



# Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)

July 2023

## Introduction

The Inclusive Framework (IF) on 17 July 2023, released its [second set of Administrative Guidance](#) on the Global Anti-Base Erosion (GloBE) Model Rules, amounting to approximately 90 pages of additional guidance (July AG). The [first set](#), roughly 110 pages, was released in February 2023 (February AG). Both of these documents add to or modify the [Commentary](#) that was released in March 2022. All these documents 'interpret' the Model Rules released in December 2021. The [Model Rules](#) themselves remain unchanged to date.

This round of guidance covers five issues: Qualified Domestic Minimum Top-up Tax (QDMTT); Safe Harbors, including both the QDMTT and Transitional UTPR Safe Harbor; tax credits; general currency conversion rules for the GloBE Rules; and the Substance-based Income Exclusion (SBIE).

The table below provides a high-level summary of the additional guidance provided on each issue.

	Issues	High-level summary of new guidance	Page
1.	Qualifying Domestic Minimum Top-up Tax (QDMTT)	The QDMTT was a new feature of the Model Rules in December 2021. Tension exists between allowing jurisdictions flexibility in the design of their QDMTTs and ensuring consistency with the outcomes provided for under the Model Rules. The guidance reflects the outcome of negotiations on that tension. The QDMTT is likely to become the central feature of the GloBE rules over time.	2
2a.	QDMTT Safe Harbor	The QDMTT Safe Harbor obviates the need for a group to compute a jurisdictional ETR under the GloBE Rules (for purposes of collecting Top-up Tax under an IIR or UTPR) in respect of a given jurisdiction in which it operates if such jurisdiction enacts a QDMTT that satisfies the requirements of the safe harbor. The practical benefit of qualifying for the QDMTT Safe Harbor is that groups will only have to compute only one ETR for the jurisdiction in accordance with the domestic QDMTT legislation.	4
2b.	Transitional UTPR Safe Harbor	This transitional safe harbor for the UTPR may apply in respect of the Ultimate Parent Entity (UPE) jurisdiction when that jurisdiction has a nominal corporate income tax rate of 20% or more. This safe harbor is applicable only for Fiscal Years that run no longer than 12 months commencing before December 31, 2025, and ending before December 31, 2026. <b>Reliance on this safe harbor precludes use of the Transitional CbCR Safe Harbor in respect of the UPE jurisdiction in future years.</b>	7
3.	Tax credits	Provides additional guidance on the treatment of tax credits, including important new guidance on transferable tax credits. The guidance effectively extends the treatment of Qualified Refundable Tax Credits (QRTCs), which are treated as akin to grants under the GloBE rules to tax credits that meet a new Marketable Transferable Tax Credit (MTTC) standard.	7

4.	General Currency Conversion Rules for the GloBE Rules	Adds to and clarifies previous rules on currency conversion contained in the first set of guidance.	9
5.	Substance-based Income Exclusion. (SBIE)	Adds to and clarifies various aspects of the SBIE, including the treatment of employees and assets located in more than one jurisdiction and leases.	11

Tax professionals are expecting further guidance later this year on the following areas: deferred tax liability (DTL) recapture, cross-border allocation of deferred tax assets and liabilities, post-filing adjustments, international shipping, intra-group transactions accounted at cost, divergences between GloBE and accounting carrying values and fund redemptions.

The remainder of this document provides a more detailed summary of the recent released Administrative Guidance.



## 1. QDMTT

The February AG set out two guiding principles that will be used to assess whether a jurisdiction's Domestic Minimum Top-up Tax (DMTT) qualifies as a QDMTT: (1) it should be consistent with the design of the GloBE Rules; and (2) it should provide for outcomes consistent with the GloBE rules (functional equivalence). Consistent therewith, the February AG identified certain elements of a QDMTT that must mirror the GloBE rules and other elements that may allow for variation. For more details, please refer to our [report](#) on the February AG.

The July AG expands upon the earlier guidance around the design of a QDMTT. Key considerations include:

- **Application to Joint Ventures (JVs) and Minority-Owned Constituent Entities (MOCEs).** The February AG provides that if a Constituent Entity (CE) is within scope of a QDMTT it must be imposed with respect to 100% of the Top-up Tax calculated for the CE, i.e., it cannot be limited to a UPE's ownership percentage in the CE. At the same time, the February AG permits a jurisdiction to limit its QDMTT to Groups where all CEs located in the jurisdiction are 100% owned by the UPE or POPE for the entire Fiscal Year. The July AG clarifies that the same principle shall generally apply to JVs and MOCEs.
- **Jurisdictional blending.** Complete jurisdictional blending is not required. A QDMTT that is calculated at a sub-national level or that computes an ETR on a CE-by-CE basis is not disqualifying.
- **Allocation of QDMTT tax liability among CEs.** The February AG provided discretion to QDMTT jurisdictions on how to allocate a QDMTT liability between local CEs. The July AG provides a non-exhaustive list of options for allocating the QDMTT liability. As one example, when a jurisdiction chooses to apply its QDMTT on a CE-by-CE basis (i.e., no blending between domestic CEs), the guidance provides that the allocation of the QDMTT charge could be only to CEs that have an ETR lower than the Minimum Rate. As another example, the guidance provides that jurisdictions could decide to allocate the QDMTT liability exclusively to wholly-owned CEs to prevent minority investors in JVs, JV Subsidiaries and MOCEs from bearing the QDMTT charge. The February AG proposes that the QDMTT liability be imposed on the JV, JV Subsidiary or MOCE itself to ensure that the other owners bear their share of the QDMTT liability. When QDMTT jurisdictions allocate the tax liability to CEs of the main Group, the July AG recommends the introduction of a mechanism to avoid double taxation (e.g., when both owners of a JV are part of MNE Groups subject to the GloBE Rules or a QDMTT).
- **Stateless CEs.** A jurisdiction's QDMTT may apply to stateless flow-through entities created there or stateless permanent establishments (PEs) located (or deemed located) there pursuant to a separate ETR and top-up tax calculation, as required for all stateless entities.
- **Flow-through UPEs.** A jurisdiction's QDMTT must take into account GloBE Income or Loss of a flow-through UPE created in its jurisdiction (unless such income or loss is eligible for reduction under Article 7), but flexibility is provided as to how any top-up tax in respect of such UPE is collected.
- **Taxes allocable to Hybrid Entities or Distributing Constituent Entities.** The February AG provides that the QDMTT ETR calculation does not take into account any allocation of taxes paid or incurred by CE-owners under Controlled Foreign Company (CFC) Regimes to CEs located in such jurisdiction, nor any taxes paid or incurred by Main Entities that are allocable to PEs located in such jurisdiction. Consistent therewith, the July AG provides that net income taxes paid by CE-owners on the income of hybrid CEs or distributions from distributing CEs are not allocated to the resident CE for purposes of calculating the ETR under a QDMTT. However, withholding taxes charged on distributions from the CE by the QDMTT jurisdiction can be taken into account.
- **Definitions.** A QDMTT must define terms in a manner that produces outcomes consistent with the GloBE Rules and similarly determine locations of a CE.

**KPMG observation:** The July AG notes that the allocation of the QDMTT charge among CEs is not binding on another jurisdiction for purposes of applying its local tax rules, including CFC Tax Regimes, which are commonly applied on a CE-by-CE basis. Complex analysis may be required to determine the “technical taxpayer” of a QDMTT for US federal income tax (USFIT) purposes in applying the US foreign tax credit provisions when the entity with legal liability for the QDMTT is not the entity that earned the income that is subject to the QDMTT.

## Transition Years

The GloBE Rules apply certain requirements for MNE Groups in a Transition Year, with provisions applying to the treatment of deferred tax attributes existing at transition and adjustments required in respect of intra-group asset transfers that have arisen since November 30, 2021, and before transition.

The February AG required that equivalent transition rules be included in the design of QDMTT legislation. The July AG provides further guidance to address scenarios where CEs are subject to a QDMTT before being subject to an Income Inclusion Rules (IIR) or Undertaxed Profit Rule (UTPR). This fact pattern could be relevant for US-parented groups with CEs in jurisdictions that introduce a QDMTT in 2024, but where the jurisdiction is not subject to an IIR or UTPR until a later period.

The July AG introduces a rule that refreshes the Transition Year for the purposes of the QDMTT when the GloBE Rules come into effect after the QDMTT. This ensures that the MNE group is no worse off for being subject to a QDMTT. When the Transition Year is “refreshed”, certain tax attributes that arose under the QDMTT will need to be eliminated or re-stated to ensure coordination in and after the Transition Year (including deferred tax attributes taken into account at the beginning of the QDMTT Transition Year as well as attributes subject to the GloBE Deferred Tax Liability (DTL) recapture rules, GloBE Loss Election, or Excess Negative Tax Expense Carry-forward provisions).

**KPMG observation:** The refresh of the Transition Year will enable a group to take into account the deferred tax expenses associated with tax attributes (such as foreign tax credits or non-refundable tax credits) in their GloBE computation (including their QDMTT computation) when they arise in a period when a CE is subject to a QDMTT, but not an IIR or UTPR.

## QDMTT payable and interaction with investment treaties

The July AG acknowledges that there may be instances where a QDMTT jurisdiction is prevented or restricted from applying the QDMTT to a CE located in the jurisdiction due to constitutional provisions or tax stabilization, investment and similar agreements. The guidance states that where a MNE Group challenges in a judicial or administrative proceeding or a tax authority has determined a QDMTT is not assessable, or collectible based on constitutional grounds, stabilization, investment or other similar agreements then the QDMTT payable shall not reduce a group’s GloBE Top-up Tax to zero, thus leaving it exposed to additional tax under either the IIR or UTPR.

**KPMG observation:** Commentators have started to question whether the introduction of a QDMTT may be incompatible with some jurisdiction’s constitutions or investment treaties. This guidance acknowledges that this may be the case, but by preventing a group from accounting for QDMTT payable in its GloBE computation during a period it is challenging a QDMTT disincentivizes groups from bringing such challenges.

## Filing obligations

In the February AG, it was noted that reporting of QDMTT computations would need to be aligned with the data points that are required to compute the GloBE tax liability. However, the July AG confirms that the GloBE Information Return (GIR) does not require QDMTT jurisdictions to use the GIR for QDMTT information collection purposes.

**KPMG observation:** It has been clarified that a jurisdiction could choose to use the GIR but is also permitted to design its own local QDMTT information return that diverges from the GIR, provided that equivalent data points are used.



## 2a. QDMTT Safe Harbor

In the absence of the QDMTT Safe Harbor any tax paid under a QDMTT will be available as a credit against the Top-up Tax liability determined with respect to that jurisdiction under the GloBE Rules, with the balance to be paid to relevant jurisdictions under the IIR or UTPR. This credit mechanism requires at least two separate Top-up Tax calculations in respect of the same jurisdiction, i.e., one for the purposes of applying the QDMTT and another for purposes of the IIR and UTPR.

The IF has agreed to introduce a QDMTT Safe Harbor replacing this credit mechanism with an exemption, to reduce compliance and administrative costs. When the safe harbor applies in a jurisdiction, the Top-up Tax payable under an IIR or UTPR will be deemed to be zero. This means MNE Groups will only need to compute their potential Top-up Tax liability once, under the relevant QDMTT rules. When the QDMTT Safe Harbor applies, the application of the GloBE Rules relies entirely on the QDMTT.

### QDMTT Safe Harbor Eligibility Requirements

To address any potential integrity risks, a QDMTT must meet the following three additional standards to qualify for the QDMTT Safe Harbor:

- 1) the **QDMTT Accounting Standard**, which requires a QDMTT to be computed based on the UPE's Financial Accounting Standard or a Local Financial Accounting Standard subject to certain conditions;
- 2) the **Consistency Standard**, which requires the QDMTT computations to be the same as the computations required under the GloBE Rules except when the relevant Commentary explicitly requires a QDMTT to depart from the GloBE Rules or when the Inclusive Framework decides that an optional variation that departs from the GloBE Rules still meets the standard; and
- 3) the **Administration Standard**, which requires the QDMTT jurisdiction to meet the requirements of an on-going monitoring process similar to the one applicable to jurisdictions implementing the GloBE Rules.

When the QDMTT Safe Harbor applies, GloBE jurisdictions are expected to provide for the exemption mechanism in their domestic legislation to ensure that – at the MNE Group's election, no further calculations are required with respect to a QDMTT Safe Harbor jurisdiction that may have otherwise generated a Top-up Tax charge. Filing CEs will have to make a separate election for each subgroup or standalone CE that is subject to a separate QDMTT calculation (e.g., members of a JV group).

**KPMG observation:** The QDMTT Safe Harbor is a sensible simplification that avoids imposing an entirely unnecessary compliance and administrative burden on taxpayers and tax administrations. The additional requirements imposed create two standards for a QDMTT, one which meets the definition of "Qualified" and another that is eligible for the safe harbor. It will be interesting to monitor whether jurisdictions that have already published (draft) legislation will adjust their domestic Top-up Tax to ensure alignment with the QDMTT Safe Harbor standards.

### The QDMTT Accounting Standard

The GloBE rules generally required a MNE to use the financial accounts used to prepare the Consolidated Financial Statements of the UPE to compute its GloBE Income or Loss. There is an exception to this rule in situations in which a CE maintains its financial accounts using an accounting standard that is different from the UPE's Financial Accounting Standard and it is not reasonably practicable to accurately calculate its Financial Accounting Net Income or Loss (FANIL) in conformity with the UPE's Standard. In such cases, the FANIL may be determined using another Acceptable Financial Accounting Standard (an angel list of approved accounting standards) or Authorized Financial Accounting Standard (adjusted for Material Competitive Distortions). Similarly, a QDMTT will meet the QDMTT Accounting Standard if it is based on the financial accounting standard used for purposes of the Consolidated Financial Statements of the UPE, except when it is not reasonably practicable to use such accounts.

A secondary provision — the Local Financial Accounting Standard Rule, has been designed to address situations in which a jurisdiction has opted for its QDMTT to be based on a Local Financial Accounting Standard. In such cases, the QDMTT Safe Harbor will be available only when:

- a. all the CEs located in that jurisdiction have financial accounts based on that standard and (i) are required to keep or use those accounts under a domestic corporate or tax law; or (ii) such financial accounts are subject to an external financial audit; and
- b. the Local Financial Accounting Standard is an (i) Acceptable Financial Accounting Standard; or (ii) Authorized Financial Accounting Standard (adjusted to prevent Material Competitive Distortions) in the QDMTT jurisdiction.

Under the Local Financial Accounting Standard Rule, when not all CEs located in the jurisdiction prepare financial accounts based on the Local Financial Accounting Standard, the QDMTT will be based on the provisions that are equivalent to the GloBE Model Rules described above.

**KPMG observation:** The intention is to only that the requirements for the QDMTT Safe Harbor will be met when the computation is based on Local Financial Accounting Standards where CEs already prepare audited accounts based on these standards. Based on the wording of the QDMTT Accounting Standard Safe Harbor provision, the full range of jurisdictions that would be able to choose to base their QDMTT on the Local Financial Accounting Standard, while remaining eligible for the safe harbor, is not readily apparent.

**KPMG observation:** It seems likely that MNE Groups will be required to perform QDMTT Top-up Tax calculations in some jurisdictions using:

1. Only the local accounting standard (this would be the case in a jurisdiction with a QDMTT based on a local accounting standard that also satisfies the requirements of the QDMTT Safe Harbor);
2. Local accounting standard and the UPE accounting standard (this would be the case in a jurisdiction with a QDMTT based on the local accounting that does not satisfy the requirements for the QDMTT Safe Harbor); and
3. Only the UPE accounting standard (this would be the case in jurisdictions with no QDMTT and jurisdiction with a QDMTT that chooses to follow the UPE accounting standard).

**KPMG observation:** Where a QDMTT jurisdiction adopts the Local Financial Accounting Standard Rule, it must require the MNE Group to apply the standard consistently which means that it must require the use of the Local Financial Accounting Standard where the conditions are met. The QDMTT legislation must not give the option to MNE Groups to choose which standard to use. This guidance notes that this rule is intended to “addresses the risk of tax planning where an MNE Group can choose which Financial Accounting Standard provides a better outcome under the QDMTT.” It will be interesting to see how jurisdictions, such as the UK, that had introduced a QDMTT that permitted an MNE Group to elect whether to apply the QDMTT based on the accounting standard used to prepare Consolidated Financial Statement or the local accounting standard respond to this requirement.

**KPMG observation:** The local accounts for a jurisdiction/entity may be prepared using a different fiscal year end than the UPE’s consolidated financial accounts. In this case the guidance provides that the QDMTT jurisdiction must require the use of the UPE’s financial accounting standard to ensure consistency between the GloBE Rules and the QDMTT.

## The Consistency Standard

A QDMTT meets the Consistency Standard if the computations under the QDMTT are the same as the computations required under the GloBE Rules, except when the QDMTT Commentary explicitly requires the QDMTT to depart from the GloBE Rules. Examples of mandatory variation include the requirement for the QDMTT not to take into account the allocation of CFC taxes incurred by a Parent Entity with respect to the income of foreign CEs or by the main entity with respect to the profits of its PE and using the local currency in certain cases.

### **Optional variations**

Optional variations will not undermine the Consistency Standard if they align with the outcomes provided for under the Model Rules and Commentary for the IIR and UTPR. The IF has, however, agreed on a list of variations that depart from the Model Rules and Commentary for the IIR and UTPR but that are considered acceptable because they will always produce equivalent or greater outcomes:

- a. No, or a more limited, SBIE;
- b. No, or a more limited, De Minimis Exclusion (currently set at average GloBE revenue of less than EUR 10 million and average GloBE income of less than EUR 1 million or a loss); and
- c. A minimum tax rate above 15% for purposes of computing the Top-up Tax Percentage for the jurisdiction.

Additional acceptable variations that depart from the GloBE Rules may be added to this list in future.

### **Switch-off Rule**

The July AG also clarifies that the Consistency Standard can be met where the QDMTT jurisdictions decides not to apply the QDMTT in certain specific circumstances that are addressed in the July AG (e.g., on Flow-through Entities created in the QDMTT jurisdiction, on Investment Entities etc.). In such scenarios, the jurisdiction will be required to inform the IF of such restrictions during the peer review process (see below) and a Switch-off Rule may be applied.

Under the Switch-off Rule, the MNE Group will be required to apply the credit method for the QDMTT (i.e., the exemption method under the safe harbor is switched off) in relation to either all or a subset of CEs located or created in the QDMTT jurisdiction to which the application of the QDMTT is limited. Importantly, the guidance states the consistency standard is not met if a jurisdiction limits its QDMTT to CEs that are wholly owned by a UPE or POPE that is in-scope of the GloBE rules. The July AG notes that the IF will consider providing further guidance on the scope of the Switch-off Rule.

## The Administration Standard

The Administration Standard requires the QDMTT jurisdiction to meet the requirements provided under the ongoing monitoring process applicable to the GloBE Rules, in order to benefit from the safe harbor. The monitoring process reviews the information collection and reporting requirements to ensure consistency with the GloBE Rules and the GIR.

A QDMTT Safe Harbor jurisdiction may, however, choose not to apply the simplified jurisdictional reporting framework available under the GIR (i.e., requiring CE-by-CE reporting):

- a. when Top-up Tax arises under the QDMTT; or
- b. when the financial information used for the purposes of the QDMTT Safe Harbor is already reported at the CE level and the compliance rules in the jurisdiction require taxable entities to file information returns or tax returns for each entity for local tax purposes.

### *Peer review process for a QDMTT Safe Harbor*

The assessment of whether a QDMTT meets the three additional standards will be done through a peer review process and is a step beyond the review of whether a DMTT is considered a QDMTT, although it can be performed at the same time. There could be cases when a DMTT is considered to be a QDMTT but does not qualify for the Safe Harbor because it does not meet all three additional conditions.

**KPMG observation:** The OECD's intention seems to be to ensure that legislation is aligned with and produces the outcomes that would be expected under the GloBE Rules. This approach should minimize instances when jurisdictions have different interpretations of the rules, therefore reducing the scope for potential disputes. A coordinated solution to dispute resolution has not yet been put forward by the OECD so an approach that preempts a high volume of disputes is important in providing some degree of certainty to taxpayers.

The review will focus on the QDMTT legislation and how it is administered and not on how the rules apply to a particular group. The peer review process is still to be developed and it is envisaged that it will incorporate both a transitional and permanent review process for the QDMTT Safe Harbor.

## Filing obligations

The GIR includes three sections that an MNE Group may be required to complete: (1) MNE Group Information; (2) Jurisdictional Safe Harbors and Exclusions; and (3) GloBE Computations. In jurisdictions where an MNE Group benefits from the QDMTT Safe Harbor it will be required to report this in section 2, but also to complete section 3 of the GIR. This means detailed reporting will be required in all circumstances when the QDMTT Safe Harbor applies.



## 2b. UTPR Safe harbor

The July AG provides an elective Transitional UTPR Safe Harbor that an MNE Group can apply in the jurisdiction where its UPE is located when that jurisdiction's nominal corporate tax rate is at least 20%. Under the safe harbor, an MNE Group's UTPR Top-up Tax Amount is deemed to be zero for Fiscal Years that begin on or before December 31, 2025, and end before December 31, 2026.

### Interaction with the Transitional Country-by-Country Reporting Safe Harbor

In December 2022, the IF released guidance providing for a Transitional Country-by-Country Reporting (CbCR) Safe Harbor available to MNE Groups for Fiscal Years beginning in 2023 through 2026. If an MNE Group does not apply the Transitional CbCR Safe Harbor with respect to a jurisdiction in a Fiscal Year in which the MNE Group is subject to the GloBE Rules, it cannot qualify for this safe harbor for that jurisdiction in a subsequent year. Importantly, while an MNE can choose either the Transitional UTPR Safe Harbor or the Transitional CbCR Safe Harbor for a jurisdiction in a particular year, it cannot apply both. Accordingly, if an MNE Group applies the Transitional UTPR Safe Harbor for the UPE, it ceases to be eligible for the Transitional CbCR Safe Harbor in future years under the "once out, always out" approach.

**KPMG observation:** In practical terms, the Transitional UTPR Safe Harbor is beneficial in circumstances when:

- The UPE jurisdiction profits are subject to a low ETR (as determined for GloBE purposes),
- The MNE Group's UPE is located in a jurisdiction that does not implement a QDMTT, and
- The MNE group has a CE in a jurisdiction that will implement a UTPR effective in 2025 or earlier.

However, because the application of the Transitional UTPR Safe Harbor will cause the UPE to lose eligibility for the Transitional CbCR Safe Harbor, an MNE that is eligible for both safe harbors in the UPE jurisdiction in 2025 would generally be better off electing the Transitional CbCR Safe Harbor.

**KPMG observation:** This safe harbor is particularly relevant for US-based MNEs given the expected absence of a QDMTT in the United States at least in the short term. Following the agreement of this new safe harbor, low-tax U.S. income of a calendar year US-based MNE is now protected from the UTPR for years prior to 2026. The safe harbor does not apply, however, to foreign subsidiaries of US-based MNEs. Furthermore, it does not protect U.S. profits from the IIR in the case of a non-US based MNE or a U.S. CE with a foreign owner.



## 3. Tax Credits

The treatment of tax credits under the GloBE Rules can materially affect the relevant jurisdictional ETR calculation and result in Top-up Tax for an MNE Group. For purposes of the ETR calculation, a tax credit is either an increase to GloBE Income (the denominator) or a reduction to Adjusted Covered Taxes (the numerator). Although both adjustments reduce the jurisdictional ETR, a reduction to Adjusted Covered Taxes has a greater downward impact on the ETR than an increase to GloBE Income.

The July AG further establishes the GloBE treatment of various types of tax credits, including transferable tax credits (such as those included in the Inflation Reduction Act (IRA)).

A transferable tax credit is one that the originator can either use to satisfy its own income tax liability or sell to a third party. Thus, it is economically similar to a refundable credit in that it has a cash value to the originator. Previous OECD guidance had not specifically addressed transferable tax credits.

### Marketable Transferable Tax Credits (MTTCs)

The July AG defines a new category of tax credit, the MTTC, as a tax credit that (i) can be used by the holder of the tax credit to reduce its Adjusted Covered Taxes in the issuing jurisdiction and (ii) meets the legal transferability and marketability standards defined in the July AG in the hands of the holder.

In the hands of an originator, MTTCs are treated (favorably) as an increase to GloBE Income. If the originator uses the credit, it includes the face value of the tax credit in GloBE income. If the originator transfers the MTTC, the originator includes the transfer price (rather than face value) in income. A purchaser of an MTTC includes the difference between the purchase price and the face value of the MTTC in its GloBE income when – and in proportion to the amount of the tax credit – the purchaser uses the credit to satisfy its Covered Tax liability. The treatment provided in the previous sentence applies to the purchaser if and only if the credit is a MTTC with respect to it (i.e., if it is also able to transfer the credit); otherwise, the amount of the discount is treated as a reduction to the purchaser’s Covered Taxes (as discussed below) .

**KPMG observation:** Because the July AG reduces the likelihood that MTTCs will result in low-taxed outcomes for GloBE purposes (helping to maintain their marketability), it is likely to be welcomed by businesses that benefit from these credits. However, it will be important to ensure that transferable tax credits meet the legal transferability and marketability standards required of MTTCs. If a transferable tax credit is not sufficiently marketable, it may be treated as a reduction to Covered Taxes.

**KPMG observation:** The transferable tax credits included in the IRA are expected to be considered MTTCs in the hands of the originator. The same tax credits in the hands of the purchaser, however, are not MTTCs because the purchaser of an IRA transferable tax credit cannot itself transfer the credit. Instead, IRA credits in the hands of the purchaser will be treated as Non-MTTCs, and the discount will be treated as a reduction to the purchaser’s Covered Taxes.

For example, if 100 of IRA transferable credits are transferred for 90, the originator will have a 90 increase to its GloBE Income and the purchaser will have a 10 decrease to its Covered Taxes.

As this example shows, IRA transferable tax credits will still decrease the Pillar Two ETR of both the originator and the purchaser. Nonetheless, the guidance is considered favorable for market participants because the originator benefits from above-the-line treatment and the purchaser is only required to recognize the discount (rather than the entire face value of the credit) as a reduction to its Covered Taxes.

## Qualified Flow Through Tax Benefits (QFTBs)

The July AG also revises the rules applicable to QFTBs that may apply to a MNE Group that obtains a tax credit through a tax transparent equity method investment and makes an Equity Investment Inclusion Election (EIIE). These rules were initially included in the February AG to mitigate the negative impact of a tax equity credit to the entity’s Covered Taxes to the extent it would not otherwise recover its investment in a Qualified Ownership Interest (QOI). Once the entity has recovered its investment, non-refundable tax equity credits may reduce its Covered Taxes as they are utilized.

The July AG provides alternative timing rules for when QFTBs reduce Covered Taxes for GloBE purposes. These new timing rules may be mandatory or elective (depending on the accounting standard used to account for these credits) and may favorably affect the MNE Group’s relevant ETR calculation because any reduction to Covered Taxes for the credits under these rules would be spread over a number of years, rather than back-loaded.

Additionally, the July AG also expands the availability for beneficial treatment of QFTBs when the holder’s interest in a tax equity structure is accounted for under IFRS as a loan.

## Categories of tax credits under the GloBE Rules

The table below provides a high-level summary of the treatment of the various categories of credits for GloBE purposes as of the July AG. When a transferable tax credit qualifies as a QRTC (as defined below), the GloBE treatment for a QRTC applies regardless of whether the credit additionally qualifies as a MTTC. For an originator of an IRA credit, such credit may qualify as QRTC and MTTC during the direct pay period, in which case the GloBE treatment for a QRTC applies during this period.

	Type of tax credit	Definition	GloBE treatment	Key changes in July AG
1.	<b>Qualified Refundable Tax Credit (QRTC)</b>	Refundable tax credit that must be paid as cash or made available as cash equivalent within four years	Increase to GloBE Income	Timing for recognition when accounted for over the productive life of an asset
2.	<b>Non-qualified refundable tax credit (Non-QRTC)</b>	Refundable tax credit (in whole or in part) that is not a QRTC	Reduction to Covered Taxes	Timing (see above)



	Type of tax credit	Definition	GloBE treatment	Key changes in July AG
3.	<b>Marketable Transferable Tax Credit (MTTC)</b>	Tax credit that can be used by the holder of the credit to reduce its liability for a Covered Tax and meets the “legal transferability standard” and “marketability standard”	In the hands of the originator (i.e., the developer of the project that originates the tax credits), an increase to GloBE Income.  In the hands of the purchaser, the difference between the purchase price and the face value is an increase to GloBE Income so long as the credit remains a MTTC in its hands.	New typology and guidance
4.	<b>Non-Marketable Transferable Tax Credit (Non-MTTC)</b>	Tax credit that, if held by the originator, is transferable but is not a MTTC, and if held by a purchaser, is not a MTTC (e.g., because not transferable by it).	The originator reduces its Covered Taxes to the extent the tax credit is used to satisfy its liability for a Covered Tax and to the extent of any amount received in exchange for the credit.  A purchaser shall reduce its Covered Taxes by any excess of the face value of the tax credit over its purchase price (i.e., the discount).	New typology and guidance
5.	<b>Other Tax Credits</b>	Non-refundable and non-transferable credits that can only be used to offset a Covered Tax liability of the originator	Reduction to Covered Taxes	Clarification that other tax credits are treated as a reduction to Covered Taxes irrespective of how they are accounted for.



## 4. Foreign Currency Conversion Rules

The July AG notes that coordinated currency translation rules are required to ensure consistent application of the GloBE Rules across implementing jurisdictions. The guidance focuses on four key questions outlined in the table below.

	Question	Approach specified in the July AG
1.	<i>In which currency should the GloBE calculations be made, including for disclosure purposes in the GloBE Information Return?</i>	The July AG confirms that MNE Groups will be required to undertake all the relevant calculations for the GloBE Rules for each jurisdiction and report the relevant amounts in the GIR in the presentation currency of the MNE Group’s Consolidated Financial Statements. This is regardless of the local currency of the relevant jurisdiction. However, the July AG does require that local currency be used for a QDMTT when certain conditions are met.

	Question	Approach specified in the July AG
2.	<i>When amounts relevant to the GloBE calculations are not already translated into the presentation currency or purposes of preparing Consolidated Financial Statements, how should these amounts be translated?</i>	This could occur because those amounts do not exist in presentation currency or because the amounts are translated at the aggregate level for GloBE computation purposes post accounting consolidation (i.e., not at the CE level). In such cases, the July AG confirms that these amounts will need to be translated to the presentation currency, specifically for GloBE computation purposes, in accordance with the relevant currency translation principles of the Authorized Financial Accounting Standard used to prepare its Consolidated Financial Statements (for example, IAS 21 under IFRS or ASC 830 under U.S. GAAP). However, MNE Groups may use approximations such as the average rates for the relevant period for practical reasons.
3.	<i>What currency translation rules should apply for the purposes of translating any Top-Up Tax under the IIR or the UTPR Top-Up Tax Amount determined using the presentation currency into the currency in which the GloBE tax liability is payable?</i>	Although Top-Up Tax amounts allocable (or equivalent adjustment) to a CE in accordance with the GloBE Rules are determined using the MNE Group's presentation currency, implementing jurisdictions can then apply their own foreign currency translation rules to convert the Top-Up Tax liability into local currency for purposes of assessment and/or payment, as long as the exchange rate is reasonable and relevant to the Fiscal Year or payment date. Examples of what may be considered a reasonable foreign exchange translation basis include the average foreign exchange rate for the Fiscal Year, the foreign exchange rate on the last day of the Fiscal Year, or the foreign exchange rate on the date payment is required.
4.	<i>What currency translation rules apply for the purposes of determining whether a monetary threshold has been met when the monetary threshold is expressed in a currency different from the presentation currency?</i>	Under the existing Commentary, as amended by the February AG, when the thresholds in the GloBE Rules are expressed in domestic legislation in a non-EUR currency, such as the revenue threshold for determining which MNE Groups are subject to the GloBE rules, the amounts will need to be rebased annually. Under the July AG, for purposes of determining whether the relevant threshold has been met, the MNE Group will be required to translate the relevant amount from its presentation currency to the currency in which the relevant threshold is expressed in domestic law, based on the average foreign exchange rate for the December month of the previous Fiscal Year. The rebasing rules introduced in the July AG apply to both current and future Euro-denominated thresholds incorporated in the Commentary of the GloBE Rules by Administrative Guidance.

A series of examples in the July AG, which will be included in the GloBE Model Rules Examples, seek to show the operation of the foreign currency conversion rules.

The July AG also makes clear that the adjustment to GloBE Income for Asymmetric Foreign Currency Gains or Losses is determined with reference to the accounting and tax functional currencies of the CE. However, the resulting amount of the required adjustment will need to be translated to the presentation currency of the MNE Group's Consolidated Financial Statements for purposes of determining the CE's GloBE Income or Loss in accordance with Article 3.1.2., Article 3.1.3., and the relevant commentary.

**KPMG observation:** Confirmation that the Consolidated Financial Statement presentation currency should be used to prepare the GloBE calculations provides more certainty for MNE Groups as they assess the availability of data required for the GloBE ETR calculations and plan for future changes in their systems, as needed. The IF has taken a pragmatic approach by allowing some flexibility in the rates used for currency translations when amounts relevant to the GloBE ETR calculations are not already in the presentation currency of the MNE Group's Consolidated Financial Statements.



## 5. Substance-based Income Exclusion

The July AG on the SBIE deals with issues related to location, simplification, stock-based compensation, deductible dividend regimes, leases, and impairment.

### Location

The SBIE is generally the sum of 5% of the extended payroll of the Eligible Employees that perform activities in the jurisdiction of a CE and 5% of the carrying value of the Eligible Tangible Assets located in the jurisdiction. However, a transition rule gradually reduces these percentages (from 10% to 5.8% for Eligible Payroll Costs and from 8% to 5.4% for Eligible Tangible Assets) from 2023 through 2032.

There are often circumstances when employees or in-scope contractors work outside the jurisdiction of their employer. For example, they may work from home in another jurisdiction, see customers or suppliers outside the jurisdiction, be engaged in the international transportation or similar business, or work in international waters.

Similarly, Eligible Tangible Assets owned by a CE may be located outside the CE's jurisdiction because, for example, they are used in international transportation or used in multiple jurisdictions such as in the case of a submarine cables or farming equipment.

The July AG modifies the SBIE rules to address these concerns. For Eligible Payroll costs, if an Eligible Employee spends more than 50% of their time in the jurisdiction of their CE employer, the full amount of their eligible costs are allocated to that jurisdiction. If an Eligible Employee spends less than 50% of their time in the jurisdiction of their CE employer, then the portion their payroll corresponding to their time in the jurisdiction will be available for the payroll carve-out.

Similarly for tangible assets, if a tangible asset is located in the jurisdiction of the CE owner more than 50% of the time, all of the carrying value of the tangible asset is available for the carve-out. If less than 50% of the time, then the portion of the carrying value corresponding to its location in the jurisdiction may be used.

**KPMG observation:** The above rules may not produce appropriate answers for the shipping and airline industries, given the amount of time “in port” for ships or “on the ground” for aircraft. A specified allocation mechanism in respect of these industry specific issues may be outlined in future guidance.

### Simplification

While a CE may make an election not to apply the SBIE, prior to the July AG, there was a question of whether a CE that wishes to apply the SBIE could choose to perform the calculation with respect to only a portion of the Eligible Payroll Costs or Eligible Tangible Assets. The July AG clarifies that an MNE Group could elect to calculate its SBIE by reference to only a proportion of its Eligible Employees or Eligible Tangible Assets.

**KPMG observation:** The July AG provides the reasonable position that MNEs are not required to calculate the maximum allowable exclusion in order to make a claim under the SBIE. Thus, an MNE may choose not to include costs or assets if the compliance costs of doing so exceed the likely benefit.

### Stock-based compensation

For purposes of determining GloBE income, the GloBE rules generally provide that deductions for stock-based compensation are the amounts expressed as costs in the relevant financial accounts, but that CEs may elect to substitute the amount allowed as a local tax deduction instead. The July AG clarifies that for the purpose of the SBIE, MNEs are required to use the amounts contained in the financial accounts regardless of whether a CE makes an election to use the local tax deduction amount for purposes of determining GloBE income.

### Deductible Dividend Regimes

When a UPE is subject to a Deductible Dividend Regime and distributes a Deductible Dividend, the amount of its GloBE income is reduced by the amount of the Deductible Dividend. The July AG clarifies that a proportionate amount of Eligible Payroll Costs and Eligible Tangible Assets is also reduced to ensure that these costs are not disproportionately large compared with GloBE Income. This treatment mirrors the rule that similarly adjusts Eligible Payroll Costs and Eligible Tangible Assets when the UPE is a Flow-Through Entity and the GloBE income of the UPE is reduced by the amount of income attributable to each Ownership Interest that meets certain criteria.

## Leases

The Model Rules provide that Eligible Tangible Assets include a lessee's right-of-use of tangible assets located in that jurisdiction. They also state that "the tangible asset carveout computation does not include the carrying value of property (including land or buildings) that is held for sale, lease or investment."

The Commentary states that in a lease agreement a lessee recognizes a "right-of-use" asset on its balance sheet and will be treated as the owner of the tangible asset for the purposes of the SBIE.

The July AG provides that this Commentary is withdrawn and replaced by a more nuanced set of rules that expands on the treatment of finance leases and operating leases. They are as follows:

- In the case of a short-term rental asset, being 30 days or less, a lessee's right of use shall be deemed to be zero.
- In the case of a finance lease, the lessor is treated, in effect, as transferring the underlying assets and no longer has the carrying value of tangible assets in its financial accounts and hence will not be able to include an amount in the SBIE. The lessee will, however, be permitted to include the carrying value of its right-of-use asset in its SBIE.
- In the case of an operating lease, it is possible that the lessee and lessor will have a right-of-use amount on each of their balance sheets. Under the new guidance, the lessor will be able to claim an amount equal to the excess of the lessor's average carrying value over the average of the lessee's carrying value. Thus, both the lessor and the lessee are able to claim carrying values in respect of a tangible asset without there being duplication.
- When the lessor and lessee are CEs in the same jurisdiction, this calculation is undertaken after eliminating entries in consolidation.
- Also, when the lessor leases a substantial part of an Eligible Tangible Asset to a lessee, but retains a residual part for its own use (i.e., a "dual use asset"), the carrying value must be allocated between the two components based on a reasonable allocation key and the lessor may apply the new guidance for operating leases to the carrying value allocated to the leased part.

**KPMG observation:** The position adopted for operating leases is a sensible change from the previous position given it is consistent with both the accounting standards and the economics of the leasing arrangements.

MNEs should review their lease arrangements when the SBIE is likely to have an impact on any GloBE liabilities.

## Impairment losses

For the purposes of determining the carrying value of Eligible Tangible Assets required for the SBIE, both impairment losses and the reversal of impairment losses will be included. However, an impairment charge may only be reversed to the extent that it does not cause the total carrying value to exceed the amount of the carrying value determined without the recognition of any impairment loss.

## Contributors

### Danielle Rolfes

E: [drolfes@kpmg.com](mailto:drolfes@kpmg.com)

### Kevin Brogan

E: [kevinbrogan@kpmg.com](mailto:kevinbrogan@kpmg.com)

### Marcus Heyland

E: [mheyland@kpmg.com](mailto:mheyland@kpmg.com)

### Quyen Huynh

E: [qhuynh1@kpmg.com](mailto:qhuynh1@kpmg.com)

### Alistair Pepper

E: [alistairpepper@kpmg.com](mailto:alistairpepper@kpmg.com)

### Marissa Rensen

E: [mrensen@kpmg.com](mailto:mrensen@kpmg.com)

### Seevun Koza

E: [skozar@kpmg.com](mailto:skozar@kpmg.com)

### Daren Gottlieb

E: [darengottlieb@kpmg.com](mailto:darengottlieb@kpmg.com)

### Natalia Benedetti

E: [nbenedetti@kpmg.com](mailto:nbenedetti@kpmg.com)

### Samira Varanasi

E: [samiravaranasi@kpmg.com](mailto:samiravaranasi@kpmg.com)

### Monica Zubler

E: [mzubler@kpmg.com](mailto:mzubler@kpmg.com)

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

[kpmg.com/socialmedia](https://kpmg.com/socialmedia)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

KPMG refers to the global organization or to one or more of the member firms of KPMG International Limited ("KPMG International"), each of which is a separate legal entity. KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. For more detail about our structure please visit [kpmg.com/governance](https://kpmg.com/governance).

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.