Pillar Two and tax incentives

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This article provides an analysis of how the application of different types of tax incentives may trigger a potential Top-up Tax exposure for MNE Groups in scope of the GloBE rules. Moreover, the article discusses how countries may be incentivized to adjust their tax system to ensure tax incentives remain effective and efficient following the implementation of Pillar Two.

Key takeaways:

- The aim of Pillar Two is to ensure a global minimum corporate income tax rate of 15 percent for in-scope MNE Groups. In very simple terms, this is achieved by determining the combined effective tax rate (ETR) of all of the Constituent Entities located in a specific jurisdiction, comparing the resulting blended rate to the minimum rate and establishing a Top-up Tax where the 15 percent minimum is not achieved.

- Even where the local statutory corporate tax rate is 15 percent or higher, Top-up Tax may be triggered due to reduced rates applicable to certain categories of income (e.g., IP boxes) or other types of tax incentives provided under local law. Please refer to the examples in Chapter 3 for further details.

- Incentives will result in a lower impact on the jurisdictional ETR where they trigger (short-term) temporary book-to-tax differences, which are recognized under Pillar Two via deferred tax accounting. This is the case of, for example, accelerated depreciation or immediate expensing rules. On the other hand, incentives that generate a permanent book-to-tax difference – such as tax holidays, tax allowances, notional interest deductions will have a downward impact on the ETR. Please refer to the examples in Chapter 3 for further details.

- Incentives such as grants, subsidies and certain types of tax credits, will generally have a lower impact on the ETR where they are treated as an increase to GloBE Income (e.g., grants, subsidies, qualified refundable tax credits, marketable transferrable tax credits) compared to those treated as a reduction to Covered Taxes (e.g., non-qualifying tax credits). Please refer to the examples in Chapter 3 for further details.

- The impact may be limited where incentives or special tax treatments are related to types of income that are excluded for GloBE purposes (e.g., shipping income) or that are subject to similar GloBE adjustments (e.g., excluded equity gains).

- The impact of an incentive available to certain entities in a jurisdiction may be further limited where the profits of other Constituent Entities in the same jurisdiction are effectively taxed at higher rates (i.e., because they do not benefit from incentives). Due to the jurisdictional blending approach, a lower ETR in one Constituent Entity may be offset by a higher ETR in other entities in the same jurisdiction. This will particularly be the case where the headline corporate tax rate is high.

- The impact may also be limited where the incentives focus on investments in tangible assets and labour. Under the Substance-based Income Exclusion (SBIE), profits to which the Top-up Tax rate applies are reduced by a markup on the carrying value of eligible tangible assets and eligible payroll costs. The markups are initially 8 percent for tangible assets and 10 percent for payroll – with both metrics reducing over a ten-year period to 5 percent). The resulting Top-up Tax amount will therefore be lower where the SBIE is high, i.e. where the value of assets and payroll are higher.

- Incentives that drive the GloBE ETR below the 15 percent minimum rate will result in a Top-up Tax liability, which offsets a proportion of the tax benefit. Jurisdictions implementing Pillar Two and that wish to continue to issue incentives as a policy tool will be interested in reforming existing incentives that are no longer efficient in the new Pillar Two environment. This may include incentives that allow the faster recovery of costs related to tangible assets (e.g. accelerated depreciation and immediate write-offs), refundable tax credits to support employment opportunities, training, infrastructure and innovation, improved expat income tax incentives (can allow for reduction of salary costs to MNEs) or social security contribution (SSC)-related reliefs, non-tax related incentives such as government loans or grants for green investments.

- However, the intention of the GloBE rules is not to replace a perceived "race to the bottom" on CIT tax rates with a race to the bottom on incentives.

As such, the OECD is likely to review local incentives to ensure that those policies will be aligned with the goals of the BEPS project and do not result in unintended or conflicting outcomes.

- While only a limited number of countries have so far announced concrete measures to address Pillar Two implications for existing local incentives, there is a trend of introducing a Domestic Minimum Top-up Tax (DMTT) to ensure that Top-up Tax revenue in respect of local low-tax profits is not collected in other jurisdictions.

01 What is the general concept of Pillar 2?

The aim of Pillar 2 is to ensure a global minimum effective tax rate of 15 percent for MNEs (and – in some jurisdictions, including those in the EU, large-scale domestic groups) with at least EUR 750 million in consolidated revenues, by imposing an additional tax on the low-taxed income of Constituent Entities.

For this purpose, it is necessary to calculate the ETR of all of the Constituent Entities located in a jurisdiction (jurisdictional blending) and to compare it to the Minimum Tax Rate of 15 percent. The ETR for a jurisdiction is equal to the sum of the adjusted Covered Taxes (the numerator) divided by the GloBE Income or Loss of Constituent Entities located in the jurisdiction (the denominator).

If the ETR is lower than the Minimum Tax Tate, and if Excess Profits remain after deducting the SBIE, a Top-up Tax is levied to achieve the required minimum taxation. The SBIE is determined as a markup on the carrying value of eligible tangible assets and eligible payroll costs

The markups are initially 8 percent for tangible assets and 10 percent for payroll – both metrics reduce over a ten-year period to 5 percent.

Top-up Tax may not apply where an MNE Group can benefit from the de-minimis exclusion (where it has less than EUR 10 million of revenue and EUR 1 million of profit in a jurisdiction) or Safe Harbour rules (e.g., transitional Country-by-County (CbyC) Reporting Safe Harbour, transitional Undertaxed Profits Rule (UTPR) Safe Harbour) that reduce the Top-up Tax to zero.

The individual Constituent Entities of a group of companies within the scope of the GloBE rules are obliged to submit a GloBE Information Return in their respective country of residence. However, it is also possible that, under certain conditions, the declaration is submitted by the Ultimate Parent Entity (UPE) in its country of residence or that another legal entity is named for this purpose. The returns must be filed within 15 months of the end of the financial year to which they relate.

02 How is the GloBE ETR calculated?

Once it has been determined that an MNE Group falls within scope of the GloBE rules, the next step is to determine whether the ETR for each jurisdiction in which the group operates is less than the agreed minimum tax rate of 15 percent. The ETR for a jurisdiction is equal to the sum of the adjusted Covered Taxes (the numerator) divided by the GloBE Income or Loss of Constituent Entities located in the jurisdiction (the denominator).

GloBE Income or Loss (denominator)

The starting point for determining GloBE Income or Loss is the financial accounting net income or loss (FANIL) of a Constituent Entity. This is determined based on the Consolidated Financial Statements (CFS) of the UPE before any consolidation adjustments (i.e., the stand-alone accounts including the effect of intra-group transactions). Under certain conditions, the FANIL of a Constituent Entity can also be determined based on an acceptable accounting standard that is different to the one applied by the UPE.

The GloBE Income or Loss of each Constituent Entity is determined by making certain adjustments to its FANIL in order to arrive at a determination of its GloBE Income or Loss (see table 1 for further detail). The adjustments made to convert FANIL to GloBE Income are intended to better align the tax base for the global minimum tax with those that are typically applied for local tax purposes. Many jurisdictions, for example, exempt (or provide other relief) for intra-group dividends and capital gains in relation to equity investments or apply special rules for calculating the deduction attributable to stock-based compensation.

In addition, the Model Rules provide for a safeguard provision in respect of tax credits to reduce the risk of them being used to distort the ETR calculation. Certain qualifying tax credits are treated as income for GloBE purposes, whereas other tax credits reduce the amount of Adjusted Covered Taxes.

Financial accounting income

- The starting point for determining the GloBE tax base in the profit (or loss) of a Constituent Entity as determined for preparing the CFS of the UPE before any consolidated adjustment (i.e., stand alone accounts including result inter-company transactions).
- The relevant financial accounting standard for calculation the GloBE tax base is, in general, the financial accounting standard used by the UPE.
- However, entity-level financial information can also be used, even if such financial information is not prepared in strict accordance with the parent's financial accounting standard where:

  a. the financial accounts of the Constituent Entity are maintained based on another "acceptable financial accounting standard",

  b. the information is reliable, and

  c. permanent differences in excess if EUR 1 million are conformed to the treatment required under the accounting standard of the parent.

- The Commentary notes that this rule is not expected to apply in many cases because an MNE Group will typically have mechanisms in place to convert stand-alone accounts to the UPE's accounting standard when preparing CFS.

Additions

+ Net taxes expenses
+ Policy disallowed expenses
+ Expenses attributable to intra-group financing arrangements

Reductions

– Excluded dividends

– International shipping income

– (Optional) exclusion of debt release income

± Excluded equity gains/losses

± Adjustment in respect of tax credits

± Adjustments in respect of gains/losses from disposition of assets and liabilities

± Asymmetric foreign currency gains/losses

± Included revaluation method gain/losses

± Accrued pension expense

± Prior period error and changes in accounting principles

± Transactions between members of the MNE Group

± Adjustments for increase/ decrease in insurance company's liability to policy holders

± Adjustments for distributions paid or payable/received in respect of additional tier one capital

± (Optional) adjustments for stock-based compensation expenses

± (Optional) consolidated accounting treatment

± (Optional) adjustments for aggregate asset gains

± (Optional) adjustments for fair value or impairment accounting.

± Allocation adjustments in respect of flow-through entities and permanent establishments

± Adjustment in respect of deductible dividend regimes

± Further adjustments in accordance with Article 6 and 7 of the Model Rules.

Table 1: Calculation of GloBE Income or Loss

Covered Taxes (numerator)

The starting point for the calculation of the ETR numerator is the amount of Covered Taxes that is included in the FANIL calculation in the financial statements, which includes deferred tax adjustments and the tax benefit of any losses. As with the calculation of GloBE Income, the amount of Covered Taxes is subject to a number of adjustments, including reductions for tax expenses relating to excluded income (for example, non-portfolio dividends) and uncertain tax positions, as well as accrued taxes that are not paid within three years.

Covered Taxes also take account of deferred taxes (i.e., differences between the recognition in the timing of receipts and expenses for tax and financial reporting purposes as well as the impact of the utilization of tax losses). The fact that the GloBE rules take into account movements in deferred tax assets and liabilities recorded in the financial accounts, allows the rules to accommodate these timing differences without giving rise to Top-up Tax.

Certain adjustments are made to the existing deferred tax accounts to protect the integrity of the GloBE rules. For example, the credit for deferred tax liabilities is capped at the minimum rate in order to prevent any excess tax sheltering unrelated income (recast mechanism). The rules also include a recapture mechanism that adjusts for certain deferred tax liabilities that have not reversed (i.e., the tax has not actually been paid) within five years.

The Model Rules also require adjustments to Covered Taxes where it is necessary to allocate Covered Taxes from one Constituent Entity to another either because of the nature of the taxpayer (for example, flow-through entities, hybrid entities or PEs) or because of the cross-border character of the tax (for example, controlled foreign company (CFC) rules and withholding taxes).

Covered Taxes	Additions	Reductions
Covered Taxes include: a. Taxes recorded in the financial accounts of a Constituent Entity with respect to income or profits b. Taxes on distributed profits imposed under an Eligible Distribution Tax System c. Taxes imposed in lieu of a generally applicable corporate income tax d. Taxes levied by reference to retained earning and corporate equity, including a Tax on multiple components based on income and equity Covered Taxes do not include: a. Top-up Tax accrued by Parent Entity under Qualified IIR b. Top-Up Tax accrued by a Constituent Entity under a Qualified Domestic Minimum Top-Up Tax c. Taxes attributable to an adjustments made by a Constituent Entity as a result of the application of a Qualified UTPR d. A Disqualified Refundable Imputation Tax e. Taxes paid by an insurance company in respect of returns to policyholders	+ (Optional) GloBE Loss Deferred Tax Asset + Covered Taxes relating to payments for an uncertain tax position which was treated as a reduction to Covered Taxes in a prior Fiscal Year	– Covered Taxes relating to excluded GloBE Income or Loss – Covered Taxes in respect of any net gain or loss adjustments resulting from the aggregate asset gain election – Currents tax expense relating to an uncertain tax position – Current tax expense that is not expected to be paid within 3 years of the last day of the fiscal Year – Excess net tax expense carryforward
	± Adjustments in respect of tax credits and refunds ± Allocation adjustments in respect of cross-border taxes ± Allocation adjustments in respect of flow-through entites and permanent establishments ± Total Deferred Tax Adjustments Amount ± Post-filing Adjustments ± Covered Taxes recorded in equity or other comprehensive income relating to amounts in the GLoBE Income or Loss computation that will be subject to tax under local tax rules.	

Table 2: Calculation of Adjusted Covered Taxes

03 To what extent do certain types of tax incentives trigger Top-up Tax liability?

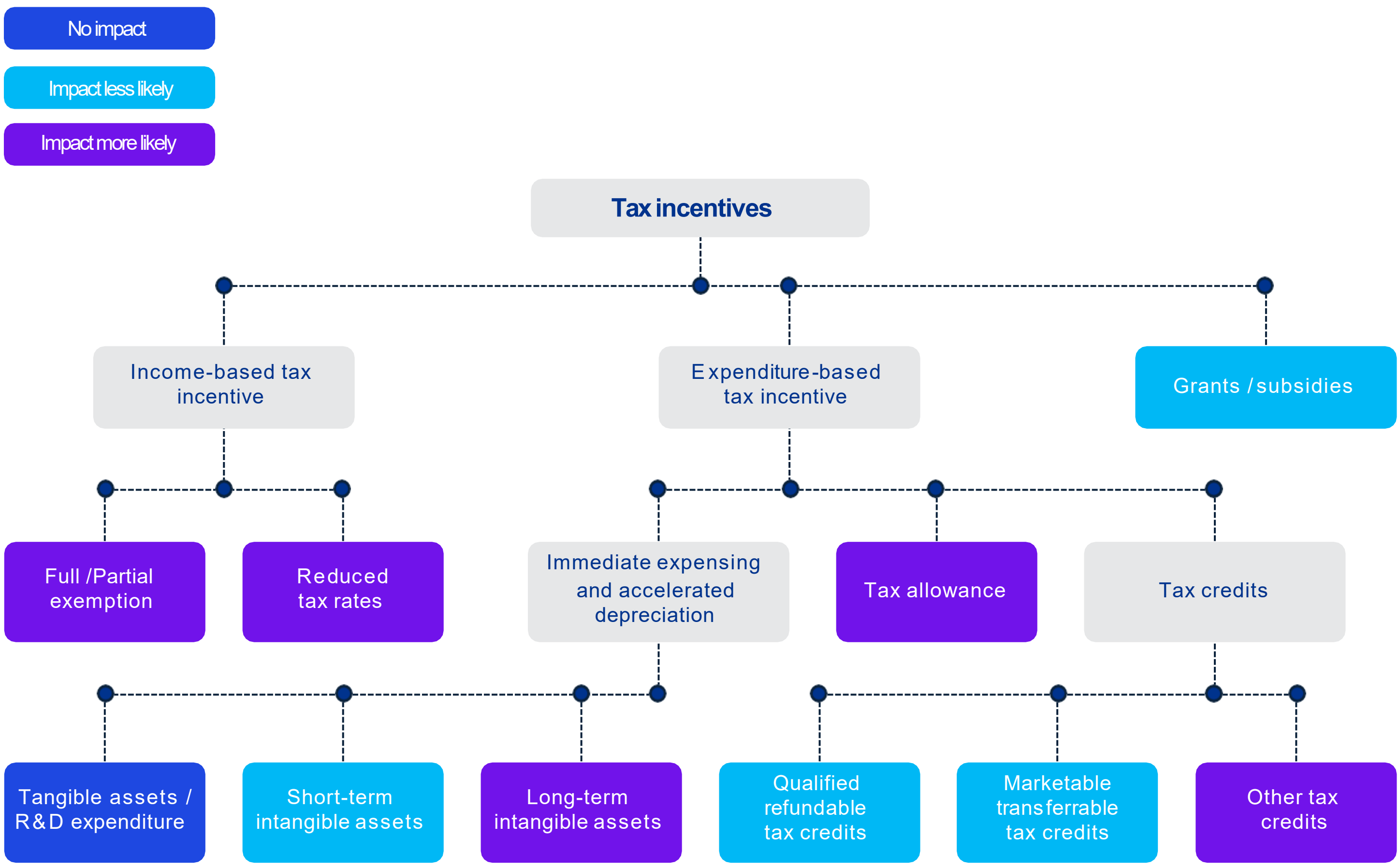
Where a jurisdiction’s statutory corporate income tax is set at a rate below 15 percent, MNE Groups are likely to be subject to Top-up Tax with respect to operations in that jurisdiction. However, more commonly, jurisdictions apply rates below 15 percent only to special categories of income and/or provide under local law certain tax deductions or credits (i.e., base modifications) in relation to either the income or expenditure side of the profit and loss statement.[1]

In order to determine to what extent an incentive may contribute to a Top-up Tax liability (i.e., whether the MNE Group has low-tax profits within the jurisdiction), it is necessary to look at both the applicable tax rate in the jurisdiction as well as the tax base.

The impact on the GloBE ETR depends on the type and design of preferential rates or base modifications, as illustrated in the following diagram.

The following section provides a high-level assessment of the impact of certain categories of tax incentives (assessed in isolation, i.e., without taking into account potential other income streams of the Constituent Entity that are subject to a higher effective taxation).

1 As an example, the OECD Corporate Tax Statistics 2024 indicate that R&D tax incentives have reduced the “*effective average tax rate*” to 14.2% in 2023.



* Depending on whether jurisdictional blending with other group member is possible under GloBE and to the extent the Substance-based Income Exclusion reduces the excess profits. Country exposure to de-minimis exclusion may also influence the impact of tax incentives.

Table 3: Different types of tax incentives and their impact on the GloBE ETR

Example 1: Tax holidays

Tax holidays are often used by developing countries and are directed to new firms or taxpayers that invest in certain areas or types of activities, which are exempt from income taxation, either permanently or for a specified period of time (potentially followed by low tax rates for additional years).

The income that is subject to those tax exemptions should generally be reflected in the Constituent Entities' FANIL.

Since the GloBE rules generally do not provide for any base adjustments in this respect (only a limited amount of exclusions is provided, e.g., for qualifying income and gains from equity investments and shipping activities), the exempted income is also reflected in the GloBE Income.

However, no corresponding Covered Tax is recognized, due to the availability of the tax holidays.

As such, tax holidays create a **permanent book-to-tax difference** that increases the GloBE ETR denominator without a corresponding increase in the ETR numerator, therefore reducing the GloBE ETR. Depending on the headline tax rate and the presence of other group entities in the same jurisdiction – the taxed results of which could serve to increase the overall jurisdictional ETR through blending, such tax holidays could result in a Top-up Tax liability.

	Country A	Country B	Country C
Domestic tax rate	30%	20%	20%
Profit before tax in financial accounts **(=GloBE Income)**	100	200	100
Less: income subject to tax holiday	(50)	(50)	(50)
Local tax base for current tax expense	50	150	50
Current tax expense **(= Covered Taxes)**	15	30	10
Effective Tax Rate	**15%**	**15%**	**10%**
Top-Up Tax	**0**	**0**	**5**

Example 2: IP regimes

Another common example of tax incentives is a preferential treatment of intellectual property (IP) income – commonly referred to as "patent boxes," "IP boxes," "innovation boxes," or "knowledge development boxes". Under this type of regimes, qualifying IP income is either (partially) exempt or subject to a reduced tax rate.[2]

Similar to Example 1, the income that is subject to a reduced rate or that is (partly) excluded for local tax purposes should generally be reflected in full in the Constituent Entities' FANIL and also in the GloBE Income (no GloBE adjustment available).

The GloBE rules also do not provide for any corresponding adjustment to the amount of Covered Tax that are recognized in the FANIL.

As such, IP regimes that drive the ETR below 15 percent on a standalone basis may give rise to a Top-up Tax liability depending on the tax rate that applies to other types of taxable income and the presence of high-taxed group entities in that jurisdiction.

	Country A	Country B	Country C
Domestic tax rate	30%	20%	20%
Profit before tax in financial accounts **(= GloBE Income)**	100	200	100
there of IP income (subject to preferential rate of 5%)	50	50	50
Tax expense on ordinary income	15	30	10
Tax expense on IP income	3	3	3
Currect tax expense **(= Covered Taxes)**	18	33	13
Effective Tax Rate	**18%**	**16%**	**13%**
Top-Up Tax	**0**	**0**	**2.5**

Example 3: Notional interest deduction regime

Within the EU, several countries provide for a tax allowance for equity financing, commonly referred to as notional interest deduction (NID) regimes. While the measures differ in policy design, they broadly allow tax deductions equal to the amount of equity increases multiplied by a notional interest rate.[3]

The notional interest deduction is only relevant for local tax purposes and would otherwise not be reflected in the Constituent Entities' FANIL.

In other words, the GloBE Income will not be adjusted to reflect the lower tax base, whereas the deduction reduces the amount of tax that the entity pays and therefore the tax expense that is reflected in the FANIL and hence the amount of Covered Tax.

As such, a NID regime triggers a **permanent book-to-tax difference** that has a negative impact on the GloBE ETR and may give rise to Top-up Tax depending on the tax rate that applies to the overall taxable income and the presence of high-taxed group entities in that jurisdiction.

[2] The OECD Tax Statistics Database contains information on 61 IP regimes that were in place in 46 different jurisdictions in the year 2024. According to the OECD Corporate Tax Statistics 2024, 43 of these regimes have been found to be not harmful by the Forum on Harmful Tax Practices. Those regimes offer tax benefits that range from a full exemption to a reduction of about 40 percent of the standard tax rate that would have otherwise applied (reduced rates range from 0 to 18.75 percent). Five of the six regimes that are in the process of being amended or eliminated offer a full exemption from taxation for IP income.

[3] According to the OECD **Corporate Tax Statistics 2023**, among all 89 jurisdictions covered for 2022, the following eight jurisdictions had an allowance for corporate equity: Belgium, Cyprus, Italy, Liechtenstein, Malta, Poland, Portugal and Türkiye. The report highlights that the inclusion of such provisions in their tax code has led to an additional reduction in their "effective average tax rates" of between 0.2 to 4.5 percentage points. In 2022, the European Commission issued a Directive proposal for a common equity allowance (see Euro Tax Flash **Issue 475**). Discussions at Council level are currently suspended in relation to this so-called debt equity bias reduction allowance (DEBRA) proposal. Meanwhile, Italy (as from 2024) and Belgium (as from 2023) have repealed their NID regimes. By contrast, the Portuguese NID regime was amended in the 2023 Budget law taking into account proposed DEBRA elements. The 2024 Budget proposed further amendments to enhance the Portuguese equity allowance. It therefore remains to be seen whether the position of member states on the DEBRA initiative has evolved since the proposal was put on hold in December 2022.

	Country A	Country B	Country C
Domestic tax rate	30%	20%	20%
Profit before tax in financial accounts **(= GloBE income)**	100	200	100
Less:Notional interest deduction	(50)	(50)	(50)
Equity increase	1,000	1,000	1,000
Notional interest rate	5%	5%	5%
Local tax base for current tax expense	50	150	50
Current tax expense **(= Covered Taxes)**	15	30	10
Effective Tax Rate	**15%**	**15%**	**10%**
Top-Up Tax	**0**	**0**	**5**

Example 4: Investment allowance

Investment allowances are used to reduce the taxable income of the entity with reference to the value of expenditures on qualifying investments (frequently referred to as “super deductions”).

Similar to the case of NIDs described above, where the tax deductions in excess of the economic expenditure are allowed (e.g., deduction of 200 percent of eligible incurred costs), the excess amount creates a permanent difference for GloBE purposes, i.e. a deduction that is reflected in the tax accounts but not accounted for in the financial statements.

Such **permanent book-to-tax difference** would have a downward impact on the GloBE ETR and may give rise to Top-up Tax depending on the tax rate that applies to the overall taxable income and the presence of high-taxed group entities in that jurisdiction.

	Country A	Country B	Country C
Domestic tax rate	30%	20%	20%
Profit before tax in financial accounts **(= GloBE Income)**	100	200	100
Add: Investment expenditure	50	50	50
Less: Tax investment expenditure (200%)	(100)	(100)	(100)
Local tax base for current tax expense	50	150	50
Current tax expense **(= Covered Taxes)**	15	30	10
Effective Tax Rate	**15%**	**15%**	**10%**
Top-Up Tax	**0**	**0**	**5**

Example 5: Accelerated depreciation and immediate expensing

Another common incentive is accelerated depreciation, whereby the cost of an asset may be depreciated for tax purposes at a rate that is faster than the economic rate of depreciation.[4] This may take the form of a shorter period of depreciation, a different method of depreciation (e.g., double declining balance) or a special deduction in the first year (e.g., immediate expensing).

Accelerated depreciation only triggers a **temporary book-to-tax difference**, which will generally be “neutral” for GloBE purposes due to the use of adjustments for deferred tax, provided that the difference reverses within five years (i.e., the tax liability is settled within this period).

However, this five-year recapture of unpaid deferred tax liabilities does not apply to an agreed list of “recapture exception accruals” under the Model Rules. This includes, for example, tax systems that provide for accelerated tax depreciation of certain tangible capital assets. As such, such incentives would not impact the GloBE ETR.

4 According to the OECD [Corporate Tax Statistics 2024](), 79 of the 90 jurisdictions covered for 2023 provide for accelerated depreciation mechanisms.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Domestic tax rate	30%	30%	30%	30%	30%	30%	30%	30%
Asset (tax value)	800	600	400	200	0	0	0	0
Asset (book value)	875	750	625	500	375	250	125	0
Profit before tax in financial accounts **(= GloBE income)**	100	100	100	100	100	100	100	100
Add: accounting depreciation	125	125	125	125	125	125	125	125
Less: tax depreciation	(200)	(200)	(200)	(200)	(200)	0	0	0
Local tax base for current tax expense	25	25	25	25	25	225	225	225
Timing difference liability (asset) on assets	75	150	225	300	375	250	125	0
less: opening timing difference		(75)	(150)	(225)	(300)	(375)	(250)	(125)
Net timing difference for deferred tax expense	75	75	75	75	75	(125)	(125)	(125)
Current tax expense	8	8	8	8	8	68	68	68
Deferred tax expense (recast at 15%)	11	11	11	11	11	(19)	(19)	(19)
Covered Taxs in financial accounts **(= Covered Taxes)**	**18.75**	**18.75**	**18.75**	**18.75**	**18.75**	**48.75**	**48.75**	**48.75**
Effective Tax Rate	19%	19%	19%	19%	19%	49%	49%	49%
Top-Up Tax	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Moreover, consideration should also be given to temporary differences in respect of expenses related to non-tangible assets that do not unwind within five years. Those may have a downward impact on the GloBE ETR and may give rise to Top-up Tax depending on the tax rates that apply to the taxable income.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Domestic tax rate	30%	30%	30%	30%	30%	30%	30%	30%
Asset (tax value)	800	600	400	200	0	0	0	0
Asset (book value)	875	750	625	500	375	250	125	0
Profit before tax in financial accounts **(= GloBE income)**	100	100	100	100	100	100	100	100
Add: accounting depreciation	125	125	125	125	125	125	125	125
Less: tax depreciation	(200)	(200)	(200)	(200)	(200)	0	0	0
Local tax base for current tax expense	25	25	25	25	25	225	225	225
Timing difference liability (asset) on assets	75	150	225	300	375	250	125	0
less: opening timing difference		(75)	(150)	(225)	(300)	(375)	(250)	(125)
Net timing difference for deferred tax expense	75	75	75	75	75	(125)	(125)	(125)
Current tax expense	8	8	8	8	8	68	68	68
Deferred tax expense (recast at 15%)	11	11	11	11	11	(19)	(19)	(19)
Covered Taxs in financial accounts **(= Covered Taxes)**	**18.75**	**18.75**	**18.75**	**18.75**	**18.75**	**48.75**	**48.75**	**48.75**

Effective Tax Rate	19%	19%	19%	19%	19%	49%	49%	49%
Top-Up Tax	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Recapture amount	(19)	(19)	(19)					
Effective Tax Rate (re-calculate in Year 5)	0%							
Effective Tax Rate (re-calculate in Year 6)		0%						
Effective Tax Rate (re-calculate in Year 7)			0%					
Top-Up Tax (recalculated)	**15**	**15**	**15**					

Example 6: Tax credits

Tax credits are forms of tax relief that are based on the value of expenditures on qualifying investments and are used to directly reduce the amount of taxes to be paid.[5] For GloBE purposes, it is important to distinguish between different types of tax credits. While credits reduce a company's effective corporate tax rate, the impact of tax credits will be less significant when they affect the denominator (GloBE Income), compared to tax credits that affect the nominator (Covered Taxes).

For GloBE purposes, both Qualified Refundable Tax Credit (QRTC) and Marketable Transferable Tax Credit (MTTC) are generally treated as an increase to GloBE Income. A QTRC is a refundable tax credit that must be paid as cash, or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving it.

A MTTC is a tax credit that (i) can be used by the holder of the tax credit to reduce its Adjusted Covered Taxes in the issuing jurisdiction and (ii) meets the legal transferability and marketability standards defined in the July AG in the hands of the holder. In the hands of an originator, MTTCs are treated (favorably) as an increase to GloBE Income. If the originator uses the credit, it includes the face value of the tax credit in GloBE Income. If the originator transfers the MTTC, the originator includes the transfer price (rather than face value) in GloBE 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.

	Financial accounts			**GLoBE**		
			QRTC		**NQRTC**	
	Country A	**Country B**	**Country A**	**Country B**	**Country A**	**Country B**
Domestic tax rate	30%	20%	30%	20%	30%	20%
Profit before tax in financial accounts (Local tax base for current tax expense)	175	175	175	175	**175**	**175**
Tax expense before tax credit	53	35	53	35	53	35
R&D tax credit (assumed 25)	-25	-25	-25	-25	-25	-25
Current tax expense with tax credit	28	10	28	10	**28**	**10**
GloBE adjustment QRTC: tax credit not treated as income in financal accounts (adjustments required) NQRTC: tax credit treated as reduction of tax expense (no adjustment required - in line with GLoBE)						
GloBE Covered Tax for QRTC (impact of tax credit removed)			**53**	**35**		
GloBE Income for QRTC (tax credit added to income)			**200**	**200**		
Effective Tax Rate			**26%**	**18%**	**16%**	**6%**
Top-up Tax			**0**	**0**	**0**	**16**

Scenario: credit reduces the tax expense in the financial accounts.

5 According to the OECD Corporate Tax Statistics 2023, 21 out of the 33 OECD countries offered refundable (payable) tax credits or equivalent incentives in 2022. Such provisions explicitly target SMEs and young firms compared to large enterprises in Australia, Canada and France.

Example 7: Cash grants

Similar to QRTC and MTTCs, the GloBE rules treat government cash grants (that are available regardless of whether a Constituent Entity is paying taxes) as increases to the GloBE Income. Where government subsidies and grants are exempt from local taxation, they may reduce the ETR (provided that the subsidized costs remain tax deductible).

However, as mentioned above, subsidies and grants have a lower downward impact on the ETR compared to, for example, non-qualifying tax credits or investment allowances.

	Country A	Country B	Country C
Domestic tax rate	30%	20%	15%
Profit before tax in financial accounts **(=GLoBE income)**	**200**	**200**	**200**
Less: Tax free subsidy	(25)	(25)	(25)
Local tax base for current tax expense	175	175	175
Current tax expense **(=Covered taxes)**	**53**	**35**	**26**
Effective Tax Rate	**26%**	**18%**	**13%**
Top-Up Tax	**0**	**0**	**4**

Importantly, even where incentives give rise to low-taxed profits, jurisdictional blending and/or the SBIE may minimize the Top-up Tax ultimately due by an MNE. Similarly, the transitional Safe Harbour provisions that have been agreed by the Inclusive Framework may eliminate Top-up Tax liabilities that would otherwise be triggered by incentives.

Jurisdictional blending

Where a Constituent Entity by itself has low-taxed profits, Top-up Tax liability may nevertheless not be triggered in the jurisdiction due to the jurisdictional blending approach under the GloBE rules. As noted above, the ETR is computed by reference to all the Constituent Entities of the MNE Group located in the same jurisdiction. If the blended ETR for the jurisdiction is below the 15 percent minimum rate, all Constituent Entities in that jurisdiction are deemed to be low-taxed Constituent Entities (LTCEs). Similarly, if the blended ETR for the jurisdiction is equal to or above the 15 percent minimum rate, none of the Constituent Entities in that jurisdiction will be considered LTCEs.

Calculating a group-wide ETR for the jurisdiction therefore means that: (i) an Entity might qualify as a low-taxed Constituent Entity even if its ETR on a stand-alone basis would equal or exceed the Minimum Rate (i.e., on a stand-alone basis it would not be considered low-taxed); and (ii) a Constituent Entity might not qualify as a low-taxed Constituent Entity even if its ETR on a stand-alone basis would fall below the Minimum Rate.

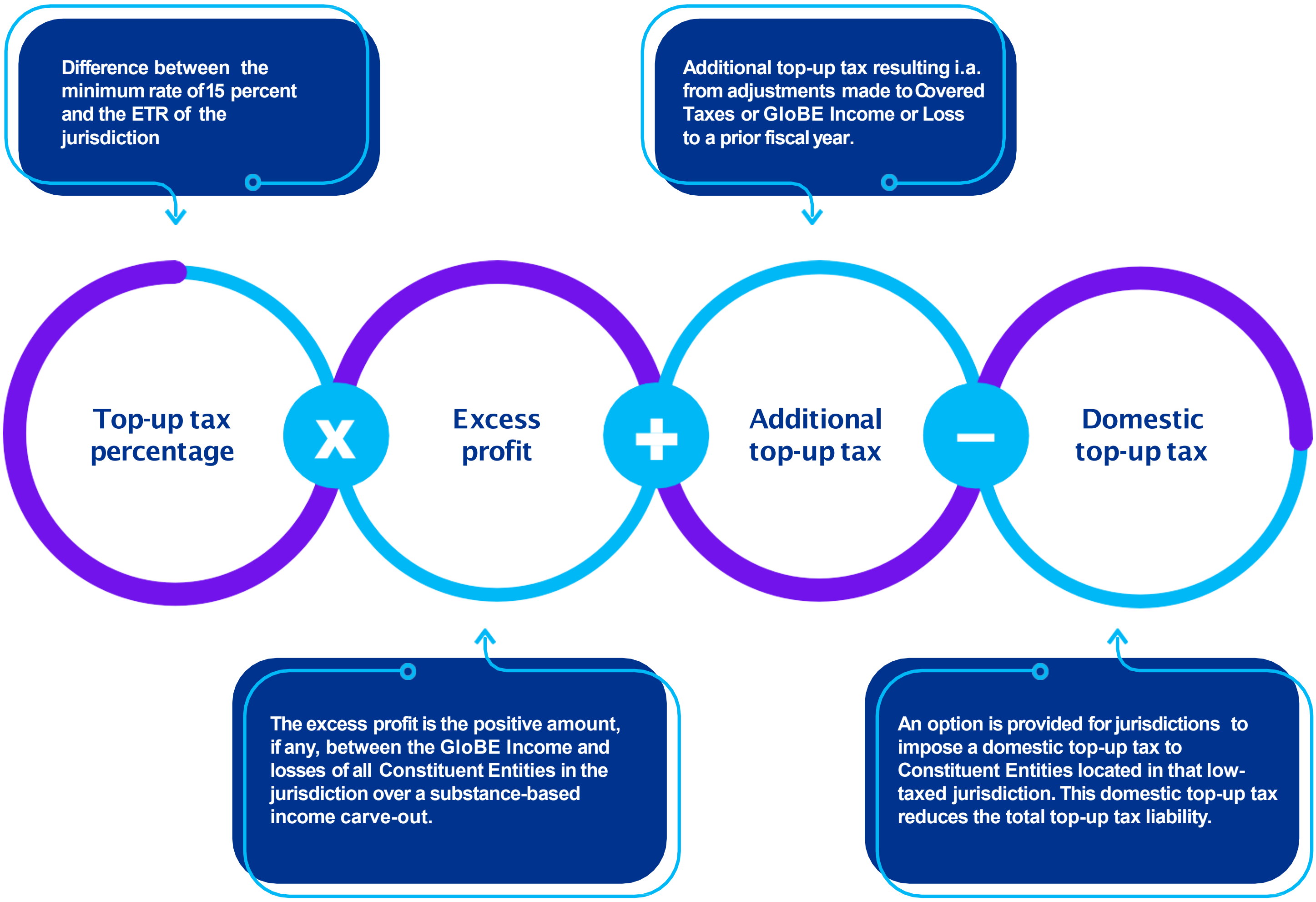
Importantly, an exception applies for certain types of entities that are subject to a standalone ETR and Top-up Tax computation (e.g., Investment Entities, Joint Venture groups, Minority-Owned groups, Stateless Entities).[6]

Substance-based Income Exclusion (SBIE)

An MNE Group that has low-taxed profit will not be subject to Top-up Tax to the extent that its operations are supported by investments in tangible assets and labour in the jurisdiction due to the SBIE.

As illustrated below, the Top-up Tax for a low-taxed jurisdiction is calculated by multiplying the Top-up Tax percentage (i.e., difference between the minimum rate of 15 percent and the ETR of the jurisdiction) by the Excess Profit for a jurisdiction. The Excess Profit is the positive difference, if any, between the GloBE Income and losses of all Constituent Entities in the jurisdiction and the SBIE.

6 Note, however, that such standalone calculation for Minority-Owned Constituent Entities (MOCEs) is not required under the transitional CbyC Reporting Safe Harbour. Depending on the level of taxation of the MOCE, this could have a temporary upward or downward impact on the ETR.



As mentioned, the SBIE carve-out is determined as a markup on the carrying value of eligible tangible assets and eligible payroll costs in the respective jurisdiction. The markups are initially 8 percent for tangible assets and 10 percent for payroll – both metrics reduce over a ten-year period to 5 percent. As such, the SBIE formula applies as follows:

- 2023: 8% x value of eligible tangible assets + 10% x value of eligible payroll costs
- 2024: 7.8% x value of eligible tangible assets + 9.8% x value of eligible payroll costs
- […]
- 2032: 5.4% x value of eligible tangible assets + 5.8% x value of eligible payroll costs
- 2033: 5% x value of eligible tangible assets + 5% x value of eligible payroll costs

Payroll costs that qualify for the carve-out include wage and salary costs, employee benefits that provide a direct personal benefit to the employee (like health insurance and pension contributions), payroll taxes and social security contributions borne by the employer. The tangible assets carve-out is based on the average carrying value (net of accumulated depreciation) in the financial statements of assets located in the jurisdiction. Tangible assets that qualify include property, plant and equipment, natural resources as well as licenses for the use of immovable property or exploitation of natural resources.

The SBIE serves to reduce the profits to which the Top-Up Tax percentage applies and can significantly reduce the amount of Top-up Tax due to the extent that the income is generated by significant investments in tangible assets and personnel.[7] The rationale behind this carve out is that profits derived from operations supported by adequate substance, such as employees and tangible assets, pose a lower risk of being shifted to a low-taxed jurisdiction and therefore to lead to base-erosion.

Important to note is that the SBIE applies separately for certain types of entities that are subject to a standalone ETR and Top-up Tax computation (e.g., Investment Entities, Joint Venture groups, Minority-Owned groups, Stateless Entities).[8] As such, groups will need to consider in which group entities substance is located. In addition, groups need to carefully analyze how certain operating models (e.g., leasing, subcontracting, remote working) may limit SBIE benefits in a jurisdiction.

7 According to a 2024 OECD Working Paper The Global Minimum Tax and the taxation of MNE profit, around 6.9 percent of global profit will remain subject to an ETR lower than 15 percent at the end of the ten-year transition period, either because they are derived from excluded industries or because they are carved-out by the SBIE.
8 Note again that a standalone calculation for Minority-Owned Constituent Entities (MOCEs) is not required under the transitional CbyC Reporting Safe Harbour.

Transitional UTPR Safe Harbour

There may be instances where the mechanism through which Top-up Tax is collected with respect to the UPE's jurisdiction is the UTPR. This will typically be the case where the UPE jurisdiction has not (yet) adopted the GloBE rules, but the UPE or other CEs in that jurisdiction (that are not owned by a foreign group entity) are considered low-taxed and therefore give rise to a Top-up Tax liability. However, for fiscal years that begin on or before December 31, 2025 and end before December 31, 2026, an MNE Group in this position might nevertheless not be subject to Top-up Tax (charged under the UTPR mechanism) to the extent that it has low-taxed profits in the UPE jurisdiction and that jurisdiction has a statutory corporate income tax rate of at least 20 percent and does not apply a DMTT (or domestic Income Inclusion Rule (IIR)). Based on the July Administrative Guidance, the MNE Group can elect to apply the Transitional UTPR Safe Harbour that would deem the UTPR Top-up Tax Amount for the UPE jurisdiction to be zero where those conditions are met.

As such, tax incentives in headquarter jurisdictions might be protected in this transitional period for cases where the Top-up Tax liability triggered by, e.g., the availability of those incentives, can only be collected through UTPR. These jurisdictions will ultimately be granted more time to assess whether and how to align their existing tax incentives with the desired outcomes of Pillar Two.

Transitional CbyC Reporting Safe Harbour

The GloBE Implementation Framework provides an elective CbyC Reporting Safe Harbour that provides for simplified calculations using CbyC Reporting data and financial accounting data that is tested against the de minimis threshold, excluded substance-based income (routine profits) or agreed effective minimum rates. The election is applicable to fiscal years beginning on or before December 31, 2026 (but not to fiscal years that end after June 30, 2028).

The simplified ETR test is based on the jurisdiction's income tax expense as reported in the MNE Group's Qualified Financial Statements (Simplified Covered Taxes) divided by the jurisdiction's income as reported on the MNE group's Qualified CbyC Report (Simplified GloBE Income). Whilst the Safe Harbour provisions require a limited number of adjustments,[9] they do not include the majority of the adjustments required under the regular GloBE rules, including adjustments in respect of tax credits (QRTC and NQRTC) as well as adjustments in respect of deferred tax expenses (e.g. inclusion of unrecognized DTAs, recast and recapture mechanism, transitional rules).

As a result, under the transitional CbyC Reporting Safe Harbour rules the use of tax incentives might lead to a Simplified ETR that is different compared to regular GloBE ETR. Where the Simplified ETR does not exceed 15 percent (2023 and 2024), 16 percent (2025) and 17 percent for fiscal years beginning in 2026, the Top-up Tax is deemed to be zero. Otherwise, the jurisdictional Top-up Tax needs to be calculated based on the regular GloBE rules (provided the de-minimis and routine profits tests are also not met). In other words, whilst the Simplified ETR test under the CbyC Reporting Safe Harbour may deem Top-up Tax to be zero, it does not lead to an increased Top-up Tax liability (i.e., the Top-up Tax liability is limited to the amount calculated under the regular GloBE rules).

04 Adjusting existing tax incentives

As shown above, depending on their type and design, existing tax incentives may trigger Top-up Tax liability in respect of low-taxed profits, which would offset the benefit of the respective incentives to a certain extent. Note that tax incentives enjoyed in combination can be particularly impactful on ETRs. As such, Inclusive Framework jurisdictions may consider reforming existing incentive regimes to a design that is consistent with the desired outcomes of Pillar Two.

From a theoretical standpoint, jurisdictions with a relatively high headline corporate tax rate and broad tax base (i.e., limited tax incentives) might be less incentivized to take any action to adjust existing tax incentives on the grounds that the extent of local low-taxed profits is limited (in particular in light of the jurisdictional blending approach outlined above). Similarly, there will be little incentive for countries to adjust special rates and base modifications that are only available to out-of-scope taxpayers, solely in response to Pillar Two.

By contrast, jurisdictions that are more likely to have in-scope taxpayer with low-taxed excess profits in the jurisdiction (e.g., due to a low statutory rate or a narrow tax base), may reconsider the effectiveness of existing incentives. Such incentives may either be removed completely, or replaced by a new tax incentive system. It is worth noting that tax holidays can often be supported by contractual agreements between the government and the taxpayers, which would in principle need to be amended (potentially subject to agreement with the taxpayers) where the government opts for a change in policy.

Overall, expenditure-based incentives that are linked to investments in tangible assets and labour may be favored in a new Pillar Two environment. They result in an increase in the operational footprint that an MNE has in a jurisdiction and, thus, will be reflected in an increased SBIE. This may include incentives the goals of which are aligned with the intended outcomes of the OECD project, including allowing the faster recovery of costs related to tangible assets (e.g., accelerated depreciation and immediate write-offs) or grants, refundable or transferrable tax credits to support employment opportunities, training, infrastructure and innovation. It may also include personal income tax related incentives, such as improved expat income tax incentives

9 E.g., removal of taxes that are not Covered Taxes or that relate to uncertain tax positions.

(can allow for reduction of salary costs to MNEs) or SSC-related reliefs. In this context, it is important to note that discussions at Inclusive Framework level are still ongoing with more Administrative Guidance expected to be released over time that may provide for better treatment of certain existing incentives.

However, the decision to revise the current tax incentive regime will likely be based on various considerations, i.e. not only based on a potential Pillar Two exposure. Jurisdiction may take into account the offered cash tax value for taxpayers as well as whether the jurisdiction's economic circumstances allow for the granting of e.g. grants or refunds. Countries may also consider the level of administrative burden for authorities and taxpayers that is triggered by different policy options. For example, temporary differences may result in data granularity challenges and complexities on recasting and recapture, whilst grants and refundable credits may require additional resources for eligibility checks and fraud prevention.

Beyond design features of tax incentives, the enhancement of framework conditions such as political and institutional stability, the availability of infrastructure and a skilled workforce are likely to be considered by jurisdictions. According to the OECD, in the absence of otherwise attractive economic conditions, tax incentives may result in limited cost-efficiency and effectiveness.

KPMG observation:

The following section provides observations as at the date of this publication (January 31, 2025) on how countries have responded to Pillar Two implementation in practice and which actions or legislative amendments have already been taken or are being considered locally.

Europe

A number of European countries have announced concrete considerations or measures to address Pillar Two implications for existing incentives, which can be categorized as follows:

1) Jurisdictions introducing incentives regime aligned with Pillar Two

In Hungary, the adopted Pillar Two implementation bill introduces a new R&D tax credit. The credit generally amounts to 10 percent of eligible R&D expenses (capped at a certain amount per taxpayer and per project, depending on the type of activity) and subject to variations in case of joint research projects with higher education institutions. Taxpayers are entitled to receive a cash refund where the credit has not been used against the corporate income tax liability within a period of four years. According to the bill, the credit will be considered a refundable tax credit under the GloBE rules – see E-News Issue 187.

In Norway, the Pillar Two bill provides for a 19 percent tax refund for certain eligible expenses related to R&D projects. According to the bill, the regime should qualify as a Qualified Refundable Tax Credit – see E-News Issue 187.

In Malta, the government is still in discussions with the European Commission regarding the introduction of grants or QRTCs that are compatible with the EU (State aid) rules and the Pillar Two rules – see E-News Issue 202

2) Jurisdictions adapting existing incentive regimes in light of Pillar Two

The Pillar Two law in Belgium includes changes to the Belgian Income Tax Act whereby the period within which the R&D tax credit become refundable is shortened to four years (previously five years), to align the regime with the criteria for a Qualified Refundable Tax Credit.

As a result of these changes, R&D tax credit can be used in the current year and carried forward for three assessment years (instead of four assessment years) at the election of the taxpayer. Any non-deductible amount will be refunded after four assessment years (instead of five assessment years). The modified R&D tax credit is applicable as from assessment year 2025. In addition, Belgium reformed the increased investment deduction regime in 2024 (which can also be claimed as a refundable tax credit). For more information on Belgian tax incentives, please refer to a dedicated report prepared by KPMG in Belgium.

Ireland amended its R&D tax credit to ensure that it is considered a qualifying refundable tax credit for Pillar Two and US foreign tax credit purposes. Changes are that (i) companies now have the option to request payment without offsetting against other tax liabilities first and (ii) current limits on the payable element of the credit have been removed. Changes include also the increase in ETR to 10 percent (from 6.25 percent) to align with the subject to tax rule (see report prepared by KPMG in Ireland).

In Poland, the government announced plans to reform its tax incentives system in response to the global Pillar Two implementation. The proposed changes include replacing the current Polish Investment Zone regime and R&D tax credit regime with a cash grant system. This new system aims to be more attractive for larger groups by avoiding top-up tax exposure under Pillar Two rules. The cash grants would be distributed annually over 15 years, based on investment value, profitability and other quality criteria. Additionally, the government is considering allowing taxpayers to settle existing R&D tax relief through current tax or refund applications – see E-News Issue 202.

In the United Kingdom, the creative industry tax reliefs have been redesigned to become Qualified Refundable Tax Credits from January 1, 2024 (previously operating as deductions against taxable profit). Note that the UK further enhanced the existing Qualified Refundable Tax Credit (R&D Expenditure Credit) by increasing the rate from 13 percent to 20 percent for expenditure from April 1, 2023. The UK also introduced in the Spring Budget 2023 a full expensing policy in respect of qualifying expenditure for new plant and machinery (see report prepared by KPMG in the UK).

3) Jurisdictions where new incentive regimes or reforms of existing incentives are not linked to Pillar Two

In Denmark, beside the expansion of loss deduction carry forwards, dividend exemptions and abolishment of immediate write offs for software and IP, new legislation contains initiatives for increased R&D tax credits as well as increased R&D investment allowances – see E-News Issue 205.

In Finland, a draft proposal was published on the introduction of a corporate income tax credit to support large-scale industrial investments driving the transition to a net-zero economy. The credit targets investments in renewable energy, decarbonization of industrial processes, and production of green technologies. It offers a 20 percent credit on qualifying costs, capped at EUR 150 million per group, with a minimum investment of EUR 50 million per facility. Applications for the credit must be made by 2025, and it can be used against annual corporate tax liabilities from 2028 to 2047. A payout option is not proposed. The proposal is subject to approval by the European Commission under EU State aid rules – see E-News Issue 201.

In France, the government introduced a new tax credit to support the transition to a greener economy that ranges from 20 percent to 60 percent of the cost of investments in qualifying tangible or intangible assets. Examples of qualifying assets include land, buildings, plant and machinery, patent rights, licenses, and intellectual property rights. Conditions for eligibility include: (i) the investment should be carried out in France, and (ii) operate for at least five years and (iii) a ruling has to be obtained from the French Tax Authorities no later than December 31, 2025. The tax credit will be deductible against the corporate income tax due for the company in the fiscal year in which the expenditure is incurred. Any excess credit will be refundable to the taxpayer – see E-News Issue 185.

In Greece, the government implemented several measures as part of the 2025 tax reform. This includes the introduction of a participation exemption regime for dividends and capital gains derived from shareholding in non-EU entities, income tax deductions for patent commercialization as well as enhanced super deductions of up to 315 percent on expenditures for collaborations with start-ups and research centers - see E-News Issue 205 and a report prepared by KPMG in Greece.

In Italy, a new tax credit was introduced in 2024 and is available for investments in qualifying tangible and intangible assets to support digitalization and the green transition of companies. In addition, a new tax credit was introduced to support qualifying investments in special economic zones (ZES unica regions: Abruzzo, Basilicata, Calabria, Campania, Molise, Puglia, Sardinia, and Sicily) – see E-News Issue 203.

In Luxembourg, a new tax credit for investments in digital transformation and energy transition was introduced with effect from 2024. The credit is calculated based on the acquisition cost of assets and qualifying deductible expenses. Furthermore, an amendment of the tax credit for global investment is intended, increasing the basic tax rate from 8 percent to 12 percent and eliminating the EUR 150,000 threshold – see E-News Issue 189.

In Portugal, the 2025 Budget reduces the corporate income tax rate from 21 percent to 20 percent and to enhance existing tax incentives, including an increased equity allowance and increased deduction for employment costs – see E-News Issue 205.

4) Jurisdictions considering not adapting existing incentives in response to Pillar Two implementation

In Czechia, the explanatory notes to the Pillar Two draft bill clarify that there is no intention to change any existing tax incentives that would be impacted by Pillar Two (even where they might reduce the ETR below 15 percent). However, Czechia is currently considering a new tax incentives in form of cash grants for investments in strategic sectors vital for a climate-neutral economy (e.g., batteries or solar panels) in the range from EUR 150 to 350 million, depending on investment and region. The proposed grants are still subject to approval by the European Commission under EU State aid rules.

In the Netherlands, a government official noted that the impact of the minimum tax rules on existing incentive regimes (e.g., IP box and tonnage taxation) is expected to be limited due to the EUR 750 million revenue threshold and the local 25.8 percent corporate tax rate, which would keep most group's GloBE ETR above 15 percent. Furthermore, the government wants to conduct a careful assessment of whether a qualified tax credit should be introduced. According to the government official, this would require a careful analysis of the benefit and necessity of such tax credit (taking into consideration the scope, design and objectives) – see E-News Issue 202.

Asia Pacific (ASPAC)

In ASPAC, quite a number of jurisdictions are moving ahead with Pillar Two implementation. These are forming into two “waves” of adoption – 2024 and 2025. 2024 starters (for at least one of the P2 rules) are Australia, Japan, Korea, and Vietnam. 2025 starters are New Zealand, Hong Kong (SAR, China), Malaysia, Singapore, and Thailand. Mainland China and India have not yet committed to specific dates and remain ‘wait and see’ cases.

In Europe, certain countries have moved to update their incentives for Pillar Two in tandem with their release of draft and final legislation. With ASPAC jurisdictions generally somewhat behind with their Pillar Two legislation, and certain key jurisdictions just having their rules effective from 2025, concrete action on updating incentives is largely still pending.

This is not to say that interest is lacking in the topic. With incentives being a key element of the ASPAC business environment, the post-Pillar Two shape of the ASPAC incentive environment is a particularly hot topic with businesses and policy makers in the region. This is reflected in the engagement of ASPAC countries, including Indonesia, Malaysia and Thailand, with the OECD on a pilot program to help countries analyze the impact of Pillar Two on their existing tax incentives and evaluate potential alternatives.

A general challenge for ASPAC jurisdictions is the form taken by existing incentives in the region.

Most incentive support is delivered by way of tax holidays, low rates or exemptions for particular income types and super deductions. While some ASPAC jurisdictions do offer tax credits (Australia, Japan, Korea, New Zealand) most do not. As such, the "nip/tuck"' approach to turning existing credits into QRTCs (taken by several European countries) is not open to most countries in the region.

That being said, we have observed jurisdictions in the region having considered different paths in response to the Pillar Two impacts.

1) Jurisdictions taking steps towards introducing incentives regime aligned with Pillar Two

A leading example is the Singapore refundable investment credit (RIC), which is intended to qualify as a QRTC. According to Singapore's Budget 2024, followed by the amendments to the Income Tax Act 1947 and the RIC Factsheet released by the Economic Development Board (EDB) in December 2024, qualifying companies stand to receive a tax credit of up to 50 percent of each qualifying expenditure category (e.g., capital expenditures, manpower, freight and logistics costs, professional fees etc.). The tax credit is offsetable against corporate tax liabilities and refundable in cash within four years. In addition, Singapore has introduced the Alternative Net Tonnage Basis of Taxation (for shipping companies) and a supplementary incentive tax-rate tier (i.e., 15 percent), in addition to the existing 5 percent and 10 percent concessionary rates under its Development and Expansion Incentive (DEI) and Global Trader Programme regime, to address GloBE and STTR concerns.

In Malaysia, to assist in mitigating the effects of the Global Minimum Tax (which comes into effect in 2025), the government announced a review of existing tax incentives, plans to introduce non-tax incentives and an examination of the feasibility of a Strategic Investment Tax Credit (which conceivably could be designed to qualify as a QRTC). For more information, see a report prepared by KPMG in Malaysia.

In Hong Kong (SAR, China), following the public consultation conducted from December 2023 to March 2024, the government has recently indicated that they would need to carefully consider the feasibility of implementing a QRTC regime in Hong Kong (SAR, China) as there will be major policy and financial implications to the government (e.g., the cash outlay involved, the specific industries covered and the scope of qualifying activities). In addition, the government indicated in the 2024 Policy Address announced in October 2024 that it will introduce new tax deduction arrangements for ship lessors under the ship leasing tax incentive in view of the Pillar Two implementation.

New Zealand has had for some time a tax credit that is partially refundable, and so partially qualifies as a QRTC. That being said, there is no indication that New Zealand would look to tweak this further to make it entirely a QRTC for GloBE purposes (this may be reflective of New Zealand's relatively high corporate income tax rate, lessening the circumstances in which local entities would have ETRs below 15 percent).

Australia proposes to introduce two new tax offsets for priority industries. Under legislation before the Australian Parliament, the Critical Minerals Production Tax Incentive (CMPTI) and Hydrogen Production Tax Incentive (HPTI) will apply in years commencing from July 1, 2027 and ending before July 1, 2040. The CMPTI would allow eligible entities to claim 10 percent of eligible expenditure for processing and refining certain critical minerals. The HPTI would provide a tax offset at AUD 2 per kilogram of eligible hydrogen produced, available in respect of hydrogen produced from eligible facilities. Both tax offsets are proposed to be refundable in the year the relevant tax return is lodged.

2) Jurisdictions considering to use enhanced national investment funds

Another interesting development in the region has been the manner in which both Thailand and Vietnam have moved to use enhanced national investment funds as a platform for providing new post-Pillar Two incentives to businesses. At present, tax holidays are key incentives offered by these jurisdictions – clearly the benefits of these could be impacted by Pillar Two. In response both countries are looking to offer instead cash grants from their national investment funds.

In Vietnam, the Government approved to set up an investment support fund to support, encourage and attract strategic investments in certain priority sectors. An official Government's decree was signed on December 31, 2024 with effectiveness from fiscal year 2024 for the establishment, management, and use of the investment support fund. The cash grants (exempt from corporate income tax) would be available to (large scale) eligible enterprises that make investments in high-tech sectors (high-tech enterprises, high-tech application projects, high-tech product manufacturing projects, or R&D center investment projects) including semiconductors and artificial intelligence data centres. Cost categories to enjoy the support fund include training and human resource development, research and development, capital expenditures, high-tech product manufacturing costs, social infrastructure developments, initial investment project costs, and other cases as decided by the Government.

In Thailand, according to the plans approved by the Thai Cabinet to implement Pillar Two rules from 2025, 50 to 70 percent of top-up taxes collected under Pillar Two would be allocated to the Competitiveness Enhancement Fund of the BOI (details will be further discussed between the Revenue Department and the BOI).

A further question arises as to what would happen to (out of favor) tax holidays. Thailand was looking at the possibility to provide an eligible 10 percent CIT rate in lieu of income tax exemption, which would also double the taxpayer's tax incentive period by the remaining tax exemption period.

3) Jurisdictions that keep existing incentives or introduce incentives that drive down ETR

In Hong Kong (SAR, China), while GloBE-compliant new incentives are being considered, the government went already ahead with the introduction of a new patent box regime, which would offer a 5 percent concessionary tax rate for Hong Kong (SAR, China) sourced taxable (i.e., non-capital) profits derived from use or sale of eligible IP, subject to certain conditions. For more details, please refer to a KPMG Hong Kong SAR alert.

Similarly, Japan will introduce a new tax incentive for intellectual property, named the "Innovation Box" regime, for seven years beginning April 1, 2025. This is aimed at encouraging companies to conduct their R&D activities in Japan and strengthening the competitive ability of Japan as a site location for such activities. The regime provides for a 30 percent deduction for qualifying income from domestic transfers or domestic or international licences of IP rights, provided the company carries out the R&D activities in Japan.

Australia has also had, since July 2022, a patent box regime that provides a 17 percent concessional tax rate for corporate income derived directly from medical and biotechnology patents.

Indonesia and the Philippines are jurisdictions that have traditionally offered many tax incentives (in form of tax holiday, concessionary tax rate and tax allowance), with more being recently announced. No information or indication of any change to the existing and new incentives is published to date. For example, Indonesia has recently issued a new tax holiday regulation. Under that regulation it is still possible to obtain a tax holiday (the same requirements apply as before). However, it specifically mentions that Indonesia is allowed to levy a top-up tax of 15 percent in case the local entity is a low taxed entity under the Pillar Two rules. This applies for existing and new tax holidays.

Furthermore, it is quite likely that lot of existing incentives may remain as they are currently. In Australia, Japan and Korea, high ETRs are the norm, in consequence of high statutory rates and broad bases (Australia, Japan), and a local alternative minimum tax (Korea). Taiwan will soon join this club as they will increase the Alternative Minimum Tax (AMT) rate from 12 percent to 15 percent from 2025. These may not see any need to adapt their existing incentives to become more GloBE friendly. It may also be the case that for the many tax holidays, low rates, super deductions in the region (also available to smaller groups not in scope of Pillar Two), countries will seek to retain them, in part because they are more comfortable with established mechanics for delivering these incentives.

Other regions

Barbados intends to introduce tax credits that meet the requirements of a QRTC under the GloBE rules. These credits, which shall be offset against corporation tax (and any other tax liability) are intended to encourage economic growth, development and employment in strategic sectors. QRTCs will be available to companies taxed at the rate of 9 percent and to companies subject to the DMTT of 15 percent. For example, a refundable payroll tax credit on eligible payroll costs is introduced in respect of full-time employees engaged in designated activities (with a maximum effective payroll credit of 300 percent). In addition, a credit of 50 percent of qualifying expenses incurred for qualifying research and development activities is introduced.

In addition, Barbados announced a defensive DMTT from 2024 – only applicable where the UPE of the group is based in a jurisdiction that has introduced an IIR or a UTPR. For more details, please refer to KPMG's Tax News Flash. Note that, to date, the OECD has not formally reacted with an evaluation of these initiatives.

Following the introduction of a DMTT (applicable from 2024), the government in the Bahamas has announced an intention to explore the development of an incentives package to promote competitiveness, economic development and MNE investments. According to public statements, this incentives package may include tax credits in relation to extra-territorial turnover, capital expenditure, employee training and local investments. In addition, the government noted that it is collaborating with the Ministry of Finance and Bahamas Maritime Authority to implement a tonnage tax on shipping income.

The government of Bermuda intends to introduce a QRTC that will be determined by reference to substance-based factors (e.g. existing and expanded employment opportunities for Bermudians and Bermuda residents, training, infrastructure, innovation) with further details to be released in 2024. For more details, please refer to KPMG's Tax News Flash.

In tandem with the Pillar Two implementation, Brazil announced plans to partially or fully convert its Free Trade Zone regimes (SUDENE and SUDAM) into a Qualified Refundable Tax Credit for Pillar Two purposes, as from 2026. For more information, please refer to a report prepared by KPMG in Brazil.

In the United Arab Emirates (UAE), the Ministry of Finance has recently announced plans to incorporate into its new 9 percent corporate tax system (applicable to tax periods commencing on or after June 1, 2023) a new package of tax incentives. According to the Ministry release, this would include a tax credit of 30 percent to 50 percent of qualifying R&D expenditures. The R&D tax credit would apply to fiscal years starting on or after January 1, 2026 and would be refundable depending on the revenue and number of employees of the business in the UAE. Furthermore, based on the Ministry release, the UAE considers the introduction of a refundable tax credit linked to high-value employment activities. This would be available from January 1, 2025 and would be provided as a percentage of eligible salary costs for employees that have high-value positions.

05 Related benefits restrictions

The GloBE rules require a number of conditions to be met in order for a Domestic Minimum Top-up Tax or IIR regime to achieve Qualified status, including that the rules are implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary and that the jurisdiction not to provide any benefits that are related to such rules.[10]

The related Commentary notes that the language used in Article 10 of the Model Rules ("provide any benefits that are related to such rules") is intentionally drafted broadly to take into account different mechanisms through which the benefit might be provided, including not only tax incentives but also grants or subsidies.

The Commentary further lists relevant (but not decisive) indicators for harmful benefits, including whether the tax benefit or grant benefits only taxpayers subject to the GloBE rules, whether the benefit is marketed as part of the GloBE rules and if the regime was introduced after the OECD/G20 Inclusive Framework started discussing the GloBE rules.

As such, Inclusive Framework jurisdictions that have signed up to Pillar Two will be expected not to undermine the goals of the agreement by compensating MNEs in any form (i.e., tax or non-tax related). In this sense, the OECD has already indicated that, for example, the excessive application of subsidies to compensate MNE Groups for their Top-up Tax liability might lead to a disqualification of local Pillar Two rules (IIR, UTPR, DMTT) under the anticipated peer review process.

As part of the releases on January 15, 2025, the OECD noted that further work on assessing and addressing benefits / incentives that could qualify as related benefits and therefore pose a risk of undermining the goals of Pillar Two is being done by the OECD. As such, it is expected that the OECD will release further guidance in this context.[11]

Please note that – in addition to the denial of the qualified status based on the peer review process, individual jurisdictions may introduce measures against harmful related benefits.

One example is legislation in Australia, which restricts the amount of foreign tax credits that can be claimed in Australia for DMTT paid in another jurisdiction where a subsidiary in that jurisdiction has claimed certain benefits such as refundable tax credits, transferable tax credits and cash grants. .

Another example is the examination of the EU Code of Conduct Group of the option of establishing a link between Pillar Two and the EU listing exercise in relation to non-cooperative jurisdictions. There are ongoing discussions on whether the results of the Pillar Two peer review process may be added as an EU listing criterion, with the result that an unfavorable peer review result would put the jurisdiction at risk of being added to the EU list of non-cooperative jurisdictions. Conceivably, this would lead to the application of defensive measures[12] by EU countries against those jurisdictions that offer benefits that are deemed harmful for Pillar Two purposes.

06 Additional links

1. Chand/Romanovska (2023), The Impact of Pillar Two on Corporate Tax Incentives and Incentives Post Pillar Two – The Potential Rise of Tax Credits and Subsidies, International Tax Studies (Volume 6), No. 9
2. Den Ridder/Ruige/de Wilde (2023), Fiscal Subsidies Aspirers Beware of the No Benefit Requirement in Pillar Two
3. European Parliamentary Research Services (2023), Tax incentives after the minimum corporate tax ('Pillar Two')
4. OECD (2022), Tax Incentives and the Global Minimum Corporate Tax: Reconsidering Tax Incentives after the GloBE Rules
5. OECD (2023), Minimum Tax Implementation Handbook (Pillar Two)
6. OECD (2023), Corporate Tax Statistics 2023
7. OECD (2024), Corporate Tax Statistics 2024

10 See the definition of a Qualified Domestic Minimum Top-Up-Tax and Qualified Income Inclusion Rule under Article 10 of the Model Rules.
11 See OECD (2025), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on Article 9.1 of the Global Anti-Base Erosion Model Rules, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-article-9-1-globe-rules-pillar-two-january-2025.pdf.
12 For more information, on EU defensive measures against non-cooperative jurisdictions, please refer to our dedicated KPMG webpage.

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