

Euro Tax Flash from KPMG's EU Tax Centre

European Commission publishes notice in support of Pillar Two Side-by-Side Package

Issue 573 – January 12, 2026

On January 12, 2026, the European Commission (EC) published a [notice](#) in the Official Journal of the EU acknowledging the release of the Side-by-Side Package and confirming the application of the following Safe Harbours through Article 32 of the EU Minimum Tax Directive:

- the Simplified ETR Safe Harbour;
- the extension of the Transitional CbCR Safe Harbour;
- the Substance-based Tax Incentive Safe Harbour;
- the Side-by-Side Safe Harbour; and
- the UPE Safe Harbour.

Whilst there is no intention to amend the EU Directive as a result, EU countries may still see a need for their national Pillar Two laws to be amended.

Subject to local implementation, the Package will be available for fiscal years commencing on or after January 1, 2026. One exception applies to the Simplified ETR Safe Harbour, which can be implemented by jurisdictions for fiscal years beginning on or after December 31, 2025.



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European Commission – Pillar Two – Side-by-Side Package – Side-by-Side Safe Harbour – UPE Safe Harbour – Substance-based Tax Incentive Safe Harbour – Transitional Country-by-Country Reporting Safe Harbour – Simplified ETR Safe Harbour

Context: Inclusive Framework agrees Pillar Two Side-by-Side Package

On January 5, 2026, the Inclusive Framework on BEPS (IF) released an agreed [package of measures](#) (Side-by-Side Package), which modifies key aspects of the Pillar Two framework. Key components include:

- *Side-by-Side (SbS) Safe Harbour:* The SbS Safe Harbour will ‘turn off’ the application of the Income Inclusion Rule (IIR) and Undertaxed Profits Rule (UTPR) if the Ultimate Parent Entity (UPE) of a MNE Group is located in a jurisdiction that imposes minimum taxation requirements with respect to both domestic and foreign income, and provides a foreign tax credit for Qualified Domestic Minimum Top-up Taxes (QDMTTs), subject to any generally applicable limitations under its domestic law (a Qualified SbS Regime). According to the [OECD Central Record](#), the only jurisdiction currently eligible for the SbS Safe Harbour is the US. The SbS Safe Harbour will be available for fiscal years commencing on or after January 1, 2026, subject to local implementation (i.e., the SbS Package does not provide for retroactive application of the SbS Safe Harbour to fiscal years 2024 or 2025).
- *UPE Safe Harbour:* Separately, in parallel, the existing Transitional UTPR Safe Harbour is set to be replaced with a new, permanent UPE Safe Harbour. For a given MNE Group, the UPE Safe Harbour will protect UPE jurisdiction profits from foreign UTPRs if the UPE is located in a jurisdiction that imposes minimum taxation requirements with respect to domestic income (a Qualified UPE Regime), but will not protect profits of foreign subsidiaries or permanent establishments (PEs) from the application of the IIR or the UTPR (nor would it protect profits of a subsidiary located in the UPE jurisdiction from the application of the IIR). The UPE Safe Harbour will be available for fiscal years commencing on or after January 1, 2026, subject to local implementation.
- *Substance-based Tax Incentives (SBTI) Safe Harbour:* Where MNE Groups elect to apply the SBTI Safe Harbour, certain Qualifying Tax Incentives (QTIs) are treated as an increase to the ETR numerator (Adjusted Covered Taxes) in the amount of their deemed tax value. At the same time, QTIs are not to be included in the ETR denominator (GloBE Income). The increase to the ETR numerator is subject to a cap equal to the higher of 5.5 percent of the payroll costs or depreciation on tangible assets in the jurisdiction. Alternatively, MNE Groups can make a five-year election to apply a cap equal to 1 percent of the carrying value of tangible assets in the jurisdiction (excluding land and other non-depreciable assets). The SBTI Safe Harbour applies broadly to different forms of incentives, including tax credits, super deductions, exemptions or preferential rates subject to a number of conditions. Amongst others, QTIs must be calculated based on eligible expenditures or, in the case of production-based incentives, on the basis of the amount of tangible property produced in a jurisdiction. MNE Groups can make the SBTI Safe Harbour election for Fiscal Years beginning on or after January 1, 2026.
- *Extension of the Transitional Country-by-Country Reporting Safe Harbour (TCSH):* The existing TCSH has been extended for an additional year, with the Simplified ETR test continuing to apply at 17 percent.
- *Simplified ETR Safe Harbour (SESH):* A permanent Safe Harbour is introduced to eventually replace the TCSH. Under the SESH, MNE Groups will be required to calculate their Simplified ETR on a jurisdictional basis. The SESH is more detailed than the Simplified ETR Test from the TCSH but potentially less complex than the full GloBE Rules, with the calculation based on financial accounting data (rather than Country-by-Country data), subject to a number of adjustments to determine the Simplified Income and Simplified Taxes. Where the Simplified ETR exceeds 15 percent, the MNE Group shall be deemed to have no top-up tax liability in respect of that jurisdiction. The SESH will apply for fiscal years beginning on or after December 31, 2026, but can be implemented by jurisdictions for fiscal years beginning on or after December 31, 2025. Notably, in contrast to the TCSH, the SESH does not operate on a “once-out-always-out” basis. Broadly, an MNE Group will be eligible to elect the SESH for Tested Jurisdiction if it did not have a Top-up Tax Liability in the preceding two fiscal years.

For more information, please refer to a [report](#) prepared by KPMG International.

EU implementation: European Commission notice published in EU Official Journal

Background

On December 15, 2022, the Council of the EU unanimously adopted the Council Directive (EU) 2022/2523 (EU Minimum Tax Directive). The final text of the Directive was published in the Official Journal on December 22, 2023, and entered into force on the following day.

The Directive text is closely aligned with the OECD GloBE Model Rules and seeks to implement the OECD rules in a manner which is compatible with the EU Treaties. In addition, the preamble of the Directive includes a recital indicating that Member States should rely on the Commentary to the GloBE Model Rules as well as the GloBE Implementation Framework, including its safe harbor rules, as a source of illustration or interpretation.

The Directive also includes a specific article that deals with safe harbor provisions (other than the EU QDMTT safe harbor), under which top-up tax shall be deemed to be zero in a jurisdiction where the effective level of taxation of the local constituent entities fulfils the conditions of an international set of rules and conditions which all Member States have consented to (Article 32 of the EU Directive). It is worth noting that Cyprus is the only EU Member State that is not a member of the OECD/G20 Inclusive Framework. Separate consent from Cyprus is therefore a requirement for the conditions of Article 32 of the Directive to be met.

Application of the SbS Package through Article 32 of the EU Minimum Tax Directive

On January 8, 2026, the Cypriot Government [published](#) a press release announcing its consent to the SbS Package published on January 5, 2026, including the SbS Safe Harbour, the UPE Safe Harbour, the SESH, the extension of the TCSH, and the SBTI Safe Harbour.

Subsequently, on January 12, 2026, the EC published a [notice](#) in the Official Journal of the EU acknowledging the release of the SbS Package and confirming its application through Article 32 of the EU Minimum Tax Directive without any amendments to the Directive needed.

Next steps

Subject to local implementation, the SbS Safe Harbour, the UPE Safe Harbour, the SESH, and the SBTI Safe Harbour will be available for fiscal years commencing on or after January 1, 2026.

One exception applies to the SESH, which can be implemented by jurisdictions for fiscal years beginning on or after December 31, 2025.

ETC Comment:

Implementation of previously-issued Safe Harbours

The implementation of the SbS package is not the first time Article 32 is used to introduce Safe Harbours or Administrative Guidance. The TCSH, the transitional UTPR Safe Harbour and the permanent QDMTT Safe Harbour and related Administrative Guidance agreed on at the level of the IF subsequent to the entry into force of the EU Minimum Tax Directive were also implemented based on the provisions of Article 32, following confirmation from Cyprus (see E-News [Issue 199](#)).

In addition, in November 2023, the EC and the Council issued statements confirming that the TCSH, UTPR Safe Harbour and QDMTT Safe Harbour as well as the December 2022, February 2023 and July 2023 Administrative Guidance are compatible with the EU Minimum Tax Directive. The statements also confirmed the intention of the EU Member States to follow the Administrative Guidance when transposing the EU Minimum Tax Directive into their national law in order to avoid divergences and inconsistencies in interpretation – see Euro Tax Flash [Issue 527](#).

Local implementation

A Commission notice is adopted to clarify or provide an interpretation of prescribed rules. Their publication is meant to explain how the Commission interprets binding rules, but does not create new law.

The EC notice confirms that all EU countries have agreed to the SbS Package and, therefore, takes the position that the requirements for the application of Article 32 of the EU Minimum Tax Directive are met. Whilst there is no intention to amend the EU Directive as a result, experience with previously-issued Safe Harbours shows, however, that EU countries may still see a need for their national Pillar Two laws to be amended.

Where countries need to legislate for the SbS Package, in many jurisdictions the rules will likely not be transposed into national law before the second half of 2026 or even 2027, given the length of domestic approval processes. Implementing jurisdictions will be expected to apply the rules retroactively from 2026, with some countries, including the Netherlands and the UK, already announcing plans to legislate for the SbS Package with retroactive effect from January 1, 2026. The SbS package notes that some jurisdictions may not be able to apply the rules with retroactive effect due to constitutional grounds or other superior law. These instances may be limited, in particular where the provisions of the package are considered to be favorable to the taxpayer. In-scope groups should closely monitor the legislative process in each relevant jurisdiction, as the date of adoption will vary across the EU and among other adopting jurisdictions in the Inclusive Framework.

Stocktake by 2029

As part of the SbS Package release, the Inclusive Framework has committed to a stocktaking exercise on the effect of the Pillar Two and SbS system, including the level of implementation of QDMTTs, to be concluded by 2029.

The Inclusive Framework stocktake will also be accompanied by an assessment by the European Commission on the implementation and effects of the SbS System and its impact on EU Competitiveness. It has been reported that such assessment may take into consideration an extension of the option provided to some Member States to defer the application of the IIR and the UTPR.

Currently, the EU Minimum Tax Directive allows EU countries to defer the application of the IIR and UTPR up to December 31, 2029, where a maximum number of twelve UPEs are based in that EU Member State. Estonia, Malta, Latvia, Lithuania, and Slovakia have opted to defer the application of the IIR and the UTPR. Slovakia has nevertheless implemented a QDMTT for financial years starting on or after December 31, 2023.

Should you have any queries, please do not hesitate to contact [KPMG's EU Tax Centre](#) or, as appropriate, your local KPMG tax advisor.



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