KPMG

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

July 2023

Introduction

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

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

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

	Issues	High-level summary of new guidance	Pages
1.	Qualifying Domestic Minimum Top-up Tax ("QDMTT")	The QDMTT was a new feature of the Model Rules in December 2021. There is a tension between allowing jurisdictions flexibility in the design of their QDMTTs, and ensuring similar rules for all QDMTTs which assists in its implementation for businesses and other revenue authorities. The guidance reflects the outcome of negotiations on that tension. The QDMTT is likely to become the central feature of the GloBE rules over time.	2
2a.	QDMTT Safe Harbour	The QDMTT Safe Harbour will switch-off the application of the GloBE Rules in other jurisdictions in favor of the jurisdiction with a QDMTT that meets certain conditions, allowing a group to undertake one GloBE computation under the QDMTT to automatically reduce its Top-up Tax in other jurisdictions to zero.	3
2b.	Transitional UTPR Safe Harbour	A new transitional safe harbour for the UTPR which will apply to a Ultimate Parent Entity ("UPE") jurisdiction where that jurisdiction has a nominal corporate income tax rate of 20% or more. This will only apply for Fiscal Years which run no longer than 12 months commencing before 31 December 2025 and ending before 31 December 2026.	6
3.	Tax credits	Provides additional guidance on the treatment of tax credits, including important new guidance on transferable tax credits, which are monetizable and not refundable. The guidance effectively extends the treatment of Qualifying Refundable Tax Credits ("QRTCs"), which are treated as akin to grants under the GloBE rules to tax credits that meet a new Marketable Transferable Tax Credit ("MTTC") standard.	6

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4.	General Currency Conversion Rules for the GloBE Rules	Adds to and clarifies previous rules on currency conversion contained in the first set of guidance.	8
5.	Substance-based Income Exclusion. ("SBIE")	Adds to and clarifies various aspects of the SBIE, including the treatment of employees and assets located in more than one jurisdiction and leases.	10

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

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

1. QDMTT

The February AG states that for a jurisdiction's Domestic Minimum Top-up Tax ("DMTT") to qualify as a QDMTT, it must provide for outcomes consistent with the GloBE Rules, which generally requires that any variations do not produce a lower liability than under the GloBE Rules. The February AG identified certain elements of a QDMTT that need to be identical to the GloBE Rules, and other elements where variations may be permissible. For more details, please refer to our report on the February AG.

The July AG supplements the earlier guidance and identifies further elements of the design of a QDMTT that would generally need to follow the GloBE principles (e.g., treatment of Flow-through Entities, Investment Entities and Multi-Parented Multinational Enterprise ("MNE") Groups). In addition, the guidance allows some flexibility for QDMTT jurisdictions where this would not impact the overall Top-up Tax liability of the Group, including options to decide whether to apply the QDMTT to certain types of entities that are subject to a standalone effective tax rate ("ETR") and Top-up Tax computation, as well as how to impose the QDMTT charge in respect of certain types of entities that may be treated as tax neutral in the QDMTT jurisdiction. The guidance also allows further variations from the GloBE Rules where particular GloBE provisions would be redundant in light of the jurisdiction's tax system (e.g., where a jurisdiction does have an Eligible Distribution Tax System).

Further notable clarifications on the operation of the QDMTT include the following items.

Application on split-ownership structures

The February AG provided that a QDMTT must be imposed with respect to 100 percent of the Top-up Tax calculated for local Constituent Entities ("CEs"), i.e., it cannot be limited to a UPE's ownership percentage in the CEs. The July AG clarifies that the same principle shall generally apply to Joint Ventures ("JVs") and Minority-Owned Constituent Entities ("MOCEs"). As such, the Top-up Tax under a QDMTT in respect of those Entities is the whole amount irrespective of the UPE's ownership percentage.

Allocation of QDMTT liability among Constituent Entities

The February AG provided discretion to QDMTT jurisdictions on how to allocate QDMTT liability between local CEs. The July AG provides some possible design options for allocating the QDMTT liability (not an exhaustive list):

- **Regular jurisdictional blending:** Allocation of the QDMTT charge pursuant to the ratio of the CE's GloBE Income to the sum of the GloBE Income of all CEs located in the jurisdiction that have GloBE Income. Alternatively, the allocation could be carried out based on the ratio of the Excess Profits of the CE to the Excess Profit of all CEs located in the jurisdiction. To prevent minority investors from bearing the QDMTT charge, jurisdictions could decide to allocate it exclusively to wholly-owned CEs.
- **Blending on entity-level:** Where a QDMTT applies on an CE-by-CE basis to the ETR calculation (i.e., no blending between CEs), the guidance proposes the allocation of the QDMTT charge only to CEs that have an ETR lower than the Minimum Rate.
- **Co-ownership rules:** The guidance proposes that the QDMTT liability be imposed on the JV, JV Subsidiary or MOCE itself to ensure that the other owners bear their share of the QDMTT liability. Where QDMTT jurisdictions allocate the tax liability to CEs of the main Group, the July AG recommends the introduction of a mechanism to avoid double taxation (e.g., where both owners of a JV are part of MNE Groups subject to the GloBE Rules or a QDMTT).

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Observation: The July AG notes that the allocation of the QDMTT charge among CEs is not binding on another jurisdiction for purposes of applying its local tax rules, including Controlled Foreign Company ("CFC") Tax Regimes, which are commonly applied on a CE-by-CE basis. As such, it will be necessary to monitor whether and how countries seek to align the allocation of QDMTT between local CEs for GloBE and CFC purposes to reduce the risk of double taxation.

Filing obligations

In the February AG, it was noted that reporting of QDMTT computations would need to be aligned with the data points that are required to compute the GloBE tax liability. However, the July AG confirms that the GloBE Information Return ("GIR") does not require QDMTT jurisdictions to use the GIR for QDMTT information collection purposes. In this respect, it has been clarified that a jurisdiction could choose to use the GIR but is also permitted to design its own local QDMTT information return that diverges from the GIR, provided that equivalent data points are used.

Observation: The explanatory notes accompanying the GIR clarify that the QDMTT Safe Harbour will not provide an exemption from the detailed reporting requirements contained in section 3 of the GIR. As such, detailed reporting in the GIR will be required in all cases where Top-up Tax is assessable under a QDMTT. In addition, MNEs may be required to complete a local QDMTT information return, depending on the requirements of the relevant jurisdiction.

Timing aspects and GloBE charging provisions

The July AG also seeks to address scenarios where an MNE Group experiences the introduction of aspects of the GloBE Rules on a phased implementation basis (e.g., a jurisdiction introduces a QDMTT for local CEs, in advance of the same CEs being caught within the scope of Income Inclusion Rules (IIRs) / UTPRs). The GloBE Rules apply certain requirements for MNE Groups in a Transition Year, with provisions applying to the treatment of deferred tax attributes and intra-group asset transfers that have arisen since 30 November 2021.

The February AG required that equivalent transition rules be included in the design of QDMTT legislation. However, in a case of phased implementation of QDMTT and GloBE charging provisions, a question arises as to how an MNE Group should transition to QDMTT and then subsequently transition for wider GloBE purposes. The July AG introduces a rule that refreshes the Transition Year for the purposes of the QDMTT when the GloBE Rules come into effect after the QDMTT.

When a new Transition Year is required, certain tax attributes that arose under the QDMTT will need to be eliminated or re-stated to ensure coordination in and after the transition year (including deferred tax attributes taken into account at the beginning of the QDMTT Transition Year as well as attributes subject to the GloBE DTL Recapture rules, GloBE Loss Election, or Excess Negative Tax Expense Carry-forward provisions).

2a. QDMTT Safe Harbour

A QDMTT should lead to outcomes consistent with the GloBE Rules. Some design variations are permitted, but these should generally not produce a lower tax liability then would be expected under the IIR or UTPR. In the absence of the QDMTT Safe Harbour any tax paid under a QDMTT will be available as a credit against the Top-up Tax liability determined with respect to that jurisdiction under the GloBE Rules, with the balance to be paid to relevant jurisdictions under the IIR or UTPR. This credit mechanism requires at least two separate Top-up Tax calculations in respect of the same jurisdiction, i.e., one for the purposes of applying the QDMTT and a separate calculation based on the GloBE Rules.

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

QDMTT Safe Harbour Eligibility Requriements

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

1) the **QDMTT Accounting Standard**, which requires a QDMTT to be computed based on the UPE's Financial Accounting Standard or a Local Financial Accounting Standard subject to certain conditions.

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2. the **Consistency Standard**, which requires the QDMTT computations to be the same as the computations required under the GloBE Rules except where the relevant Commentary explicitly requires a QDMTT to depart from the GloBE Rules or where the Inclusive Framework decides that an optional variation that departs from the GloBE Rules still meets the standard; and
3. the **Administration Standard** which requires the QDMTT jurisdiction to meet the requirements of an on-going monitoring process similar to the one applicable to jurisdictions implementing the GloBE Rules.

Observation: It will be interesting to monitor whether jurisdictions that have already published (draft) legislation will adjust their domestic Top-up Tax to ensure alignment with the QDMTT Safe Harbour standards. The EU Directive implementing the GloBE Rules already provides for a QDMTT Safe Harbour, which was designed and adopted in 2022 and is therefore not fully aligned with the July AG. The EU Safe Harbour requires only that the QDMTT is computed in accordance with the parent entity's acceptable accounting standard or IFRS and does not refer to these newly-introduced tests. It remains to be seen how EU Member States will adapt to the new standards.

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

The QDMTT Accounting Standard

The general rule with respect to the financial accounts to be used when determining the amount of GloBE Income or Loss of a CE under the GloBE Model Rules requires an MNEs to use the accounts used in preparing the Consolidated Financial Statements of the UPE. An exception to this rule deals with situations where the CE maintains its financial accounts using an accounting standard that is different from the UPE's Financial Accounting Standard and it is not reasonably practicable to accurately calculate its Financial Accounting Net Income or Loss ("FANIL") in conformity with the UPE's Standard. In such cases, the FANIL may be determined using another Acceptable Financial Accounting Standard or Authorised Financial Accounting Standard (adjusted for Material Competitive Distortions). Similarly, a QDMTT will meet the QDMTT Accounting Standard if it is based on accounts and the financial accounting standard used for purposes of the Consolidated Financial Statements of the UPE, except where it is not reasonably practicable to use such accounts.

A secondary provision — the Local Financial Accounting Standard Rule, has been designed to address situations where a GloBE jurisdiction has opted to require for the QDMTT to be based on a Local Financial Accounting Standard. In such cases, the QDMTT Safe Harbour will be available only where:

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

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

Observation: The intention here is to only allow the requirement for the QDMTT to be based on Local Financial Accounting Standards where CEs already prepare accounts based on these standards. Based on the wording of the QDMTT Accounting Standard Safe Harbour provision, the full range of jurisdictions which would be able to choose to base their QDMTT on the Local Financial Accounting Standard is not readily apparent. This is an area that will need to be monitored closely over the coming months, as the legislative process in many jurisdictions progresses.

The Consistency Standard

A QDMTT meets the Consistency Standard if the computations under the QDMTT are the same as the computations required under the GloBE Rules, except where the QDMTT Commentary explicitly requires the QDMTT to depart from the GloBE Rules. An example of a mandatory variation is the requirement for the QDMTT not to take into account the allocation of CFC taxes incurred by a Parent Entity with respect to the income of foreign CEs. This exclusion is needed to maintain the ordering rule aimed at attributing primary taxing rights to the jurisdiction applying the QDMTT.

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

a. No, or a more limited, SBIE;

b. No, or a more limited, De Minimis Exclusion; and

c. A minimum tax rate above 15% for purposes of computing the Top-up Tax Percentage for the jurisdiction.

Observation: Additional acceptable variations that depart from the GloBE Rules may be added to this list in future. The July AG also clarifies that the Consistency Standard is generally deemed to be met where the QDMTT jurisdictions decides to not apply the QDMTT in certain specific circumstances that are addressed in the July AG (e.g., on Flow-through Entities created in the QDMTT jurisdiction, on Investment Entities). However, under a Switch-off Rule, the MNE Group will be required to apply the credit method for the QDMTT (i.e., the exemption method under the Safe Harbour is switched off) in relation to either all or a subset of CEs located or created in the QDMTT jurisdiction in such cases. The July AG notes that the IF will consider providing further guidance on the scope of the Switch-Off Rule.

The Administration Standard

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

A QDMTT Safe Harbour jurisdiction will, however, be allowed not to apply the simplified reporting framework available under the GIR:

a. when Top-up Tax arises under the QDMTT; or

b. where the financial information used for the purposes of the QDMTT Safe Harbour is already reported at the CE level and the compliance rules in the jurisdiction require taxable entities to file information returns or tax returns for each entity for local tax purposes.

Peer review

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

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

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

Observation: It is expected that the transitional review process could be based on a jurisdiction's self-assessment against a specified set of criteria. If this is the case, it will be important for MNE Groups to be able to rely on this assessment, and that if the peer review process reaches a different conclusion this would only effect the prospective application of the GloBE Rules.

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2b. UTPR Safe harbour

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

Interaction with the Transitional CbCR Safe Harbour

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

Observation: In practical terms, the Transitional UTPR Safe Harbour is beneficial in circumstances where:

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

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

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

3. Tax Credits

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

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

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

Marketable Transferable Tax Credits ("MTTCs")

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

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In the hands of an originator, MTTCs are treated (favourably) as an increase to GloBE Income. If the originator uses the credit, it includes the face value of the tax credit in GloBE income. If the originator transfers the MTTC, the originator includes the transfer price (rather than face value) in income. A purchaser of a MTTC includes the difference between the purchase price and the face value of the MTTC in its GloBE income when – and in proportion to the amount of the tax credit – the purchaser uses the credit to satisfy its Covered Tax liability.

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

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

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

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

Qualified Flow Through Tax Benefits ("QFTBs")

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

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

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

Categories of tax credits under the GloBE Rules

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

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

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

4. Foreign Currency Conversion Rules

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

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

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

A series of examples in the July AG seek to show the operation of the currency translation rules.

The July AG also makes clear that the adjustment to GloBE Income for Asymmetric Foreign Currency Gains or Losses is determined with reference to the accounting and tax functional currencies of the CE. However, the resulting amount of the required adjustment will need to be translated to the presentation currency of the MNE Group.

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

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5. Substance-based Income Exclusion

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

Location

The SBIE is based on 50% on the extended payroll of the Eligible Employees that perform activities in the jurisdiction of a CE and 50% on the carrying value of the Eligible Tangible Assets located in the jurisdiction. In the first year, the SBIE is calculated based on 10% of the Eligible Payroll Costs which reduces to 5% over 10 years and 8% of carrying value of the Eligible Tangible Assets which reduces to 5% over 10 years.

There are often circumstances where an employee or an in-scope contractor works outside the jurisdiction, say because they work from home in another jurisdiction; or are seeing customers or suppliers outside the jurisdiction; or international travel is central to the business such as international transportation; or they may work in international waters.

Similarly, Eligible Tangible Assets may be located outside a CE jurisdiction because say they are used in international transportation; or used in multiple jurisdictions such as a submarine cable or farming equipment.

The July AG provides a similar test for both payroll and assets. If an Eligible Employee spends more than 50% of their time in the CE jurisdiction the whole of their eligible costs are allocated to that jurisdiction. If it is less than 50%, then the portion of their time referable to that jurisdiction will be available for the payroll carve-out.

Similarly for tangible assets, if more than 50% of the use of tangible assets is referable to the jurisdiction, all of the carrying value of the tangible asset is available for the carve-out. If it is less than 50%, then the actual proportionate use is available.

Observation: The above rules may not produce appropriate answers for the shipping and airline industries, given the amount of time 'in port' for ships or 'on the ground' for aircraft. These industry specific issues may be dealt with in future guidance.

Simplification

While a CE may make an election not to apply the SBIE, there was a question of whether they would need to undertake a full calculation of the relevant payroll costs and tangible assets if they did apply the SBIE. The July AG clarifies that an MNE Group could elect to calculate its SBIE by reference to only a proportion of its Eligible Employees or Eligible Tangible Assets.

Observation: The July AG provides the sensible position that MNEs are not required to calculate the maximum allowable claim if they are to claim under the SBIE. Thus, an MNE may not wish to include in-scope independent contractor costs if the compliance costs of doing so exceed the likely benefit.

Stock-based compensation

For stock-based compensation the GloBE rules use the amount in the financial statements to determine a Constituent Entities Financial Accounting Net Income or Loss. Under the GloBE rules, MNEs may elect to adopt a methodology that reflects the local taxation treatment. However, for the purpose of the SBIE, MNEs are required to use the amounts contained in the financial accounts and not amounts which are modified by the election where adopted.

Deductible Dividend Regimes

Where an Ultimate Parent Entity is subject to a Deductible Dividend Regime and distributes a Deductible Dividend the amount of its GloBE income is reduced by the amount of the Deductible Dividend. The rules provide that a proportionate amount of Eligible Payroll Costs and Eligible Tangible Assets is also reduced to ensure that these costs are not disproportionately large compared to GloBE Income.

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Leases

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

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

This Commentary has been withdrawn and replaced by a more nuanced set of rules. They are as follows:

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

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

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

Impairment losses

For the purposes of determining the carrying value of Eligible Tangible Assets required for the SBIE, both impairment losses and the reversal of impairment losses will be included provided the reversal does not mean that the carrying value would be exceeded if there was no impairment loss.

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