

# Agreed Administrative Guidance on the GloBE Model Rules (Pillar Two)



## Overview

On 17 June 2024 the OECD/G20 Inclusive Framework (“IF”) released its fourth tranche of Administrative Guidance on the Global Anti-Base Erosion (“GloBE”) Model Rules (“June 24 AG”). The guidance is more than 140 pages and covers six chapters. The new material provides detailed recapture rules for deferred tax liabilities, new rules on deferred tax assets and liabilities where there are divergences between GloBE rules and accounting carrying values, the allocation of cross-border current and deferred taxes, the allocation of profits and taxes in structures involving Flow-through Entities, and the treatment of securitisation vehicles. The June 24 AG is principally relevant for the application of the GloBE Model Rules and has limited relevance for the Transitional CbCR Safe Harbour.

We are expecting additional guidance this year, some of which may be an extension of the commentary in this guidance and some of which will be new subject material. The expected additional guidance (based on IF statements) is outlined below.

### 1. DTL Recapture

The GloBE Rules stipulate that the accrual of a Deferred Tax Liability (“DTL”) that does not reverse within five years shall be subject to recapture, with a Multinational Enterprise (“MNE”) Group required to re-compute its GloBE Effective Tax Rate (“ETR”) excluding such DTLs and pay any additional Top-up Tax due.

MNE Groups had raised concerns with the IF that their existing accounting systems did not allow for sufficient granularity to track the movement of DTLs on an asset-by-asset basis. The June 24 AG attempts to address this by permitting MNE Groups to track DTLs on an aggregate basis, whilst simultaneously ensuring that this aggregation does not undermine the original policy objective of the DTL recapture rule. The resulting guidance is highly complex, though many MNE Groups may find that they are not actually impacted.

The June 24 AG explains that many MNE Groups track DTLs based on an aggregation of all General Ledger (“GL”) accounts under a Balance Sheet account, or a subset of GL accounts (a sub-Balance Sheet account). For this reason, the June 24 AG permits the tracking of DTL reversal based on an Aggregate DTL Category, but places limits on the GL accounts to which this simplification can be applied (e.g. excluding non-amortizable intangible assets, amortizable intangible assets with an accounting life of more than five years, and related party receivables and payables). The June 24 AG provides two methodologies to compute the DTLs subject to recapture in a given year where an MNE Group tracks DTLs on a GL account or Aggregate DTL Category basis — generally, a “last-in-first-out” (“LIFO”) methodology and a “first-in-first-out” (“FIFO”) methodology — and prescribes rules for when each methodology may be used.

### KPMG observation

For many MNE Groups, the most significant DTLs that do not reverse within five years are those associated with intangibles. The guidance limits the aggregation of DTLs related to non-amortizable intangibles, such as goodwill and amortizable intangible assets with an accounting life of more than five years, to the GL account. Hence, this exclusion limits the simplification benefit provided by the new guidance.

## KPMG observation

MNE Groups in certain sectors, such as mining, oil and gas or construction, are more likely to have material DTLs that do not reverse within five-years. It is groups in these sectors for which this new guidance will be most impactful.

The GloBE Rules already included an Unclaimed Accrual election that enables MNE Groups to disregard (and hence not track) movements in DTLs that they did not expect to reverse entirely within five years. The June 24 AG introduces a new Unclaimed Accrual Five-Year Election with respect to DTLs in a specific GL account or Aggregate DTL Category irrespective of the expected reversal time period.

## KPMG observation

The Unclaimed Accrual Five-Year Election provides MNE Groups with the opportunity to simplify their GloBE compliance in jurisdictions where their GloBE ETR exceeds 15 percent without taking into account the DTLs subject to the Election.

## Actions for companies

In jurisdictions where MNE Groups are subject to the GloBE Rules and do not qualify for the Transitional CbCR Safe Harbour, they will need to put in place the necessary systems to enable them to track DTLs at an appropriate level going forward. The guidance gives MNE Groups a variety of options about how to track DTLs, which they should assess carefully, including whether to opt to exclude DTLs as an Unclaimed Accrual or under the new Unclaimed Accrual Five-Year Election.

## 2. Divergence between GloBE and accounting carrying values

The June 24 AG provides additional guidance on how to determine Adjusted Covered Taxes of Constituent Entities in cases where the accounting and GloBE carrying values (and the associated deferred tax assets/liabilities) diverge as a follow-up to the February 23 AG, the June 24 AG also addresses the GloBE treatment of an intercompany transaction accounted for at cost by the acquiring Constituent Entity.

The June 24 AG establishes that the computation of deferred taxes for purposes of the numerator of the GloBE ETR is based on the difference in carrying value for GloBE purposes and local tax purposes, unless otherwise specified in the GloBE Rules. In instances in which the GloBE carrying value is different than the local tax carrying value and the financial accounting carrying value, a deferred tax item is “recognized” solely for GloBE purposes.

## KPMG observation

This guidance effectively requires MNEs to track “GloBE carrying value” in their accounting system which will lead to an increase in compliance costs, and may move some MNEs further in the direction of needing a full set of ‘GloBE accounts’, alongside existing financial and local tax accounts. Recognizing this, the June 24 AG notes: “The Inclusive Framework will further consider potential simplification measures to mitigate the compliance burdens associated with divergences between GloBE and accounting carrying values.”

The June 24 AG also clarifies that certain measures governing reorganisations do not apply pre-Transition Year. Prior to the June 24 AG there was uncertainty as to whether various measures governing reorganisations (including the exception as outlined in Article 6.2.2 to treat the acquisition of a Controlling Interest as a purchase of the underlying assets and liabilities, and the other measures governing reorganisations in Articles 6.3.1, 6.3.3 and 6.3.4 of the GloBE Rules) applied to transactions executed prior to the Transition Year. The June 24 AG clarifies that none of the aforementioned measures governing reorganisations apply to transactions executed prior to the Transition Year.

## KPMG observation

While the June 24 AG clarifies that the various exceptions to the “no purchase accounting rule” do not apply prior to the Transition Year, it is important to consider the impact of the ability to recognize deferred taxes solely for GloBE purposes. For example, if an MNE acquired a target entity in 2020 (i.e., pre-Transition Year) and the jurisdiction of the target entity allowed a basis step-up in the target’s assets for local tax purposes, this could cause a low GloBE ETR in the jurisdiction of the target. This is because the increased amortization/depreciation of the target’s assets may be recognized for local tax purposes, but not for GloBE purposes. The June 24 AG now appears to allow for the recognition of a deferred tax asset (‘DTA’), because the local tax basis in the target’s assets exceeds the GloBE basis. The IF may have considered this approach as providing similar outcomes as applying the reorganization measures back in time, but without having to test the facts and circumstances of historical M&A transactions.

### Actions for companies

Companies should review all historical M&A transactions (at least to the extent the historical transactions resulted in attributes that are still present in 2024 and future years) and determine if a basis step-up was provided for local tax purposes and how the GloBE rules, including the June 24 AG, will respond to those historical transactions.

Finally, the June 24 AG addresses differences between accounting standards in respect of intercompany asset transfers. Prior to the June 24 AG, intercompany asset transfers were treated less favourably in the acquiring jurisdiction under accounting standards that account for intragroup transactions at cost, e.g. US GAAP, as compared to accounting standards that account for intragroup transactions at fair value. The June 24 AG seeks to neutralize that difference by allowing deemed amortization in the acquiring jurisdiction even if the relevant accounting standard does not. This clarification might be viewed as complementing the clarifications in the February 23 AG, on the disposing Constituent Entity-level treatment of intercompany transfers initially booked at historic cost. This guidance applies to transactions executed in the Transition Year and subsequent years. The transition rules in Article 9.1.3 continue to apply for transactions executed during the transition period i.e., transactions executed after 30 November 2021 and the Transition Year.

## KPMG observation

A significant limitation with this guidance is that it only applies in respect of intercompany asset transfers executed after the Transition Year. Thus, MNEs that prepare their consolidated financial statements using accounting standards that account for intragroup transactions at cost and that have transferred assets prior to the transition period, will continue to have less favourable outcomes as compared to MNEs that prepare their consolidated accounts under accounting standards that account for intragroup transactions at fair value.

### Actions for companies

In addition to considering the impact of the GloBE rules for all intercompany asset transfers going forward, companies should also review all intercompany asset transfers executed prior to the transition period and determine how those transaction will be treated for GloBE purposes and if a better result is available if Local GAAP financial statements are prepared.

### 3. Allocation of Cross-border Current Taxes

The June 24 AG revises the method provided in prior commentary for allocating current taxes of a Main or Parent Entity to another constituent entity (“CE”) under a tax system where multiple sources of income are blended and cross-crediting of foreign taxes is allowed. The June 24 AG provides for a four-step methodology that generally attempts to determine how much of the Main or Parent Entity’s tax expense arises from the GloBE income of each particular CE. The approach determines the allocable taxes by hypothesizing how much tax the Main or Parent Entity would pay without the foreign source income (with the allocable taxes being the excess of the tax actually owed over that hypothetical tax amount), and then allocates the allocable taxes based on the relative taxable income of each CE. For purposes of applying this methodology, the June 24 AG clarifies how the foreign tax credit (“FTC”) rules of the Main Entity’s domestic tax system impact the allocation of taxes to other CEs. For example, additional taxes paid by a Main Entity due to the allocation of expenses of the Main Entity against the foreign source income of another entity

in computing the FTC limitation will be included in the ETR calculation of the Main Entity, not allocated to another CE. The guidance also clarifies when a CE’s income is treated as “foreign source income” for purposes of applying the allocation methodology, including situations where domestic law characterization may differ from that of the GloBE rules.

The June 24 AG also clarifies that losses arising from a PE are generally treated in a manner consistent with the domestic law of the Main Entity, including its FTC rules. This would allow the losses arising from one PE to offset the profits of another PE, rather than the Main Entity, in many cases. Previous commentary indicated that such losses would be allocated against the income of the Main Entity.

The methodology presented in the June 24 AG will not impact the temporary simplified allocation methodology related to taxes arising under a Blended CFC Tax Regime, generally applicable for fiscal years beginning before 2026, introduced in the February 223 AG.

#### KPMG observation

The approach of the June 24 AG is a stark departure from the method for allocating taxes under the temporary allocation of taxes due to a Blended CFC Tax Regime, which applies to the allocation of US taxes related to GILTI. Under the Blended CFC Tax Regime allocation, US tax that arises from the allocation of US shareholder expenses against GILTI income is included in the ETR calculation of low-taxed foreign jurisdictions rather than the US ETR calculation. By contrast, the allocation method set forth in the June 24 AG (which applies to taxes other than Blended CFC Tax Regimes) would cause US taxes incurred as a result of US shareholder expense allocation to be included in the US ETR calculation. That different approach may be helpful, harmful, or neither depending on a taxpayer’s facts, as explained in the following paragraphs. The June 24 AG does not state whether the new approach to expense allocation will apply to Blended CFC Tax Regimes after the transitional rule expires.

Focusing on US parented groups, companies that have material low-tax income in foreign jurisdictions that do not implement a QDMTT, or that have stateless income, may be negatively impacted by the approach in the June 24 AG because such taxpayers will not be able to push as much tax down to increase GloBE ETR on low-tax foreign income that would be subject to an IIR or UTPR.

On the other hand, for companies that have low-taxed US income (for example, due to Research & Development (“R&D”) credits combined with Foreign-Derived Intangible Income (“FDII”) benefits), the method provided in the June 24 AG may be beneficial, as it will tend to increase the US. ETR, which will reduce exposure to the UTPR. This will be particularly true for companies whose material foreign income is either high-taxed or subject to a QDMTT, as taxes paid by a Main or Parent entity may not be allocated to another CE for purposes of applying a QDMTT.

Finally, this guidance should have no impact on Pillar 2 exposure for US companies that already have a sufficiently high US ETR and whose material foreign income is either in high tax jurisdictions or jurisdictions with a QDMTT.

#### Actions for companies

US MNEs anticipating a low ETR in their material foreign jurisdictions should make it a priority to perform a review of their expense allocation methodologies applied in calculating the FTC limitation. Identifying opportunities to appropriately change the allocation of expenses could alleviate some of the expected Pillar 2 risk.

## 4. Allocation of Cross-border Deferred Taxes

The guidance provides a five-step process for the allocation of deferred CFC taxes from a Parent Entity to its CFC. The same principles apply to allocate deferred taxes to Hybrid Entities, Reverse Hybrid Entities, and Permanent Establishments. A five-year election can be made in respect of a Parent Entity jurisdiction pursuant to which no deferred taxes are allocated to another CE under Article 4.3 (and are also excluded from the Covered Taxes of the Parent Entity). Notably, GILTI deferred taxes are not allocated under Article 4.3 (and are also disregarded on transition), so that they are only taken into account when they reverse and become current tax items.

The five-step process is as follows:

- First, a Parent Entity divides its deferred taxes into three categories, those related to:
  - Non-GloBE Income;
  - GloBE Income; and
  - Passive GloBE Income.

- Second, taxpayers determine the pre-FTC deferred tax on each category of the CFC's income (recast at a 15 percent rate in steps four and five if the applicable rate exceeds 15 percent) and the anticipated FTCs (in case of a DTL)/used FTCs (in case of a DTA) in respect of each.
- Third, the net amount determined in step two in respect of non-GloBE Income is excluded from the CFC's and Parent Entity's Adjusted Covered Taxes.
- Fourth, the amount determined in step two in respect of GloBE Income is allocated to the relevant CFC CE.
- Fifth, the amount determined in step two in respect of passive GloBE Income is allocated to the relevant CFC CE, subject to the limitation contained in Article 4.3.3 on allocating taxes to passive income.

### Actions for companies

Companies will have to carefully dissect their Parent Entity deferred taxes to sort them into the three categories required by step one. Companies that record deferred CFC taxes (or other deferred taxes) on a net basis (i.e. the pre-FTC deferred tax liability is recorded net of the anticipated FTC to be utilized against any deferred tax liability) will need to disaggregate the two components to determine whether the pre-FTC deferred tax liability is tax-effected at a rate above 15 percent and must be recast. As part of step two, companies will need to allocate anticipated FTCs among the three categories of income determined in step one under a reasonable basis.

This process will be complex for jurisdictions that have cross-crediting regimes, such as the US, as FTCs may potentially be used not only across the three categories of income within each CFC, but also across different CFCs (as well as on a carry-forward basis).

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

The GloBE Rules generally allocate income to the jurisdiction in which it is subject to tax in the hands of the MNE group. Article 3.5 accomplishes this with respect to a "Flow-through Entity" (tax transparent where located) by allocating its income (not allocable to a PE) to (i) its owner if the entity is a "Tax Transparent Entity" or (ii) the entity itself if it is a "Reverse Hybrid Entity." The June 24 AG clarifies these definitions are made by reference to the first owner in the chain that is not a Flow-through Entity (or the UPE when none exists) (either, the "Reference Entity").

A Flow-through Entity is a "Tax Transparent Entity" when it and each entity between it, and the Reference Entity, is fiscally transparent in the jurisdiction of the Reference Entity. The June 24 AG also clarifies that for purposes of determining the status of a Flow-through Entity, a jurisdiction's laws must affirmatively provide for the entity's

treatment as fiscally transparent — thus, a jurisdiction that has no corporate income tax is not considered to treat an entity as fiscally transparent.

Similarly, the June 24 AG clarifies that Article 3.5.3 reduces GloBE Income of a Flow-through Entity allocable to a non-MNE Group member unless such owner holds its interest directly or indirectly through the UPE.

The "matching principle" under the GloBE Rules seeks to align Covered Taxes and the related GloBE Income within the same jurisdictional ETR computation. The June guidance revises the definition of "Hybrid Entity" to allow for the allocation of tax paid by (i) an indirect owner of an entity that is fiscally transparent with respect to the indirect owner (but not its direct owner) and (ii) an owner in respect of the income of a Reverse Hybrid Entity.

## Actions for companies

Companies should revisit how they previously classified Flow-through Entities within their MNE Group. If an entity's classification is changed, the allocation of its income may need to be corrected. For example, a Flow-through Entity owned indirectly by a corporation through another Flow-through Entity will be treated as a Tax Transparent Entity under the guidance if both entities are treated as fiscally transparent in the jurisdiction in which the corporation is located, with the result that its income should be included in the ETR calculation of the jurisdiction in which the corporation is located. If the lower-tier Flow-through Entity is treated as opaque in the jurisdiction in which the intermediate Flow-through Entity is created, a company may have previously concluded that it should be treated as a Reverse Hybrid Entity with its income subject to a separate stateless ETR calculation.

## Actions for companies

Companies that have previously concluded they were unable to allocate taxes paid by parent entities in respect of GloBE Income of lower-tier entities should revisit such assessments in light of the guidance. For example, a US MNE Group that owns a lower-tier disregarded entity ("FDRE2") through another disregarded entity ("FDRE1") may allocate US federal income tax paid with respect to the income of FDRE2 under the revised definition of Hybrid Entity.

## 6. Treatment of Securitisation Vehicles

The possibility of top up tax arising in a securitisation entity (most likely in relation to fair value movements on hedging instruments where no deferred tax is recognized) has presented a significant impediment to certain structures in some markets. This risk primarily arises in relation to QDMTTs given that Securitisation Entities are unlikely to be liable to the IIR.

The June 24 AG allows jurisdictions adopting QDMTTs to:

- not impose top-up tax liabilities on entities used in securitisation transactions, and instead allocate those liabilities to another member of the group; and
- exclude a Securitisation Entity from the scope of its QDMTT.

Where a jurisdiction chooses to do this, its QDMTT should still meet the Consistency Standard for the purposes of the QDMTT Safe harbour.

The difference between the two options is that if a jurisdiction excludes securitisation entities from its QDMTT, the switch off rule means that groups with exempt Securitisation Entities may not benefit from the QDMTT safe harbour in respect of all entities in that jurisdiction. In contrast, if a jurisdiction provides for top-up tax in relation to a Securitisation Entities to be allocated to other group members, the switch-off rules should not apply (so the group will be entitled to apply the QDMTT safe harbour for that jurisdiction).

## Actions for companies

Pursuant to the June 24 AG, MNE Groups borrowing using securitisation entities should monitor whether the jurisdictions where their vehicles are based change their QDMTT rules as allowed by the new guidance. MNEs should also consider if entities in their structure qualify as a "securitisation entity" under the Pillar 2 rules and evaluate the impact on top-up tax liability (if any) on other CEs within the same jurisdiction.

As 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, this guidance provides welcome certainty on the imposition of top-up tax liability for securitisation vehicles.

The optional nature of these rules and the potential loss of the QDMTT safe harbour, makes these changes less than perfect. This is likely to lead to pressure for future changes to how securitisation entities are treated for Pillar 2 purposes.

The latest guidance is not expected to be the final word on how Pillar 2 applies to securitisation transactions. The June 24 AG states that further work will be done to consider 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 securitisation entities. Further consideration will also be given to the treatment of any distributions received by the originator or any Constituent Entities in the borrowing group from the securitisation entity.

Concerns about the impact of a securitisation entity becoming liable to top-up tax charges under the GloBE Rules (either on its own profits, or on profits of the borrowing group) led to the UK treating securitisation vehicles as excluded entities for QDMTT, and as not being part of the group for QDMTT (other than in calculating whether the group is over the revenue threshold), notwithstanding that such vehicles may be included in consolidated accounts. As a result, where a group consolidates UK securitisation vehicles in its accounts, it will need to consider the potential loss of the QDMTT safe harbour. If the Inclusive Framework can agree changes to the Model Rules to exclude Securitisation Entities, then the impact of such an exclusion under the QDMTT should not give rise to loss of the QDMTT safe harbour.

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## Other items still to come

Throughout the June 24 AG there are references to further guidance under consideration by the IF to refine or supplement the items covered in the document.

- **DTL Recapture:** The new guidance is based on the balance sheet approach to deferred tax. The IF will consider whether to supplement this to deal with aspects of other deferred tax models. More generally, the IF will monitor outcomes under the DTL recapture rules in practice and assess any need for changes in 2028.
- **GloBE-accounting carrying value divergences:** Under the guidance, an acquirer-level GloBE DTA can be recognized for a transition period asset transfer under Article 9.1.3, even where no DTA is recognized in the financial accounts. It is however noted that the IF will consider possible limits on this where the acquirer is located in a jurisdiction with no corporate income tax regime. The IF will also consider how the rules on interjurisdictional Covered Tax allocation (Article 4.3) interact with Article 9.1.3. More generally, the IF will consider potential simplifications to the new guidance on GloBE-accounting carrying value divergences, to limit compliance burdens.
- **Allocation of current taxes:** Further to the new cross-crediting allocation mechanism, the IF will consider how to handle post-filing adjustments.
- **Allocation of deferred taxes:** Further to the new guidance on the application of the Substitute Loss Carry-forward DTA in respect of Parent/Main Entity domestic losses (including carried forward losses) in relation to PEs, Hybrids and Reverse Hybrids, the IF will monitor for the sufficiency and effectiveness of the mechanism. The IF will also consider the case where losses of one CFC, PE, Hybrid, Reverse Hybrid are used against the income of another such entity, in the Parent/Main Entity's domestic tax calculation.
- **Securitisation Vehicles:** The IF will further consider whether there are circumstances in which a Securitisation Entity should be treated as deconsolidated for GloBE purposes. Consideration will also be given to a limited realization basis election and to the treatment of distributions received by originators.

Separately it might also be noted that, in various public statements and media reports, indications have been given on other contemplated items of Administrative Guidance. These have included possible integration of anti-arbitrage rules inform the Country-by-Country Reporting Safe Harbour into the full GloBE rules, Substance-Based Income Exclusion (SBIE) application to mobile assets, and the handling of prior year adjustments, among other items. It remains to be seen over what time frame further guidance will emerge on these matters.

# Contact us

For more information, contact a KPMG tax professional:

**Danielle Rolfes**

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

**Michael Plowgian**

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

**Kevin Brogan**

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

**Quyen Huynh**

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

**Marcus Heyland**

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

**Alistair Pepper**

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

**John DerOhanesian**

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

**Marissa Rensen**

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

**Samira Varanasi**

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

**Natalia Benedetti**

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

[www.kpmg.com](http://www.kpmg.com)

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