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), June 2024

Inclusive Framework on BEPS

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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 GloBE Rules 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 Model Rules were approved and released by the Inclusive Framework on 20 December 2021 *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (OECD, 2021[1]). The GloBE Model 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[2]) and the *Model Tax Convention on Income and on Capital: Condensed Version 2017*, (the "OECD Model Tax Convention") (OECD, 2017[3]).

3. The Commentary to the GloBE Model Rules was first approved and released by the Inclusive Framework on 14 March 2022 *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* (OECD, 2022[4]) 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 among implementing jurisdictions. Although the Commentary is detailed and comprehensive, it does not provide guidance on every aspect of the GloBE Model Rules.

4. The Model GloBE Rules envision that the Inclusive Framework may issue guidance on both the interpretation and the operation of the rules. The Inclusive Framework has provided interpretive guidance to ensure consistent and common interpretation of the GloBE Rules, provide certainty for MNE Groups and facilitate coordinated and transparent outcomes under the rules. Once agreed, the Administrative Guidance is incorporated into the Commentary as it supplements or replaces paragraphs in the Commentary or explains how to apply the language of the rules to particular fact patterns. The text of the Commentary has been updated in 2024 to incorporate the various pieces of Administrative Guidance that were approved by the Inclusive Framework before the end of December 2023 *Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023): Inclusive Framework on BEPS* (OECD, 2024[5]).

June 2024 Administrative Guidance

5. This document sets out the fourth set of Administrative Guidance released by the Inclusive Framework. This package includes guidance on application of the recapture rule applicable to deferred tax liabilities (DTL), including how to aggregate DTL categories and methodologies for determining whether a DTL reversed within five years. This guidance also clarifies how to determine deferred tax assets and liabilities for GloBE purposes when the rules result in divergences between GloBE and accounting carrying value of assets and liabilities. This package also includes further guidance on cross-border allocation of current and deferred taxes, allocation of profits and taxes in certain structures involving Flow-through Entities, and the treatment of securitisation vehicles. This Administrative Guidance will be incorporated into the Commentary.

1. DTL recapture

1.1. Introduction

1. Article 4.4.4 stipulates that the accrual of a Deferred Tax Liability (DTL) that is claimed in the Adjusted Covered Taxes for the relevant Fiscal Year shall be subject to recapture if it does not reverse within the subsequent five Fiscal Years (the DTL recapture rule). The policy objective of the rule is to protect the integrity of the GloBE Rules from situations where the Adjusted Covered Taxes of a Constituent Entity are increased based on accrual of DTLs that have a long-term or even indefinite reversal horizon. The DTL recapture rule does not apply to DTLs that qualify as Recapture Exception Accruals (REAs) pursuant to Article 4.4.5. Nor does it apply to an Unclaimed Accrual under Article 4.4.7.

2. In practice, DTL recapture means that the Adjusted Covered Taxes and the ETR for the Fiscal Year in which the DTL was accrued and claimed are re-computed without such DTL. If the re-computed ETR is below the Minimum Rate, an Additional Top-up Tax is computed for that Fiscal Year. In the Fiscal Year that a recaptured DTL reverses, Article 4.4.2(b) excludes the reversal of the Recaptured DTL from the computation of the Adjusted Covered Taxes in the Fiscal Year, which effectively increases the Adjusted Covered Taxes by the amount of the recaptured DTL.

3. Paragraph 89 of the Commentary to Article 4.4.4 provides that the DTL recapture rule applies to ‘categories’ of deferred tax liabilities. Compliance with the DTL recapture rule requires each Constituent Entity to (i) identify categories of DTLs that are in scope of the DTL recapture rule and (ii) determine the year in which, and the extent to which, each identified DTL accrual reverses. The main objective of this guidance is to provide clarifications on how to practically manage the DTL recapture rule in a way that is in line with the policy objective of the rule itself, as well as minimizing administrative and compliance burdens for tax administrations and MNE Groups, including by giving due regard to the MNE Group’s existing accounting processes for DTLs.

4. This note provides guidance on the criteria for determining the scope of a DTL category and methodologies for determining whether the DTL accruals in the category have reversed within five Fiscal Years. The guidance also prescribes methodologies of determining whether DTLs reversals are attributable to recaptured DTLs or pre-GloBE DTLs (i.e. DTLs that arose before the Transition Year).

5. This note also provides a simplification through an extended application of the Unclaimed Accrual election rule in Article 4.4.7. Specifically, the guidance provides that a Constituent Entity may make an Unclaimed Accrual Five-Year election for a DTL category that it does not expect to prove reversed within five Fiscal Years. The result will be that the Constituent Entity will not claim those DTL accruals in determining its Adjusted Covered Taxes and therefore will not need to determine when the DTLs reverse.

1.2. Issues to be considered

6. In general, a deferred tax asset or liability is the tax effect computed by reference to the difference between the accounting carrying value and the tax carrying value of an asset or liability, provided that such difference has a timing nature (i.e. it reverses at some point in the future). In some cases, financial

accounting standards apply or permit deferred tax accounting based on accounting-tax timing differences of income and expenses or on another basis. This guidance is drafted based on the balance sheet model that is most commonly used by MNE Groups. However, the principles of this guidance are applicable to other models of deferred tax accounting.

7. Although accounting standards focus on the different carrying values of assets and liabilities, MNE Groups do not typically measure DTLs and DTAs for each asset or liability. The tax carrying values of the Constituent Entity's assets and liabilities are not always organized and tracked in accounts that align with each of the General Ledger accounts (GL accounts) of the chart of accounts used for Consolidated Financial Statements. For example, the Constituent Entity may have a tax account used to prepare its tax balance sheet for a broader group of assets than is included in a single GL account. The reporting package process requires that the deferred tax measurement is performed in a way that harmonizes the tax balance sheet accounts with the chart of accounts used for Consolidated Financial Statements, however this harmonization generally occurs at higher levels of aggregation than the GL accounts (i.e. at Balance Sheet account or sub-Balance Sheet account level). For example, the tax accounts may correspond to a combination of two or more GL accounts. However, the tax accounts will not span two of the accounts that are separately reported in the balance sheet of the Consolidated Financial Statements. Where the aggregations between GL accounts and tax accounts align is generally the level at which the deferred tax assets and liabilities are measured for the purposes of the reporting package. The comparison of carrying values is reflected in the reporting package or in the workpapers used in preparation of the reporting package. The Constituent Entity may not have a GL account to record the results of each of these comparisons. The Consolidated Financial Statements aggregate all DTAs and DTLs determined for the Constituent Entities and report only the net balance as a deferred tax asset or deferred tax liability.

8. Each Constituent Entity computes its Adjusted Covered Taxes and GloBE Income or Loss based on the financial accounts used for the preparation of the Consolidated Financial Statements, where available. The GloBE Rules start with the financial accounts used to prepare Consolidated Financial Statements to mitigate compliance costs and to benefit from the independent review of an external auditor as noted in paragraph 7 of the Commentary to Article 3.1.2. Consequently, GloBE compliance processes are expected to be linked to and to rely on the accounting processes already established by the MNE Groups for the purposes of the preparation of the Consolidated Financial Statements, i.e. the reporting package process. Thus, to minimize compliance costs, this guidance provides MNE Groups the ability, in certain cases, to align DTL categories to the GL accounts or BS accounts that are referenced in computing DTLs for financial accounting purposes.

9. In some instances, however, the GloBE Rules deviate from financial accounting requirements. Tracking DTLs to determine the time frame in which they reverse is not required for accounting purposes but is necessary under the GloBE Rules. This naturally means that MNE Groups will need to develop processes and mechanisms in addition to their existing accounting processes to determine whether DTLs reverse within five years.

10. The purpose of the DTL recapture rule is to ensure that the ETR is not overstated by giving credit for DTLs that will not actually reverse within five years. The GloBE Rules concerning the inclusion of DTL accruals in the Adjusted Covered Taxes distinguish between DTLs that fully reverse within five Fiscal Years (Short-term DTLs) and DTLs that do not fully reverse within five Fiscal Years (Long-term DTLs). Reporting packages that aggregate Short-term and Long-term DTLs present a challenge in complying with the purpose of the DTL recapture rule. In these circumstances, a reliable methodology for determining the extent to which different DTLs have reversed is necessary where a DTL category includes an aggregation of Short-term and Long-term DTLs. Otherwise, the Short-term and Long-term DTLs would need to be separated.

11. GL accounts are the primary tool to track and manage the financial information of a business. GL accounts are organized according to the structure defined in the chart of accounts, which is the list of all

the accounts a business uses to record its financial transactions. Businesses tailor the chart of accounts and GL accounts based on a combination of factors, such as industry-specific standards or regulations, reporting requirements, organizational structure, their size and complexity and tax compliance. The ending balance of each GL account includes any opening amounts and all the transactions registered in that account during the relevant financial year. The ending balances of all the GL accounts constitute the trial balance for the relevant financial year and is the starting point for the preparation of the financial statements.

12. There may be cases in which a single GL account reflects multiple assets and some of the assets have different timing rules for tax purposes. For example, a Constituent Entity may account for two assets that have a ten-year depreciation period for accounting purposes using the same GL account. However, one has a five-year depreciation period for tax purposes and the other is immediately deductible for tax purposes. In such cases, the Constituent Entity is not required to separate the assets in the GL account into separate sub-GL accounts solely for purposes of the DTL recapture rule.

13. As explained above, for reporting package purposes many MNE Groups track DTLs in relation to an aggregation of assets or liabilities in GL accounts that are encompassed by the same Balance Sheet account. The MNE generally measure the DTLs based on an aggregation of all GL accounts under the Balance Sheet account (a BS account) or different subsets of GL accounts under the BS account (a sub-BS account). It is very rare that DTL measurement for reporting package is based on single GL accounts. However, MNE Groups do not aggregate GL accounts from different BS accounts for purposes of measuring DTLs. DTLs measured and tracked by reference to an aggregate of GL accounts are referred to as Aggregate DTL Categories in this guidance.

14. There are three risks that arise from aggregation of DTLs related to assets and liabilities in different GL accounts. The first risk is that some of the GL accounts in the Aggregate DTL Category may have a DTA balance on a stand-alone basis such that the DTL for category is essentially a net of DTLs over the DTAs in the category. Consequently, the amount of the DTL offset by the DTA would not be subject to the recapture rule. The second risk is the risk that the DTL category will include a mix of DTLs that fully reverse within five Fiscal Years (Short-Term DTLs) and DTLs that do not fully reverse within five Fiscal Years (Long-term DTLs) and that such a mix could undermine the effective recapture of Long-term DTLs. The third risk is that a DTL arising from a related party transaction can be engineered to remain outstanding indefinitely.

15. One way to mitigate these risks and ensure that the recapture rule applies to DTLs that do not reverse within five years is to disaggregate the DTLs into more narrow categories. Indeed, if each DTA and DTL were tracked separately, none of the risks would arise. However, separate tracking of all DTAs and DTLs is not practical for MNE Groups. Nor is it necessary in all cases. Instead, aggregation can be limited to DTLs that have similar reversal timelines. Aggregation of Short-term DTLs does not present an integrity risk because all of the DTLs reverse within a five-year period. Exclusion of Long-term DTLs from Aggregate DTL Categories that include Short-term DTLs will ensure that reversals of Short-term DTLs do not cause an appearance that the Long-term DTLs are reversing in full within five years. Further, exclusion of DTAs from categories that include Long-term DTLs will ensure that those DTLs do not avoid recapture due to netting within the category. Finally, requiring separate tracking of DTLs associated with related party transactions ensures that those DTLs will be recaptured to the extent they are not reversed within five years.

16. Another way of mitigating the risks is in the methodology used to determine whether DTLs in the category have reversed within five years (the recapture methodology). Tracking the DTLs in a category item-by-item will ensure that Long-term DTLs are appropriately recaptured, but as noted above this is only practical in limited circumstances. Therefore, the recapture methodologies make assumptions as to which DTLs in the Aggregate DTL category have reversed when a reversal occurs. For example, a recapture methodology may assume that reversals or net reversals for a given year relate to the oldest outstanding

DTLs in the category, i.e. a FIFO recapture methodology. The FIFO approach effectively assumes that the DTLs outstanding at year end relate to the most recently accrued DTLs, whether Long-term or Short-term DTLs. Alternatively, a recapture methodology could include an assumption that reversals relate to the most recently accrued DTLs in the category, i.e. a LIFO recapture methodology. The LIFO approach effectively assumes that the DTLs outstanding at year end relate to Long-term DTLs and not Short-term DTLs. Depending on the DTLs in the category, either of these recapture methodologies may appropriately recapture the DTLs in the Aggregate DTL category to the extent that they have not reversed within five years. On the other hand, because they are based on assumptions about the outstanding DTLs at year end, both may result in recapture of Short-term DTLs in some circumstances.

1.2.1. Principles for aggregating DTLs under GloBE Rules

17. For purposes of the DTL recapture rule, a Constituent Entity may track DTLs on an Aggregate DTL Category basis, rather than an item-by-item tracking or based on a single GL account. An Aggregate DTL Category means a category of DTLs determined in relation to two or more GL accounts that, consistent with the chart of accounts used for the purposes of Article 3.1.2 or 3.1.3, fall under the same balance sheet account or sub-balance sheet account. An Aggregate DTL Category is not required to include all of the GL accounts that fall under the same balance sheet account. A Constituent Entity may have more than one Aggregate DTL Category that falls under the same balance sheet account.

18. An Aggregate DTL Category may include Short-term DTLs and Long-term DTLs. A Short-term DTL is an individual DTL that fully reverses within five Fiscal Years or a DTL that is determined in relation to a GL account and that fully reverses within five Fiscal Years. A Long-term DTL is an individual DTL that does not fully reverse within five Fiscal Years or a DTL that is determined in relation to a GL account and that does not fully reverse within five Fiscal Years.

19. Where a Constituent Entity cannot demonstrate that an Aggregate DTL Category satisfies the aggregate tracking requirements or the conditions for the simplification for Short-term DTLs (as set out in below paragraphs), the Constituent Entity cannot claim the accrual of that DTL in the computation of its Adjusted Covered Taxes. Where a Constituent Entity fulfils the aggregate tracking requirements but cannot demonstrate that the Aggregate DTL Category satisfies the FIFO requirements (as defined in below paragraphs), the Constituent Entity must apply LIFO recapture methodology.

Exclusion of certain types of GL accounts and separate tracking

20. Considering the risks of Aggregate DTL Categories, the Inclusive Framework has determined that DTLs related to certain assets and liabilities may be aggregated up to the GL account and cannot be aggregated with other GL accounts. DTLs related to the following assets or liabilities that might be claimed in the computation of Adjusted Covered Taxes may be aggregated for purposes of the DTL recapture rule only up to the GL account level:

- Non-amortizable intangible assets, including goodwill;
- Amortizable intangible assets with an accounting life of more than five years; and
- Related party receivables and payables.

Exclusion of GL accounts that generate DTAs

21. The inclusion of a GL account that on a standalone basis generates a DTA in an Aggregate DTL Category would have the distortive effect of diminishing the DTLs subject to recapture because the DTA accrual would have the same effect as a DTL reversal and therefore it would appear that part of the DTL has reversed when it has not. An Aggregate DTL Category cannot include any GL account that on a standalone basis would always generate only DTA. A Constituent Entity will need to be able to demonstrate

that the accounting and tax timing differences in respect of the assets and liabilities in the GL accounts encompassed by the Aggregate DTL Category can only generate a DTL.

Exclusion of swinging accounts and separate tracking

22. A swinging account is a GL account for which variances in the accounting and tax timing rules result in a net DTA or a net DTL at different points over the life of the encompassed assets or liabilities. Including a swinging account in an Aggregate DTL Category can create the same distortion as including a GL account with a DTA nature in the Aggregate DTL Category. Moreover, an aggregation of swinging accounts causes the same issue to arise because when a GL account swings to a DTA balance the Aggregate DTL Category will appear to have a reversal of a DTL. Considering the risks of Aggregate DTL Categories, the Inclusive Framework has determined that swinging accounts cannot be aggregated with other GL accounts. DTLs related to swinging accounts that are claimed in the computation of Adjusted Covered Taxes must be tracked separately for purposes of the DTL recapture rule at the level of a single GL account.

Exclusion of DTL related to items excluded from GloBE Income or Loss

23. Movements in DTLs that are related to items that do not factor into the computation of the GloBE Income or Loss are excluded from the computation of the Total Deferred Tax Adjustment Amount. Only DTLs which are claimed in the Total Deferred Tax Adjustment Amount are subject to the DTL Recapture rule. A DTL related to excluded items shall not be included in a GL account or Aggregate DTL Category.

24. For example, a DTL related to items which are accounted in Other Comprehensive Income should be excluded from the scope of the DTL recapture rule, unless Article 4.1.1(c) applies. If items accounted in Other Comprehensive Income are recycled through profit and loss, DTLs related to those items are included accordingly in the computation of the Total Deferred Tax Adjustment Amount and those DTLs are subject to the DTL recapture rule.

Exclusion of Recapture Exception Accruals

25. The DTL recapture rule does not apply to a DTL that meets the definition of a Recapture Exception Accrual in Article 4.4.5. However, if a Constituent Entity has a GL account or Aggregate DTL Category that includes one or more DTLs that is a Recapture Exception Accrual, the DTL recapture rule will apply with respect to the GL account or the entire Aggregate DTL Category.

1.2.2. Mechanisms to recapture Long-term DTLs in an Aggregate DTL Category

General principles

26. The DTL recapture rule is intended to recapture the benefit of including a DTL accrual in the ETR computation if that DTL does not reverse within five Fiscal Years. Determining when a particular DTL reverses presents some challenges because Constituent Entities typically do not create a separate DTL for each transaction and then reverse that DTL when the relevant carrying value and tax basis come back into line. Instead, Constituent Entities typically compare the difference between the year-end carrying value and tax basis of assets and liabilities reflected in a GL account or a group of GL accounts to determine the DTL in respect of those assets or liabilities. The deferred tax expense attributable to a DTL reported in the income statement is based on the net movement in the balance of the DTL from the end of the previous year. For DTL recapture purposes, where DTL tracking is performed on an aggregate basis, the net increase in the balance of the GL account or Aggregate DTL Category is treated as a DTL accrual and the net decrease is treated as a DTL reversal.

27. The DTL balance related to a GL account or to an Aggregate DTL Category may remain constant even where assets and liabilities are recorded and reversed for accounting and tax purposes if other assets and liabilities are also recorded in the relevant GL account(s). To illustrate, assume CE1 acquires an asset on the last day of Year 1 and the cost of acquiring the asset is fully deductible for tax purposes in the year of the acquisition (Year 1) and amortized over two years starting from when it is first used for accounting purposes (Year 2). If CE1 acquires the asset for 100 and has a 15% tax rate, it will record a DTL of 15 at the end of Year 1. The DTL related to the asset at the end of Year 2 will be 7.5. However, if another similar asset is purchased for 100 in Year 2 and starts to be amortized in Year 2, the net balance of the DTL in Year 2 will remain at 15.

28. In the example, it appears that part of the DTL from Year 1 reversed in Year 2 and the DTL reflected in the ending balance was a new accrual. However, MNE Groups may not commonly make accounting entries that reflect whether the DTLs at any given point in time are in relation to pre-existing or newly acquired assets or liabilities. Their financial accounts only indicate whether, in the aggregate, there is an accrual of a DTL (i.e. a net increase in the DTL balance) or reversal of part or all of the DTL (i.e. a net decrease in the DTL balance).

29. Because MNE Groups generally do not trace the balance of a DTL to particular assets or liabilities reflected in the corresponding GL account or Aggregate DTL category, a methodology with certain assumptions is needed to determine whether a reversal (i.e. a decrease in the ending balance) relates to amounts that accrued in the preceding five Fiscal Years or to amounts that were previously subject to recapture under Article 4.4.4. One approach would be to assume that reversals relate to the oldest accruals. This would be a first-in, first-out or FIFO methodology. Another approach would be to assume that reversals relate to the most recent accruals. This would be a last-in, first-out or LIFO methodology.

30. These different methodologies produce different outcomes in terms of the amount of DTLs recaptured and the Fiscal Years in which the recapture occurs. They will further result in the corresponding recapture reversal (pursuant to Article 4.4.2(b)) occurring in different Fiscal Years. However, it is not possible to determine in absolute terms whether a particular methodology is more or less favourable for the taxpayer (in terms of amount overall subject to recapture) in all cases, because it depends on the actual trend of DTL increases and decreases in the year-end balances of a given GL account or Aggregate DTL category.

31. Nevertheless, in the case of Aggregate DTL Categories, the FIFO methodology could shield an un-reversed DTL accrual from recapture in some circumstances. The risk arises where the Aggregate DTL Category contains GL accounts that have both Short-term DTLs and Long-term DTLs. In such cases, the accruals and reversals in the Short-term DTLs can make it appear on a FIFO basis that all of the DTLs have reversed within five years when in fact, the Long-term DTLs remain outstanding for more than five years.

32. The LIFO methodology is a more conservative approach because it mitigates the risk that the Long-term DTLs encompassed by an Aggregate DTL Category would not be recaptured after five years or that the relevant recapture would be postponed indefinitely.

33. A Constituent Entity may use the FIFO methodology to determine DTL reversals in the following cases:

a. The DTL is determined in relation to a single GL account;

b. The DTL is determined in relation to an Aggregate DTL Category that consists solely of DTLs determined in relation to GL accounts with a similar reversal trend; or

c. The DTLs are aggregated within an Aggregate DTL Category without a similar reversal trend but where MNE can demonstrate that the FIFO methodology nevertheless results in appropriate recapture of DTLs to the extent their reversal trend extends beyond 5 years.

For any Aggregate DTL Category for which the Constituent Entity does not choose to use the FIFO methodology or for which it cannot demonstrate that the conditions above are satisfied, the LIFO methodology must be used.

34. DTLs related to an Aggregate DTL Category are considered to have a similar reversal trend if such DTLs fully reverse within a two-year period of each other. For example, if all of the DTLs related to GL accounts in an Aggregate DTL Category will fully reverse within 9 to 11 years from the Fiscal Year in which they arise, those DTLs have a similar reversal trend.

35. A Constituent Entity may be able to demonstrate that the FIFO method appropriately recaptures Long-term DTLs based on facts and circumstances related to the nature of the transactions and the relevant tax rules. For example, a Constituent Entity may be able to demonstrate that the DTLs in respect of an Aggregate DTL Category reverse ratably over a 10-year period beginning in the Fiscal Year after the accrual and that the FIFO method recaptures half of the DTL accruals related to that Aggregate DTL Category.

36. The functioning of both the FIFO and LIFO methodology of determining DTL reversals and recapture is based on the determination of the Unjustified Balance in the current Fiscal Year (i.e. the fifth subsequent Fiscal Year after the tested Fiscal Year). The Tested Fiscal Year is the one in which the DTL accrual occurs and is claimed in the Adjusted Covered Taxes (to be subject to DTL recapture rule). The Testing Period is the five-year period which follows the Tested Fiscal Year. The Unjustified Balance represents the total amount of the DTL that has not been reversed before the end of Testing Period (i.e. the total amount of recaptured DTL) and is determined as the excess (if any) of the Outstanding Balance of the DTL over the Maximum Justifiable Amount for that category. The Outstanding Balance is the DTL balance as of the end of the Testing Period computed starting from the Transition Year. The Maximum Justifiable Amount is determined in two different ways depending on whether the FIFO or LIFO methodology applies. If the Maximum Justifiable Amount is equal to or greater than the Outstanding Balance of the Aggregate DTL Category or GL account, there is no DTL recapture for the tested Fiscal Year. If the Maximum Justifiable amount is lower than the Outstanding balance of the Aggregate DTL Category or GL account, the difference is an Unjustified Balance. The Unjustified Balance is compared with the previous year Unjustified Balance amount (if any), in order to determine whether there is an increase or a decrease for the relevant tested Fiscal Year. If the Unjustified Balance increases in the current Fiscal Year, the amount of the increase represents the DTL accrual which shall be recaptured (i.e. excluded from the computation of the Adjusted Covered Taxes of the tested Fiscal Year in the ETR re-computation under Article 5.4). If the Unjustified Balance decreases in the current Fiscal Year, the amount of the decrease must be treated either as a reversal of a recaptured DTL, or reversal of an Unclaimed Accrual, or reversal of pre-Transition Year DTL.

FIFO Methodology

37. Under the FIFO methodology, the Maximum Justifiable amount corresponds to the sum of the net increases in the outstanding DTL balance for each Fiscal Year in the five-year testing period in which there was a net increase in the outstanding DTL balance. In this way, a net decrease in the DTL balance with a Fiscal Year (representing, on net, a reversal) is considered to reduce the net increase in DTL balance in the earliest Fiscal Year in chronological order.

LIFO Methodology

38. Under the LIFO methodology, the Maximum Justifiable amount is determined as the greater of zero or the net amount of the DTL accruals and reversals that occurred during the five-year testing period.

In this way, the reversals occurring during the Testing Period are first allocated to the DTL accruals of the Testing Period.

1.2.3. Simplification for Short-term DTLs

39. A Constituent Entity that has an Aggregate DTL Category that is comprised exclusively of Short-term DTLs may benefit from the simplification described in the following paragraphs. If a Constituent Entity's existing Aggregate DTL Category contains Short-term DTLs and Long-term DTLs, it is allowed to separate the GL accounts with Short-term DTLs from the GL accounts with Long-term DTLs and apply this simplification to the individual GL accounts or an Aggregate DTL Category that includes two or more of such GL accounts. For example, a Constituent Entity may have an Aggregate DTL Category comprised of some GL accounts for inventory that will be reflected in the balance sheet for less than five years and some GL accounts for inventory, such as replacement parts for manufactured products, that remains on the balance sheet for a long period of time. If the Constituent Entity can separate that Aggregate DTL Category and separately determine the DTLs related to the replacement parts and the remainder of the inventory, the Constituent Entity can apply the simplification described below with respect to the remainder of the inventory.

40. The Constituent Entity may be able to demonstrate on the basis of objective facts, that all DTLs related to the assets or liabilities in a GL account or all DTLs included in an Aggregate DTL Category reverse within five fiscal years of the accrual year. In such cases, the Constituent Entity is not obligated to put in place a tracking system and recapture methodology to demonstrate that such DTLs have a short-term reversal. These objective facts shall take into account (i) the difference between the tax base and the accounting carrying value, applicable to the relevant DTLs, and, where relevant (ii) the economic features of the underlying assets and liabilities. Short-term DTLs can benefit from this compliance simplification where the Constituent Entity is able to demonstrate the short-term reversal based on objective facts. For this purpose, the Constituent Entity shall maintain proper evidence to support the conclusion that the DTLs have a short-term reversal period.

41. The guidance below provides examples illustrating the objective facts in relation to certain circumstances that may be relevant for the purposes of demonstrating that DTLs are Short-term DTLs.

42. If a Constituent Entity's existing practice of measuring DTLs has an Aggregate DTL Category that has only Short-term DTLs and DTAs, the Constituent Entity is allowed to include the DTAs in the Aggregate DTL Category and to benefit from the Short-term DTL simplification.

43. Where the Constituent Entity is no longer able to benefit from the Short-term DTL simplification for a given GL account or an Aggregate DTL Category starting from a given Fiscal Year, the Constituent Entity will start applying the DTL recapture rule starting from that Fiscal Year. For example, this could happen as a consequence of a change in the tax rules that causes DTLs to become Long-term DTLs. In order to apply the DTL recapture rule, the Constituent Entity shall determine whether the Aggregate DTL Category meets the aggregate tracking requirements and determine the applicable recapture methodology (FIFO or LIFO). The outstanding DTL for the relevant GL account or an Aggregate DTL Category (that meets the aggregate tracking requirements) as of the beginning of the Fiscal Year in which the simplification is no longer available shall be treated in the same manner as if they were pre-Transition Year DTLs (as set out below in the guidance).

1.2.4. Reversal of DTLs that accrued before the Transition Year

44. The DTL recapture rule applies to DTLs that are included in the computation of Adjusted Covered Taxes starting from the Transition Year. DTLs imported into the GloBE system pursuant to Article 9.1.1 are not subject to the DTL recapture rule (as stated in paragraph 6.3 of the Commentary to Article 9.1.1).

45. Accordingly, the reversal of pre-Transition Year DTLs should be excluded from the application of the DTL recapture rule in a way that is consistent with the Constituent Entity's DTL recapture methodology.

46. For example, where the Constituent Entity uses the FIFO methodology to determine recaptured DTLs, DTL reversals shall be first allocated to pre-Transition Year DTLs and as such shall be excluded from the computation of the Outstanding Balance. Once the amount of those pre-Transition Year DTLs is exhausted, the subsequent reversals will be included in the computation of the Outstanding Balance and factored into the relevant DTL recapture methodology. Where the Constituent Entity uses LIFO as its DTL recapture methodology, the reversals for the Fiscal Year shall be first allocated to the Outstanding Balance to the extent thereof and then to pre-Transition Year DTL.

1.2.5. Changes in the scope of an Aggregate DTL Category

47. It is expected that Constituent Entities will not want to frequently change their DTL categories because of the administrative burdens. However, a Constituent Entity may want or need to change the scope of an Aggregate DTL category in situations in which the chart of account or the reporting package set-up changes, for example, in connection with the combination of two MNE Groups or upgrades to the MNE Group's financial reporting and information systems. A Constituent Entity may want or need to change the scope of an Aggregate DTL Category for other reasons as well.

To properly manage the transition, the Constituent Entity must determine the amount of its DTL recapture attributes for each Aggregate DTL Category and allocate those amounts among the new DTL categories on a reasonable basis such that after the transition there will not be double counting or double non-counting. For this purpose, the DTL recapture attributes are (i) the amount of the Unjustified Balance, (ii) the Outstanding Balance of the Aggregate DTL Category, (iii) any amount of pre-Transition Year DTLs not yet reversed, and (iv) DTL accruals during the five-year period preceding the change.

1.2.6. Clarification on the Recapture Exception Accrual under Article 4.4.5(a)

48. A lessor of a tangible asset may use lease accounting to recover the cost of the leased property for accounting purposes. Under lease accounting, the lessor may reflect the cost of the tangible asset that is subject to the lease as a receivable in the financial accounts, rather than as a tangible asset. For tax purposes, however, the lessor may recover the cost of the leased property through depreciation, often accelerated depreciation. In such cases, the timing of the cost recovery for the leased asset will be different for accounting and tax purposes and will often give rise to a deferred tax liability. That deferred tax liability is with respect to cost recovery allowances on the leased property and is within the scope of Article 4.4.5(a) if the leased property is a tangible asset.

1.2.7. Unclaimed Accrual Election

49. Article 4.4.7 provides an Annual Election which allows a Constituent Entity to exclude the DTL accrual in a given Fiscal Year if it is not expected to reverse, in its entirety, by the end of the fifth subsequent Fiscal Year. If the Unclaimed Accrual election is made, the reversal of the unclaimed DTL shall also be excluded from the computation of the Adjusted Covered Taxes (pursuant to Article 4.4.2(a)). The DTL recapture rule only applies to the DTL accrual that is included in the computation of the Adjusted Covered Taxes for the relevant Fiscal Year. If a DTL accrual is not included in the Adjusted Covered Taxes, it is not subject to the DTL recapture rule.

50. The Unclaimed Accrual election is allowed in respect of DTLs that are not expected to reverse entirely within five Fiscal Years. The Unclaimed Accrual election must be made with respect to a DTL consistently with the tracking approach used by the Constituent Entity for that DTL. If DTL are tracked individually, the Unclaimed Accrual election must be made on each DTL on an item-by-item basis, if tracking is based on a GL account, the election must be made for all the DTLs encompassed in the GL

account, if tracking is based on Aggregate DTL Category, the election must be made for all the DTLs encompassed in the Aggregate DTL Category. It follows that the election cannot be made with respect to a subset of DTLs within a GL account or within an Aggregate DTL Category or a portion of the DTL accrued as an individual DTL.

51. A Constituent Entity may make an Unclaimed Accrual Annual Election with respect to DTLs that it expects will reverse in more than five years after accrual. A Constituent Entity may make an Unclaimed Accrual Five-Year Election with respect to a DTL for a GL account or an Aggregate DTL Category irrespective of any expectations about the reversal time period of the DTLs individually or the GL account or Aggregate DTL Category as a whole.

52. If an Unclaimed Accrual Five-Year Election is made in the Transition Year for a given DTL category (i.e. the DTL related to a GL account or an Aggregate DTL Category), all relevant DTL accruals and reversals of the DTL category shall be excluded from the Adjusted Covered Taxes until the election is revoked. The Constituent Entity must determine the amount in the Aggregate DTL Category or GL account that relate to the pre-Transition Year DTLs because reversals of pre-Transition Year DTLs should be included in the computation of Adjusted Covered Taxes. For this purpose, the first reversals in the Aggregate DTL Category or GL account shall be treated reversals of pre-Transition Year DTLs.

53. In cases where a Constituent Entity makes an Annual Election for an Unclaimed Accrual in some Fiscal Years but not in others or revokes a Five-Year Election for an Unclaimed Accrual, the Constituent Entity must apply the appropriate DTL tracking methodology to determine whether DTL reversals in subsequent Fiscal Years relate to claimed or unclaimed DTLs.

54. In cases where a Constituent Entity begins applying the DTL recapture rules to a GL account or an Aggregate DTL Category for which an Unclaimed Accrual election applied to all preceding Fiscal Years beginning with the Transition Year, reversals of the amount of DTL accrual that was not claimed in the previous Fiscal Years shall be ignored in the computation of Adjusted Covered Taxes. In determining which DTL reversals relate to Unclaimed Accruals in an Aggregate DTL Category or GL account, the Constituent Entity shall apply its methodology for determining which DTL reversals related to pre-Transition Year DTLs and treat the Unclaimed Accruals as arising chronologically after the pre-Transition Year DTLs and before any DTLs that are subject to the DTL recapture rule. For example, if the Constituent Entity uses the FIFO method as the recapture methodology for the Aggregate DTL Category, the DTL reversals will be treated as reversals of Unclaimed Accruals only after all of the pre-Transition Year DTLs have been reversed.

1.2.8. QDMTT Considerations

55. A QDMTT generally must provide for Aggregate DTL Categories consistent with the principles and exclusions set out in the Commentary to Article 4.4.4 of the GloBE Rules. Application of those principles and exclusions to the DTLs that are tracked under a local accounting standard may result in categories that do not align with the Aggregate DTL Categories that would be used under the accounting standard required under Article 3.1.2 or Article 3.1.3. Accordingly, the Constituent Entity may have different Aggregate DTL Categories where a QDMTT (whether or not it meets the requirements of a QDMTT Safe Harbour) permits or requires QDMTT computations based on local financial accounting standards.

56. A QDMTT must provide for an Unclaimed Accrual election consistently with the principles set out in the Commentary to Article 4.4.7 of the GloBE Rules (including the Unclaimed Accrual Five-Year Election).

1.3. Guidance

57. Paragraph 89 of the Commentary to Article 4.4.4 is replaced with the following paragraph:

89. Article 4.4.4 establishes a recapture rule (the DTL recapture rule) for categories of deferred tax liabilities (DTL), other than Recapture Exception Accruals defined in Article 4.4.5, that are included in the Total Deferred Tax Adjustment Amount in a Fiscal Year and do not reverse by the end of the fifth subsequent Fiscal Year. Pursuant to the DTL recapture rule, the amount of the recaptured deferred tax liability has to be excluded from the Adjusted Covered Taxes in the Fiscal Year in which it was originally included in the Total Deferred Tax Adjustment Amount component of Adjusted Covered Taxes and the Effective Tax Rate for that Fiscal Year must be re-computed under Article 5.4. A corollary of the DTL recapture rule is in Article 4.4.2(b). Article 4.4.2(b) excludes the reversal of a Recaptured DTL from the computation of the Total Deferred Tax Adjustment amount in the Fiscal Year in which the reversal occurs. Article 4.4.4 and Article 4.4.2(b) ensure that deferred tax liabilities which reverse after five Fiscal Years are not taken into account for GloBE purposes in the year of accrual, but in the year of the reversal. The term “payment” in Article 4.4.4 and Article 4.4.2(b) refers to the accounting reversal of the DTL or of the recaptured DTL.

58. Paragraph 90 of the Commentary to Article 4.4.4 is revised to read as follows:

Principles for tracking DTLs under GloBE Rules

90. DTL recapture applies at the Constituent Entity level. For purposes of the DTL recapture rule, a Constituent Entity may track its DTLs according to three possible approaches:

a. on an item-by-item basis, where DTLs related to each single asset or liability are tracked individually,
b. on a General Ledger account (GL account) basis, where DTLs related to all the assets or liabilities encompassed in a GL account are grouped and tracked as a single DTL category, or
c. on an Aggregate DTL Category basis (as defined in paragraph 90.6).

The tracking approaches under (a) and (b) can be used for each DTL that is in scope of the DTL recapture rule. However, DTLs may be tracked based on approach (c) only where the Aggregate DTL Category is consistent with the principles and exclusions set out in paragraphs 90.6 through 90.11 (the aggregate tracking requirements). The Constituent Entity is allowed to set-up a tracking system which may combine different tracking approaches for different DTLs in scope of the recapture rule. For example, it may use the Aggregate DTL Category approach for the DTLs related to certain Balance Sheet accounts (BS accounts) (provided the requirements set out below are met), the GL account tracking approach for the DTLs related to certain GL accounts, and the item-by-item tracking for the DTLs encompassed in a GL account. A Constituent Entity cannot aggregate only some DTLs in a GL account and track the remainder on an item-by-item basis.

59. The following paragraphs are inserted after paragraph 90 of the Commentary to Article 4.4.4:

90.1. The DTL recapture guidance set out below is based on the balance sheet model that is most commonly used by MNE Groups. In cases where other models of deferred tax accounting are used, principles equivalent to the ones set out in this guidance must be applied. The Inclusive Framework will consider whether further guidance is needed to assist in applying the principles of this guidance to other deferred tax accounting models.

90.2. The principles and exceptions as well as the recapture methodologies set out below are expected to produce outcomes that are consistent with the objective of the DTL recapture rule and simultaneously address the risks of applying the DTL recapture rule to Aggregate DTL Categories. The Inclusive Framework will evaluate the outcomes under the guidance set out below, giving consideration to the amount potentially subject to recapture as well as the actual recaptured amount, and in 2028 assess the need for any changes to the guidance.

Exclusion of DTL related to items excluded from GloBE Income or Loss

90.3. Movements in DTLs that are related to items that do not factor into the computation of the GloBE Income or Loss are excluded from the computation of the Total Deferred Tax Adjustment Amount. Only DTLs which are claimed in the Total Deferred Tax Adjustment Amount are subject to the DTL Recapture rule. A DTL related to excluded items shall not be included in a GL account or Aggregate DTL Category.

90.4. For example, a DTL related to items which are accounted in Other Comprehensive Income should be excluded from the scope of the DTL recapture rule, unless Article 4.1.1(c) applies. If items accounted in Other Comprehensive Income are recycled through profit and loss, DTLs related to those items are included accordingly in the computation of the Total Deferred Tax Adjustment Amount and those DTLs are subject to the DTL recapture rule.

Recapture Exception Accruals

90.5. The DTL recapture rule does not apply to a DTL that meets the definition of a Recapture Exception Accrual in Article 4.4.5. However, if a Constituent Entity has a GL account or Aggregate DTL Category that includes one or more DTLs that is a Recapture Exception Accrual, the DTL recapture rule will apply with respect to the GL account or the entire Aggregate DTL Category.

Principles for aggregating DTLs under GloBE Rules

90.6. For purposes of the DTL recapture rule, a Constituent Entity may track DTLs on an Aggregate DTL Category basis, rather than an item-by-item tracking or based on a single GL account. An Aggregate DTL Category means a category of DTLs determined in relation to two or more GL accounts that, consistent with the chart of accounts used for the purposes of Article 3.1.2 or 3.1.3, fall under the same balance sheet account or sub-balance sheet account. An Aggregate DTL Category is not required to include all of the GL accounts that fall under the same balance sheet account. A Constituent Entity may have more than one Aggregate DTL Category that falls under the same balance sheet account.

90.7. An Aggregate DTL Category may include Short-term DTLs and Long-term DTLs. A Short-term DTL is an individual DTL that fully reverses within five Fiscal Years or a DTL that is determined in relation to a GL account and that fully reverses within five Fiscal Years. A Long-term DTL is an individual DTL that does not fully reverse within five Fiscal Years or a DTL that is determined in relation to a GL account and that does not fully reverse within five Fiscal Years.

90.8. Where a Constituent Entity cannot demonstrate that an Aggregate DTL Category satisfies the aggregate tracking requirements (set out in paragraphs 90.6 through 90.11) or the conditions for the simplification for Short-term DTLs, the Constituent Entity cannot claim the accrual of that DTL in the computation of its Adjusted Covered Taxes. Where a Constituent Entity fulfils the aggregate tracking requirements but cannot demonstrate that the Aggregate DTL category satisfies the requirements described in paragraphs 90.19 or 90.21 (the FIFO requirements), the Constituent Entity must apply LIFO recapture methodology.

Exclusions from Aggregate DTL Categories

Exclusion of certain types of GL accounts and separate tracking

90.9. Considering the risks of Aggregate DTL Categories, the Inclusive Framework has determined that DTLs related to certain assets and liabilities may be aggregated up to the GL account and cannot be aggregated with other GL accounts. DTLs related to the following assets or liabilities that might be claimed in the computation of Adjusted Covered Taxes may be aggregated for purposes of the DTL recapture rule only up to the GL account level:

a) Non-amortizable intangible assets, including goodwill;
b) Amortizable intangible assets with an accounting life of more than five years; and
c) Related party receivables and payables.

Exclusion of GL accounts that generate DTAs

90.10. The inclusion of a GL account that on a standalone basis generates a DTA in an Aggregate DTL Category would have the distortive effect of diminishing the DTLs subject to recapture because the DTA accrual would have the same effect as a DTL reversal and therefore it would appear that part of the DTL has reversed when it has not. An Aggregate DTL Category cannot include any GL account that on a standalone basis would always generate only DTA (except as provided in the simplification for Short-term DTLs, set out in paragraphs 90.25 through 90.29 below). A Constituent Entity will need to be able to demonstrate that the accounting and tax timing differences in respect of the assets and liabilities in the GL accounts encompassed by the Aggregate DTL Category can only generate a DTL.

Exclusion of swinging accounts and separate tracking

90.11. A swinging account is a GL account for which variances in the accounting and tax timing rules result in a net DTA or a net DTL at different points over the life of the encompassed assets or liabilities. Including a swinging account in an Aggregate DTL Category can create the same distortion as including a GL account with a DTA nature in the Aggregate DTL Category. Moreover, an aggregation of swinging accounts causes the same issue to arise because when a GL account swings to a DTA balance the Aggregate DTL Category will appear to have a reversal of a DTL. Considering the risks of Aggregate DTL Categories, the Inclusive Framework has determined that swinging accounts cannot be aggregated with other GL accounts. DTLs related to swinging accounts that are claimed in the computation of Adjusted Covered Taxes must be tracked separately for purposes of the DTL recapture rule at the level of a single GL account.

Mechanisms to recapture Long-term DTLs

General principles

90.12. The DTL recapture rule is intended to recapture the benefit of including a DTL accrual in the ETR computation if that DTL does not reverse within five Fiscal Years. Determining when a particular DTL reverses presents some challenges because Constituent Entities typically do not create a separate DTL for each transaction and then reverse that DTL when the relevant carrying value and tax basis come back into line. Instead, Constituent Entities typically compare the difference between the year-end carrying value and tax basis of assets and liabilities reflected in a GL account or a group of GL accounts to determine the DTL in respect of those assets or liabilities. The deferred tax expense attributable to a DTL reported in the income statement is based on the net movement in the balance of the DTL from the end of the previous year. For DTL recapture purposes, where DTL tracking is performed on an aggregate basis, the net increase of the balance of the Aggregate DTL Category or GL account is treated as a DTL accrual and the net decrease is treated as a DTL reversal.

90.13. The DTL balance related to a GL account or to an Aggregate DTL Category may remain constant even where assets and liabilities are recorded and reversed for accounting and tax purposes if other assets and liabilities are also recorded in the relevant GL account(s). To illustrate, assume CE1 acquires an asset on the last day of Year 1 and the cost of acquiring the asset is fully deductible for tax purposes in the year of the acquisition (Year 1) and amortized over two years starting from when it is first used for accounting purposes (Year 2). If CE1 acquires the asset for 100 and has a 15% tax rate, it will record a DTL of 15 at the end of Year 1. The DTL related to the asset at the end of Year 2 will be 7.5. However, if another similar asset is purchased for 100 in Year 2 and starts to be amortized in Year 2, the net balance of the DTL in Year 2 will remain at 15.

90.14. In the example, it appears that part of the DTL from Year 1 reversed in Year 2 and the DTL reflected in the ending balance was a new accrual. However, MNE Groups may not commonly make accounting entries that reflect whether the DTLs at any given point in time are in relation to pre-existing or newly acquired assets or liabilities. Their financial accounts only indicate whether, in the aggregate, there is an accrual of a DTL (i.e. a net increase in the DTL balance) or reversal of part or all of the DTL (i.e. a net decrease in the DTL balance).

90.15. Because MNE Groups generally do not trace the balance of a DTL to particular assets or liabilities reflected in the corresponding Aggregate DTL Category or GL account, a methodology with certain assumptions is needed to determine whether a reversal (i.e. a decrease in the ending balance) relates to amounts that accrued in the preceding five Fiscal Years or to amounts that were previously subject to recapture under Article 4.4.4. One approach would be to assume that reversals relate to the oldest accruals. This would be a first-in, first-out or FIFO methodology. Another approach would be to assume that reversals relate to the most recent accruals. This would be a last-in, first-out or LIFO methodology.

90.16. These different methodologies produce different outcomes in terms of the amount of DTLs recaptured and the Fiscal Years in which the recapture occurs. They will further result in the corresponding recapture reversal (pursuant to Article 4.4.2(b)) occurring in different Fiscal Years. However, it is not possible to determine in absolute terms whether a particular methodology is more or less favourable for the taxpayer (in terms of amount overall subject to recapture) in all cases, because it depends on the actual trend of DTL increases and decreases in the year-end balances of a given Aggregate DTL Category or GL account.

90.17. Nevertheless, in the case of Aggregate DTL Categories, the FIFO methodology could shield an un-reversed DTL accrual from recapture in some circumstances. The risk arises where the Aggregate DTL Category contains GL accounts that have both Short-term DTLs and Long-term DTLs. In such cases, the accruals and reversals in the Short-term DTLs can make it appear on a FIFO basis that all of the DTLs have reversed within five years when in fact, the Long-term DTLs remain outstanding for more than five years.

90.18. The LIFO methodology is a more conservative approach because it mitigates the risk that the Long-term DTLs encompassed by an Aggregate DTL Category would not be recaptured after five years or that the relevant recapture would be postponed indefinitely.

90.19. A Constituent Entity may use the FIFO methodology to determine reversals in the following cases:

a) The DTL is determined in relation to a single GL account;
b) The DTL is determined in relation to an Aggregate DTL Category that consists solely of DTLs determined in relation to GL accounts with a similar reversal trend (see paragraph 90.20); or

c) The DTLs are aggregated within an Aggregate DTL Category without a similar reversal trend but where MNE can demonstrate that the FIFO methodology nevertheless results in appropriate recapture of DTLs to the extent their reversal trend extends beyond 5 years (see paragraph 90.21).

For any Aggregate DTL Category for which the Constituent Entity does not choose to use the FIFO methodology or for which it cannot demonstrate that the conditions above are satisfied, the LIFO methodology must be used.

90.20. DTLs related to an Aggregate DTL Category are considered to have a similar reversal trend (for the purposes of paragraph 90.19(b) above) if such DTLs fully reverse within a two-year period of each other. For example, if all of the DTLs related to GL accounts in an Aggregate DTL Category will fully reverse between 9 and 11 years from the Fiscal Year in which they arise, those DTLs have a similar reversal trend.

90.21. A Constituent Entity may be able to demonstrate that the FIFO method appropriately recaptures Long-term DTLs based on facts and circumstances (for the purposes of paragraph 90.19(c) above) related to the nature of the transactions and the relevant tax rules. For example, a Constituent Entity may be able to demonstrate that the DTLs in respect of an Aggregate DTL Category reverse ratably over a 10-year period beginning in the Fiscal Year after the accrual and that the FIFO method recaptures half of the DTL accruals related to that Aggregate DTL Category.

90.22. The functioning of both the FIFO and LIFO methodology of determining DTL reversals and recapture is based on the determination of the Unjustified Balance in the current Fiscal Year (i.e. the fifth subsequent Fiscal Year after the tested Fiscal Year). The Tested Fiscal Year is the one in which the DTL accrual occurs and is claimed in the Adjusted Covered Taxes (to be subject to DTL recapture rule). The Testing Period is the five-year period which follows the Tested Fiscal Year. The Unjustified Balance represents the total amount of the DTL that has not been reversed before the end of Testing Period (i.e. the total amount of recaptured DTL) and is determined as the excess (if any) of the Outstanding Balance of the DTL over the Maximum Justifiable Amount for that category. The Outstanding Balance is the DTL balance as of the end of the Testing Period computed starting from the Transition Year. The Maximum Justifiable Amount is determined in two different ways depending on whether the FIFO or LIFO methodology applies. See paragraphs 90.23 and 90.24 below. If the Maximum Justifiable Amount is equal to or greater than the Outstanding Balance of the Aggregate DTL Category or GL account, there is no DTL recapture for the tested Fiscal Year. If the Maximum Justifiable amount is lower than the Outstanding balance of the Aggregate DTL Category or GL account, the difference is an Unjustified Balance. The Unjustified Balance is compared with the previous year Unjustified Balance amount (if any), in order to determine whether there is an increase or a decrease for the relevant tested Fiscal Year. If the Unjustified Balance increases in the current Fiscal Year, the amount of the increase represents the DTL accrual which shall be recaptured (i.e. excluded from the computation of the Adjusted Covered Taxes of the tested Fiscal Year in the ETR re-computation under Article 5.4). If the Unjustified Balance decreases in the current Fiscal Year, the amount of the decrease must be treated either as a reversal of a recaptured DTL, or reversal of an Unclaimed Accrual, or reversal of pre-Transition Year DTL.

FIFO Methodology

90.23. Under the FIFO methodology, the Maximum Justifiable amount corresponds to the sum of the net increases in the outstanding DTL balance for each Fiscal Year in the five-year testing period in which there was a net increase in the outstanding DTL balance. In this way, a net decrease in the DTL balance with a Fiscal Year (representing, on net, a reversal) is considered to reduce the net increase in DTL balance in the earliest Fiscal Year in chronological order.

LIFO Methodology

90.24. Under the LIFO methodology, the Maximum Justifiable amount is determined as the greater of zero or the net amount of the DTL accruals and reversals that occurred during the five-year testing period. In this way, the reversals occurring during the Testing Period are first allocated to the DTL accruals of the Testing Period.

Simplification for Short-term DTLs

Aggregation of Short-term DTLs

90.25. A Constituent Entity that has an Aggregate DTL Category that is comprised exclusively of Short-term DTLs may benefit from the simplification described in the following paragraphs. If a Constituent Entity's existing Aggregate DTL Category contains Short-term DTLs and Long-term DTLs, it is allowed to separate the GL accounts with Short-term DTLs from the GL accounts with Long-term DTLs and apply this simplification to the individual GL accounts or an Aggregate DTL Category that includes two or more of such GL accounts. For example, a Constituent Entity may have an Aggregate DTL Category comprised of some GL accounts for inventory that will be reflected in the balance sheet for less than five years and some GL accounts for inventory, such as replacement parts for manufactured products, that remains on the balance sheet for a long period of time. If the Constituent Entity can separate that Aggregate DTL Category and separately determine the DTLs related to the replacement parts and the remainder of the inventory, the Constituent Entity can apply the simplification described below with respect to the remainder of the inventory.

90.26. The Constituent Entity may be able to demonstrate on the basis of objective facts, that all DTLs related to the assets or liabilities in a GL account or all DTLs included in an Aggregate DTL Category reverse within five fiscal years of the accrual year. In such cases, the Constituent Entity is not obligated to put in place a tracking system and recapture methodology to demonstrate that such DTLs have a short-term reversal. These objective facts shall take into account (i) the difference between the tax base and the accounting carrying value, applicable to the relevant DTLs, and, where relevant (ii) the economic features of the underlying assets and liabilities. Short-term DTLs can benefit from this compliance simplification where the Constituent Entity is able to demonstrate the short-term reversal based on objective facts. For this purpose, the Constituent Entity shall maintain proper evidence to support the conclusion that the DTLs have a short-term reversal period.

90.27. The following examples illustrate the objective facts that may be relevant for purposes of demonstrating that specific DTLs are Short-term DTLs.

a) For DTLs related to amortizable assets that are not Recapture Exception Accruals under Article 4.4.5, it may be possible to objectively determine that the reversal occurs within five years where, for example, a purchased intangible asset (e.g. customer list) is amortized using the straight-line method for accounting purposes in ten years, while the tax amortization period (also based on the straight-line method) is set at five years, it is possible to objectively determine that the reversal will occur within five years of the accrual.
b) For DTLs related to certain receivables, the tax timing rule may follow the cash basis principle (i.e. the revenue is included in the taxable income in the year of actual receipt) while for accounting purposes, revenue recognition follows the accrual basis principle (e.g. when the payment is due under the contract). In such case, where the Constituent Entity is able to demonstrate that the receivables related to such DTLs are collected, written-off (or monetized in other ways, e.g. via subsequent sale, where relevant for tax purposes)

within five years of when the payment is due, it can benefit from the Short-term DTL simplification. For this purpose, the Constituent Entity may take into account the terms of payment as reflected in the underlying contracts, historical observation of account collections, its policies and practices concerning expensing bad debts, and any other circumstance which can be objectively observed and documented.

c) For DTLs related to a tax rule that allows deferral of gain from the sale of property for up to a maximum of five years, it is possible to objectively determine that the reversal of such DTLs occur within five-years.

d) DTLs related to certain deferred costs that are not Recapture Exception Accruals under Article 4.4.5 might arise because the accounting rule requires the expenses to be spread over the relevant economic life of the asset, or contract, or service to which it refers (e.g. license for the utilization of software), while for tax purposes the cost is fully deducted in the year of the actual payment. In such cases, where the Constituent Entity is able to demonstrate that the economic life over which the deferred costs are spread for accounting purposes, is not longer than five years, it will be able to benefit from the DTL Short-term simplification.

e) DTLs might arise in relation to long-term contracts where the accounting revenue recognition criteria follows the percentage of completion method while for tax purposes revenue are taxable only at the completion of the contract (irrespective of when payments on the contract are received). In such cases, where the Constituent Entity can demonstrate that the duration of each construction contract is shorter than five years, it can benefit from the Short-term DTL simplification.

f) DTLs might arise in relation to inventory of fungible goods where the accounting valuation criteria are different from the one used for tax purposes. For example, where the Constituent Entity uses the FIFO inventory method for both tax and accounting purposes but uses a valuation technique for inventory that consistently results in a lower value for tax purposes than for accounting purposes and is able to demonstrate that the inventory is sold over a period that is shorter than five fiscal year, it will be able to benefit from the Short-term DTLs simplification. DTLs related to long-term inventories (for example, aged wine or spirits) are expected not to be able to benefit from the Short-term DTL simplification.

90.28. If a Constituent Entity's existing practice of measuring DTLs has an Aggregate DTL Category that has only Short-term DTLs and DTAs, the Constituent Entity is allowed to include the DTAs in the Aggregate DTL Category and to benefit from the Short-term DTL simplification.

90.29. Where the Constituent Entity is no longer able to benefit from the Short-term DTL simplification for a given GL account or an Aggregate DTL Category starting from a given Fiscal Year, the Constituent Entity will start applying the DTL recapture rule starting from that Fiscal Year. For example, this could happen as a consequence of a change in the tax rules that causes DTLs to become Long-term DTLs. In order to apply the DTL recapture rule, the Constituent Entity shall determine whether the Aggregate DTL Category meets the aggregate tracking requirements and determine the applicable recapture methodology (FIFO or LIFO). The outstanding DTL for the relevant GL account or an Aggregate DTL Category (that meets the aggregate tracking requirements) as of the beginning of the Fiscal Year in which the simplification is no longer available shall be treated in the same manner as if they were pre-Transition Year DTLs (as provided in paragraph 90.30 and 90.31 below).

Reversal of DTLs that accrued before the Transition Year

90.30. The DTL recapture rule applies to DTLs that are included in the computation of Adjusted Covered Taxes starting from the Transition Year. DTLs imported into the GloBE system pursuant to Article 9.1.1 are not subject to the DTL recapture rule (as stated in paragraph 6.3 of the Commentary to Article 9.1.1).

90.31. Accordingly, the reversal of pre-Transition Year DTLs should be excluded from the application of the DTL recapture rule in a way that is consistent with the Constituent Entity's DTL recapture methodology. For example, where the Constituent Entity uses the FIFO methodology to determine recaptured DTLs, DTL reversals shall be first allocated to pre-Transition Year DTLs and as such shall be excluded from the computation of the Outstanding Balance. Once the amount of those pre-Transition Year DTLs is exhausted, the subsequent reversals will be included in the computation of the Outstanding Balance and factored into the relevant DTL recapture methodology. Where the Constituent Entity uses LIFO as its DTL recapture methodology, the reversals for the Fiscal Year shall be first allocated to the Outstanding Balance to the extent thereof and then to pre-Transition Year DTL.

Changes in the scope of an Aggregate DTL Category

90.32. It is expected that Constituent Entities will not want to frequently change their GL account or Aggregate DTL Categories because of the administrative burdens. However, a Constituent Entity may want or need to change the scope of a GL account or Aggregate DTL Category in situations in which the chart of account or the reporting package set-up changes, for example, in connection with the combination of two MNE Groups or upgrades to the MNE Group's financial reporting and information systems. A Constituent Entity may want or need to change the scope of a GL account or Aggregate DTL Category for other reasons as well.

90.33. To properly manage the transition, the Constituent Entity must determine the amount of its DTL recapture attributes for each GL account or Aggregate DTL Category and allocate those amounts among the new GL accounts or Aggregate DTL Categories on a reasonable basis such that after the transition there will not be double counting or double non-counting. For this purpose, the DTL recapture attributes are (i) the amount of the Unjustified Balance, (ii) the Outstanding Balance of the GL account or Aggregate DTL Category, (iii) any amount of pre-Transition Year DTLs not yet reversed, and (iv) DTL accruals during the five-year period preceding the change.

Clarification on the scope of the Recapture Exception Accrual under Article 4.4.5(a)

60. The following paragraph is inserted after paragraph 95 of the Commentary to Article 4.4.5:

95.1 A lessor of a tangible asset may use lease accounting to recover the cost of the leased property for accounting purposes. Under lease accounting, the lessor may reflect the cost of the tangible asset that is subject to the lease as a receivable in the financial accounts, rather than as a tangible asset. For tax purposes, however, the lessor may recover the cost of the leased property through depreciation, often accelerated depreciation. In such cases, the timing of the cost recovery for the leased asset will be different for accounting and tax purposes and will often give rise to a deferred tax liability. That deferred tax liability is with respect to cost recovery allowances on the leased property and is within the scope of Article 4.4.5(a) if the leased property is a tangible asset.

Unclaimed Accrual Election

61. The following paragraphs are inserted after paragraph 112 of the Commentary to Article 4.4.7:

112.1 Article 4.4.7 provides an Annual Election which allows a Constituent Entity to exclude the DTL accrual in a given Fiscal Year if it is not expected to reverse, in its entirety, by the end of the fifth subsequent Fiscal Year. If the Unclaimed Accrual election is made, the reversal of the unclaimed DTL shall also be excluded from the computation of the Adjusted Covered Taxes (pursuant to Article 4.4.2(a)). The DTL recapture rule only applies to the DTL accrual that is included in the computation of the Adjusted Covered Taxes for the relevant Fiscal Year. If a DTL accrual is not included in the Adjusted Covered Taxes, it is not subject to the DTL recapture rule.

112.2 The Unclaimed Accrual election is allowed in respect of DTLs that are not expected to reverse entirely within five Fiscal Years. The Unclaimed Accrual election must be made with respect to a DTL consistently with the tracking approach used by the Constituent Entity for that DTL. If DTL are tracked individually, the Unclaimed Accrual election must be made on each DTL on an item-by-item basis, if tracking is based on a GL account, the election must be made for all the DTLs encompassed in the GL account, if tracking is based on Aggregate DTL Category, the election must be made for all the DTLs encompassed in the Aggregate DTL Category. It follows that the election cannot be made with respect to a subset of DTLs within a GL account or within an Aggregate DTL Category or a portion of the DTL accrued as an individual DTL.

112.3 A Constituent Entity may make an Unclaimed Accrual Annual Election with respect to DTLs that it expects will reverse in more than five years after accrual. A Constituent Entity may make an Unclaimed Accrual Five-Year Election with respect to a DTL for a GL account or an Aggregate DTL Category irrespective of any expectations about the reversal time period of the DTLs individually or the GL account or Aggregate DTL Category as a whole.

112.4. If an Unclaimed Accrual Five-Year Election is made in the Transition Year for a given DTL category (i.e. the DTL related to a GL account or an Aggregate DTL Category), all relevant DTL accruals and reversals of the DTL category shall be excluded from the Adjusted Covered Taxes until the election is revoked. The Constituent Entity must determine the amount in the Aggregate DTL Category or GL account that relate to the pre-Transition Year DTLs because reversals of pre-Transition Year DTLs should be included in the computation of Adjusted Covered Taxes. For this purpose, the first reversals in the Aggregate DTL Category or GL account shall be treated reversals of pre-Transition Year DTLs.

112.5. In cases where a Constituent Entity makes an Annual Election for an Unclaimed Accrual in some Fiscal Years but not in others or revokes a Five-Year Election for an Unclaimed Accrual, the Constituent Entity must apply the appropriate DTL tracking methodology to determine whether DTL reversals in subsequent Fiscal Years relate to claimed or unclaimed DTLs.

112.6. In cases where a Constituent Entity begins applying the DTL recapture rules to a GL account or an Aggregate DTL Category for which an Unclaimed Accrual election applied to all preceding Fiscal Years beginning with the Transition Year, reversals of the amount of DTL accrual that was not claimed in the previous Fiscal Years shall be ignored in the computation of Adjusted Covered Taxes. In determining which DTL reversals relate to Unclaimed Accruals in an Aggregate DTL Category or GL account, the Constituent Entity shall apply its methodology for determining which DTL reversals related to pre-Transition Year DTLs and treat the Unclaimed Accruals as arising chronologically after the pre-Transition Year DTLs and before any DTLs that are subject to the DTL recapture rule. For example, if the Constituent Entity uses the FIFO method as the recapture methodology for the Aggregate DTL Category, the DTL reversals will be treated as reversals of Unclaimed Accruals only after all of the pre-Transition Year DTLs have been reversed.

QDMTT Considerations

62. The following paragraphs are inserted after paragraph 118.53 of the Commentary to the definition of Qualified Domestic Minimum Top-up Tax:

> 118.53.1 A QDMTT generally must provide for Aggregate DTL Categories consistent with the principles and exclusions set out in the Commentary to Article 4.4.4 of the GloBE Rules. Application of those principles and exclusions to the DTLs that are tracked under a local accounting standard may result in categories that do not align with the Aggregate DTL Categories that would be used under the accounting standard required under Article 3.1.2 or Article 3.1.3. Accordingly, the Constituent Entity may have different Aggregate DTL Categories where a QDMTT (whether or not it meets the requirements of a QDMTT Safe Harbour) permits or requires QDMTT computations based on local financial accounting standards.
>
> 118.53.2 A QDMTT must provide for an Unclaimed Accrual election consistently with the principles set out in the Commentary to Article 4.4.7 of the GloBE Rules (including the Unclaimed Accrual Five-Year Election).

1.4. Examples

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

Example 4.4.4-1 – DTL tracking approach definition

1. A Co is a Constituent Entity located in Country A. A Co prepares its reporting package accounts using IFRS and recognises deferred tax liabilities in relation to trade receivables. IFRS recognition criteria for revenues from transactions with customers are different from the corporate tax rules applicable in Country A and the tax basis of trade receivables is different from the corresponding IFRS carrying value. The trade receivables Balance Sheet account in the relevant chart of accounts is composed of a number of General Ledger accounts (e.g. receivables from the sale of product 1, product 2, service A, service B, etc.), and each General Ledger account contains a certain number of sub-accounts (e.g. individual accounts related to each customer), as represented in the below table.

		Tax basis	*IFRS*	Timing difference	DTL (15%)
BS account	**Trade receivables**	**1,000**	**1,700**	**700**	**105**
GL account 1	from sale of product 1	**200**	**400**	**200**	**30**
	- customer X	*-*	*100*	*100*	*15*
	- customer Y	*100*	*200*	*100*	*15*
	- customer Z	*100*	*100*	*-*	*-*
GL account 2	from sale of product 2	**100**	**300**	**200**	**30**
	- customer W	*100*	*300*	*200*	*30*
GL account 3	from sale of service A	**400**	**400**	**-**	**-**
	- customer X	*400*	*400*	*-*	*-*
GL account 4	from sale of service B	**300**	**600**	**300**	**45**
	- customer Y	*300*	*600*	*300*	*45*

2. If A Co measures and tracks DTLs based on each of the four GL accounts and determines whether or not there is a DTL accrual or reversal in each GL account at the end of the Fiscal Year, it may apply the DTL recapture rule on the basis of the GL account tracking.

3. If A Co measures and tracks DTLs based on the Trade Receivables Balance Sheet account, which contains the four GL accounts, it may apply the DTL recapture rule to that Aggregate DTL Category.

Example 4.4.4-2 – FIFO methodology

1. A Co has an Aggregate DTL Category in relation to trade receivables that is consistent with the chart of accounts used for the Consolidated Financial Statements. A Co is able to determine and prove that each GL account included in the Aggregate DTL Category has a similar reversal trend and therefore is eligible to apply the FIFO methodology.

2. The table below shows for each Fiscal Year the net DTL increases (i.e. accrual) and net DTL decreases (i.e. reversal) determined for the Aggregate DTL Category.

		Net DTL movement per Fiscal Year															
DTL category	**Trade receivables**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**
GL account 1	on product 1	10	10	10	10	10	10	10	10	10	10	10	(110)				
GL account 2	on product 2		100								(100)						
GL account 3	on service A			100	100				-100				(100)				
GL account 4	on service B		10	20	10	-	10	10	20	-	10	10	(100)				
GL account 5	on service C						100	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
Net DTL movement		10	120	130	120	10	120	10	(80)	-	(90)	10	(320)	(10)	(10)	(10)	(10)

3. The table below shows the application of the FIFO methodology to the above identified DTL accruals and reversals for the Aggregate DTL Category.

DTL category - FIFO methodology	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**
Net DTL movement	**10**	**120**	**130**	**120**	**10**	**120**	**10**	**(80)**	**-**	**(90)**	**10**	**(320)**	**(10)**	**(10)**	**(10)**	**(10)**
(A) Outstanding balance	10	130	260	380	390	510	520	440	440	350	360	40	30	20	10	-
(B) Maximum justifiable amount						500	390	260	140	130	20	10	10	10	10	-
(A-B) Unjustified Balance						10	130	180	300	220	340	30	20	10	-	-
Unjustified balance (yearly movement)						**10**	**120**	**50**	**120**	**(80)**	**120**	**(310)**	**(10)**	**(10)**	**(10)**	**-**

4. The DTL recapture test determines a DTL Recaptured amount of 10, to be excluded from the Adjusted Covered Taxes in Year 1 (the Tested Fiscal Year) for the purposes of computing Year 6 Additional Current Top-up Tax. For the Tested Fiscal Year (Year 1), the Maximum Justifiable amount is equal to 500, while the Outstanding Balance (equal to the sum of all the net DTL accruals over the Testing Period) is equal to 510. The excess of the Outstanding Balance over the Maximum Justifiable amount represents the Unjustified Balance for the current Year (i.e. Year 6). Because the Unjustified Balance for the previous Fiscal Year is zero, an increase in the Unjustified Balance is determined for the current year. A DTL Recapture is also determined for Year 7, 8, 9 and 11. An adjustment pursuant to Article 4.4.2(b) shall be made for Year 10, 12, 13, 14 and 15 for an amount corresponding to the yearly decrease in the Unjustified Balance. Example 4.4.4-3 – LIFO methodology.

Example 4.4.4-3 – LIFO methodology

1. A Co has an Aggregate DTL Category in relation to trade receivables that is consistent with the chart of accounts used for the Consolidated Financial Statements. A Co is not able to determine and prove that each GL account included in the Aggregate DTL Category has a similar reversal trend. Based on that, A Co decides to apply the LIFO methodology to the Aggregate DTL Category.

2. The table below shows for each Fiscal Year the relevant net DTL increases (i.e. accrual) and net DTL decreases (i.e. reversal) corresponding to the Aggregate DTL Category.

DTL category	Trade receivables	Net DTL movement per Fiscal Year															
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
GL account 1	on product 1	10	10	10	10	10	10	10	10	10	10	10	(110)				
GL account 2	on product 2		100				(100)										
GL account 3	on service A				200				(200)								
GL account 4	on service B		100	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)				
GL account 5	on service C						50	(10)	10	(10)	(10)	(10)	20	(10)	(10)	(10)	(10)
Net DTL movement		10	210	-	200	-	(50)	(10)	(190)	(10)	(10)	(10)	(100)	(10)	(10)	(10)	(10)

3. The table below shows the application of the LIFO methodology to the above identified DTL accruals and reversals for the Aggregate DTL Category.

LIFO methodology - Aggregate DTL category																
Fiscal Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**
Net DTL movement	**10**	**210**	**-**	**200**	**-**	**(50)**	**(10)**	**(190)**	**(10)**	**(10)**	**(10)**	**(100)**	**(10)**	**(10)**	**(10)**	**(10)**
(A) Outstanding balance	**10**	**220**	**220**	**420**	**420**	**370**	**360**	**170**	**160**	**150**	**140**	**40**	**30**	**20**	**10**	**-**
(B) Maximum justifiable amount						**360**	**140**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
(A-B) Unjustified Balance						**10**	**220**	**170**	**160**	**150**	**140**	**40**	**30**	**20**	**10**	**-**
Unjustified balance (yearly movement)						**10**	**210**	**(50)**	**(10)**	**(10)**	**(10)**	**(100)**	**(10)**	**(10)**	**(10)**	**(10)**

4. The DTL recapture test determines a DTL Recaptured amount of 10, to be excluded from the Adjusted Covered Taxes in Year 1 (the Tested Fiscal Year) for the purposes of computing Year 6 Additional Current Top-up Tax. For the Tested Fiscal Year (Year 1), the Maximum Justifiable amount is equal to 360, while the Outstanding Balance (equal to the sum of all the net DTL accruals and reversals computed starting from the Transition Year till the end of the Testing Period) is equal to 370. The excess of the Outstanding Balance over the Maximum Justifiable amount represents the Unjustified Balance for the current Year (i.e. Year 6). Considered that the Unjustified Balance for the previous Fiscal Year is zero, an increase in the Unjustified Balance is determined for the current year. A DTL Recapture of 210 is also determined for Year 7. An adjustment pursuant to Article 4.4.2(b) is required for Year 8 throughout Year 16, for an amount corresponding to the yearly decrease in the Unjustified Balance for that Year.

Example 4.4.4-4 – Pre-Transition Year DTL allocated under FIFO methodology

1. The fact patterns are the same as Example 4.4.4 – 2, except that A Co has pre-Transition Year DTLs for the Aggregate DTL Category equal to 150. For the purposes of the DTL recapture rule, the reversals of pre-Transition Year DTL shall not be computed in the Outstanding Balance otherwise they would be treated as reversals of DTLs that accrued starting from the Transition Year. This principle is reflected in the table below by excluding the reversals attributable to pre-Transition Year DTLs from the "net DTL movement" of the aggregate DTL category as relevant for the determination of the Outstanding Balance, for the DTL recapture mechanism.

2. A Co uses a FIFO recapture methodology for the Aggregate DTL Category. The reversal of pre-Transition Year DTLs must be determined in accordance with the FIFO approach. Under the FIFO approach, the first net DTL decreases in the Aggregate DTL Category are treated as reversals of pre-Transition Year DTLs and as such excluded from the computation of the net DTL movement of the relevant Fiscal Year.

3. The below table shows that the first net DTL decreases occur in Year 7, Year 8 and Year 10. Such net decreases are treated as reversals of pre-Transition Year DTLs and as such are excluded from the computation of the net DTL movement of such Fiscal Years. The 150 of pre-Transition Year DTLs are

Aggregate DTL category - FIFO methodology		**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**
Net DTL movement		**10**	**100**	**130**	**70**	**-**	**120**	**(20)**	**(80)**	**-**	**(90)**	**10**	**(360)**	**(10)**	**(10)**	**(10)**	**(10)**
Pre-Transition Year DTL	**150**																
Reversals allocated to pre-Transition Year DTL (FIFO)		**-**	**-**	**-**	**-**	**-**	**-**	**(20)**	**(80)**	**-**	**(50)**	**-**	**-**	**-**	**-**	**-**	**-**
Net DTL movement (after allocation to Pre-Transition Year DTL)		**10**	**100**	**130**	**70**	**-**	**120**	**-**	**-**	**-**	**(40)**	**10**	**(360)**	**(10)**	**(10)**	**(10)**	**(10)**
(A) Outstanding balance		10	110	240	310	310	430	430	430	430	390	400	40	30	20	10	-
(B) Maximum justifiable amount							420	320	190	120	120	10	10	10	10	10	-
(A-B) Unjustified Balance							10	110	240	310	270	390	30	20	10	-	-
Unjustified balance (yearly movement)							**10**	**100**	**130**	**70**	**(40)**	**120**	**(360)**	**(10)**	**(10)**	**(10)**	**-**

treated as reversing in Year 7, for an amount equal to 20, in Year 8, for an amount equal to 80 and in Year 10, for the residual amount of 50. Accordingly, the net DTL movement for Year 7 and 8 is re-determined to zero, while the net DTL movement for Year 10 is re-determined from -90 to -40.

Example 4.4.4-5 – Pre-Transition Year DTLs allocated under LIFO methodology

1. The fact patterns are the same as Example 4.4.4 - 3 above, except that A Co has pre-Transition Year DTLs for the Aggregate DTL Category equal to 150. For the purposes of the DTL recapture rule, the reversals of pre-Transition Year DTL shall not be computed in the Outstanding Balance otherwise they would be treated as reversals of DTLs that accrued starting from the Transition Year. This principle is reflected in the table below by excluding the reversals attributable to pre-Transition Year DTLs from the "net DTL movement" of the aggregate DTL category as relevant for the determination of the Outstanding Balance, for the DTL recapture mechanism.

2. A Co uses LIFO as recapture methodology for the relevant DTL category. The reversal of pre-Transition Year DTLs must be determined in accordance with the LIFO approach. Under the LIFO approach, the net DTL decreases in the Aggregate DTL Category are first allocated to DTLs accrued starting from the Transition Year and as such computed in the Outstanding Balance. Once the Outstanding Balance is negative (i.e. the overall reversals exceed the overall accruals), the net DTL decreases that causes the Outstanding balance to become negative are treated as reversals of pre-Transition Year DTLs. In the Fiscal Year in which the Outstanding Balance is negative and there is a net decrease in the net DTL movement, the net DTL decrease is treated as reversal of pre-Transition Year DTLs, but only to the extent that such decreases reduces the Outstanding Balance below zero.

3. The below table shows that the Outstanding Balance is negative in Year 12 till Year 16. In Year 12, there is a net DTL decrease of 140 which causes the Outstanding Balance turning to negative to an amount of -110. The amount of 110, out of 140, represents the reversals which are overall in excess in respect to the overall accruals (computed in the Outstanding Balance, i.e. starting from the Transition Year) and as such shall be treated as reversals of pre-Transition Year DTLs. In Year 13, the Outstanding Balance is still negative and the net decreases is equal to -10. This net DTL decrease shall be treated as reversal of pre-Transition Year DTLs. Same thing occurs for Year 14, Year 15 and Year 16 where the relevant net DTL decreases is treated as reversal of pre-Transition Year DTL.

4. Based on the above, the net DTL movement is re-determined without taking into account the net decreases which are allocated to pre-Transition Year DTLs. In particular, for Year 12 to 16, the net DTL movement is re-determined to zero.

Aggregated DTL category - LIFO methodology																
Fiscal Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Net DTL movement	10	190	-	150	(10)	(50)	(40)	(190)	(10)	(10)	(10)	(140)	(10)	(10)	(10)	(10)
Pre-Transition Year DTLs 150																
Outstanding Balance	10	200	200	350	340	290	250	60	50	40	30	(110)	(120)	(130)	(140)	(150)
Reversals allocated to pre-Transition Year DTLs (LIFO)												(110)	(10)	(10)	(10)	(10)
Net DTL movement after allocation to pre-Transition Year DTLs	10	190	-	150	(10)	(50)	(40)	(190)	(10)	(10)	(10)	(30)	-	-	-	-
(A) Outstanding balance (after allocation of pre-Transition Year DTLs)	10	200	200	350	340	290	250	60	50	40	30	-	-	-	-	-
(B) Maximum justifiable amount						280	50	-	-	-	-	-	-	-	-	-
(A-B) Unjustified Balance						10	200	60	50	40	30	-	-	-	-	-
Unjustified balance (yearly movement)						10	190	(140)	(10)	(10)	(10)	(30)	-	-	-	-

Example 4.4.7-1 – Unclaimed Accrual Five-Year election

1. A Co has DTLs on related party receivables that corresponds to a sub-BS account according to the chart of accounts used for Consolidated Financial Statements. This sub-BS account is comprised of a number of GL accounts. As such, it is considered an Aggregate DTL Category. A Co does not have the ability to track DTLs for related party receivables at the GL account level. A Co decides to make the

Unclaimed Accrual election for the Aggregate DTL Category in the Transition Year. Under this election, each net DTL accrual and related reversal as determined in relation to the entire sub-BS account is excluded from the computation of the Adjusted Covered Taxes.

2. The pre-Transition Year DTLs determined as of the beginning of the Transition Year for the related party receivables is equal to 100. The first net decreases in the DTL category shall be treated as reversal of pre-Transition Year DTL and shall be accordingly included in the computation of the Adjusted Covered Taxes. Once the pre-Transition Year DTLs are fully reversed, the subsequent reversals shall be treated as reversal of the unclaimed DTL accruals and as such shall be excluded from the computation of the Adjusted Covered Taxes.

Example 4.4.7-2 – Annual Unclaimed Accrual election

1. A Co has a DTL category related to service contracts (corresponding to an Aggregate DTL Category, i.e. an aggregation of GL accounts) that vary in length from 5 to 10 years and as such is not expected to entirely reverse entirely within five years.

2. A Co decides to make an election under Article 4.4.7 in Year 1 and does not include the DTL accrual of 100 in its computation of Adjusted Covered Taxes for Year 1. A Co recognises another DTL accrual in Year 2 for such DTL category, but it is claimed in the computation of the Adjusted Covered Taxes for Year 2 (i.e. no election under Article 4.4.7). Although A Co did not claim the Year 1 accrual in its Adjusted Covered Taxes computation, it will have to determine when that accrual reverses so that it can claim the taxes in its Adjusted Covered Taxes upon reversal of the deferred tax liability based on the DTL recapture methodology used by A Co for the relevant DTL category. In particular, for the purposes of the correct functioning of the Unclaimed Accrual election and of the DTL recapture methodology used for the relevant DTL category, A Co will have to exclude the unclaimed DTL accrual in Year 1 for the purposes of the computation of the Outstanding Balance. On the other hand, the reversal shall be included in the determination of the Outstanding Balance in order to determine the timing of the relevant reversals and corresponding adjustment pursuant to Article 4.4.2(a).

Example 4.4.7-3 – pre-Transition Year DTLs under an Unclaimed Accrual Five-Year Election

1. A Co makes an Unclaimed Accrual Five-Year Election in the Transition Year in respect to an Aggregate DTL Category. For the purposes of the DTL recapture rule, A Co has determined the pre-Transition Year DTLs for such DTL category. The reversals of pre-Transition Year DTLs must be taken into account in the computation of the Adjusted Covered Taxes and as such shall not be treated as reversal of unclaimed accruals. The reversal of pre-Transition Year DTLs are determined in accordance with a FIFO approach. In other words, the first net DTL decreases shall be treated as reversal of pre-Transition Year DTLs.

2. The Table below shows that the first net DTL decreases occur in Year 7, Year 8, Year 10 and so forth. Under the FIFO approach the net DTL movements to be excluded for the purposes of the Unclaimed Accrual election shall not take into account the net DTL decrease of 20 in Year 7, of 80 in Year 8 and of 50 in Year 10.

Aggregated DTL category		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Net DTL movement		10	100	130	70	-	120	(20)	(80)	-	(90)	10	(360)	(10)	(10)	(10)	(10)
Pre-Transition Year DTL	150																
Reversals allocated to pre-Transition Year DTL (FIFO)		-	-	-	-	-	-	(20)	(80)	-	(50)	-	-	-	-	-	-
Net DTL movement (after allocation to Pre-Transition Year DTL) to be excluded from Adjusted Covered Taxes under the Unclaimed Accrual election		10	100	130	70	-	120	-	-	-	(40)	10	(360)	(10)	(10)	(10)	(10)

2. Divergences between GloBE and accounting carrying values

2.1. Divergences between GloBE and accounting carrying values

2.1.1. Introduction

1. This note provides guidance on how MNE Groups should determine Adjusted Covered Taxes of Constituent Entities in cases where the accounting and GloBE carrying values and the deferred tax assets/liabilities determined therefrom diverge.

2. It also provides guidance in relation to the GloBE treatment of an intragroup transaction accounted for at cost by the acquiring Constituent Entity, as foreshadowed in Chapter 2.1 of the Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), released on 2 February 2023 (the February 2023 AG).

3. Divergences between the carrying value of assets and liabilities and the underlying deferred tax positions for GloBE and accounting purposes may occur pursuant to a number of other provisions under the GloBE Rules. Where there is a divergence between the GloBE and accounting carrying value of the assets and liabilities of a Constituent Entity it is important that the relevant elements of the Total Deferred Tax Adjustment Amount of the Constituent Entity be determined and subsequently adjusted on the basis of the carrying value relevant to the application of the GloBE Rules. The Inclusive Framework will further consider potential simplification measures to mitigate the compliance burdens associated with divergences between GloBE and accounting carrying values.

2.1.2. Issues to be considered

Divergences between GloBE and accounting carrying values

4. The GloBE Rules generally rely on the amounts reflected in the financial accounts of a Constituent Entity used in the preparation of Consolidated Financial Statements of the Ultimate Parent Entity as the starting point for determining the GloBE Income or Loss (under Article 3.1.2 or Article 3.1.3) and Adjusted Covered Taxes (Article 4.1) of each Constituent Entity. As discussed in the Commentary to Article 4.4.1, “the starting point for the Total Deferred Tax Adjustment Amount is the amount of deferred tax expense accrued in the financial accounts of a Constituent Entity". Further, paragraph 71.1 of the Commentary to Article 4.4.1 notes that “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”. The exception to this is in circumstances where the income and expense attributable to a Constituent Entity are reflected only in the Consolidated Financial Accounts, as such Article 3.1.2 and Article 4.4 allows for income and expenses, and deferred tax expenses in relation to those items, to be included in the calculation of the GloBE Income or Loss and Total Deferred Tax Adjustment Amount for that Constituent

Entity, where they are directly traced to the Constituent Entity (see paragraph 71.1 of the Commentary to Article 4.4.1).

5. However, there are cases where the GloBE Rules require a Constituent Entity to determine its GloBE Income or Loss and Adjusted Covered Taxes by reference to a carrying value that may be different from the carrying value reflected in the financial accounts otherwise used for GloBE purposes. The following Articles are affected:

- Article 3.2.1(i), which adjusts a Constituent Entity's Financial Accounting Net Income or Loss for accrued pension expense;
- Article 3.2.2, which provides an election to substitute the amount of stock-based compensation allowed as a deduction in the computation of a Constituent Entity's taxable income for the amount of stock-based compensation expense reported in the financial accounts;
- Article 3.2.3, which requires MNE Groups to apply the Arm's Length Principle to certain intra-group transactions in order to protect the integrity of jurisdictional blending;
- Article 3.2.5, which provides an election to determine gains and losses using the realisation principle in lieu of fair value accounting;
- Article 6.2.1(c), which provides that a target in the acquisition year and each succeeding year shall determine its GloBE Income or Loss and Adjusted Covered Taxes using its historical carrying value of the assets and liabilities;
- Article 6.2.2, which provides that certain acquisitions or disposals of a Controlling Interest in a Constituent Entity shall be treated as an acquisition or disposal of the assets and liabilities;
- Article 6.3.1, in circumstances where Article 3.2.3 applies in respect of asset transfers not recorded at arm's length and requires a transaction between Constituent Entities located in different jurisdictions that is not recorded in the same amount in the financial accounts of both Constituent Entities or that is not consistent with the Arm's Length Principle to be adjusted so as to be in the same amount and consistent with the Arm's Length Principle;
- Article 6.3.2, which requires an acquiring Constituent Entity in a GloBE Reorganisation to determine its GloBE Income or Loss after the acquisition using the disposing Entity's carrying values of the acquired assets and liabilities upon disposition;
- Article 6.3.3, which requires an acquiring Constituent Entity in a GloBE Reorganisation wherein a disposing Constituent Entity recognises Non-qualifying Gain or Loss to determine its GloBE Income or Loss after the acquisition using the disposing Entity's carrying value of the acquired assets and liabilities upon disposition adjusted consistent with local tax rules to account for the Non-qualifying Gain or Loss; and
- Article 6.3.4, when an MNE Group makes an election to align the outcomes under the GloBE Rules with those that apply under local tax law and the Constituent Entity recognises gain or loss and adjusts the carrying value of its assets and liabilities for purposes of the GloBE Rules.

6. Article 4.4.1(a) excludes from a Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year any amount of deferred tax expense with respect to items excluded from the computation of GloBE Income or Loss under Chapter 3. Article 3.2.11 requires adjustments to a Constituent Entity's Financial Accounting Net Income or Loss where necessary to reflect the requirements of Chapters 6 and 7.

7. If the GloBE Income or Loss of a Constituent Entity is calculated based on an asset or liability's carrying value that differs from that used to determine the deferred tax expense accrued in the financial accounts of a Constituent Entity, then any deferred tax expense or benefit accrued in connection with a deferred tax asset or deferred tax liability related to the asset or liability is no longer appropriate for computing the Total Deferred Tax Adjustment Amount under Article 4.4 to determine the Adjusted Covered Taxes of the Constituent Entity. This is because the timing differences in respect of the asset or liability

under the GloBE Rules will not correspond to the timing differences reflected in the financial accounting deferred tax assets and liabilities.

8. To ensure the correct determination of the Total Deferred Tax Adjustment Amount under the GloBE Rules, any deferred tax asset or liability must be computed based on the GloBE carrying value and then adjusted in accordance with the relevant accounting standard and the deferred tax expense or benefit in respect of such deferred tax asset or liability and its subsequent adjustments must be used to compute the Total Deferred Tax Adjustment Amount for purposes of determining the Adjusted Covered Taxes of the Constituent Entity. In circumstances where the GloBE carrying value of an asset or liability is adjusted to be aligned with the tax carrying value (tax basis) of the asset or liability, the result will be that the related deferred tax expense recorded for accounting purposes will be disregarded for GloBE purposes. This includes for the purposes of Article 4.4.4 and is intended to apply broadly to the GloBE Rules, not just to the Articles outlined in paragraph 5 above. This guidance contains certain instances that reference the excluding or disregarding of deferred tax assets or deferred tax liabilities in the financial accounts of a Constituent Entity. This is predicated on the assumption that many jurisdictions have a tax carrying value (tax basis) that will equal the GloBE carrying value of certain assets and liabilities. However, this will not necessarily be the case in all jurisdictions and all circumstances. In all cases, deferred tax assets or liabilities must be computed based on the GloBE carrying value and then adjusted in accordance with the relevant financial accounting standard.

9. It may be the case that the GloBE carrying value of an asset or liability does not match the local tax carrying value (tax basis under the income tax laws of the relevant jurisdiction). Where this is the case, even if there was no deferred tax asset or liability recorded (for instance, because the accounting carrying value and tax basis were equal), Article 4.4. must take into account any deferred tax asset or liability calculated in accordance with the relevant accounting standard, but based on the GloBE carrying value, rather than the carrying value used to determine the deferred tax expense accrued in the Constituent Entity's financial accounts (i.e. the Constituent Entity's financial accounts used in preparing Consolidated Financial Statements of the Ultimate Parent Entity). However, where the initial recognition exception applies under the relevant accounting standard and would continue to be applicable in the context of the required adjustments for GloBE purposes, the deferred tax asset or liability would not be included in calculating the Total Deferred Tax Adjustment amount even though the GloBE carrying value differs from the tax basis.

10. Similarly, in circumstances where items of income, gain, expense or loss with respect to a specific asset or liability are excluded from the GloBE calculations, such as amortization of an asset arising as a result of purchase accounting, any deferred tax asset or deferred tax liability in the financial accounts related to that specific asset or liability must be disregarded for the purposes of calculating a Constituent Entity's Total Deferred Tax Adjustment Amount.

Clarifications in relation to the effect of divergences between GloBE and accounting carrying values and the Transition Rules.

11. Given the impact of the Articles in Chapter 6 listed above and Article 3.2.3, which may result in a divergence between the GloBE carrying value and the accounting carrying value, it is essential to clarify how to determine the GloBE carrying value, and associated deferred tax assets and liabilities, in the case of pre-GloBE transactions.

12. Chapters 1 through 8 of the GloBE Rules have been generally drafted based on the assumption that the relevant items arise in a Fiscal Year in which the Constituent Entity is subject to the GloBE Rules, with Chapter 9 providing the specific rules on how the GloBE Rules apply to transactions and tax attributes that took place or arose before the GloBE Rules came into effect. Specifically, Article 9.1.1 outlines the deferred tax accounting attributes of a Constituent Entity relevant to the GloBE Rules in its Transition Year, subject to the modifications specified in Article 9.1.2 and 9.1.3. These attributes must be utilised in

calculating a Constituent Entity's Covered Taxes and the Effective Tax Rate (ETR) in a jurisdiction during the Transition Year and subsequent years. This transition rule avoids requiring complex calculations as if the Constituent Entity had been subject to GloBE Rules in prior years.

13. The exception to Article 9.1.1 is Article 6.2.1(c). Paragraph 51 of the Commentary to Article 6.2.1(c) makes the position clear in relation to direct and indirect disposals of Ownership Interests resulting in an Entity either becoming or ceasing to be a Constituent Entity. That Commentary specifies that "push-down" accounting adjustments (i.e. purchase price accounting adjustments) are excluded for the purposes of determining the carrying value of an asset or a liability for GloBE purposes, even where the transaction occurs prior to the GloBE Rules coming into effect. Where the financial accounting standard used by the UPE in preparing its Consolidated Financial Statements permits the UPE to "push down" adjustments to the carrying value of assets and liabilities that were attributable to a purchase of a business to the separate accounts of the acquired Constituent Entity, the Constituent Entity can only use the carrying value reflected in its separate accounts if the acquisition occurred prior to 1 December 2021 and the MNE Group does not have sufficient records to determine its Financial Accounting Net Income or Loss with reasonable accuracy based on the unadjusted carrying values of the acquired assets and liabilities. No such concession applies to direct and indirect disposals of Ownership Interests resulting in an Entity either becoming or ceasing to be a Constituent Entity on or after 1 December 2021.

14. The purpose of the prohibition on using GloBE carrying values that include purchase price accounting adjustments in such circumstances is tied to the GloBE principle that purchase price accounting adjustments should not affect the Financial Accounting Net Income or Loss and Adjusted Covered Taxes calculations of a Constituent Entity. Given this, the Inclusive Framework considered it necessary to have comprehensive application in circumstances where MNE Groups have sufficient records to undertake the necessary adjustments. It follows that in circumstances where Article 6.2.1(c) applies to an asset or liability of a Constituent Entity, the GloBE carrying value is the relevant value for the purposes of determining the amount of any resulting deferred tax assets or deferred tax liabilities for the purposes of Article 9.1.1.

15. However, given the potential complexity for MNE Groups and Tax Administrations to apply Article 3.2.3, Article 6.2.2, and Article 6.3.1 through Article 6.3.4 in the case of a pre-GloBE transaction, these Articles should only apply to Constituent Entities in the Transition Year and subsequent Fiscal Years. To apply such articles to prior Fiscal Years would undermine the policy purpose of Article 9.1.1. The meaning of Transition Year in such circumstances also takes into account the modification of that term where an MNE Group is subject to the Transitional CbCR Safe Harbour in a jurisdiction. As such, where the Transitional CbCR Safe Harbour has been applied, the Articles mentioned above can only have effect in the first Fiscal Year in which the relevant Tested jurisdiction no longer qualifies for or applies the Transitional CbCR Safe Harbour.

16. It should also be noted that divergences may occur between the amounts of deferred tax assets and deferred tax liabilities relevant for GloBE purposes and those amounts reflected in the financial accounts as a result of Article 9.1.3. The relevant treatment of these situations has been covered in the Administrative Guidance "Asset carrying value and deferred taxes under 9.1.3 [AG22.04.T2]" released in February 2023 and reflected in the Commentary to Article 9.1.3. As such, this guidance does not apply to assets acquired in transactions within the scope of Article 9.1.3. However, to the extent that Article 9.1.3 applies to an asset that has been subject to Article 6.2.1(c), the relevant carrying value for purposes of determining deferred tax assets and deferred tax liabilities is the GloBE carrying value established by Article 6.2.1(c).

17. The Commentary to Article 9.1.3 (paragraph 10.8) has been amended to clarify that where the acquiring Constituent Entity is subject to the GloBE Rules, the initial recognition of the GloBE deferred tax asset due to taxes paid by the disposing entity on the transfer shall not reduce the Adjusted Covered Taxes of the acquiring Constituent Entity. It has also been amended to clarify that a deferred tax asset should be recognised for GloBE purposes based on the rules of Article 9.1.3 even in circumstances where no such

deferred tax asset would arise, or would arise in a different amount, under the relevant accounting standard.

18. As a result of these clarifications, a deferred tax asset for GloBE purposes will arise regardless of whether a deferred tax asset is recognised in the financial accounts. However, because the limitation on the amount of the deferred tax asset determined under Article 9.1.3 looks to the local tax basis in the asset, the Inclusive Framework will consider providing further guidance in relation to the limitation on the amount of the deferred tax asset determined under Article 9.1.3 in situations where the jurisdiction of the acquiring Constituent Entity is located in a jurisdiction that does not have a corporate income tax system. The Inclusive Framework will also consider providing further guidance in relation to the application of the principles of Article 4.3 in the context of transfers subject to Article 9.1.3.

Intragroup transactions accounted for at cost

19. Article 6.3.1 aims at aligning the GloBE carrying values of the acquiring Constituent Entity and the amount realized on disposition that is taken into account in determining gain or loss for the disposing Constituent Entity, where the latter generally reflects the fair market value of the asset and liabilities at the time of disposition. It is premised on the assumption that intra-group transactions (transactions between Constituent Entities) are accounted for at fair value on a separate entity basis and then adjusted to eliminate intra-group income in the preparation of the Consolidated Financial Statements. However, some MNE Groups account for intra-group transactions at cost, meaning the disposing Constituent Entity does not recognise income, gain or loss on the transaction and the acquiring Constituent Entity records an asset in its financial accounts at the disposing Constituent Entity's cost.

20. 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. Article 3.2.3 also applies to transactions between Joint Ventures (which are deemed to be Constituent Entities for purposes of Chapters 3 through 7) and Constituent Entities. Without Article 3.2.3, MNE Groups could shift income from one jurisdiction to another by simply recording transactions in the financial accounts of Constituent Entities at prices that do not reflect fair value. Thus, for an MNE Group that records intra-group transactions at cost, the arm's length price is relevant for purposes of determining the GloBE income or loss of the disposing Constituent Entity, due to the application of Article 3.2.3. The February 2023 AG confirmed this application of the GloBE Rules in such situations to the disposing Constituent Entity.

21. Article 3.2.3 also applies to the acquiring Constituent Entity. Under the GloBE Rules the acquiring Constituent Entity must compute its GloBE Income or Loss on the basis that the asset (or liability) was acquired for its arm's length price. Therefore, any deferred tax asset or liability in relation to the acquired asset (or liability) must be computed for the purposes of determining Adjusted Covered Taxes under Article 4.4 based on the acquired asset's (or liability's) carrying value for GloBE purposes. The arm's length price should be the same for the disposing Constituent Entity and the acquiring Constituent Entity, and if the acquiring Constituent Entity's tax basis is also the same amount, there will not be a deferred tax asset or liability on the initial acquisition.

22. Determination of deferred tax assets based on GloBE carrying values does not displace the application of the relevant accounting standard. As such, to the extent the relevant accounting standard does not allow the recognition of the deferred tax asset or liability on certain transfers (e.g. if the Initial Recognition Exemption in IAS 12 would continue to be applicable in light of the required GloBE adjustments), no deferred tax expense will be taken into account for GloBE purposes, except in cases where the GloBE Rules specifically create a GloBE deferred tax asset (e.g. under Article 9.1.3). Further, the acquiring Constituent Entity must determine its Financial Accounting Net Income or Loss by applying the accounting treatment applicable under the relevant accounting standard to the acquired asset or liability based on the GloBE carrying value.

23. For example, a Constituent Entity (Entity A) in Jurisdiction A transfers an asset to another Constituent Entity (Entity B) in Jurisdiction B (corporate tax rate of 20%). The carrying value of the asset for Entity A is 50 and the fair market value of the asset is 150. The transfer is recorded at cost (50) for accounting purposes in accordance with the financial accounting standard used by Entity A for purposes of Article 3.1.2. Entity A reports no gain on the transaction and Entity B records a deferred tax asset in its accounts of 20 (the difference between the accounting carrying value of 50 and the tax basis of 150 multiplied by the tax rate) in accordance with Entity A's financial accounting standard. Ordinarily this deferred tax asset would be recast to 15 for GloBE purposes in accordance with Article 4.4.1. However, Entity A is required to include 100 of gain from the sale in its GloBE Income due to the application of Article 3.2.3. Because the transaction is subject to Article 3.2.3, Entity B will have a GloBE carrying value for the asset of 150 based on the asset's fair market value. As such, Entity B would not record any deferred tax asset for GloBE purposes upon acquisition. After recognition, the asset would be amortised under the relevant accounting standard based on its GloBE carrying value for the Fiscal Year and subsequent Fiscal Years. Thus, if the asset is amortised for accounting purposes on a straight-line basis over 10 years, the annual amortisation expense for GloBE purposes will be equal to 15 (150/10). However, if the asset is amortised for tax purposes over a different period, e.g. five years, a deferred tax liability shall be determined for GloBE purposes based on the timing differences that arise after the acquisition and the corresponding deferred tax expense shall be included in the computation of Entity B's Adjusted Covered Taxes (subject to recasting at the Minimum Rate because the corporate tax rate in Jurisdiction B is above 15%). Further, the deferred tax liability determined for GloBE purposes is subject to recapture for the purposes of Article 4.4.4, unless the deferred tax liability meets the definition of a Recapture Exception Accrual in Article 4.4.5.

24. However, for assets and liabilities subject to impairment testing under the relevant financial accounting standard, the GloBE carrying value will not undergo independent impairment testing if it differs from the accounting carrying value. This approach is designed to prevent MNE Groups from having to conduct separate impairment testing based on the GloBE carrying value. Impairment of the asset or liabilities' GloBE carrying value (and the related effects on the Constituent Entity's Adjusted Covered Taxes and GloBE Income or Loss) will only occur if the accounting value (attributable to the same asset or liability) is subject to an impairment in accordance with the relevant financial accounting standard. In such cases, the GloBE carrying value will be reduced to match the accounting carrying value, with the corresponding consequences included in the Constituent Entity's GloBE Income or Loss and Total Deferred Tax Adjustment Amount. Where the accounting carrying value of an asset or liability post-impairment still exceeds its GloBE carrying value, the GloBE carrying value will remain unchanged and there should be no effect on the Constituent Entity's GloBE Income or Loss or Adjusted Covered Taxes as a result of the accounting impairment.

Interaction between divergences in GloBE and accounting carrying values and the Substance-based Income Exclusion

25. Article 5.3 sets out that the Net GloBE Income for the jurisdiction shall be reduced by the Substance-based Income Exclusion (SBIE) for the jurisdiction to determine the Excess Profit for purposes of computing the Top-up Tax under Article 5.2. The SBIE amount for a jurisdiction is the sum of the payroll carve-out and the tangible asset carve-out for each Constituent Entity, except for Constituent Entities that are Investment Entities, in that jurisdiction.

26. In determining the amount of the SBIE under Article 5.3.5 the MNE Group must ascertain the sum of the payroll carve-out and the tangible asset carve-out. The Commentary to Article 5.3.5 at paragraph 49 states the following:

> "…to determine the carrying value for purposes of the carve-out in conformity with the carrying value of the asset as recorded for purposes of preparing the Consolidated Financial Statements

(i.e. after taking into account purchase accounting adjustments and elimination adjustments attributable to inter-company sales)".

27. As such and in line with the current application of Article 5.3.5, the relevant carrying value of an asset for SBIE calculation purposes shall be based on the average of the carrying value (net of accumulated depreciation, amortisation, or depletion and including any amount attributable to capitalisation of payroll expense) at the beginning and ending of the Reporting Fiscal Year as recorded for the purposes of preparing the Consolidated Financial Statements of the Ultimate Parent Entity. Any adjustment to the carrying value of an asset for GloBE purposes under this Administrative Guidance is for the purposes of determining the GloBE Income or Loss and Covered Taxes of a Constituent Entity and therefore does not affect the carrying value for SBIE purposes.

2.1.3. Guidance

28. The following text in bold will be inserted in paragraph 86 of the Commentary to Article 3.2.1(i):

86. 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 **Net** 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. **For the purposes of calculating the Constituent Entity's Adjusted Covered Taxes, the deferred tax asset or deferred tax liability in the financial accounts of the Constituent Entity used in the preparation of the Consolidated Financial Statements should be excluded under Article 4.1.3(a). However, where a deferred tax expense or benefit relating to pension surplus, it should be included in the computation of the Constituent Entity's computation of Adjusted Covered Taxes.**

29. The following text in bold will be inserted in paragraph 89 and a new paragraph 89.1 inserted after paragraph 89 of the Commentary to Article 3.2.2:

89. This disparity between the amount of expense allowed in the computation of financial accounting income and the local tax base would often depress the GloBE ETR, in some cases below the Minimum Rate. The election under Article 3.2.2 brings the GloBE Income or Loss more into line with the local tax rules in those jurisdictions that allow a deduction based on the value of the stock at the exercise date. **Where the election is made, any amount of stock-based compensation determined for accounting purposes that would be expensed through the income statement, either as an immediate expense or as amortization or depreciation in respect of an asset, must be excluded from the computation of GloBE Income or Loss, and any deferred tax expense or benefit computed for the purposes of determining the Constituent Entity's Adjusted Covered Taxes must be calculated by reference to the stock-based compensation amount included in the Constituent Entity's GloBE Income or Loss.** If the election is not made, the Constituent Entity simply computes its GloBE Income or Loss taking into account the amount of stock-based compensation allowed in the computation of its Financial Accounting Net Income or Loss **and any deferred tax expense in relation to its stock-based compensation amount, adjusted as required by Article 4.4, is included in Adjusted Covered Taxes**.

89.1 Where the election under Article 3.2.2 applies and an amount of stock-based compensation expense that was deducted for tax purposes but capitalized to another asset, such as a building, for accounting purposes, such amount shall be excluded from the GloBE carrying value of the asset for purposes of determining GloBE Income or Loss. Deferred tax assets and liabilities determined in respect of that other asset must be determined based on the GloBE carrying value of the asset.

30. The following text in bold will be inserted in paragraph 96 of the Commentary to Article 3.2.3:

96. Article 3.2.3 requires transactions between Group Entities to be priced consistently with the Arm's Length Principle and recorded at the same price for GloBE purposes for all Constituent Entities that are parties to the transaction. **Article 3.2.3 only applies to transactions undertaken by a Constituent Entity in a Transition Year and subsequent Fiscal Years. See paragraph 10 through 10.11 of the Commentary to Article 9.1.3 for rules applicable to carrying values and deferred taxes recorded prior to the Transition Year.**

31. The following paragraphs will be inserted after paragraph 104 of the Commentary to Article 3.2.3:

104.1 As noted in the Commentary to Article 6.3.1, Article 3.2.3 applies to transactions between Constituent Entities of an MNE Group. Where Article 3.2.3 applies the disposing Constituent Entity would determine its GloBE Income or Loss based on the Arm's Length Principle. Similarly, in accordance with paragraph 73.2 of the Commentary to Article 6.3.1, the acquiring Constituent Entity will take a GloBE carrying value that reflects this arm's length price (rather than the carrying value in the financial statements of the Constituent Entity or the MNE Group). This GloBE carrying value is used in determining its GloBE Income or Loss and, in accordance with the Commentary to Article 4.4, its Adjusted Covered Taxes in the Fiscal Year that the transaction occurs and future Fiscal Years.

104.2 For example, a Constituent Entity (Entity A) in Jurisdiction A transfers an asset to another Constituent Entity (Entity B) in Jurisdiction B (corporate tax rate of 20%). The carrying value of the asset for Entity A is 50 and the fair market value of the asset is 150. The transfer is recorded at cost (50) for accounting purposes in accordance with the financial accounting standard used by Entity A for purposes of Article 3.1.2. Entity A reports no gain on the transaction and Entity B records a deferred tax asset in its accounts of 20 (the difference between the accounting carrying value of 50 and the tax basis of 150 multiplied by the tax rate) in accordance with Entity A's financial accounting standard. Ordinarily this deferred tax asset would be recast to 15 for GloBE purposes in accordance with Article 4.4.1. However, Entity A is required to include 100 of gain from the sale in its GloBE Income due to the application of Article 3.2.3. Because the transaction is subject to Article 3.2.3, Entity B will have a GloBE carrying value for the asset of 150 based on the asset's fair market value. As such, Entity B would not record any deferred tax asset for GloBE purposes upon acquisition. After recognition, the asset would be amortised under the relevant accounting standard based on its GloBE carrying value for the Fiscal Year and subsequent Fiscal Years. Thus, if the asset is amortised for accounting purposes on a straight-line basis over 10 years, the annual amortisation expense for GloBE purposes will be equal to 15 (150/10). However, if the asset is amortised for tax purposes over a different period, e.g. five years, a deferred tax liability shall be determined for GloBE purposes based on the timing differences that arise after the acquisition and the corresponding deferred tax expense shall be included in the computation of Entity B's Adjusted Covered Taxes (subject to recasting at the Minimum Rate because the corporate tax rate in Jurisdiction B is above 15%). Further, the deferred tax liability determined for GloBE purposes is subject to recapture for the purposes of Article 4.4.4, unless the deferred tax liability meets the definition of a Recapture Exception Accrual in Article 4.4.5.

104.3 To further illustrate, assume the same facts as the example above, except that the tax basis of the transferred asset determined in accordance with the tax laws applicable to Jurisdiction B is $160. Given the difference between the GloBE carrying value ($150) and the tax basis ($160), Entity B will accrue a deferred tax asset of $1.50 for GloBE purposes. This recognition of the deferred tax asset will result in a reduction of Entity B's Adjusted Covered Taxes by $1.50 in the Fiscal Year of the acquisition. After recognition, the asset would be amortised under the relevant accounting standard based on its GloBE carrying value for the Fiscal Year and subsequent Fiscal Years and the deferred tax asset would reverse over the accounting amortisation period.

32. The following paragraph will be inserted after paragraph 118 of the Commentary to Article 3.2.5:

118.1 In accordance with the Commentary to Article 4.4, where an election to use the realisation method is made under Article 3.2.5, any deferred tax expense for the purposes of determining the Constituent Entity's Adjusted Covered Taxes must be determined by reference to the GloBE carrying value of the relevant assets at the commencement of the Fiscal Year in which the election is made. For assets acquired after the first day of Fiscal Year in which election is made, Adjusted Covered Taxes must be determined by reference to the carrying value of the asset (determined in accordance with the GloBE Rules, including the election to use the realisation method). For example, in the case of an equity security acquired after the election date that is subject to fair value accounting but subject to tax on a realisation basis, any movement in the accounting deferred tax expense in relation to the asset should be disregarded as it relates to gains or losses attributable to amounts that are excluded from the computation of GloBE Income or Loss under the election. In contrast, any deferred tax asset or liability related to an equity security owned by the Constituent Entity at the beginning of the Fiscal Year in which the election was made will reverse when and to the extent that the carrying value of the asset or liability subject to the realisation method election is included in the computation of the Constituent Entity's GloBE Income or Loss. Where assets and liabilities covered by the election are also subject to tax on a mark-to-market basis, any deferred tax asset or deferred tax liability should be determined by reference to the GloBE carrying value (either the GloBE carrying value of the relevant assets at the commencement of the Fiscal Year in which the election is made or when the asset was acquired).

33. The following paragraph will be inserted after paragraph 145 of the Commentary to Article 3.2.11:

145.1 Where Article 3.2.11 applies and requires an adjustment to the carrying value of an asset or liability for GloBE purposes, any deferred tax expense included in a Constituent Entity's Adjusted Covered Taxes (i.e., the Total Deferred Tax Adjustment Amount) must be computed on the basis of the GloBE carrying value of the asset or liability, unless the GloBE Rules specifically permit or require the deferred tax assets or liabilities to be determined on another basis. That is, where a

Constituent Entity's Financial Accounting Net Income or Loss is adjusted to reflect the requirements of the relevant provisions of Chapters 6 and 7, its Adjusted Covered Taxes, including its Total Deferred Tax Adjustment Amount must be calculated reflecting equivalent adjustments to the carrying value of the assets or liabilities.

34. The following bold text will be added to paragraph 68 of the Commentary to Article 4.4:

68. While Article 4.4 uses existing deferred tax accounts maintained by MNE Groups to the greatest extent possible to simplify compliance, certain adjustments are required to protect the integrity of the GloBE Rules. These adjustments include using the lower of the Minimum Rate or the applicable tax rate to calculate deferred tax assets and liabilities in order to prevent deferred tax amounts from sheltering unrelated GloBE Income. The rules also require the recapture of certain amounts claimed as deferred tax liabilities that are not paid within five years. Exceptions **to the recapture requirement** are provided for the most common and material book to tax differences when they relate to substance in a jurisdiction or are not prone to taxpayer manipulation. These amounts do not require monitoring for recapture.

35. The following paragraphs will be inserted after paragraph 68 of the Commentary to Article 4.4:

68.1. The GloBE Rules generally rely on the amounts reflected in the financial accounts of a Constituent Entity used in the preparation of Consolidated Financial Statements of the UPE as the starting point for determining the GloBE Income or Loss (under Article 3.1.2 or Article 3.1.3) and Adjusted Covered Taxes (under Article 4.1 through Article 4.4) of each Constituent Entity. As noted in paragraph 70 below, for the purposes of determining the Total Deferred Tax Adjustment Amount for a Constituent Entity, the starting point is the amount of deferred tax expense accrued in the financial accounts of a Constituent Entity used in the preparation of the UPE's Consolidated Financial Statements.

68.2. Deferred tax expense is typically computed based on differences between the financial accounting and tax carrying values of assets and liabilities. However, there are cases where the GloBE Rules require the Constituent Entity to determine its GloBE Income or Loss by reference to a carrying value of assets or liabilities that may be different from the carrying value reflected in those financial accounts. These carrying value divergences may arise under various circumstances, including the following circumstances:

(a) Article 3.2.1(i), which adjusts a Constituent Entity's Financial Accounting Net Income or Loss for accrued pension expense;

(b) Article 3.2.2, which provides an election to substitute the amount of stock-based compensation allowed as a deduction in the computation of a Constituent Entity's taxable income for the amount of stock-based compensation expense reported in the financial accounts;

(c) Article 3.2.3, which requires MNE Groups to apply the Arm's Length Principle to certain intra-group transactions in order to protect the integrity of jurisdictional blending;

(d) Article 3.2.5, which provides an election to determine gains and losses using the realisation principle in lieu of fair value accounting;

(e) Article 6.2.1(c), which provides that a target in the acquisition year and each succeeding year shall determine its GloBE Income or Loss and Adjusted Covered Taxes using its historical carrying value of the assets and liabilities;

(f) Article 6.3.1,

(i) when Article 6.2.2 applies, which provides that certain acquisitions or disposals of a Controlling Interest in a Constituent Entity shall be treated as an acquisition or disposal of the assets and liabilities; or

(ii) when Article 3.2.3 applies in respect of asset transfers not recorded at arm's length, whereby any transaction between Constituent Entities located in different jurisdictions (and between Joint Ventures and Constituent Entities located in the same jurisdiction) that is not recorded in the same amount in the financial accounts of both Constituent Entities or that is not consistent with the Arm's Length Principle must be adjusted so as to be in the same amount and consistent with the Arm's Length Principle;

(g) Article 6.3.2, which requires an acquiring Constituent Entity in a GloBE Reorganisation to determine its GloBE Income or Loss after the acquisition using the disposing Entity's carrying values of the acquired assets and liabilities;

(h) Article 6.3.3, which requires an acquiring Constituent Entity in a GloBE Reorganisation wherein a disposing Constituent Entity recognises Non-qualifying Gain or Loss to determine its GloBE Income or Loss after the acquisition using the disposing Entity's carrying value of the acquired assets and liabilities adjusted consistent with local tax rules to account for the Non-qualifying Gain or Loss; and

(i) Article 6.3.4, when an MNE Group makes the election to align the outcomes under GloBE with those that apply under local tax law and the Constituent Entity recognises a gain or loss and adjusts the carrying value of its assets and liabilities for purposes of the GloBE Rules.

68.3. Where the GloBE Income or Loss of the Constituent Entity is calculated based on different carrying values of assets or liabilities, it is not appropriate for the purposes of Article 4.4 to rely on any deferred tax expense or benefit accrued in the financial accounts in connection with deferred tax assets and liabilities determined by reference to the accounting carrying value of assets or liabilities. This is because the timing differences in respect of the asset or liability under the GloBE Rules will not correspond to the timing differences reflected in the financial accounting deferred tax assets and liabilities. In such cases, MNE Groups must determine the deferred tax assets and liabilities for GloBE purposes based on the GloBE carrying value (rather than the carrying amount in the financial accounts) and the tax carrying value (tax basis), unless otherwise specified under the GloBE Rules, and the deferred tax expense or benefit in respect of such deferred tax asset or liability and its subsequent adjustments must be used to compute the Total Deferred Tax Adjustment Amount for purposes of determining the Adjusted Covered Taxes of the Constituent Entity. The recognition and measurement of any deferred tax asset or deferred tax liability and adjustments based on the GloBE carrying value shall apply for all GloBE purposes, and therefore the deferred tax expense or benefit of a Constituent Entity for GloBE purposes must be recalculated based on the GloBE carrying value of the relevant assets and liabilities in accordance with the Acceptable Financial Accounting Standard (or Authorised Financial Accounting Standard, if applicable), unless otherwise specified under the GloBE Rules. For example, the amount of a deferred tax liability determined by reference to the GloBE carrying value of an asset or liability is still subject to recasting under Article 4.4.1. As such, movements in the deferred tax asset or liability calculated based on the accounting carrying value are ignored for purposes of the GloBE Rules when deferred tax assets and liabilities are calculated based on the GloBE carrying value, including any amortisation or depreciation of the relevant asset or liability with the relevant financial accounting standard for GloBE purposes in future Fiscal Years.

68.4. Determination of deferred tax assets based on GloBE carrying values does not displace the application of the financial accounting standard used under Article 3.1.2 or Article 3.1.3. As such, to the extent that the relevant financial accounting standard does not allow the recognition of the deferred tax asset or liability on such transfers (e.g. if the Initial Recognition Exemption in IAS 12 would continue to be applicable in light of the required GloBE adjustments), no deferred tax expense should be taken into account for GloBE purposes, except in cases where the GloBE Rules specifically create a GloBE deferred tax asset (e.g. under Article 9.1.3). Similarly, the conditions in Article 4.4.1 continue to apply to a deferred tax asset or deferred tax liability based on the GloBE carrying value. For example, to the extent the deferred tax expense arising from a deferred tax asset or deferred tax liability based on the accounting carrying value was in respect of items excluded from the computation of a Constituent Entity's GloBE Income or Loss, the deferred tax asset or deferred tax liability based on GloBE carrying value should similarly be excluded from the Constituent Entity's Total Deferred Tax Adjustment Amount.

68.5. However, for assets and liabilities subject to impairment testing under the relevant financial accounting standard, the GloBE carrying value will not undergo independent impairment testing if it differs from the accounting carrying value. This approach is designed to prevent MNE Groups from having to conduct separate impairment testing based on the GloBE carrying value. Impairment of the asset or liabilities' GloBE carrying value (and the related effects on the Constituent Entity's Adjusted Covered Taxes and GloBE Income or Loss) will only occur if the accounting value (attributable to the same asset or liability) is subject to an impairment in accordance with the relevant financial accounting standard and the post-impairment accounting carrying value is lower than the GloBE carrying value. In such cases, the GloBE carrying value will be reduced to match the accounting carrying value, with the corresponding consequences included in the Constituent Entity's GloBE Income or Loss and Total Deferred Tax Adjustment Amount. However, any inclusion of an amount in GloBE Income and Loss and Total Deferred Tax Adjustment Amount remains subject to the general application of the GloBE Rules. For instance, such amounts should not pertain to items excluded from the computation of GloBE Income or Loss under Chapter 3. Where the accounting carrying value is impaired in accordance with the relevant financial accounting standard and the post-impairment carrying value is higher than the asset or liabilities GloBE carrying value, the GloBE carrying value will remain unaffected by the impairment and there should be no effect on the Constituent Entity's GloBE Income or Loss, or its Adjusted Covered Taxes.

68.6. There are also instances in the GloBE Rules where an amount contained in financial accounts used to compute the Financial Accounting Net Income or Loss of a Constituent Entity is substituted from another amount. Typically, these substituted amounts are aligned with the income tax amounts in the jurisdiction the Constituent Entity is located. For example, where an election is made in accordance with Article 3.2.2. a Constituent Entity may substitute the amount allowed as a deduction in the computation of its taxable income in its location for the amount expensed in its financial accounts for a cost or expense of such Constituent Entity that was paid with or accrued with respect to stock-based compensation. In situations where the amount in the financial accounts is no longer the basis for computation of a Constituent Entity's GloBE Income or Loss, any deferred tax asset or deferred tax liability in the financial accounts in relation to the amount should be disregarded for the purposes of Article 4.4.1 and any deferred tax asset or deferred tax liability in relation should be calculated by reference to the amount included in the Constituent Entity's GloBE Income or Loss.

36. The following paragraph will be inserted after paragraph 90 of the Commentary to Article 4.4.4:

90.1 To the extent that a deferred tax liability arises in circumstances where there is a divergence between the carrying value of an asset or liability for financial accounting and GloBE purposes, the amount of the deferred tax liability calculated by reference to the GloBE carrying value is subject to recapture for the purposes of Article 4.4.4, unless the deferred tax liability meets the definition of a Recapture Exception Accrual in Article 4.4.5 or is subject to an Unclaimed Accrual election under Article 4.4.7. Whether an accrued deferred tax liability reverses within five years is determined based on the GloBE carrying value of the asset or liability to which the deferred tax liability relates. In the Fiscal Year to which the divergence between the carrying value of an asset or liability for financial accounting and GloBE purposes originally occurs and subsequent Fiscal Years, the deferred tax liability (if any) for GloBE purposes must be calculated on the basis of the GloBE carrying value.

37. The following text in bold will be inserted in paragraph 49 of the Commentary to Article 5.3.5:

49. Article 5.3.5 sets out the rules for determining the carrying value of Eligible Tangible Assets for purposes of the tangible asset carve-out. The Article requires the MNE Group to determine the carrying value for purposes of the carve-out in conformity with the carrying value of the asset as recorded for purposes of preparing the Consolidated Financial Statements (i.e. after taking into account purchase accounting adjustments and elimination adjustments attributable to inter-company sales). **While there may be situations where the carrying value for the purposes of calculating the GloBE Income or Loss of a Constituent Entity is different to that recorded in the financial accounts of the Constituent Entity (e.g. due to the application of Article 6.3.4), the carrying value used in the preparation of the Consolidated Financial Statements shall be used for purposes of the tangible asset carve-out (not the GloBE carrying value).** The carrying value of each asset for purposes of the carve-out is the average of the beginning and end of year carrying values. Thus, if an asset is acquired or disposed during the Fiscal Year, its carrying value at the beginning or end of the Fiscal Year will be zero. Because the zero carrying value is included in the computation of the average, the carve-out for assets acquired or disposed during the year will be based on half of the carrying value of asset at the end or beginning of the year. The consequence of taking into account purchase accounting adjustments in respect of Eligible Tangible Assets and ignoring inter-company sales adjustments is that the tangible asset carve-out is based on the cost of acquiring the assets from unrelated persons and reflects the MNE Group's actual investment in the relevant assets. Failure to include purchase accounting adjustments would understate the actual investment and including inter-company sales could overstate or understate the actual investment.

38. The following text will be inserted after paragraph 17 of the Commentary to Chapter 6:

17.1. Given this, using the example provided in paragraphs 13 through 16 above, the carrying value of A Co's assets will be retained at their historical carrying value of USD 100 for GloBE purposes in accordance Article 6.2.1(c) upon MNE Group B's acquisition of A Co. Any deferred tax liability recognised on acquisition attributable to a business combination should be disregarded for GloBE purposes on the basis that the deferred tax liability arises as a result of purchase accounting adjustments and therefore must be disregarded for GloBE purposes. Further, on disposal of the assets, A Co will include USD 200 in its GloBE Income or Loss (equal to the sale price of USD 300 *less* the GloBE carrying value of USD 100). Any reversal of the deferred tax liability recognised in the accounts on acquisition is also excluded from A Co's Total Deferred Tax Adjustment Amount.

39. The following text will be inserted after paragraph 46 of the Commentary to Article 6.2:

46.1. With the exception of Article 6.2.1(c), the rules described in Article 6.2.1 and Article 6.2.2 apply to direct or indirect disposition or acquisition of a Controlling Interest that occurs during a Transition Year and subsequent Fiscal Years. As described in paragraph 51, Article 6.2.1(c) applies to pre-Transition Year transactions as well as transactions occurring in the Transition Year and subsequent Fiscal Years. Article 6.2.2 applies during the Transition Year and subsequent Fiscal Years. In these circumstances, the definition of the Transition Year also considers any modifications to that term when an MNE Group is subject to the Transitional CbCR Safe Harbour in a specific jurisdiction.

40. The following paragraphs will be inserted after paragraph 51 of the Commentary to Article 6.2.1:

51.1. In accordance with the Commentary to Article 4.4, the computation of a Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year in relation to assets and liabilities to which Article 6.2.1 applies must be calculated based on the carrying value of those assets or liabilities for GloBE purposes (corresponding to the historical carrying value, as of the year of the acquisition, and adjusted for depreciation, amortisation as well additions, capitalised expenditure and disposals of the assets and liabilities of the acquired Constituent Entity for each subsequent Fiscal Year) and accounted for in subsequent Fiscal Years in accordance with the relevant accounting standard.

51.2. Where the relevant transaction has occurred prior to a Transition Year for the acquiring Constituent Entity and is subject to Article 6.2.1(c), the relevant deferred tax assets and deferred tax liabilities for the purposes of Article 9.1.1 must be based on the GloBE carrying value instead of the carrying value amounts used to determine the deferred tax expense accrued in the financial accounts. A deferred tax asset or deferred tax liability may be taken into account for the purposes of Article 9.1.1 even in cases where none is recorded for financial accounting purposes (for instance, where carrying value amount in the financial accounts of the Constituent Entity is equal to the tax basis, but where the GloBE carrying value after applying Article 6.2.1(c) differs). The meaning of Transition Year in such circumstances also takes into account the modification of that term where an MNE Group is subject to the Transitional CbCR Safe Harbour in a jurisdiction.

41. The following paragraph will be inserted after paragraph 70 of the Commentary to Article 6.3:

70.1. Article 6.3.1 through Article 6.3.4 apply to the acquisition or disposition of assets and liabilities that occur during a Transition Year and subsequent Fiscal Years. For acquisitions or dispositions of assets and liabilities that occur prior to a Transition Year and deferred tax assets and deferred tax liabilities related to such assets and liabilities, see Articles 9.1.1 through 9.1.3. For the purposes of the application of the abovementioned Articles, the definition of the Transition Year also considers any modifications to that term when an MNE Group is subject to the Transitional CbCR Safe Harbour in a specific jurisdiction.

42. The following text in bold will be inserted in paragraphs 71 and 72 of the Commentary to Article 6.3.1:

71. Article 6.3.1 relates to an acquisition or disposition of assets and liabilities that is not part of a GloBE Reorganisation. The Article follows the accounting treatment for both the disposing Entity and the acquiring Entity. Financial accounting rules generally recognise a seller’s gain or loss on the disposition of assets and liabilities and require the acquirer to use the acquisition price, which is generally the fair value of the assets, to measure the assets and liabilities upon its acquisition. As such, for GloBE purposes, the disposing Entity must include gain or loss from the disposition of assets and liabilities in its computation of GloBE Income or Loss and the acquiring Entity must use the adjusted carrying value as determined under the financial accounting standard used in preparing the Consolidated Financial Statements of the UPE. **As discussed in paragraph 18 of the Commentary to Chapter 6, any adjustments in the financial accounts due to an acquisition of assets and liabilities that is treated as a business combination under the relevant accounting standard but not a GloBE Reorganisation should be taken into account under Article 6.3.1 in determining the GloBE Income or Loss and Adjusted Covered Taxes of a Constituent Entity. An acquisition of a combination of assets and liabilities without the acquisition of the legal entity that transferred the assets may be treated as a business combination under the relevant accounting standard. Where such transactions are treated as business combinations under the relevant accounting standard, Adjusted Covered Taxes of a Constituent Entity shall be determined in accordance with the requirements of the income tax accounting standard (e.g. IAS 12) that prescribes income tax accounting for business combinations. This ensures that business combinations are accounted for consistently for both GloBE Income or Loss and Adjusted Covered Taxes.**

72. In a transfer to which Article 6.2.2 applies, the carrying value of the acquired assets and liabilities for GloBE purposes is based on their fair value to the extent a gain or loss on those assets and liabilities was included in the GloBE Income or Loss computation of the ~~selling~~ **disposing**

Constituent Entity of an MNE Group. The fair value must be used in the computation of the acquiring **Constituent** Entity's computation of GloBE Income or Loss in the acquisition year and subsequent Fiscal Years irrespective of whether the fair value adjustments are reflected in the Entity's financial accounts or the MNE Group's consolidated financial accounts. **In accordance with the Commentary to Article 4.4, the computation of the acquiring Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year and subsequent Fiscal Years in relation to assets and/or liabilities to which Article 6.2.2 applies must similarly be calculated based on their carrying value for GloBE purposes (fair value to the extent a gain or loss on those assets and liabilities was included in the GloBE Income or Loss computation of the disposing Constituent Entity).**

43. The following text in strikethrough will be removed from and the following text in bold will be inserted in paragraph 73.1 of the Commentary to Article 6.3.1 and the following inserted after paragraph 73.1 of the Commentary to Article 6.3.1:

> 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 **at the time of the transfer**. ~~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.~~
>
> 73.2. Further, where Article 6.3.1 applies, the acquiring Constituent Entity will take a carrying value for GloBE purposes based on the Arm's Length Principle as determined under the preceding paragraph for purposes of determining the acquiring Constituent Entity's GloBE Income or Loss in respect of the transferred asset or liability in the Fiscal Year of acquisition and subsequent Fiscal Years. This is regardless of whether the MNE Group, for financial accounting purposes, determines its deferred tax assets or liabilities by comparing the tax basis of the relevant asset or liability to the disposing Constituent Entity's carrying value or to its fair value at the time of the transfer. In accordance with the Commentary to Article 4.4, the computation of a Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year and subsequent Fiscal Years in relation to assets and liabilities to which the adjustment made by Article 3.2.3 applies must similarly be calculated based on their carrying value for GloBE purposes.

44. The following text in bold will be inserted in paragraph 75 of the Commentary to Article 6.3.2:

> 75. Article 6.3.2(a) provides that the disposing Constituent Entity will not recognise the gain or loss from the transfer of the assets and liabilities for GloBE purposes. Pursuant to Article 6.3.2(b) future profit or loss of the acquiring Constituent Entity will be determined on the basis of the historical carrying amounts of the acquired assets and liabilities. **The computation of the acquiring Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year and subsequent Fiscal Years in relation to assets and/or liabilities to which Article 6.3.2 applies must similarly be calculated based on their carrying value for GloBE purposes (historical carrying value). The GloBE carrying value of the assets and liabilities at the end of the Fiscal Year and subsequent Fiscal Years is determined by applying the relevant accounting standard to the GloBE carrying value initially determined under Article 6.3.2. This would exclude any deferred tax asset or deferred tax liability from the GloBE calculations on acquisition to the extent the GloBE and tax carrying values of the asset or liability are aligned.** The Constituent Entity must maintain accounting records to support the computation of GloBE Income or Loss **and Total Deferred Tax Adjustment Amount** by reference to the historical carrying amounts of the acquired assets and liabilities.

45. The following text in bold will be inserted in paragraph 77 of the Commentary to Article 6.3.3:

77. In the context of such GloBE Reorganisations, Article 6.3.3 provides that the disposing Constituent Entity will include a gain or loss to the extent of the Non-Qualifying Gain or Loss. This means that the computation of GloBE Income or Loss will include the lesser of the amount of gain or loss reflected in the financial accounts or the amount of the taxable gain or loss arising from the GloBE Reorganisation. Further, the acquiring Constituent Entity will increase or decrease the carrying amounts of the acquired assets and liabilities to account for the Non-qualifying Gain or Loss. The changes in carrying value for GloBE purposes must be allocated among assets and liabilities in a manner consistent with the increases and decreases of those assets under the tax law applicable to the acquiring Constituent Entity. For example, if the Constituent Entity is required by local tax rules to allocate the basis increases due to the tax gain, first to depreciable assets up to the amount of built-in gain on such assets, and then to inventory and other current assets, the Constituent Entity must do the same for GloBE purposes. However, the increase or decrease in carrying value of assets and liabilities for GloBE purposes cannot exceed the Non-qualifying Gain or Loss. **The computation of a Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year and subsequent Fiscal Years in relation to assets and/or liabilities to which Article 6.3.3 applies must similarly be calculated based on their carrying value for GloBE purposes. The GloBE carrying value of the assets and liabilities at the end of the Fiscal Year and subsequent Fiscal Years is determined by applying the relevant accounting standard to the GloBE carrying value initially determined under Article 6.3.3. This would exclude any deferred tax asset or deferred tax liability from the GloBE calculations on acquisition to the extent the GloBE and tax carrying values of the asset or liability are aligned.**

46. The following text in bold will be inserted in paragraph 81 of the Commentary to Article 6.3.4:

81. Pursuant to paragraph (b), the Constituent Entity will use the fair value of the assets and liabilities to compute its GloBE Income or Loss in the Fiscal Years ending after the triggering event. The fair value to be used is the fair value of the assets determined pursuant to the financial accounting standard used in the Consolidated Financial Statements. **The computation of a Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year and subsequent Fiscal Years in relation to assets and/or liabilities to which Article 6.3.4 applies must similarly be calculated based on their carrying value for GloBE purposes. The GloBE carrying value of the assets and liabilities at the end of the Fiscal Year and subsequent Fiscal Years is determined by applying the relevant accounting standard to the GloBE carrying value initially determined under Article 6.3.4.**

81.1. In the Fiscal Year that the election is made, any deferred tax assets and deferred tax liabilities of the Constituent Entity that existed prior to the triggering event must be fully reversed and included in Constituent Entity's Total Deferred Tax Adjustment Amount. Accrual of deferred tax amounts for accounting purposes as a result of the tax basis of the Constituent Entity's assets and liabilities being reset to fair value for tax purposes must be excluded from the Constituent Entity's Total Deferred Tax Adjustment Amount because the computation of a Constituent Entity's Total Deferred Tax Adjustment Amount for the Fiscal Year and subsequent Fiscal Years in relation to assets and/or liabilities to which Article 6.3.4 applies should be recalculated based on their carrying value for GloBE purposes as noted in paragraph 81.

47. The following text in strikethrough will be removed from paragraph 6 of the Commentary to Article 9.1.1 and the following text in bold will be inserted in paragraph 6, and additional paragraphs inserted after paragraph 6 of the Commentary to Article 9.1.1:

6. Article 9.1.1 provides the basis to use these attributes in determination of Covered Taxes pursuant to Article 4.4. Therefore, when a pre-existing deferred tax attribute is used for financial

reporting purposes in a Fiscal Year in which the GloBE Rules apply, such attribute is available for use in the application of Article 4.4, subject to the limitations of Article 9.1. For example, if a Constituent Entity incurred a tax loss of 100 in a year before the GloBE **Rules** applied, a deferred tax expense of 15 ~~(i.e. deferred tax benefit)~~ will be included in the Total Deferred Tax Adjustment Amount under Article 4.4 when the associated tax loss is used in a Fiscal Year in which the GloBE applies. ~~The GloBE Implementation Framework will consider providing Agreed Administrative Guidance related to the measurement and treatment of items of deferred tax expense (i.e. deferred tax assets and deferred tax liabilities) in the Transition Year and subsequent years.~~

6.0.1. Article 9.1.3 and Article 6.2.1(c) apply to assets and liabilities that were acquired after 30 November 2021 and prior to the Transition Year. In such cases, the pre-existing deferred tax assets or liabilities based on the historic carrying value of the relevant assets or liabilities will be relevant for the purposes of Article 9.1.1, rather than any deferred tax assets or liabilities determined based on the acquiring Entity's accounting carrying value of the assets or liabilities. The carrying value for determining the amount of any deferred tax assets or liabilities for the purposes of Article 9.1.1 may be modified by Article 9.1.3.

6.0.2. For example, ABC Group sold all the shares of C Co to DEF Group for EUR 200 on 1 January 2021. C Co owns a single asset, which had a carrying value of EUR 100 at the time of sale, as recorded for ABC Group's Consolidated Financial Statements. C Co is subject to a corporate tax rate of 15%, and the tax basis of the asset is also EUR 100. According to the accounting standard applicable to DEF Group's Consolidated Financial Statements, the acquisition of C Co's shares constitutes a business combination. The entire purchase price is attributed to the fair value of the asset. In C Co's financial statements, in accordance with relevant financial accounting standard that permits push down accounting, the asset is recognised with an accounting carrying value of EUR 200 and is subject to amortisation over a 10-year period for tax and accounting purposes. Given the tax basis of the asset is 100, for simplicity this example assumes that C Co has a deferred tax liability of EUR 15 recorded in its accounts related to the asset. Article 6.2.1(c) applies to this transaction, leading to a GloBE carrying value for the asset of EUR 100. Because the GloBE carrying value and the tax carrying value are equal, A Co has no deferred tax expense in relation to the asset for GloBE purposes. C Co becomes subject to the GloBE Rules on 1 January 2024. At the start of the Transition Year, C Co's accounting carrying value of the asset is EUR 140 due to amortisation, while the tax basis is EUR 70. Consequently, C Co has a deferred tax liability of EUR 10.5 recorded in its financial accounts in relation to the asset. However, for the purposes of Article 9.1.1, since the GloBE carrying value of the asset is EUR 70 (because of the effect of Article 6.2.1(c), no deferred tax asset or liability is considered for GloBE purposes. C Co will continue to apply the relevant accounting standard to the GloBE carrying value when determining the amortisation expense included in its GloBE Income or Loss. Additionally, any deferred tax expense related to the asset will be considered for determining C Co's Adjusted Covered Taxes for the Transition Year and future Fiscal Years.

6.0.3. To further illustrate, assume the same facts as the example above, except that upon acquisition, the local tax laws stipulate that the tax basis of the asset is stepped up to EUR 200. As the carrying value of the asset in the financial accounts of C Co determined in accordance with an Acceptable Financial Accounting Standard that permits push down accounting is EUR 200 and the asset's tax basis is also EUR 200, no deferred tax expense is recorded in C Co's financial accounts. However, as the GloBE carrying value of the asset is EUR 100 due to the application of Article 6.2.1(c), C Co will include a deferred tax asset of EUR 15 for GloBE purposes based on the difference between the tax basis (EUR 200) and the GloBE carrying value (EUR 100). C Co becomes subject to the GloBE Rules on 1 January 2024. At the start of the Transition Year, C Co's accounting carrying value and tax basis of the asset is EUR 140. Consequently, C Co continues to have no deferred tax expense recorded in its financial accounts in relation to the asset. However, for the purposes of Article 9.1.1, since the GloBE carrying value of the asset is EUR 70, a deferred tax asset of EUR 10.5 will be recognised for GloBE purposes under Article 9.1.1 and will be used in the computation of Adjusted Covered Taxes in the Transition Year and future Fiscal Years. C Co will continue to apply the relevant accounting standard to the GloBE carrying value when determining the amortisation expense included in its GloBE Income or Loss. Additionally, the deferred tax asset for GloBE purposes related to the asset will be considered for determining C Co's Adjusted Covered Taxes for the Transition Year and future Fiscal Years.

48. The following text in bold will be inserted in paragraph 10.1 of the Commentary to Article 9.1.3:

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 **(or loss)** 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. **Further, where an acquiring Constituent Entity uses its own accounting carrying value of an asset or liability as provided under paragraph 10.9 below, no deferred tax asset is created under Article 9.1.3.**

49. The following text in bold will be inserted in paragraph 10.7 of the Commentary to Article 9.1.3:

10.7. 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. **The creation of a deferred tax asset under this paragraph shall not reduce the Adjusted Covered Taxes of the acquiring Constituent Entity.** 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 10.8.

50. The text in bold will be substituted for the text in paragraphs 10.8 and the existing text of paragraph 10.8 will be moved to paragraphs 10.8.1 through 10.8.3 with the language in bold added:

10.8. **As noted above in paragraph 10.1, the main purpose of Article 9.1.3 is to prevent MNE Group's transferring assets in the run-up to the Transition Year without paying tax on the full amount of the disposing Entity's built-in gain and then avoiding tax under the GloBE Rules or a QDMTT on that gain because the asset takes a carrying value equal to its fair value or the accounting standard provides a deferred tax asset that produces the same or similar effect. However, where the MNE Group has paid tax on the built-in gain on the transfer, there is less risk that the transaction was conducted for tax avoidance reasons. The Inclusive Framework has agreed that it is appropriate to allow a deferred tax asset solely for GloBE purposes to the extent that the MNE Group can demonstrate that tax was paid in respect of gain on the intra-group transfer.**

10.8.1. Accordingly, in a transfer to which Article 9.1.3 applies, the acquiring Entity may take into account a deferred tax asset to the extent of tax paid in respect of the transfer 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 transfer and that would have been allocated to the disposing Entity under Article 4.3.

10.8.2. **The deferred tax asset for GloBE purposes will arise regardless of whether a deferred tax asset would be recognised by the acquiring Constituent Entity under the relevant accounting standard. The amount of the deferred tax asset for GloBE purposes shall be determined without reference to a deferred tax asset that would otherwise have been recognised by the acquiring Constituent Entity in the absence of Article 9.1.3. However,** 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.

10.8.3. The deferred tax asset for GloBE purposes shall be taken into account in determining the acquiring Constituent Entity's Adjusted Covered Taxes instead of any deferred tax asset that was created in respect of the acquired asset under the relevant accounting standard. The creation of a deferred tax asset under this paragraph shall not reduce the Adjusted Covered Taxes of an acquiring Constituent Entity **where the acquiring Constituent Entity is subject to the GloBE Rules**. 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.

3. Allocation of Cross-border Current Taxes

3.1. Principles for allocating cross-border, current taxes under a cross-crediting corporate tax system

3.1.1. Introduction

1. The GloBE Rules operate by allocating Covered Taxes to the GloBE Income with respect to which they were accrued. Under Article 4.3.2(a), Covered Taxes included in the accounts of a Main Entity which are with respect to GloBE Income or Loss of a Permanent Establishment are to be allocated to that Permanent Establishment. Taxable branch regimes generally mitigate double taxation by giving a credit for taxes paid to the PE's jurisdiction. Thus, the Covered Taxes allocated under Article 4.3.2(a) will often be the residual tax due after tax credits.

2. Corporate tax systems vary in how they treat foreign source income. Some such systems allow for 'cross-crediting' of foreign taxes. In these cases, taxes paid with respect to one source of income arising in one jurisdiction give rise to foreign tax credits which can be used against another source of income arising in another jurisdiction. For example, taxes paid with respect to one Permanent Establishment may give rise to tax credits for the Main Entity which can be used against the income included from a different Permanent Establishment. Cross-crediting tax regimes generally have a limitation to prevent foreign tax credits from being used to offset domestic taxes on domestic source income.

3. Where the corporate tax system applicable to the Main Entity allows for the cross-crediting of taxes, a methodology is required to determine whether (and how much) of the Main Entity's Covered Tax has been accrued with respect to the GloBE Income of each Permanent Establishment. Paragraph 52 of the Commentary to Article 4.3.2 sets out a mechanism for determining the allocation of Covered Taxes to a Permanent Establishment under a cross-crediting system. The process seeks to take into account both the taxes accrued by the relevant Permanent Establishment as well as 'an appropriate amount' of excess creditable taxes accrued with respect to other income which can be cross-credited under the domestic tax regime. It states:

> The appropriate amount of excess creditable taxes should be determined by allocating the total amount of excess creditable taxes among PE inclusions based on the relative residual tax liability due to each PE inclusion taking into account only creditable taxes paid by that PE (i.e. the liability after the credit for taxes paid by the PE but before excess credits are allocated).

4. Cross-crediting domestic tax systems may also create separate ‘categories’ or ‘baskets’ of income. In such cases, cross-crediting may be allowed within a particular category or basket of income but not between different categories or baskets of income. For example, a jurisdiction could create a separate category for passive income such that cross-crediting is allowed between different foreign sources of passive income but cross-crediting is not allowed between passive income and non-passive income. The Commentary to the GloBE Rules does not set out in detail how to allocate taxes between different categories or baskets of income.

5. It is important that a consistent mechanism is used to allocate such taxes to prevent cases in which double taxation or double non-taxation could arise.

6. Similar issues arise with respect to CFC Taxes (Article 4.3.2(c)) as well as taxes on Hybrid Entities or Reverse Hybrid Entities (Article 4.3.2(d)). The Administrative Guidance of February 2023 also contained a temporary rule with respect to the allocation of Blended CFC Taxes. This document sets out a methodology for allocating cross-border, current taxes, other than taxes arising under a Blended CFC Tax Regime which are covered by the Administrative Guidance of February 2023. This allocation mechanism is directly relevant to the application of Article 4.3.2(a), (c), (d) and (e).

3.1.2. Issues to be considered

7. Stakeholders have asked whether further guidance could be provided regarding how to allocate taxes from a Main Entity to the various Permanent Establishments under a cross-crediting system including cross-crediting systems which only allow cross-crediting between specific categories or ‘baskets’ of income. Similarly, stakeholders have asked whether further guidance could be provided to allocate taxes under a CFC Tax or taxes on Hybrid Entities or Reverse Hybrid Entities.

3.1.3. Guidance

8. The GloBE Rules allocate Covered Taxes of a Main Entity to a Permanent Establishment to the extent that those Covered Taxes have been accrued with respect to the GloBE Income of the Permanent Establishment. Where the Main Entity’s domestic tax system blends together the income of multiple Permanent Establishments, a mechanism is required for determining the extent to which the relevant taxes are to be allocated to one Permanent Establishment or another Permanent Establishment. Where the tax system also blends such income with foreign source income of the Main Entity, the mechanism must also determine the extent to which the taxes are accrued with respect to the GloBE Income of Permanent Establishments and thus are allocable to Permanent Establishments at all, as opposed to remaining with the Main Entity.

9. The general purpose of the allocation mechanism is to match Covered Taxes to the GloBE Income with respect to which they were accrued. In particular, this allocation mechanism applies in the case of current cross-credited taxes that must be allocated between a Main Entity and its Permanent Establishments or a Parent Entity and its CFCs, Hybrid Entities or Reverse Hybrid Entities when the income of such CFC, Hybrid Entity or Reverse Hybrid Entity is included in the taxable income of the Parent Entity. In some cases, the current cross-credited taxes may need to be further allocated between a CFC and its Permanent Establishments, Hybrid Entities or Reverse Hybrid Entities. It is designed to provide a common and simplified methodology for allocating cross-credited taxes to Constituent Entities. The mechanism seeks to allocate the current tax expense determined after taking into account foreign tax credits allowed. The allocation mechanism of cross-border deferred taxes is outlined in the Administrative Guidance on cross-border deferred tax allocations. Under a system that only allows credit for taxes accrued by the specific PE, the tentative tax determined based on the income can be simply reduced by the credit allowed and allocated to the PE. Where foreign taxes are cross-credited under the domestic tax system, a mechanism is necessary to allocate Covered Taxes between the Main Entity and its PEs. To the extent that foreign taxes are cross-credited under the domestic tax system only within a particular category or categories of income, the mechanism is to be applied separately to each such category of income.

10. The allocation mechanism is a four-step process for allocating current taxes which have been accrued under a tax system which 'blends' together income from multiple sources and allows the cross-crediting of tax credits within the relevant category of income. The primary purpose of this allocation mechanism is to allocate taxes from one Constituent Entity to another under Article 4.3.2. However, it will also determine any amount of current Covered Taxes accrued with respect to the income of a non-Constituent Entity, which would generally be excluded entirely from the Adjusted Covered Taxes of the Main Entity/Parent Entity under Article 4.1.3(a). The four-step allocation mechanism is intended to be sufficiently flexible so as to accommodate differing treatments of foreign source income under various corporate tax systems.

11. Under the first step of the allocation mechanism, the phrase 'foreign source income' refers to income of domestic entities to the extent the Main Entity/Parent Entity jurisdiction considers the income to be from foreign sources for purposes of determining the extent to which a foreign tax credit is allowed. In addition to income of the Permanent Establishments of the Main Entity, this may include income of a CFC, Hybrid Entity or Reverse Hybrid Entity that is included in the taxable income of the Main Entity under the domestic tax system, as well as other income received by the Main Entity from foreign sources, such as certain dividends, royalties, and interests.

12. Foreign source income is the net amount which is included in the taxable income of the Main Entity/Parent Entity. As a net concept, it is necessary to determine what expenses are taken into account. Where the domestic tax regime requires the Main Entity/Parent Entity to include the Permanent Establishment's net income into its taxable income, this will implicitly allocate expenses and therefore the included amount is the foreign source income. In other cases, it will be necessary to allocate expenses of the Main Entity/Parent Entity to the Permanent Establishment, foreign Hybrid Entity or foreign Reverse Hybrid Entity in order to determine the foreign source income of that Permanent Establishment or Entity. In these cases, only the expenses which are taken into account in determining the GloBE Income or Loss of the Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity are taken into account. For example, consider a Parent Entity with two foreign Hybrid Entities (A Co and B Co) which are subject to a cross-crediting regime. The Parent Entity has 1000 of interest expense of which 400 is allocated to a basket of income which includes the two Hybrid Entities and under the domestic law of the Parent Entity jurisdiction which determines the Parent Entity's foreign tax credit limitation. Of this 400 in interest expense, 100 is recognised as an expense of A Co for the purpose of calculating A Co's GloBE Income or Loss. The other 300 is not recognised as an expense in calculating the GloBE Income or Loss of A Co or B Co. For the purposes of step one of the cross-crediting regime, A Co's foreign source income takes into account 100 of this interest expense (that is, A Co's foreign source income is reduced by 100). There is no adjustment for the remaining interest expense.

13. In some cases, expenses are only allocated to a 'basket' of income. Allocating such expenses to individual Permanent Establishments and Entities would involve significant compliance costs. These expenses are only allocated in determining the foreign source income under the first step to the extent that the relevant expenditure is taken into account as an expense in calculating the GloBE Income or Loss of the relevant Permanent Establishment or Entity. However, such expenses do reduce the Allocable Covered Taxes under Step Two even if they are not taken into account under Step One. This is set out in further detail below.

14. Foreign source income is adjusted where the domestic tax system includes an offsetting deduction which is calculated directly by reference to that income. For example, if the Main Entity/Parent Entity must include an amount in its taxable income but is also entitled to a deduction equal to 40% of the amount included, only the net amount (that is, 60% of the total amount) will be considered to have been included in the Main Entity/Parent Entity's taxable income.

15. One of the simplest cases of a cross-crediting tax regime is where the relevant domestic tax regime in the Main Entity jurisdiction applies cross-crediting only to the income of foreign Permanent Establishments and the foreign source income derived directly by the Main Entity itself (and not through a Permanent Establishment).

16. In such a case, the first step is to determine the amount of each Permanent Establishment's income which has been included in the taxable income of the Main Entity. It is also necessary to determine the amount of foreign source income of the Main Entity itself.

17. The second step is to calculate the total 'Allocable Covered Taxes'. This step seeks to calculate the total Covered Taxes which are to be allocated between the various Permanent Establishments and the Main Entity's foreign source income. Allocable Covered Taxes are determined by the formula:

$$\begin{aligned}
&Allocable\ Covered\ Taxes \\
&= Total\ current\ tax\ expense\ accrued\ by\ the\ Main\ Entity\ with\ respect\ to\ the\ applicable\ tax\ regime \\
&- domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income \\
&- Blended\ CFC\ Taxes
\end{aligned}$$

18. This formula determines the positive amount (if any) of the total tax accrued in current tax expense of the Main Entity under the applicable tax regime which is attributable to foreign source income arising both directly (that is, as income of the Main Entity itself) and from its Permanent Establishments. This is achieved by subtracting from the total current tax accrued the amount which would have been accrued in the absence of any foreign source income and foreign tax attributes as well as any amounts of Blended CFC Taxes which have been allocated under paragraphs 58.1 to 58.7 of the Commentary to Article 4.3.2(c). If the current tax expense is zero or negative, then there is nothing to allocate to the PE under the allocation mechanism. The total current tax expense with respect to the applicable tax regime does not take into account current tax expenses which relate to an uncertain tax position or which is not expected to be paid within three years of the last day of the relevant taxable period.

19. Similarly, by pooling together the current tax accrued with respect to foreign source income, the allocation mechanism effectively allows for losses arising from one Permanent Establishment to offset the profits of another. The allocation mechanism does not require calculating the hypothetical amount which would have been accrued by each Permanent Establishment independently of all of the others. The domestic tax liability calculated without regard to any foreign source income cannot be a negative amount. If there would be no domestic tax liability in the absence of foreign source income, all of the current tax accrued will be attributable to foreign source income. Allocable Covered Taxes cannot exceed the total current tax accrued. The total current tax expense accrued by the Main Entity/Parent Entity with respect to the applicable tax regime refers to the amount of the current tax expense that is paid or accrued for the taxable year of the Main Entity with respect to the corporate income tax within which the cross-crediting mechanism applies. This does not include current tax expense accrued by the Main Entity/Parent Entity with respect to foreign taxes (regardless of whether or not a foreign tax credit is available). Such source taxes are not imposed under the applicable tax regime and they are separately allocated.

20. Adjustments are required for Qualified Refundable Tax Credits, Marketable Transferable Tax Credits and Qualified Flow-Through Tax Benefits (where the Equity Investment Inclusion Election has been made) to the extent that they are not accounted for consistently with their required GloBE treatment. For the purposes of the cross-crediting allocation mechanism, these are treated as an increase in the domestic source income of the Main Entity/Parent Entity and require adjustments to both the total current tax expense and the hypothetical domestic tax liability calculated without regard to any foreign source income. For example, a Main Entity has domestic source income of 1000 and foreign source income of 1000 under the Main Entity domestic tax regime. The Main Entity jurisdiction has a 20% tax rate. The Main Entity also receives 100 in Qualified Refundable Tax Credits under the Main Entity's domestic tax regime. Accordingly, it has a domestic tax liability of 300 for the year ((2000 x 20%) - 100). For the purposes of applying the cross-crediting allocation mechanism, the Main Entity is treated as having domestic source income of 1100 (1000 + 100). Its total current tax expense is 400 (300 + 100) and its domestic tax liability without regard to any foreign source income is 220 (1100 x 20%).

21. In some cases, the Main Entity/Parent Entity jurisdiction may apply progressive tax rates such that a different tax rate applies depending upon the amount of income earned. If all income is subject to one tax rate where a certain threshold of total income is met, the domestic tax liability without regard to any foreign source income must be calculated by applying the tax rate which in fact applied to the Main Entity/Parent Entity. This amount is not calculated using the rate which would have been applied if the Main Entity/Parent Entity did not have foreign source income. If the progressive tax regime applies different tax rates to different 'bands' of income such that one rate is applied to income up to a particular threshold and another rate is applicable beyond that threshold, then the domestic tax liability without regard to any foreign source income must be calculated having allocated a proportionate share of each progressive tax rate band between the various sources of taxable income. For example, a Main Entity Jurisdiction has progressive tax rates such that the first 200 of income is subject to tax at a 10% rate and all subsequent income is subject to tax at a 20% rate. A Main Entity has 100 of domestic source income, 100 of taxable income from PE1 and 200 of taxable income from PE2. As the domestic source income has given rise to 25% of the total taxable income (100/400), it is allocated 25% of each threshold. Accordingly, the Main Entity is treated as having 50 of income subject to tax at 10% rate (200 x 25%) and 50 of income subject to tax at a 20% rate (200 x 25%). As a result, the domestic tax liability calculated without regard to any foreign source income is 15 ((50 x 10%) + (50 x 20%)).

22. The third step is to calculate the Cross-Crediting Allocation Key for each Permanent Establishment as well as for the Main Entity itself. The Cross-Crediting Allocation Key is designed to provide a common and simplified methodology to allocate taxes from a Main Entity to Constituent Entities. The Cross-Crediting Allocation Key is the positive number, if any, resulting from the following formula:

$$\begin{aligned} &Cross - Crediting\ Allocation\ Key\ for\ a\ PE \\ &\quad = (taxable\ income\ of\ the\ PE\ \times applicable\ tax\ rate) \\ &\quad - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ PE's\ income \end{aligned}$$

$$\begin{aligned} &Cross - Crediting\ Allocation\ Key\ for\ the\ Main\ Entity\ /\ Parent\ Entity \\ &\quad = (Main\ Entity\ taxable\ income\ arising\ directly\ from\ foreign\ source\ income \\ &\quad \times applicable\ tax\ rate) \\ &\quad - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ foreign\ source\ income \end{aligned}$$

23. The taxable income of the Permanent Establishment is the amount determined in the first step. The applicable tax rate is the tax rate in the Main Entity jurisdiction which is applicable to the taxable income of the Permanent Establishment under the tax regime applicable in the Main Entity jurisdiction. Where multiple taxes are placed on the Main Entity with respect to the income of the Permanent Establishment, the cross-crediting allocation mechanism must be applied separately to each tax. The applicable tax rate does not aggregate tax rates from different tax bases. The creditable foreign taxes accrued with respect to the Permanent Establishment means foreign taxes paid or accrued, including tax paid or accrued under a Qualified Domestic Minimum Top-up Tax, with respect to the Permanent Establishment's income, but only if the tax meets the definition of a creditable tax under the tax laws of the Main Entity's jurisdiction. This can include creditable foreign taxes which are imposed by a jurisdiction other than the PE Jurisdiction. For example, a withholding tax paid to a third jurisdiction with respect to income derived by the PE. Similarly, creditable foreign taxes accrued with respect to the foreign source income would generally include taxes paid in the source jurisdiction with respect to foreign source income which is accrued by the Main Entity directly (such as royalty withholding tax). The Cross-Crediting Allocation Key for a Permanent Establishment cannot be negative. If the result of the above formula is negative, the Cross-Crediting Allocation Key for the Permanent Establishment is zero.

24. A Cross-Crediting Allocation Key is also required for the Main Entity itself. This is to capture the fact that current taxes have been accrued with respect to foreign source income which has been earned by the Main Entity directly (that is, not through a Permanent Establishment). The Main Entity's relevant taxable income is that which it derives directly from foreign source income and not through a Permanent Establishment or foreign subsidiary (for example, royalty income). The current tax accrued with respect to this income would include creditable taxes paid or accrued in current tax expense by the Main Entity on this income (for example, royalty withholding tax imposed on the Main Entity but collected and remitted by the payor).

25. In some cases, the Main Entity may have multiple types of foreign source income which are effectively subject to different tax rates. This could occur because of a partial exemption or a deduction which is linked to the amount of the inclusion in taxable income from that type of income). It could also occur because different types of income are subject to tax at different rates (despite tax credits being available for cross-crediting between types of income with different tax rates). In such cases, a single Cross-Crediting Allocation Key must be determined for the Main Entity. Where different effective tax rates are applied through the use of an exemption or a related deduction, the applicable Cross-Crediting Allocation Key for the Main Entity is given by the formula above. Where there are multiple applicable tax rates which apply to different types of income, it is necessary to determine the Main Entity's pre-foreign tax credit liability arising directly from foreign source income. The Main Entity's pre-foreign tax credit liability arising directly from foreign source income is the sum of each type of foreign source income multiplied by the tax rate applicable to that type of income. In such cases, the creditable foreign taxes accrued with respect to the foreign source income includes creditable foreign taxes on each such type of income.

26. For example, consider a jurisdiction (Jurisdiction X) which allows for cross-crediting between different types of foreign source income and applies a tax rate of 10% to Type A income and 20% to Type B income. A Main Entity located in Jurisdiction X has 100 of Type A income which has been subject to 5 of creditable withholding tax and 100 of Type B income which has been subject to 15 of creditable withholding tax. The Cross-Crediting Allocation Key of the Main Entity in Jurisdiction X is 10 ((100 x 10%) + (100 x 20%) – (5 + 15)).

27. By comparison, Jurisdiction Y has a 20% tax rate and a cross-crediting regime which applies to Type A and Type B foreign source income. However, Jurisdiction Y provides a Main Entity with a deduction equal to 50% of the amount of Type A Income. Jurisdiction Y does not reduce the available foreign tax credits from Type A Income as a result of this deduction. As above, the Main Entity has 100 of Type A income (subject to 5 in creditable withholding tax all of which remains creditable despite the related deduction) and 100 of type B income (subject to 15 of creditable withholding tax). As a result of the directly related deduction, the Main Entity has 150 of foreign source income (50 + 100) which is subject to a tax rate of 20%. The Cross-Crediting Allocation Key of the Main Entity in Jurisdiction Y is also 10 (((50 + 100) x 20%) – (5 + 15)).

28. Where the Main Entity/Parent Entity is subject to a progressive tax rate regime as described in paragraph 21, the applicable tax rate for each Permanent Establishment or Entity will be the rate identified in that paragraph. If all income is subject to one tax rate where a certain threshold of total income is met, the applicable tax rate is the rate which was in fact applied to the Main Entity/Parent Entity in determining its taxable income. If the progressive tax regime applies different tax rates to different 'bands' of income such that one rate is applied to income up to a particular threshold and another rate is applicable beyond that threshold, then the domestic tax liability without regard to any foreign source income must be calculated having allocated a proportionate share of each progressive tax rate band between the various sources of taxable income.

29. The fourth step is to determine the allocation to each Permanent Establishment as well as the Main Entity. This is given by the following formula:

$$Allocation\ to\ the\ PE\ (or\ Main\ Entity) = Allocable\ Covered\ Taxes \times \left(\frac{Cross - Crediting\ Allocation\ Key\ for\ the\ Permanent\ Establishment\ (or\ Main\ Entity)}{The\ sum\ of\ all\ Cross - Crediting\ Allocation\ Keys}\right).$$

30. This final step takes the total amount of Allocable Covered Taxes and apportions it between the various Permanent Establishments and the Main Entity in accordance with the Cross-Crediting Allocation Key. These taxes are allocated to the respective Permanent Establishments under Article 4.3.2(a). Taxes which are allocable to the Main Entity will not be reallocated under Article 4.3.2 but they must be taken into account as part of the Cross-Crediting Allocation Key mechanism in order to accurately allocate taxes to the Permanent Establishments.

Domestic source income of foreign Permanent Establishments, CFCs, Hybrid Entities and Reverse Hybrid Entities

31. There may be cases where a Main Entity/Parent Entity is imposing tax on a foreign Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity which is earning income from the Main Entity/Parent Entity jurisdiction. Where this occurs outside the context of a cross-crediting regime, the general principles outlined in paragraphs 46 to 51 of the Administrative Guidance to Article 4.3.2 applies. Where the relevant income is subject to a cross-crediting regime and is treated as foreign source income for the purposes of an applicable foreign tax credit limitation, the income will be treated as foreign source income under the cross-crediting allocation mechanism. Finally, where the income is not treated as foreign source income of the Main Entity/Parent Entity for the purposes of applying the foreign tax credit limitation but is nevertheless included in the GloBE Income of the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity, that income will be treated as foreign source income for the purposes of the cross-crediting allocation mechanism and all taxes paid with respect to that income are allocated under the cross-crediting allocation mechanism. The amount is treated as forming part of the taxable income of the relevant Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity for the purposes of applying Step 1 of the cross-crediting allocation mechanism.

32. For example, consider a Main Entity (located in Jurisdiction A) that has a Permanent Establishment (located in Jurisdiction B). The Permanent Establishment earns income from transactions with an unrelated entity (X Co) in Jurisdiction A that is included in the Permanent Establishment’s GloBE Income or Loss. Jurisdiction A imposes tax on the Permanent Establishment’s income from transactions with X Co and the income from X Co is not treated as foreign source income for the purposes of calculating the foreign tax credit limitation applicable to Main Entity. In such cases, the PE’s income from transactions with X Co is treated as foreign source income of the Permanent Establishment and the Jurisdiction A taxes paid with respect to that income are allocated under the cross-crediting allocation mechanism.

33. Where the Main Entity/Parent Entity jurisdiction has multiple baskets within which its cross-crediting tax regime applies, the domestic source income will be allocated to the basket to which foreign taxes on that income are allocated. If the domestic tax regime of the Main Entity/Parent Entity does not provide foreign tax credits on domestic source income, the domestic source income will be allocated to the same basket to which foreign taxes are (or would be) allocated if the income had been foreign source income of the same type under the Main Entity/Parent Entity jurisdiction's law. For example, a Parent Entity jurisdiction allows for cross-crediting within two separate baskets – active source income (Basket A) and passive foreign source income (Basket B). A foreign Hybrid Entity earns passive income from a third party in the Parent Entity Jurisdiction on which no foreign tax credit is allowable under the Parent Entity's domestic tax regime. This income is treated as domestic source income for the purposes of the foreign tax credit limitation. In this case, the rule would determine that the passive income from the third party in the Parent Entity Jurisdiction was treated as foreign source income allocated to Basket B. This is because if that type of income (passive income) had been earned from foreign sources, any creditable taxes paid with respect to it would have been allocated to Basket B.

Cross-crediting between permanent establishments and taxable distributions

34. If the Main Entity's domestic tax system allows for cross-crediting between Permanent Establishments and distributions from foreign subsidiaries, the allocation mechanism is required to allocate the relevant taxes between the Permanent Establishments and the subsidiary Constituent Entities. The GloBE Rules allow for the allocation of such taxes to the respective Permanent Establishments and subsidiary Constituent Entities under Article 4.3.2(a) and Article 4.3.2(e) respectively. In such cases, the Constituent Entity paying the tax is both the Main Entity with respect to the Permanent Establishments and a Parent Entity with respect to the subsidiaries which made the distributions ('Main Entity/Parent Entity').

35. In such cases, the above formula is modified to take into account the ability to cross-credit between Permanent Establishments and taxable distributions as follows:

36. The first step also requires calculating the Main Entity/Parent Entity's inclusion in taxable income as a result of the distribution from the relevant distributing Entity. If the Main Entity/Parent Entity's domestic tax system includes in the taxable income of the Main Entity/Parent Entity a 'gross-up' for any taxes paid by the distributing Entity, that amount is also included in this step. For example, a distributing Entity earns 100 of income, pays 10 of local tax and makes a distribution of 90 to its Parent Entity. If the Parent Entity jurisdiction grants an indirect tax credit for the foreign taxes paid with respect to that distribution (10) but adds the amount of these indirect foreign tax credits to the taxable income of the Parent Entity such that the total inclusion in taxable income is 100, the addition 10 is included in taxable income as a 'gross-up' amount. The total foreign source income is 100.

37. The second step requires calculating Allocable Covered Taxes taking into account both the taxable income of all Permanent Establishments as well as any distributions from distributing Entities. The domestic tax liability calculated without regard to any foreign source income requires excluding the income from both foreign Permanent Establishments and distributions from foreign subsidiaries as well as the tax liability arising from any foreign source income of the Main Entity/Parent Entity. The formula is applied as follows:

$$
\begin{aligned}
&\mathit{Allocable\ Covered\ Taxes} \\
&\qquad = \mathit{Total\ current\ tax\ expense\ accrued\ by\ the}\ \boldsymbol{Main\ Entity} \\
&\qquad /\ \boldsymbol{Parent\ Entity}\ \mathit{with\ respect\ to\ the\ applicable\ tax\ regime} \\
&\qquad - \mathit{domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income} \\
&\qquad - \mathit{Blended\ CFC\ Taxes}
\end{aligned}
$$

38. The third step requires determining the Cross-Crediting Allocation Key for the distributing Entities. The Cross-Crediting Allocation Keys for each Permanent Establishment and the Main Entity remain unchanged. The Cross-Crediting Allocation Key for each distributing Entity is given by the positive amount, if any, from the following formula:

$$\begin{aligned}&Cross - Crediting\ Allocation\ Key\ for\ a\ distributing\ Entity\\&\quad = (taxable\ income\ arising\ from\ the\ distribution \times applicable\ tax\ rate)\\&\quad - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ distribution\end{aligned}$$

39. As per the first step, the taxable income arising from the distribution includes any 'gross-up' for taxes paid in the distributing Entity jurisdiction and is adjusted for any deductions permissible under the Main Entity/Parent Entity's domestic tax system in respect of such distribution. The applicable tax rate is that which is applied to the relevant income in the hands of the Main Entity/Parent Entity. The creditable foreign taxes accrued with respect to the distribution includes all relevant foreign taxes for which a foreign tax credit is granted notwithstanding any foreign tax credit limitation. Depending on the foreign tax credit rules applicable in the Main Entity jurisdiction, this would include taxes which give rise to a direct foreign tax credit (for example, a withholding tax) or an indirect foreign tax credit (for example, a regime which grants the Main Entity a foreign tax credit equal to its proportionate share of the corporate income taxes paid by the distributing entity). It will also include Qualified Domestic Minimum Top-up Taxes if the Main Entity jurisdiction gives a foreign tax credit for such taxes. The Cross-Crediting Allocation Key for such entities also cannot be negative. If the outcome of the formula is negative, the Cross-Crediting Allocation Key for the relevant distributing Entity will be zero.

40. The fourth step is largely unchanged. Each Permanent Establishment and distributing Entity, as well as the Main Entity itself, receives an allocation of the Allocable Covered Taxes in proportion to its Cross-Crediting Allocation Key.

$$\begin{aligned}&Allocation\ to\ the\ PE\ or\ Entity\\&\quad = Allocable\ Covered\ Taxes\\&\quad \times \left(\frac{Cross - Crediting\ Allocation\ Key\ for\ the\ PE\ or\ Entity}{The\ sum\ of\ all\ Cross - Crediting\ Allocation\ Keys}\right).\end{aligned}$$

Cross-crediting within separate categories or baskets of income

41. If the Main Entity/Parent Entity jurisdiction's domestic tax system contains separate categories or 'baskets' of foreign source income within which cross-crediting is allowed, the formula must be modified to calculate a separate amount of Allocable Covered Taxes for each such category or basket. The above formula for Allocable Covered Taxes assumes a single basket of income. Where the tax system contains multiple baskets, the Allocable Covered Taxes for each basket are calculated using the following formula:

$$\begin{aligned}&Allocable\ Covered\ Taxes\ for\ \boldsymbol{Basket\ A}\\&= Total\ current\ tax\ expense\ accrued\ by\ the\ Main\ Entity\ with\ respect\ to\ the\ applicable\ tax\ regime\\&- domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income\\&- Blended\ CFC\ Taxes - \boldsymbol{domestic\ tax\ liability\ attributable\ to\ remaining\ Baskets}\end{aligned}$$

42. In determining the domestic tax liability attributable to each basket it may be necessary to allocate certain relevant tax attributes between the income in different baskets. This must be done using a reasonable allocation method which takes into account the design of the relevant domestic tax system and making reasonable assumptions where necessary. The sum of the domestic tax liability without regard to any foreign source income and the domestic tax liability attributable to each basket must be equal to the total tax paid by the Main Entity/Parent Entity. For these purposes, an allocation must be positive or zero. The methodology cannot result in a negative allocation to any basket or to the domestic tax liability calculated without regard to any foreign source income.

43. The remaining steps are then applied within the relevant category or basket of income. The income and current taxes accrued by a PE or Entity with respect to foreign source income in one basket is irrelevant to the application of the cross-crediting allocation mechanism to foreign source income in another basket. The allocation to each PE or Entity with respect to its income within the basket is given by the following formula.

$$\begin{aligned}&Allocation\ to\ the\ PE\ or\ Entity\\&= Allocable\ Covered\ Taxes\ for\ the\ Basket\ \mathrm{X}\ \left(\frac{Cross-Crediting\ Allocation\ Key\ for\ the\ PE\ or\ Entity\ for\ the\ Basket}{The\ sum\ of\ all\ Cross-Crediting\ Allocation\ Keys\ \boldsymbol{in\ the\ Basket}}\right)\end{aligned}$$

44. If a Permanent Establishment or Entity has income in multiple baskets, the total allocation to that Constituent Entity will be the sum of the allocations under each basket of income.

45. The above example contains Covered Taxes which are to be allocated to a Permanent Establishment under Article 4.3.2(a) as well as allocations to a distributing Constituent Entity under Article 4.3.2(e). These principles are also applicable to determine the allocation of other Covered Taxes which are subject to an allocation under Article 4.3.2.

Current Taxes accrued with respect to non-GloBE Income

46. The four-step process described above is a mechanism for allocating current taxes accrued by a Main Entity/Parent Entity under its domestic corporate income tax system on the income of its respective Permanent Establishments and distributing Entities. This allocation mechanism does not presume an allocation towards the GloBE Income of Constituent Entities. In cases where the Main Entity/Parent Entity has accrued current tax expense with respect to profits which are excluded from GloBE Income, the relevant tax expense will be excluded from Adjusted Covered Taxes of the Permanent Establishment or distributing Constituent Entity. Whether or not the current tax expense accrued by the Main Entity/Parent Entity were accrued with respect to GloBE Income is determined by reference to the relevant tax regime applicable in the Main Entity/Parent Entity and making reasonable assumptions as necessary.

47. For example, a Parent Entity could pay tax with respect to a distribution which is an Excluded Dividend under the GloBE Rules from a non-Constituent Entity. The allocation formula would determine the amount of current tax expense accrued with respect to that Excluded Dividend. These taxes would have been accrued with respect to an amount excluded from GloBE Income or Loss under Chapter 3. The taxes were not accrued with respect to GloBE Income and are therefore excluded from the Adjusted Covered Taxes of the Parent Entity by Article 4.1.3(a).

48. Furthermore, to the extent that the cross-crediting allocation mechanism allocates tax to non-GloBE Entities (i.e. Entities that are not Constituent Entities, Joint Ventures or JV Subsidiaries), that amount of tax must be allocated to such non-GloBE Entities to ensure that such tax is properly excluded from the Adjusted Covered Taxes of the Constituent Entities, Joint Ventures or JV Subsidiaries of the MNE Group for GloBE purposes where the distribution is not included in the GloBE Income or Loss of the Main Entity/Parent Entity. Tax allocable to non-Constituent Entities will not be excluded from the Adjusted Covered Taxes of the Main Entity/Parent Entity if the distribution is included in the Main Entity/Parent Entity's GloBE Income or Loss (for example, if the Main Entity/Parent Entity has a Short-term Portfolio Shareholding in the distributing Entity).

Revisions to the Commentary

49. The text in strikethrough will be deleted from and the text in bold added to paragraph 52 of the Commentary to Article 4.3.2:

> 52. Determining the amount of Tax paid on a PE income inclusion is more complicated when cross-crediting is allowed because Taxes paid by one PE are allowed to reduce the tax liability arising in respect of other PE income inclusions. Cross-crediting means that the Tax paid with respect to an income inclusion from a low-taxed PE may not equal the pre-credit tax liability on the inclusion less the tax credit allowed for Taxes paid by that PE. **Where cross-crediting is allowed, an allocation mechanism is required to determine the extent to which the current taxes accrued by the Main Entity have been accrued with respect to its Permanent Establishments as opposed to other sources of income (for example, foreign source income earned directly by the Main Entity itself). The following four-step process is designed to allocate the taxes of the Main Entity by reference to the design of the Main Entity's tax regime. This methodology is only used to allocate the taxes imposed on the Main Entity under the corporate income tax which applies the cross-crediting tax regime. The methodology is not used to allocate other taxes imposed with respect to the income included in the cross-credited tax regime (for example, it does not allocate current tax expense with respect to a withholding tax for which a foreign tax credit is granted under the cross-credited tax regime). The first step calculates the foreign source income of each PE. The second step calculates the total Allocable Covered Taxes which have been accrued with respect to foreign source income and are available for allocation. The third step assigns a 'Cross-Crediting Allocation Key' to each PE as well as the Main Entity itself). The fourth step allocates the Allocable Covered Taxes between the PEs and the Main Entity. The allocations to the PEs are made under Article 4.3.2(a). The methodology is set out in the paragraphs below. The Inclusive Framework will consider further guidance with respect to the impact of post-filing adjustments on the cross-crediting allocation mechanism.** ~~Where cross-crediting is allowed, the Taxes paid in respect of an inclusion should be determined by subtracting the credit allowed for Taxes paid by the particular PE, and then further subtracting an appropriate amount of excess creditable Taxes paid by other PEs from the pre-credit tax liability of the PE. The appropriate amount of excess creditable taxes should be determined by allocating the total amount of excess creditable taxes among PE inclusions based on the relative residual tax liability due to each PE inclusion taking into account only creditable taxes paid by that PE (i.e. the liability after the credit for taxes paid by the PE but before excess credits are allocated). Allocating the excess creditable taxes based on relative residual tax liability determined based solely on the PE's creditable taxes will ensure that the amount of the Main Entity's Covered Taxes allocated to PEs does not exceed the amount of Taxes actually arising on the related income inclusions. Deferred~~

~~tax liabilities with respect to PE income are allocated in the same manner. The rules with respect to the recognition of deferred tax liabilities are set forth in Article 4.4.~~

50. The following paragraphs will be added after paragraphs 52 of the Commentary to Article 4.3.2:

52.1. Where cross-crediting is allowed between different sources of foreign source income, including different Permanent Establishments and/or distributions from Entities, the current tax accrued by the Main Entity/Parent Entity must be allocated to the Permanent Establishments and/or distributing Constituent Entities by applying the principles contained in the following four-step calculation. Where cross-crediting is allowed between all foreign source income, there will only be a single 'pool' or 'basket' of income to which the allocation mechanism will apply. Where cross-crediting is only allowed within a particular 'pool' or 'basket' of income, this calculation is to be applied separately to each such pool or basket of income. Where multiple taxes with different tax bases are placed on the Main Entity with respect to the foreign source income (for instance, separately applied under a federal and an applicable subnational tax with a different tax base), this cross-crediting allocation mechanism must be applied separately to allocate the amount of Allocable Covered Taxes that relates to each such tax. In the case of multiple taxes with identical tax bases that apply to the same Entities (for example, a surtax), those taxes may be aggregated in determining the amount of Allocable Covered Taxes such that the mechanism can be applied once on an aggregated basis with respect to those taxes, rather than separately for each tax.

52.2. First, the relevant inclusion in the Main Entity/Parent Entity's taxable income arising from each Permanent Establishment and distributing Entity must be determined. The foreign source income earned directly by the Main Entity/Parent Entity which is included in its taxable income must also be calculated. Foreign source income means income of domestic entities to the extent the Main Entity/Parent Entity jurisdiction considers the income to be from foreign sources for purposes of determining the extent to which a foreign tax credit is allowed. It includes, for example, the income of foreign Permanent Establishments, CFCs, Hybrid Entities or Reverse Hybrid Entities which is included in the taxable income of the Main Entity/Parent Entity under its domestic tax system along with certain dividends, royalties and interest payments received by the Main Entity/Parent Entity from foreign sources.

52.3. Foreign source income is a net amount. It takes into account both income and expenses which are used in determining the total inclusion of foreign source income in the taxable income of the Main Entity. Where the applicable tax regime includes a net amount of the Permanent Establishment or Entity's income in the Main Entity/Parent Entity's taxable income, this net amount will be the foreign source income. However, where the domestic tax regime applicable in the Main Entity/Parent Entity requires an allocation of expenses of the Main Entity to foreign source income only for the purposes of applying the foreign tax credit limitation (and not for determining the inclusion in the Main Entity's taxable income), these expenses are not allocated to each PE or Entity for the purposes of the first step.

52.4. Where only an 'after-tax' amount is included in the Main Entity/Parent Entity's taxable income (for example, the amount of an actual or deemed distribution) but a 'gross-up' is required for taxes paid by the distributing Entity, the taxable income of the Main Entity/Parent Entity will also include the 'gross-up' amount. For example, a distributing Entity earns 100, pays 10 of local tax and makes a distribution of 90 to its Parent Entity. If the Parent Entity jurisdiction grants an indirect tax credit for the foreign taxes paid with respect to that distribution (10) but adds the amount of these indirect foreign tax credits to the taxable income of the Parent Entity such that the total inclusion in taxable income is 100, the addition 10 is included in taxable income as a 'gross-up' amount. The amount of foreign source income must also be adjusted for any deduction or exclusion calculated directly reference to the amount of the relevant inclusion in taxable income. For example, if the Main Entity/Parent Entity must include an amount in its taxable income but is also entitled to a deduction equal to 40% of the amount included, only the net amount (that is, 60% of the total amount) will be considered to have been included in the Main Entity/Parent Entity's taxable income.

52.5 Under some domestic tax regimes, the Main Entity may have multiple types of foreign source income which are subject to the same cross-crediting regime but are subject to different tax rates or for which there is a different linked deduction or exclusion from taxable income as described in paragraph 52.4. In such cases, there is still only a single amount of foreign source income for the Main Entity for the purposes of Step 1.

52.6 Where a foreign Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity earns income which is (a) treated as domestic source income of the Main Entity/Parent Entity under the Main Entity/Parent Entity's domestic tax regime and (b) included in the GloBE Income of the Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity, that income is treated as foreign source income for the purposes of the cross-crediting allocation mechanism. For example, consider a Main Entity (located in Jurisdiction A) which has a Permanent Establishment (located in Jurisdiction B) which earns income from an unrelated entity (X Co) in Jurisdiction A which is included in the GloBE Income or Loss of the Permanent Establishment. Jurisdiction A imposes tax on the Permanent Establishment's profits from X Co and the income from X Co is not treated as foreign source income for the purposes of calculating the foreign tax credit limitation applicable to Main Entity. In such cases, the PE's income from X Co is treated as foreign source income of the Permanent Establishment and the taxes paid with respect to that income are allocated under the cross-crediting allocation mechanism.

52.7 If the domestic tax regime of the Main Entity/Parent Entity has several baskets in which cross-crediting may occur, the domestic source income earned by the Permanent Establishment, CFC, foreign Hybrid Entity or Reverse Hybrid Entity that is treated as foreign source income under paragraph 52.6 should be allocated to the same basket to which the foreign taxes paid by the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity are (or would be) allocated under the domestic tax regime of the Main Entity/Parent Entity. If the domestic tax regime of the Main Entity/Parent Entity does not provide foreign tax credits on domestic source income, the domestic source income will be allocated to the same basket to which foreign taxes would be allocated if the income had been foreign source income of the same type under the Main Entity/Parent Entity jurisdiction's law.

52.8 Where a payment is made from the Main Entity/Parent Entity to the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity which is disregarded for the purposes of applying the Main Entity/Parent Entity's domestic tax regime that income will be treated as foreign source income of the Permanent Establishment, CFC or foreign Hybrid if it is included in the GloBE Income or Loss of the recipient Constituent Entity. For example, consider a Parent Entity with a foreign Hybrid Entity (X Co, in Jurisdiction X) under a cross-crediting tax regime. Under the Parent Entity's domestic tax regime, all payments between Parent Entity and X Co are disregarded in determining foreign source income within a basket. Parent Entity makes a 500 payment and a 100 payment to X Co. X Co includes the 500 payment in its GloBE Income or Loss but not the 100 payment. X Co has no other income or expense for the year. For the purposes of the cross-crediting allocation mechanism, X Co's foreign source income is 500.

52.9 A similar issue arises where a payment is made from a Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity to the Main Entity/Parent Entity which is disregarded for the purposes of calculating the foreign tax credit limitation applicable to the Main Entity/Parent Entity. In such cases, the payment will only be treated as reducing the foreign source income of the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity to the extent that it is taken into account as an expense in calculating the GloBE Income or Loss of the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity.

52.10 There can also be a payment which is made from one Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity of a Main Entity/Parent Entity to another Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity of the same Main Entity/Parent Entity. In such cases, the payment will only be treated as income of the recipient of the payment for the purposes of this cross-crediting allocation mechanism if the payment is both taken into account as income in calculating the GloBE Income or Loss of the Recipient and as an expense in calculation the GloBE Income or Loss of the payor.

52.11 In some cases, the Main Entity/Parent Entity jurisdiction's tax regime will not determine a net amount of foreign source income for each Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity. Instead, it may include all the income and expense of that PE, CFC, Hybrid Entity or Reverse Hybrid Entity in determining the taxable income of the Main Entity/Parent Entity and only allocate a portion of the total expenses of the Main Entity/Parent Entity to a basket of foreign source income for the purposes of applying its foreign tax credit limitation. In such cases, where the domestic tax regime only allocates domestic expenses to foreign source income for the purposes of calculating the foreign tax credit limitation, those expenses will be included in determining the foreign source income of the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity for the purposes of the first step but only to the extent that those expenses are included in determining the GloBE Income or Loss of the Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity. To the extent there are expenses allocated to the basket of foreign source income which are not included in the determination of GloBE Income or Loss of any Permanent Establishment, CFC, foreign Hybrid Entity or foreign Reverse Hybrid Entity, those expenses remain in the Main Entity/Parent Entity.

52.12 For example, consider a Parent Entity with two foreign Hybrid Entities (A Co and B Co) which are subject to a cross-crediting regime. The Parent Entity jurisdiction's tax regime does not determine a net income amount of foreign source income from the Hybrid Entities which is included in the taxable income of the Parent Entity. Instead, the Parent Entity jurisdiction's domestic tax regime includes all of the income and expenses of the Hybrid Entities and allocates expenses to a basket of foreign source income solely for the purposes of applying the foreign tax credit limitation. The Parent Entity has 1000 of deductible interest payments of which 400 is allocated to a basket of income which includes the two Hybrid Entities for the purposes of determining the Parent Entity's foreign tax credit limitation. Of this 400 of deductible interest, 100 is recognised as an expense of A Co for the purpose of calculating A Co's GloBE Income or Loss. The other 300 is not recognised as an expense in calculating the GloBE Income or Loss of A Co or B Co. For the purposes of step one of the cross-crediting regime, A Co's foreign source income takes into account 100 of this interest expense (that is, A Co's foreign source income is reduced by 100). There is no adjustment for the remaining 900 of interest expense.

52.13. Second, the Allocable Covered Taxes are determined using the formula:

$$\begin{aligned}
&Allocable\ Covered\ Taxes \\
&\qquad = Total\ current\ tax\ expense\ accrued\ by\ the\ Main\ Entity \\
&\qquad /\ Parent\ Entity\ with\ respect\ to\ the\ applicable\ tax\ regime \\
&\qquad - domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income \\
&\qquad - Blended\ CFC\ Taxes
\end{aligned}$$

This formula operates to exclude taxes which have been accrued with respect to the domestic source income of the Main Entity/Parent Entity as well as taxes imposed under a Blended CFC Tax Regime which have been allocated in accordance with paragraphs 58.1 to 58.7 of the Commentary to Article 4.3.2(c).

52.14 Total current tax expense accrued by the Main Entity/Parent Entity with respect to the applicable tax regime is the current tax expense for the relevant period with respect to the corporate income tax within which the cross-crediting mechanism applies. This does not include current tax expense accrued by the Main Entity/Parent Entity with respect to foreign taxes (regardless of whether or not a foreign tax credit is available). Such source taxes are not imposed under the applicable tax regime and they are separately allocated.

52.15 The total current tax expense with respect to the applicable tax regime does not take into account current tax expenses which relate to an uncertain tax position, or which are not expected to be paid within three years of the last day of the relevant taxable period.

52.16 The total current tax expense takes into account the GloBE treatment of any applicable tax credits. For example, non-refundable tax credits which reduce the total tax payable by the Main Entity/Parent Entity under the applicable tax regime would reduce the amount of total current tax expense. Adjustments are required for Qualified Refundable Tax Credits, Marketable Transferable Tax Credits and Qualified Flow-Through Tax Benefits (where the Equity Investment Inclusion Election has been made) to the extent that they are not accounted for consistently with their required GloBE treatment. For the purposes of the cross-crediting allocation mechanism, these are treated as an increase in the domestic source income of the Main Entity/Parent Entity and result in a corresponding adjustment to both the total current tax expense and the domestic tax liability calculated without regard to any foreign source income.

52.17 For example, a Main Entity has domestic source income of 1000 and foreign source income of 1000 under the Main Entity domestic tax regime. The Main Entity jurisdiction has a 20% tax rate. The Main Entity also receives 100 in Qualified Refundable Tax Credits under the Main Entity's domestic tax regime. Accordingly, it has a domestic tax liability of 300 for the year ((2000 x 20%) - 100). For the purposes of applying the cross-crediting allocation mechanism, the Main Entity is treated as having domestic source income of 1100 (1000 + 100). Its total current tax expense is 400 (300 + 100) and its domestic tax liability without regard to any foreign source income is 220 (1100 x 20%).

52.18. The domestic tax liability without regard to any foreign source income requires a hypothetical calculation of the domestic tax liability in the absence of income and other tax attributes arising from foreign sources, as determined under the domestic tax rules. Foreign source income for these purposes are the amounts determined under Step One except as adjusted by paragraph 52.20.

52.19 Where an amount is treated as foreign source income under paragraphs 52.6 to 52.12, there is a corresponding adjustment to the calculated domestic tax liability of the Main Entity or Parent Entity. Where the Main Entity or Parent Entity directly earns both foreign source income (for example, royalty income) and domestic source income, the adjustment will be made in proportion to each type of directly earned income. For example, consider a Main Entity/Parent Entity in Jurisdiction A which has taxable income of 1000 of which 750 has arisen from domestic source income and 250 is directly earned foreign source royalty income of the Main Entity/Parent Entity. The Main Entity/Parent Entity also has indirect foreign source income from a PE of 500. The Main Entity/Parent Entity has also made a disregarded payment of 400 to a Hybrid Entity (B Co) in Jurisdiction B, which B Co has included in its taxable income and GloBE Income. For the purposes of applying Step 2, the Main Entity/Parent Entity's 'domestic tax liability without regard to any foreign source income' is calculated as follows. First, the corresponding adjustment for the 400 in disregarded payments which has been treated as foreign source income under paragraph [52.8] must be allocated proportionately between the directly earned domestic source income and the directly earned foreign source income of the Main Entity/Parent Entity. Accordingly, 300 is allocated to domestic sources (400 x (750 / (750 + 250))). The indirect foreign source income from the PE is not relevant to the allocation. As a result, the corresponding adjustment reduces Main Entity/Parent Entity's domestic source income for the purposes of Step 2 by 300. Accordingly, the Main Entity/Parent Entity's 'domestic tax liability without regard to any foreign source income' is 90 ((750 – 300) x 20%).

52.20 Where the domestic tax regime allocates domestic expenses to foreign source income for the purposes of calculating a foreign tax credit limitation, those expenses are excluded when calculating the hypothetical domestic tax liability. As a result, the allocation of domestic expenses to foreign source income under a Main Entity/Parent Entity's tax regime increases the hypothetical domestic tax liability and therefore reduces the amount of Allocable Covered Taxes under the formula.

52.21 For example, a Parent Entity in Jurisdiction X has a foreign Hybrid (Y Co) located in Jurisdiction Y. Y Co has 600 of gross revenue and 400 of domestic expenses producing domestic taxable income of 200. Jurisdiction X includes this 200 in Parent Entity's taxable income. However, in addition, Jurisdiction X allocates 50 of Parent Entity's expenses to a basket of income including Y Co's income for the purposes of applying its foreign tax credit limitation. As a result, Parent Entity includes in its taxable income 200 of foreign source income as a result of Y Co but Parent Entity's foreign source income for the purposes of applying the foreign tax credit limitation is 150. No taxes are paid in Jurisdiction Y. Parent Entity also has domestic source income of 800, producing a total taxable income of 1000 in Jurisdiction X. Jurisdiction X applies a 20% rate and therefore imposes 200 in taxes. In the above example, Y Co has 200 of foreign source income for the purposes of Step One of the cross-crediting allocation mechanism. However, for the purposes of Step Two of the cross-crediting allocation mechanism, Y Co has foreign source income of 150. Accordingly, Parent Entity's domestic tax liability without regard to any foreign source income is 170 (850 x 20%), The Allocable Covered Taxes are 30 (200 – 170).

52.22 The hypothetical domestic tax liability cannot be a negative amount. If the hypothetical domestic tax liability would be negative, or is zero, Allocable Covered Taxes will be all of the current tax accrued by the Main Entity. Allocable Covered Taxes must also either be positive or zero. If the hypothetical domestic tax liability exceeds the total current tax accrued in the Main Entity, Allocable Covered Taxes will be zero. The domestic tax liability without regard to any foreign source income is determined under the applicable tax regime and is unaffected by Article 4.3.4.

52.23 If the domestic regime applies a progressive tax rate regime such that one tax rate is applicable to all income (and not just the income above the relevant threshold), then the domestic tax liability without reference to foreign source income is determined by applying the rate which was applied to the Main Entity/Parent Entity in determining its tax liability (and not the rate which would have applied in the absence of the foreign source income). Where the Main Entity/Parent Entity jurisdiction applies progressive tax rates such that one tax rate is applicable to income up to a certain threshold followed by a different tax rate applicable to income above that threshold, the domestic tax liability without regard to any foreign source income must be calculated having allocated a proportionate share of each progressive tax rate band between the various sources of taxable income. For example, a Main Entity Jurisdiction has progressive tax rates such that the first 200 of income is subject to tax at a 10% rate and all subsequent income is subject to tax at a 20% rate. A Main Entity has 100 of domestic source income, 100 of taxable income from PE1 and 300 of taxable income from PE2 and PE3 has a taxable loss of 100. Accordingly, it has total taxable income of 400 (100 + 100 + 300 – 100). As the domestic source income has given rise to 25% (100/400) of the total taxable income, it is allocated 25% of each threshold. Accordingly, the Main Entity is treated as having 50 (200 x 25%) of income subject to tax at 10% rate and 50 (200 x 25%) of income subject to tax at a 20% rate. As a result, the domestic tax liability calculated without regard to any foreign source income is 15 ((50 x 10%) + (50 x 20%)).

52.24. The third step is to calculate the 'Cross-Crediting Allocation Key' for each Permanent Establishment and distributing Entity as well as for the Main Entity/Parent Entity itself. These Cross-Crediting Allocation Keys are given by the following formula:

$$\begin{aligned} Cross - Crediting\ Allocation\ Key\ for\ a\ PE \\ &= (Main\ Entity\ taxable\ income\ arising\ from\ the\ PE \times applicable\ tax\ rate) \\ &- creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ PE's\ income \end{aligned}$$

$$Cross - Crediting\ Allocation\ Key\ for\ a\ distributing\ Entity$$
$$= (Parent\ Entity\ taxable\ income\ arising\ from\ distribution \times applicable\ tax\ rate) - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ distribution$$

$$Cross - Crediting\ Allocation\ Key\ for\ the\ Main\ Entity\ /\ ParentEntity$$
$$= (Main\ Entity\ taxable\ income\ arising\ directly\ from\ foreign\ source\ income \times applicable\ tax\ rate) - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ foreign\ source\ income$$

52.25. The Main Entity/Parent Entity taxable income arising from the PE or distribution is the amount given in the first step. The applicable tax rate is the tax rate applicable to the relevant cross-crediting pool of taxable income by the jurisdiction of the Main Entity/Parent Entity. If the Main Entity has different types of foreign source income which are subject to different applicable tax rates and still fall within a single cross-crediting regime, it is necessary to determine the Main Entity's pre-foreign tax credit (FTC) liability arising directly from foreign source income. This is the sum of each type of foreign source income multiplied by the tax rate applicable to that type of income in the Main Entity jurisdiction. Where the Main Entity/Parent Entity is subject to a progressive tax rate regime such that a different tax rate is applicable to different portions of its taxable income, each source of income will be treated as having been subject to tax at each progressive tax rate in proportion to its share of the total taxable income as described in paragraph 52.23. The Cross-Crediting Allocation Key is then given by the following formula:

$$Cross - Crediting\ Allocation\ Key\ for\ the\ Main\ Entity\ /\ Parent\ Entity$$
$$= Main\ Entity\ Parent\ Entity\ Pre\ FTC\ tax\ liability\ arising\ from\ foreign\ source\ income - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ foreign\ source\ income$$

52.26 The tax paid to the Permanent Establishment jurisdiction is the tax paid or accrued in current tax expense of the Permanent Establishment for which the Main Entity receives a foreign tax credit under the Main Entity Jurisdiction's domestic tax regime. Depending on the foreign tax credit rules applicable in the Main Entity jurisdiction, this would include taxes which give rise to a direct foreign tax credit (for example, a withholding tax) or an indirect foreign tax credit (for example, a regime which grants the Main Entity a foreign tax credit equal to its proportionate share of the corporate income taxes paid by the distributing entity). It will also include Qualified Domestic Minimum Top-up Taxes if the Main Entity jurisdiction gives a foreign tax credit for such taxes. With respect to the allocation key for the Main Entity, current tax expense accrued with respect to the foreign source income includes taxes paid by the Main Entity/Parent Entity for which a foreign tax credit is available (for example, royalty withholding tax for which the Main Entity was liable, but which was collected and remitted by the payor in another jurisdiction). The Cross-Crediting Allocation Key for a PE or Entity cannot be a negative amount. It must be positive or zero. If the Cross-Crediting Allocation Key for a PE or Entity would be negative it will be zero for the purposes of applying the cross-crediting allocation mechanism.

52.27 The fourth step allocates the Allocable Covered Taxes (as determined under Step 2) in proportion to the Cross-Crediting Allocation Key for each PE or Entity (as determined under Step 3). This is done in accordance with the following formula:

$$Allocation\ to\ each\ PE\ or\ Entity = Allocable\ Covered\ Taxes \times \left(\frac{Cross - Crediting\ Allocation\ Key\ for\ the\ PE\ or\ Entity}{The\ sum\ of\ all\ Cross - Crediting\ Allocation\ Keys}\right).$$

The sum of all Cross-Crediting Allocation Keys includes the Cross-Crediting Allocation Keys of all Permanent Establishments and distributing Entities as well as the allocation key of the Main Entity/Parent Entity itself. This formula determines the allocation to each such Entity.

52.28 For the purposes of allocating Covered Taxes under Article 4.3.2, the relevant allocations are those with respect to each Permanent Establishment and distributing Constituent Entity. However, the MNE Group's allocation of Covered Taxes ought to be consistent with the hypothetical allocations. For example, to the extent that tax has been paid with respect to a distribution from a non-Constituent Entity which is not included in the Parent Entity's GloBE Income, that amount is not included in the Adjusted Covered Taxes of the Main Entity/Parent Entity. To the extent that the cross-crediting allocation mechanism allocates tax to non-GloBE Entities (i.e. Entities that are not Constituent Entities, Joint Ventures or JV Subsidiaries) in which it has a direct or indirect Ownership Interest, that amount of tax must be allocated to such non-GloBE Entities to ensure that such tax is properly excluded from the Adjusted Covered Taxes of the Constituent Entities, Joint Ventures or JV Subsidiaries of the MNE Group for GloBE purposes where the distribution is not included in the GloBE Income or Loss of the Main Entity/Parent Entity. Tax allocable to non-Constituent Entities will not be excluded from the Adjusted Covered Taxes of the Main Entity/Parent Entity if the distribution is included in the Main Entity/Parent Entity's GloBE Income or Loss (for example, if the Main Entity/Parent Entity has a Short-term Portfolio Shareholding in the distributing Entity).

52.29. The above formula is used to allocate Covered Taxes accrued in current tax expense by a Main Entity/Parent Entity under its domestic tax system to its Permanent Establishments and distributing Constituent Entity subsidiaries. Where the above formula allocates Covered Taxes to a Permanent Establishment or distributing Constituent Entity which have been incurred with respect to an amount excluded from GloBE Income or Loss, the Permanent Establishment or distributing Constituent Entity must then exclude those Covered Taxes under Article 4.1.3(a) in order to determine its Adjusted Covered Taxes. This principle applies to any other applicable adjustment under Article 4.1.3.

52.30. Where the domestic tax system of the Main Entity/Parent Entity allows only for cross-crediting within particular categories or 'baskets' of income, the above formula must be modified to determine the allocation within each basket of income. The Allocable Covered Taxes for each basket are calculated using the following formula:

$$\begin{aligned} Allocable\ Covered\ Taxes\ for\ Basket\ A &= (total\ current\ tax\ expense\ accrued\ in\ the\ Main\ Entity \\ &/\ Parent\ Entity\ jurisdiction \\ &- domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income \\ &- domestic\ tax\ liability\ attributable\ to\ remaining\ Baskets) \end{aligned}$$

52.31. In determining the domestic tax liability attributable to each basket it may be necessary to allocate tax attributes (for example, a loss or a tax credit) between the income in different baskets. This must be done using a reasonable allocation method which takes into account the design of the relevant domestic tax system and making reasonable assumptions where necessary. The same allocation method must be applied consistently by the MNE Group in calculating its liabilities under any IIR, UTPR or qualified domestic minimum top-up tax. The sum of the domestic tax liability without regard to any foreign source income and the domestic tax liability attributable to each basket must be equal to the total current tax expense accrued by the Main Entity/Parent Entity. An allocation must be positive or zero. The methodology cannot result in a negative allocation to any basket.

52.32. The remaining steps in the formula are then also calculated separately for each category or basket of income. The Cross-Crediting Allocation Key for each PE or Entity for each basket is calculated separately from that PE's or Entity's allocations with respect to other baskets. Accordingly, the formula to determine the allocation to a given Permanent Establishment or distributing Constituent Entity is as follows:

$$Allocation\ to\ each\ PE\ or\ Entity = Allocable\ Covered\ Taxes\ for\ the\ Basket \times \left(\frac{Cross-Crediting\ Allocation\ Key\ for\ the\ Entity\ for\ the\ Basket}{The\ sum\ of\ all\ Cross-Crediting\ Allocation\ Keys\ in\ the\ Basket}\right).$$

The sum of all Cross-Crediting Allocation Keys in the Basket (that is, the denominator in this formula) includes the Cross-Crediting Allocation Keys of the Main Entity/Parent Entity itself, all Permanent Establishments and all other distributing Entities (including non-Constituent Entities).

52.33. A Permanent Establishment or distributing Entity may have an allocation with respect to multiple baskets. In such cases, the total allocation to that Permanent Establishment or Entity will be the sum of its allocation with respect to each basket.

52.34. The Inclusive Framework will further consider the impact of post-filing adjustments with respect to the application of the cross-crediting allocation mechanism and its interaction with Article 4.6.1.

51. Paragraphs 53 and 54 of the Commentary to Article 4.3.2 are revised to read as follows:

> 53. **The above principles are to be applied with respect to other circumstances in which a domestic tax regime allows for the cross-crediting of foreign taxes on income from different sources. The purpose of the formula is to provide a common mechanism for allocating taxes which arise as a result of a domestic tax calculation which combines attributes from multiple different jurisdictions. The mechanism must take into account the design of the domestic tax system and make reasonable assumptions.** ~~In the case of a Flow-through Entity Article 4.3.2(a) allocates, in accordance with the allocation of GloBE Income or Loss pursuant to Article 3.5.1(a), the underlying taxes to the PE. If for instance the Constituent Entity-owner of a Flow-through Entity (such as a partner of Tax Transparent Entity that is a partnership which is itself also a Constituent Entity) is required to pay the tax with respect to the income attributable to the PE due to the activities undertaken through a Tax Transparent Entity that tax is allocated pursuant to Article 4.3.2 (a) from the Partner to that PE.~~ **The principles outlined in paragraphs 52 to 52.33 are also applicable to other Covered Taxes which are to be allocated under Article 4.3.2, such as CFC Taxes under Article 4.3.2(c), taxes in respect of the income of Hybrid Entities or Reverse Hybrid Entities under Article 4.3.2(d), and taxes on distributions from a Constituent Entity under Article 4.3.2(e). For example, a Hybrid Entity may be treated as equivalent to a foreign Permanent Establishment under an applicable domestic tax regime and included in a cross-crediting 'pool' or 'basket' of foreign source income. In such cases, the principles outlined in paragraphs 52 to 52.33 are applied to allocate Covered Taxes to that Hybrid Entity as part of the relevant 'pool' or 'basket' of cross-credited foreign source income. Where a cross-border allocation of Covered Tax would be made to a CFC (under Article 4.3.2(c)), Hybrid Entity (under Article 4.3.2(d)) or Reverse Hybrid Entity (under Article 4.3.2(d)) under this methodology, the limitation in Article 4.3.3 with respect to Passive Income will limit the cross-border allocation (where applicable). Where the limitation in Article 4.3.3 applies, any tax amount will remain with the Constituent Entity-owner and will not be reallocated to another Entity under the formula.**
>
> 54. **There may be occasions where multiple Constituent Entities under the GloBE Rules are recognised as only a single entity for the purposes of applying the Main Entity/Parent Entity's tax regime. For example, a Parent Entity jurisdiction's CFC Tax Regime may only recognise a single CFC where the CFC has a Permanent Establishment or the CFC owns another Entity which is disregarded (treated as part of the CFC) for the purposes of the Main Entity/Parent Entity's tax regime. The GloBE Rules require a mechanism of allocating CFC taxes of the Parent Entity between the CFC and the CFC's Permanent Establishment. In such cases, foreign source income of the single entity recognised under the Main Entity/Parent Entity's tax regime must be allocated between the Constituent Entities which form a part of that single recognised entity (which may be separate tested units under the applicable Main Entity/Parent Entity tax regime). This allocation must be done by reference to the applicable Main Entity/Parent Entity tax regime. For instance, where the Main Entity/Parent Entity's tax return requires separate disclosure of the attributable foreign source income from Constituent Entity as a separate taxable unit (for example, a tested unit or qualified business unit), this must be used for allocating the foreign source income between the Constituent Entities. The creditable foreign taxes with respect to each such Constituent Entity must be separately determined and cannot be allocated proportionately to the foreign source income itself. Creditable foreign taxes must have been paid with respect to**

the relevant foreign source income. ~~Recognizing that there is significant variation in how countries impose tax on PEs (including variation in the treatment of losses and foreign tax credits), as discussed in the first paragraphs of the Commentary to this Article, the GloBE Implementation Framework includes the development of a common methodology to determine the amount of Covered Taxes allocated from a Constituent Entity to a PE in connection with specific country regimes.~~

3.2. Clarification of Article 3.4.5

3.2.1. Introduction and issue presented

52. The methodology for allocation of Main Entity tax on PE income set out above references the domestic tax rules to determine the extent to which current tax expense is accrued with respect to the PE income. A similar issue arises with respect to determining the extent to which the loss of a PE is taken into account of the Main Entity when there are other PEs with income.

53. Article 3.4.5 allows a Main Entity to take into account a PE loss in computing its GloBE Income or Loss to the extent that such loss is treated as an expense in the computation of the Main Entity's domestic taxable income. In determining the extent to which the loss of a PE is treated as an expense of the Main Entity, the domestic rules for measuring PE income for which a tax credit is allowed must be taken into account including whether the loss is first set off against the income of another PE.

3.2.2. Guidance

54. The language in bold will be added to paragraph 200 of the Commentary to Article 3.4.5:

> 200. A GloBE Loss of a PE shall be treated as an expense of the Main Entity for purposes of computing its GloBE Income or Loss, to the extent that the loss of the PE is treated as an expense in the computation of the domestic taxable income or loss of such Main Entity. This provision applies irrespective of whether the tax base of the Main Entity takes into account the net loss of the PE or each of its items of income and expense. Thus, if the Main Entity takes into account only 80% of a PE loss in computing its domestic taxable income, then the same percentage of the PE's GloBE Loss is treated as an expense in the computation of the Main Entity's GloBE Income or Loss and the remaining 20% is treated as a loss in computing the PE's GloBE Income or Loss. However, if a PE loss produces a time-limited loss carryforward for the Main Entity it is treated as an expense in the computation of the Main Entity's domestic taxable loss irrespective of whether such carry-forward expires before it is used in full. **In determining the extent that a PE loss is treated as an expense in the computation of domestic taxable income, proper regard shall be given to the rules of the Main Entity jurisdiction for determining the PE Income, including foreign tax credit rules. For example, if the rules of a Main Entity's jurisdiction offset PE losses against PE income in determining the amount of foreign source income against which a foreign tax credit is allowed, then the PE loss should be first allocated to the other PE Income and only the excess above the other PE income should be considered an expense in the computation of GloBE Income or Loss of the Main Entity. In a case where two or more PEs have a loss and those losses are offset by income of one or more other PEs, the amount of the loss taken into account by the Main Entity under Article 3.4.5 shall be apportioned between the loss PEs in proportion to their separate losses as determined under the applicable regime. For example, if PE1 has income of 100 and PE2 and PE3 each have losses of 150, the Main Entity will take into account a net loss of 200. That loss shall be considered to have taken into account 100 of loss from PE2 and 100 of loss from PE3 under Article 3.4.5.**

3.2.3. Examples

Example 4.3.2-3

1. An MNE Group with a UPE in Jurisdiction X is subject to a worldwide tax system applied by Jurisdiction X. Under this tax system, Jurisdiction X imposes tax on both domestic and foreign source income, including dividends received from foreign corporations, and allows a tax credit for taxes paid on foreign source income. Jurisdiction X has a cross-crediting foreign tax credit regime pursuant to which taxes paid in all foreign jurisdictions on all categories of foreign source income are creditable against the UPE's tax liability arising from foreign source income. Under the Jurisdiction X's domestic tax regime, the foreign tax credit allowed for any given Fiscal Year cannot exceed the tax liability arising from the income inclusion of foreign sources and the foreign tax credit limitation.

2. The UPE has PEs in jurisdictions A (PE1), B (PE2), and C (PE3) and owns a subsidiary (A Co) in jurisdiction A. The UPE owns 100% of A Co and all of A Co's after-tax profits are distributed to the UPE annually. For the Fiscal Year, UPE earns domestic source income of 400, PE1 generates income of 100, PE2 generates income of 250, PE3 has a loss of 50, and A Co generates income of 200. All of the PE income is active income. The UPE also derives a royalty income of 100 from a payment from a non-Constituent Entity (B Co) (which is in addition to its 400 of domestic income) and dividend income of 200 from a non-Constituent Entity C Co in jurisdiction B. Jurisdiction X also has a foreign tax credit limitation equal to its domestic tax liability multiplied by the proportion of foreign source income to total income. The dividend income from C Co is included in the UPE's taxable income under the cross-crediting regime but is not within the UPE's GloBE Income or Loss.

3. Tax rates in jurisdictions and Tax accrued with respect to the income of the UPE, each PE and the distributing Entity and royalty are as follows:

Jurisdiction	Entity	Income	Corporate income tax rate	Corporate income tax	Withholding tax rate	Withholding tax
Jurisdiction X	UPE	400	20%	80		
Jurisdiction A	PE1	100	5%	5		
	A Co	200	5%	10	5%	9.5
Jurisdiction B	PE2	250	10%	25		
	UPE's income from B Co payment*	100			20%	20
	C Co**	200	10%	20	0%	0
Jurisdiction C	PE3	-50	25%	0		

*Note that both the payment UPE receives from B Co and the dividend received from C Co are included in the taxable income of the UPE in addition to UPE's 400 of domestic source income.

**Note that the figures with respect to C Co in this table reflect UPE's proportionate share of the income and taxes of C Co. That is, they are 20% of the total income and taxes of C Co.

4. Under the cross-crediting tax system in jurisdiction X:

   a. Taxable income of the UPE is 1200 = 400+100+200+250+100-50+200.
   b. Pre-credit tax liability payable in Jurisdiction X is 240 = 1200×20%.
   c. Tax accrued in foreign jurisdictions is 89.5 = 5+10+25+9.5+20+20.
   d. Foreign tax credit limitation is 160 = 240×800/1200.
   e. Allowed foreign tax credit is 89.5 which is the lower of c and d.
   f. Tax payable in jurisdiction X is 150.5 = 240-89.5.

5. The Allocable Covered Taxes is determined as follows:

$$\begin{aligned}&Allocable\ Covered\ Taxes\\&= Total\ current\ tax\ expense\ accrued\ by\ the\ Main\ Entity\ with\ respect\ to\ the\ applicable\ tax\ regime\\&- domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income\\&- Blended\ CFC\ Taxes\end{aligned}$$

= (150.5 – (400 × 20%)) = 70.5.

6. The Cross-Crediting Allocation Keys for the PEs, distributing Entity and the Main Entity/Parent Entity are determined using the relevant formulae below:

$$\begin{aligned}&Cross - Crediting\ Allocation\ Key\ for\ a\ PE\\&= (Main\ Entity\ taxable\ income\ arising\ from\ the\ PE \times applicable\ tax\ rate)\\&- creditable\ foreign\ taxes\ accrued\ to\ the\ PE's\ income\end{aligned}$$

$$\begin{aligned}&Cross - Crediting\ Allocation\ Key\ for\ a\ distributing\ Entity\\&= (Parent\ Entity\ taxable\ income\ arising\ from\ distribution\\&\times applicable\ tax\ rate)\\&- creditable\ foreign\ taxes\ accrued\ with\ respect\ \ to\ the\ distribution\end{aligned}$$

$$\begin{aligned}&Cross - Crediting\ Allocation\ Key\ for\ the\ Main\ Entity\ or\ Parent\ Entity\\&= (Main\ Entity\ taxable\ income\ arising\ directly\ from\ foreign\ source\ income\\&\times applicable\ tax\ rate)\\&- creditable\ foreign\ taxes\ accrued\ with\ respect\ \ to\ the\ foreign\ source\ income\end{aligned}$$

Entity	Main Entity taxable income arising from the foreign source income	Applicable tax rate	Tax accrued with respect to the foreign source income	Cross-Crediting Allocation Key
	[1]	[2]	[3]	[4] = ([1] × [2]) - [3]
PE1	100	20%	5	15
PE2	250	20%	25	25
PE3	-50	20%	0	0
A Co	200	20%	19.5	20.5
C Co	200	20%	20	20
Main Entity	100	20%	20	0
In total				80.5

7. The Allocable Covered Taxes of 70.5 is allocated to the PEs, the distributing Entities and Main Entity as follows:

$$\begin{aligned}&Allocation\ to\ each\ PE\ or\ Entity\\&= Allocable\ Covered\ Taxes\ x\left(\frac{Cross - Crediting\ Allocation\ Key\ for\ the\ PE\ or\ Entity}{The\ sum\ of\ all\ Cross - Crediting\ Allocation\ Keys}\right)\end{aligned}$$

Entity	Cross-Crediting Allocation key for the Entity	The sum of all Cross-Crediting Allocation Keys	Allocable Covered Taxes	Allocation to the Entity
	[1]	[2]	[3]	[4] = ([1] / [2]) × [3]
PE1	15	80.5	70.5	13.14
PE2	25			21.89

PE3	0			0
A Co	20.5			17.95
C Co	20			17.52
Main Entity	0			0
In total				70.5

8. The final result is that the Main Entity has accrued 150.5 in Covered Taxes, of which 13.14 is allocated to PE1, 21.89 is allocated to PE2, 17.95 is allocated to A Co and 17.52 is allocated to C Co. As C Co is not part of the MNE Group, this allocation of 17.52 to C Co is not included in the Adjusted Covered Taxes of the MNE Group. The remainder (80) is not reallocated.

Example 4.3.2-4

1. The facts are the same as Example 4.3.2-3, except that Jurisdiction X does not tax UPE's dividend income or grant any foreign tax credit with respect to foreign dividend income. The tax rates in jurisdictions and Tax accrued with respect to each PE, distributing Entity and royalty income are as follows:

Jurisdiction	Entity	Income	Corporate income tax rate	Corporate income tax	Withholding tax rate	Withholding tax
Jurisdiction X	UPE	400	20%	80		
Jurisdiction A	PE1	100	5%	5		
	A Co	200*	5%	10	5%	9.5
Jurisdiction B	PE2	250	10%	25		
	UPE's income from B Co payment	100			20%	20
	C Co	200*	10%	20	0%	0
Jurisdiction C	PE3	-50	25%	0		

*Note that distributions from A Co and C Co are not included in the UPE's taxable income under the UPE's domestic tax regime in this example.

**Note that the figures with respect to C Co in this table reflect UPE's proportionate share of the income and taxes of C Co. That is, they are 20% of the total income and taxes of C Co.

2. In this case, under the cross-crediting tax system:

a. Taxable income of the UPE is 800=400+100+250+100-50.
b. Pre-credit tax liability payable in Jurisdiction X is 160=800×20%.
c. Tax accrued in foreign jurisdictions is 50=5+25+20.
d. Foreign tax credit limitation is 80=160×400/800.
e. Allowed tax credit is 50 which is the lower of c and d.
f. Tax payable in jurisdiction X is 110=160-50.

3. The Allocable Covered Taxes is determined as follows:

$$\begin{aligned}&Allocable\ Covered\ Taxes\\&= Total\ current\ tax\ expense\ accrued\ by\ the\ Main\ Entity\ with\ respect\ to\ the\ applicable\ tax\ regime\\&- domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income\\&-Blended\ CFC\ Taxes\end{aligned}$$

(110 - (400×20%)) = 30

4. The Cross-Crediting Allocation Key for each Entity is computed as set out below:

Entity	Main Entity taxable income arising from the foreign source income	Applicable tax rate	Tax accrued with respect to the foreign source income	Cross-Crediting Allocation Key
	[1]	[2]	[3]	[4] = ([1]×[2]) - [3]
PE1	100	20%	5	15
PE2	250	20%	25	25
PE3	-50	20%	0	0
Main Entity	100	20%	20	0
In total				40

5. The Allocable Covered Taxes of 30 is allocated to each Entity as follows:

Entity	Cross-Crediting Allocation key for the Entity	The sum of all Cross-Crediting Allocation Keys	Allocable Covered Taxes	Allocation to the Entity
	[1]	[2]	[3]	[4] = ([1] / [2]) × [3]
PE1	15	40	30	11.25
PE2	25			18.75
PE3	0			0
Main Entity	0			0
In total				30

6. The final result is that the Main Entity has accrued 110 in Covered Taxes, of which 11.25 is allocated to PE1, 18.75 is allocated to PE2. The remainder (80) is not reallocated.

Example 4.3.2-5

1. An MNE Group with a UPE in Jurisdiction X is subject to a worldwide tax system applied by Jurisdiction X. Under this tax system, Jurisdiction X imposes tax on both domestic and foreign source income and allows a tax credit for taxes paid on foreign source income. Jurisdiction X allows cross-crediting of Taxes, but only within certain categories of foreign-source income, i.e., foreign branch income basket, passive income basket, etc. Foreign tax credit limitations are also computed based on the categories. The foreign branch income basket includes the income from all Permanent Establishments. The passive income basket includes the income from both royalty payments and distributions received by the UPE.

2. The UPE has PEs in jurisdictions A (PE1), and B (PE2) and owns a subsidiary (C Co) in jurisdiction C. The UPE owns 100% of C Co and all of C Co's after-tax profits are distributed to the UPE annually. For the Fiscal Year, UPE earns domestic income of 400, PE1 generates income of 100, PE2 generates income of 200. All of the PE income is active income. C Co earns income of 200. The UPE also derives a royalty income of 100 from a non-Constituent Entity (B Co) (which is in addition to its domestic income of 400) in jurisdiction B and a dividend of 200 from a non-Constituent Entity (D Co) in jurisdiction C.

3. Tax rates in jurisdictions and Tax accrued with respect to each PE, distributing Entity and royalty income are as follows:

Jurisdiction	Entity	Income	Corporate income tax rate	Corporate income tax	Withholding tax rate	Withholding tax
Jurisdiction X	UPE	400	20%	80		
Jurisdiction A	PE1	100	25%	25		
Jurisdiction B	PE2	200	30%	60		
	UPE's income from B Co payment	100			20%	20
Jurisdiction C	C Co	200	5%	10	5%	9.5
	D Co	200	5%	10	5%	9.5

4. In this case, under the cross-crediting tax system:

   a. Taxable income of the UPE is 1200 = 400+100+200+100+200+200.

b. Pre-credit tax liability payable in Jurisdiction X is 240 = 1200×20%.

c. With respect to the Branch Income basket:

- The Tax accrued is 85 (25 + 60).
- The foreign tax credit limitation is 60 = 240 × ((100+200)/1200).
- The allowed foreign tax credit is 60 (foreign tax credits are limited).

d. With respect to the Passive Income basket:

- The Tax accrued is 59 = 20+10+9.5+10+9.5.
- The foreign tax credit limitation is 100 = 240 × ((100+200+200)/1200).
- The allowed foreign tax credit is 59 (foreign tax credits are not limited).

e. Tax payable in jurisdiction X is 121 = 240 - 59 - 60.

5. The Allocable Covered Taxes are determined as follows:

$$\begin{aligned}&Allocable\ Covered\ Taxes\ for\ Basket\ A\\&= Total\ current\ tax\ expense\ accrued\ by\ the\ Main\ Entity\ with\ respect\ to\ the\ applicable\ tax\ regime\\&- domestic\ tax\ liability\ without\ regard\ to\ any\ foreign\ source\ income\\&- Blended\ CFC\ Taxes - domestic\ tax\ liability\ attributable\ to\ remaining\ baskets\end{aligned}$$

Allocable Covered Taxes for the Branch Income Basket

= 121 – (400 x 20%) – 41 = 0.

Allocable Covered Taxes for the Passive Income Basket

= 121 – (400 x 20%) – 0 = 41.

6. In this example, there have been no taxes imposed on the UPE with respect to the Branch Income Basket. This is because there were sufficient allowable foreign tax credits in the basket to fully displace any further taxation arising in the Main Entity/Parent Entity. Put differently, the allowable tax credits exceeded the pre-credit domestic tax liability that would have arisen with respect to the income in the Branch Income basket. However, there has been additional tax paid in Jurisdiction X with respect to income in the Passive Income Basket. The allowable foreign tax credits do not fully displace the pre-tax credit liability arising with respect to this income. Accordingly, 41 is allocable to the Passive Income Basket. The Passive Income basket is composed of three amounts – an amount from a taxable distribution from C Co (a CE), an amount from a taxable distribution from D Co (a Non-CE) and an amount attributable to the payment income from B Co (a 3rd party).

7. The Passive Income Basket does not contain a Permanent Establishment. However, there are distributions from a Constituent Entity (C Co) and a non-Constituent Entity (D Co). The Cross-Crediting Allocation Keys are given by the formulae:

$$\begin{aligned}&Cross - Crediting\ Allocation\ Key\ for\ a\ distributing\ Entity\\&\quad = (Parent\ Entity\ taxable\ income\ arising\ from\ distribution\\&\quad \times applicable\ tax\ rate)\\&\quad - \text{creditable foreign taxes accrued with respect } to\ the\ distribution\end{aligned}$$

Cross-Crediting Allocation Key for C Co = (200 × 20%) – 19.5 = 20.5.

Cross-Crediting Allocation Key for D Co = (200 × 20%) – 19.5 = 20.5

$$Cross-Crediting\ Allocation\ Key\ for\ the\ Main\ Entity\ or\ Parent\ Entity \\ = (Main\ Entity\ taxable\ income\ arising\ directly\ from\ foreign\ source\ income \\ \times\ applicable\ tax\ rate) \\ -\ creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ foreign\ source\ income$$

Cross-Crediting Allocation Key for UPE = (100 × 20%) – 20 = 0.

8. Accordingly, allocations to C Co and D Co are given by the formula:

$$Allocation\ to\ each\ Entity \\ = Allocable\ Covered\ Taxes\ for\ the\ Basket \\ \times \left(\frac{Cross-Crediting\ Allocation\ Key\ for\ the\ Entity\ for\ the\ Basket}{The\ sum\ of\ all\ Cross-Crediting\ Allocation\ Keys\ in\ the\ Basket}\right).$$

Allocation to C Co = 41 x (20.5 / (20.5+20.5)) = 20.5.

Allocation to D Co = 41 × (20.5 / (20.5+20.5)) = 20.5.

9. The final result is that the UPE has accrued 121 in Covered Taxes, of which 20.5 is allocated to C Co, 20.5 is allocated to D Co which is not included in the Adjusted Covered Taxes of the MNE Group and the remainder (80) is not reallocated.

Example 4.3.2-6

1. UPE is located in Jurisdiction X. UPE has a PE (PE1) and a wholly-owned CFC (A Co) located in Jurisdiction A. UPE has a wholly owned CFC B1 Co (in Jurisdiction B) and C Co (in Jurisdiction C). It also has a 20% Ownership Interest in B2 Co (also located in Jurisdiction B). For the Fiscal Year, the income of these entities and the tax accrued with respect to the jurisdiction in which they are located are set out in the table below. None of the income is Passive Income for the purposes of Article 4.3.3.

Jurisdiction	Entity	Income	Corporate income tax rate	Corporate income tax
Jurisdiction X	UPE	300	30%	90
Jurisdiction A	PE1	50	20%	10
	A Co	150	20%	30
Jurisdiction B	B1 Co	200	25%	50
	B2 Co (20% owned by UPE)	500	25%	125
Jurisdiction C	C Co	200	5%	10

2. Jurisdiction X operates a worldwide tax system and includes both domestic and foreign income of foreign permanent establishments and CFCs. A Co, B1 Co, B2 Co and C Co are all CFCs under the tax regime applicable in Jurisdiction X and UPE is required to include in its taxable income the UPE's proportionate share of their respective income. Jurisdiction X allows for tax credits paid on foreign income and operates a cross-crediting system within certain categories of income. It has three relevant baskets. First, there is a basket for the income of foreign permanent establishments. Second, there is a basket for income of CFCs which are located in jurisdictions with nominal tax rates below 10% (low tax CFC basket). Third, there is a basket for income of CFCs which are located in jurisdictions with nominal tax rates above 10% (non-low tax CFC basket). The foreign tax credit limitation is applied separately with respect to each basket or category of income.

3. In this case, under the cross-crediting tax system:

a. Taxable income of the UPE is 1000 (300 + 150 + 50 + 200 + (500×20%) + 200).

b. Pre-credit tax liability payable in Jurisdiction X is 300 = 1000×30%.

c. With respect to the Branch Income basket:

- The foreign source income is 50
- The Tax accrued is 10.
- The foreign tax credit limitation is 15 (300 x (50/1000)).
- The allowed foreign tax credit is 10 (the foreign tax credits limitation does not apply).
- The branch income basket tax liability is 5 ((50 x 30%) – 10).

d. With respect to the low tax jurisdiction CFC basket:

- The foreign source income is 200.
- The Tax accrued is 10.
- The foreign tax credit limitation is 60 (300 x (200/1000)).
- The allowed foreign tax credit is 10 (the foreign tax credits limitation does not apply).
- The low tax jurisdiction CFC basket tax liability is 50 ((200 x 30%) – 10).

e. With respect to the non-low tax jurisdiction CFC basket:

- The foreign source income is 450 (150 + 200 + (500 x 20%)).
- The Tax accrued is 105 (30 + 50 + 25).
- The foreign tax credit limitation is 135 (300 x (450/1000)).
- The allowed foreign tax credit is 105 (the foreign tax credits limitation does not apply).
- The non-low tax jurisdiction CFC basket tax liability is 30 ((450 × 30%) – 105)

f. Total tax payable in jurisdiction X is 175 (300 – 10 – 10 – 105).

4. The Allocable Covered Taxes for each basket is given by subtracting from the total tax liability accrued the domestic tax liability calculated without regard to any foreign source income as well as the allocations to the other relevant baskets. In this case, there is 175 of total tax payable and 90 (300 x 30%) is referable to domestic source income. The remaining 85 (175 – (300 x 30%)) must be allocated between the three baskets taking into account the design of the relevant tax system. In this case, the allocations for each basket are:

a. 5 to the branch income basket (175 – (300 x 30%) – (50 + 30));

b. 50 to the low tax jurisdiction CFC basket (175 – (300 x 30%) – (5 + 30); and

c. 30 to the non-low tax jurisdiction CFC basket (175 – (300 x 30%) – (5 + 50)).

5. All 5 of Allocable Covered Taxes in the branch income basket is allocated to the PE as the PE is the only entity with foreign source income in that basket. Accordingly, there is 5 in Covered Taxes allocated from UPE to PE under Article 4.3.2(a).

6. All 50 of the Allocable Covered Taxes in the low tax jurisdiction CFC basket is allocated to C Co as C Co is the only entity with foreign source income in that basket. Accordingly, 50 in Covered Taxes is allocated from UPE to C Co under Article 4.3.2(c). None of the income is Passive Income so Article 4.3.3 does not apply.

7. The 30 of Allocable Covered Taxes in the non-low tax jurisdiction CFC basket must be allocated between A Co, B1 Co and B2 Co in accordance with their respective Cross-Crediting Allocation Keys. The Cross-Crediting Allocation Keys are as follows:

a. A Co is 15 ((150 x 30%) – 30).

b. B1 Co is 10 ((200 x 30%) – 50).

c. B2 Co is 5 ((500 x 20%) x 30%) – (125 x 20%).

8. Accordingly, the allocation to each entity is as follows:

a. The cross-crediting allocation formula makes an allocation to A Co of 15 (30 x 15/30). This is allocated from UPE to A Co under Article 4.3.2(c). None of this income is Passive Income and therefore Article 4.3.3 does not apply.

b. The cross-crediting allocation formula makes an allocation to B1 Co of 10 (30 x 10/30). This is allocated from UPE to B1 Co under Article 4.3.2(c). None of this income is Passive Income and therefore Article 4.3.3 does not apply.

c. The cross-crediting allocation formula makes an allocation to B2 Co of 5 (30 x 5/30). However, as B2 Co is not a Constituent Entity, there is no allocation of Covered Taxes to B2 Co under Article 4.3.2.

9. The income of B2 Co is not included in the GloBE Income of UPE. Accordingly, the 5 in Covered Taxes which has been allocated to B2 Co under the formula is excluded from the Adjusted Covered Taxes of UPE under Article 4.1.3(a).

Example 4.3.2-7

1. Jurisdiction X has a worldwide tax system with cross-crediting and a foreign tax credit limitation which is calculated by reference to baskets of foreign source income. A Main Entity operating in Jurisdiction X has PE1 operating in Jurisdiction A. PE1 has 200 of GloBE Income which is all included in the taxable income of Main Entity. PE1 has accrued 30 in Covered Taxes to Jurisdiction A on this income (at a 15% rate). The Main Entity also has 300 of domestic income (which takes into account 100 of domestic deductions which are allocated to the foreign source income both for the purposes of determining taxable income from foreign sources and applying the foreign tax credit limitation in Jurisdiction X but are not deductible under the tax system in the PE Jurisdiction).

2. The Main Entity's tax liability in Jurisdiction X is calculated as follows:

a. Taxable Income = 500 (100 + 400).

b. Tax rate = 20%.

c. Pre-foreign tax credit tax liability = 100.

d. Foreign Source Income after allocable expenses = 100 (200 – 100).

e. Gross foreign tax credits = 30.

f. Allowable foreign tax credits = 20 = 100×100/500.

g. Tax liability = 80 (100 – 20).

3. The GloBE calculation applies as follows:

a. Step 1 - Calculate the foreign source income of each PE and Entity

i. The foreign source income of PE1 is 100 (200 of income from PE1 is included in the Main Entity's taxable income but 100 of the expenses of the Main Entity are allocated to PE1 both for the purposes of calculating the taxable income from foreign sources and applying the foreign tax credit limitation).

ii. The Main Entity has no foreign source income.

b. Step 2 – determine the Allocable Covered Taxes for the foreign branch basket

i. The Allocable Covered Taxes for the basket are determined by starting with the total tax liability (80) and subtracting the domestic tax liability calculated without regard to foreign source income. Where domestic expenses are allocated to foreign source income for the purposes of the foreign tax credit limitation, they are excluded from the determination of domestic source income. Accordingly, there is 400 of domestic source income (which is the domestic source income of 300 and then adding back 100 in expense allocated to foreign source income for the purposes of the foreign tax credit liability). The hypothetical domestic tax liability on this income is 80 (400 x 20%).

ii. Accordingly, the Allocable Covered Taxes for the foreign branch basket is 0 (80 – 80). There are no Allocable Covered Taxes.

c. As there are no Allocable Covered Taxes to be allocated, the remaining steps are unnecessary.

4. In this example, there is no amount of Main Entity taxation to allocate to the PE. Jurisdiction X's domestic tax system requires an allocation of expenses for the purposes of determining foreign source income and applying its foreign tax credit limitation (200 – 100). The PE has accrued 30 of tax with respect to this income which exceeds the pre-tax credit liability which arises with respect to this income. Accordingly, there is no amount to allocate to the PE.

Example 4.3.2-8

1. Jurisdiction X has a worldwide tax system with cross-crediting and a foreign tax credit limitation which is calculated by reference to baskets of foreign source income. A Main Entity operating in Jurisdiction X has PE1 and PE2 operating in Jurisdictions A and B respectively. PE1 has 100 of GloBE Income which is all included in the taxable income of Main Entity. PE1 has accrued 5 in Covered Taxes to Jurisdiction A on this GloBE Income (at a 5% rate). PE2 has 200 of GloBE Income which is all included in the taxable income of the Main Entity. PE2 has accrued 10 of Covered Tax (at a 5% rate). There are no expenses allocated to PE1 under this methodology. The Main Entity also has 300 of domestic income taking into account the 200 of deductions which are allocated to the foreign source income only for the purposes of applying the foreign tax credit limitation. The 200 of deductions allocated to the foreign branch basket.

2. The Main Entity's tax liability in Jurisdiction X is calculated as follows:

a. Taxable Income = 600 (100 + 200 + 300).

b. Tax rate = 20%.

c. Pre-foreign tax credit tax liability = 120.

d. Foreign Source Income after allocable expenses = 100 (300 – 200).

e. Gross foreign tax credits = 15 (5 + 10).

f. Allowable foreign tax credits = 20 (120×100/600).

g. Tax liability = 105 = (120 – 15).

3. The GloBE calculation applies as follows:

h. Step 1 - Calculate the foreign source income of each PE and Entity

i. The foreign source income of PE1 is 100 (100 of income from PE1 is included in the Main Entity's taxable income).

ii. The foreign source income of PE2 is 200 (200 of income from PE2 is included in the Main Entity's taxable income).

iii. The Main Entity has no foreign source income.

i. Step 2 – determine the Allocable Covered Taxes for the foreign branch basket.

   i. The Allocable Covered Taxes for the basket is determined by starting with the total tax liability (105) and subtracting the domestic tax liability calculated without regard to foreign source income. Where domestic expenses are allocated to foreign source income for the purposes of the foreign tax credit limitation, they are excluded from the determination of domestic source income. Accordingly, there is 500 of domestic source income (which is the domestic source income of 300 and then adding back the 200 in expense allocated to foreign source income for the purposes of the foreign tax credit limitation). The hypothetical domestic tax liability on this income is 100 (500 x 20%).

   ii. Allocable Covered Taxes is 5 (105 – 100).

j. Step 3 – determine the Cross-Crediting Allocation Key with respect to each Entity

   i. The Cross-Crediting Allocation Key for a PE is given by the formula:

$$\begin{aligned} &Cross - Crediting\ Allocation\ Key\ for\ a\ PE \\ &\quad = (Main\ Entity\ taxable\ income\ arising\ from\ the\ PE \times applicable\ tax\ rate) \\ &\quad - creditable\ foreign\ taxes\ accrued\ with\ respect\ to\ the\ PE's\ income \end{aligned}$$

PE1's Cross-Crediting Allocation Key is 15 ((100 x 20%) – 5).

PE2's Cross-Crediting Allocation Key is 30 ((200 x 20%) – 10).

k. Step 4 – determine the allocation to each PE

   i. The allocation to each Entity is given by the formula:

$$\begin{aligned} &Allocation\ to\ each\ PE\ or\ Entity \\ &\quad = Allocable\ Covered\ Taxes \\ &\quad \times \left(\frac{Cross - Crediting\ Allocation\ Key\ for\ the\ PE\ or\ Entity}{The\ sum\ of\ all\ Cross - Crediting\ Allocation\ Keys}\right). \end{aligned}$$

Accordingly, the allocation to each PE is as follows:

Allocation to PE1 = 5 x (15 / (15+30)) = 1.67.

Allocation to PE2 = 5 × (30 / (15+30)) = 3.33.

4. The final result is that the Main Entity has accrued 105 in Covered Taxes, of which 1.67 is allocated to PE1, 3.33 is allocated to PE2, and the remainder (100) is not reallocated.

Example 4.3.2-9

1. Parent Entity is located in Jurisdiction X and has Sub Co 1 located in Jurisdiction Y. Sub Co 1 earns 100 in profit in Jurisdiction Y and accrues 10 in tax (at a 10% tax rate). Sub Co 1 makes a distribution of 90 to Parent Entity. Under Jurisdiction X's tax system, Parent Entity includes the distribution of 90 in its taxable income. Jurisdiction X grants Parent Entity an indirect tax credit for the foreign taxes paid with respect to that distribution (10) but adds the amount of these indirect foreign tax credits to the taxable income of the Parent Entity. As a result, Parent Entity has an increase in taxable income of 100 and an indirect foreign tax credit of 10.

2. For the purposes of applying the above cross-crediting allocation formula, the foreign source income of Parent Entity is 100. This includes the received distribution of 90 and the 10 'gross-up' for the indirect foreign tax credit amount.

Example 4.3.2-10

1. Main Entity is located in Jurisdiction X and has PE1 (in Jurisdiction A) and PE2 (in Jurisdiction B). In Year 1, Main Entity makes domestic source income of 100. PE1 has a loss of 40 and PE2 has income of 40. In Year 2, the Main Entity has domestic source income of 100, PE1 has income of 40 and PE2 has income of 40. Under Jurisdiction X's tax system, Main Entity directly includes the income or loss of each PE in its taxable income. Jurisdiction X has a 20% tax rate. Jurisdiction A does not have a corporate income tax and Jurisdiction B has a tax rate of 10%. Jurisdiction X has a foreign tax credit limitation equal to 20% of net foreign source income. Any unused foreign tax credits are carried forward to a following year.

2. In Year 1, Main Entity's tax in Jurisdiction X is as follows:

   a. Taxable Income = 100 (100 - 40 + 40).

   b. Tax rate = 20%.

   c. Pre-foreign tax credit tax liability = 20 (100 x 20%).

   d. Foreign Source Income after allocable expenses = 0 (40 – 40).

   e. Gross foreign tax credits = 4.

   f. Allowed foreign tax credits = 0 (20×(0/100)). 4 in foreign tax credits is carried forward.

   g. Tax liability = 20 = (20 – 0).

3. In Year 2, Main Entity's tax in Jurisdiction X is as follows:

   a. Taxable Income = 180 (100 + 40 + 40).

   b. Tax rate = 20%.

   c. Pre-foreign tax credit tax liability = 36 (180 x 20%).

   d. Foreign Source Income after allocable expenses = 80 (40 + 40).

   e. Gross foreign tax credits = 8 (4 + 4) (this includes 4 in carried forward tax expense).

   f. Allowed foreign tax credits = 8 (as the foreign tax credit limitation is 16 (36 ×80/180)).

   g. Tax liability = 28 = (36 – 8).

4. In Year 1, there is no allocation of tax from the Main Entity to either PE. As Jurisdiction X's regime sets off PE1's loss against PE2's income in applying its foreign tax credit limitation, the Main Entity has no foreign source income for Year 1 and there is no amount of Allocable Covered Taxes to be allocated under the formula. There is also no net loss to be taken into account by the Main Entity in determining its taxable income as the loss of PE1 is effectively cancelled out by the income in PE2. As a result, Article 3.4.5 does not apply to reallocate any GloBE Loss from PE1 to the Main Entity. The Adjusted Covered Taxes do not take into account any deferred tax expense for the carried forward foreign tax credits due to the operation of Article 4.4.1(e).

5. In Year 2, the Main Entity has foreign source income of 80. The Allocable Covered Taxes are 8 (28 - (100 x 20%)). This takes into account current taxes as well as the carried forward foreign tax credit. This amount is then allocated between PE1 and PE2 in accordance with their respective Cross-Crediting Allocation Keys (the Main Entity has no foreign source income of its own). PE1's Cross-Crediting Allocation Key is 8 ((40 x 20%) - 0) and PE2's Cross-Crediting Allocation Key is 4 (40 x 20%) – 4). For the purposes of calculating the Cross-Crediting Allocation Key, the taxes accrued by the PE include the current year taxes *but do not take into account* the unused foreign tax credits from the previous year which have been carried forward. As a result, 5.33 is allocated to PE1 (8 x (8/12)) and 2.67 is allocated to PE2 (8 x 4/12). PE1 has an ETR of 13.3% (5.33/40) and PE2 has an ETR of 16.7% ((4+2.67)/40).

Example 4.3.2-11

1. This example is identical to the example above except that Jurisdiction X's foreign tax credit limitation is calculated separately for each Permanent Establishment. That is, there is no netting of foreign branch income and loss in setting the foreign tax credit limitation. This means that there is still 40 in foreign source income (as there is no netting) and the 4 foreign tax credits are allowed for Year 1.

2. In Year 1, Main Entity's tax in Jurisdiction X is as follows:

   a. Taxable Income = 100 (100 - 40 + 40).

   b. Tax rate = 20%.

   c. Pre-foreign tax credit tax liability = 20 (100 x 20%).

   d. Foreign Source Income after allocable expenses = 40.

   e. Gross foreign tax credits = 4.

   f. Allowed foreign tax credits = 4 (as the foreign tax credit limitation is 8 (20×40/100).

   g. Tax liability = 16 = (20 – 4).

3. In Year 2, Main Entity's tax in Jurisdiction X is as follows:

   a. Taxable Income = 180 (100 + 40 + 40).

   b. Tax rate = 20%.

   c. Pre-foreign tax credit tax liability = 36 (180 x 20%).

   d. Foreign Source Income after allocable expenses = 80 (40 + 40).

   e. Gross foreign tax credits = 4.

   f. Allowed foreign tax credits = 4 (as the foreign tax credit limitation is 16 (36×80/180)).

   g. Tax liability = 32 (36 – 4).

4. In Year 1, PE2 has 40 of foreign source income (Step 1). The Allocable Covered Taxes are equal to the total tax liability (16) less the domestic tax liability calculated without regard to foreign source income but taking into account deductions for a foreign PE Loss which gives rise to a GloBE Loss under Article 3.4.5 (12 ((100 – 40) x 20%)). This results in Allocable Covered Taxes of 4 (16 – 12) (Step 2). As PE2 is the only entity with foreign source income, all 4 in Allocable Covered Taxes are allocated to PE2 (Steps 3 and 4). Accordingly, PE2 has an ETR of 20% ((4 + 4) / 40).

5. Assuming the other conditions have been met, Art. 3.4.5 applies with respect to PE1 in Year 1. The Main Entity takes PE1's GloBE Loss into account in calculating its GloBE Income or Loss. Accordingly, the Main Entity's GloBE Income is only 60 for Year 1. It has an ETR of 20% (12/60). Due to the operation of Art. 3.4.5, PE1 has no GloBE Income or Loss. It also has no Covered Taxes.

6. In Year 2, there is foreign source income of 40 for PE2 (Step 1). PE1's 40 of income is treated as domestic source income of the Main Entity as it is income of a foreign PE which offsets a previously included loss for which there had been a GloBE reallocation under Article 3.4.5. The Allocable Covered Taxes are 4 (32 – (140 x 20%)). In calculating the Allocable Covered Taxes, the income of PE1 which is reallocated to the Main Entity under Art. 3.4.5 is treated as domestic source income which is relevant in determining the hypothetical domestic tax liability. As PE2 is the only entity with foreign source income, the 4 in Allocable Covered Taxes is allocated to PE2. As a result, in Year 2, the Main Entity has an ETR of 20% (28/140), PE1 has no GloBE Income or Loss (and no Covered Taxes) and PE2 has an ETR of 20% ((4 + 4)/40).

Example 4.3.2-12 – Carry-forwarded losses from a PE.

1. The Main Entity (in Jurisdiction X) has PE1 (Jurisdiction A) and PE2 (Jurisdiction B). Jurisdiction X has a tax rate of 20% and Jurisdiction A has a tax rate of 5%. In Year 1, PE1 makes a loss of 40. There is no income or loss for Main Entity and PE2. In Year 2, Main Entity has income of 100, PE1 has income of 40 and PE2 has income of 40. In Year 2, PE1 accrues no tax despite the 5% tax rate because it has carried forward losses from the previous year under Jurisdiction A's tax system. PE2 accrues 4 of tax in Jurisdiction B (10% rate). Under its domestic tax system, Jurisdiction X takes into account carry-forward losses from foreign Permanent Establishments when determining the foreign tax credit limitation.

2. In Year 1, Main Entity's tax in Jurisdiction X is as follows:

   a. Taxable Income = -40.

   b. Tax rate = 20%.

   c. Pre-foreign tax credit tax liability = 0.

   d. Foreign Source Income after allocable expenses = 0.

   e. Gross foreign tax credits = 0.

   f. Allowed foreign tax credits = 0.

   g. Tax liability = 0.

3. In Year 2, Main Entity's tax in Jurisdiction X is as follows:

   a. Taxable Income = 140 (100 + 40 + 40 - 40) (including a carry-forward loss of 40).

   b. Tax rate = 20%.

   c. Pre-foreign tax credit tax liability = 28 (140 x 20%).

   d. Foreign Source Income after allocable expenses = 40 (this is PE2's foreign source income of 40. PE1's income of 40 has been reallocated to the Main Entity under Art. 3.4.5 along with the 40 carry forward loss which had previously been allocated to the Main Entity in Year 1).

   e. Gross foreign tax credits = 4.

   f. Allowed foreign tax credits = 4 (as the foreign tax credit limitation is 8 (28 x 40/140. In this example, the Main Entity jurisdiction takes into account the carry forward loss in calculating the FTC limitation).

   g. Tax liability = 24 = (28 – 4).

4. In Year 1, there is no tax liability to allocate from the Main Entity to either PE. PE1's loss is taken into account in determining the taxable income of the Main Entity and, assuming it meets the other criteria, Article 3.4.5 applies to allocate the GloBE Loss from PE1 to the Main Entity. In Year 1, there is a GloBE Loss of 40 in the Main Entity. There is also a GloBE Loss Deferred Tax Asset of 6 (40 x 15%).

5. In Year 2, the Allocable Covered Taxes is 4 (24 – (100 x 20%)). The total tax liability is 24. The domestic tax liability takes into account the 100 of domestic income less the 40 carry forward loss (from the previously allocated 40 loss from PE1 in Year 1) plus the reallocated 40 from PE1 under Article 3.4.5 in Year 2). Accordingly, the hypothetical domestic tax liability is 20 ((100 – 40 + 40) x 20%). PE1 has no foreign source income in Year 2 as its 40 of income is treated as domestic source income of the Main Entity and has been allocated under Art. 3.4.5. PE2 has foreign source income of 40. There is no foreign source income of the Main Entity itself. As a result, all of the Allocable Covered Taxes (4) are allocated to PE2.

6. In Year 2, the GloBE Income of Main Entity is 140 (100 + 40 under Article 3.4.5). Its Adjusted Covered Taxes are 26. This is 20 of domestic tax and 6 as a result of the reversed GloBE Loss DTA of 6 from Year 1 (calculated at 15% of the 40 loss). This is an ETR of 18.5%. This is the outcome of an effective blending of the 20% rate on the domestic income of 100 and the reversal of the GloBE Loss DTA of 6 which has been calculated as 15% of a 40 loss. PE1 has no GloBE Income (as its income is treated as domestic source income of the Main Entity and has been reallocated under Article 3.4.5) and no Covered Taxes. PE2 has 40 in GloBE Income and 8 in Covered Taxes (4 of its own taxes at a 10% rate and 4 of Main Entity taxes which have been allocated). Accordingly, PE2 has an ETR of 20%.

Example 4.3.2-13 – Deferred Tax Expense or benefit interaction

5. An MNE Group with a UPE in Jurisdiction X is subject to a worldwide tax system applied by Jurisdiction X. Under this tax system, Jurisdiction X imposes tax on both domestic and foreign source income, including dividends received from foreign corporations, and allows a tax credit for taxes paid on foreign source income. Jurisdiction X has a cross-crediting foreign tax credit regime pursuant to which taxes paid in all foreign jurisdictions on all categories of foreign source income are creditable against the UPE's tax liability arising from foreign source income. Under the Jurisdiction X's domestic tax regime, the foreign tax credit allowed for any given Fiscal Year cannot exceed the tax liability arising from the income inclusion of foreign sources and the foreign tax credit limitation. The tax rate in Jurisdiction X is 20%.

6. The UPE has PEs in jurisdictions A (PE1), B (PE2) and owns a subsidiary (C Co) in jurisdiction C. The UPE owns 100% of C Co and all of C Co's after-tax profits are distributed to the UPE annually. C Co is not subject to the CFC Tax Regime of Jurisdiction X. The UPE wholly owns a CFC in jurisdiction A (A Co), which is a Constituent Entity. A Co's income is Passive Income. It also has a 20% Ownership Interest in B Co which is located in Jurisdiction B and is neither a Constituent Entity nor a CFC. The dividend income from B Co is included in the UPE's taxable income under the cross-crediting regime but is not within the UPE's GloBE Income or Loss.

Year 1

7. In year 1, UPE earns domestic source income of 400, PE1 generates income of 500, PE2 generates income of 100, and A Co (CFC) generates income of 100 which is passive income. All of the PE income is active income. The UPE derives dividend income of 200 from B Co and dividend income of 300 from C Co. The UPE also derives royalty income of 100 from a 3rd party company located in Jurisdiction C. Jurisdiction X also has a foreign tax credit limitation equal to its domestic tax liability multiplied by the proportion of foreign source income to total income. Suppose that in Jurisdiction A, Jurisdiction B and Jurisdiction C, the financial income and taxable income are the same.

8. Tax rates and Tax accrued with respect to the income of the UPE, each PE, subsidiary, CFC and non-Constituent Entity in the jurisdiction where they are located are as follows:

Jurisdiction	Entity	Financial Income	Taxable Income	Corporate income tax rate	Corporate income tax	Withholding tax rate	Withholding tax
Jurisdiction X	UPE	400	400	20%	80		
Jurisdiction A	PE1	500	500*	5%	25		
	A Co (CFC)	100	100	5%	5		
Jurisdiction B	PE2	100	100*	25%	25		
	B Co** (Non-CE)	200	200	25%	50	10%	15
Jurisdiction C	C Co (Subsidiary)	300	300	5%	15	5%	14.25
	3rd party company	100				10%	10

**Note that the taxable income for these amounts differs between the tax system applicable in the jurisdiction of the PE and the tax system of the UPE under its worldwide system.*

***The figures with respect to B Co in this table reflect UPE's proportionate share of the income and taxes of B Co. That is, they are 20% of the total income and taxes of B Co.*

9. At the beginning of Year 1, PE1 purchases equipment with the carrying value of 400. For accounting purposes, the equipment is depreciated in 2 years and Jurisdiction A also depreciates such asset in 2 years under domestic tax regime. However, Jurisdiction X allows for immediate expense of the asset for tax purposes. In Year 1, PE 2 has recorded a reserve for bad debt of 100. However, the bad debt is only deductible in Jurisdiction X for tax purposes when the debt is proven to be uncollectible. Suppose there is no timing differences with respect to other foreign source income or domestic income of the UPE. As a result, there are differences between the taxable income of PE1 and PE2 as calculated under the tax regime in the jurisdiction of the PE and as calculated under Jurisdiction X's tax regime as applicable to foreign Permanent Establishments.

Allocation of cross-border current tax expense

10. Step 1: determine the amount of each foreign source income which in included in the taxable income of the UPE.

	Jurisdiction A		Jurisdiction B		Jurisdiction C	
	PE1	A Co	PE2	B Co	C Co	3rd Party Company
Taxable Income	300	100	200	200	300	100

Note: Because equipment in PE1 can be expensed immediately in Jurisdiction X, the taxable income of PE 1 included in Jurisdiction X is 300 while its accounting income is 500. This is because for tax purposes, PE1 has a 400 deduction in Year 1 (immediate expensing) while for accounting purposes the 400 carrying value is treated as an expense of 200 in Year 1 and 200 in Year 2. Because the reserve for bad debt is not allowed to be deducted in Jurisdiction X in Year 1, the taxable income of PE2 included in Jurisdiction X is 200 rather than the 100 accounting profit.

11. Step 2: Calculate the Allocable Covered Taxes

a. Taxable income of the UPE is 1600 = 400+300+100+200+200+300+100

b. Pre-credit tax liability payable in Jurisdiction X is 320 = 1600×20%

c. Tax accrued in foreign jurisdictions is 159.25 = 25+5+25+50+15+15+14.25+10

d. Foreign tax credit limitation is 240 = 320×(1200/1600)

e. Allowed foreign tax credit is 159.25 which is the lower of c and d

f. Tax payable in Jurisdiction X is 160.75 = 320-159.25

g. Allocable Covered Taxes = 160.75- (400×20%) = 80.75

12. Step 3: Determine the Cross-crediting Allocation Key for each PE and Entity's foreign source income

Entity	Main Entity taxable income arising from the foreign source income	Applicable tax rate	Tax accrued with respect to the foreign source income	Cross-Crediting Allocation Key
	[1]	[2]	[3]	[4] = ([1]×[2]) - [3]
PE1	300	20%	25	35
A Co	100		5	15
PE2	200		25	15
B Co	200		65	0
C Co	300		29.25	30.75
Main Entity	100		10	10
In total				105.75

13. Step 4: Determine allocation to each PE and Entity

	Allocable Covered Taxes	Cross-Crediting Allocation key for the Entity	The sum of all Cross-Crediting Allocation Keys	Allocation to the Entity
	[1]	[2]	[3]	[4] = [1] x ([2]/[3])
PE1	80.75	35	105.75	26.73
A Co		15		11.45
PE2		15		11.45
B Co		0		0
C Co		30.75		23.48
Main Entity		10		7.64
In total				80.75

14. For purposes of Article 4.3.3, the ETR for A Co (ignoring any CFC Tax Regimes and tax transparency regimes) would have been 5% (= 5/100) and thus the Top-up Tax Percentage for A Co is 10%(=15%-5%). Therefore, the current tax expense of 10 is allocated to A Co and the remaining amount of 1.45 (=11.45-10) is included in the Adjusted Covered Taxes of the UPE.

15. As a result, of the 160.75 in current taxes accrued by the Main Entity (UPE), 71.66 (=80.75 – 7.64 – 1.45) is allocated between its PE1, A Co, PE2, B Co and C Co. The remaining 89.09 is not reallocated and remains as Covered Tax of UPE.

Allocation of *deferred tax expense or benefit*

16. At the end of Year 1, the carrying value of the equipment of PE1 is 200, and the tax basis of the equipment is 0. The timing difference is 200 and the UPE records a DTL of 40(=200×20%) with respect to the equipment based on the timing difference. There is no creditable tax credit in relation to the equipment. The deferred tax expense arising from the recognition of the DTL is recast to 30 and allocated to PE1.

17. With respect to the reserve for bad debt in PE2, there is a deductible timing difference of 100 in the UPE. The UPE records a DTA of 20(=100×20%) accordingly. The deferred tax benefit arising from the recognition of the DTA is recast to 15 and allocated to PE2.

Adjusted Covered Taxes after allocation

18. The calculation of Adjusted Covered Taxes is as follows:

Jurisdiction	Entity	Tax accrued in each jurisdiction	Allocation of Current tax expense	Current tax expense after allocation	Deferred tax expense after recast before allocation	Allocation of Deferred tax	Deferred tax expense included	Adjusted Covered Taxes
		[1]	[2]	[3]=[1]+[2]	[4]	[5]	[6]=[4]+[5]	[7]=[3]+[6]
X	UPE	160.75	-71.66+10*	99.09	15	-15	0	99.09
A	PE1	25	26.73	51.73		30	30	81.73
	A Co (CFC)	5	10	15				15
B	PE2	25	11.45	36.45		-15	-15	21.45
	B Co (Non-CE)	65	0	65				65
C	C Co (Subsidiary)	29.25	23.48	52.73				52.73

**Note: The 10 of withholding tax paid in jurisdiction C with respect to the royalty income of UPE shall be added to the Adjusted Covered Taxes of the UPE.*

ETR for each jurisdiction

19. The calculations of the Year 1 ETR for each jurisdiction are as follows:

	Jurisdiction X	Jurisdiction A	Jurisdiction B	Jurisdiction C
GloBE Income	400+100*	600	100	300
Adjusted Covered Taxes	99.09	96.73	21.45	52.73
ETR	19.82%	16.12%	21.45%	17.58%

**Note: The 100 of royalty income derived from a 3rd party company in Jurisdiction C shall be added to the GloBE Income of the UPE.*

Year 2

20. The facts are the same as Year 1, except that the bad debt in PE 2 has been proven to be uncollectible in year 2 and is allowed as a deduction for tax purposes in Jurisdiction X.

Allocation of cross-border current tax expense

21. Step 1: determine the amount of foreign source income which is included in the taxable income of the UPE.

	Jurisdiction A		Jurisdiction B		Jurisdiction C	
	PE1	A Co	PE2	B Co	C Co	3rd Party Company
Taxable Income	700*	100	0*	200	300	100

**Note: As all of the depreciation of the equipment in PE1 was claimed in Year 1 (under immediate expensing), there are no further deductions for this equipment under Jurisdiction X's tax law in Year 2. Accordingly, the taxable income of PE1 included in Jurisdiction X is 700 (500 + 200). Furthermore, the bad debt of PE2 which had been taken as an expense for accounting purposes in Year 1 is allowed as a deduction for tax purposes in Jurisdiction X in Year 2. Accordingly, the taxable income of PE2 included in Jurisdiction X is 0 (100 – 100).*

22. Step 2: Calculate the Allocable Covered Taxes

a. Taxable income of the UPE is 1800 = 400+700+100+0+200+300+100

b. Pre-credit tax liability payable in Jurisdiction X is 360 = 1800×20%

c. Tax accrued in foreign jurisdictions is 159.25 = 25+5+25+50+15+15+14.25+10

d. Foreign tax credit limitation is 280 = 360×(1400/1800)

e. Allowed foreign tax credit is 159.25 which is the lower of c and d

f. Tax payable in jurisdiction X is 200.75 = 360-159.25

g. Allocable Covered Taxes = 200.75 – (400×20%) = 120.75

23. Step 3: Determine the Cross-crediting Allocation Key for each PE and Entity.

Entity	Main Entity taxable income arising from the foreign source income	Applicable tax rate	Tax accrued with respect to the foreign source income	Cross-Crediting Allocation Key
	[1]	[2]	[3]	[4] = ([1]×[2]) - [3]
PE1	700	20%	25	115
A Co	100		5	15
PE2	0		25	0
B Co	200		65	0
C Co	300		29.25	30.75
Main Entity	100		10	10
In total				170.75

24. Step 4: Determine allocation to each PE and Entity

	Allocable Covered Taxes	Cross-Crediting Allocation key for the Entity	The sum of all Cross-Crediting Allocation Keys	Allocation to the Entity
	[1]	[2]	[3]	[4] = [1] x ([2]/[3])
PE1	120.75	115	170.75	81.32
A Co		15		10.61
PE2		0		0
B Co		0		0
C Co		30.75		21.75
Main Entity		10		7.07
In total				120.75

25. For purposes of Article 4.3.3, assume that the Top-up Tax Percentage for A Co is 10%. Therefore, the current tax expense of 10 is allocated to A Co and the remaining amount of 0.61 (=10.61-10) is included in the Adjusted Covered Taxes of the UPE.

26. As a result, of the 200.75 in current taxes accrued by the Main Entity (UPE), 113.07 (120.75 – 7.07 – 0.61) is allocated between its PE1, A Co, PE2, B Co and C Co. The remaining 87.68 is not reallocated and remains as Covered Tax of UPE.

Allocation of deferred tax expense or benefit

27. At the end of Year 2, the carrying value of the equipment of PE1 is 0, and the tax basis of the equipment is 0. There is no timing difference and the UPE records a reversal of the DTL that was recast to 30 with respect to the equipment based on the timing difference. The deferred tax benefit of 30 arising from this DTL reversal is allocated to PE1.

28. With respect to the reserve for bad debt in PE2, there is no longer a timing difference at the end of Year 2 and the UPE records a reversal of the DTA that was recast to 15 accordingly. The deferred tax expense of 15 arising from this DTA reversal is allocated to PE2.

Adjusted Covered Taxes after allocation

29. The calculation of Adjusted Covered Taxes are as follows:

Jurisdiction	Entity	Tax accrued in each jurisdiction	Allocation of Current tax expense	Current tax expense after allocation	Allocable deferred tax expense for GloBE purposes	Allocation of deferred tax	Deferred tax expense included	Adjusted Covered Taxes
		[1]	[2]	[3]=[1]+[2]	[4]	[5]	[6]=[4]+[5]	[7]=[3]+[6]
X	UPE	200.75	-113.07+10*	97.68	-15	+15	0	97.68
A	PE1	25	81.32	106.32		-30	-30	76.32
	A Co (CFC)	5	10	15				15
B	PE2	25	0	25		15	15	40
	B Co (Non-CE)	65	0	65				65
C	C Co (Subsidiary)	29.25	21.75	51				51

**Note: The 10 of withholding tax paid in jurisdiction C with respect to the royalty income of UPE shall be added to the Adjusted Covered Taxes of the UPE.*

ETR for each jurisdiction

30. The calculations of the Year 2 ETR for each jurisdiction are as follows:

	Jurisdiction X	Jurisdiction A	Jurisdiction B	Jurisdiction C
GloBE Income	400+100*	600	100	300
Adjusted Covered Taxes	97.68	91.32	40	51
ETR	19.54%	15.22%	40%	17%

**Note: The 100 of royalty income derived from a 3rd party company in Jurisdiction C shall be added to the GloBE Income of the UPE.*

4. Allocation of Cross-border Deferred Taxes

4.1. Extension of the Substitute Loss Carry-forward DTA Introduction

1. The February 2023 Administrative Guidance introduced the Substitute Loss Carry-forward DTA which applied where a Parent Entity has a domestic tax loss in the same year as foreign CFC income against which it is used. The same issues arise both with respect to other Constituent Entities (foreign Permanent Establishments, Hybrid Entities and Reverse Hybrid Entities) and where the domestic loss of the Main Entity or Parent Entity is carried forward and used against the income of a Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity in a subsequent year. This guidance addresses the application of the Substitute Loss Carry-forward DTA in such cases. The guidance only addresses cases where the relevant loss arises from the Main Entity or Parent Entity jurisdiction (that is, a domestic source loss). It does not address cases where a loss arising from one Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity is used to offset income from another Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity.

2. The Inclusive Framework will further consider whether this mechanism is fully effective in addressing cases where losses arising from the Main Entity or Parent Entity jurisdiction are used to offset income arising from a Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity. It will consider whether the applicable mechanism (including limitations on the application of the Substitute Loss Carry-forward DTA) is sufficient in all cases. The Inclusive Framework will also consider whether adjustments are appropriate in cases where a loss arising from one Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity is used against taxable income arising from another Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity under the Main Entity or Parent Entity's domestic tax law.

3. Certain domestic tax regimes require a Constituent Entity with a domestic tax loss to use that loss against foreign income prior to the use of the foreign tax credits which arise with respect to that income. Under certain domestic tax regimes, these foreign tax credits can be carried forward and used against future domestic income. Paragraphs 82.1 to 82.4 of the Commentary to Article 4.4.1€ clarify that in such cases a 'Substitute Loss Carry-forward DTA' can arise (subject to certain limitations).

4. Paragraph 82.2 of the Commentary to Article 4.4.1(e) sets out the general requirements for a Substitute Loss Carry-forward DTA to arise where the excess foreign tax credits can be carried forward into a subsequent year. Although the Substitute Loss Carry-forward DTA guidance was aimed at CFC Tax Regimes, neither paragraph 82.1 nor paragraph 82.2 refer specifically to a CFC Tax Regime. Arguably, the language in these paragraphs applies to foreign source income arising for a Parent Entity under a CFC Tax Regime or via a Hybrid Entity or Reverse Hybrid Entity and for a Main Entity with respect to a foreign Permanent Establishment.

5. Paragraph 82.3 of the Commentary to Article 4.4.1(e) notes that certain CFC Tax Regimes produce equivalent results despite not allowing for excess foreign tax credits to be carried forward through a loss recapture mechanism. In such cases, the GloBE Rules also create a Substitute Loss Carry-forward DTA. Unlike paragraphs 82.1 and 82.2, paragraph 82.3 of the Commentary to Article 4.4.1(e) refers to CFC Tax Regimes specifically. It does not address whether it applies to cases where equivalent regimes arise with respect to a Main Entity and its foreign Permanent Establishments or a Constituent Entity which includes the income of a foreign Hybrid Entity or foreign Reverse Hybrid Entity in its domestic taxable income.

4.1.1. Issues

6. It is necessary to clarify whether the guidance on Substitute Loss Carry-forward DTAs in paragraph 82.3 is also applicable to foreign source income derived from Permanent Establishments, Hybrid Entities or Reverse Hybrid Entities where the conditions of the guidance are also met.

7. It is also necessary to clarify whether the guidance on Substitute Loss Carry-forward DTAs also applies to domestic source tax loss carry-forwards.

4.1.2. Guidance

8. The Inclusive Framework has determined that the Substitute Loss Carry-forward DTA guidance in paragraphs 82.1 through 82.4 should be equally applicable to other similar domestic corporate income tax regimes which apply with respect to foreign Permanent Establishments and foreign subsidiaries that are treated as Hybrid Entities or Reverse Hybrid Entities under the GloBE Rules. The following amendments shown in bold text will be made to paragraphs 82.1 and 82.3 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 **(arising under a CFC Tax Regime or a regime which taxes foreign branches, Permanent Establishments, Hybrid Entities or Reverse Hybrid Entities)** 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.

82.3 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. **Some domestic corporate income tax regimes provide equivalent treatment through a loss recapture mechanism (including in cases where a foreign tax credit carry-forward is also allowed) for the foreign income of foreign branches, Permanent Establishments or foreign subsidiaries which are treated as fiscally transparent under the domestic regime and which are Hybrid Entities or Reverse Hybrid Entities under the GloBE Rules.** Provided ~~**this**~~ **the applicable** 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, **if the applicable regime does not allow foreign tax credit carry-forwards,** 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**. In any case in which such a loss recapture mechanism applies, whether or not a foreign tax credit carry-forward is allowed, the Substitute Loss Carry-forward DTA is treated as** 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.

9. The following paragraphs are to be added following paragraph [82.5] of the Commentary to Article 4.4.1(e):

82.6 The issues outlined above also arise where a Main Entity or Parent Entity has a domestic source tax loss carry-forward which is used to offset income of a foreign Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity. In these cases, where the carry-forward loss gave rise to a DTA which is taken into account for the purposes of determining the Main Entity or Parent Entity's Total Deferred Tax Adjustment Amount, the relevant deferred tax expense will reverse when the carry-forward loss is used, resulting in an increase in the Adjusted Covered Taxes of the Parent Entity. In these circumstances, a Substitute Loss Carry-forward DTA will be treated as arising and reversing to the same extent as if the domestic source tax loss carry-forward were a domestic source tax loss in the same tax year and subject to the limitations in paragraph [82.3]. Similarly, a Substitute Loss Carry-forward DTA is also available in these circumstances where equivalent results are provided through another mechanism (for example, by recharacterizing subsequent domestic income as foreign source income for the purposes of the foreign tax credit limitation) that 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).

82.7 The Inclusive Framework will further consider whether this mechanism is fully effective in addressing cases where losses arising from the Main Entity or Parent Entity jurisdiction are used to offset income arising from a Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity. It will consider whether the applicable mechanism (including limitations on the application of the Substitute Loss Carry-forward DTA) is sufficient in all cases. The Inclusive Framework will also consider whether adjustments are appropriate in cases where a loss arising from one Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity is used against taxable income arising from another Permanent Establishment, CFC, Hybrid Entity or Reverse Hybrid Entity under the Main Entity or Parent Entity's domestic tax law.

4.2. Principles for allocating deferred taxes from one Constituent Entity to another Constituent Entity

4.2.1. Introduction

10. The GloBE Rules seek to match Covered Taxes with the relevant GloBE Income. Where taxes are accrued by a Constituent Entity in one jurisdiction with respect to GloBE Income which is earned by a different Constituent Entity located in another jurisdiction, the GloBE Rules allow for the cross-border allocation of Covered Taxes. This is addressed in Article 4.3 of the GloBE Rules. The allocation of Covered Taxes from one Constituent Entity to another Constituent Entity is subject to various limitations, including a limitation on the allocation of taxes incurred with respect to Passive Income where the tax has been incurred with respect to a CFC, Hybrid Entity or Reverse Hybrid Entity. The Passive Income limitation is contained in Article 4.3.3.

11. Where Covered Taxes are expected to be accrued by a Constituent Entity in a different year to the year in which that Constituent Entity earns the GloBE Income to which they relate, the rules addressing timing differences operate to match the timing of Covered Taxes to the timing of GloBE Income. Timing differences are addressed in Article 4.4 of the GloBE Rules, which relies upon deferred tax accounting.

12. The Covered Taxes of the relevant Constituent Entity are adjusted by the Total Deferred Tax Adjustment Amount. This is the mechanism used to manage timing differences between the recognition of GloBE Income and the Covered Taxes which have been accrued with respect to that income. The Total Deferred Tax Adjustment Amount is based upon the deferred tax expense or benefit which has been accrued in the financial accounts of the Constituent Entity in accordance with Article 3.1 of the Model Rules (for example, the financial accounts used in the preparation of the Consolidated Financial Statements where Article 3.1.2 applies) (subject to adjustments). Where the deferred tax expense or benefit has been calculated by reference to a tax rate which is higher than the Minimum Rate, it will be ‘recast’ to the Minimum Rate. That is, the deferred tax assets and liabilities will be calculated as if the applicable tax rate were 15% if the relevant statutory rate is above 15%.

13. These two mechanisms (in Article 4.3 and Article 4.4) raise the question of how the GloBE Rules address cases where there is deferred tax expense or benefit recorded in the financial accounts of one Constituent Entity which arises due to the GloBE Income of a different Constituent Entity. This is clarified in paragraph 42 to the Commentary on Article 4.3.1, which confirms that the allocation of Covered Taxes from one entity to another under Article 4.3.1 also applies to deferred taxes under Article 4.4.

14. Deferred tax expenses or benefits with respect to CFC Tax Regimes can arise for different reasons. In some cases, a deferred tax liability arises because the income of the CFC is recognized for accounting purposes before it is recognized for tax purposes. For instance, a deferred tax liability could arise as a result of an asset owned by the CFC that is depreciated over 15 years under the applicable accounting standard but can be depreciated over 5 years for the purposes of the relevant CFC Tax Regime.

15. Alternatively, a deferred tax liability could arise because some CFC Tax Regimes only include the CFC’s income in the taxable income of the Parent Entity in the following year. This one-year delay in the recognition of the income under the CFC Tax Regime creates a timing difference between the recognition of the income in the accounts of the CFC under the applicable accounting standard and the inclusion of that same income under the CFC Tax Regime applicable to the Parent Entity. Accordingly, the Constituent Entity will record a deferred tax liability in recognition of the tax due the following year.

16. Under certain circumstances, a Parent Entity may also record deferred tax assets with respect to a foreign subsidiary Constituent Entity which is subject to the applicable CFC Tax Regime. This could occur where there is an expense in the subsidiary which is recognised under the applicable accounting standard before it is allowed as a deduction under the applicable CFC Tax Regime. For example, the applicable accounting standard may provide a reserve for bad debts where bad debts are only deductible for tax purposes when the debt is proven to be un-collectible.

17. A further complication arises as different MNE Groups may adopt different practices with respect to the recognition of their deferred tax expenses or benefits where foreign tax credits arise with respect to the CFC's income. For example, if the timing of recognition of income was the same under both the CFC's domestic income tax regime and the CFC Tax Regime, the MNE Group may record the deferred tax liability on a 'net basis' or on a 'gross basis'. Consider a case where 100 income is recognised for accounting purposes in year 1 but for tax purposes (in both the CFC's domestic tax system and the CFC Tax Regime) it is recognised in Year 2. The applicable tax rate under CFC's domestic income tax regime is 15% and the tax rate under the Parent Entity's CFC Tax Regime was 20%. In Year 2, the Parent Entity will have a 20 pre-credit tax liability along with a 15 foreign tax credit for the 15 of tax paid by the CFC itself. As a result, the Parent Entity pays 5 of CFC Tax in Year 2.

18. If the MNE Group adopts a 'net basis' approach, the Parent Entity would simply record a 5 deferred tax liability in Year 1 when the income is recognised for accounting purposes. This 5 deferred tax liability reflects the net amount of CFC Tax Regime tax which is anticipated in Year 2 (after taking into account both the CFC's income and the foreign tax credit for the CFC taxes). Alternatively, the MNE Group may adopt a 'gross basis' approach and record a 20 deferred tax liability for the CFC's income as well as a 15 deferred tax asset for the anticipated foreign tax credit.

19. While the gross basis approach and the net basis approach net to the same position (5 deferred tax expense), the gross basis approach separately records a deferred tax asset for a foreign tax credit which, without further clarification, could be excluded from GloBE consideration due to the operation of Article 4.4.1(e). If the effect of the deferred tax asset for the expected foreign tax credit were ignored, the actual deferred tax expense that will arise under the CFC Tax Regime would be over-stated and it would not be appropriate to allocate the over-stated amount to the CFC under Article 4.3.2(c). In the example, there is only 5 of CFC tax that will arise in respect of the CFC's income and no more than that should be allocated to the CFC under Article 4.3.2. Furthermore, the entire amount of the DTL must be excluded from the computation of the Constituent Entity-owner's Adjusted Covered Taxes (except as provided in Article 4.3.3) because it is related to income that is earned by the CFC and is thus effectively excluded from the Constituent Entity-owner's financial accounting income and thus its GloBE Income.

20. Accordingly, guidance is needed to clarify that only the net deferred tax can be allocated under Article 4.3.2 and that any deferred tax expense or benefit in excess of the net amount is excluded from the Constituent Entity-owner's Adjusted Covered Taxes. The cross-border allocation of deferred taxes requires consideration of the relevant foreign tax credits in order to determine the net deferred tax amount for allocation. However, this does not mean that a deferred tax asset is granted with respect to foreign tax credits. Deferred tax assets with respect to tax credits are excluded from the Total Deferred Tax Adjustment Amount by the operation of Article 4.4.1(e).

21. The methodology for allocating deferred tax expenses or benefits from one Constituent Entity to another Constituent Entity must address two key limitations noted above. The first is the limitation on the allocation of Passive Income in Article 4.3.3. The second is the requirement to 'recast' deferred tax expenses or benefits to the Minimum Rate where they have been recorded at above the Minimum Rate.

22. With respect to the Passive Income limitation in Article 4.3.3, the limitation operates so that the Covered Taxes in excess of the limitation remain Covered Taxes of the Parent Entity. The Passive Income limitation is designed to prevent the pushdown of CFC Taxes on Passive Income from 'sheltering' other sources of low taxed profit in the subsidiary jurisdiction.

23. With respect to the 'recast' requirement in Article 4.4,1, the taxes referable to the amount in excess of 15% are counted when they are accrued in current tax expense. For example, if there is 100 of income recognized for accounting purposes in Year 1 but only recognized for tax purposes in Year 2 and an applicable tax rate of 20%, the Constituent Entity can only take into account a 15 deferred tax expense (that is, it has been subject to a 'recast' at 15%). This can allow the Constituent Entity to recognize 15 of Adjusted Covered Taxes in Year 1 to match the recognized GloBE Income. In Year 2, the timing difference reverses and the Constituent Entity pays 20 of tax under the domestic tax system. For GloBE purposes, this results in a net inclusion of 5 in Year 2 Adjusted Covered Taxes as a result of an inclusion of 20 of Covered Taxes and a reduction of 15 of reversed deferred tax expenses. The result is that the non-recast amount (the 5 in excess of the allowed deferred tax expense) is taken into account when it is accrued in current tax expense.

24. Blended CFC Tax regimes present specific challenges with respect to the cross-border allocation of taxes. At least in part as a result of these challenges, Authorised Financial Accounting Standards do not always require, or even allow, for deferred tax expenses or benefits to be calculated with respect to Blended CFC Tax Regimes. In light of both this complexity and the inconsistent treatment between accounting standards, this guidance disregards both the accrual and reversal of any deferred tax expense or benefit associated with a Blended CFC Tax Regime such that only current tax expense associated with a Blended CFC Tax Regime is allocable under Article 4.3.2(c). Accordingly, the cross-border allocation of Blended CFC Tax Regimes is exclusively addressed in paragraphs 58.1 to 58.7 of the Commentary to Article 4.3.2.

4.2.2. Issues

25. Administrative Guidance is necessary to clarify the methodology by which deferred tax expenses and benefits recorded with respect to a Parent Entity (or Main Entity) are to be allocated to another Constituent Entity under Article 4.3.2(a), (c), (d), (e).

4.2.3. Guidance

26. Where a deferred tax expense or benefit arises in the financial accounts of a Parent Entity with respect to a CFC Tax Regime, the deferred tax expense or benefit is allocated to the applicable CFC and recast to the Minimum Rate if the Parent Entity's applicable tax rate is higher than 15%. However, the cross-border allocation is subject to the limitation in Article 4.3.3 on the 'push down' of Passive Income. The cross-border allocation of the deferred tax expense or benefit is to occur on a 'net basis' which prevents the allocation of a deferred tax expense which will not be paid due to an offsetting foreign tax credit. This approach is designed to maintain consistency with both the mechanisms for allocating Covered Taxes from one Constituent Entity to another Constituent Entity and for addressing timing differences.

27. The principles applicable to allocation of deferred CFC taxes also apply with respect to allocation of deferred taxes of a Parent Entity in respect of income from a Hybrid Entity or Reverse Hybrid Entity and deferred taxes of a Main Entity in respect of a Permanent Establishment, except that Article 4.3.3. does not apply to taxes allocable to a Permanent Establishment.

Allocation of deferred tax expenses or benefits under a CFC Tax Regime

28. This Guidance is to be applied for CFC Tax Regimes, other than Blended CFC Tax Regimes. The guidance sets out a five-step process for allocating deferred tax expenses or benefits under Article 4.3.2(c).

29. The first step is to separate the deferred tax assets and liabilities reflected in the Parent Entity's financial accounts with respect to the assets and liabilities of each CFC Constituent Entity and determine the deferred tax expense or benefit (that is, a negative deferred tax expense) as a consequence of the movement of such assets and liabilities in the particular year split between the following three categories based upon the relevant income of the CFC:

a. Income which is not GloBE Income;

b. GloBE Income which is not Passive Income; and

c. GloBE Income which is Passive Income.

30. The second step is to calculate the pre-foreign tax credit deferred tax expense or benefit arising under the CFC Tax Regime for the Parent Entity (Step 2A) as well any creditable foreign taxes expected to be paid by the CFC Constituent Entity which would give rise to foreign tax credits which would be available (absent a foreign tax credit limitation) to offset the expected pre-foreign tax credit expense ('Relevant Creditable Foreign Taxes')(Step 2B). Some Constituent Entities may already record the pre-foreign tax credit deferred tax expense with respect to CFC Income separately from the deferred tax asset for the relevant foreign tax credit in their financial accounts. Other Constituent Entities may adopt a 'net basis' approach and only record the net deferred tax expense having taken into account both the pre-foreign tax credit liability under the CFC Tax Regime and a foreign tax credit for the foreign taxes paid by the CFC Constituent Entity expected to offset the pre-foreign tax credit liability. To the extent the financial accounts adopt a 'net basis' approach, the calculation will need to be disaggregated to calculate the pre-foreign tax credit deferred tax expense for the CFC tax separately from the relevant deferred tax benefit (that is, negative deferred tax expense) arising from the foreign tax credits.

31. The Relevant Creditable Foreign Taxes under Step 2B comprises two amounts. First, it includes any creditable foreign taxes which have been paid with respect to the relevant source of income. This includes taxes paid in a different tax year but giving rise to foreign tax credits which could be carried forward or carried back to offset the expected pre-foreign tax credit liability under the domestic tax regime of the Parent Entity. This first amount is not limited by any applicable foreign tax credit limitation. Second, it includes a reasonable allocation of excess foreign tax credits arising from other sources of income which are available for use against the relevant source of income under the tax regime applicable in the Parent Entity jurisdiction. This will include excess foreign tax credits arising from income of other entities located in other jurisdictions if such tax credits may be cross-credited under the tax regime applicable in the Parent Entity jurisdiction. The amount of excess foreign tax credits arising from other sources of income is limited by any applicable foreign tax credit limitation. Any excess foreign tax credits must be allocated between the relevant pre-foreign tax credit deferred tax expenses using a reasonable allocation method which takes into account the design of the relevant domestic tax system and making reasonable assumptions where necessary. A reasonable method could not result in an allocation of the same creditable foreign tax in multiple years. The total Relevant Creditable Foreign Taxes under Step 2B cannot exceed the pre-foreign tax credit deferred tax expense calculated under Step 2A.

32. For example, consider a case where there is an expected future inclusion of 100 of CFC Income in the Parent Entity which is subject to a 25% rate with an expected foreign tax credit of 5 on the relevant income. Some Constituent Entities may record this in their financial accounts as a 25 deferred tax expense on the CFC Income in addition to a 5 deferred tax asset (and therefore deferred tax benefit) for the 5 of foreign tax credits. Other Constituent Entities may record this in their financial accounts as a net 20 deferred tax expense. If a Constituent Entity adopts the latter approach, the deferred tax expense on the CFC Tax will need to be disaggregated into two amounts to determine the pre-foreign tax credit deferred tax expense (25) and the Relevant Creditable Foreign Taxes with respect to this expense (5).

33. The third step is to allocate the deferred tax expense or benefit for the first category (deferred tax expense or benefit with respect to income which is not GloBE Income). This category is allocated to the CFC Constituent Entity but then excluded due to the operation of Article 4.4.1(a). Accordingly, this deferred tax expense or benefit is not taken into account by either the Parent Entity or the CFC Constituent Entity.

34. The fourth step is to allocate the deferred tax expense or benefit for the second category (deferred tax expense or benefit with respect to GloBE Income which is not Passive Income) to the CFC Constituent Entity. Unless the MNE Group makes a relevant Five-Year Election as outlined in paragraph 43, the full amount of the deferred tax expense or benefit is allocated to the CFC Constituent Entity. Accordingly, no amount of deferred tax expense or benefit with respect to this category remains in the Parent Entity. Once allocated, the CFC Constituent Entity must 'recast' its pre-foreign tax credit deferred CFC tax liability down to 15% if it had been calculated by reference to a tax rate above 15%. This step is necessary to produce outcomes which are consistent with the principle that deferred tax expenses or benefits are only taken into account at a rate of up to 15%. The Relevant Creditable Foreign Taxes are not recast to the minimum rate (nor are they adjusted by reference to any applicable foreign tax credit limitation). The amount of Relevant Creditable Foreign Taxes is also capped at the amount of the relevant pre-foreign tax credit deferred tax expense. The CFC Constituent Entity includes in its deferred tax expense the amount given by the following formula:

$$CFC\ Constituent\ Entity\ DTE\ Inclusion =$$

$$Movement\ in\ (the\ recast\ gross\ CFC\ Tax\ DTL\ (or\ DTA) - Relevant\ Creditable\ Foreign\ Taxes\ (or\ used\ foreign\ tax\ credits)$$

35. The recast CFC Tax DTL or DTA is computed by multiplying the difference in carrying value of the asset or liability for accounting and tax purposes by 15%. The CFC Constituent Entity deferred tax expense inclusion amount effectively reflects the additional amount, if any, of CFC Tax that is expected to be paid in the future if the applicable rate under the CFC Tax Regime were 15% or the CFC tax that is paid currently that relates to accounting income that is expected to be reported in the future. This gives effect to the policy intention behind recasting deferred taxes at 15% whilst also taking into account the fact that CFC Tax Regimes may impose additional tax on top of that imposed on the CFC Constituent Entity itself. Any additional taxes (above a combined 15% rate from the CFC Tax Regime and the Covered Taxes on the underlying CFC) are taken into account only when they are accrued in current tax expense.

36. For example, consider a case where 100 of GloBE Income is recorded in Year 1 with respect to a CFC and there is an expected future inclusion of 100 of CFC Income in the Parent Entity in Year 2 which is subject to a 25% rate with an expected foreign tax credit of 5 on the relevant income (also arising in Year 2). The DTL for the deferred CFC tax (pre-foreign tax credit) will be 25 but this will be 'recast' down to 15. The Relevant Creditable Foreign Taxes of 5 are not recast. This ensures that the correct net figure is included. Accordingly, the net deferred CFC tax expense allocable to the CFC Constituent Entity under Article 4.3.2(c) is 10. The CFC Constituent Entity will record its own deferred tax expense of 5 for its domestic corporate income tax and include a net deferred tax expense of 10 in its Adjusted Covered Taxes. Accordingly, the total deferred tax liability with respect to the CFC Constituent Entity in Year 1 is 15. This is in line with the principle that anticipated future tax expenses are capped at a 15% rate.

37. In Year 2, the timing difference reverses and the CFC itself pays its 5 tax liability and the Parent Entity pays its 20 CFC tax liability (25 – 5 tax credit). This causes a reversal of 25 in the DTL in the Parent Entity's accounts. For GloBE purposes, this is a 15 reversal of the Parent Entity's deferred tax expense (after the recast). In Year 2, the Parent Entity also uses the 5 in Relevant Creditable Foreign Taxes which had been taken into account in Year 1. As a result, the CFC Constituent Entity DTE Inclusion is -10 (= (-15) – (-5)). This is the reversal of the 10 in Constituent Entity DTE Inclusion from Year 1. However, when combined with the 20 in current taxes accrued with respect to the CFC in Year 2, the result is a net addition of 10 to the Adjusted Covered Taxes of the CFC.

38. In some cases, there may be a recast gross CFC DTA. This would arise, for example, where an amount is included in the taxable income of the Parent Entity before it is included in the GloBE Income of the CFC. In practical terms, the MNE Group has effectively paid tax on an amount which will only subsequently be included in GloBE Income. In these cases, there will be a negative CFC Constituent Entity DTE Inclusion in the earlier year which reverses when the GloBE Income is recognized.

39. For example, consider a case where 100 of taxable income arises in the CFC and in the Parent Entity (under a CFC Tax Regime) in Year 1. This same income is only recognized as GloBE Income of the CFC in Year 2. In Year 1, the CFC is subject to a tax rate of 5% (giving rise to a tax credit of 5) while the Parent Entity is subject to a tax rate of 25% on the CFC Income. In Year 1, the Parent Entity pays 20 in tax (25 – 5) giving rise to a net DTA of 20 in its financial accounts (this could be recorded as a DTA of 25 and a DTL of 5). The CFC itself has paid 5 in tax and has a DTA of 5 in its financial accounts. In this case, the recast gross CFC Tax DTA is -15 (recast from -25) and the relevant used foreign tax credits is -5. As a result, the CFC Constituent Entity DTE Inclusion is -10 (= (-15) – (-5)). When combined with the current tax accrued by the Parent Entity of 20, there is a net addition of 10 to the CFC's Adjusted Covered Taxes from the Parent Entity in Year 1. In Year 2, the GloBE Income arises and the timing difference reverses. There is a CFC Constituent Entity DTE Inclusion of 10.

40. A recast gross CFC DTA will also arise where the income is included in the Parent Entity's CFC Tax Regime in Year 1 but is only included in both the taxable income and GloBE Income of the CFC in Year 2. Consider a case that is identical to the above example except that the income of the CFC is only recognized for tax purposes in the CFC jurisdiction in Year 2 (rather than Year 1). In such a case, there will be a pre-foreign tax credit CFC Tax liability of 25 in Year 1. If the Parent Entity jurisdiction does not allow for the use of foreign tax credits against this amount (as no foreign taxes have been paid with respect to this amount in Year 1), then the Parent Entity will pay CFC Tax of 25. This will give rise to current tax expense of 25 and an offsetting DTA of 25 in the Parent Entity's accounts which will be recast to 15 for GloBE purposes. The CFC Constituent Entity DTE Inclusion will be a deferred tax expense of -15 (a deferred tax benefit). The current tax expense of 25 will also be allocated to the CFC Jurisdiction. As a result, the net impact on the CFC Constituent Entity's Adjusted Covered Taxes will be 10 in Year 1 (25 – 15). In Year 2, the deferred tax benefit will reverse, increasing the Adjusted Covered Taxes of the CFC Constituent Entity by 15. The CFC itself will also pay 5 in tax under its domestic CIT in Year 2 but this has not given rise to foreign tax credits which are available for use against the CFC Tax in Year 1. The Parent Entity has paid 25 in CFC Tax, 15 of which was matched to the underlying GloBE Income through the deferred tax methodology (that is, in Year 2) and the remaining 10 (the amount in excess of the Minimum Rate) is taken into account when accrued in current tax expense (Year 1).

41. The fifth step is to allocate the third category (deferred tax expenses or benefits with respect to GloBE Income which is Passive Income). Article 4.3.3 limits the amount of CFC Taxes which can be allocated to the CFC to the amount which would raise the Covered Taxes on the passive income (included under the CFC Regime) to 15%. Any CFC Taxes in excess of this limitation remain in the Covered Taxes of the Parent Entity.

42. Unless the MNE Group makes a relevant Five-Year Election as outlined in paragraph 43, the Parent Entity will allocate the deferred tax expense or benefit with respect to CFC Taxes on GloBE Income which is Passive Income to the CFC subsidiary as follows. First, it must calculate the Passive Income limitation in Article 4.3.3 with respect to all taxes (current and deferred) arising under a CFC Tax Regime or a fiscal transparency rule. The limitation in Article 4.3.3 is applied collectively to all such taxes allocated to a Constituent Entity pursuant to Article 4.3.2(c) and (d). If the combined allocation of deferred and current taxes to the CFC can be made without exceeding the limitation in Article 4.3.3, the full allocation is made. To the extent that the combined allocation of all Covered Taxes and deferred tax expense for the year would exceed the amount specified in paragraph 4.3.3(b), the excess shall be treated as first comprised of new deferred tax expense and then current tax expense and such excess will not be allocated to the CFC. To the extent that an amount of deferred tax expense cannot be allocated to the CFC due to the operation of Article 4.3.3(b), the amount will be included in the deferred tax expense of the Parent Entity.

43. Alternatively, an MNE Group can make a Five-Year Election with respect to a jurisdiction to exclude the allocation of all deferred tax expenses and benefits under Article 4.3.2(a), (c), (d) and (e) arising under tax regimes (including subnational tax regimes) applicable to Constituent Entities located in that jurisdiction. This means that the election is made with respect to the Parent Entity jurisdiction and not with respect to each Permanent Establishment or subsidiary jurisdiction separately. Where the election is made, the deferred tax expense or benefit which otherwise would have been allocated from the Constituent Entity located in the jurisdiction subject to the election to another Constituent Entity under Article 4.3.2(a), (c), (d) and (e) will be excluded from the Adjusted Covered Taxes of all Constituent Entities and Permanent Establishments. The relevant deferred tax expense or benefit must also be excluded from the Adjusted Covered Taxes of the Parent Entity or Main Entity which accrues the deferred tax expense. Where the election is made, the deferred tax expense or benefit with respect to Passive Income which would have been allocated to another Entity under Article 4.3.2(c) or (d) if Article 4.3.3 were not applied is also excluded from the Adjusted Covered Taxes of the Parent Entity. Where the election has been made, taxes arising under the relevant tax regimes are only allocated when they are accrued in current tax expense.

44. The following paragraphs are to be added following paragraph 71.3 of the Commentary to Article 4.4.1:

> 71.4. Where deferred tax expenses or benefits arise under a CFC Tax Regime other than a Blended CFC Tax Regime, the deferred tax expenses or benefits are to be allocated to the CFC Constituent Entities in accordance with the following five step process. Accrual and reversal of any deferred tax expense or benefit arising under a Blended CFC Tax Regime is excluded from the MNE Group's computation of Adjusted Covered Taxes for all jurisdictions. This five-step process only allocates the deferred tax expenses and benefits with respect to the CFC Tax Regime itself. It does not allocate deferred tax expenses and benefits with respect to taxes which are creditable foreign taxes for the purposes of applying the CFC Tax Regime. For example, if a CFC Tax Regime provided a credit for corporate income tax paid by a CFC, the five-step methodology only applies to allocate deferred tax expenses and benefits under the CFC Tax Regime. It does not apply to allocate deferred tax expenses or benefits with respect to the corporate income tax of the CFC itself.
>
> 71.5. The first step is to separate the deferred tax expenses and benefits reflected in the Parent Entity's financial accounts with respect to the assets and liabilities of each CFC Constituent Entity into three categories based upon the relevant income of the CFC:
>
> a. income that is not GloBE Income.
>
> b. GloBE Income that is not Passive Income; and
>
> c. GloBE Income that is Passive Income.

71.6. The second step is to calculate the pre-foreign tax credit deferred CFC tax expense arising in the accounts of the Parent Entity with respect to the CFC income in each of the three categories above. The pre-foreign tax credit deferred CFC tax expense or benefit is the deferred tax expense or benefit which would arise if the Parent Entity did not have any foreign tax credits to use against that CFC income. In general, this is the amount of CFC income expected to be included in the taxable income of the Parent Entity multiplied by the applicable tax rate. A pre-foreign tax credit deferred CFC tax benefit can also arise if there is CFC income that is currently included in taxable income but is only expected to be included in accounting income in the future.

71.7 In the second step, the MNE Group must also calculate the Relevant Creditable Foreign Taxes. The Relevant Creditable Foreign Taxes are creditable foreign taxes (including any QDMTTs for which a foreign tax credit is available under the Parent Entity's foreign tax regime) which could be available to offset the expected (pre-foreign tax credit) CFC tax liability. This is composed of two amounts. First, it includes all creditable foreign taxes imposed with respect to the relevant income (calculated without reduction for any foreign tax credit limitation). Second, it includes a share of any excess foreign tax credits arising from other sources of income which are available for cross-crediting against tax liabilities arising from the relevant source of income under the Parent Entity's domestic tax regime. The amount of excess foreign tax credits arising from other sources available to be offset is reduced by any applicable foreign tax credit limitation. The Relevant Creditable Foreign Taxes must be allocated to each category using a reasonable allocation method which takes into account the design of the relevant domestic tax system and making reasonable assumptions where necessary. The total Relevant Creditable Foreign Taxes (comprising both amounts outlined above) is limited to the pre-foreign tax credit deferred CFC tax expense.

71.8. The third step is to determine and allocate the deferred tax expense or benefit attributable to income that is not GloBE Income. For example, this could occur where a Parent Entity recorded a deferred tax liability with respect to anticipated capital gain of a CFC which is referable to the CFC's Ownership Interest in another entity which is not a Portfolio Shareholding. As this deferred tax expense is with respect to a potential Excluded Equity Gain or Loss which is excluded from GloBE Income under Article 3.2.1(c), the deferred tax expense is attributable to income which is not GloBE Income (unless the MNE Group has made an applicable Equity Investment Inclusion Election). The deferred tax expense attributable to income that is not GloBE Income is the pre-foreign tax credit deferred CFC tax expense referable to that income less the amount of creditable foreign taxes with respect to that income as determined under the second step. This deferred tax expense is allocated to the CFC Constituent Entity but then excluded from the Total Deferred Tax Adjustment Amount due to the operation of Article 4.4.1(a). Accordingly, deferred tax expenses referable to this category are not taken into account by either the Parent Entity or the CFC.

71.9. The fourth step is to allocate the deferred tax expense or benefit attributable to GloBE Income which is not Passive Income to the CFC Constituent Entity. The deferred tax expense or benefit attributable to GloBE Income is the pre-foreign tax credit deferred CFC tax expense or benefit referable to that income less the amount of creditable foreign taxes with respect to that income as determined under the second step. Subject to an MNE Group making the election outlined below in paragraph 71.16, the CFC Constituent Entity includes in its deferred tax expense the amount given by the following formula:

$$CFC\ Constituent\ Entity\ DTE\ Inclusion =$$

$$Movement\ in\ (the\ recast\ gross\ CFC\ Tax\ DTL\ (or\ DTA)) - Relevant\ Creditable\ Foreign\ Taxes\ (or\ used\ foreign\ tax\ credits)$$

The full amount of the deferred tax expense can only be allocated to the CFC Constituent Entity. Accordingly, no amount of deferred tax expense or benefit with respect to this category remains in the Parent Entity. Where a recast gross CFC Tax DTL arises, the formula subtracts Relevant Creditable Foreign Taxes to reach the CFC Constituent Entity DTE Inclusion. Where a recast gross CFC Tax DTA arises, the formula subtracts foreign tax credits which have been used against the pre-foreign tax credit liability giving rise to that DTA in order to reach the CFC Constituent Entity DTE Inclusion.

71.10. Under this formula, a recast gross CFC Tax DTA enters the formula as a negative figure. Similarly, the use of a foreign tax credit enters the formula as a negative figure. For example, consider a case where a CFC earns 100 which is included in the taxable income of both the CFC and in the Parent Entity (under a CFC Tax Regime) in Year 1 under their respective domestic tax regimes. This same income is not recognized as GloBE Income of the CFC until Year 2. In Year 1, the CFC is subject to a tax rate of 5% (giving rise to a tax credit of 5) while the Parent Entity is subject to a tax rate of 25% on the CFC Income. In Year 1, the Parent Entity has a pre-foreign tax credit liability of 25 but uses 5 of foreign tax credits in Year 1 which results in 20 in tax paid (25 – 5). The Parent Entity has a DTA of 20 while the CFC itself has paid 5 in tax and has a DTA of 5. In this case, the recast gross CFC Tax DTA is -15 and the relevant used foreign tax credits is -5. As a result, the CFC Constituent Entity DTE Inclusion is -10 (= (-15) – (-5)) for Year 1. When combined with the current tax accrued by the Parent Entity of 20, there is a net addition of 10 to the CFC's Adjusted Covered Taxes from the Parent Entity in Year 1.

71.11 If the pre-foreign tax credit deferred CFC tax liability (or asset) was calculated by reference to a rate above the Minimum Rate, it will be 'recast' down to 15%. The expected creditable foreign taxes on this income (as determined under the second step) are not recast to the Minimum Rate. The Relevant Creditable Foreign Taxes are also capped at the amount of the relevant recast gross CFC Tax DTL. Any additional Relevant Creditable Foreign Taxes are disregarded. Where there is a recast gross CFC Tax DTL, the excess (if any) of the pre-foreign tax credit deferred CFC tax liability over the expected foreign creditable taxes is allocated to the CFC. The movement in that net deferred tax liability for the Fiscal Year is included in the CFC's deferred tax expense.

71.12. When the timing difference reverses and the CFC Tax is accrued in current tax expense in respect of the GloBE Income which is not Passive Income, the reversal of the DTL that was allocated to the CFC Constituent Entity will offset the current tax expense. In some cases, the reduction in Adjusted Covered Taxes by reason of the DTL reversal may be smaller than the additional current tax expense, such as where the DTL was recast, in which case any amount of CFC Taxes that had been excluded due to the 'recast' and that exceeds the foreign tax credit allowed will be included in the Covered Taxes of the CFC. This may also occur where the actual foreign tax credit in the year of the reversal is less than the Relevant Creditable Foreign Taxes taken into account in determining the amount of deferred CFC tax expense (for example, because of a foreign tax credit limitation). Conversely, the reduction in Adjusted Covered Taxes by reason of the DTL reversal may exceed the current tax expense in some cases, such as where the actual foreign tax credit is greater than the Relevant Creditable Foreign Taxes that were taken into account in determining the amount of deferred CFC tax expense (for example, due to additional tax credits available due to cross-crediting). No amount of CFC Taxes on this category of income are included in the deferred tax expenses or Covered Taxes of the Parent Entity.

71.13 In some cases, the Parent Entity may have a pre-foreign tax credit deferred CFC tax asset. This could arise where there is an amount included in taxable income before it is included in accounting income. If the Parent Entity has recorded a deferred tax benefit (a negative deferred tax expense) for such amounts which has been calculated by reference to a rate above the Minimum Rate, it will be 'recast' down to 15%. Any amount of deferred tax asset in excess of the recast and any related deferred tax liability related to the deferred tax asset will be included in the CFC's deferred tax expense in the year it accrues.

71.14 The fifth step is to allocate the deferred tax expenses or benefits attributable to GloBE Income which is Passive Income. Subject to an MNE Group making the election outlined below in paragraph 71.16, the Parent Entity will need to determine whether all of the current and deferred tax with respect to the Passive Income can be allocated to the CFC. Article 4.3.3. limits the total amount of current and deferred taxes which can be allocated to a Constituent Entity for a given Fiscal Year to an amount equal to the Top-up Tax Percentage for the CFC Jurisdiction calculated without regard to the current and deferred Covered Taxes to be pushed down to the subsidiary under the CFC Tax Regime or fiscal transparency rule multiplied by the amount of the subsidiary's Passive Income that is includible under the CFC Tax Regime or fiscal transparency rule (under Article 10.2.2). To the extent that the limitation is applicable, any disregarded amount will be included in the Adjusted Covered Taxes of the Parent Entity.

71.15 Where the limitation in Article 4.3.3 applies, it is necessary to determine which current and deferred CFC Taxes have been allocated to the CFC and which have not. Accordingly, there is an ordering rule with respect to the cross-border allocations. The first allocation is made with respect to the reversal of any deferred tax expenses or benefits which had previously been allocated from the Parent Entity to the CFC. The second allocation is made with respect to any CFC current tax expense (for example, as a result of applying the cross-crediting allocation mechanism as contained in paragraphs 52 to 52.33 of the Commentary to Article 4.3.2). The third allocation is made with respect to any further deferred tax expense or benefit which has arisen during the year. Where the Article 4.3.3 limitation prevents the cross-border allocation of all of the CFC tax, any remaining CFC taxes are included in the Covered Taxes of the Parent Entity. As a result of this ordering rule, reversals of deferred tax assets and liabilities that were taken into account when they arose by the Parent Entity or CFC will be taken into account by the same Constituent Entity (whether that is the Parent Entity or the CFC).

71.16 An MNE Group can make a Five-Year Election with respect to a jurisdiction to exclude the allocation of all deferred tax expenses and benefits under Article 4.3.2(a), (c), (d) and (e) arising under tax regimes (including subnational tax regimes) applicable to Constituent Entities located in that jurisdiction. In other words, the election is made with respect to the Parent Entity jurisdiction and not with respect to each Permanent Establishment or subsidiary jurisdiction separately. Where the election is made, the deferred tax expense or benefit which otherwise would have been allocated from the Constituent Entity located in the jurisdiction subject to the election to another Constituent Entity under Article 4.3.2(a), (c), (d) and (e) will be excluded from the Adjusted Covered Taxes of all Constituent Entities and Permanent Establishments. The relevant deferred tax expense or benefit must also be excluded from the Adjusted Covered Taxes of the Parent Entity or Main Entity which accrues the deferred tax expense. Where the election is made, the deferred tax expense or benefit with respect to Passive Income which would have been allocated to another Entity under Article 4.3.2(c) or (d) if Article 4.3.3 were not applied is also excluded from the Adjusted Covered Taxes of the Parent Entity. Where the election has been made, taxes arising under the relevant tax regimes are only allocated when they are accrued in current tax expense.

71.17 For example, an MNE Group has a Parent Entity (A Co) in Jurisdiction A which has two subsidiaries – B Co (in Jurisdiction B) and C Co (in Jurisdiction C). A Co is subject to CFC Tax Regimes at both the national level (National CFC Tax) and subnational level (Subnational CFC Tax). If the MNE Group made the Five-Year Election with respect to Jurisdiction A, only current tax expense would be taken into account with respect to the National CFC Tax and Subnational CFC Tax. The deferred tax expenses or benefits with respect to these CFC Tax Regimes would be excluded from the Adjusted Covered Taxes of A Co, B Co and C Co. The Five-Year Election applies for all taxes for which there can be an allocation under Article 4.3.2(a), (c), (d) and (e) imposed on Constituent Entities located in Jurisdiction A. The MNE Group cannot elect to apply deferred tax expenses or benefits to National CFC Tax but not Subnational CFC Tax. Similarly, the election also cannot be made with respect to the allocation of CFC Taxes imposed on A Co with respect to CFCs in Jurisdiction B but not CFCs in Jurisdiction C.

Allocation of deferred tax expenses and benefits from a Parent Entity to a Hybrid Entity or Reverse Hybrid Entity

45. The following paragraph will be inserted after paragraph 59.3 of the Commentary to Article 4.3.2(d):

59.4. The principles outlined in paragraphs 71.4 to 71.17 of the Commentary to Article 4.4.1 also apply to the allocation of deferred taxes to a Hybrid Entity or Reverse Hybrid Entity under a tax transparency regime.

Allocation of deferred tax expenses and benefits from a Main Entity to a Permanent Establishment

46. The text in strikethrough will be deleted from paragraph 52 of the Commentary to Article 4.3.2(a):

52. Determining the amount of Tax paid on a PE income inclusion is more complicated when cross-crediting is allowed because Taxes paid by one PE are allowed to reduce the tax liability arising in respect of other PE income inclusions. Cross-crediting means that the Tax paid with respect to an income inclusion from a low-taxed PE may not equal the pre-credit tax liability on the inclusion less the tax credit allowed for Taxes paid by that PE. ~~**Deferred tax liabilities with respect to PE income are allocated in the same manner. The rules with respect to the recognition of deferred tax liabilities are set forth in Article 4.4.**~~

47. The following paragraph will be inserted after paragraph 52.34 of the Commentary to Article 4.3.2(a):

52.35. The principles outlined in paragraphs 71.4 to 71.13 and 71.16 to 71.17 of the Commentary to Article 4.4.1 also apply with respect to taxation regimes which include the income of foreign Permanent Establishments. With respect to such regimes, any taxes on GloBE Income which is Passive Income are allocated as part of step four as outlined in paragraphs 71.9 to 71.13. Paragraphs 71.14 and 71.15 are not applicable because the limitation in Article 4.3.3 is not applicable to the allocation of taxes on foreign Permanent Establishments under paragraph 4.3.2(a).

Deferred tax expenses and benefits on Transition

48. The text in bold will be added to paragraph 5 of the Commentary to Article 9.1.1:

5. Article 9.1.1 sets out the deferred tax accounting attributes of a Constituent Entity that may be utilised in calculating the ETR in a jurisdiction in the Transition Year and subsequent years. Rather than requiring an MNE Group to undertake complex calculations as if the Constituent Entity had been subject to the GloBE Rules in prior years, it uses a simplified approach that 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. The applicable domestic tax rate is the rate at which an item of deferred tax expense has been recorded in the financial accounts. However, deferred tax assets in respect of GloBE Losses that have been recorded at a rate lower than the Minimum Rate may be recast at the Minimum Rate if the taxpayer can demonstrate that the deferred tax asset is attributable to a loss that would have been a GloBE Loss had the MNE Group been subject to the GloBE Rules in the year in which the loss arose. These attributes include losses that have not been recognised due to an accounting recognition adjustment or valuation allowance. **Any deferred tax assets or liabilities arising under a Blended CFC Tax Regime are disregarded for all jurisdictions for the purposes of Article 9.1.1.**

4.2.4. Examples

Example 4.4.1(e)-3

1. A Co is a Constituent Entity of a MNE Group in Country A. Country A imposes a 25% CIT rate and has a Controlled Foreign Company (CFC) Tax Regime which imposes Taxes on shareholders in respect of Passive Income derived by foreign (CFC) subsidiaries. Country A CFC Tax Regimes provides for the taxation of the CFC income by including such income in the domestic taxable income of the CE-owner in the tax year immediately following the tax year when the income is derived by the CFC.

2. A Co wholly owns B Co, which is located in Country B. Country B imposes a 5% CIT rate on Passive Income and imposes 9% CIT rate on operating income. B Co is the only Constituent Entity located in Country B.

3. In year 1, B Co has GloBE Income of 200, of which 100 is Passive Income. B Co pays 14 of Country B tax, including 5 of Country B tax on Passive Income and 9 of Country B tax on other income.

4. In Year 2, Country A imposes its CFC charge on the 100 of Passive Income earned by B Co in Year 1. This CFC charge is computed by applying the Country A CIT rate of 25% to the Passive Income earned by B Co, less any applicable foreign tax credit (FTC) for taxes paid on that Passive Income. In this context, A Co records a DTL for the deferred CFC tax (pre-foreign tax credit) of 25 and records a DTA for the foreign tax credit of 5 for accounting purposes.

Year 1

5. The table below illustrates the tax calculation for both A Co and B Co in Year 1.

A Co (Country A)	
Country A Income	
Operating Income	0
CFC Inclusion (B Co)	0
Total Taxable Income	0
Country A Tax	
Tax on Operating Income (25%)	0
DTL on CFC Inclusion (25%)	25
DTA on Foreign Tax Credit (CFC Inclusion)	-5
Total Country A current Tax expense	0
Total Country A accrued Tax expense* (current and deferred)	20
**Entirely attributable to CFC inclusion since there is no other income*	

B Co (Country B)	
Country B Income	
Operating Income	100
Passive Income	100
Total Taxable Income	200
Country B Tax	
Tax on Operating Income (9%)	9
Tax on Passive Income (5%)	5
Total Country B current Tax expense	14
Total Country B accrued Tax expense (current and deferred)	14

6. For purposes of GloBE Rules, the DTL on the CFC Inclusion of 25 is recast to 15. The Relevant Creditable Foreign Taxes with respect to the income remains 5 (it is not recast). Accordingly, the net deferred CFC tax expense allocable to B Co which would be allocable to B Co prior to the application of Article 4.3.3 is 10 (=15 - 5).

7. Article 4.3.3 is then applied to limit the extent to which the deferred tax expense or benefit can be allocated to the CFC. In year 1, the ETR for Country B (ignoring any CFC Tax Regimes and tax transparency regimes) would have been 7% (=14/200). Its Top-up Tax Percentage absent the application of CFC Tax Regimes and tax transparency regimes would be 8% (=15%-7%). Therefore, the maximum amount of CFC Taxes that can be allocated from Country A to Country B is 8 (the lesser of 10 and 8 = (8%×100)). The remaining deferred tax expense of 2 is included in the deferred tax expense of A Co.

8. The table below illustrates the allocation of the deferred tax expense and the calculation of Adjusted Covered Taxes for both A Co and B Co.

	Current tax expense	Deferred tax expense for accounting purposes	Allocable deferred tax expense for GloBE purposes	Cross-border allocation of deferred tax expense	Deferred tax expense after allocation	Adjusted Covered Taxes
A Co	0	20	10	-8	2	2
B Co	14	0	0	8	8	22

9. The ETR calculations for Country A and Country B are as follows:

	Country A	Country B
GloBE Income	0	200
Adjusted Covered Taxes	2	22
ETR	--	11%

Year 2

10. In year 2, A Co imposes its CFC charge on the 100 of Passive Income earned by B Co in year 1. Accordingly, A Co pays its CFC tax liability of 20 (=25-5) and records a reversal of DTL of 25 and a reversal of DTA of 5 in its accounts.

11. In year 2, B Co has GloBE Income of 300, of which 200 is Passive Income. B Co pays 19 of Country B tax, including 10 of Country B tax on Passive Income and 9 of Country B tax on other income. There is an expected future inclusion of 200 of CFC Income in A Co in Year 3 which is subject to a 25% rate with an expected foreign tax credit of 10 on the relevant income. Accordingly, A Co records a DTL for the deferred CFC tax (pre-foreign tax credit) of 50 and records a DTA for the foreign tax credit of 10 in its accounts.

12. The table below illustrates the tax calculation for both A Co and B Co in Year 2.

A Co (Country A)	
Country A Income	
Operating Income	0
CFC Inclusion (B Co)	100
Total Taxable Income	100
Country A Tax	
Tax on Operating Income (25%)	0
DTL on CFC Inclusion (25%)	-25+50
DTA on Foreign Tax Credit (CFC Inclusion)	5-10
CFC tax	20
Total Country A current Tax expense	20
Total Country A accrued Tax expense (current and deferred)*	40
**Entirely attributable to CFC inclusion since there is no other income*	

B Co (Country B)	
Country B Income	
Operating Income	100
Passive Income	200
Total Taxable Income	300
Country B Tax	
Tax on Operating Income (9%)	9
Tax on Passive Income (5%)	10
Total Country B current Tax expense	19
Total Country B accrued Tax expense (current and deferred)	19

13. Before applying Article 4.3.3, it is necessary to calculate the allocations which would have been made in the absence of Article 4.3.3. First, there has been a reversal of previously allocated deferred tax expense (that is, -2 to A Co and -8 to B Co). Second, the current taxes must be allocated. In this case, 20 of tax has been paid by A Co, all of which is allocable to B Co. This allocation is determined independently of the allocation of deferred taxes. Third, there is the allocation of further deferred tax expenses. In this case, there would be an allocation of 20 to B Co (this is the 50 in pre-foreign tax credit liability, recast to 30 and then subtracting the expected foreign tax credits of 10). As a result, prior to the application of Article 4.3.3, there would be a net allocation to B Co of 32 (-8 + 20 + 20).

14. Second, it is necessary to calculate the limitation under Article 4.3.3. Under Article 4.3.3, the ETR for Country B (ignoring any CFC Tax Regimes and tax transparency regimes) would have been 6.33% (=19/300). Its Top-up Tax Percentage absent the application of CFC Tax Regimes and tax transparency regimes would be 8.67% (=15%-6.33%). Therefore, the maximum amount of CFC Taxes that can be allocated from Country A to Country B is 17.34 (the lesser of 32 and 17.34 (=8.67%×200)).

15. As the Article 4.3.3 limitation is less than the full allocation under the CFC Tax Regime, it is necessary to determine which amounts are not allocated due to the limitation. As outlined in paragraph 71.12, the allocations are made in the order (i) reversal of previously allocated amounts (-8), (ii) current tax expenses (20) and (iii) further deferred tax expense (20). As -8 is less than 17.34, the first allocation from the reversal of previously allocated amounts can be made. The second (ii) allocation can also be made as 12 (-8 + 20) is less than 17.34. However, the final allocation cannot be made in full as 32 (-8 + 20 + 20) is greater than 17.34. Accordingly, the full allocations are made under (i) and (ii) but only 5.34 (17.34 – 12) of (iii) can be allocated. Accordingly, of the 20 in further deferred tax expense, 5.34 is allocated to B Co and 14.66 (20 – 5.34) is retained by A Co due to the limitation in Article 4.3.3.

16. As a result, due to the ordering rule in paragraph 71.12, Article 4.3.3 applies to allow full allocations of (i) previously allocated deferred taxes which are reversing (-8 to B Co and -2 to A Co) and (ii) current taxes (20 to B Co). However, of (iii) the further deferred tax expenses, only 5.34 is allocated to B Co and the remainder is allocated to A Co (14.66).

17. The table below illustrates the allocation of the deferred tax expense and the calculation of Adjusted Covered Taxes for both A Co and B Co.

	Current tax expense before allocation	Cross-border Allocation of Current tax expense	Current Tax expense after allocation	Deferred tax expense for accounting purposes	Allocable deferred tax expense for GloBE purposes	Cross-border allocation of deferred tax expense	Deferred tax expense after allocation	Adjusted Covered Taxes
A Co	20	-20	0	20	-10+20*	- (-8) - 5.34	12.66	12.66
B Co	19	20	39	0	0	(-8) + 5.34	-2.66	36.34

Note: Allocable deferred tax expense for GloBE purposes for A Co is 10 (=-10+20), which includes the reversal of deferred tax expense recognized in year 1 (-10) and future deferred tax expense recognized in year 2 (20) which is the 50 in pre-foreign tax credit liability, recast to 30 and then subtracting the expected foreign tax credits of 10.

18. The ETR calculations for Country A and Country B are as follows:

	Country A	Country B
GloBE Income	0	300
Adjusted Covered Taxes	12.66	36.34
ETR	--	12.11%

Example 4.4.1(e)-4

1. A Co is a Constituent Entity of a MNE Group in Country A. Country A imposes a 20% CIT rate. Country A taxes foreign branches and allows for foreign tax credit to eliminate double taxation. A Co has a PE in Country B. Country B imposes 10% income tax.

2. In Year 1, the PE purchases a machine with carrying value of 900. For accounting purposes, the machine is depreciated for three years (300 per year). In Country B, the PE is allowed to use an accelerated depreciation method to deduct the expenses of the machine in two years (450 per year). In Year 2 and Year 3, there is no timing difference other than the one arising from the machine purchased by the PE in Year 1.

3. The table below illustrates the timing differences and recognition of deferred tax liability in the PE.

	Carrying value of the machine	Tax basis of the machine	Timing differences	Deferred tax liability	Deferred tax expense with respect to DTL movements
	[1]	[2]	[3] = [1]-[2]	[4] = [3]×10%	
Year 1	600	450	150	15	15
Year 2	300	0	300	30	15
Year 3	0	0	0	0	-30

4. In Year 1, there is no timing difference with respect to the domestic income of A Co reported for accounting purposes in its domestic tax regime. However, Country A imposes taxes on PE and allows for an immediate expense of 900 for the purchase of the machine by the PE. In Year 2 and Year 3, there is no timing difference other than the one arising from the machine purchased by the PE in Year 1.

5. Because a DTL recorded in a PE that upon reversal will increase the taxes paid in Country B, it may give rise to foreign tax credits in Country A that will be used to reduce its tax liability. In this case, the DTL in relation to the PE will result in a deferred tax asset being recorded by A Co, i.e., the deferred benefit of the future tax credits)

6. The table below illustrates the timing differences and recognition of DTL and DTA in A Co.

	Carrying value of the machine	Tax basis of the machine	Timing differences	Deferred tax liability	Deferred tax expense with respect to DTL movements	DTA with respect to foreign tax credit	Deferred tax expense with respect to DTA movements	Deferred tax expense
	[1]	[2]	[3]=[1]-[2]	[4]=[3]×20%	[5]	[6]	[7]	[8]=[5]+[7]
Year 1	600	0	600	120	120	15	-15	105
Year 2	300	0	300	60	-60	30	-15	-75
Year 3	0	0	0	0	-60	0	30	-30

7. In year 1, A Co records a DTL of 120 based on the timing difference of the machine in the PE. The DTL on the PE income of 120 is recast to 90 (recasting from a 20% rate to a 15% rate) and the creditable foreign taxes with respect to this amount remains 15 (it is not recast). Accordingly, the net deferred tax expense allocable to PE is 75 = (90-15). The deferred tax expense for purposes of calculating Adjusted Covered Taxes in PE is 90 (=15+75). This is the PE's own deferred tax expense of 15 in addition to the allocation of 75 in deferred tax expense allocated from A Co. The deferred tax expense of 105 accrued by A Co shall not be included in the Adjusted Covered Taxes of A Co for GloBE purposes.

8. The table below illustrates the allocation of deferred tax expense for A Co to the PE in year 1.

	Deferred tax expense for accounting purposes	Allocable deferred tax expense for GloBE purposes	Allocation of deferred tax expense	Deferred tax expense after allocation
A Co	105	75	-75	0
PE	15	15	75	90

9. In year 2, A Co records reversal of DTL of 60 based on the timing difference of the machine in the PE. The DTL on the PE income of -60 is recast to -45 (recasting from a 20% rate to a 15% rate) and the creditable foreign taxes with respect to this amount remains 15 (it is not recast). Accordingly, the net deferred tax expense or benefit allocable to PE is -60 (= -45-15). This is a deferred tax benefit (a negative deferred tax expense). The deferred tax benefit for purposes of calculating Adjusted Covered Taxes in PE is -45 (=15-60). This is the PE's own deferred tax expense of 15 in addition to the allocation of -60 in deferred tax expense (or benefit) allocated from A Co. The deferred tax expense or benefit of -75 accrued by A Co shall not be included in the Adjusted Covered Taxes of A Co for GloBE Purposes.

10. The table below illustrates the allocation of deferred tax expense for A Co to the PE in year 2.

	Deferred tax expense for accounting purposes	Allocable deferred tax expense for GloBE purposes	Allocation of deferred tax expense	Deferred tax expense after allocation
A Co	-75	-60	60	0
PE	15	15	-60	-45

11. In year 3, A Co records reversal of DTL of 60 based on the timing difference of the machine in the PE. The DTL on the PE income of -60 is recast to -45 (recasting from a 20% rate to a 15% rate) and the use of creditable foreign taxes is -30. Accordingly, the net deferred tax expense or benefit allocable to PE is -15 (=-45+30). The deferred tax expense or benefit for purposes of calculating Adjusted Covered Taxes in PE is -45 (=-30-15). The deferred tax expense or benefit of -30 accrued by A Co shall not be included in the Adjusted Covered Taxes of A Co for GloBE Purposes.

12. The table below illustrates the allocation of deferred tax expense for A Co to the PE in year 3.

	Deferred tax expense for accounting purposes	Allocable deferred tax expense for GloBE purposes	Allocation of deferred tax expense	Deferred tax expense after allocation
A Co	-30	-15	15	0
PE	-30	-30	-15	-45

5. Allocation of profits and taxes in structures including Flow-through Entities

5.1. Introduction

1. The GloBE Rules are designed to ensure that multinational enterprises pay a minimum level of tax on their profits in each jurisdiction. There are consequently rules to determine how profits and taxes should be allocated between jurisdictions.

2. This guidance clarifies how the rules are intended to allocate profits and taxes between Constituent Entities in structures where different jurisdictions take different views as to whether Entities in the structure are fiscally transparent. This guidance is important to ensure profits and taxes are allocated appropriately and consistently between jurisdictions.

3. Generally, the GloBE Rules assign profits to the Constituent Entity that earned the income. The jurisdiction where that Constituent Entity is located would typically have, or be expected to have, the right to tax those profits. So, for example, the GloBE Rules assign profits of a Permanent Establishment to the Permanent Establishment and those profits are reflected in the GloBE computations of the jurisdiction where the Permanent Establishment is located. Similarly, Article 3.2.3 generally requires adjustments to ensure that the allocation of profits between Constituent Entities reflects the allocation of profit between those entities for local tax purposes. These income allocation rules are designed to ensure that the Effective Tax Rate computation for each jurisdiction appropriately reflects the existing allocation of taxing rights between jurisdictions.

4. The income allocation rules are complemented by Article 4.3, which reallocates Covered Taxes between Constituent Entities. The Article applies to specified cases when a Constituent Entity is charged tax in respect of the profits of another Constituent Entity. It reallocates that tax to the Constituent Entity that recognises the profit under the GloBE Rules. This ensures that the ETR calculation in each jurisdiction properly reflects the full amount of taxes that the multinational has paid on those profits. The tax is matched with the income that has been subject to the tax.

5. The principle of matching the tax with the income that has been subject to the tax also applies to Flow-through Entities (i.e. entities that are fiscally transparent in the jurisdiction where the entity is created). However, instead of moving the tax to the location of the income as in the case of taxes on the income of a Controlled Foreign Company (CFC) or Permanent Establishment, profit of a Flow-through Entity is assigned to the Constituent Entity that is, or would be expected to be, taxable on those profits. Article 3.5.1 sets out how this profit should be allocated. Under this article, the profit is first allocated to any Permanent Establishment through which the business of the Flow-through Entity is carried on. This means the profits will be attributed to the jurisdiction where the profit was earned (which will often be the jurisdiction where the Flow-through Entity was created) when that jurisdiction has taxing rights over those business profits.

Any profits that are not allocated to a Permanent Establishment are then allocated to its owners to the extent that the Flow-through Entity is treated as fiscally transparent in the jurisdiction of the owner, i.e. it is a Tax Transparent Entity. Thus, the profits are allocated to the owner under the GloBE Rules if the owner is taxed on its share of the Flow-through Entity's profits. This treatment is designed to match the income with the tax on a jurisdictional basis.

6. If, on the other hand, the Flow-through Entity is not treated as fiscally transparent in the jurisdiction of an owner, i.e. it is a Reverse Hybrid Entity, that owner's share of the profits is not allocated and remains the profits of the Flow-through Entity, which is treated as a Stateless Entity. This reflects that the MNE Group is not subject to residence-based taxation on those profits in either the jurisdiction where the Flow-through Entity was created or the jurisdiction of its owner.

7. This Administrative Guidance considers various issues relating to the allocation of profits under Article 3.5.1(b) as well as related issues with the profit and tax allocation of Flow-through Entities and Hybrid Entities. However, the Administrative Guidance does not address issues relating to Permanent Establishments and so the issues discussed, and examples cited, assume either that there is no Permanent Establishment through which the business of a Flow-through Entity is carried on, or that the allocation under Article 3.5.1(a) has already occurred prior to the allocation of the remaining profits of the Flow-through Entity.

5.2. Application of Article 3.5.1(b) and Article 10.2.1 definitions

5.2.1. Issue 1: Tax law of the jurisdiction in which the owner is located

8. Article 10.2.1 determines whether a Flow-through Entity is classified as a Tax Transparent Entity or a Reverse Hybrid Entity based on how the Flow-through Entity is treated in the "jurisdiction in which the owner is located". This determination is made with respect to each Ownership Interest so a Flow-through Entity can be both a Tax Transparent Entity and a Reverse Hybrid Entity where it has multiple owners.

9. Paragraph 154 of the Commentary to Article 10.2.1 of the Model Rules states that the reference to the "jurisdiction in which the owner is located" refers to the jurisdiction of the direct owner of the Flow-through Entity. Accordingly, the difference between a Tax Transparent Entity and a Reverse Hybrid Entity depends on whether the domestic tax law of the jurisdiction of the direct owner treats the Entity as fiscally transparent.

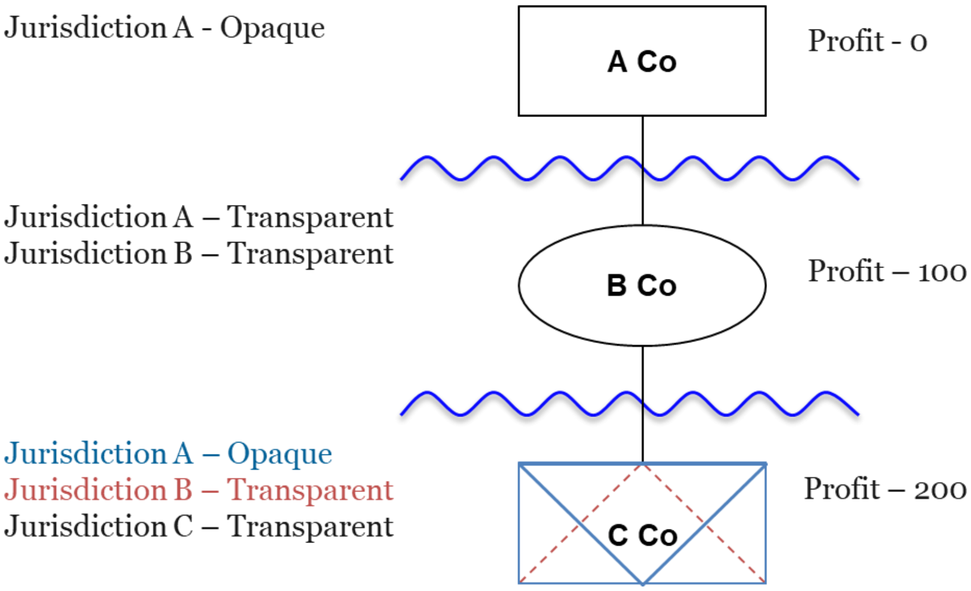
10. Stakeholders have identified that there is some uncertainty over how Article 10.2.1 applies when a Flow-through Entity is held directly by another Flow-through Entity.

11. The uncertainty arises because Flow-through Entities are generally treated as Stateless Constituent Entities that do not have a location under the GloBE Rules. Some have interpreted this to mean that a Flow-through Entity cannot be the direct owner for the purposes of Article 10.2.1 because it is not located in a jurisdiction (unless it is the UPE or an Intermediate Parent Entity that is subject to an IIR). Under this interpretation, the direct owner would consequently be ignored, and Article 10.2.1 would be applied by reference to the next owner further up the ownership chain.

12. In contrast, others have interpreted that the direct owner of the Flow-through Entity is the owner for the purposes of Article 10.2.1, even if that direct owner is a Flow-through Entity.

13. These different interpretations could result in implementing jurisdictions attributing profits to different jurisdictions, creating a significant risk of uncoordinated outcomes and multiple jurisdictions imposing top-up taxes in relation to the same profits.

14. This is illustrated in the following example.



15. This example is based on a structure where A Co wholly owns B Co and B Co owns C Co. A Co is located in Jurisdiction A. B Co and C Co were created in Jurisdictions B and C respectively but are fiscally transparent in those jurisdictions and are thus treated as Stateless Constituent Entities under the GloBE Rules. B Co has 100 of profit and C Co has 200 of profit. The table below summarises how each jurisdiction's tax laws treat the Entities.

	Classification of Entities in the ownership chain		
Jurisdiction	A Co	B Co	C Co
A	Opaque	Transparent	Opaque
B		Transparent	Transparent
C			Transparent

16. In this case, the tax base of A Co would include B Co's profit of 100. It will not include C Co's profit of 200 because under jurisdiction A's law, C Co is not fiscally transparent.

17. The profits of C Co will also not be taxable in Jurisdictions B or C. This is because both B Co and C Co are considered fiscally transparent in the jurisdiction in which they are created and are consequently not subject to Covered Taxes in respect of their income.

18. Under the GloBE Rules, the 100 profit of B Co will be allocated to A Co. This is because B Co is a Tax Transparent Entity in relation to A Co. However, the allocation of the 200 profit of C Co depends upon whether Jurisdiction A or Jurisdiction B is considered the jurisdiction where the "owner" is located for the purposes of Article 10.2.1(a) and (b).

19. If Jurisdiction A were considered the jurisdiction of the owner under Article 10.2.1, C Co would be treated as a Reverse Hybrid Entity because Jurisdiction A views C Co as fiscally opaque. This would result in C Co's 200 of profits being attributed to C Co and included in a separate ETR computation.

20. Alternatively, if Jurisdiction B were considered the jurisdiction of the owner, then C Co would be treated as a Tax Transparent Entity because Jurisdiction B views C Co as fiscally transparent. C Co's 200 of profits would be allocated to A Co because B Co is also a Tax Transparent Entity. Under this analysis, A Co's adjusted profits would be 300, despite the fact A Co is only subject to tax on 100 of those profits.

21. This question of which owner is relevant for purposes of Article 10.2.1 needs to be clarified in order to prevent uncoordinated application of the rules. The Inclusive Framework considers that the status of a Flow-through Entity as a Tax Transparent Entity or Reverse Hybrid Entity should generally be determined by reference to the tax law of the Constituent Entity-owner closest to such Entity in the ownership chain that is not itself a Flow-through Entity.

22. This interpretation of “owner” is more consistent with the underlying principles of profit allocation and matching taxes with the related income that are reflected in the GloBE Rules. Under these principles, the profits of a Flow-through Entity should only be allocated to an owner when the owner is subject to tax on those profits, in order to ensure that the income and the tax with respect to that income are included in the same jurisdictional ETR computation. Conversely, if an owner is not subject to tax on the income, the profits should remain with the Flow-through Entity.

23. It follows from this that the profits of a Flow-through Entity should not generally be allocated to another Flow-through Entity (a ‘Flow-through Entity owner’) under the GloBE Rules. This is because the Flow-through Entity owner will typically not be subject to a Covered Tax on its profits or the profits of an Entity that it owns, given it is treated as fiscally transparent under the tax laws of the jurisdiction in which it was created.

24. This will be true for both stateless Flow-through Entities and Flow-through Entities which are located in a jurisdiction because they are required to apply the IIR. In both cases, the Flow-through Entity owner will not be subject to a Covered Tax on its profits or the profits of an Entity that it owns. Consequently, the profits should not be allocated to a Flow-through Entity owner in either case and the application of Article 10.2.1 will not depend upon the location of the Flow-through Entity owner.

25. There is however an exception when the Flow-through Entity owner is the UPE of the MNE Group (‘Flow-through UPE'). This is because the owners of the UPE will not be Constituent Entities of the MNE Group. As such, the profits of the Flow-through Entity owner or any Flow-through Entities it owns cannot be allocated to these owners. The owners could nonetheless be subject to tax on those profits. Article 7.1 is designed to address this situation by reducing the GloBE Income of the UPE to the extent that the owners are subject to tax on those profits (or the other conditions in Article 7.1 are met). The profits of a Flow-through Entity will be allocated to the UPE so that Article 7.1 is tested by reference to the total profits that could be subject to tax in the hands of the owners.

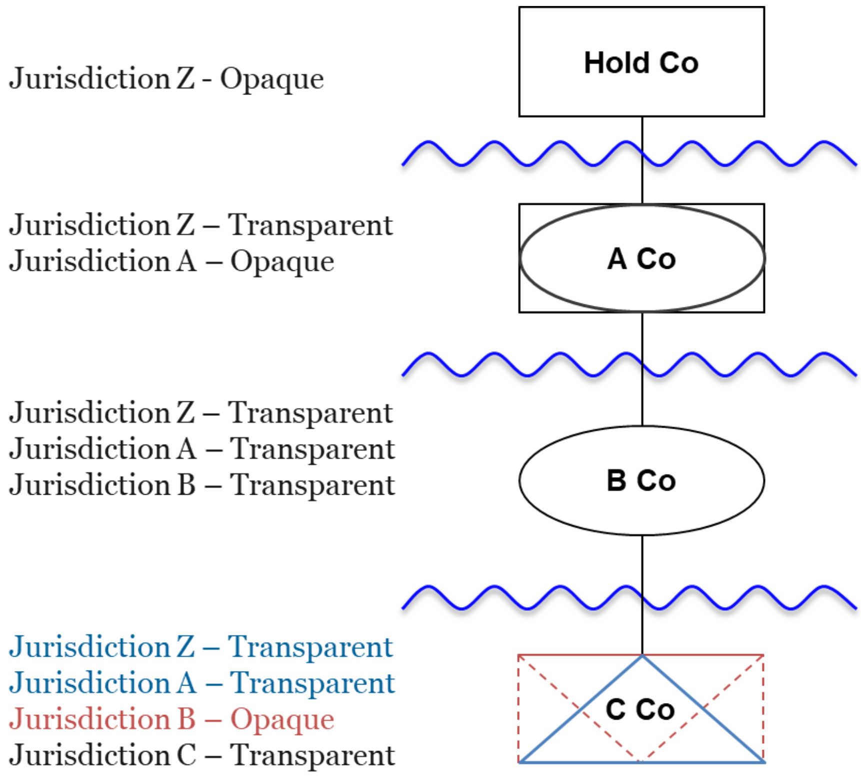
26. Consequently, the Commentary will be updated to clarify that a Flow-through Entity (other than a Flow-through UPE) will not be considered an owner for the purposes of Article 10.2.1. Instead, the owner for the purposes of Article 10.2.1 will be the next owner further up the ownership chain that is not a Flow-through Entity or where there is no such Entity, a Flow-through UPE (referred to as the Reference Entity in the guidance below).

27. This means that the treatment of an Entity as a Tax Transparent Entity or Reverse Hybrid Entity will depend on how the tax law of the Reference Entity’s jurisdiction treats the Entity. Further, because this determination is made based on each Ownership Interest, an Entity with multiple owners in different jurisdictions could have more than one classification for GloBE purposes. Where this guidance refers to the tax law of the relevant Entity’s jurisdiction, it is referring to all of the laws of the jurisdiction that result in treatment of the Entity as fiscally transparent and taxation of its income or loss at the owner level. In other words, tax law in the context of determining whether an Entity is fiscally transparent means the jurisdiction’s laws, including tax laws, that affirmatively provide for the result that the Entity’s income, expenditure, profit or loss is considered that of the owner for purposes of a Covered Tax.

28. The Commentary will also be updated to clarify what is meant by fiscally transparent in the case of an Entity that is not subject to a corporate income tax or other Covered Tax. A jurisdiction must have tax laws that affirmatively provide for fiscal transparent treatment to satisfy the definition. Accordingly, a jurisdiction that does not have a generally applicable corporate income tax or a similar Covered Tax cannot

be considered to treat an Entity created in the jurisdiction or an Entity owned by an Entity created in the jurisdiction as fiscally transparent. However, an Entity located in a jurisdiction without a corporate income tax may still be considered a Tax Transparent Entity in certain cases under Article 10.2.4.

29. This rule also appropriately addresses situations where more than one owner is subject to tax on a Flow-through Entity's income. This can arise when an owner that is subject to tax on the Flow-through Entity's income is a Hybrid Entity. This is illustrated in the following example.



	Classification of Entities in the ownership chain			
Jurisdiction	Hold Co	A Co	B Co	C Co
Z	Opaque	Transparent	Transparent	Transparent
A		Opaque	Transparent	Transparent
B			Transparent	Opaque
C				Transparent

30. The example is the same as that in paragraphs 14 and 15 above, except that C Co is viewed as fiscally transparent in Jurisdiction A and not fiscally transparent in Jurisdiction B; and there is a fourth Entity at the top of the structure, Hold Co. The tax laws of Hold Co's jurisdiction treat the three other Entities in the ownership chain as fiscally transparent. Both Hold Co and A Co are subject to tax on C Co's income. This raises the question which Entity should be allocated C Co's profit under the GloBE Rules.

31. This guidance allocates C Co's profit to A Co because it is the Entity closest to C Co in the ownership chain that is not a Flow-through Entity, i.e. it is not fiscally transparent in its jurisdiction. A Co meets the definition of a Hybrid Entity because Jurisdiction Z views A Co as fiscally transparent. Consequently, any taxes that Hold Co pays on C Co's profits will be reallocated to A Co under Article 4.3.2(d).

32. This solution ensures that the principle of matching the tax with the income that has been subject to the tax is satisfied. C Co's profits and taxes on those profits will be recognised in the same jurisdictional ETR computation. The solution is consistent with the general approach to the profit and tax allocation of Hybrid Entities, which is to recognise the profit in the Hybrid Entity and then allocate any taxes in respect of these profits paid by the owner to the Hybrid Entity.

5.2.2. Guidance

33. The strikethrough text will be deleted, and the bold text will be added to paragraphs 154 to 156 of the Commentary to Article 10.2.1.

> 154. Flow-through Entities can further be divided into two categories: Tax Transparent Entities and Reverse Hybrid Entities. The difference between these terms depends on how **those Entities are treated under the tax law of** the ~~direct~~ owners (i.e. **direct or indirect** owners of their Ownership Interest)~~ are treating them under their domestic tax law~~. **The determination of whether a tested Entity is a Tax Transparent Entity or Reverse Hybrid Entity is made for each Ownership Interest. As a result, an Entity with multiple owners in different jurisdictions could have more than one classification for GloBE purposes.**
>
> **154.1 Whether a Flow-through Entity (the tested Entity) is a Tax Transparent Entity or a Reverse Hybrid Entity depends on how the tax law of the jurisdiction in which the Reference Entity is located treats the tested Entity and each Entity through which the Reference Entity owns its Ownership Interest in the tested Entity. The Reference Entity is the Constituent Entity-owner that is closest in the ownership chain to the tested Entity and that is either (a) not a Flow-through Entity or (b) where there is no such Constituent Entity-owner, a Flow-through Entity that is the Ultimate Parent Entity of the MNE Group (Flow-through UPE).**
>
> 155. A Flow-through Entity is a Tax Transparent Entity if the tax law of the **Reference Entity's jurisdiction treats the tested Entity and each Entity through which the Reference Entity owns its Ownership Interest in the tested Entity** ~~owners also treat it~~ as fiscally transparent.~~ and requires the owner to recognize the income, expenditure, profit or loss of the Flow-through Entity as if it was income earned or expenditure borne by the owners~~.
>
> 156. ~~On the other hand, a~~ A Flow-through Entity is a Reverse Hybrid Entity if the~~ domestic~~ tax law of the jurisdiction in which the Reference Entity is located does not treat the tested Entity and each Entity through which the Reference Entity owns its Ownership Interest in the tested Entity ~~the owners are not treating it~~ as fiscally transparent~~ and therefore, it does not recognize the income, expenditure, profit or loss when earned or incurred by the Entity, but until the Entity distributes profits or make an equivalent payment to its owners~~.

34. The bold text will be added to paragraph 160 of the Commentary to Article 10.2.2.

> 160. Article 10.2.2 describes what is meant by fiscally transparent in Articles 10.2.1 and 10.2.5. It states that an Entity is treated as fiscally transparent under the laws of a jurisdiction, if such jurisdiction treats the income, expenditure, profit or loss of that Entity as if they were derived or incurred by the direct owner of the Entity in proportion to its interest. **This requires the jurisdiction to have laws that affirmatively provide for the result that the Entity's income, expenditure, profit or loss is considered to be the owner's income, expenditure, profit or loss for purposes of a Covered Tax. For example, a jurisdiction that does not have a corporate income tax or a similar Covered Tax cannot be considered to treat an Entity created in the jurisdiction or an Entity owned by an Entity created in the jurisdiction as fiscally transparent.**

35. The strikethrough text in the heading will be deleted, and paragraph 214 to the Commentary to Article 3.5.1 is replaced by a new paragraph 214.

Residual allocated to ~~direct~~ owners

~~214. If the Constituent Entity-owners are also Tax Transparent Entities, then paragraph (b) of Article 3.5.1 applies again and allocates the residual Financial Accounting Net Income or Loss to the next Constituent Entity-owner up the ownership chain (unless the Ownership Interest holder is the UPE, in which case Article 3.5.1(c) applies). Thus, if all the Constituent Entities are Tax Transparent Entities (i.e. a Tax Transparent Structure), all of the MNE Group's income or loss is ultimately allocated to the UPE under Article 3.5.1(b) and 3.5.1(c).~~

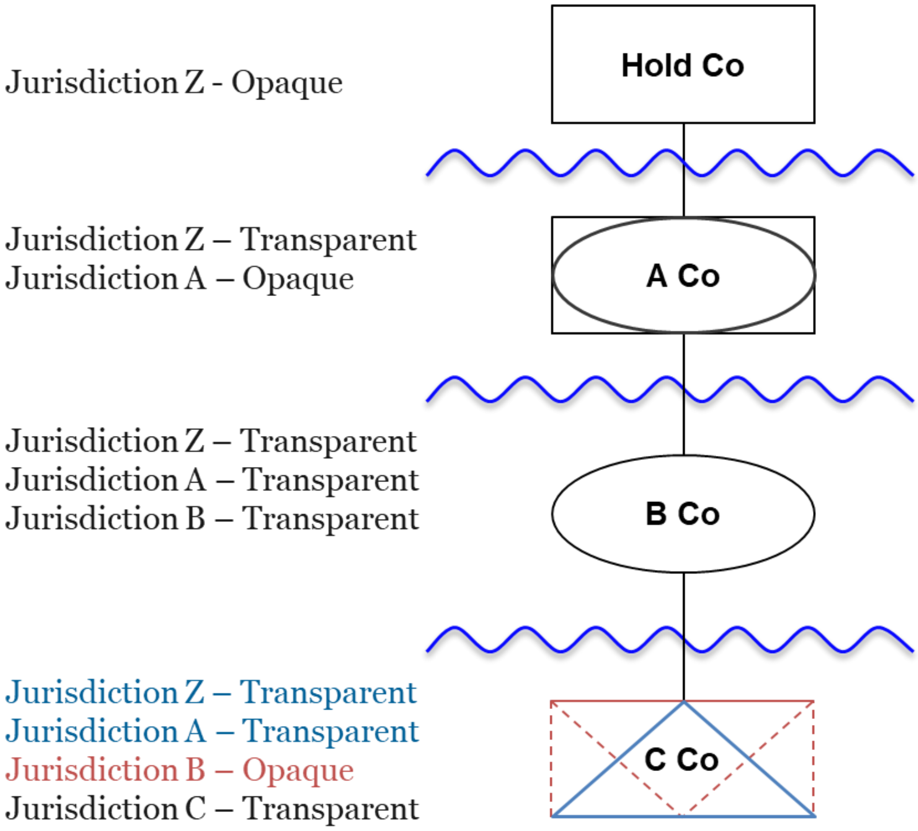
214. **The income of a Tax Transparent Entity is allocated to the Constituent Entity-owner that is the Reference Entity under Article 10.2.1. This ensures the income allocation is consistent with the rules that classify a Flow-through Entity as a Tax Transparent Entity or Reverse Hybrid Entity.**

5.2.3. Examples

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

Example 10.2.1-1

1. Assume Hold Co owns A Co, A Co owns B Co, and B Co owns C Co. Hold Co is not a Flow-through Entity. The tax law of the jurisdiction in which Hold Co is located, Jurisdiction Z, treats Hold Co as a fiscally opaque entity and A Co, B Co and C Co as fiscally transparent. The tax law of the jurisdiction in which A Co is located, Jurisdiction A, treats A Co as fiscally opaque, and B Co and C Co as fiscally transparent. The tax law of the jurisdiction in which B Co is created, Jurisdiction B, treats B Co as fiscally transparent but treats C Co as fiscally opaque. The tax law of the jurisdiction in which C Co is created, Jurisdiction C, treats C Co as fiscally transparent. See illustration below.

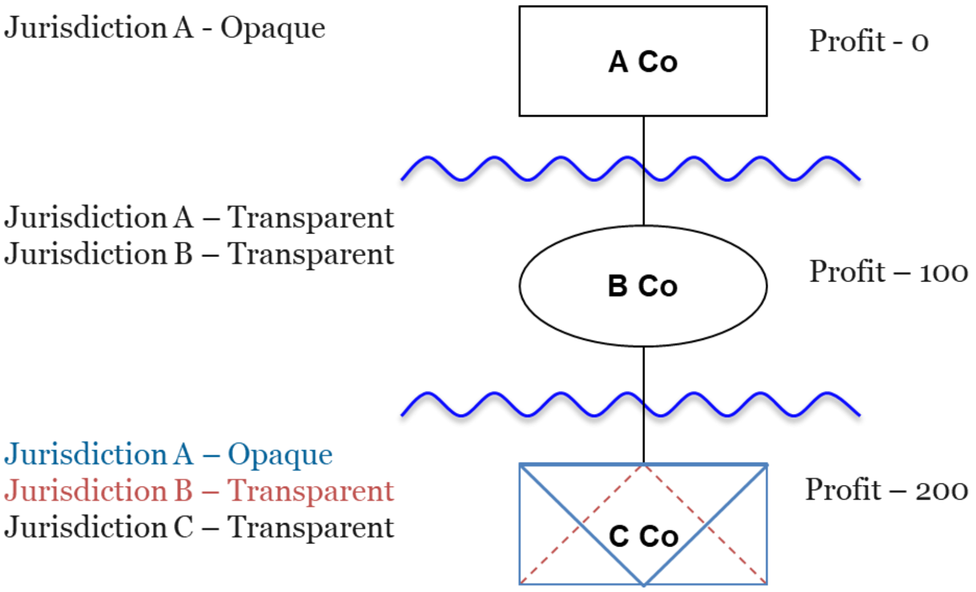


2. C Co is a Flow-through Entity because it is treated as fiscally transparent by the tax law of the jurisdiction where it was created (Jurisdiction C). It is a Tax Transparent Entity because A Co is the Reference Entity and Jurisdiction A's tax laws treat C Co and every Constituent Entity through which A Co's Ownership Interest in C Co is owned as fiscally transparent. A Co is the Reference Entity because it is the closest Constituent Entity-owner to C Co that is not treated as fiscally transparent under the tax laws in its place of creation (i.e. a Flow-through Entity).

3. In accordance with Article 3.5.1(b), the profit or loss of C Co is consequently allocated to A Co because A Co is the Reference Entity which determined that C Co is a Tax Transparent Entity. A Co also meets the Hybrid Entity definition because Jurisdiction Z's tax laws treat A Co as fiscally transparent so A Co's profits are subject to tax in both Jurisdiction A and Jurisdiction Z. Consequently, any Covered Taxes paid by Hold Co with respect to C Co's income shall be allocated to A Co under Article 4.3.2(d) because A Co is a Hybrid Entity and the profit or loss of C Co has been allocated to A Co.

Example 10.2.1-2

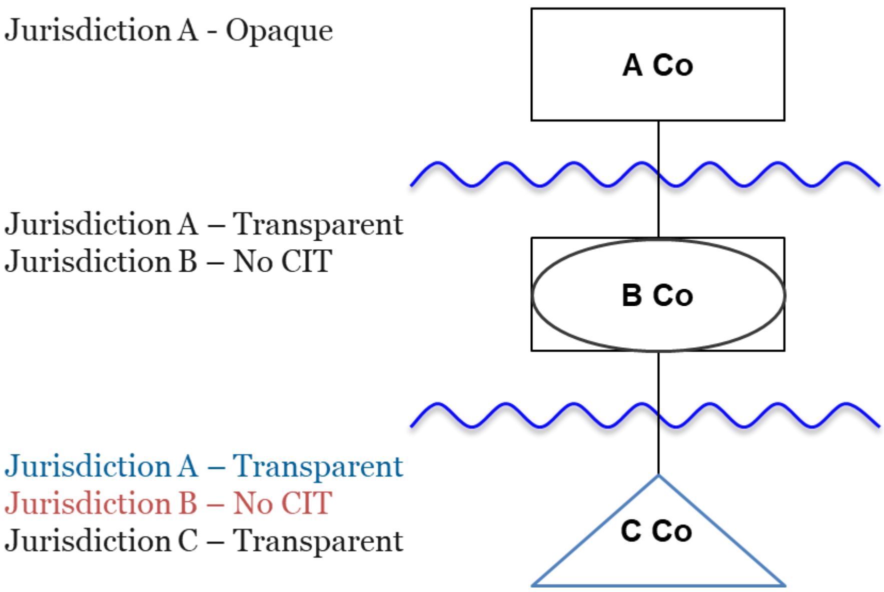
1. Assume A Co owns B Co and B Co owns C Co. A Co is not a Flow-through Entity. The tax law of the jurisdiction in which A Co is located, Jurisdiction A, treats A Co as fiscally opaque, B Co as fiscally transparent and C Co as fiscally opaque. The tax law of the jurisdiction in which B Co is created, Jurisdiction B, treats B Co and C Co as fiscally transparent. The tax law of the jurisdiction in which C Co is created treats C Co as fiscally transparent. Assume B Co's profit is 100 and C Co's profit is 200. See illustration below.



2. C Co is a Reverse Hybrid Entity because it is a Flow-through Entity that is not treated as fiscally transparent by the tax law of the first owner up the ownership chain that is not a Flow-through Entity (i.e. A Co). C Co's 200 of profit is not allocated to B Co or A Co, and remains in C Co in accordance with Article 3.5.1(c). This follows the principle that no jurisdiction's tax law is treating C Co's income as income of its own Constituent Entities. B Co is a Tax Transparent Entity because it is treated as fiscally transparent by the tax legislation of the first owner up the ownership chain that is not a Flow-through Entity (i.e. A Co). The 100 of profit of B Co is allocated to A Co in accordance with Article 3.5.1(b).

Example 10.2.1-3

1. Assume A Co wholly owns B Co which in turn owns C Co. A Co is located in Jurisdiction A. B Co and C Co are created in Jurisdictions B and C, respectively.



2. A Co is subject to tax on C Co's profits in Jurisdiction A, B Co is not considered fiscally transparent under Article 10.2.4. The table below summarises how each jurisdiction's tax laws treat the entities.

	Classification of Entities in the ownership chain		
Jurisdiction	A Co	B Co	C Co
A	Opaque	Transparent	Transparent
B		N/A	N/A
C			Transparent

3. B Co is created in a jurisdiction without a Corporate Income Tax and as such does not have laws that treat B Co or C Co as fiscally transparent. Accordingly, B Co is the Reference Entity because it is the Entity closest to C Co in the ownership chain that is not a Flow-through Entity. C Co is a Reverse Hybrid Entity because it is fiscally transparent under the tax laws of Jurisdiction C but not Jurisdiction B. C Co's profit is consequently allocated to C Co under Article 3.5.1(c).

5.3. Application of Article 3.5.3

37. Article 3.5.3 reduces a Flow-through Entity's Financial Accounting Net Income or Loss by the amount of income or loss that is allocable to owners that are not Group Entities and whose Ownership Interests in the Flow-through Entity are owned directly or indirectly through a Tax Transparent Structure. This ensures that the MNE Group does not pay top-up tax on income that it is not entitled to and on which no Constituent Entity is subject to tax.

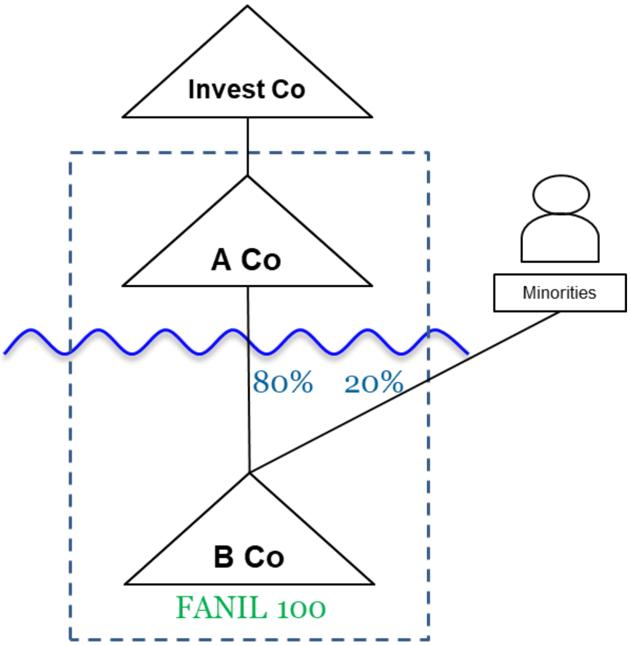
38. Two issues have been raised around the application of this Article. The first concerns the application of Article 3.5.3 to a partially owned Flow-through Entity when the UPE of the MNE Group is also a Flow-through Entity. The second concerns how Article 3.5.3 applies when the minority owners hold their interest in the tested Entity indirectly through another Constituent Entity of the MNE Group.

5.3.1. Issue 2a: Interaction of Article 3.5.3 and Article 3.5.4(b)

39. Article 3.5.4 states that Article 3.5.3 does not apply in the following two scenarios: (a) where the UPE of the MNE Group is a Flow-through Entity; and (b) where such a Flow-through UPE owns the Flow-through Entity directly or indirectly through a Tax Transparent Structure.

40. Article 3.5.4 was included to ensure that Ownership Interests that non-group Entities hold in the UPE do not cause the Financial Accounting Net Income or Loss of a Flow-through Entity to be reduced under Article 3.5.3. Otherwise, Article 3.5.3 could have resulted in the Financial Accounting Net Income or Loss of a Flow-through Entity being reduced to zero where the UPE is the Flow-through Entity or where the Flow-through Entity is owned by a Flow-through UPE through a Tax Transparent Structure. This is because the owners of the Flow-through UPE are all non-Group Entities. This would essentially have excluded the Entity, and potentially the entire MNE Group, from the GloBE Rules irrespective of whether the income is taxed in the hands of the non-Group owners. Instead, Article 7.1 applies and defines the conditions that needs to be met for the income to be reduced.

41. Stakeholders have identified some uncertainty over how Article 3.5.4(b) applies to Flow-through Entities that are not wholly owned by the UPE. Some have interpreted Article 3.5.4(b) to only disapply Article 3.5.3 with respect to Ownership Interests in the Flow-through Entity that are owned by non-Group Entities through the UPE. This would mean that the Financial Accounting Net Income or Loss allocable to other non-Group Entities would still be excluded by Article 3.5.3. Others consider that Article 3.5.3 does not apply to any Ownership Interests owned by non-Group Entities when Article 3.5.4(b) is met. The impact of the different interpretations is illustrated in the following example.



42. In this example, A Co is the UPE of the MNE Group and a Flow-through Entity. It is owned by Invest Co. A Co holds 80% of the Ownership Interests in B Co, a Flow-through Entity that is part of the same MNE Group. The remaining 20% of the Ownership Interests in B Co are directly held by persons that are not Group Entities. The Financial Accounting Net Income or Loss of B Co is 100.

43. Article 3.5.4 will apply because A Co is a Flow-through UPE. This ensures that B Co's Financial Accounting Net Income or Loss is not reduced because of Invest Co's Ownership Interests in A Co. The interpretation that Article 3.5.4 disapplies Article 3.5.3 fully would mean that none of the Financial Accounting Net Income or Loss of B Co will be excluded. The full 100 would be allocated to A Co in accordance with Article 3.5.1(b). Because the owners of the UPE will not be subject to tax on the 20 of income that is attributable to the Ownership Interests in B Co owned by non-Group Entities, it is unlikely the GloBE Income of the Flow-through UPE would be reduced to nil under Article 7.1. This could result in the MNE Group paying a top-up tax liability in respect of the income attributable to the non-Group Entity owners. This would be inconsistent with the policy intention of Articles 3.5.3 and 3.5.4.

44. Alternatively, if Article 3.5.4(b) applies to the extent that the Ownership Interests are owned directly or indirectly by the UPE, then it means that Article 3.5.3 continues to apply with respect to the Ownership Interests owned by non-Group Entities. The effect is that the Financial Accounting Net Income or Loss of B Co is reduced by 20 in accordance with Article 3.5.3 and the remaining 80 are then allocated to A Co in accordance with Article 3.5.1(b).

45. This provides for the correct answer on the application of Article 3.5.3 because the provision continues to apply to Ownership Interests owned by persons that are not Group Entities and not the UPE. It also provides for a consistent answer because it has the same effect on:

a. a structure where the Ownership Interests in the Flow-through Entity are owned directly by the UPE and directly or indirectly (through a Tax Transparent Structure) by persons that are not Group Entities; and

b. a structure where the Ownership Interests are owned indirectly by the UPE through a Tax Transparent Structure, and directly or indirectly (through a Tax Transparent Structure) by persons that are not Group Entities.

46. Therefore, this guidance clarifies that Article 3.5.4(b) applies when the Ownership Interests in the Flow-through Entity are owned by the UPE directly or indirectly through a Tax Transparent Structure and applies to the extent of the Ownership Interests owned by the UPE.

5.3.2. Guidance

47. The bold text and new paragraph 232.1 will be added to the Commentary to Article 3.5.4:

> 232**.** Article 3.5.4 sets out two cases where Article 3.5.3 does not apply. The first one is included in paragraph (a) which covers the case where the UPE is a Flow-through Entity. ~~Paragraph (b) covers the situation where the Flow-through Entity is held by a Flow-through UPE~~ **~~directly or~~** ~~through a Tax Transparent Structure. These cases are~~ **This case is** not contemplated in Article 3.5.3 because all of the owners of the Flow-through Entity are non-Group owners, ~~which~~ **and** is **instead** covered by Article 7.1.
>
> **232.1. Paragraph 3.5.4(b) disapplies Article 3.5.3 in relation to Ownership Interests of the Flow-through Entity that are owned directly by the UPE or indirectly by the UPE through a Tax Transparent Structure. This ensures the Financial Accounting Net Income or Loss of a Flow-through Entity is not reduced due to Ownership Interests of the UPE's owner(s). Instead, Article 3.5.1 will apply to allocate the profit of the Flow-through Entity between Constituent Entities, and Article 7.1 would apply to the UPE. However, Article 3.5.4(b) only disapplies Article 3.5.3 in respect of owners which have indirect Ownership Interests in the Flow-through Entity through Ownership Interests in the UPE. Article 3.5.3 will continue to apply to the extent that Ownership Interests in the Flow-through Entity are owned by non-Group Entities either directly or indirectly through Ownership Interests in Entities other than the UPE.**

5.3.3. Example

48. The following example will be included in the GloBE Model Rules Examples.

> *Example 3.5.4-1*
>
> 1. A Co is the UPE of the MNE Group and a Flow-through Entity. It owns 80% of the Ownership Interests in B Co, a Flow-through Entity that is part of the same MNE Group. The remaining 20% of the Ownership Interests in B Co are owned by persons that are not Group Entities.
>
> 2. The profit of B Co is 100. In this case, Article 3.5.4(b) applies only with respect to the 80% of the Ownership Interests in B Co that are owned by the UPE (which represent 80 of B Co's profit). This means that Article 3.5.3 still applies with respect to the 20% of the Ownership Interests in B Co that are owned by the persons that are not Group Entities and therefore, B Co's profit should be reduced by 20 prior to the allocation of the profit in accordance with Article 3.5.1.

5.3.4. Issue 2b: Application of Article 3.5.3 when a minority owner holds its interest indirectly through another Constituent Entity

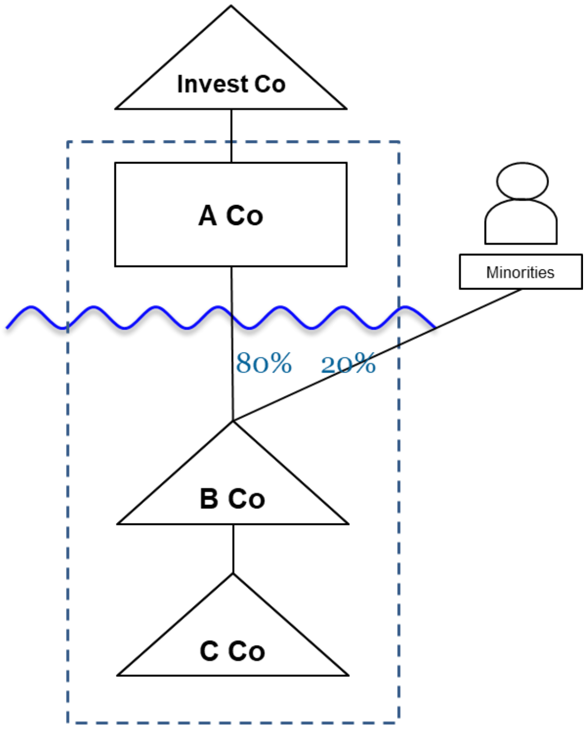
49. As above, Article 3.5.3 reduces the FANIL of a Flow-through Entity by the amount that is allocable to owners that are not Group Entities ('minority owners'). This reduction applies when these owners hold their interest in the tested Entity either directly or through a Tax Transparent Structure.

50. Where a minority owner holds its Ownership Interests in the tested Entity directly, the FANIL of the tested Entity will be reduced under Article 3.5.3 regardless of whether the tax laws of the minority owner's jurisdiction treat the tested Entity as a fiscally transparent entity. The FANIL will consequently be reduced even in cases where the minority owner is not subject to tax in respect of the tested Entity's income. This reflects that the MNE Group is not entitled to the income attributable to the minority owner, and prevents the MNE Group from having to determine the treatment of the tested Entity according to the jurisdiction(s) of minority owners.

51. In contrast, where a minority owner owns its Ownership Interests in the tested Entity indirectly, the FANIL will only be reduced when the interest is owned through a Tax Transparent Structure (i.e. a chain of Tax Transparent Entities). This condition reflects that an indirect interest owned through a Tax Transparent Structure is comparable to a direct interest because in both cases there will not be a Constituent Entity in the MNE Group that is subject to tax on the income. This also ensures that indirect Ownership Interests of minority owners do not lead to the FANIL of the tested Entity being reduced under Article 3.5.3 when its owner is a Constituent Entity that is not a Flow-through Entity. This reflects that the income of the tested Entity is attributable to the Constituent Entity-owner and so it is appropriate to include this income as part of the MNE Group's GloBE Income.

52. However, Inclusive Framework members have raised that there is some uncertainty over whether the reference to Tax Transparent Structure in Article 3.5.3 only refers to Ownership Interests of Constituent Entities of the MNE Group or whether it also covers the Ownership Interests owned by the minority investors.

53. This is illustrated in the following example.



54. The example is similar to the Example in Issue 2a, except that A Co is not a Flow-through Entity and the minority owners' Ownership Interests in C Co (the tested Entity) are owned through B Co, which is also a Flow-through Entity and is a Constituent Entity in the MNE Group.

55. A Co is the Reference Entity as it is the closest Constituent Entity-owner to C Co in the ownership chain that is not a Flow-through Entity. Both B Co and C Co are Tax Transparent Entities in relation to A Co.

56. If the reference to Tax Transparent Structure in Article 3.5.3 is determined solely by reference to the Ownership Interests owned directly or indirectly by Constituent Entities in the MNE Group and the treatment of the Entities in the Tax Transparent Structure under the laws of the Reference Entity's jurisdiction, then Article 3.5.3 will be satisfied given the minority owners hold their interests through B Co, which is treated as a Tax Transparent Entity according to A Co. Accordingly, the FANIL of C Co will be reduced to reflect that 20% of the Ownership Interests are (indirectly) attributable to owners that are not Group Entities. The remaining 80% of the profit will be allocated to A Co.

57. Conversely, if the reference to Tax Transparent Structure also refers to the treatment of the Entities through which the minority owners own their Ownership Interests in the tested Entity under the laws of the minority owners' jurisdiction(s), then C Co's FANIL would only be reduced to the extent that the tax laws of the minority owners' jurisdiction(s) treat B Co as a fiscally transparent entity. Where these tax laws do not treat B Co as a fiscally transparent entity, the FANIL would not be reduced under Article 3.5.3. 100% of C Co's profits would consequently be allocated to A Co, in spite of the fact that A Co has only 80% of the Ownership Interests in C Co. This would also lead to substantially different outcomes based on whether the minority owners' Ownership Interests in the tested Entity are owned directly or indirectly.

58. The Inclusive Framework has agreed that the first interpretation is correct. The Commentary will consequently be revised to clarify that Article 3.5.3 requires the FANIL to be reduced when the minority owners' Ownership Interests in the tested Entity are held directly or are indirectly owned through a Constituent Entity-owner which is a Flow-through Entity and is closer in the ownership chain to the tested Entity than the Reference Entity (i.e. is between the tested Entity and the Reference Entity).

5.3.5. Guidance

59. Paragraph 231 of the Commentary to Article 3.5.3 is revised to read as follows:

> 231. This provision also applies where the Ownership Interests of the tested Entity are owned indirectly by non-Group Entities through a Tax Transparent Structure. An Entity that is not a Group Entity is considered to indirectly own its interest in a tested Entity through a Tax Transparent Structure where the non-Group Entity owns an interest in a Flow-through Entity that sits between the Reference Entity and the tested Entity in the MNE Group's ownership structure.

5.4. Allocation of cross-border taxes under Article 4.3 in structures including Flow-through Entities

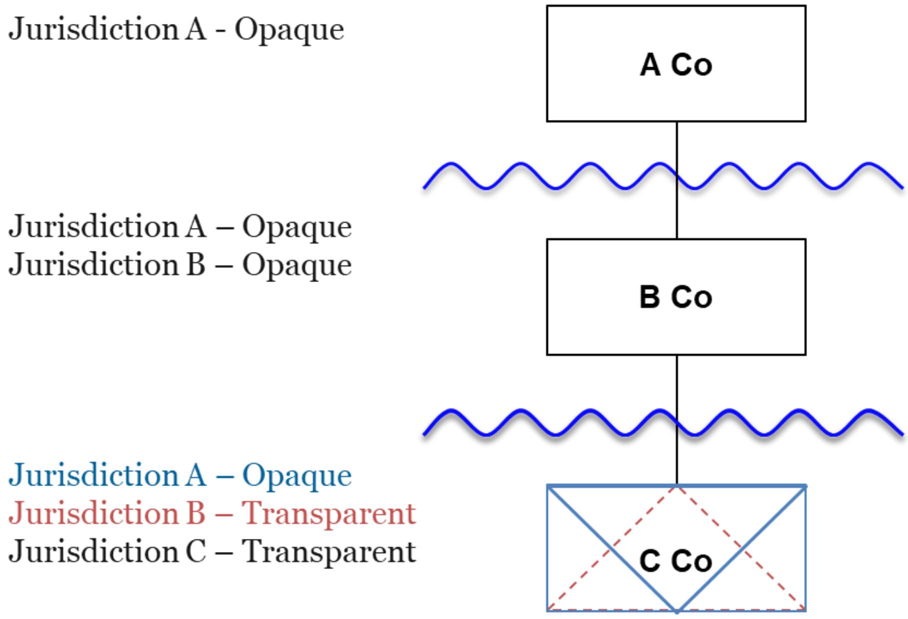
5.4.1. Issue 3: Allocation of cross-border taxes under Article 4.3 in structures including Flow-through Entities

60. Where profits of a Tax Transparent Entity are allocated to a Constituent Entity-owner under Article 3.5.1(b), Article 4.3.2(b) provides that any Covered Taxes accrued by the Tax Transparent Entity with respect to this income should also be allocated to the Constituent Entity-owner. This is based on the

matching principle that taxes should be included in the same jurisdictional ETR computation as the profits to which they relate.

61. However, Article 4.3.2(b) refers only to Covered Taxes that are accrued in the Tax Transparent Entity's financial accounts that are used to compute its Financial Accounting Net Income or Loss. It does not expressly apply to any Covered Taxes that are reallocated from another Constituent Entity to the Tax Transparent Entity under another provision in Article 4.3, for example a CFC charge.

62. This raises the question whether these Covered Taxes should also be reallocated to the Constituent Entity-owner of the Tax Transparent Entity or whether these Covered Taxes should be treated as Covered Taxes of the Tax Transparent Entity. This is illustrated in the following example:



63. Pursuant to this new guidance, C Co is a Tax Transparent Entity and its profits will be allocated to B Co. However, A Co is subject to tax under a Controlled Foreign Company Tax Regime on the profits of C Co. This CFC tax charge would be allocated to C Co under Article 4.3.2(c). The question addressed by this guidance is whether this CFC tax charge would subsequently be allocated to B Co along with the income of C Co.

64. This guidance clarifies that taxes allocated to a Tax Transparent Entity under Article 4.3.2 should be allocated under Article 4.3.2(b) in the same way as Covered Taxes accrued by the Tax Transparent Entity. In other words, the tax will follow the allocation of the income.

65. This means Covered Taxes should first be allocated to the Tax Transparent Entity under the relevant sub-paragraph of Article 4.3.2. Article 4.3.2(b) then applies to both Covered Taxes accrued by the Tax Transparent Entity and any Covered Taxes that are allocated to it.

66. This ensures that Covered Taxes are ultimately allocated to the same Constituent Entity to which the Financial Accounting Net Income or Loss was allocated under Article 3.5.1. This is consistent with the matching principle and ensures the jurisdictional ETR computations include all Covered Taxes with respect to the income.

67. In some cases, the same Flow-through Entity can be considered a Tax Transparent Entity, in part, and a Reverse Hybrid Entity, in part. In these cases, Article 3.5.1 allocates the profit or loss of the Flow-through Entity to the Constituent Entity-owner to the same extent that the Entity's income, expenditure, profit or loss is treated as being derived or incurred by the owner in proportion to its interest in the Entity. Any profit or loss not allocated to the Constituent Entity-owner remains in the Flow-through Entity (i.e. the amount that relates to its treatment as a Reverse Hybrid Entity). Article 4.3.2(b) would follow this allocation and allocate Covered Taxes to the relevant Constituent Entity-owner(s) (where the Flow-through Entity is a Tax Transparent Entity) and to the Reverse Hybrid Entity (where the Flow-through Entity is a Reverse Hybrid Entity) to the same extent that the profit or loss of the Flow-through Entity is allocated under Article 3.5.1.

68. However, where the Covered Taxes related to a CFC charge are allocated to the Tax Transparent Entity under Article 4.3.2(c), the mechanism of following Article 3.5.1(b) is modified to ensure CFC taxes are only allocated to Reference Entities through which the Parent Entity paying the CFC tax owns its Ownership Interests in the Tax Transparent Entity (i.e. the CFC). This ensures the CFC tax is matched with the income that the tax relates to. The allocation mechanism ignores Ownership Interests held by other owners (e.g. Reference Entities that are not owned by the Parent Entity paying the CFC tax and minority owners) to ensure that the full amount of CFC tax is allocated.

69. Finally, there is a question about the interaction between this guidance and the allocation mechanism for Blended CFC Tax Regimes. The computation of the Blended CFC Allocation Key takes into account the income attributable to the CFC. This means that this calculation needs to be undertaken before allocating income of a CFC that is a Flow-through Entity to a Constituent Entity-owner. After the right amount of CFC tax has been allocated to the CFC based on the Blended CFC Allocation Key, then its profit along with the amount of Blended CFC Tax allocated to the CFC shall be allocated to Constituent Entity-owners in accordance with Article 3.5.1 and Article 4.3.2(b).

5.4.2. Guidance

70. The following text will be added to the Commentary to Article 4.3.2(b)

> 57.1. Article 4.3.2(b) applies to CFC tax charges allocated to a Tax Transparent Entity under Article 4.3.2(c) as well as to Covered Taxes accrued in the financial accounts of the Tax Transparent Entity. Such CFC tax charges could be imposed on the profit of a Tax Transparent Entity where a Constituent Entity-owner, other than the Reference Entity, does not treat the Entity as fiscally transparent and therefore considers it a Controlled Foreign Company. In such cases, Article 4.3.2(b) allocates the amount of CFC tax imposed with respect to the profit of the Tax Transparent Entity to the Constituent Entity-owner to which the profit has been allocated pursuant to Article 3.5.1(b). The initial allocation of the CFC tax down to the Tax Transparent Entity under Article 4.3.2(c) (prior to that allocation to the Constituent Entity-owner under Article 4.3.2(b)) is still subject to the limitation of Article 4.3.
>
> 57.2. A Tax Transparent Entity may be owned by multiple Reference Entities. In such cases, CFC taxes imposed with respect to the profit of the Tax Transparent Entity should only be allocated to a Reference Entity when the Parent Entity (that pays the CFC tax) owns its Ownership Interest in the Tax Transparent Entity indirectly through the Reference Entity.

57.3. Where the Parent Entity (that pays the CFC tax) owns its Ownership Interests in the Tax Transparent Entity through multiple Reference Entities, the CFC tax is allocated between these Reference Entities to the same extent that the profit or loss of the Tax Transparent Entity is allocated between those Reference Entities (i.e. in the same proportion). This is consistent with the principle that Covered Taxes follow the GloBE Income or Loss to which it was imposed. This rule also applies in situations where the same Flow-through Entity is considered a Tax Transparent Entity and a Reverse Hybrid Entity with respect to different Ownership Interests. In such cases, the amount of the CFC tax is allocated to the Reference Entity (where the Flow-through Entity is a Tax Transparent Entity) and the Reverse Hybrid Entity (where the Flow-through Entity is a Reverse Hybrid Entity) to the same extent that the profit or loss of the CFC is allocated to the Reference Entity and the Reverse Hybrid Entity under Article 3.5.1.

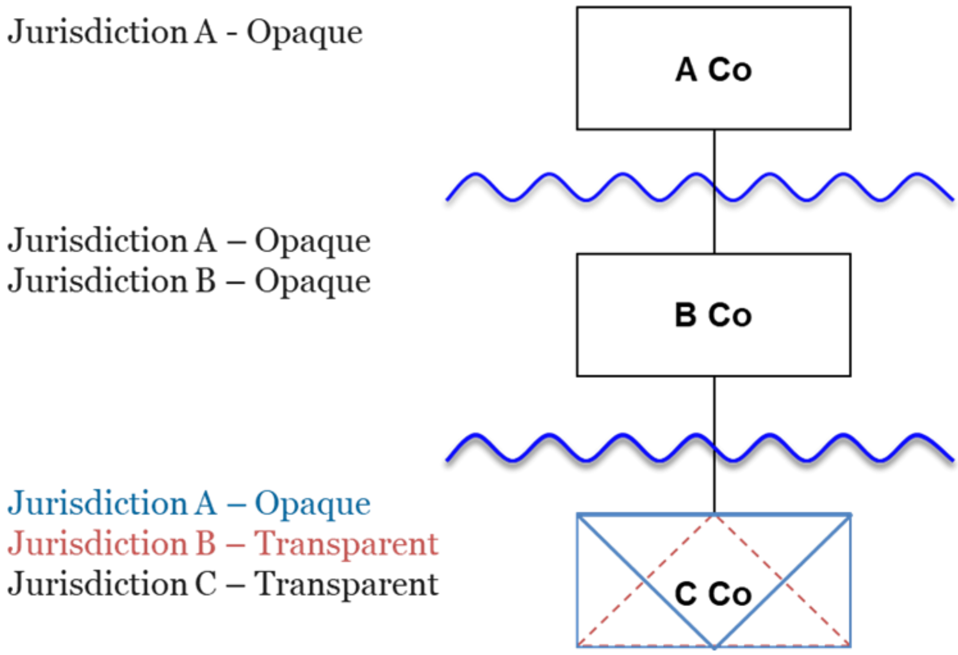
57.4. The computation of the Blended CFC Allocation Key for purposes of allocating Blended CFC Taxes (see paragraphs 58.1 to 58.7) takes into account the income attributable to the CFC. If the CFC is a Tax Transparent Entity, the computation of the Blended CFC Allocation Key shall be made before allocating the profit or loss of the Tax Transparent Entity to a Constituent Entity-owner. After the right amount of Blended CFC Tax has been allocated to the CFC (i.e., the Tax Transparent Entity), the profit or loss is allocated in accordance with Article 3.5.1. After the allocation of the profit or loss, the amount of Blended CFC Tax that has been previously allocated to the CFC in accordance with the Blended CFC Allocation Key will be allocated to the Constituent Entity-owner in accordance with Article 4.3.2(b) as explained in paragraphs 58.8 to 58.10.

5.4.3. Example

71. The following example will be included in the GloBE Model Rules Examples

Example 4.3.2-3 CFC taxes paid in respect of a Tax Transparent Entity

1. A Co owns B Co, and B Co owns C Co. The jurisdiction in which A Co is located, jurisdiction A, does not treat A Co, B Co or C Co as fiscally transparent. The jurisdiction in which B Co is located, jurisdiction B, treats B Co as not fiscally transparent and C Co as fiscally transparent. The jurisdiction in which C Co is created treats C Co as fiscally transparent. See illustration below.

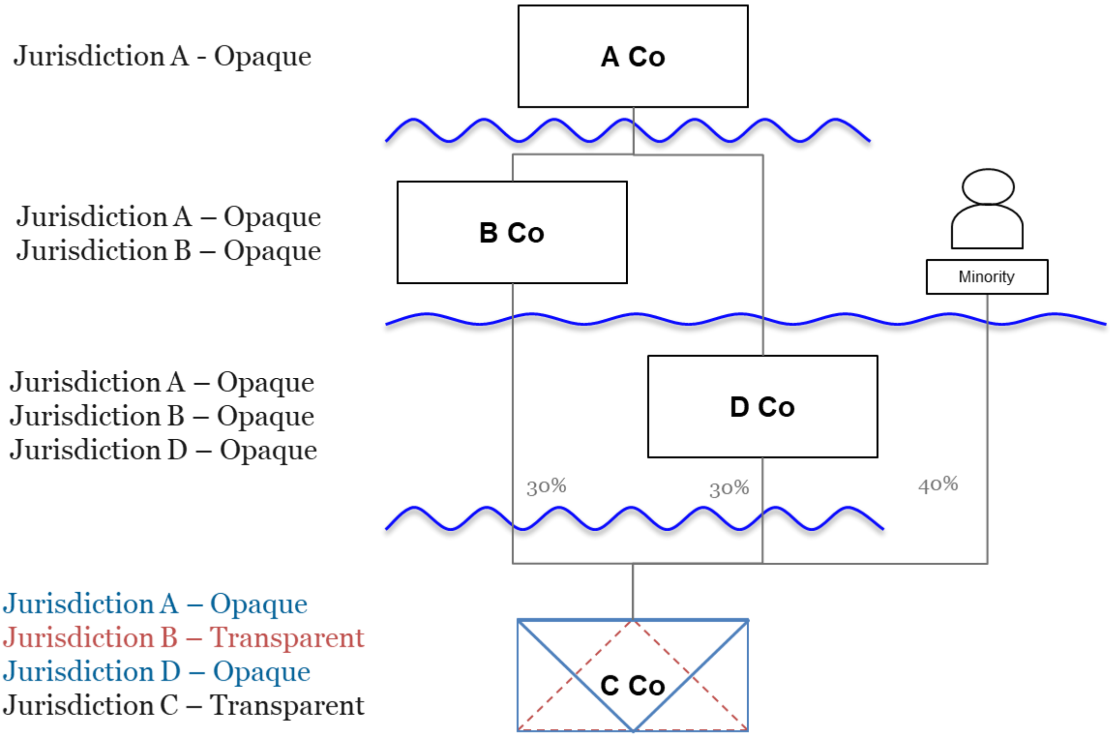


2. C Co has a profit of 100 and an ETR of 0%. B Co is the Reference Entity as it is the closest Constituent Entity-owner in the ownership chain to C Co that is itself not a Flow-through Entity. C Co is a Tax Transparent Entity according to the law of Jurisdiction B.

3. Jurisdiction A requires A Co to apply its CFC Tax Regime with respect to the profit of C Co and charges a CFC tax of 15 on that profit. Article 4.3.2(c) allocates the CFC tax (15) paid by A Co to C Co. This tax is then allocated to B Co under Article 4.3.2(b) because C Co's profit has been allocated to B Co under Article 3.5.1.

Example 4.3.2-4 CFC taxes paid in respect of a Tax Transparent Entity – cont.

1. The facts are the same as those in Example 4.3.2-3, except that C Co is only 30% owned by B Co. D Co, located in Jurisdiction D which does not see C Co as fiscally transparent, owns another 30%, while a minority owner located in Jurisdiction B owns the remaining 40% of C Co. See illustration below.



2. Jurisdiction B and D do not have Controlled Foreign Company Tax Regimes. Jurisdiction A requires A Co to apply its CFC Tax Regime with respect to its ownership interests in the profits of C Co and charges a CFC tax of 9 (15%*60%*100) on these profits. Article 4.3.2(c) allocates the CFC tax paid by A Co (9) to C Co.

3. The next step is to consider whether there is a further allocation of the 9 of CFC tax under Article 4.3.2(b). B Co and D Co are Reference Entities and are both held by A Co (the Parent Entity paying the CFC tax). C Co is a Tax Transparent Entity in relation to B Co and a Reverse Hybrid Entity in relation to D Co. As C Co is a Tax Transparent Entity in relation to B Co, part of the CFC tax will be further allocated to B Co under Article 4.3.2(b). The remaining part will remain in C Co. This matches the allocation of the tax with the allocation of profit. The 9 of CFC tax is allocated in the same proportion as how C Co's profits are allocated between B Co and C Co under Article 3.5.1 (ignoring any Ownership Interests attributable to minority owners or Reference Entities which are not owned by A Co), so 4.5 (9*(30/60)) is allocated to B Co and 4.5 is allocated to C Co. No CFC tax is allocated to the minority owner.

5.5. Hybrid Entities

72. Article 4.3.2(d) allocates Covered Taxes that are included in the financial accounts of a Constituent Entity-owner of a Hybrid Entity to the Hybrid Entity. This is again based on the matching principle that taxes should be included in the same jurisdictional ETR computation as the profits to which they relate.

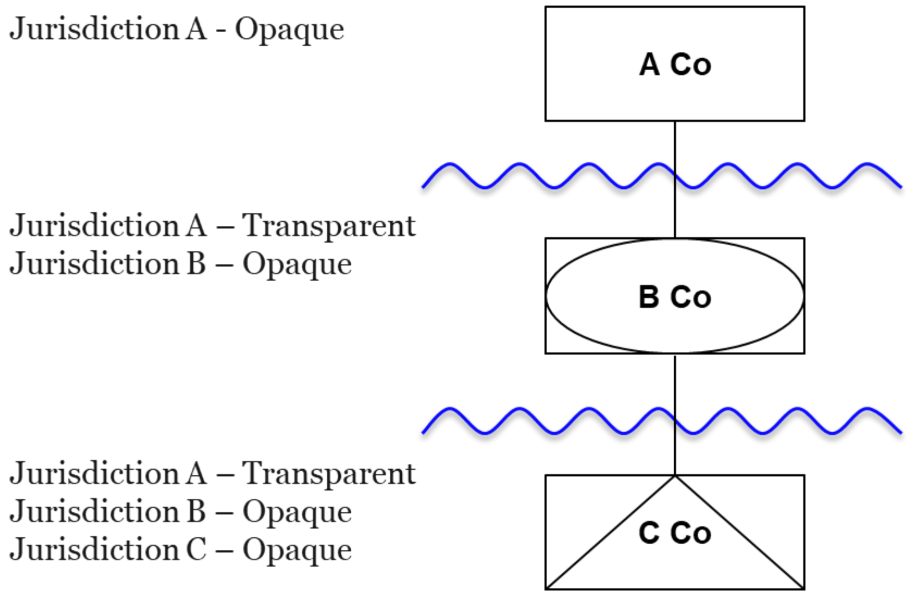
73. A Hybrid Entity is defined in Article 10.2.5 as a separate taxable person for income tax purposes in the jurisdiction where it is located but fiscally transparent in the jurisdiction where its owner is located.

74. Two issues have been identified with this definition. First, it is not clear from Article 10.2.5 nor its Commentary whether the word "owner" refers only to the direct owner or if it also refers to the indirect owner. Second, Entities which are located in jurisdictions without a CIT will not be treated as a separate taxable person for income tax purposes in their jurisdiction and so will not meet the definition in Article 10.2.5.

5.5.1. Issue 4: Extension to indirect owners

75. The first issue is relevant in cases where the indirect owner is subject to a Covered Tax on the Hybrid Entity's income. If Article 10.2.5 were limited to the direct owner, then any tax paid by the indirect owner would not be taken into account for the GloBE calculations in the jurisdiction where the Hybrid Entity is located. A further question would be whether such tax could be included in the GloBE calculations of the Parent Entity considering Articles 4.1.3(a) (which removes taxes related to income excluded from the GloBE calculations) and 4.3.3 (which requires taxes paid by a Parent Entity which cannot be allocated to a CFC or Hybrid Entity because of the passive income limitation to be kept in the parent jurisdiction).

76. This is illustrated in the following example:



77. In this example, A Co wholly owns B Co which in turn wholly owns C Co. A Co is located in Jurisdiction A, B Co in Jurisdiction B and C Co in Jurisdiction C. The table below summarises how each jurisdiction's entity classification rules treat the entities.

	Classification of Entities in the ownership chain		
Jurisdiction	A Co	B Co	C Co
A	Opaque	Transparent	Transparent
B		Opaque	Opaque
C			Opaque

78. Jurisdiction A regards both B Co and C Co as fiscally transparent entities. A Co is consequently subject to tax on C Co's profits. As C Co is regarded as fiscally opaque in Jurisdiction C, it will also be subject to tax on its profits.

79. Jurisdiction B's tax laws do not treat C Co as a fiscally transparent entity. This means C Co will not meet the Hybrid Entity definition with respect to B Co. This would also be the case where Jurisdiction B does not have a Corporate Income Tax, and accordingly does not have tax laws, because in such cases Jurisdiction B will not treat C Co as a fiscally transparent entity. If the reference to owner in Article 10.2.5 is limited to the direct owner, this would prevent taxes paid by A Co on C Co's profits from being allocated to C Co. This could result in double taxation if top-up taxes are payable with respect to C Co. This could also result in an inflated ETR for Jurisdiction A if the tax is included in the ETR computation for Jurisdiction A as a result of not being allocated to C Co.

80. Alternatively, if the reference to 'owner' in Article 10.2.5 includes an indirect owner, then C Co would be regarded as a Hybrid Entity because A Co is also subject to tax on its profits. This would allow any taxes paid by A Co with respect to these profits to be allocated to C Co under Article 4.3.2(d), which would prevent double taxation and be more consistent with the matching principle of the GloBE Rules.

81. The Inclusive Framework considers this is the more appropriate outcome and accordingly, the Commentary to Article 10.2.5 will be modified to clarify that the word "owner" refers to both the direct and indirect Constituent Entity-owner of the Entity. Consequently, Covered Taxes reflected in the financial accounts of the direct and indirect Constituent Entity-owners that relates to the income of the Hybrid Entity and are imposed because the Entity is fiscally transparent under the tax law applicable to such direct and indirect Constituent Entity-owners will be allocated to the Hybrid Entity subject to the limitations in Article 4.3.3.

5.5.2. Guidance

82. The bold text will be added to paragraph 59 of the Commentary to Article 4.3.2(d):

> 59. Paragraph (d) allocates Taxes of **direct and indirect** Constituent Entity-owners arising in connection with the income of Hybrid Entities. If a Constituent Entity-owner of a Hybrid Entity is located in a tax jurisdiction that imposes Tax on the owner's share of the Hybrid Entity's income under a fiscal transparency regime (see discussion in Commentary to Article 10.2), the Covered Taxes included in the financial accounts of the Constituent Entity-owner should be assigned to the Hybrid Entity. The same general process described in paragraph (a) above for allocating Covered Taxes imposed on the Main Entity in respect of a PE can be used to determine the amount of taxes allocated by a Constituent Entity owner to a Hybrid Entity, however any taxes allocated to a Hybrid Entity by a Constituent Entity-owner in respect of Passive Income are subject to limitation under Article 4.3.3, which is discussed further below. If the Constituent Entity-owner is subject to a withholding tax or net basis taxes on distributions from the Hybrid Entity, such Taxes would also be allocated to the Hybrid Entity pursuant to paragraph (e).

83. The following paragraphs will be added after paragraph 59 of the Commentary to Article 4.3.2(d):

> 59.1. Article 4.3.2(d) allocates Covered Taxes included in the financial accounts of a direct and indirect Constituent Entity-owner on the income of the Hybrid Entity to the Hybrid Entity. This means that Covered Taxes in the financial accounts of multiple Constituent Entity-owners having, directly or indirectly, the same Ownership Interests can be allocated to the Hybrid Entity.
>
> 59.2. For example, A Co is a tax resident in jurisdiction A which owns B Co, a tax resident in jurisdiction B, which owns C Co, a tax resident in jurisdiction C. The MNE Group owns no other Constituent Entities in jurisdiction C. A Co, B Co and C Co are not Flow-through Entities. Jurisdiction A treats B Co and C Co as fiscally transparent. Jurisdiction B also treats C Co as fiscally transparent. C Co's profit is 100 which is composed only of active income and subject to a 10% tax in jurisdiction C (10 of tax). Jurisdiction B taxes C Co's profit at a rate of 15% and provides a foreign tax credit such that B Co pays 5 of tax. Jurisdiction A also taxes C Co's profit at a rate of 18% and provides a foreign tax credit for taxes paid in jurisdictions B and C such that A Co pays 3 of tax. The taxes paid by A Co and B Co are reflected in their financial accounts.
>
> 59.3. In this case, Article 4.3.2(d) will effectively allocate 5 of tax paid by B Co and 3 of tax paid by A Co to C Co because those taxes were paid in respect of C Co's income. The Effective Tax Rate of jurisdiction C will be 18% ([10+5+3]/100).

5.5.3. Issue 5: Entities located in jurisdictions without a Corporate Income Tax

84. The second issue relates to when a Constituent Entity is located in a jurisdiction without a corporate income tax or another Covered Tax. Pursuant to the guidance in paragraph 34 of this document, such Entities cannot be considered fiscally transparent under the definition of fiscal transparency in Article 10.2.2 unless it is considered a Tax Transparent Entity in certain cases under Article 10.2.4. If the Constituent Entity is not treated as a fiscally transparent Entity under the specific rule in Article 10.2.4, for instance because it has a place of business in the jurisdiction where it was created, then its profits will not be allocated to another Constituent Entity.

85. If a Constituent Entity-owner is located in a jurisdiction that regards the Constituent Entity as fiscally transparent, this owner could nonetheless be subject to tax on the Constituent Entity's profits. However, this tax would not be allocated to the Constituent Entity because Article 4.3.2(d) only applies when the Constituent Entity is a Hybrid Entity or a Reverse Hybrid Entity. Under Article 10.2.5, an Entity can only be considered a Hybrid Entity if it is treated as a separate taxable person for income tax purposes in the jurisdiction where it is located. Consequently, the Hybrid Entity definition in Article 10.2.5 does not apply when a Constituent Entity is located in a jurisdiction without a CIT because the Entity will not be treated as a separate taxable person in such a jurisdiction.

86. This would lead to a breakdown in the matching principle because the tax of the Constituent Entity-owner will not be included in the same jurisdictional ETR computation as the profit to which it relates. There is also no clear policy justification for only allocating taxes to a Constituent Entity when it is located in a jurisdiction with a CIT.

87. Accordingly, the Inclusive Framework has agreed to clarify that the Hybrid Entity definition will also apply to an Entity that is not treated as fiscally transparent under Article 10.2.4 and is located in a jurisdiction under Article 10.3.1(b).

5.5.4. Guidance

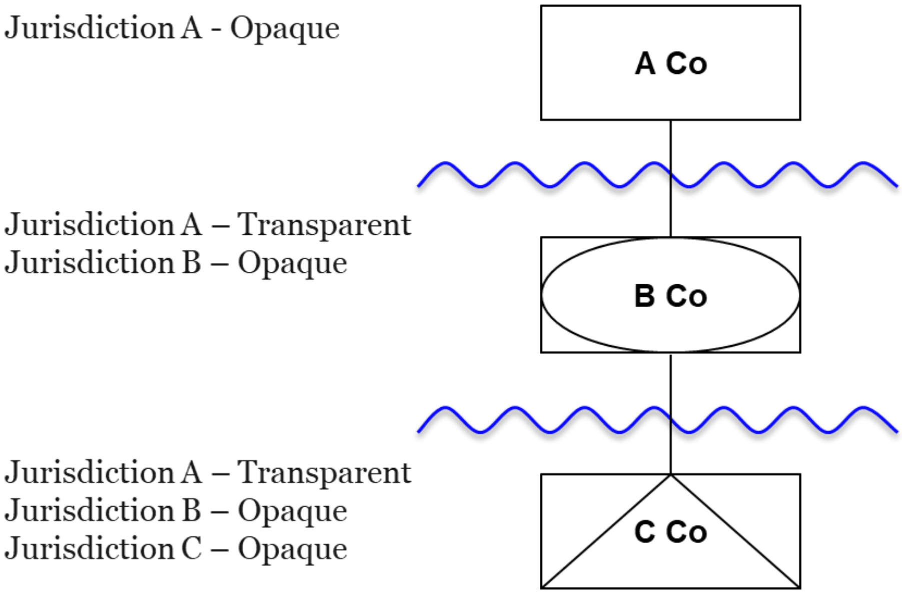
88. The bold text will be added to the Commentary to 10.2.5:

> 169. Article 10.2.5 defines a Hybrid Entity as an Entity that is treated as a separate taxable person for income tax purposes in the jurisdiction where it is located (i.e. a tax resident) but treated as fiscally transparent in the jurisdiction where its owners are located. **An Entity that is located in a jurisdiction that does not have a Corporate Income Tax will also be treated as a Hybrid Entity if it is treated as fiscally transparent in the jurisdiction where its owners are located and is not treated as a fiscally transparent entity under Article 10.2.4 (for example because the Entity has a place of business in the jurisdiction where it was created). The word "owner" refers to both the direct and indirect owner of the Ownership Interests of the Hybrid Entity.** Similar to other definitions in Article 10.2, the phrase "with respect to its income, expenditure, profit or loss to the extent that it is fiscally transparent in the jurisdiction in which its owner is located" allows that an Entity can be considered a Hybrid Entity only with respect to the owners that treat it as fiscally transparent. The term Hybrid Entity is relevant for purposes of Article 4.3.2(d).

5.5.5. Examples

Example 10.2.1-4 Extension of Article 10.2.5 to indirect owners

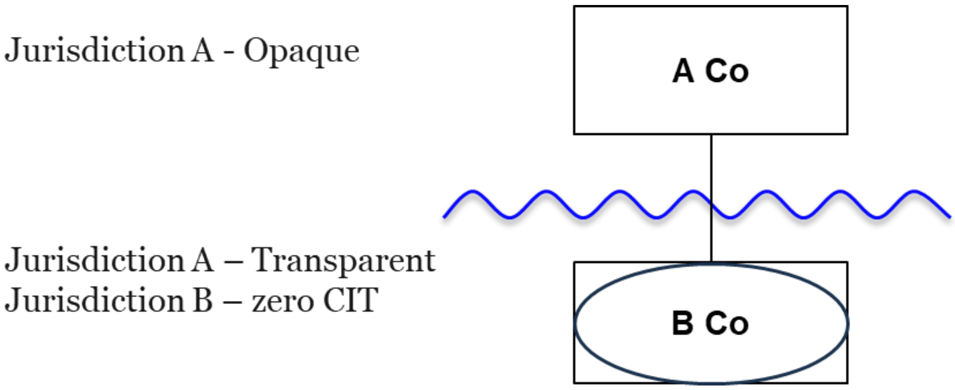
1. Assume A Co wholly owns B Co which in turn wholly owns C Co. A Co is located in Jurisdiction A, B Co in Jurisdiction B and C Co in Jurisdiction C. Jurisdiction A regards both B Co and C Co as fiscally transparent entities. Jurisdiction B's tax laws do not treat C Co as a fiscally transparent entity. See illustration below.



2. C Co is a Hybrid Entity because A Co, the 'owner' referred to in Article 10.2.5, is subject to tax on C Co's profits. Consequently, any taxes paid by A Co with respect to C Co's profits are allocated to C Co under Article 4.3.2(d).

Example 10.2.1-5 Entities located in jurisdictions without a Corporate Income Tax

1. Assume A Co owns B Co. The tax laws of Jurisdiction A treat B Co as fiscally transparent, therefore A Co is subject to tax on B Co's profits. Jurisdiction B does not have a Corporate Income Tax regime. B Co does not meet the definition of a Tax Transparent Entity under Article 10.2.4 because it has a place of business in Jurisdiction B, where it is created. See illustration below.



2. B Co is a Hybrid Entity because it is treated as fiscally transparent in the jurisdiction where its owner is located and is not treated as a fiscally transparent entity under Article 10.2.4.

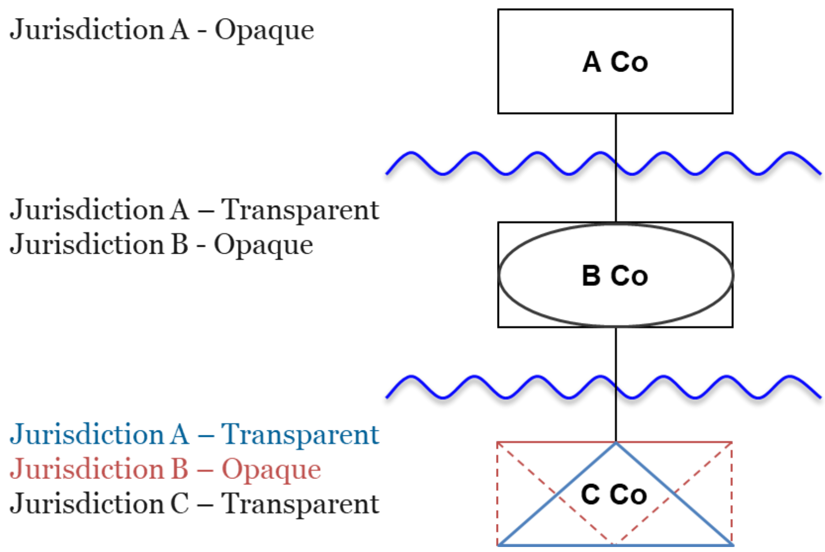
5.6. Taxes paid by a Constituent Entity-owner with respect to a Reverse Hybrid Entity's income

5.6.1. Issue 6: Matching of taxes and income where an owner is subject to tax with respect to a Reverse Hybrid Entity's income

89. Under this guidance, the tax law of the Reference Entity's jurisdiction determines whether a Flow-through Entity is treated a Tax Transparent Entity or a Reverse Hybrid Entity. This will generally ensure the profits of a Flow-through Entity are allocated consistently with the principles that income should be allocated to the jurisdiction that would be expected to have the primary taxing rights in respect of that income and the matching principle that income and tax with respect to that income should be matched in the same jurisdictional ETR computation.

90. However, this rule may not always put the Flow-through Entity's profit and the MNE Group's tax on that profit in the same jurisdictional ETR computation if the Entity is owned through a chain of Entities. This is because the jurisdictions where the owners are located could take different views on the transparency of an Entity, leading some owner(s) to conclude that an Entity is fiscally transparent and (the) other owner(s) to conclude that it is not fiscally transparent. This inconsistent treatment will lead to a mismatch in the allocation of profits and taxes if an indirect owner views the Entity (and each Entity through which the owner owns its Ownership Interest in the Entity) as fiscally transparent and pays tax on its income, but the Reference Entity views the Entity as fiscally opaque. This is because under this guidance, the Entity will be classified as a Reverse Hybrid Entity (because it is not viewed as fiscally transparent by the Reference Entity), and this will prevent the profits of the Entity from being allocated to the indirect owner that is subject to tax on the Entity's income. Further, the taxes paid by the indirect owner on this income would not be allocated to the Reverse Hybrid Entity under Article 4.3.2.

91. This is illustrated in the following example.



92. In this example, A Co wholly owns B Co which in turn owns C Co. A Co is located in Jurisdiction A, B Co in Jurisdiction B, and C Co in Jurisdiction C. The table below summarises how each jurisdiction's tax laws treat the entities.

	Classification of Entities in the ownership chain		
Jurisdiction	A Co	B Co	C Co
A	Opaque	Transparent	Transparent
B		Opaque	Opaque
C			Transparent

93. Because Jurisdiction A's tax laws consider both B Co and C Co as fiscally transparent, the profits or losses of C Co are included in A Co's taxable income and subject to tax. These profits or losses are not taxed in either Jurisdiction B, because its tax laws regard C Co as fiscally opaque, or Jurisdiction C, because its tax laws regard C Co as fiscally transparent.

94. Under Article 10.2.1, C Co is considered a Reverse Hybrid Entity because B Co is the Reference Entity, and the tax laws of Jurisdiction B do not treat C Co as fiscally transparent. This means that the GloBE Income or Loss of C Co is not allocated to another Constituent Entity and is effectively treated as stateless income. The tax paid by A Co with respect to C Co's income is not allocated to C Co.

95. This outcome is inconsistent with the policy of matching income and the taxes on that income for purposes of the GloBE ETR computations. This could result in double taxation to the extent that Top-up Taxes are paid under an IIR or UTPR in respect of C Co's profits in addition to the taxes A Co has paid on those profits. Similarly, there are also instances where the direct owners of the Reverse Hybrid Entity are subject to tax on the income of the Reverse Hybrid Entity. Leaving the Covered Tax in the jurisdiction of the direct owners while the profits remaining with the Reverse Hybrid Entity can also lead to double taxation under GloBE.

96. Accordingly, the Commentary will be revised to clarify that Covered Taxes paid by a direct or indirect Constituent Entity-owner with respect to the profits of a Reverse Hybrid Entity are allocated to the Reverse Hybrid Entity under Article 4.3.2(d). This will ensure that taxes are appropriately matched with the income that the tax relates to, in line with the matching principles of the GloBE Rules. Article 4.3.2(d) shall apply in the same way to the income of a Reverse Hybrid Entity as it applies to the income of a Hybrid Entity. Accordingly, the allocation of Covered Taxes from a Constituent Entity-owner to a Reverse Hybrid Entity will be subject to the passive income limitation in Article 4.3.3.

97. For the purposes of computing the ETR under a QDMTT, Paragraphs 118.28 to 118.30 of the Commentary require a QDMTT to exclude from the Adjusted Covered Taxes the Covered Tax expense of a Constituent Entity-owner on income of a Hybrid Entity that is allocable to a Hybrid Entity located in the QDMTT jurisdiction, as well as the Covered Tax expense of a Constituent Entity-owner on income of a Reverse Hybrid Entity that is allocable to a Reverse Hybrid Entity created in the QDMTT jurisdiction. For the avoidance of doubt, this requirement does not apply to taxes imposed by a QDMTT jurisdiction itself on a direct or indirect Constituent Entity-owner's share of income of a Reverse Hybrid Entity created in the QDMTT jurisdiction, as such taxes resulted from the QDMTT jurisdiction's exercise of its primary taxing rights.

5.6.2. Guidance

98. The following additions in bold will be made to the Commentary to Article 4.3.2(d):

Paragraph (d) - Hybrid Entities ***and Reverse Hybrid Entities***

59. Paragraph (d) allocates Taxes of Constituent Entity-owners arising in connection with the income of Hybrid Entities **and Reverse Hybrid Entities**. If a Constituent Entity-owner of a Hybrid Entity **or Reverse Hybrid Entity** is located in a tax jurisdiction that imposes Tax on the owner's share of the Hybrid Entity~~'s~~ **or Reverse Hybrid Entity's** income under a fiscal transparency regime (see discussion in Commentary to Article 10.2), the Covered Taxes included in the financial accounts of the Constituent Entity-owner should be assigned to the Hybrid Entity **or Reverse Hybrid Entity**. **In some cases, an indirect Constituent Entity-owner that is further up the ownership chain than the Reference Entity (i.e. the owner whose tax law determined that the Flow-through Entity is treated as a Reverse Hybrid Entity) may be subject to tax on the Reverse Hybrid Entity's income under a domestic fiscal transparency regime notwithstanding that the Entity is not a Tax Transparent Entity under the GloBE Rules. Similarly, the jurisdiction in which the Reverse Hybrid Entity is created may impose a Covered Tax on a direct Constituent Entity-owner that is located in another jurisdiction in respect of the Reverse Hybrid Entity's income. In those cases, Taxes of the Constituent Entity-owner must be allocated to the Reverse Hybrid Entity in the same manner as if it were a Hybrid Entity.** The same general process described in paragraph (a) above for allocating Covered Taxes imposed on the Main Entity in respect of a PE can be used to determine the amount of taxes allocated by a Constituent Entity owner to a Hybrid Entity **or Reverse Hybrid Entity**, however any taxes allocated to a Hybrid Entity **or Reverse Hybrid Entity** by a Constituent Entity-owner in respect of Passive Income are subject to limitation under Article 4.3.3, which is discussed further below. If the Constituent Entity-owner is subject to a withholding tax or net basis taxes on distributions from the Hybrid Entity **or Reverse Hybrid Entity**, such Taxes would also be allocated to the Hybrid Entity **or Reverse Hybrid Entity** pursuant to paragraph (e).

99. The bold text will be added to the Commentary to Article 4.3.3:

62. Article 4.3.3 imposes a limitation on the "push-down" of Taxes from a Constituent Entity-owner that are attributable to Passive Income of the subsidiary Constituent Entity. This rule is designed to maintain the integrity of the jurisdictional blending rules in relation to mobile income. In the absence of Article 4.3.3, the rules in Article 4.3.2(c) and (d), which allocate Taxes paid by a Constituent Entity-owner under a CFC Tax Regime or in respect of a Hybrid Entity **or Reverse Hybrid Entity**, would effectively blend the Taxes paid on that mobile income in the Constituent Entity-owner's high tax jurisdiction with other income arising in the Low-Tax Jurisdiction. Without the rule of Article 4.3.3, an MNE Group could shift mobile income from high-tax jurisdictions to Low-Tax Jurisdictions to reduce overall tax liability (including Top-up Tax liability) in the MNE Group.

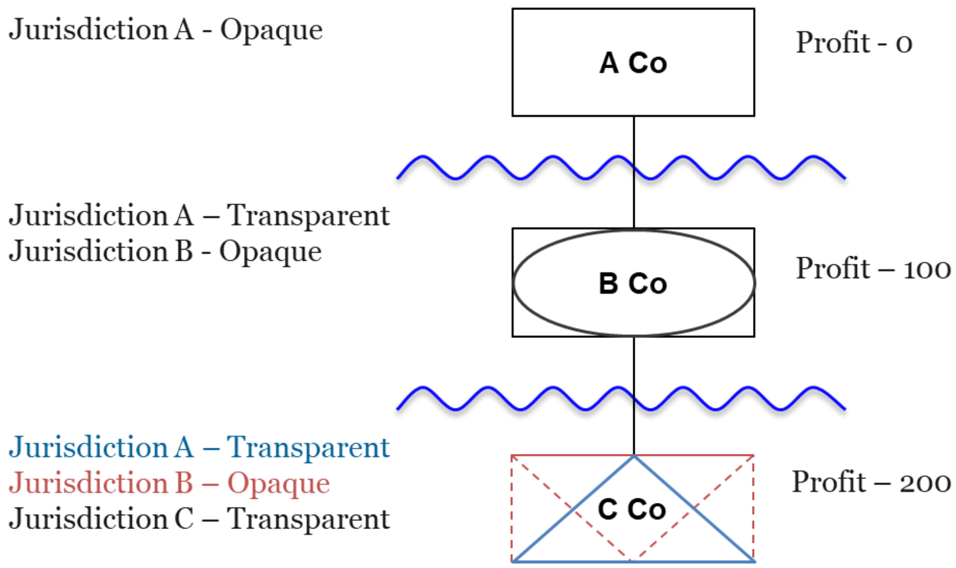
100. The following additions in bold will be made to the Commentary to the definition of a Qualified Domestic Minimum Top-up Tax in Article 10.1:

118.30 For purposes of computing the ETR, a QDMTT shall exclude Covered Tax expense of: (i) 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; (ii) a Main Entity that is allocable under Article 4.3.2(a) to a Permanent Establishment located in the jurisdiction; (iii) a Constituent Entity-owner on income of a Hybrid Entity **or a Reverse Hybrid Entity** that is allocable **under Article 4.3.2(d)** to a Hybrid Entity **or Reverse Hybrid Entity that is either** located in the jurisdiction **or is included in the scope of the QDMTT because the QDMTT applies to stateless Flow-through Entities created in the QDMTT jurisdiction** ~~under Article 4.3.2(d)~~; and (iv) a Constituent Entity-owner (e.g. net basis taxes), other than a withholding tax imposed by the QDMTT jurisdiction, that is allocable to a distributing Constituent Entity located in the jurisdiction under Article 4.3.2(e). Withholding taxes that are described in Article 4.3.2(e) imposed by the QDMTT jurisdiction itself on distributions from a Constituent Entity located in the QDMTT jurisdiction are allocated to the distributing Constituent Entity under the QDMTT. **Similarly, Covered Taxes accrued in the financial accounts of a Constituent Entity-owner of a Hybrid Entity or Reverse Hybrid Entity are included in the Adjusted Covered Taxes of the Hybrid Entity or Reverse Hybrid Entity where the taxes (a) are allocated to the Hybrid Entity or Reverse Hybrid Entity under Article 4.3.2(d), (b) are imposed by the jurisdiction of the Hybrid Entity or Reverse Hybrid Entity and (c) relate to the income of the Hybrid Entity or Reverse Hybrid Entity. This could include for example taxes in respect of immovable property located in the QDMTT jurisdiction.**

5.6.3. Examples

Example 10.2.1-6

1. Assume A Co owns B Co and B Co owns C Co. A Co is not a Flow-through Entity. The tax law of the jurisdiction in which A Co is located, Jurisdiction A, treats A Co as fiscally opaque and B Co as fiscally transparent and C Co as fiscally transparent. B Co is not a Flow-through Entity. The tax law of the jurisdiction in which B Co is created, Jurisdiction B, does not treat C Co as fiscally transparent. The tax law of the jurisdiction in which C Co is created treats C Co as fiscally transparent. Assume B Co's profit is 100 and C Co's profit is 200. See illustration below.



2. B Co is the Reference Entity because it is the closest Constituent Entity-owner to C Co that is not a Flow-through Entity. Because Jurisdiction B's tax laws do not treat C Co as fiscally transparent, C Co's income will not be subject to tax in Jurisdiction B. C Co would consequently be treated as a Reverse Hybrid Entity.

3. A Co is subject to tax on C Co's income. Any taxes paid by A Co in respect to C Co's profit of 200 will be allocated to C Co under Article 4.3.2(d).

6. Treatment of Securitisation Vehicles

6.1. Securitisation Vehicles

6.1.1. Introduction

1. Securitisation is a financing technique that enables a creditor (the “originator”) – typically a credit institution or a corporation – to refinance a set of loans, exposures or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables, by transforming them into tradable securities.

2. The originator pools and repackages a portfolio of its assets and typically organises them into different risk categories for different investors, thus giving investors access to investments in assets to which they normally would not have direct access and enabling the originator to raise finance at a lower cost. Returns to investors are generated from the cash flows of the assets.

3. The technique requires the repackaged portfolio of assets to be isolated from the credit risk of the originator. This is accomplished by using special purpose vehicles (SPVs) to hold the assets (or assets deriving their value from them) and issue the debt secured on them, thus making the wider creditworthiness of the originator irrelevant to the credit risk assumed by the holders of the SPV’s debt instruments. Such SPVs are often referred to as “bankruptcy remote” because of this isolation of the assets.

6.1.2. Overview

4. In a classical securitisation transaction, assets producing the relevant revenue streams – (for example loans, mortgages, bonds, leases, or contracts corresponding to the performance of such assets or exposures) will be transferred by the originator to an SPV (or multiple SPVs). These SPVs could take the form of a company or a trust or a similar arrangement depending on the structure concerned.

5. Where the SPV is a company, the SPV will typically be owned by an unconnected third party which does not consolidate the SPV. Where it is a trust or similar arrangement, the originator may hold Ownership Interests in the SPV, or it may not hold such Ownership Interests which could instead be held by an unconnected third party. In the case of a securitisation transaction with multiple SPVs, one SPV may hold all of the Ownership Interests of another SPV (e.g. all of the ordinary shares of a company) but the Ownership Interests in the upper tier SPV may be owned by an unconnected third party. This facilitates the bankruptcy remoteness of the SPV from the originator, by ensuring it will not be subject to secondary liabilities and isolates the risk of the asset pool (which is further described below) from the wider credit risk associated with the originator.

6. The SPV may be consolidated into the same group as the originator, and consequently be a Constituent Entity in the originator's Group under the GloBE Rules. This could be due to the originator's Ownership Interests in the SPV or due to a servicing agreement or other arrangement that the originator enters into with the SPV, under which the originator takes responsibility for the day-to-day management of the asset pool. This (together with the cash extraction mechanism below) can lead to it being treated as having control under some financial accounting standards. Even within the same accounting standard, the consolidation requirements can be sensitive to the precise details and structuring of the arrangement, like the terms of the servicing agreement or other arrangement. It is often not clear cut and there are many cases where the question of whether to consolidate an SPV into its originators group is difficult and nuanced (and where different auditors can take different views of the same arrangements). The outcome can have significant implications under the GloBE Rules, because the SPV would be treated as a Constituent Entity of the originator's Group in cases where it is consolidated.

7. The SPV will issue debt instruments normally via the bond markets. The proceeds of the debt instruments issued are used to finance the acquisition of the asset pool. The payment stream on the assets is then used to service the debt instruments. In a synthetic securitisation, the underlying asset pool is not transferred to an SPV. Instead, the SPV becomes party to a derivative contract or guarantee under which it assumes the risk of the performance of the underlying asset pool, while itself also owning highly secure assets such as government debt. The combination of returns from the highly secure assets and additional payments received from the originator group in consideration of the SPV becoming party to the derivative contract or guarantee in relation to the underlying asset pool put the SPV – and hence its creditors in the same economic position as if the SPV had itself owned the underlying asset pool.

8. The originator (or another Constituent Entity in the same MNE Group as the originator) will often also hold some of the debt instruments issued by the SPV (which commonly rank junior to the debt issued to third-party creditors). This enables the SPV to hold more collateral in the form of the underlying asset pool than the principal on the debt instruments issued to third parties, thus replicating the economic effect of typical commercial transactions where third-party lenders will generally require security over underlying assets with a greater value than the amount they are lending. This reduces the risk of the third-party lenders because any losses would first fall on the originator. This overcollateralization and the bankruptcy remoteness described above enables third-party loan notes to be issued at a lower cost than if the originator had borrowed directly.

9. The SPV generally has an asset pool yielding more income than it is expected to need to meet its liabilities. This incorporates a margin of error if some of the assets do not produce as much income as expected. It also means the transferred asset pool will often yield a greater amount than is necessary to service and repay the SPV's debt instruments. The SPV is only designed to make a negligible profit, at most, on the difference between the payment stream it receives from the underlying asset pool and its costs servicing the debt instruments so the structure will typically include a mechanism to return any excess cash from the SPV to the originator or another Constituent Entity in the same MNE Group as the originator ("cash extraction mechanism"). The precise form of the cash extraction mechanism varies depending on the structure, but payments are commonly made on a monthly or quarterly basis so surplus cash is typically not retained in the SPV for a significant period of time.

Hedging arrangements

10. As noted above, SPVs are generally structured so they only make a negligible profit (at most) over the life of the transaction, after taking into account the impact of the cash extraction mechanism. This is because the cash extraction mechanism will require surplus cash to be paid out to the originator (or another Constituent Entity in the same MNE Group as the originator).

11. Despite this, SPVs can recognise significant profits or losses in their Financial Accounting Net Income or Loss in a given Fiscal Year. This can arise through hedging arrangements, which SPVs use to hedge risks that could lead to the payment stream from the asset pool becoming insufficient to meet the SPV's liabilities under the debt instruments. These commonly include currency hedges where the loan notes were issued in a different currency than the currency of the asset pool or interest rate swaps where the SPV is exposed to interest rate risk (for example if the assets carry a fixed rate of interest but debt instruments carry a variable rate of interest).

12. Where the SPV is unable to, or does not, adopt hedge accounting, these hedging instruments can be subject to fair value accounting and changes in their fair value will lead to profits or losses being recognised in the income statement. This can create a mismatch if the corresponding profit or loss on the hedged asset or liability is not also subject to fair value accounting.

13. Many SPVs do not as a rule recognise deferred tax. This can be because the SPV is exempt from Corporate Income Tax or because the hedged profits and losses are excluded from the tax base and the SPV is only subject to Corporate Income Tax on the negligible profit it has made in the Fiscal Year. Where deferred tax is not recognised, there will not be an amount in the Adjusted Covered Taxes to offset the impact of the GloBE Income or Loss attributable to the hedge. This could lead to a top-up tax in relation to the Fiscal Years where fair value profits arise from the hedge, even though the SPV will not recognise more than a negligible profit from the overall transaction.

6.1.3. Issues to be considered

Impact of imposing a top-up tax liability on the SPV

14. Securitisation transactions are designed to achieve objectives such as lowering the originator's cost of borrowing or reducing its liquidity risks by transferring assets to a bankruptcy remote entity that is removed from the wider risks of the originator and is thus able to achieve a better credit rating. This could be significantly undermined if the SPV became liable to top-up tax charges under the GloBE Rules because the exposure to a potential top-up tax charge elsewhere in the group would mean the SPV is no longer actually insulated from the originator Group. This could impact the solvency of the SPV and lead credit rating agencies to downgrade its credit rating (even before any tax liability materialises), which could affect the viability of many securitisation transactions.

Treatment of profits or losses arising in a securitisation vehicle

15. The Model Rules have generally been designed to ensure that the GloBE Rules do not impose top-up taxes when the MNE Group has not made an economic profit in the jurisdiction or because income has been taxed in a different period than the period in which the income is recognised in under the GloBE Rules.

16. As noted above, SPVs used in securitisation transactions will be structured so that any surplus cash recognised by a SPV will be paid to the originator and so the SPV cannot make more than a negligible profit from the arrangement (after taking into account the cash extraction mechanism). As the SPV will, at most, make a negligible economic profit over the life of the arrangement, the SPV would not be expected to give rise to significant top-up taxes under the GloBE Rules even if that negligible profit was untaxed.

17. However, fair value movements, for example in relation to hedging arrangements, can give rise to significant profits or losses in a given Fiscal Year. Furthermore, the mechanisms in the Model Rules to deal with this volatility in the profit and loss may not always work effectively for SPVs because deferred tax is not usually recognised. Consequently, there will not be a corresponding amount of Adjusted Covered Taxes to offset the impact of these amounts of GloBE Income or GloBE Loss. This could lead to top-up taxes being payable that are not commensurate with the economic profit the SPV has made.

6.1.4. Guidance

18. The Inclusive Framework agrees that jurisdictions adopting QDMTTs are not required to impose top-up tax liabilities on SPVs used in securitisation transactions. The Commentary will consequently be revised to clarify that a QDMTT liability in respect of a Securitisation Entity should generally be imposed on other Constituent Entities located in the jurisdiction. The Commentary will also clarify that a QDMTT may exclude a Securitisation Entity from its scope (such that the Securitisation Entity is not treated as a Constituent Entity for the purposes of that QDMTT).

19. The Inclusive Framework also agrees that QDMTTs that impose the top-up tax liability computed for a Securitisation Entity on other Constituent Entities located in the jurisdiction or that exclude Securitisation Entities from the scope of the tax would both still meet the Consistency Standard for the purposes of the QDMTT Safe Harbour. Revisions will consequently be made to the Commentary to add these to the Switch-off Rule.

20. The Commentary already provides that Article 2.4.1 does not prescribe how the UTPR Top-up Tax Amount is allocated among the Constituent Entities that are located in the UTPR jurisdiction. Therefore, jurisdictions may exclude Securitisation Entities from liability to top-up taxes under the UTPR. A jurisdiction that excludes Securitisation Entities from liability to top-up taxes under the UTPR would not be in a position to impose any additional cash tax expense in the scenario where the Securitisation Entity is the only Constituent Entity located in the jurisdiction. In the unlikely scenario where the UTPR jurisdiction would be allocated UTPR Top-up Tax in a year when a Securitisation Entity is the only Constituent Entity located in the jurisdiction, Article 2.6.3 provides that this jurisdiction would be excluded from the allocation mechanism provided under Article 2.6.1 in subsequent Fiscal Years if the top-up tax remains uncollected.

21. As a Securitisation Entity would not be expected to be a Parent Entity within a MNE Group, it would not in practice be liable to a top-up tax charge under the IIR and so no changes to the Commentary are necessary.

22. The Inclusive Framework also recognises Securitisation Entities can have significant accounting profits or losses in a given Fiscal Year, even in circumstances where negligible economic profit or loss is realised over the life of the transaction. It will in a timely manner consider issuing further Administrative Guidance to ensure that the use of securitisation transactions (and arrangements of the kind entered into by SPVs that give rise to fair value movements) do not result in MNE Groups paying top-up taxes that are not commensurate with the economic profit that the SPV has made from the activities. This will include considering whether a Securitisation Entity should be treated as being deconsolidated from the MNE Group for the purposes of the GloBE Rules and whether these issues could be addressed by making an adjusted realisation basis election available in relation to the profits of SPVs. Further consideration will also be given to the treatment of any distributions received by the originator or any Constituent Entities in the MNE Group from the SPV.

23. The following paragraph will be inserted into the Commentary to the definition of Qualified Domestic Minimum Top-up Tax in Article 10.1

Securitisation Entity

> 118.40.10 Securitisation Entities are designed to be bankruptcy remote from the originator and the other Constituent Entities of the MNE Group. A jurisdiction may therefore allocate the liability for any QDMTT top-up tax to another Constituent Entity (if any) that is located in the jurisdiction. A QDMTT may also include provisions that ensure the top-up tax cannot be imposed on a Securitisation Entity. A QDMTT may also exclude a Securitisation Entity from its scope (i.e. the Securitisation Entity could be excluded from the Effective Tax Rate calculation for the jurisdiction). In this case, the income of such Securitisation Entities would remain within the scope of the GloBE Rules.

24. The following paragraphs will be added to the Commentary to Article 10.1:

Securitisation Entity

148.1 Special purpose entities used in securitisation transactions (securitisation entities) are structured so they only make, at most, a negligible profit over the life of the transaction. This is because the arrangements between the securitisation entity and the originator of the assets will typically include a cash extraction mechanism that requires surplus cash to be paid out to the originator (or another Constituent Entity in the same MNE Group as the originator).

148.2 A "Securitisation Entity" means an Entity which is a participant in a Securitisation Arrangement, and which satisfies all of the following conditions:

a. the Entity only carries out activities that facilitate one or more Securitisation Arrangements

b. it grants security over its assets in favour of its creditors (or the creditors of another Securitisation Entity)

c. it pays out all cash received from its assets to its creditors (or the creditors of another Securitisation Entity) on an annual or more frequent basis, other than:

    i. cash retained to meet an amount of profit required by the documentation of the arrangement, for eventual distribution to equity holders (or equivalent); or

    ii. cash reasonably required under the terms of the arrangement for either (or both) of the following purposes:

        1. to make provision for future payments which are required, or will likely be required, to be made by the Entity under the terms of the arrangement; or

        2. to maintain or enhance the creditworthiness of the Entity

148.3 An Entity shall not be treated as a Securitisation Entity unless any profit referred to in paragraph 148.2(c)(i) above for a given Fiscal Year is negligible relative to the revenues of the Entity.

148.4 A Securitisation Arrangement means an arrangement which satisfies the following conditions:

a. It is implemented for the purpose of pooling and repackaging a portfolio of assets (or exposures to assets) for investors that are not Constituent Entities of the MNE Group in a manner that legally segregates one or more identified pools of assets and

b. It seeks through contractual agreements to limit the exposure of those investors to the risk of insolvency of an Entity holding the legally segregated assets by controlling the ability of identified creditors of that Entity (or of another Entity in the arrangement) to make claims against it through legally binding documentation entered into by those creditors.

25. The following additions in bold will be made to the Commentary to the QDMTT Safe Harbour:

38. To strike the right balance between having a QDMTT Safe Harbour that applies on a jurisdictional basis and avoiding that particular restrictions affect the ability of a QDMTT to meet the Consistency Standard, the Inclusive Framework agreed that the following cases should not affect a QDMTT from meeting the Consistency Standard:

(a) A QDMTT jurisdiction decides not to impose a QDMTT on Flow-through Entities created in its jurisdiction.

(b) A QDMTT jurisdiction decides not to impose a QDMTT on Investment Entities subject to Articles

7.4, 7.5, and 7.6 of the GloBE Rules.

(c) A QDMTT jurisdiction decides to adopt Article 9.3 in a QDMTT legislation with no limitation (i.e., option three of paragraph 118.51 of the QDMTT Commentary).

(d) A QDMTT jurisdiction includes members of a JV Group (which includes Joint Ventures) within the scope of the QDMTT but imposes the liability on Constituent Entities of the main group instead of directly on the members of the JV Group as permitted under paragraph 118.11 of the QDMTT Commentary.

(e) A QDMTT jurisdiction decides not to impose a QDMTT on Securitisation Entities.

Example 10 Securitisation Entities

49.1 A jurisdiction may decide not to impose a QDMTT on Securitisation Entities. This could be because Securitisation Entities are not included within the scope of the QDMTT. Alternatively, Securitisation Entities could be included within the scope of the QDMTT, but the QDMTT could include provisions that ensure any top-up tax liabilities cannot be imposed on a Securitisation Entity. In either case, the Consistency Standard will still be met notwithstanding the QDMTT is not imposed on these Securitisation Entities. The MNE Group will apply the Switch-off Rule with respect to the jurisdiction where the Securitisation Entity is located. However, where the jurisdiction includes Securitisation Entities within the scope of its QDMTT, but includes provisions to impose any top-up tax liability in respect of the income of a Securitisation Entity on another CE of the MNE Group that is not a Securitisation Entity, or on the Securitisation Entity itself if the top-up tax liability cannot be otherwise collected, the MNE group will not apply the Switch-off Rule with respect to the jurisdiction where the Securitisation Entity is located (i.e. the MNE Group would be allowed to apply the QDMTT Safe Harbour for the QDMTT jurisdiction).