

OECD Release of Administrative Guidance outlining an extension of the limitation of the use of deferred tax assets under the transitional rules (Article 9.1)

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On January 15, 2025, the Inclusive Framework (IF) on BEPS released Administrative Guidance (AG5) on a specific provision dealing with the use of deferred tax assets under the GloBE transitional rules. Other material concerning the GloBE Information Return, the qualification process and exchange of information were also released. This brief focuses on the guidance on deferred tax assets under Article 9.1.

Background

The GloBE rules use deferred tax accounting concepts to deal with temporary differences and carried forward losses. In order to minimize distortions and for simplification, transitional rules allow pre-GloBE deferred tax assets arising from temporary differences and carryforwards to be carried into the GloBE regime and used in the calculation of the effective tax rate (ETR) of a Constituent Entity of a relevant group (CE). As those deferred tax assets reverse in an accounting period, there is a deferred tax expense which, when added to the current tax expense, lifts the ETR for that period.

However, Article 9.1.2 of the model rules 'undoes' certain deferred tax assets relating to transactions that occurred after 30 November 2021 that are perceived to give rise to tax advantages which are not considered to be 'economic'. An example is an investment allowance giving rise to super deductions.

However, Inclusive Framework were concerned that other governments have put in place rules that gave rise to tax benefits resulting in deferred tax assets prior to a CE entering the GloBE rules. Those deferred tax assets would reverse once the GloBE regime was operating, thereby increasing deferred tax expense and the CE's ETR in a manner that some governments considered to be inconsistent with the objectives of the GloBE rules.

In response, AG5 sets out additional rules that effectively exclude deferred tax assets from recognition under the transitional rules, including in the three scenarios outlined below. However, deferred tax assets in these three scenarios are subject to a grace period and limitation, which provide partial benefits.

Scenarios for an extension of the 9.1.2 limitation

The three scenarios are as follows:

- Where a deferred tax asset is attributable to a government arrangement concluded after 30 November 2021 and the arrangement gives rise to a tax credit or other tax relief (such as a tax basis step-up) that does not arise independently of the arrangement. A tax credit or relief arises independently of a government arrangement if no critical aspect of the credit or relief, such as the eligibility or amount, relies on discretion exercised by the general government. (First scenario – non-independent tax benefit).
- Where a deferred tax asset is attributable to an election or choice exercised or changed after 30 November 2021 which retroactively changes the treatment of a transaction in determining its taxable income in a tax year for which an assessment has been made or tax return has already been filed. (Second scenario – retroactive election).

- Where a deferred tax asset or deferred tax liability arose pursuant to a corporate income tax that was enacted by a jurisdiction that did not have a pre-existing corporate income tax that became effective after 30 November 2021 and before the Transition Year (as defined). Carry-forward losses are subject to a rule which is discussed below. (Third scenario – no preexisting corporate income tax).

Grace Period Limitation

The rules generally limit the benefit of deferred tax assets attributable to the three scenarios to a cap (the Grace Period Limitation) equal to 20% of the amount of each deferred tax asset originally recorded (with the deferred tax asset measured at the lower of 15% or the applicable domestic tax rate).

The period in which the 20% allowable cap must be used depends on the scenario. For the first and second scenarios – non-independent tax benefit & retroactive elections - the deferred tax expense must be attributable to a reversal in Fiscal Years beginning on or after 1 January 2024 and before 1 January 2026, but not including a Fiscal Year that ends after 30 June 2027. For the third scenario – no pre-existing corporate income tax - the Grace Period is for Fiscal Years beginning on or after 1 January 2025 and before 1 January 2027, but not including a Fiscal Year that ends after 30 June 2028.

For the first and second scenarios, the Grace Period Limitation is not available if the government arrangement is concluded or amended, or the election or choice is made after 18 November 2024. Also the Grace Period Limitation does not allow for the improvement of a position, absent the new restrictions. That is, it does not undo restrictions already embedded in the rules.

For what tests do the new rules apply?

The extension of 9.1.2 under AG5 to deny the benefit of certain deferred tax assets applies for the main Model Rules under the IIR and the UTPR and Transitional CbCR Safe Harbour. They will also apply to the QDMTT Safe Harbour, such that if the rules are breached, the Switch-off mechanism will apply to undo the benefit of the QDMTT Safe Harbour and impose a credit methodology.

Additional five year limitation on losses where there is a new corporate tax regime

AG5 provides that 9.1.2 will not preclude a government that is introducing a new corporate tax regime from allowing for carry forward losses, provided the losses do not exceed five years preceding the effective date of the new corporate income tax.

Further work on Related Benefits

AG5 notes that the IF is developing further guidance on identifying benefits that must be treated as a refund of tax that reduces Adjusted Covered Taxes (e.g., tax credits, government grants, and other benefits that are calculated based on income or taxes). It notes that the definition of 'Tax' in the GloBE Model Rules includes only compulsory 'unrequited' payments to General Government.

In addition, AG5 states that the IF is developing further guidance on the concept of "Related Benefits" and the impact of such benefits on the qualified status of a jurisdiction's rules. Under previous Commentary, if there are Related Benefits in a specific jurisdiction, it may impact the qualified status of the jurisdiction's rules for the purpose of the operation of Qualified Domestic Minimum Top-up Tax Safe Harbour.

KPMG Observations

Some MNEs will welcome the fact that the carry forward of losses from the preceding five years will be allowable under the transitional GloBE rules where a new corporate income tax regime has been established. However, for some MNEs the denial of the deferred tax expense attributable to the three scenarios called out above may lead to additional top-up tax.

Actions for companies

MNEs need to review the potential operation of the changes to 9.1.2, both for the purposes of the operation of the Transitional Safe Harbour and the basic operation of the Model Rules. This may involve additional calculations to utilize the benefits of the Grace Period.

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