend income is not included in the adjustment for Excluded Dividends and thus would be included in the GloBE Income or Loss. Any Taxes paid under local law in respect of those dividends would be included in the Adjusted Covered Taxes (the numerator) of the ETR calculation under Article 4.1.1. The treatment of dividends on Short-term Portfolio Shareholdings applies equally to dividends on stock in domestic and foreign corporations. Including dividends on Short-term Portfolio Shareholdings in the GloBE Income or Loss eliminates the need to exclude the related expenses and the need for rules to determine the scope and amount of those related expenses. Although local tax rules typically disallow deductions for expenses associated with income that is excluded from taxable income, for simplicity, the GloBE Rules do not disallow expenses related to Excluded Dividends **(except movements in insurance reserves related to Excluded Dividends from securities held on behalf of policyholders)** and therefore rules to determine the scope and amount of those related expenses are unnecessary. **Alternatively, a Filing Constituent Entity can (for each Constituent Entity) make a Five-Year Election to include in the computation of GloBE Income all dividends received by the Constituent Entity with respect to Portfolio Shareholdings, regardless of whether these are Short-term Portfolio Shareholdings, notwithstanding the adjustment for Excluded Dividends that would apply in the absence of the election. This means that in this situation, after the election, all dividends on Portfolio Shareholdings of the elected Constituent Entities will be included in the computation of the Constituent Entity's GloBE Income or Loss.**

## 3.6. Application of Article 7.5 to Mutual insurance companies [AG22.04.T7]

### 3.6.1. Introduction

1. This section provides guidance on how the Investment Entity Transparency Election in Article 7.5 applies when an Investment Entity is owned by a mutual insurance company.
2. The Investment Entity Transparency Election allows a Constituent Entity-owner to elect to treat an Investment Entity (including an Insurance Investment Entity) as a Tax Transparent Entity for the purposes of the GloBE Rules.
3. When the election is made, the financial accounting net income or loss of the Investment Entity is allocated to its Constituent Entity-owner. This enables the MNE Group to bring the treatment of the Investment Entity under the GloBE Rules into line with the local tax treatment, where the income of a fund is typically taxed at the level of its investors rather than in the fund vehicle itself.
4. To maintain the integrity of the GloBE Rules, the availability of the Article 7.5 election is subject to certain conditions. The first condition is that the Constituent Entity-owner is subject to tax under a mark-to-market or similar regime based on the annual changes in the fair value of its Ownership Interests in the Investment Entity. The second condition is that the tax imposed is at a rate that equals or exceeds the minimum rate.
5. These conditions are designed to restrict the election to circumstances where the income of the Investment Entity is in substance taxed as though it was a tax transparent entity for local tax purposes, with the unrealised income and gains of the fund in effect subject to tax at the investor level on an annual basis.

### 3.6.2. Issue to be considered

6. Mutual insurance companies are regulated insurance companies which are owned exclusively by their policyholders. These companies do not have share capital and consequently any returns generated from their investments are returned as surplus to their policyholders.
7. As the returns are wholly attributable to the policyholders, the income from investments is exactly matched by an offsetting expense, which corresponds to the increase in the company's liabilities to its policyholders.
8. There is therefore no profit from an accounting perspective, which means the mutual insurance company would not ordinarily be expected to have GloBE Income or be subject to taxation under the GloBE Rules.
9. However, some mutual insurance companies make investments in Investment Entities on behalf of their policyholders. In some cases, these Investment Entities will be controlled by the mutual insurance company and will therefore be separate Constituent Entities in the MNE Group whose Effective Tax Rate will be measured under the rules in Article 7.4.
10. As with all investments by a mutual insurance company, these investments are ultimately held for the benefit of policyholders, and there is therefore no accounting profit in either the financial accounts of the mutual insurance company or from a consolidated MNE Group perspective.
11. However, the Investment Entity's financial accounts will not include an offsetting expense in respect of liabilities to policyholders. This is because the financial obligations to policyholders belong to the mutual insurance company rather than the Investment Entity. This means that the Investment Entity's accounts will often include an accounting profit, which could give rise to a Top-up Tax liability unless the

mutual insurance company is able to make the Article 7.5 election to treat its controlled Investment Entity as a Tax Transparent Entity.

12. There is some uncertainty whether mutual insurance companies meet the conditions for the Article 7.5. election. On the one hand, mutual insurance companies are generally subject to tax, and pay tax, on their investment returns on behalf of their policyholders. However, certain types of income may not be subject to this regime and because a mutual insurance company accrues an expense for its surplus, all of which is payable to policyholders, it does not generate profits and may not incur corporate tax on this type of income.

### 3.6.3. Guidance

13. Delegates have agreed that mutual insurance companies should be eligible to make the Article 7.5 election with respect to Investment Entities and Insurance Investment Entities that they control, because this is necessary to ensure that the GloBE Rules reflect the underlying economics of these arrangements, and in particular the fact that all profits earned by mutual insurance companies on behalf of policyholders are immediately expensed by the MNE Group in the Consolidated Financial Statements.

14. Paragraph 91 of the Commentary to the Investment Entity Transparency Election under Article 7.5 will be revised by substituting a new sentence for the first sentence, adding a new sentence after the first sentence, and inserting a reference to Insurance Investment Entities where necessary in the paragraph. The paragraph is revised by the bold and underlined text below to read as follows:

91. **A Filing Constituent Entity may elect to treat a Constituent Entity that is an Investment Entity or an Insurance Investment Entity as a Tax Transparent Entity if the Constituent Entity-owner of that Investment Entity or Insurance Investment Entity is subject to tax in its location under a mark-to-market or similar regime based on the annual changes in the fair value of its Ownership Interest in the Investment Entity or Insurance Investment Entity and the tax rate applicable to the Constituent Entity-owner with respect to such income equals or exceeds the Minimum Rate. For this purpose, a Constituent Entity that is a policyholder-owned, regulated insurance Entity (a “regulated mutual insurance company”) and that owns an Ownership Interest in an Investment Entity or an Insurance Investment Entity is considered to be subject to tax under a mark-to-market or similar regime based on the annual changes in the fair value of its Ownership Interest in the Investment Entity or Insurance Investment Entity at a rate that exceeds the Minimum Rate.** The election does not need to be made with respect to all Constituent Entity-owners of the Investment Entity or an Insurance Investment Entity. However, the election applies to all of a Constituent Entity-owner’s interests in the Investment Entity or Insurance Investment Entity.

15. In addition, a new paragraph 91.1 will be added to read as follow:

91.1. The previous paragraph is further clarified by the following example. Company A is a regulated mutual insurance company which is wholly policyholder-owned. It decides to set up Subsidiary B to invest funds for the benefit of its policyholders. Subsidiary B is an Insurance Investment Entity as defined in Article 10.1. Subsidiary B is 100% owned by Company A and is a Constituent Entity in Company A’s MNE Group. Subsidiary B’s Financial Accounting Net Income or Loss for the Fiscal Year is 100. Company A’s financial accounts include a fair value gain of 100 on the increase in the value of its ownership interests in Subsidiary B. This is offset by an expense of 100 in respect of the increase in Company A’s liabilities to its policyholders, meaning that Company A has no Financial Accounting Net Income or Loss for the Fiscal Year. However, the fair value gain is excluded from Company A’s GloBE Income or Loss under Article 3.2.1(c). Consequently, Company A would have a GloBE Loss of 100, while Subsidiary B would have a GloBE Income of 100. From the MNE Group’s perspective, there is no net income as the 100 of income from the fund

is economically the income of the policyholders rather than the income of the MNE Group. As Company A is a regulated mutual insurance company, it is eligible to make an Article 7.5 election to treat Subsidiary B as a Tax Transparent Entity. While the election is in effect, Subsidiary B's income is allocated to Company A in accordance with Article 3.5. Company A therefore includes the 100 of Financial Accounting Income or Loss, which is matched against the expense of 100 from the movement in liabilities to policyholders, and results in GloBE Income of zero. Subsidiary B also has GloBE Income of zero as its Financial Accounting Net Income or Loss has been allocated to Company A.



# 4 Transition

## 4.1. Deferred tax assets with respect to tax credits under Article 9.1.1 [AG22.04.T12]

### 4.1.1. Introduction

1. Article 9.1.1 is a transition rule that is designed to allow pre-existing deferred tax accounting attributes to be used in the calculation of the Adjusted Covered Taxes to prevent distortions in the calculation of the Effective Tax Rate (ETR) upon entry into the GloBE regime. Article 9.1.1 allows the MNE Group to take into account the deferred tax accounting attributes of the MNE Group at the beginning of the Transition Year, at the lower of the Minimum Rate or the applicable domestic tax rate. In case of a DTA that has been recorded at a rate lower than the Minimum Rate, such DTA may be taken into account at the Minimum Rate if the taxpayer can demonstrate that the DTA is attributable to a GloBE Loss.

2. The Commentary clarifies that Article 9.1.1 provides the basis to use these attributes in the determination of Adjusted Covered Taxes pursuant to Article 4.4. Therefore, when a pre-existing deferred tax attribute is used for financial accounting purposes in a Fiscal Year in which the GloBE Rules apply, such attribute is available for use in the application of Article 4.4.

3. Article 4.4 establishes the mechanism to address temporary differences. The mechanism is based on deferred tax accounting as used in the financial accounts with certain adjustments to protect the integrity of the GloBE Rules. One of these adjustments, Article 4.4.1(e), excludes the deferred tax expense with respect to the generation of tax credits as well as the deferred tax expense with respect to the use of tax credits.

4. Generally, a tax credit is an amount that taxpayers can subtract directly from taxes owed to a government. DTAs are recognised in the financial accounts for the carry-forward of unused tax credits to the extent that it is probable that future taxable profit will be available against which the tax credits can be utilised. This may occur when tax credits are granted in a jurisdiction due to a tax liability imposed in another jurisdiction, such as foreign tax credits, or tax credits are granted due to qualifying expenditure incurred that can be used to decrease future tax liabilities, such as investment tax credit.

### 4.1.2. Issues to be considered

5. Article 9.1.1 allows the MNE Group to “take into account *all of the deferred tax assets* [emphasis added] and deferred tax liabilities reflected or disclosed in the financial accounts of all of the Constituent Entities in a jurisdiction for the Transition Year”. In contrast, Article 4.4.1(e) excludes any deferred tax expense arising from the generation and the use of tax credits from the Total Deferred tax Adjustment Amount.

6. Stakeholders have asked whether Article 9.1.1 permits the pre-existing deferred tax assets with respect to tax credits to be utilised in calculating the ETR for a jurisdiction in the Transition Year and subsequent years. Delegates have also asked whether other adjustments set forth in Article 4.4 (in addition

to Article 4.4.1(e)) must be taken into account for purposes of determining the amount of pre-existing deferred tax accounting attributes.

#### 4.1.3. Guidance

7. As explained in the Commentary, Article 9.1.1 is not intended to require an MNE Group to undertake complex calculation as if the Constituent Entity had been subject to the GloBE Rules in prior years. There are no compelling reasons to exclude particular DTAs from deferred tax attributes to be taken into account in the Transition Year and used in the ETR calculation for a jurisdiction. Accordingly, DTAs attributable to tax credit carry-forwards are taken into account in computing Adjusted Covered Taxes in the Transition Year and subsequent Fiscal Years under Article 9.1.1. Article 4.4.1(e) does not apply to such DTAs.

8. Article 9.1.1 states that the DTAs “must be taken into account at the lower of the Minimum Rate or the applicable domestic tax rate”. Where a DTA is computed based on the difference in the accounting and tax carrying value of an asset or liability, a DTA can be recast by simply multiplying that difference by 15% instead of the rate used to create the financial accounting DTA. Similarly, in the case of a DTA arising from a loss carry-forward, the DTA can be recast by taking the outstanding balance of the loss carry-forward at the beginning of the Transition Year and multiplying it by 15%. However, it might be difficult to similarly recast DTAs arising from tax credit carry-forwards because they are not computed based on the deferred tax effect of differences in the carrying values of assets or liabilities otherwise reflected in the financial accounts.

9. A DTA attributable to a foreign tax credit carry-forward is based on the amount of foreign tax paid. One approach to recasting foreign tax credit carry-forward DTAs might be to determine the amount of foreign income on which the creditable tax was paid and then multiply that income by 15% (assuming the tax rate were above the Minimum Rate). However, tracking and tracing foreign tax credits and underlying foreign income through multiple prior years would be complex and burdensome, particularly where a jurisdiction allows taxes paid in respect of some foreign income to be cross-credited against taxes on other foreign income. Moreover, the foreign tax credit carry-forward may be due to an indirect tax credit allowed with respect to the income of a controlled foreign company (CFC). In that case, the foreign tax credit is attributable to tax paid by the branch on its income, but the credit carry-forward will be used against the tax liability of the CFC’s shareholder, which may be taxed at a different rate from the CFC’s rate.

10. The amount of a DTA attributable to other tax carry-forwards may be based on expenditures that qualify for a credit or some other basis. Where tax credits are granted based on qualifying expenditures, the DTAs will be recognised for the unused tax credit, without regard to an income item previously taken into account and applicable tax rate.

11. To avoid complexity and protect the integrity of the GloBE Rules, a simplified approach of recasting DTAs with respect to tax credits could be used where the applicable domestic tax rate is equal to or higher than the Minimum Rate. The recast is not permitted where the applicable domestic tax rate is lower than the Minimum Rate. The recast amount for such DTAs shall be determined in accordance with the following formula:

$$\frac{\text{Deferred tax assets reflected in the financial accounts}}{\text{Applicable domestic tax rate}} \times \text{Minimum Rate}$$

12. In general, the applicable domestic tax rate is the tax rate applicable to the Constituent Entity in the Fiscal Year preceding the Transition Year. However, if the tax rate applicable to the Constituent Entity changes in a subsequent Fiscal Year, the formula must be re-applied to the outstanding balance of the tax credit in the financial accounts to determine the revised DTA for GloBE purposes.

13. It is reasonable to expect that the tax credits will be used to decrease a future tax liability, which will be determined by multiplying the relevant taxable income by the applicable domestic tax rate. The simplified approach recognises that amount of taxable income as an appropriate proxy for purposes of recasting DTAs with respect to tax credit carry-forwards. In essence, the formula divides the DTA by the domestic tax rate to determine the amount of domestic taxable income that will be sheltered by the credit when used and then multiplies that amount of income by the Minimum Rate. In so doing, the formula ensures that the tax credit utilised in the Adjusted Covered Taxes computation in respect of that future income does not provide excess shelter to other income.

*Interaction with Article 3.2.4 and Article 4.1.3 (b)*

14. Article 3.2.4 provides that “Qualified Refundable Tax Credits shall be treated as income in the computation of GloBE Income or Loss of a Constituent Entity”. When a Qualified Refundable Tax Credit (QRTC) is settled to reduce the tax payable in a year, it does not reduce the Constituent Entity’s Covered Taxes. On the other hand, Article 4.1.3(b) provides that “any amount of credit or refund in respect of a Non-Qualified Refundable Tax Credits (Non-QRTC) that is not recorded as a reduction to the current tax expense” will be treated as a reduction to Covered Taxes of a Constituent Entity. With respect to refundable tax credits that were recorded as income in the financial accounts in any Fiscal Years prior to the Transition Year, it may be unnecessary to make such distinction between the QRTC and Non-QRTC because of the favourable treatment applicable to DTAs arising from other tax credit carry-forwards explained above. The suggested approach is to treat QRTCs and non-QRTCs in the same way for GloBE purposes, i.e. as income, not a reduction to the current tax expense. In addition to increasing compliance and administrative burdens, the alternative approach of treating QRTCs and Non-QRTCs differently as provided under Article 3.2.4 and Article 4.1.3(b) could lead to unexpected and unintended outcomes. For example, a Constituent Entity that was granted non-refundable tax credits prior to becoming subject to the GloBE Rules would have recognised a DTA arising from the unused tax credits. Such DTA can be used to increase the Constituent Entity’s Adjusted Covered Taxes in the indefinite future under the transition rule in Article 9.1.1 as interpreted in this guidance. In contrast, if the tax credits are refundable and the tax refunds or tax credits that do not meet the QRTC definition need to be treated as a reduction to the current tax expense for GloBE purposes, the non-QRTCs coming into the GloBE Rules would be treated less favourably than non-refundable tax credits under the transition rule. This approach might also encourage taxpayers to take aggressive positions as to the proper accounting treatment of tax credits arising prior to the Transition Year.

15. Based on the foregoing, when Article 9.1.1 applies, the DTAs with respect to tax credit carry-forwards reflected in the financial accounts of a Constituent Entity shall be taken into account in the Transition Year and the amount of such deferred assets shall be recast when the applicable domestic tax rate is higher than the Minimum Rate. Further, the settlement of any refundable tax credit arising prior to the Transition Year shall not reduce Adjusted Covered Taxes. This rule applies regardless of whether or not the settlement amount satisfies a tax liability in the Transition Year or subsequent years and without regard to whether such tax credits meet the definition of a QRTC.

*Interaction with other adjustments set forth in Article 4.4*

16. Requiring an MNE Group to undertake the full calculation of the ETR as if the Constituent Entity had been subject to the GloBE Rules in prior years would produce significant compliance burdens. In order to facilitate compliance by MNEs upon entry into the GloBE Rules, the pre-existing deferred tax attributes are available for use notwithstanding the adjustments otherwise provided in Article 4.4, except to the extent there are limitations on their use in Article 9.1.

17. To clarify, the following guidance will be included after paragraph 6 of the Commentary to Article 9.1.1:

6.1 Deferred tax assets with respect to tax credit carry-forwards reflected or disclosed in the financial accounts of a Constituent Entities in a jurisdiction shall be treated as deferred tax accounting attributes to be used in the calculation of the ETR in the Transition Year and subsequent years. Article 4.4.1(e) shall not apply to such deferred tax assets arising prior to the Transition Year. The amount of deferred tax assets recorded for purpose of Article 9.1.1 shall be equal to the deferred tax assets accrued in the financial accounts if the tax rate used to determine the deferred tax assets is below the Minimum Rate or, in any other case, such deferred tax assets shall be determined in accordance with the following formula:

$$\frac{\text{Deferred tax assets reflected in the financial accounts}}{\text{Applicable domestic tax rate}} \times \text{Minimum Rate.}$$

For this purpose, the Applicable domestic tax rate is the tax rate in the Fiscal Year preceding the Transition Year. However, if the tax rate applicable to the Constituent Entity changes in a subsequent Fiscal Year (the re-application year), the formula must be re-applied to the outstanding balance of the tax credit in the financial accounts at the beginning of the re-application year to determine the revised DTA for GloBE purposes. The change in the amount of the DTA resulting from re-application of the formula shall not be treated as deferred tax expense included in the computation of Adjusted Covered Taxes in the re-application year. Rather, the deferred tax expense for the re-application year and subsequent years shall be determined by reference to the amount of the reversal of the DTA after re-application of the formula.

6.2 Refundable tax credits might have been recorded as income in the financial accounts of a Constituent Entity before the applicability of the GloBE Rules. In this case, no deferred tax accounting attributes would be generated and thereby subject to Article 9.1.1. Nevertheless, to avoid unintended outcomes, the settlement of refundable tax credits that accrued prior to the beginning of the Transition Year, whether or not the amount satisfies an income tax liability, generally should not be treated as a reduction to Adjusted Covered Taxes

6.3 Further, except as provided in Article 9.1.2, attributes imported into the GloBE attributes pursuant to Article 9.1.1 are not subject to any adjustments to deferred tax expense under Article 4.4.1(a), (b), (c), or (d), or Article 4.4.4. Under Article 9.1.1, a Constituent Entity's tax attributes at the beginning of the Transition Year shall include any deferred tax asset that was not recognised because the recognition criteria was not met.

#### 4.1.4. Examples

18. The following examples will be included in the GloBE Model Rules Examples.

##### *Example 9.1.1-1*

1. A Co is a Constituent Entity of an MNE Group that will become subject to the GloBE Rules for its Fiscal Year ending on 31 December 2023 for the first time. A Co is located in country A, which applies worldwide tax system and provides foreign tax credit to mitigate the potential for double taxation. Country A imposes a 20% corporate income tax. A Co's taxable year for country A tax purposes ends on 31 December.

2. In year 2022, A Co earned interest income of 100 from an investment in country B which has been subject to a withholding tax of 30 in country B. Under the domestic tax law of country A, A Co was allowed to use 20 of the withholding tax as a tax credit in 2022 and to carry forward the remaining 10 of tax credit. A Co established a deferred tax asset of 10 in its financial accounts.

3. Also in year 2022, A Co incurred certain qualifying expenditure on R&D and was granted an investment tax credit of 10. A Co recognised a deferred tax asset of 10 in the financial accounts accordingly.

4. The deferred tax asset with respect to tax credit carry-forwards shall be taken into account in the Transition Year and subsequent Fiscal Years, and such deferred tax asset should recast at the Minimum Rate because the applicable domestic tax rate is equal to or higher than the Minimum Rate. The deferred tax assets arising from foreign tax credit carry-forward (10) and investment tax credit carry-forward (10) shall recast in accordance with the formula described in the Commentary to Article 9.1.1. Under these facts the recast deferred tax asset for each carry-forward is equal to 7.5 (= [10 deferred tax asset / 20% domestic tax rate] x 15% Minimum Rate).

#### *Example 9.1.1-2*

1. The facts are the same as in Example 9.1.1-2, except that A Co did not treat the investment tax credit as a deferred tax asset but as income in the financial accounts. The investment tax credit does not meet the definition of Qualified Refundable Tax Credit. In year 2027, A Co settles the investment tax credit of 10 and reduces the cash tax owed for 2027. A Co's Adjusted Covered Taxes is not reduced by the amount of the investment tax credit settled in that year.

## 4.2. Applicability of Article 9.1.3 to transactions similar to asset transfers [AG22.04.T16]

### 4.2.1. Introduction

1. This section provides guidance on the applicability of Article 9.1.3 to domestic and cross-border transactions which are treated similarly to asset sales from an accounting perspective.
2. Article 9.1.3. provides a limitation on asset transfers which take place after 30 November 2021 and before the commencement of a Transition Year (hereinafter referred to as the Pre-GloBE Period). Its policy intent is to limit MNE Groups' ability to enter into tax-free or low-tax transactions during the Pre-GloBE Period that increase an asset's carrying value. With such transactions, an MNE Group can use the higher carrying value to reduce its GloBE Income, for example through depreciation or amortization expenses, during GloBE years without any risk of Top-up Tax on the corresponding gain because the asset was transferred in the Pre-GloBE Period.
3. Therefore, under Article 9.1.3., if an asset (other than inventory) is transferred during the Pre-GloBE Period, and Entities involved in the transfer would have been Constituent Entities of the same MNE Group had the GloBE Rules been in effect with respect to that MNE Group, the acquiring Entity must use the disposing Entity's carrying value at the time of the disposition for purposes of determining the asset's carrying value at the beginning of the Transition Year.
4. Depending upon the financial accounting standard, an MNE can use a variety of transactions to increase an asset's carrying value in the acquiring Entity's financial accounts. For example:

Transaction type	Element of transaction which can be low-tax or tax free
A sale of an asset	Gain from sale of asset
A capital lease, which is accounted for in the same or similar manner as a purchase of an asset	Gain from sale of asset
A license that is effectively treated as a sale for accounting purposes	Gain from sale of asset
A transfer of assets through a sale of a Controlling Interest	Gain from sale of asset
A prepayment of royalty or rents where the licensor/lessor records the prepayment as income and the licensee/lessee capitalizes and amortizes the asset in its financial accounts	Lump sum income on prepaid royalty or rent
A total return swap where the underlying asset is transferred to the financial accounts of the Entity that acquired the rights to income and capital gains generated by an underlying asset	Gain from transfer of underlying asset
A migration of an Entity/Entities where an MNE Group receives a step-up in the tax basis or carrying value (e.g. based on fair value of assets) of the relocated assets	Exit from original jurisdiction
A change to fair value accounting where the Entity records the relevant gains or losses from fair value changes of the underlying asset and corresponding adjustments to the carrying value of the asset	Adjustment to opening equity upon accounting principle change and annual gains from fair value accounting

### 4.2.2. Issues to be considered

5. How should "transfer of assets" be interpreted under Article 9.1.3? Does it cover only transactions that are structured as a sale? Or does it also cover other transactions that are accounted for similar to a sale (i.e. transactions which give rise to an asset in the financial accounts, the cost of which may be taken into account in computing the Entity's GloBE Income or Loss in subsequent years)?
6. Does Article 9.1.3 apply where the relevant financial accounting standard requires a single Entity to increase the carrying value of an asset or a deferred tax asset related to such asset in the same or similar manner as if the Entity had both sold and acquired the asset?

7. Does Article 9.1.3 apply to a transaction where the asset arises for accounting purposes during the Pre-GloBE Period but the legal transfer occurs in or after the Transition Year?

#### **4.2.3. Guidance**

8. The integrity of the GloBE Rules would be undermined if MNE Groups were allowed to engage in asset transactions during the Pre-GloBE Period where the income from the transaction is taxed below the minimum rate without the risk of Top-up Tax and the corresponding increase in carrying value shields future income from potential Top-up Tax. This can also happen in the case of transfers or deemed transfers that happen within the same Entity, where the Entity is taxed at a low rate during the Pre-GloBE Period, and the same Constituent Entity can use the corresponding carrying value increase in computing its GloBE Income after the Transition Year. Therefore, all transactions and corporate restructurings that are accounted for similar to an asset transfer (i.e. where the MNE Group creates or increases the carrying value of an asset), regardless of their form and whether they take place within an Entity or among Entities, should be viewed as a “transfer of asset” under Article 9.1.3.

9. These conclusions will be incorporated into the Commentary to Article 9.1.3. The language is set out in the paragraphs numbered 10.2 through 10.7 in section 4.3.3 of this document.

### 4.3. Asset carrying value and deferred taxes under 9.1.3 [AG22.04.T2]

#### 4.3.1. Introduction

1. This section provides guidance on the rule in Article 9.1.3. Article 9.1.3 is a transition rule that is designed to prevent an MNE from stepping-up the GloBE carrying value of a capital asset through the use of an intragroup transfer. Article 9.1.3 applies when an asset (other than inventory) is transferred between Entities after 30 November 2021 and before the Transition Year of an MNE Group. When this transition rule applies, it will limit the carrying value of the asset for GloBE purposes and therefore affect the MNE Group's computations under the GloBE Rules in the Transition Year and subsequent Fiscal Years. Article 9.1.3 provides that:

[i]n the case of a transfer of assets between Constituent Entities after 30 November 2021 and before the commencement of a Transition Year, the basis in the acquired assets (other than inventory) shall be based upon the disposing Entity's carrying value of the transferred assets upon disposition with the deferred tax assets and liabilities brought into GloBE determined on that basis.

2. The Commentary to the article clarifies that the rule only applies where the relevant Entities would have been Constituent Entities of the same MNE Group if that MNE Group had been subject to the GloBE Rules at the time of the asset transfer. It is not intended to apply to transfers of assets in connection with a merger or acquisition in which an Entity becomes a Constituent Entity of an MNE Group. Accordingly, the rule only applies to transfers of assets between Entities that would have been Group Entities of the same MNE Group before the transaction and not as a result of the transaction.

3. In an asset transfer between Constituent Entities, the acquiring Constituent Entity may take a cost or fair value basis in the acquired asset for local tax purposes. This may occur where the disposing Constituent Entity is subject to local tax on the sale or the acquiring Constituent Entity is in a different jurisdiction. In some circumstances, the MNE Group may create a deferred tax asset in connection with the sale based on the difference between the group's financial accounting carrying value of the asset upon disposition and the tax basis of the asset. This may occur because the Acceptable Financial Accounting Standard treats the acquiring Constituent Entity as having acquired the asset at the MNE Group's carrying value rather than at fair value. Alternatively, it may occur because the MNE Group has a practice of determining its deferred tax assets and liabilities after eliminating gains and losses attributable to intra-group transactions.

4. The purpose of the transition rule in Article 9.1.3 is explained in the Commentary. The rule is designed to prevent an MNE Group from transferring assets (other than inventory) within the group before it becomes subject to the GloBE Rules in order to increase the carrying value of the assets in the hands of the acquiring Entity and thereby reduce its GloBE Income (or increasing its GloBE Loss) in future years without subjecting the corresponding gain to potential application of the GloBE Rules in the hands of the disposing Entity.

#### 4.3.2. Issues to be considered

5. Under Article 9.1.3, where assets are transferred among Constituent Entities after 30 November 2021 and before the beginning of the Transition Year, the acquiring Constituent Entity's "basis in those assets" shall be "based upon" the disposing Entity's carrying value of those assets upon disposition "with the deferred tax assets and liabilities brought into GloBE determined *on that basis*" [emphasis added]. This language raises the following questions:

- a. Does the phrase "basis in those assets" refer to tax basis or the carrying value of the assets for purposes of the GloBE Rules?



- b. Does the phrase “based upon the disposing Entity’s carrying value of the transferred assets upon disposition” freeze the carrying value at the date of transfer or does it allow for accounting adjustments that occur after 30 November 2021 and before the beginning of the Transition Year?
- c. Does the phrase “on that basis” mean that the MNE Group should determine deferred tax assets and liabilities based on the difference between the GloBE carrying value and the local tax basis of the asset? Or does it mean that the MNE Group must use the deferred tax asset or liability, if any, that was reflected in the financial accounts before the transaction that triggered the rule?
- d. If any pre-existing deferred tax asset or liability on the transferred asset is reflected in the financial accounts of the disposing constituent entity, in relation to any pre-existing difference between the local tax basis of the asset and its accounting carrying value, how should this timing difference be taken into account by the purchasing constituent entity?

#### **4.3.3. Guidance**

6. The term “basis” typically refers to the tax carrying value of an asset. Although the GloBE Rules generally are drafted in terms of carrying value, Article 9.1.3 uses the term basis. Nonetheless, Article 9.1.3 is referring to the carrying value under the GloBE Rules. Thus, Article 9.1.3 provides a rule for the carrying value that should be used for purposes of determining depreciation, amortization, gain, loss, etc., with respect to the asset under the GloBE Rules.

7. Article 9.1.3 states that the acquiring Entity’s carrying value of the asset is “based upon” the disposing Entity’s carrying value of the transferred asset. By using the phrase “based upon the disposing Entity’s carrying value”, Article 9.1.3 contemplates that such carrying value may change during the period after acquisition and before the Entity becomes subject to the GloBE Rules. Thus, at the date of the transfer, the acquiring Entity takes the disposing Entity’s carrying value in the asset under Article 9.1.3. Thereafter, the acquiring Entity accounts for the asset in accordance with its financial accounting standard. Accordingly, the acquiring Entity may depreciate or amortize the asset from the date of acquisition, but must do so using the acquisition carrying value determined under Article 9.1.3 for GloBE purposes. Similarly, the acquiring Entity may add to the carrying value any capitalised costs under its accounting standard.

8. As explained in the Commentary, Article 9.1.3 is intended to limit the ability to step-up the basis (i.e. the GloBE carrying value) in the transferred assets without including the resulting gain in the computation of the GloBE Income or Loss. If the MNE Group were allowed to take into account a deferred tax asset created in connection with the sale, it would, in combination with the financial accounting carrying value upon disposition, affect the applicability of the GloBE Rules in much the same way as allowing the step-up in carrying value of the asset for GloBE purposes. The step-up in carrying value essentially eliminates an amount of income equal to the step-up from the acquiring Constituent Entity’s GloBE Income or Loss computation, either at the time of a subsequent sale by the acquiring Constituent Entity’s or over the asset’s depreciation or amortization period. The carrying value upon disposition requirement of Article 9.1.3 preserves that income in the GloBE income or Loss computation, but the corresponding deferred tax asset amount, if allowed, would be included in the Covered Taxes and, in effect, would shield that income from Top-up Tax. This result would be inconsistent with the policy and purpose of Article 9.1.3.

9. When Article 9.1.3 applies, the acquired asset must be initially recorded at its carrying value upon disposition for GloBE purposes to limit the ability to step-up its basis (i.e. its carrying value for GloBE purposes) without including the corresponding gain in the computation of GloBE Income or Loss. Because there is no change in asset carrying value when the transitional rule applies, items of deferred tax expense

with respect to such assets will be recorded for GloBE purposes with respect to the carrying value of the assets transferred.

10. In order to clarify this intended outcome and the conclusion reflected in section 4.2.3 of this document, the Commentary to Article 9.1.3 will be revised by deleting paragraph 10 and replacing it with the following text:

10.1 Article 9.1.3 provides a limitation on intra-group asset transfers before applicability of the GloBE Rules. Article 9.1.3 applies when an asset (other than inventory) is transferred between Entities after 30 November 2021 and before commencement of the Transition Year of an MNE Group if such Entities would have been Constituent Entities of that MNE Group had the GloBE Rules been in effect with respect to that MNE Group immediately before the transfer. When Article 9.1.3 applies, the acquiring Entity must treat the asset for purposes of the GloBE Rules as acquired for an amount equal to the carrying value in the hands of the disposing Entity upon disposition. That carrying value of the asset can easily be determined because the gain on the intra-group transfer must be eliminated in the Consolidated Financial Statements. Thereafter, the acquiring Entity's carrying value of the asset may be increased by capitalised expenditures or decreased by amortization or depreciation in accordance with the accounting standard used in the UPE's Consolidated Financial Statements. The carrying value used for GloBE purposes beginning in the Transition Year is the carrying value upon disposition of the transferred asset on the day of transfer adjusted for capital expenditures, amortization or depreciation after the transaction and before the beginning of the Transition Year. Any increased depreciation or amortization, if any, attributable to recording the asset at fair value in the financial accounts of the acquiring Entity must be excluded from the computation of its GloBE Income or Loss. Similarly, gain or loss from a subsequent sale of the asset shall be determined for GloBE purposes based on its carrying value determined under Article 9.1.3. The rule in Article 9.1.3, however, does not apply to inventory because of the routine nature of intragroup inventory sales and the typically brief period that it is held before sale outside the MNE Group.

#### *Scope of transactions covered*

10.2 As explained above, the policy intention of Article 9.1.3 is to disallow the normal accounting treatment of asset transactions after 30 November 2021 and before the commencement of a Transition Year (hereinafter referred to as the Pre-GloBE Period) where the income is taxed below the minimum rate and the corresponding deductions shield future income from potential Top-up Tax. Allowing the normal accounting treatment of such transactions would undermine the integrity of the GloBE Rules, and Article 9.1.3 addresses this integrity concern by requiring the acquiring Entity to use the disposing Entity's carrying value at the time of the asset transfer as the asset's carrying value or precluding the acquiring Entity from utilizing a deferred tax asset arising in connection with the transaction that has the same effect for GloBE purposes as an increased carrying value.

10.3 As a result, for purposes of Article 9.1.3, a "transfer of assets" should be interpreted broadly to include cross-border and domestic transactions that are treated like a sale of assets from an accounting perspective and create the integrity risks as described in the above paragraph. Accordingly, the term "transfer of assets" as used in Article 9.1.3 includes any transfer of rights to an item of economic value (e.g. intellectual property, real estate, financial instrument, business operations) in which the acquiring Entity creates or increases the carrying value of an asset in its financial accounts and the disposing Entity recognises the corresponding amount of income in the Pre-GloBE Period. This rule applies also where the MNE Group records intra-group transactions at cost and a deferred tax asset based on the difference between the carrying value in the acquiring Entity and the tax basis under the domestic tax law.

10.4 Article 9.1.3. also applies to a transfer or deemed transfer of assets within the same Entity. For example, in a relocation or migration of an Entity (in which the Entity increases the carrying value of an asset for tax or financial accounting purposes) or a change to fair value accounting (in which the Entity records a gain/loss and adjusts the carrying value of the asset accordingly), the Entity in question is considered as both the disposing Entity and the acquiring Entity for purposes of Article 9.1.3.

10.5 For example, Article 9.1.3 applies to the following types of intra-group transactions or restructurings:

- a. A sale of an asset;
- b. A capital lease, which is accounted for in the same or similar manner as a purchase of an asset;
- c. A license that is effectively treated as a sale for accounting purposes;
- d. A transfer of assets through a sale of a Controlling Interest;
- e. A prepayment of royalty or rents, where the licensor/lessor records the prepayment as income and the licensee/lessee capitalizes and amortizes the asset in its financial accounts;
- f. A total return swap where the underlying asset is transferred to the financial accounts of the Entity that acquired the rights to income and capital gains generated by an underlying asset;
- g. A migration of an Entity/Entities where an MNE Group receives a step-up in the tax basis or carrying value (e.g. based on fair value of assets) of the relocated assets; and
- h. A change to fair value accounting where the Entity records the relevant gains or losses from fair value changes of the underlying asset and corresponding adjustments to the carrying value of the asset.

10.6 Article 9.1.3 applies to transactions where the accounting impact of the transaction is reflected in the financial accounts of the disposing Entity during the Pre-GloBE Period, without regard to whether the legal transfer or the financial impact to the acquiring Entity is recorded during or after the Pre-GloBE Period.

10.7 Article 9.1.3 does not apply to a lease, license, or a total return swap where the transacting parties account for the income and corresponding expense items in the same Fiscal Years (i.e. where the lessor's or licensor's income is not front-loaded).

#### *Transactions accounted for at cost*

10.8 The purpose of Article 9.1.3 is to limit the ability to step-up the carrying value in the MNE Group's assets for GloBE purposes in an intragroup transaction without including the corresponding gain in the computation of GloBE Income or Loss. Some MNE Groups account for intra-group transactions by treating the acquiring Entity as having acquired the asset at the transferring Entity's carrying value upon disposition and create a deferred tax asset based on the difference between the tax basis of the asset and the acquiring Entity's carrying value and the tax rate in the acquiring Entity's jurisdiction. If the MNE Group were allowed to take into account a deferred tax asset created in connection with the intragroup sale, it would, in combination with the financial accounting carrying value upon disposition, affect the applicability of the GloBE Rules in much the same way as allowing the step-up in carrying value of the asset for GloBE purposes. The step-up in carrying value would essentially eliminate an amount of income equal to the step-up from the acquiring Constituent Entity's GloBE Income or Loss computation usually either at the time of a subsequent sale by the

acquiring Constituent Entity's or over the asset's depreciation or amortization period. The carrying value upon disposition preserves that income in the GloBE income or Loss computation, but the corresponding deferred tax asset amount would be included in the Covered Taxes and, in effect, would shield that same amount of income from Top-up Tax. This result would be inconsistent with the policy and purpose of Article 9.1.3. Accordingly, when Article 9.1.3 applies, the deferred tax assets or liabilities with respect to the transferred assets, if any, that are recognised at the beginning of the Transition Year are those that existed in the financial accounts of the MNE Group prior to the transaction that triggered application of Article 9.1.3, adjusted as appropriate for subsequent capitalised expenditures, amortization, and depreciation and further adjusted to the Minimum Rate if necessary pursuant to Article 9.1.1. Any deferred tax asset or liability arising in the MNE Group's financial accounts as a result of the transaction is ignored under the GloBE Rules, except as provided in paragraph 10.9.

10.9 The acquiring Entity may take into account a deferred tax asset to the extent that the disposing Entity paid tax in respect of the transaction and to the extent of any deferred tax asset that would have been taken into account under Article 9.1.1 but was reversed or was not created by the disposing Entity (Other Tax Effects) because gain from the disposition was included in the taxable income of the disposing Entity. If there is a group taxation regime applicable to the disposing Entity, this paragraph shall be applied by reference to the taxes paid by the group and Other Tax Effects on the group under the group taxation regime. This paragraph may also be applied in respect of any Covered Taxes that are attributable to the transaction and that would have been allocated to the disposing Entity under the principles of Article 4.3. The MNE Group has the burden of proving:

- (a) the amount of tax paid in respect of the transaction;
- (b) the amount of any Other Tax Effects; and
- (c) the amount of any Covered Taxes that are attributable to the transaction and that would have been allocated to the disposing Entity under Article 4.3.

A deferred tax asset created under this rule shall not exceed the Minimum Rate multiplied by the difference in the local tax basis in the asset and the GloBE carrying value of the asset determined under Article 9.1.3. The creation of a deferred tax asset under this paragraph shall not reduce the Adjusted Covered Taxes of a Constituent Entity. This deferred tax asset is adjusted annually in proportion to any decrease in the carrying value of the asset for the year, for example due to depreciation, amortization, or impairment. See Examples 9.1.3-1 through 9.1.3-6.

#### *Transactions accounted at fair value*

10.10 Where an acquiring Constituent Entity recorded an asset acquired in a transaction subject to Article 9.1.3 at fair value in its financial accounts, it may instead use the carrying value of that asset reflected in its financial accounts for GloBE purposes in all subsequent years if it would otherwise be entitled to take into account a deferred tax asset equal to the Minimum Rate multiplied by the difference in the local tax basis in the asset and the GloBE carrying value of the asset determined under Article 9.1.3. See Example 9.1.3-7.

10.11 Like Article 9.1.2, this Article does not have retroactive tax implications, but rather sets out rules with respect to how certain tax attributes are taken into account in Fiscal Years to which the GloBE Rules apply.

#### **4.3.4. Examples**

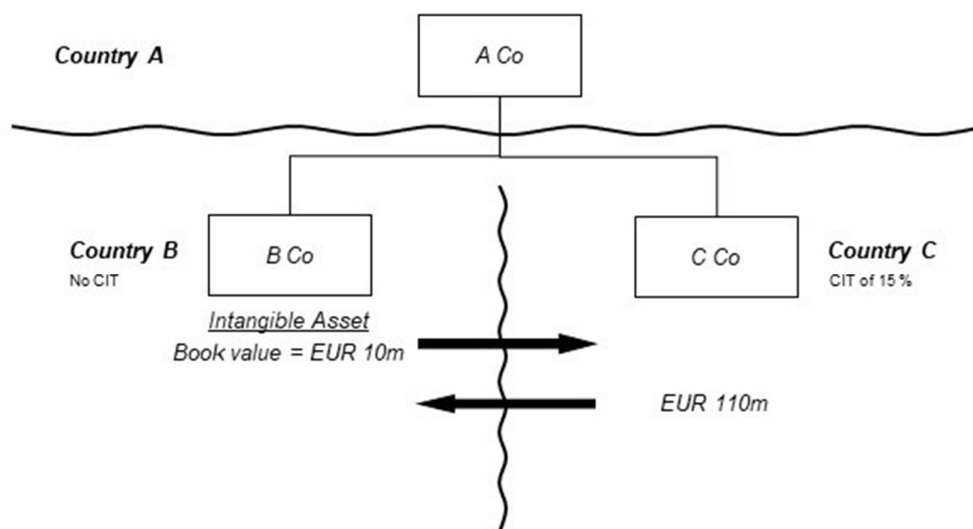
11. The following examples will be included in the GloBE Model Rules Examples.

Example 9.1.3-1

**Asset carrying value and deferred taxes under Article 9.1.3**

1. This example illustrates the application of the rule in Article 9.1.3 with regard to asset carrying value and deferred taxes.
2. A Co is located in Country A. A Co wholly owns B Co, located in Country B, and C Co, located in Country C. Country B has no corporate income tax (CIT) while Country C imposes a 15% CIT.
3. In its 2021 and all previous Fiscal Years, A Co included the assets, liabilities, income, expenses and cash flows of B Co and C Co in its Consolidated Financial Statements. B Co and C Co therefore would have been Constituent Entities of an MNE Group having A Co as its UPE, had the GloBE Rules been in effect with respect to such MNE Group immediately before the transfer described below.
4. B Co owned an intangible asset that was recorded at a carrying value of EUR 10 million on its balance sheet but had a fair market value of EUR 110 million. There is no deferred tax assets with respect to the intangible asset recorded in B Co's or the MNE Group's financial accounts. The asset was not inventory in the hands of B Co. On 5 December 2021, B Co sold the intangible asset to C Co for EUR 110 million.
5. A diagram illustrating the holding structure, location of the members and the asset transfer is set out below.

Figure 4.1. Holding structure and asset transfer



Source: OECD

6. Jurisdiction C allows a cost basis for local tax purposes so that C Co's local tax basis in the intangible asset is EUR 110 million. Under the accounting standard used in preparing A Co's Consolidated Financial Statements, C Co's carrying value of the intangible asset is EUR 10 million, rather than the EUR 110 million cost of acquiring the asset. However, under that accounting standard, C Co records a EUR 15 million deferred tax asset with respect to the intangible asset

attributable to the EUR 100 million difference between the accounting and tax carrying value of the asset.

7. Because the intra-group sale occurred after 30 November 2021 but before the commencement of a Transition Year, Article 9.1.3 is triggered and C Co's basis in the acquired intangible asset for GloBE purposes is B Co's carrying value upon disposition (EUR 10 million) adjusted for any subsequent capitalised expenditures or amortization. Because country B does not have CIT, there were no deferred tax assets with respect to the intangible asset recorded in B Co's or the MNE Group's financial accounts prior to the disposition, the gain was not included in B Co's taxable income and no tax was paid in respect of the disposition. Accordingly, no deferred tax assets are recognised with respect to this intangible asset for purposes of the GloBE Rules.

#### *Example 9.1.3-2*

##### ***Asset carrying value and deferred taxes under Article 9.1.3***

1. The facts are the same as in Example 9.1.3-1, except that
  - a. Country B imposes a corporate income tax at 20%,
  - b. B Co had EUR 20 million of other taxable income after deducting EUR 40 million of expenses from EUR 60 million of revenues, and
  - c. B Co paid EUR 24 million of tax (20% rate) on EUR 120 million of total taxable income for its taxable year ended on 31 December 2021 (EUR 100 million from the intragroup asset transfer and EUR 20 million from ordinary course of business).
2. C Co is allowed a deferred tax asset under Article 9.1.3 equal to the lesser of the amount of tax paid in respect of, or 15% of, the intercompany gain on the asset transfer. B Co was subject to a 20% tax rate on all of its income, and thus EUR 20 million of tax was paid on the EUR 100 million gain. C Co is entitled to a EUR 15 million deferred tax asset for GloBE purposes in respect of the acquired intangible asset. Under the facts of this example, Country C imposes a corporate income tax at a 15% rate. Coincidentally, the deferred tax assets established under Article 9.1.3 are equal to the amount of deferred tax assets recognised for financial accounting purposes in C Co's separate financial statements. This deferred tax asset is adjusted annually along with the deferred tax asset that reversed for financial accounting purposes.

#### *Example 9.1.3-3*

##### ***Asset carrying value and deferred taxes under Article 9.1.3***

1. The facts are the same as in Example 9.1.3-2, except that
  - a. B Co had a DTL of EUR 2 million referred to the transferred asset, due to accelerated depreciation, where the tax basis is nil and the accounting carrying value is EUR 10 million.
  - b. B Co determines a taxable gain on the asset transfer equal to EUR 110 million (= EUR 110 million – zero). This taxable gain is fully subject to tax at B Co and the corresponding taxes paid are equal to EUR 22 million (EUR 110 million \* 20%)
2. C Co recognises the assets at EUR 10 million. The GloBE carrying value of the asset is equal to EUR 10 million.
3. As a for the deferred tax asset and liabilities recognizable for GloBE purposes, a two-step analysis shall be done: (i) any deferred tax asset or liability that existed prior to the transaction at B

Co level shall be recognised for GloBE purpose at C Co level and recast at 15% (the lesser of the Minimum Rate and CIT rate applicable to C Co), (ii) any deferred tax asset or liability accounted at C Co in relation to the transaction shall be taken into account if condition under para 10.9 would be met. In particular, C Co will recognise the following DTA and DTL for GloBE purposes:

(EUR/m)	C Co
CIT rate	15%
DTL ante transaction	-1.5
DTA upon transaction	16.5
Net DTA	15

4. If no taxes were paid by B Co in relation to the asset transfer, the DTA recognition at C Co would have been equal to zero, pursuant to Article 9.1.3 and only the pre-existing DTL would have been recognised for GloBE purposes in the amount of EUR 1.5 million (i.e. recast at the Minimum Rate).

#### *Example 9.1.3-4*

##### **Asset carrying value and deferred taxes under Article 9.1.3**

1. The facts are the same as in Example 9.1.3-1, except that
  - a. B Co was subject to a 10% tax rate on capital gains and 20% tax rate on income other than capital gains,
  - b. B Co paid EUR 4 million of tax (20% rate) on the other income and EUR 10 million of tax (10% rate) on the intangible asset sale, and
  - c. In total, B Co paid EUR 14 million of tax on EUR 120 million of total taxable income for its taxable year ended on 31 December 2021.
2. C Co is allowed a deferred tax asset under Article 9.1.3 equal to the lesser of the amount of tax paid in respect of, or 15% of, the intercompany gain on the asset transfer. B Co was subject to a 10% tax rate on the gain from the sale of its intangible asset and paid EUR 10 million of tax on the EUR 100 million gain. C Co is entitled to a EUR 10 million deferred tax asset for GloBE purposes in respect of the acquired intangible asset.

#### *Example 9.1.3-5*

##### **Asset carrying value and deferred taxes under Article 9.1.3**

1. The facts are the same as in Example 9.1.3-1, except that
  - a. B Co was subject to a 10% tax rate on all of its income,
  - b. Country B allows tax losses to be carried forward indefinitely,
  - c. B Co had EUR 20 million of deductible expenses, and
  - d. Thus, B Co paid EUR 8 million of tax (10% rate) on EUR 80 million of total taxable income for its taxable year ended on 31 December 2021.
2. If the gain from the sale of the intangible asset had not been included in B Co's income, it would have reported a loss of EUR 20 million and created a deferred tax asset of EUR 2 million. C Co is allowed a deferred tax asset under Article 9.1.3 equal to the lesser of 15% of the intercompany

gain on the asset transfer or the sum of the amount of tax paid on the asset transfer and the amount of deferred tax asset that would have been established and recognised under Article 9.1.1 if the gain were not included in taxable income. C Co is entitled to a EUR 10 million deferred tax asset for GloBE purposes in respect of the acquired intangible asset.

3. During the first year of application of the GloBE Rules, C Co sells the asset to a third party at a price of EUR 110 million. The accounting carrying value is EUR 10 million (no amortization is performed for accounting purposes) and a gain from the sale, equal to EUR 100 million, is registered for accounting purposes, but no current taxes are accrued on the sale since the tax basis of the asset is EUR 110 million (it is assumed no amortization also for tax purposes). The EUR 10 million deferred tax asset, previously accrued, is reversed and included in C Co's Adjusted Covered Taxes. Assuming C Co has no other income for the year, the ETR in Country C is 10% (= EUR 10 million Adjusted Covered Taxes / EUR 100 million GloBE Income).

#### *Example 9.1.3-6*

##### ***Asset carrying value and deferred taxes under Article 9.1.3***

1. The facts are the same as in Example 9.1.3-1, except that
  - a. B Co had EUR 100 million loss carry-forward for local tax purposes (that meets the requirements under Article 9.1.1) and a corresponding deferred tax asset of EUR 20 million,
  - b. Country B has a 20% tax rate and allows tax losses to be carried forward indefinitely, and
  - c. B Co paid no tax for its taxable year ended on 31 December 2021 due to the offsetting with the available tax loss.
2. C Co is allowed a deferred tax asset under Article 9.1.3 up to the amount of the deferred tax asset that would have been recognised under Article 9.1.1 in the absence of the offsetting with the gain triggered by the intragroup transfer. The EUR 20 million deferred tax asset associated with B Co's tax loss carry-forward of EUR 100 million is eligible for recognition under Article 9.1.1 because it was generated before 30 November 2021 and does not expire before the Transition Year. Accordingly, C Co is allowed a deferred tax asset equal to EUR 15 million.

#### *Example 9.1.3-7*

##### ***Asset carrying value and deferred taxes under Article 9.1.3***

1. The facts are the same as in Example 9.1.3-2, except that under the accounting standards used in preparing A Co's Consolidated Financial Statements, C Co's carrying value of the purchased intangible asset is EUR 110 million and therefore the tax basis for local tax purposes would be equal to the accounting carrying value. Accordingly, no deferred tax assets would be accrued in the financial accounts. Nonetheless, under Article 9.1.3, the GloBE carrying value of the asset is EUR 10 million and a deferred tax asset of EUR 15 million is taken into account for GloBE purposes.
2. The asset carrying value of EUR 110 million is amortised on a straight-line basis over ten years for both corporate income tax and accounting purposes (EUR 11 million per year). Simultaneously, EUR 1.5 million of the deferred tax asset determined under Article 9.1.3 reverses each year. The amortization and reversal of the deferred tax asset determined under Article 9.1.3 occur each year irrespective of whether C Co is subject to the GloBE Rules for the year.
3. For each year in which C Co is subject to the GloBE Rules, the additional amortization of EUR 10 million (EUR 11 million - EUR 1 million) per year attributable to recording the asset at fair



value in the financial accounts must be excluded from the computation of C Co's GloBE Income or Loss. However, the deferred tax asset reversal is included in C Co's Adjusted Covered Taxes, which neutralises the effect of the additional GloBE Income on the ETR (i.e. each year the numerator of the ETR is increased by EUR 1.5 million and yield a 15% ETR on the EUR 10 million additional GloBE Income).

4. Likewise, if C Co sells the asset to a third party in a year to which the GloBE Rules apply, the GloBE Income or Loss from the sale is determined based on the GloBE carrying value at the time of sale and the remaining deferred tax asset is reversed and included in Co Co's Adjusted Covered Taxes. Thus, if C Co sells the asset after two years for EUR 100 million, the GloBE carrying value is EUR 8 million (= EUR 10 million – EUR 2 million amortization) and the GloBE Income or Loss is EUR 92 million (= EUR 100 million - EUR 8 million). The accounting and tax carrying value are rather EUR 88 million (= EUR 110 million – EUR 22 million amortization) and the accounted capital gain is equal to EUR 12 million (EUR 100 million – EUR 88 million). Thus, the GloBE Income or Loss will be increased by the higher capital gain equal to EUR 80 million, and the residual DTA (equal to EUR 12 million, i.e. EUR 80 million multiplied by 15%) will be reversed, so the effect of the higher GloBE Income will be neutralised in the ETR computation.

5. Alternatively, because the deferred tax asset allowed under Article 9.1.3 is equal to 15% of the gain subject to Article 9.1.3, C Co may use the financial accounting carrying value of the transferred assets for purposes of computing C Co's GloBE Income or Loss.

# 5 Qualified Domestic Minimum Top-up Taxes

## 5.1. Qualified Domestic Minimum Top-up Taxes

### 5.1.1. Introduction

1. The definition of “Qualified Domestic Minimum Top-up Tax” (QDMTT) is set out in Article 10.1 of the GloBE Rules. This definition distinguishes QDMTT from other minimum taxes in that it requires that the minimum tax is implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and Commentary such that it increases the MNE Group’s domestic liability on domestic Excess Profits to the Minimum Rate. The definition also prohibits the provision of benefits to the MNE Group related to the GloBE Rules. Specifically, the definition of QDMTT in Article 10.1 provides:

*Qualified Domestic Minimum Top-up Tax means a minimum tax that is included in the domestic law of a jurisdiction and that:*

- (a) Determines the Excess Profits of the Constituent Entities located in the jurisdiction (domestic Excess Profits) in a manner that is equivalent to the GloBE Rules;*
- (b) Operates to increase the domestic tax liability with respect to domestic Excess Profits to the Minimum Rate for the jurisdiction and Constituent Entities for a Fiscal Year; and*
- (c) Is implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary, provided that such jurisdiction does not provide any benefits that are related to such rules.*

*A Qualified Domestic Minimum Top-up Tax may compute domestic Excess Profits based on an Acceptable Financial Accounting Standard permitted by the Authorised Accounting Body or an Authorised Financial Accounting Standard adjusted to prevent any Material Competitive Distortions, rather than the financial accounting standard used in the Consolidated Financial Statements.*

2. The Commentary to the definition of QDMTT notes that the Implementation Framework will provide further guidance on QDMTTs and assist tax administrations in determining whether a minimum tax is considered a QDMTT. This note sets out guidance on the design of a QDMTT and that will be used for an assessment of whether a minimum tax meets the requirements for qualified status.

3. Certain aspects and implications of a QDMTT are not covered in this guidance. Accordingly, the Inclusive Framework will consider providing further guidance on the design and operation of a QDMTT, including guidance in respect of blending of income and taxes under a QDMTT in light of a jurisdiction’s domestic legal framework and the treatment of tax neutrality and distribution regimes under Chapter 7, including flow-through entities and investment entities, and the treatment of Stateless Constituent Entities. The Inclusive Framework will undertake further work on the development of a QDMTT Safe Harbour.

4. The Inclusive Framework will develop a multilateral review process in 2023 to assess whether the domestic minimum tax of a jurisdiction and the way it is administered produce outcomes that are sufficiently consistent with those of the GloBE Rules for such minimum tax to be treated as a QDMTT. This Administrative Guidance is intended to be used in the development and application of that process.

### **5.1.2. Guiding principles for evaluating QDMTTs**

5. There are two guiding principles in determining whether a minimum tax is functionally equivalent to the GloBE Rules and therefore qualifies as a QDMTT.

- a. The minimum tax must be consistent with the design of the GloBE Rules; and
- b. The minimum tax must provide for outcomes that are consistent with the GloBE Rules.

6. The qualification of a minimum tax as a QDMTT must be assessed in the context of the existing tax system and in light of the need to ensure consistent and co-ordinated outcomes in accordance with the Model Rules and Commentary. These two requirements are discussed in general terms below.

#### *QDMTT must be consistent with the design of the GloBE rules*

7. In order to tax domestic Excess Profits in a manner equivalent to the GloBE Rules and to increase the domestic tax liability on those profits to the Minimum Rate, a minimum tax must follow the architecture of the GloBE rules using mechanisms that are substantially the same as those used to calculate the effective tax rate and top-up tax payable under GloBE. The design of the minimum tax must be close enough to the GloBE Rules such that an MNE can use the same data points for calculating its minimum tax liability that it uses for calculating its GloBE tax liability.

8. The simplest way to demonstrate that a minimum tax is consistent with the GloBE rules (and therefore meets the criteria for being treated as a QDMTT) would be for a jurisdiction to mirror all the requirements of the GloBE Rules with only minor changes to the charging provisions and administrative provisions that tailor them to apply solely to domestic Constituent Entities. However, this approach may result in redundant and complex provisions that are not needed for a domestic minimum tax to achieve consistent outcomes with the GloBE Rules in the jurisdiction. For example, the provisions of Article 3.2.6 would likely be irrelevant in a jurisdiction that does not exempt gains from the sale of immovable property.

9. Some degree of customisation of a QDMTT in each jurisdiction is to be expected. Any deviation from the GloBE Rules, however, shall be justified in the context of the jurisdiction's domestic tax system and shall not result in inconsistent outcomes. Any assessment of whether a minimum tax qualifies as a QDMTT therefore requires a case-by-case analysis that also takes into account existing outcomes under domestic law. In designing a QDMTT a jurisdiction will wish to consider how its domestic tax laws will interact with various provisions of the QDMTT and ensure that these interactions will produce functionally equivalent outcomes. Jurisdictions should strive to ensure that the design of the QDMTT provisions and their interaction with the broader domestic legislative framework enhance transparency and facilitate the multilateral review process that will assess whether they are functionally equivalent to the GloBE Rules.

#### *QDMTT must result in outcomes that are consistent with GloBE rules*

10. The requirement to produce outcomes consistent with the GloBE Rules and Commentary requires that the minimum tax reliably produces an incremental liability for Top-up Tax that is equivalent to the Top-up Tax liability that would have arisen under the GloBE Rules. Variations in outcomes between the minimum tax and GloBE Rules will not prevent that tax from being treated as a QDMTT if those variations systemically produce a greater incremental tax liability or do not systematically produce lower tax liability than would be expected under the GloBE Rules and Commentary.

### 5.1.3. Guidance

11. In light of the general principles set out above. Paragraph 118 of the Commentary to Article 10.1 will be removed and replaced with the text set out below.

#### *Qualified Domestic Minimum Top-up Tax*

118.1 A domestic minimum tax must be functionally equivalent to the GloBE Rules to be treated as a Qualified Domestic Minimum Top-up Tax. To be considered functionally equivalent, a domestic minimum tax must be implemented and administered so that it reliably produces outcomes that are consistent with the outcomes for the jurisdiction that are produced under the GloBE Rules and Commentary. Specifically, in order to be considered functionally equivalent to the GloBE Rules, a minimum tax must be structured so that it is in line with the architecture of the GloBE Rules and does not systematically result in an incremental top-up tax for the jurisdiction that is less than what would have been determined under the GloBE Rules. The following discussion considers the extent to which a QDMTT needs to conform to the rules set out in each chapter of the Model Rules – the building blocks of the GloBE Rules – in order to achieve this functional equivalence.

#### **Chapter 1. Scope**

##### *Small MNE Groups and domestic Groups*

118.2 A QDMTT must apply to domestic Constituent Entities of MNE Groups that meet the EUR 750 million threshold in Article 1.1 of the GloBE Rules. However, consistent with the common approach, the application of a QDMTT could be extended to groups whose UPE is located in the jurisdiction but that are not within the scope of the GloBE Rules because their revenues are below the EUR 750 million threshold. A jurisdiction can apply an IIR to such groups and therefore, a jurisdiction can also apply its QDMTT to such groups. Furthermore, a QDMTT could also apply to purely domestic groups, i.e. groups with no foreign subsidiaries or branches. A QDMTT that applies to groups that are not within the scope of the GloBE Rules does not produce outcomes that would cause the QDMTT to fail functional equivalence.

##### *Scope of Constituent Entities*

118.3 In many cases, the Constituent Entities subject to tax under domestic law will correspond to the Constituent Entities located in the jurisdiction under the GloBE Rules. However, there may be some cases where an Entity or Permanent Establishment that is not subject to tax domestically is treated as a Constituent Entity for GloBE purposes. Failure to include the GloBE tax attributes of these Constituent Entities in the income, taxes, and ETR computations of the QDMTT could produce outcomes that are not functionally equivalent.

118.4 In order to produce functionally equivalent outcomes, a QDMTT must apply with respect to the Constituent Entities of an MNE Group that are located in the jurisdiction as determined under the GloBE Rules. This means that:

- a. the definition of Ultimate Parent Entity, MNE Group, and Constituent Entity in the QDMTT need to correspond with the definitions in the GloBE Rules; and
- b. the QDMTT must compute the tax liability for the jurisdiction by taking into account the income and covered taxes of Constituent Entities that are located in the jurisdiction as determined under the GloBE Rules.

Thus, consistent with the rules of Article 3.4, the QDMTT should take into account the income and covered taxes of Constituent Entities located in the jurisdiction and only those Constituent

Entities. For example, unless the circumstances trigger the application of Article 3.4.5, GloBE tax attributes of Permanent Establishments located in another jurisdiction should not be taken into account, even where the jurisdiction typically imposes tax on the Main Entity in respect of income earned through a foreign Permanent Establishment.

118.5 Although the tax must apply with respect to all the relevant Constituent Entities, liability for the tax need not be imposed on Entities that are not otherwise subject to tax under the laws of the jurisdiction. Liability for the tax can be imposed on a Constituent Entity that is (or Constituent Entities that are) otherwise subject to tax under the laws of the jurisdiction. To reduce compliance burden for the MNE Group, a QDMTT could be designed for all the liability for the tax to be imposed on a single Constituent Entity of an MNE Group that is subject to tax under the laws of the jurisdiction even though there could be other Constituent Entities in the same MNE Group that are also subject to tax under the laws of the jurisdiction. See discussion of Charging Provisions below.

#### *MOCEs*

118.6 Minority Owned Constituent Entities (MOCEs) are subject to special treatment under the GloBE Rules. Although they are Constituent Entities, they are separated from the other Constituent Entities in the jurisdiction and their ETR and Top-up Tax is computed separately. This separate ETR and Top-up computation will often produce a different outcome than would a blended computation, i.e. a single computation based on the income and covered taxes of all Constituent Entities in the jurisdiction). Thus, in order to be functionally equivalent, a QDMTT must determine a separate ETR and Top-up Tax amount for MOCEs.

#### *Joint Ventures*

118.7 Under Article 6.4, the ETR and Top-up Tax for Joint Ventures and JV Subsidiaries located in each jurisdiction are computed separately from the ETR and Top-up Tax of the Constituent Entities in the same jurisdiction. As the results of these computations may be different from the results of a blended ETR and Top-up Tax computation, a QDMTT must also determine a separate ETR and Top-up Tax amount for Joint Ventures and JV Subsidiaries located in the jurisdiction in order to be functionally equivalent to the GloBE Rules.

118.8 The GloBE Rules do not impose Top-up Tax on Joint Ventures and JV Subsidiaries but rather require the MNE Group to allocate such Top-up Tax to a Constituent Entity of the MNE Group under the IIR or the UTPR. Similarly, jurisdictions that have introduced a QDMTT could choose not to impose the QDMTT tax liability on Joint Ventures and JV Subsidiaries located in the jurisdiction (and any Top-up Tax computed in respect of such Joint Ventures and JV Subsidiaries will be subject to the GloBE Rules). Alternatively, a jurisdiction could impose the QDMTT tax liability computed with respect to Joint Ventures and JV Subsidiaries on another Constituent Entity of the MNE Group located in the jurisdiction.

### **Chapter 2. Charging provisions**

118.9 The charging provisions in Article 2 are not suited to a QDMTT because the IIR and UTPR primarily apply with respect to the income of foreign Constituent Entities. In contrast, a QDMTT applies exclusively with respect to domestic Constituent Entities. In lieu of the Article 2 charging provisions, a QDMTT should impose a Top-up Tax on one or more domestic Constituent Entities with respect to the Excess Profits of all domestic Constituent Entities, including the domestic Parent Entity.

118.10 The Jurisdictional Top-up Tax that is subject to the QDMTT is based on the whole amount of the Jurisdictional Top-up Tax computed under Article 5.2.3 of the GloBE Rules, irrespective of

the Ownership Interests held in the Constituent Entities located in the QDMTT jurisdiction by any Parent Entity of the MNE Group. In some situations, imposing the whole amount of the Jurisdictional Top-up Tax under a QDMTT will result in a greater tax charge than the tax charge that would otherwise have been imposed under the GloBE Rules. This could arise, for example in the situation where the MNE Group is subject to a QIIR in respect of the Constituent Entities located in the QDMTT jurisdiction and the Parent Entity imposing the IIR does not own 100% of the Ownership Interests in those Constituent Entities. Jurisdictions may choose to implement rules that apply their QDMTT only to Groups where all of the Constituent Entities located in that jurisdiction are 100% owned by the UPE or a POPE for the entire Fiscal Year.

118.11 This guidance does not require the QDMTT tax liability to be allocated to or among Constituent Entities in any particular manner, so long as all the tax liability is allocated to one or more Constituent Entities that are subject to tax in the jurisdiction. Tax arising under the QDMTT reduces (or eliminates) the GloBE Top-up Tax for the jurisdiction as a whole. If there is GloBE Top-up Tax remaining after subtracting the QDMTT, the remainder is allocated among Constituent Entities under the GloBE Rules, including Articles 5.2.4 and 5.2.5. Thus, it is not necessary to allocate both the IIR Top-up Tax and the QDMTT tax Entity-by-Entity and then subtract the QDMTT tax allocated to an Entity from the IIR Top-up Tax allocated to the Entity.

118.12 In designing the charging provisions of a QDMTT, jurisdictions should ensure that the legal liability for the tax is enforceable against at least one Constituent Entity in that jurisdiction. For example, a jurisdiction could impose joint and several liability for QDMTT tax on all the domestic Constituent Entities and collect it from any of the Constituent Entities without affecting the outcome under the GloBE Rules. In other cases, however, the laws of a jurisdiction may not permit imposition of tax on one of the Entities in respect of the average low-tax outcome of other Entities. In that case, the jurisdiction would need to allocate the QDMTT tax liability on a basis that complies with its domestic legal framework. The Inclusive Framework will consider providing further guidance in relation to the allocation of tax liability under a QDMTT among Constituent Entities where this is necessary for the proper functioning of the GloBE Rules.

118.13 Finally, the definition of a QDMTT prohibits the jurisdiction from providing any benefits that are related to the QDMTT or the GloBE Rules. The assessment of whether such benefits have been provided should be in line with an equivalent assessment made in respect of a qualified IIR or UTPR and prevents a QDMTT from being refunded directly or indirectly to the MNE Group. Crediting or refunding of tax paid pursuant to a tax regime that meets the definition of Qualified Imputation Tax in chapter 10 of the GloBE Rules will not be treated as giving rise to a benefit that would prevent it from being a QDMTT. The Inclusive Framework will consider providing further guidance in relation to the identification of benefits related to a QDMTT.

### **Chapter 3. GloBE income or loss**

#### *Financial accounting standard*

118.14 The QDMTT definition provides that a jurisdiction may require income or loss for the jurisdiction to be computed using an Authorised Financial Accounting Standard that differs from the one used in the Consolidated Financial Statements. This part of the definition recognises that the local tax authority would likely be more familiar with accounting standards that are permissible in the jurisdiction than one applied by a UPE in another jurisdiction. The jurisdiction can, of course, require or permit the computation of the income or loss based on the accounting standard used in the Consolidated Financial Statements.

118.15 The QDMTT definition allows for the use of an Acceptable Financial Accounting Standard or for the use of an Authorized Financial Accounting Standard that is not an Acceptable Financial

Accounting Standard but is adjusted as necessary to prevent Material Competitive Distortions. The Inclusive Framework may consider that a more robust definition of Material Competitive Distortion is necessary in the case of a QDMTT allows for the use of an Authorized Financial Accounting Standard that is not an Acceptable Financial Accounting Standard. The threshold for Material Competitive Distortions is EUR 75 million in a Fiscal Year for the entire MNE Group. This threshold was developed based on the premise that the Consolidated Financial Statement (CFS) would be prepared, in full, using the particular accounting standard. Thus, this threshold should not apply in the context of a QDMTT applicable to a single jurisdiction and the Inclusive Framework will consider providing further guidance on the determination of a lower threshold to provide for outcomes that are consistent with the GloBE Rules. For example, the Inclusive Framework could consider whether the threshold could be scaled to the jurisdiction based on the relative amount of the MNE Group's revenues in the jurisdiction.

#### *Local vs. reporting currency*

118.16 Tax arising under a QDMTT will be paid in local currency. This suggests that the relevant computations should be performed in local currency or in accordance with the jurisdiction's ordinary tax rules for foreign currency translation. However, the GloBE Rules do not require the MNE to compute Top-up Tax for a jurisdiction based on the local currency of the jurisdiction. Thus, if the jurisdiction requires the QDMTT computations on a different basis this could, as explained below, produce outcomes that vary on an annual basis from the GloBE Rules.

118.17 Authorised Financial Accounting Standards permit MNE Groups to employ either of two basic paradigms for converting transactions from the local functional currency to the CFS reporting currency. Under one, transactions conducted in the functional currency are contemporaneously translated and recorded in the financial accounts in the reporting currency. Under the other, transactions are recorded in the financial accounts in the functional currency and translated to the CFS reporting currency in the consolidation process. The results of computing a Constituent Entity's income or loss using these different paradigms will be the same over time but can differ from year to year. However, neither approach will be consistently more or less favourable for the MNE Group because currency movements are unpredictable. Determining the relevant financial amounts for GloBE and QDMTT purposes using a different currency conversion paradigm would be a difficult and cumbersome task, and because the computations that are not in line with the MNE Group's financial accounting paradigm would not be subject to the normal financial accounting audit procedures, it is less reliable. Determining these amounts based on foreign currency translation rules in the local tax rules would be equally complex and would often produce different outcomes.

118.18 To ensure functionally equivalent outcomes, the underlying computations should be based on the currency translation paradigm that is used for the GloBE Information Return. Because the different currency translation paradigms can produce different results year-to-year, the only way to ensure functional equivalence on an annual basis is to use the same paradigm for both the GloBE and QDMTT computations. This will also simplify the compliance and administration of the QDMTT.

118.19 This does not mean, however, that the QDMTT return has to be prepared using the currency reflected in the GloBE Information Return. A jurisdiction may require the MNE Group to translate the numbers reported in the GloBE Information Return into the local currency using a single translation rate for purposes of preparing the QDMTT return. However, in such cases, the accounting numbers that need to be translated are the numbers that are reflected in the GloBE Information Return, which may have implications as to the filing deadline for a QDMTT return.

*Permanent differences*

118.20 Income and tax computations generally need to mirror the GloBE Rules to ensure functional equivalence. Customization of a QDMTT is permissible, however, in two situations. First, it is permissible to make the QDMTT more restrictive than the GloBE Rules where the tighter restriction is consistent with local tax rules. For example, a jurisdiction that does not permit deduction of fines and penalties in any amount under its corporate income tax (CIT) can apply the same standard under its QDMTT. Because the GloBE Rules disallow fines and penalties in excess of EUR 50 000 only, this variation will not result in QDMTT tax that is less than the GloBE Top-up Tax. On the other hand, allowing an expense for fines and penalties in excess of EUR 50 000 will not produce functionally equivalent outcomes.

118.21 Second, a jurisdiction is not required to include adjustments in Chapter 3 that are not relevant to in the context of its domestic tax system. Some of the GloBE Rules are intended to bring an MNE Group's GloBE Income or Loss in line with its local taxable income computations. The election to expense the amount of stock compensation allowed as a tax deduction is a good example. This election is provided because some jurisdictions allow an expense for stock-based compensation based on the value on the exercise date rather than the expected value at the time the option is granted. However, if the jurisdiction allows stock-based compensation expense only in the amount allowed for accounting purposes, no adjustment is needed to bring the GloBE and taxable income into alignment.

*Income of a Permanent Establishment*

118.22 Although a jurisdiction may have a taxable branch regime, its QDMTT must exclude the income or loss of a foreign Permanent Establishment from the income or loss of the Main Entity consistent with the rules of Article 3.4 in order to be considered functionally equivalent. Any low-taxed income of a Permanent Establishment will be taxable under the QDMTT of the jurisdiction in which the PE is located (as determined under Article 10.3) or under the GloBE Rules. In accordance with and based on the principles of the GloBE rules, the Inclusive Framework will consider providing further guidance on the allocation of income to PEs under a QDMTT in particular circumstances (for example, in respect of stateless PEs or reverse hybrid entities).

*Income of a Tax Transparent Entity*

118.23 Under the GloBE rules, the income of a Tax Transparent Entity is allocated to its Constituent Entity-owner or a Permanent Establishment. A Constituent Entity-owner may be located in a different jurisdiction from the one in which the Tax Transparent Entity is created.

118.24 In order to be considered functionally equivalent, a QDMTT must allocate the income and taxes of a foreign or domestic Tax Transparent Entity to a Constituent Entity-owner or a Permanent Establishment located in the jurisdiction consistent with the rules in Article 3.5. Similarly, the QDMTT should exclude the income of a Tax Transparent Entity that is allocated to a foreign Constituent Entity-owner under the GloBE Rules. Without such rules, the ETR and Top-up Tax computations for the jurisdiction will routinely produce different outcomes and the QDMTT will not be functionally equivalent to the GloBE Rules.

118.25 A tax transparent UPE is located in the jurisdiction in which it is created under Article 10.3 of the GloBE Rules. A QDMTT must also include the income and taxes of a tax transparent UPE in the relevant computations if it is located in the jurisdiction, unless the QDMTT contains a provision equivalent to Article 7.1. See discussion of tax transparent UPEs below. However, if the highest-level Constituent Entity in the jurisdiction is a Tax Transparent Entity, its income and taxes may be



allocated to a foreign Constituent Entity-owner pursuant to Article 3.5. In such cases, the QDMTT must exclude the income and taxes of the Tax Transparent Entity from the relevant computations.

#### **Chapter 4. Adjusted Covered Taxes**

##### *In general*

118.26 In order for the ETR computed under the QDMTT to be functionally equivalent to the GloBE ETR for the jurisdiction, the determination of Adjusted Covered Taxes needs to be the same or more restrictive. This means that the range of taxes included in Covered Taxes needs to be the same or narrower, except as discussed below. It also means that the jurisdiction's QDMTT must adopt deferred tax accounting rules that are consistent with the GloBE Rules in Article 4.4.

118.27 A QDMTT, however, does not need to have a GloBE Loss Election as provided in Article 4.5. This election is primarily aimed at jurisdictions that do not have a tax system at all or that do not allow loss carry-forwards. A jurisdiction with a tax system that allows loss carry-forwards can rely on the rules in Article 4.4 to achieve functional equivalence with the GloBE Rules. A jurisdiction without a tax system or a loss carry-forward may want to have a GloBE Loss Election but would not need to provide the election for its QDMTT to be functionally equivalent. This is because the lack of a GloBE Loss Election would be a restriction that invariably results in more top-up tax than would be computed under the GloBE Rules.

##### *Cross-border taxes excluded from shareholder's or Main Entity's Covered Taxes*

118.28 A QDMTT must exclude tax paid or accrued by domestic Constituent Entities with respect to the income of foreign Constituent Entities under its own CFC or taxable branch regimes. Taxes of the Main Entity allocated to its foreign permanent establishment shall be excluded pursuant to Article 4.3.2.(a). Further, taxes treated as Covered Taxes of the Main Entity pursuant to Article 4.3.4. must be allocated to the Main Entity under a QDMTT. Taxes of the Constituent Entity owner of foreign CFCs shall be excluded pursuant to Article 4.3.2.(c). Because these taxes are imposed on income of Constituent Entities located in another jurisdiction under the GloBE Rules, they cannot be taken into account in the ETR computation for the jurisdiction of the shareholder or Main Entity under the GloBE Rules. The same rule is necessary under a QDMTT to avoid mismatches (and double-counting) of tax and income. The exception to this principle under the GloBE Rules is for cross-border taxes on passive income in excess of the amount allowed to be pushed down to the CFC or Hybrid Entity under Article 4.3.3. A QDMTT may follow the GloBE treatment of these taxes and allow them to be credited in the jurisdiction of the Constituent Entity-owner.

118.29 Alternatively, a jurisdiction may consider that determining the amount of domestic tax on foreign passive income is an additional and unnecessary complication and prefer to exclude all taxes that it imposes on the income of a foreign CFC or Hybrid Entity from the QDMTT's adjusted covered taxes computation. This treatment would generally increase the likelihood that tax would arise under the QDMTT and would not produce outcomes that are systematically lower than the tax liability that would arise under the GloBE Rules. Thus, this variance would be functionally equivalent.

##### *Cross-border taxes allocable to CFC or Permanent Establishment*

118.30 A QDMTT shall exclude tax paid or incurred by a Constituent Entity-owner under a CFC Tax Regime that is allocable to a domestic Constituent Entity under Article 4.3.2(c) of the GloBE Rules and tax paid or incurred by a Main Entity that is allocable under Article 4.3.2(a) to a Permanent Establishment located in the jurisdiction. Excluding such CFC and PE taxes allows the QDMTT to operate as a simple calculation and does not require the complex calculations required in some cases to allocate CFC taxes under Article 4.3.2(c) to be reported to a jurisdiction that implements a

QDMTT. Further, a specific ordering rule is aimed at attributing primary taxing rights to the jurisdiction applying the QDMTT in relation to its Constituent Entities. If the ordering rule were the opposite, so that CFC taxes or PE taxes were credited under a QDMTT, additional computations would have been required in order to avoid the QDMTT resulting in taxation that is below the Minimum Rate. Specifically, if a QDMTT is creditable against either a CFC tax charge or a PE tax charge imposed by the parent or main entity jurisdiction, any crediting of that CFC tax or PE tax against a QDMTT would make the calculation of the correct amount of QDMTT problematic, due to the interaction of the two crediting mechanisms. Excluding credits for CFC or PE taxes from QDMTT calculations will ensure that this practical problem does not arise. The Inclusive Framework will monitor the interaction between the QDMTT and CFC Tax Regimes and taxable branch regimes to ensure this interaction results in the intended outcomes under the GloBE Rules and may, in the future, consider solutions to address issues if they arise.

#### *GloBE taxes*

118.31 The definition of Covered Taxes excludes taxes arising under a Qualified IIR and a Qualified UTPR. These exceptions are necessary in the QDMTT context only where it is possible that the jurisdiction itself has an IIR or UTPR that could impose a tax liability on the same MNE Group. The rule aims at establishing a precise ordering rule according to which the QDMTT is applied primarily in respect of the IIR and UTPR under the GloBE Rules. For these purposes, the Top-up tax computation under IIR and UTPR takes into account the QDMTT. On the other hand, the IIR and UTPR must be excluded from the computation of the QDMTT Top-up Tax. For example, if the jurisdiction has in place a UTPR and the Constituent Entities in the jurisdiction are denied deductions so that the jurisdiction can collect its share of the allocable UTPR Top-up Tax, the tax liability arising under the UTPR cannot be treated as a covered tax under the QDMTT. If a jurisdiction does not have either an IIR or a UTPR, it would not need to exclude taxes paid under the GloBE Rules from the definition of QDMTT covered taxes. However, ongoing monitoring of a jurisdiction's QDMTT would need to consider whether the jurisdiction had subsequently adopted the GloBE Rules and, if so, whether it had also amended its definition of QDMTT covered taxes

#### *Coordinating a QDMTT Article 4.1.5 with the GloBE Article 4.1.5*

118.32 A QDMTT must have a provision equivalent to Article 4.1.5 to be functionally equivalent. The QDMTT-equivalent of Article 4.1.5 must be designed so that it takes into account any tax computed thereunder at the same time and in the same manner as the corresponding Additional Top-up Tax is taken into account under the GloBE Rules, including administrative guidance related to Excess Negative Tax Carry-forward.

### **Chapter 5. Computing the Top-up Tax**

#### *Jurisdictional blending*

118.33 In general, Top-up Tax is computed for the jurisdiction as a whole, but excluding the income and taxes of Investment Entities, JVs, and MOCEs. The ETR and Top-up Taxes of these various categories of Entities must be computed separately under a QDMTT to produce functionally equivalent outcomes as discussed elsewhere in this Commentary. For QDMTT purposes, however, a jurisdiction could have stricter limitations on blending of income and taxes across the ordinary Constituent Entities in the jurisdiction provided that the limitations on blending produce outcomes that are functionally equivalent to the GloBE Rules.

*Top-up Tax formula*

118.34 Article 5.2.3 of the GloBE Rules sets out the formula for computing the Top-up Tax under the GloBE Rules. The formula subtracts tax paid under a QDMTT from the current GloBE Top-up Tax. This formula must be modified for purposes of the QDMTT to eliminate that subtraction, else the computation will be circular. The current QDMTT Top-up Tax should be determined by multiplying the domestic QDMTT income by the jurisdictional top-up tax percentage and then adding any additional QDMTT top-up tax arising for the jurisdiction.

118.35 A QDMTT must also require that top-up tax computed under a provision equivalent to Article 5.2.3 in excess of the Minimum Rate is taken into account by the relevant Constituent Entity or Entities at the same time and in the same manner as such Top-up Tax is taken into account under the GloBE Rules. This means that the excess tax cannot be carried forward or treated as a reduction in prior Fiscal Years.

*Substance-based income exclusion*

118.36 In defining a QDMTT, Article 10.1 specifies that it is a tax that operates to increase the domestic tax liability with respect to domestic Excess Profits. Under the GloBE Rules, Excess Profits is generally the amount of profits over and above the Substance-based Income Exclusion in Article 5.4 (SBIE). The SBIE may be zero depending upon the circumstances and the MNE Group has the option of not applying the SBIE in a jurisdiction. A minimum tax that does not have a substance carve-out or that has a substance carve-out less generous than the SBIE will be functionally equivalent to the GloBE Rules.

118.37 A QDMTT is not required to have a substance carve-out. However, if it has a substance carve-out, such carve-out must not be broader than the substance factors as set out in the Substance-based Income Exclusion, i.e. tangible assets and payroll. The scope and measure of tangible assets and payroll must not be broader than the GloBE Rules to ensure functionally equivalent outcomes. However, the QDMTT carve-out could provide for an applicable percentage lower than the GloBE Rules. For example, a jurisdiction may want to provide a carve-out based only on 5% of tangible assets in the jurisdiction or based on 3% of tangible assets and payroll. Likewise, a jurisdiction may decide that it does not want to adopt the transition percentages in Article 9.2. However, the applicable percentage for the carve-out cannot exceed the percentages provided in the GloBE Rules (including the transition percentages) and still be considered functionally equivalent.

*Tax rate*

118.38 To be functionally equivalent, the tax rate applicable under a QDMTT must equal or exceed the Minimum Rate. Otherwise, the tax collected would consistently fall short of the GloBE Top-up Tax.

*De minimis exclusion*

118.39 A QDMTT is not required to have a De minimis exclusion pursuant to 5.5 in order to be considered functionally equivalent to the GloBE rules. However, if the QDMTT provides for a de minimis exclusion, it shall be based on the Average Revenue and Average Income or Loss, and the relevant thresholds can be equal or lower than the ones provided for under Article 5.5.1. The election shall be an Annual Election.

### **Chapter 6. Corporate restructurings and holding structures**

118.40 Chapter 6 provides rules related to corporate reorganisations. These rules are intended to harmonize the GloBE Rules with common tax reorganisation rules. To be functionally equivalent, a QDMTT needs to include rules akin to those in Chapter 6 to the extent necessary to conform to the tax reorganization rules in the jurisdiction. For example, if the jurisdiction does not have tax-deferred reorganization rules in its ordinary CIT, the jurisdiction does not need the rules applicable to GloBE Reorganisations. Similarly, if the jurisdiction does not have a rule that would allow for an election under Article 6.3.4 or does not allow for multi-parented MNE Groups, the jurisdiction need not adopt rules that correspond to Articles 6.3.4 or 6.5. On the other hand, the jurisdiction will need a rule similar to Article 6.2.1 that requires GloBE income of the target be determined using historical carrying value of assets and liabilities. Further, the jurisdiction will need a rule similar to Article 6.3.1 that requires gain or loss to be recognized upon transfer of assets among Constituent Entities in the jurisdiction.

### **Chapter 8. Administration**

#### *Filing obligations*

118.41 The filing obligations under the GloBE Rules are set out in Article 8 and require the filing of a GloBE Information Return no later than 15 months after the last day of the Reporting Fiscal Year for the MNE Group. The GloBE Information Return is expected to be a standard template that will include information concerning the MNE Group necessary to report the GloBE computations and tax liability, if any.

118.42 As previously discussed, a QDMTT must deliver outcomes similar to those achieved under the GloBE Rules, but it is not required to follow the GloBE Rules verbatim to achieve this result. Nevertheless, to ensure coordination and preserve transparency, the design of the QDMTT needs to be functionally equivalent to the GloBE Rules such that the QDMTT computations can be made with the data points that are required to compute the GloBE tax liability. Using equivalent data points for purposes of the QDMTT and the GloBE Rules will facilitate compliance for MNE Groups, as well as coordination and mutual trust between jurisdictions. The Inclusive Framework will consider providing further guidance on the information collection and reporting requirements under the QDMTT in the context of the development of the GloBE Information Return.

118.43 Article 5.2.3 of the GloBE Rules provides for a reduction in Top-up Tax liability for tax imposed under a QDMTT regime. A jurisdiction implementing a QDMTT will need to calibrate the filing deadline for the QDMTT to facilitate the correct reporting of Top-up Tax liability on the GloBE Information Return.

#### *Interaction with agreed safe harbours*

118.44 The Inclusive Framework has agreed on the design of transitional GloBE safe harbours and a regulatory framework for the development of a potential permanent GloBE safe harbours. These safe harbours allow MNE Groups to assume that the Top-up Tax for a jurisdiction is zero under certain conditions in order to reduce the burden of complying with the detailed computational requirements of the GloBE Rules. The Transitional CbCR Safe Harbour applies where it is unlikely that there would be Top-up Tax due in a jurisdiction during the initial transition period. The Permanent Simplified Calculations Safe Harbour would apply where undertaking Simplified Calculations (to be developed via future Agreed Admirative Guidance) would provide for the same final outcomes as those provided under a full application of the GloBE Rules or would not otherwise undermine the integrity of the GloBE Rules. In both cases, the GloBE Information Return will only

require the information necessary to demonstrate the qualification for the safe harbour. The information necessary for the more detailed GloBE computations will not be reported because it is not necessary to compute the MNE Group's Top-up tax liability for the jurisdiction when a safe harbour applies.

118.45 In general, the QDMTT is designed to impose top-up tax where there would otherwise be a Top-up Tax liability under the GloBE Rules. Consistent with that design principle, a QDMTT should also contain safe harbours that align with the safe harbours agreed under the GloBE Rules, including the transitional safe harbours. Otherwise, the MNE Group will be forced to undertake the detailed income and covered taxes computations solely for purposes of the QDMTT where the Inclusive Framework has determined there is little risk of top-up tax liability.

#### *QDMTT safe harbour*

118.46 The Inclusive Framework will undertake further work on the development of a QDMTT Safe Harbour. This Safe Harbour would provide compliance simplifications for MNE Groups operating in a jurisdiction that has adopted a QDMTT that meets certain conditions to be developed in future work, for example by exempting the MNE Group from the requirements to perform additional GloBE calculations in respect of Constituent Entities located in a jurisdiction that qualifies for the Safe Harbour.

### **Chapter 9. Transition rules**

118.47 The GloBE transition rules are set out in Article 9. Generally, these rules take existing tax attributes into account, including all pre-existing tax losses, to simplify the application of the GloBE Rules and reduce compliance burdens when an MNE Group first comes into scope of the rules. Article 9 also has a limitation of the application of the UTPR when an MNE Group is in its initial phase of expanding abroad. The transition rules also provide a phased introduction of the GloBE Rules through a gradual reduction of the Substance-Based Income Exclusion over a ten-year period beginning in January 2023.

#### *Tax attributes*

118.48 Article 9.1.1 sets out a general rule that an MNE Group must carry its existing deferred tax attributes into the GloBE Rules with certain adjustments, such as a recast at the Minimum Rate. These tax attributes will generally reverse in future years in which the MNE Group is subject to the GloBE Rules and may result in increases or decreases to Adjusted Covered Taxes. Because Adjusted Covered Taxes are key component of the GloBE ETR computation, it is essential that the deferred tax starting point for a QDMTT mirror that of the GloBE Rules. Otherwise, the ETR computed under the QDMTT could vary significantly from that computed under the GloBE Rules due to movements in a different deferred tax base. The deferred tax movements cannot easily be modified and tracked separately for QDMTT purposes while still providing for outcomes consistent with the GloBE Rules. Therefore, a jurisdiction adopting a QDMTT must adopt the Article 9.1.1 transition rule to take into account the same starting point for deferred tax items as the GloBE Rules.

118.49 Similarly, Articles 9.1.2 and 9.1.3 provide for GloBE-specific modifications to the Article 9.1.1 deferred tax starting point and must be adopted under a QDMTT regime to ensure the deferred tax starting point is the same for both the QDMTT and GloBE computations. Article 9.1.2 is an anti-abuse rule to prevent a taxpayer from triggering tax losses that would be excluded from the GloBE base in a pre-GloBE year and then carrying the deferred tax benefit of such loss carry-forward into the GloBE regime. Similarly, Article 9.1.3 disallows a basis step-up when a taxpayer transfers assets during the transition period to ensure that the gain associated with such transfers does not escape inclusion in the GloBE base. As with Article 9.1.1, these articles must be adopted

in a QDMTT to ensure consistent outcomes with the GloBE Rules and that the same starting point is taken into account for covered taxes and the carrying value of assets for GloBE purposes.

*Transitional relief for Substance-based Income Exclusion*

118.50 Article 9.2 of the GloBE Rules provides for a more generous Substance-based Income Exclusion during a ten-year transition period. The Substance-based Income Exclusion only serves to reduce Excess Profit in a jurisdiction for purposes of computing the Top-up Tax due with respect to a jurisdiction. Unlike Article 9.1, the failure to adopt Article 9.2 would not lead to outcomes inconsistent with the GloBE Rules, because not adopting a more generous Substance-based Income Exclusion will only lead to the collection of additional Top-up Tax with respect to the jurisdiction that has adopted the QDMTT. Accordingly, a jurisdiction adopting a QDMTT need not adopt Article 9.2 to provide for outcomes consistent with the GloBE Rules.

*Exclusion from the UTPR of MNE Groups in the initial phase of their international activity*

118.51 Article 9.3 of the GloBE Rules provides for a special exclusion from the UTPR for MNE Groups in the initial phase of international activity. Because Article 9.3 solely applies with respect to the UTPR and a QDMTT will not apply a UTPR with respect to other low-taxed outcomes in other jurisdictions, Article 9.3 need not be adopted in the context of a QDMTT. In other words, a QDMTT can apply to the Constituent Entities of MNE Groups that are excluded from the UTPR under Article 9.3.

*Transitional relief for filing obligations*

118.52 Article 9.4 provides an extended filing deadline for GloBE Information Returns in a Transition Year. Because this Article relates solely to a one-time extended filing deadline and has no bearing on GloBE computations, it need not be adopted in the context of a QDMTT. However, a jurisdiction could choose to conform its QDMTT filing deadline with the Article 9.4 filing deadline if it wished to do so, as it would not provide for outcomes inconsistent with the GloBE Rules.

**Other considerations**

*Elections*

118.53 Where the GloBE Rules permit an election, a QDMTT generally must also provide for the election and require the MNE Group to make the same election under the QDMTT as is made under the GloBE Rules. If the MNE Group is not permitted or required to make the same elections for purposes of both the GloBE Rules and the QDMTT, the outcomes of the relevant computations will not be consistent and the QDMTT may not be functionally equivalent. However, a QDMTT that does not provide for certain elections, for example GloBE Loss Election, may be functionally equivalent.

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