Pillar Two and tax incentives

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This article analyses 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. It further examines the mechanics and implications of the newly introduced Substance-based Tax Incentive Safe Harbour and assesses how jurisdictions may be incentivized to adapt their regimes to ensure that local incentive offerings remain effective and efficient in light of an evolving Pillar Two framework.

Executive summary:

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 15 percent minimum rate, and
- establishing a Top-up Tax where the minimum is not achieved.

Even where the local statutory corporate tax rate is 15 percent or higher, the ETR under the Global Anti-Base Erosion (GloBE) rules may be reduced due to the application of tax incentives under local law. The extent to which incentives impact the GloBE ETR depends on the incentive design as well as the fiscal year in which the incentives are utilized. At a high level, the extent of the impact can be summarized as follows:

- Incentives that create temporary book-to-tax differences (e.g., accelerated depreciation, immediate expensing) usually have no downward impact on the jurisdictional GloBE ETR, as these differences are ironed out under Pillar Two through deferred tax accounting, subject to the application of recapture rules.

- There will also not be a downward impact on the jurisdictional GloBE ETR for a broad range of expenditure-based and production-based incentives (e.g., refundable and non-refundable tax credits, enhanced allowances and, in limited circumstances, also reduced rates or income exemptions) to the extent substance in form of payroll costs or tangible assets is available in the jurisdiction. Notably, such favorable treatment will only be available from 2026 under the Substance-based Tax Incentive (SBTI) Safe Harbour that was adopted by the OECD Inclusive Framework in January 2026 and that introduces significant changes to the way Pillar Two deals with incentives.

- Irrespective of the application of the SBTI Safe Harbour, grants, subsidies and certain types of refundable and marketable tax credits generally have a low downward impact on the GloBE ETR by being treated as an increase to GloBE Income (i.e., the denominator of the ETR formula) rather than a reduction in Covered Taxes (i.e., the numerator of the ETR formula).

- Other types of incentives that are calculated by reference to income or other parameters (e.g., equity increases) and that reduce the amount of Covered Taxes without a corresponding adjustment of GloBE Income have a significant downward impact on the GloBE ETR.

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 of one Constituent Entity may be offset by a higher ETR of other entities in the same jurisdiction. This will particularly be the case where the headline corporate tax rate is high.

Where incentives reduce the jurisdictional GloBE ETR below the 15 percent minimum rate, a Top-up Tax may arise, partially offsetting the intended benefit of the incentive. At the same time, the Pillar Two framework provides for a number of measures that mitigate the Top-up Tax exposure of incentives:

- Top-up tax liability may be deemed to be zero based on a number of Safe Harbours provisions (e.g., Side-by-Side Safe Harbour (SbS) or the Undertaxed Profits Rule (UTPR) / Ultimate Parent Entity (UPE) Safe Harbour) regardless of how incentives impact the ETR under the full GloBE rules. For more details, please refer to a report prepared by KPMG International.

- The impact may also be further limited where the incentives focus on investments in tangible assets and labor to benefit from the Substance-based Income Exclusion (SBIE). The SBIE reduces profits to which the Top-up Tax rate applies by a markup on the carrying value of eligible tangible assets and eligible payroll costs. 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.

Jurisdictions that wish to continue to use incentives as a policy tool to encourage certain types of behavior or investments in specific areas or sectors may be interested in reforming existing incentives that are no longer efficient in the new Pillar Two environment.

Between 2022 and 2025, it could be observed that various countries have reformed or started considering reforming their pre-Pillar Two tax incentive framework. Whilst some countries introduced new incentives offerings operating within the parameters of Pillar Two, other countries amended existing tax incentives converting deductions into grants, shortening refund periods, or making R&D tax credits refundable.

Following the announcement of the new SBTI Safe Harbour, it is now conceivable that some countries may find that their existing palette of incentives fares well under the new rules while others may be prompted to modify them to enhance their investment attractiveness by calculating the benefit of an incentive by reference to expenditures incurred, or by incentivizing investments in personnel and tangible assets (in light of the substance cap). At the same time, policymakers need to keep in mind the related benefits guidance that is being worked on at the level of the Inclusive Framework as well as other design limitations (e.g., budgetary constraints, state aid rules, contractual agreements with taxpayers).

These points are considered in turn in detail in the following sections. More information on the general concept of Pillar Two and on how the GloBE effective tax rate is calculated (including specific safeguards for tax credits) are provided in the Annex.

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1. Which measures may limit or eliminate Top-up Tax exposure in the context of incentives?

Importantly, even where incentives would give rise to jurisdictional GloBE ETRs below the minimum rate under the full GloBE rules, a number of Pillar Two relief provisions may minimize or even eliminate Top-up Tax liabilities that would otherwise be triggered by incentives.

Substance based tax incentive (SBTI) Safe Harbour

As part of the SbS Package published in January 2026, the Inclusive Framework agreed to significantly revise the treatment of tax incentives for Pillar Two purposes. The new SBTI Safe Harbour introduces the concept of Qualified Tax Incentives (QTIs) that benefit from a favorable Pillar Two treatment for Fiscal Years starting on or after January 1, 2026, in the sense that the impact of QTIs on the ETR is mitigated to the extent the incentive is tied to economic substance:

- *No reduction of ETR numerator (Covered Taxes):* Where a QTI reduces the tax expense for accounting purposes, the SBTI Safe Harbour allows the QTI to be added back to the amount of Adjusted Covered Taxes with the increase being limited to the lower of (i) the deemed tax value of the QTI and (ii) the applicable Substance Cap linked to payroll and tangible assets in the jurisdiction.
- *Substance Cap:* is determined annually on a jurisdictional basis and is equal to the higher of 5.5 percent of the payroll costs or the depreciation and depletion expense in respect of tangible assets in the jurisdiction. Alternatively, a five-year election can be made to apply a substance cap equal to 1 percent of the carrying value on tangible assets (excluding land and other non-depreciable assets).
- *No increase of ETR denominator (GloBE Income):* At the same time, the deemed tax value of the QTI does not need to be added back to the amount of GloBE Income, which is different compared to the treatment of QRTCs and MTTCs.

The scope of tax incentives eligible for QTI treatment is quite broad, including different forms of incentives such as refundable and non-refundable tax credits, super deductions, exemptions or preferential rates.

However, in order to qualify as a QTI, the tax incentive must be calculated based on a portion of expenditures incurred or, in the case of production-based incentives, on the basis of the amount of tangible property produced in a jurisdiction. In addition, a number of additional criteria need to be fulfilled:

- *QTIs must be generally available:* For example, an incentive is not a QTI where it is provided on a discretionary basis / based on an agreement with the government.
- *QTIs must reduce the liability of a Covered Tax:* For example, subsidies, grants or incentives that give rise to timing differences do not qualify as QTIs even if these are related to expenditure or production outcomes.
- *QTIs must meet generosity conditions:* For example, expenditure-based tax incentives are excluded from the QTI definition where the value of the tax benefit of the incentive exceeds the expenditure.

Where QRTCs and MTTCs meet the QTI conditions, groups are allowed to make an annual election to treat QRTCs and MTTCs as a QTI.

Side-by-Side (SbS) Safe Harbour

As part of the SbS Package, the SbS Safe Harbour "turns off' the application of the Income Inclusion Rule (IIR) and the UTPR if the UPE of the 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 (QDMTT).

As a result, for groups benefiting from the SbS Safe Harbour, tax incentives will be protected where the Top-up Tax liability triggered by, for example, the availability of those incentives, can only be collected through IIR and UTPR. At the same time, tax incentives will continue to be exposed to Pillar Two rules where the group's profits are subject to QDMTTs in subsidiary jurisdictions.

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).

According to the OECD Central Record, only the US – to this date of publication – is being treated as having a Qualified SbS Regime in place, i.e., only US headquartered MNEs would benefit from IIR and UTPR exclusion as far as it stands.[1]

UTPR / UPE Safe Harbour

Furthermore, tax incentives in UPE jurisdictions might be protected where the Top-up Tax liability triggered by, e.g., the availability of those incentives, can only be collected through UTPR.

Until the end of 2025, MNE Groups can rely on the Transitional UTPR Safe Harbour, which deems the UTPR Top-up Tax for the UPE jurisdiction to be zero where its jurisdiction had a statutory corporate income tax rate of at least 20 percent and did not apply a DMTT or domestic IIR.

From fiscal years beginning on or after January 1, 2026, 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).

At present, no jurisdictions are listed as being eligible for the UPE Safe Harbour in the OECD Central Record.[2]

For more details on the UPE Safe Harbour, please refer to a report prepared by KPMG International.

Simplified ETR Safe Harbour

The SbS Package also introduced a permanent Simplified ETR Safe Harbour (SESH) generally applicable for fiscal years beginning on or after December 31, 2026.[3]

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 transitional Country-by-Country Reporting Safe Harbour (TCSH) but potentially less complex than the full GloBE Rules, with the calculation based on financial accounting data (rather than Country-by-Country data).

Whilst the SESH provides for a considerable list of adjustments to determine the Simplified Income and Taxes, it should be noted that a significant number of adjustments is optional for groups. This includes the treatment of QRTCs and MTTCs (in line with the full GloBE rules) and the treatment of QTIs (in line with the SBTI Safe Harbour). Depending on how those elections under the SESH are exercised, the downward impact of qualifying tax incentives on the Simplified ETR might be different compared to the full GloBE ETR.

Where the SESH meets the 15 percent threshold, the jurisdiction's Top-up Tax is deemed to be zero. If the 15 percent threshold (and other permanent Safe Harbour tests) are not met, the MNE group must revert to the full GloBE computation. Importantly, the SESH cannot increase a jurisdiction's Top-up Tax as the liability remains capped at the amount determined under the full GloBE rules.

For more details on the Simplified ETR Safe Harbour, please refer to a report prepared by KPMG International.

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[1] The IF will engage in an evaluation of pre-existing tax regimes, enacted and effective as of December, 31, 2025, by the end of the first half of 2026. A jurisdiction may also ask the IF to assess its regime in 2027 and 2028. As such, other members of the IF will have an opportunity to qualify for the SbS SH at a later stage as well.

[2] Similarly to the SbS Safe Harbour assessment process, an evaluation of pre-existing tax regimes, enacted and effective as of December, 31, 2025, will be made by the end of the first half of 2026.

[3] Jurisdictions can allow the use of the SESH already for fiscal years starting on or after January 1, 2026 where all the jurisdictions with a Pillar Two taxing right over the jurisdiction make the SESH rules available from 2026.

Transitional County-by-Country Reporting Safe Harbour

The TCSH provides simplified calculations using CbyC Reporting data and financial accounting data that is tested against the de minimis threshold, excluding substance-based income (routine profits) or agreed effective minimum rates. To support transition from the TCSH to the simplified ETR Safe Harbour, the IF has agreed to extend the application of the TCSH to fiscal years beginning on or before December 31, 2027 (but not to fiscal years that end after June 30, 2029).

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,[4] they do not include the majority of the adjustments required under the regular GloBE rules, including adjustments in respect of tax credits (QRTC and MTTC). The TCSH also does not allow adjustments in line with the SBTI Safe Harbour.

As a result, under the TCSH rules the use of tax incentives might lead to a Simplified ETR that is different compared to regular GloBE ETR and to the Simplified ETR calculated under the SESH. Where the Simplified ETR does not exceed 15 percent (2023 and 2024), 16 percent (2025) and 17 percent for fiscal years beginning in 2026 and 2027, 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 TCSH 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).

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 labor in the jurisdiction due to the SBIE.

The Top-up Tax for a low-taxed jurisdiction is calculated by multiplying the Top-up Tax percentage (i.e., difference between the 15 percent minimum rate and the GloBE 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.

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[5] and 10 percent for payroll[6] – both metrics reduce over a ten-year period to 5 percent.

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.

It is important to note 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,

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

[5] 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.

[6] 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.

[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 MOCEs is not required under the TCSH.

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.

2. To what extent do different 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 (assuming the SbS Safe Harbour is not applicable). 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.[9]

The effect of a tax incentive on the jurisdictional GloBE ETR depends on the type, design and mechanics of the measure (i.e., whether it reduces taxable income, reduces tax expenses, or increases income for GloBE purposes). From 2026 onward, the outcome also depends on whether an incentive qualifies for treatment as a QTI under the SBTI Safe Harbour, which may significantly reduce or neutralize the incentive's downward impact on the ETR.

Example 1: Investment allowance / super deduction

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").

Where tax deductions in excess of the economic expenditure are allowed (e.g., deduction of 200 percent of eligible costs incurred), the excess amount creates a permanent book-to-tax difference. Such permanent difference would generally 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.

However, the SBTI Safe Harbour may change the outcome from 2026 where a super deduction qualifies as a QTI. In such cases, the deemed value of the super deduction can be added back to Adjusted Covered Taxes (up to the substance cap), increasing the jurisdictional GloBE ETR and reducing potential Top-up Tax exposure. According to the SbS Package, the deemed tax value is generally the excess of the deduction over the expenditure incurred multiplied by the statutory tax rate in the jurisdiction.[10]

The following calculation example aims to illustrate the extent to which super deductions impact Top-up Tax liability under the regular GloBE rules (2025) and as QTIs under the SBTI Safe Harbour (2026). In 2025, the excess deduction for tax purposes reduces the GloBE ETR numerator (and therefore the GloBE ETR) to zero. In 2026, the SBTI Safe Harbour allows an add-back to the amount of Adjusted Covered Taxes limited to the lower of the deemed tax value of the super deduction (100 x 15 percent = 15) and the applicable substance cap[11] (200 x 5.5 percent = 11), resulting in a GloBE ETR of 11 percent. Accordingly, the Top-up Tax exposure can be significantly lower in cases where super deductions qualify as QTIs and sufficient substance is available in the jurisdiction.

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[9] As an example, the OECD Corporate Tax Statistics 2025 indicate that the "*effective average tax rate*" was reduced to 14.2 percent by expenditure-based R&D tax incentives and to 12.5 percent by income-based R&D tax incentives in 2024.

[10] At the same time, the guidance notes that the value of a tax benefit is the maximum amount by which the tax liability can be reduced by the tax incentive. Where a super deduction is claimed with respect to income that is subject a preferential rate, there is a question whether the value of the QTI is calculated based on the statutory rate or the applicable preferential rate.

[11] For simplification purposes, the carrying value and depreciation of tangible assets are disregarded for purposes of calculating the substance cap and SBIE.

	2025	2026 (QTI election)
Domestic tax rate	15%	15%
Profit before tax in financial accounts (= **GloBE Income**)	100	100
thereof payroll expenses	200	200
thereof investment expenditure	100	100
Additional tax investment expenditure (200% super deduction - QTI)	100	100
Current tax expense	0	0
Adjustment to tax expense (QTI added back)	-	11
Adjusted Covered Tax	0	11
Effective Tax Rate	**0%**	**11%**
Top-Up Tax Rate	15%	4%
SBIE (payroll expense multiplied by 9.6% (2025) / 9.4% (2026))	19.2	18.8
Excess profits (GloBE Income reduced by SBIE)	80.8	81.2
Top-up Tax	**12.12**	**3.25**

Example 2: Tax credits

Tax credits are forms of tax relief that are based on the value of expenditure on qualifying investments and are used to directly reduce the amount of taxes to be paid.

As mentioned above, under the general GloBE rules, it is important to distinguish between different types of tax credits. Credits regularly reduce the GloBE ETR. However, the impact of tax credits will be less significant when they increase the denominator (GloBE Income), which is the case for QRTCs and MTTCs. By contrast, credits that do not qualify as QRTCs or MTTCs would generally reduce the numerator (Covered Taxes) and have a more significant downward impact on the GloBE ETR.

With the introduction of the SBTI Safe Harbour from 2026, refundable and non-refundable tax credits may no longer be treated differently where they meet the QTI conditions and, in the case of QRTCs or MTTCs, an annual election is made to treat those credits (partly or in full) as a QTI. In such cases, the deemed tax value of the tax credit can be added back to Adjusted Covered Taxes (up to the substance cap), increasing the jurisdictional GloBE ETR and reducing potential Top-up Tax exposure. At the same time, the deemed tax value of the QTI does not need to be added back to the amount of GloBE Income.

Non-refundable tax credit

The following calculation example aims to illustrate the extent to which non-refundable tax credits impact Top-up Tax liability under the regular GloBE rules (2025) and as QTIs under the SBTI Safe Harbour (2026). In 2025, the tax credit reduces the GloBE ETR numerator (and therefore the GloBE ETR) to zero without the possibility to make an adjustment. In 2026, the SBTI Safe Harbour allows an add-back to the amount of Adjusted Covered Taxes limited to the lower of the deemed tax value of the tax credit (15) and the applicable substance cap[12] (200 x 5.5 percent = 11), resulting in a GloBE ETR of 11 percent. No add-back to the amount of GloBE Income is required. Accordingly, the Top-up Tax exposure can be significantly lower in cases where a non-refundable tax credit qualifies as a QTI and sufficient substance is available in the jurisdiction.

[12] For simplification purposes, the carrying value and depreciation of tangible assets are disregarded for purposes of calculating the substance cap and SBIE.

	2025	2026 (QTI election)
Domestic tax rate	15%	15%
Profit before tax in financial accounts (=**GloBE Income**)	100	100
thereof payroll expenses	200	200
Tax expense before tax credit	15	15
Non-refundable tax credit (QTI)	15	15
Current tax expense with tax credit	0	0
Adjustment to tax expense (QTI added back)	-	11
Covered Taxes	**0**	**11**
Effective Tax Rate	**0%**	**11%**
Top-Up Tax Rate	15%	4%
SBIE (payroll expense multiplied by 9.6% (2025) / 9.4% (2026))	19.2	18.8
Excess profits (GloBE Income reduced by SBIE)	80.8	81.2
Top-up Tax	**12.12**	**3.25**

Refundable tax credits

The following second calculation example aims to illustrate the extent to which refundable tax credits impact Top-up Tax liability as QRTCs under the regular GloBE rules (2025) and as QTIs under the SBTI Safe Harbour (2026).

It is assumed that the refundable tax credit is treated as income for accounting purposes (booked above the line) and is exempt for local corporate income tax purposes. As a result, in 2025, the QRTC is reflected in the amount of GloBE Income (115) and has no downward impact on the amount of Covered Taxes (15), resulting in a GloBE ETR of 13 percent. The same applies in 2026 in case the taxpayer decides not to apply the election to treat the QRTC as a QTI.

On the other hand, where that election is made in 2026, a number of calculation steps are required. First the portion of the QRTC needs to be determined that can be treated as a QTI. As before, this is limited to the lower of the deemed tax value of the tax credit (15) and the applicable substance cap[13] (200 x 5.5 percent = 11).

In a next step, the QRTC needs to be removed from both GloBE ETR numerator (15 – 11) and denominator (115 – 11).

In a third step, the GloBE ETR numerator is increased by the QTI (4 + 15). No add-back to the amount of GloBE Income is required. As such, whilst the treatment as a QRTC and a QTI results in the same amount of Covered Taxes (15), the SBTI Safe Harbour leads to a lower amount of GloBE Income (104 < 115), slightly increasing the jurisdictional GloBE ETR. In addition, the reduced amount of GloBE Income leads to a lower amount of Excess Profits, which further reduces potential Top-up Tax exposure.

Given the complexity of the interplay between QRTC and QTI treatment, modelling on the value of tax credits will be key for business decision-making.

[13] For simplification purposes, the carrying value and depreciation of tangible assets are disregarded for purposes of calculating the substance cap and SBIE.

	2025	2026 (No QTI election)	2026 (QTI election)
Domestic tax rate	15%	15%	15%
Profit before tax in financial accounts	115	115	115
thereof payroll expenses	200	200	200
thereof refundable tax credit (QTI)	15	15	15
Local tax base (excluding tax credit)	100	100	100
Tax expense (= Covered Tax)	15	15	15
Step 1 – Determine QRTC portion eligible for QTI treatment			
Lower of deemed tax value and substance cap			15 > 11
Step 2 – Reverse QRTC treatment			
Income reduced by portion of QRTC that can be treated as QTI			115 – 11 = 104
Tax expense reduced by portion of QRTC that can be treated as QTI			15 – 11 = 4
Step 3 – Apply QTI treatment			
GloBE Income (no add-back)			**104**
Covered Taxes (add-back of QTI)			4 + 11 = **15**
Effective Tax Rate	**13%**	**13%**	**14.4%**
Top-Up Tax Rate	2%	2%	0.6%
SBIE (payroll expense multiplied by 9.6% (2025) / 9.4% (2026))	19.2	18.8	18.8
Excess profits (GloBE Income reduced by SBIE)	95.8	96.2	85.2
Top-up Tax	**1.87**	**1.88**	**0.49**

Example 3: Tax holidays

Tax holidays are often used by developing countries and are directed towards 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 generally create a permanent book-to-tax difference that reduces 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 GloBE ETR through blending, such tax holidays could result in a Top-up Tax liability.

However, in limited circumstances, a tax holiday may meet the QTI criteria. In particular, this requires that the amount of income benefiting from the incentive is determined directly by reference to expenditure, and that the incentive is generally available to taxpayers (rather than on discretionary basis). In such cases, the deemed tax value of the tax holiday can be added

back to Adjusted Covered Taxes (up to the Substance Cap), increasing the jurisdictional GloBE ETR and reducing potential Top-up Tax exposure.

The following calculation example aims to illustrate the extent to which tax holidays impact Top-up Tax liability under the regular GloBE rules (2025) and as QTIs under the SBTI Safe Harbour (2026). In 2025, the income exemption reduces the GloBE ETR numerator (and therefore the GloBE ETR) to zero. In 2026, the SBTI Safe Harbour allows an add-back to the amount of Adjusted Covered Taxes limited to the lower of the deemed tax value of the tax holiday (100 x 15 percent = 15) and the applicable substance cap[14] (200 x 5.5 percent = 11), resulting in a GloBE ETR of 11 percent. Accordingly, the Top-up Tax exposure can be significantly lower in cases where tax holidays qualify as QTIs and sufficient substance is available in the jurisdiction.

	2025	**2026** **(QTI election)**
Domestic tax rate	15%	15%
Profit before tax in financial accounts (=**GloBE income**)	100	100
thereof payroll expenses	200	200
thereof income subject to tax holiday	100	100
Local tax base for current tax expense	0	0
Adjustment to tax expense (QTI added back)	-	11
Covered taxes	0	11
Effective Tax Rate	**0%**	**11%**
Top-Up Tax Rate	15%	4%
SBIE (payroll expense multiplied by 9.6% (2025) / 9.4% (2026))	19.2	18.8
Excess profits (GloBE Income reduced by SBIE)	80.8	81.2
Top-Up Tax	**12.12**	**3.25**

Example 4: 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.[15]

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 generally 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 GloBE 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, i.e., due to the jurisdictional blending.

Notably, the introduction of the SBTI Safe Harbour will not change this assessment for the majority of existing IP regimes. Under consideration of BEPS Action 5, IP regimes typically rely on eligible R&D expenditure to determine the nexus factor (and

[14] For simplification purposes, the carrying value and depreciation of tangible assets are disregarded for purposes of calculating the substance cap and SBIE.

[15] The OECD Tax Statistics Database contains information on 65 IP regimes that were in place in 50 different jurisdictions in the year 2025. According to the OECD Corporate Tax Statistics 2025, 46 of these IP-regimes have been found to be not harmful by the Forum on Harmful Tax Practices (FHTP). 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 percent to 18.75 percent). One regime was found to be potentially harmful but not actively harmful (in Brunei Darussalam). Six regimes are in the process of being amended or eliminated.

the entry into the IP regime). However, at the same time, the amount of income that is subject to a reduced rate or exemption is typically not calculated directly by reference to such expenditure. Therefore, it is currently expected that, in most cases, IP regimes will not be considered expenditure-based tax incentives eligible for QTI treatment.

	2025	**2026** **(QTI election not available)**
Domestic tax rate	15%	15%
Profit before tax in financial accounts (= **GloBE income**)	100	100
thereof payroll expenses	200	200
thereof IP income (subject to preferential rate of 5%)	50	50
Tax expense on ordinary income	7.5	7.5
Tax expense on IP income	2.5	2.5
Current Tax expense (= **Covered taxes**)	10	10
Effective Tax Rate	**10%**	**10%**
Top-Up Tax Rate	5%	5%
SBIE (payroll expense multiplied by 9.6% (2025) / 9.4% (2026))	19.2	18.8
Excess profits (GloBE Income reduced by SBIE)	80.8	81.2
Top-Up Tax	**4.04**	**4.06**

Example 5: 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.[16]

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.

Notably, the introduction of the SBTI Safe Harbour will not change this assessment for existing NID regimes since the amount of the NID is not calculated by reference to expenditure (or on the basis of the amount of tangible property produced in a

[16] According to the OECD Corporate Tax Statistics 2025, among all 104 jurisdictions covered for 2024, the following six jurisdictions had an allowance for corporate equity: Cyprus 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. However, the EC noted that the DEBRA proposal has not been taken forward by the Council, nor have Member States introduced comparable initiatives at the national level. As a result, the EC in its 2026 work program noted that it would withdraw the DEBRA Directive proposal (see Euro Tax Flash Issue 572).

jurisdiction). It is therefore expected that NID regimes would generally not qualify as QTIs under the SBTI Safe Harbour and will not benefit from a favorable treatment starting from 2026.

	2025	**2026** **(QTI election not available)**
Domestic tax rate	15%	15%
Profit before tax in financial accounts (= **GloBE income**)	100	100
thereof payroll expenses	200	200
Equity increase	1000	1000
Notional interest deduction	5%	5%
Less: Notional interest deduction	-50	-50
Local tax base for current tax expense	50	50
Current Tax expense (= **Covered taxes**)	7.5	7.5
Effective Tax Rate	**8%**	**8%**
Top-Up Tax Rate	7%	7%
SBIE (payroll expense multiplied by 9.6% (2025) / 9.4% (2026))	19.2	18.8
Excess profits (GloBE Income reduced by SBIE)	80.8	81.2
Top-Up Tax	**6.06**	**6.09**

Example 6: 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.[17] 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.

Notably, the introduction of the SBTI Safe Harbour will not change this assessment for accelerated depreciation. The SbS guidance explicitly notes that tax allowances for capital expenditure that only give rise to timing differences do not fall within the definition of QTIs given that the GloBE rules have already addressed this through deferred tax mechanisms to generally prevent such incentives from giving rise to Top-up Taxes.

[17] According to the OECD Corporate Tax Statistics 2025, 88 of the 104 jurisdictions covered for 2024 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 to 15%)	11	11	11	11	11	(19)	(19)	(19)
Covered Taxes 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**

Note, however, that Top-up Tax exposure may nevertheless be triggered where temporary differences in respect of expenses related to non-tangible assets do not unwind within five years. In such cases, Top-up Tax may arise, 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 to 15%)	11	11	11	11	11	(19)	(19)	(19)
Covered Taxes 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-calculated in Year 5)	0%							
Effective Tax Rate (re-calculated in Year 6)		0%						
Effective Tax Rate (re-calculated in Year 7)			0%					
Top-up Tax (recalculated)	**15**	**15**	**15**					

3. How may Pillar Two impact the design of local tax incentive offerings?

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 inclined to take any action to adjust existing tax incentives in light of Pillar Two alone, 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 taxpayers 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, replaced by a new tax incentive system or simply amended to align with Pillar Two design requirements.

Move toward Pillar Two compliant incentives?

Overall, incentives that are linked to investments in tangible assets and labor may be favored in a Pillar Two environment. Whilst this was already true under the initial Pillar Two framework, the introduction of the SBTI Safe Harbour reinforces this observation. Those incentives result in an increased focus on the operational footprint that an MNE has in a jurisdiction and, thus, will be reflected in both an increased substance cap (for SBTI Safe Harbour purposes) and the 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), grants and subsidies, as well as expenditure-based or production-based tax credits or enhanced allowances to support investment in employment opportunities, training, infrastructure, equipment and innovation. It may also include personal income tax related incentives, such as improved expat income tax incentives (can allow for reduction of salary costs to MNEs) or social security contribution (SSC)-related reliefs.

However, in light of the new SbS Safe Harbour, Pillar Two will have 'patchwork' rather than 'universal' application across the world. Where the Pillar Two rules do not apply (e.g., US groups operating in non-QDMTT countries), a wider range of incentives will 'work'. Where the Pillar Two rules continue to apply, the effectiveness of incentives will still depend on the extent to which they are impacted by the Pillar Two rules.

Integrity considerations

At the same time, policymakers need to take into account the ongoing work at Inclusive Framework level on assessing and addressing incentives that are considered to pose a risk of undermining the integrity of the Pillar Two framework. Various integrity measures in relation to incentive offerings have already been announced:

- *QTI status:* as part of the SbS Package, the Inclusive Framework agreed to exclude incentives from the favorable QTI treatment where they are granted under discretionary governmental arrangements (i.e., not generally available to taxpayers), in order to prevent incentives from being used to return tax in a way that would undermine the goals of Pillar Two. In addition, the Inclusive Framework agreed to set a generosity limitation by excluding expenditure-based tax incentive from being treated as a QTI if the value of the deemed tax benefit exceeds the expenditure incurred.
- *Qualified SbS regime / UPE regime status:* similarly, with respect to qualifying for the SbS Safe Harbour and the UPE Safe Harbour, the Inclusive Framework agreed that both an eligible domestic and worldwide regime must present no material risk that in-scope MNE Groups headquartered in the jurisdiction will be subject to an ETR on the overall profits of their domestic and foreign operations, respectively, below 15 percent. The evaluation of whether a country meets these conditions will particularly take into account how local incentive offerings impact the ETR. Such assessment will follow the treatment as prescribed by the GloBE rules and agreed Safe Harbours.
- *QDMTT / QIIR status:* with respect to the assessment of whether a country achieves Qualified Status for a Domestic Minimum Top-up Tax or IIR regime, the GloBE rules require jurisdictions not to provide any benefits that are related to such rules. Under such related benefits restrictions countries that have signed up to Pillar Two will be expected not to undermine the goals of Pillar Two by compensating in-scope MNE groups in any form (i.e., tax or non-tax related).

In this context, further guidance on integrity measures and the 'related benefits' rules is expected to be issued by the OECD in the course of 2026.

Further design limitations to be considered

The decision by governments on whether and how to re-design existing tax incentive regime will likely be based on various considerations, i.e., not only on a potential Pillar Two exposure.[18]

For example, countries will also need to consider internationally agreed principles (e.g., BEPS Action 5 and the related review by the OECD Forum on Harmful Tax Practices, or EU State aid rules) that set certain boundaries for the design of tax incentives.

Jurisdictions may further take into account the offered cash tax value for taxpayers as well as whether the jurisdiction's economic circumstances and budgetary constraints allow for the granting of, for example, cash grants or refundable tax credits.

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 tax credits may require additional resources for eligibility checks and fraud prevention.

In addition, certain incentives (e.g., tax holidays) can often be supported by contractual agreements between the government and 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.

Country responses (KPMG observation)

Europe

In response to the global implementation of Pillar Two, some countries introduced new qualified refundable tax credits – QRTCs – (e.g., Hungary, Norway, Switzerland, Romania) or tweaked the refundability conditions of existing credits to align with the Pillar Two rules (e.g., Ireland and Belgium). In addition, a number of countries already had in place tax credits that are aligned with the GloBE Rules before the rules came into effect (e.g., France, Germany, the UK).

However, it appears that a significant number of R&D tax incentives are still provided in the form of non-refundable tax credits, super deductions, exemptions or preferential rates across Europe. Whilst, over the past couple of years, a number of countries have reportedly been exploring options to replace those incentives that result in a significant impact on the GloBE ETR with incentives that are aligned with Pillar Two (e.g., Croatia and Poland), some may have postponed taking action in anticipation of further guidance, which was published as part of the SbS Package.

Following the announcement of the SBTI Safe Harbour (as at April 2026), yet to be implemented by most European countries into the local Pillar Two law), it is conceivable that a number of European countries may find that their existing palette of incentives fares well under the new rules. For example:

- It is expected that many tax credits will qualify as QTIs, including those that currently do not meet the refundability criteria for QRTC treatment (e.g,, the Luxembourg Investment Tax Credit or the Finnish tax credit for large investments supporting climate-neutral economy (as confirmed by local guidance)).
- In addition, many super deductions and enhanced allowances that are currently being offered by European countries are expected to be treated as QTIs (e.g., the Swiss R&D super deduction for eligible payroll costs, the Polish super deduction for R&D-related personnel costs, the Czech R&D allowance or the Finnish enhanced R&D allowance (as confirmed by local guidance)).
- In limited circumstances, local regimes that provide for income exemption or reduced CIT rates may also benefit from QTI treatment where they are considered to be calculated 'directly' by reference to expenditure and to be 'generally available' to taxpayers (e.g., the Polish Investment Zone Regime or the recently updated Czech Tax Holiday regime).

[18] The OECD "*Practical Guide to Investment Tax Incentives*" provides guidance on specific elements of incentive design that can support more effective and efficient policies.

- It is also conceivable that some of the existing incentives may see an increased use under the new SBTI Safe Harbour, with their benefits no longer being neutralized by Pillar Two.

For an overview of available R&D tax incentives, please refer to the KPMG's Global R&D Incentives Guide.

Other countries may be prompted to modify their incentive offerings to enhance their investment attractiveness. For example:

- The Swedish government is considering the introduction of new R&D tax incentives. As at the date of publication of this article, two alternative incentive models are being discussed, both proposed to apply from 2027 and to be claimed through the corporate income tax return. Under the first alternative, companies would be entitled to deduct 300 percent of qualifying R&D salary costs. Under the second alternative, a 20 percent refundable tax credit for qualifying R&D salary costs would be available. According to the Ministry of Finance's related memorandum, the proposal reflects alignment with the SBTI Safe Harbour conditions.

- In the Netherlands, a public debate in the beginning of 2026 was focusing on whether to amend the existing innovation box regime by calculating the benefit of the incentive by reference to expenditures incurred. As noted above, it is currently expected that most of the European IP regimes will not qualify as a QTI. As such, this may be a consideration also relevant for other European countries that currently provide for an IP regime (e.g., Ireland, Luxembourg, Poland, Spain, Switzerland).

- Furthermore, European countries may be considering amending existing incentive offerings to provide a stronger link to expenditure related to personnel and tangible assets (in light of the substance cap).

Asia Pacific (ASPAC)

As in other world regions, Pillar Two has prompted a need to reshape tax incentive policies in ASPAC. Ten jurisdictions in the region have introduced Pillar Two rules, half with effect from 2024 and half from 2025[19]. Policymakers in non-adopting countries are also aware that the value of their incentives to investors will be impacted by Pillar Two rules adopted by other jurisdictions. Despite this, moves in the region to update incentives have generally been slow. Several factors are in play in this regard.

Firstly, ASPAC Pillar Two adopters may be divided into high tax jurisdictions, which will only see local ETRs below 15 percent in rare cases (e.g., Australia, Japan), and jurisdictions that either have low general rates or extensive tax incentives / preferential tax regimes, with frequent instances of ETRs below 15 percent (e.g., Hong Kong SAR, Singapore, Vietnam). As it happens, most of the existing (non-refundable) tax credits in the region were, prior to Pillar Two, offered by the higher tax jurisdictions.[20] As these credits would be unlikely to lower ETRs below 15 percent (resulting in Pillar Two claw back) these jurisdictions saw little need to convert their existing credits to QRTCs to preserve their value. As such, the trend of existing tax credits being made refundable, noted in Europe, was not in evidence in ASPAC.

For ASPAC jurisdictions in which ETRs below 15 percent frequently arise, there are two main sources of low rates, both of which were problematic under the pre-SBTI Pillar Two framework – namely, income-based tax incentives (tax holidays, preferential rates, exemptions, territorial regimes) and super deductions. Two ASPAC jurisdictions that relied in particular on income-based tax incentives, Singapore and Vietnam, did take significant steps to adapt.

Singapore introduced a QRTC in 2024, the Refundable Investment Credit (RIC), with the benefit calculated at rates up to 50 percent of qualifying expenses in connection with favored activities, e.g., headquarters, innovation, green and digital projects, and advanced manufacturing. In addition, Singapore also introduced a new concessionary tax rate tier of 15% across its various tax incentives (previously 0.5 or 10 percent concessionary tax rate for most income-based tax incentives). Vietnam instead created a new tax-exempt cash grants scheme, financed from a 2024-established investment support fund, directed at large-scale investments in designated high-tech sectors, e.g., semiconductors and AI data centers. Other ASPAC jurisdictions in which ETRs below 15 percent frequently arise, including Hong Kong SAR, Indonesia, Malaysia, and Thailand, indicated that they

[19] 2024: Australia, Japan, South Korea, Vietnam; 2025: Hong Kong (SAR), Indonesia, Malaysia, New Zealand, Singapore, Thailand.

[20] Prior to Pillar 2 introduction, in the ASPAC region solely New Zealand offered a (partially) refundable tax credit.

were considering incentive regime changes, possibly including QRTC introduction, but ultimately did not seem to follow through.

The SBTI Safe Harbour significantly changes the game for ASPAC, in particular with regard to super deductions. For ASPAC jurisdictions in which ETRs below 15 percent frequently arise this is in many cases in consequence of super deductions.[21] These can be generous, ranging for example up to 400 percent in Singapore for certain categories of expenditure, e.g., R&D, employee training, etc. It is likely that for many of the ASPAC jurisdictions in respect of which Pillar Two top-up tax would have been due (under the pre-SBTI Pillar Two framework) as a result of super deductions, these exposures are significantly mitigated or eliminated under the new framework from 2026 onwards. This may consequently enhance the attractiveness of jurisdictions including China, Hong Kong SAR, Indonesia, Malaysia, Philippines, Singapore and Thailand, relative to their position under the pre-SBTI Pillar Two framework. It remains to be seen if these jurisdictions 'lean into' this advantage, e.g., by expanding the range of qualifying projects/expenditures, enhancing the rates, or by permitting businesses to opt for enhanced deduction schemes, in the place of other types of incentives, where they see fit.[22]

Open questions remain around next steps with ASPAC income-based tax incentives. Clearly, these are in many cases enjoyed by smaller enterprises outside the scope of Pillar Two and ASPAC jurisdictions offering tax holidays do not appear to be rolling these back. Tax holidays are clearly of diminished attractiveness to Pillar Two in-scope groups – policymakers and businesses in the region are still in the process of evaluating whether, post-SBTI, the existing national (Pillar Two-protected) incentive offerings are adequate to attract investment, or whether existing income-based tax incentives also need to be modified or replaced.

Regard is being had, in the region, to how some European jurisdictions are looking to adapt income-based incentives so that benefits are calculated 'directly' by reference to expenditure, in order to avail of QTI treatment. This may be a bit more challenging in many ASPAC jurisdictions, due to the frequent broad coverage of income-based incentives, e.g., tax holidays for companies operating in certain sectors or locations.[23] Typically, these tax holidays do not calculate any limitation on the relief given with reference to expenditures incurred, which may differ from the approaches taken in some European countries.

While there are indications that certain ASPAC jurisdictions are looking at further revisions to their incentive offerings (e.g., Indonesia, Philippines), the exact future trajectory of tax incentives in ASPAC is largely a case of wait and see.

Other regions

In other regions across the globe, countries also introduced or announced new incentives taking into account the design restriction posed by the Pillar Two framework, including:

- Barbados introduced in 2024 tax credits aimed to align with the requirements of a QRTC under the GloBE rules. These credits are offset against corporation tax (and any other tax liability) and 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 QDMTT[24] of 15 percent. For example, a refundable payroll tax credit on eligible payroll costs was introduced in respect of full-time employees engaged in designated activities (with a maximum

[21] ASPAC non-refundable tax credits and production-based tax incentives (Australia) will also see improved Pillar Two treatment under SBTI. However, as noted above, these are mainly offered by high-tax jurisdictions in which the ETR would only rarely dip below 15 percent, so the net effect on the value of these incentives may be limited.

[22] For example, the 2024 CREATE MORE Law in the Philippines currently provides options for certain qualified registered business enterprises that, subsequent to the tax holiday period, they can choose to enjoy either 5 percent special CIT rate or enhanced deduction regime in the subsequent 10 years. This way of designing the incentives with optionality may work better now, in concept, under the SBTI Pillar Two framework.

[23] While patent boxes do exist in ASPAC they are relatively limited, e.g., Hong Kong, India, Japan. The Singapore Intellectual Property Development Incentive is sometimes also referred to as a patent box.

[24] Barbados introduced a conditional QDMTT for 2024 that is only applicable where the UPE of the group is based in a jurisdiction that has introduced an IIR or a UTPR. From 2025, the QDMTT is applied to all local entities that are part of an in-scope MNE group (i.e., unconditional QDMTT).

effective payroll credit of 100 percent). In addition, a credit of 50 percent of qualifying expenses incurred for qualifying research and development activities was introduced.

- Following the introduction of a DMTT (applicable from 2024) in The Bahamas, a Business Development Incentives Programme was introduced on July 1, 2025. An eligible licensee may be awarded financial incentives for engaging in qualifying investment activities (e.g., capital expenditure, job creation, employee training, research and innovation, as well as adopting, maintaining or expanding the use of The Bahamas as the situs of senior management functions and decision-making or centres of excellence). A financial incentive may only be based on expenditures incurred or turnover earned by an eligible licensee in 2023 and where the eligible licensee carried on business operations with annual turnover exceeding B$50 million (approximately EUR 43 million). The financial incentive may offset liabilities under the Business Licence Act, 2023 or the Domestic Minimum Top-Up Tax Act, 2024. A financial incentive may be carried forward and used to offset eligible tax liabilities arising within a four-year period.

- In Bermuda, following the introduction of a 15 percent corporate income tax (applicable from January 1, 2025), a substance-based tax credit was introduced for fiscal years beginning on or after January 1, 2025 for the insurance sector. The amount of the tax credit is calculated with reference to eligible expenses incurred in the jurisdiction (including payroll, premises, tangible assets, training). In addition, a community development tax credit has been introduced and is calculated by reference to donations made to registered Bermuda charities for the fulfilment of charitable purposes in the jurisdiction. Where these tax credits cannot be used to offset tax liabilities within a four-year period, the tax credit benefits may be refunded to the taxpayer, subject to conditions.

- In Brazil, although the Pillar Two legislation expressly provides that some regional tax incentives (*i.e.*, SUDAM / SUDENE) may be converted into QRTCs by the Executive Branch as from 2026, this has not happened yet. Further guidance from the Executive branch and the Brazilian IRS is yet to be issued.

- The United Arab Emirates recently introduced a non-refundable R&D tax credit that is expected to qualify as a QTI. The credit is applied at a rate of 15, 35 or 50 percent depending on the amount of qualifying R&D expenditure and the average number of R&D staff per qualifying entity or tax group in each fiscal year. Qualifying R&D expenditure comprises staff costs, consumables costs, subcontracting fees and arm's length contributions to cost contribution arrangements, provided that they are attributable to qualifying R&D activity, with a maximum expenditure of AED 5 million (approximately EUR 1.2 million). The credit is non-refundable and may be utilized against UAE corporate income tax and/or Top-up Tax liabilities of the qualifying entity, tax group or domestic group. For more details, please see a report by KPMG in the UAE.

4. Conclusion

The changes to the Pillar Two framework agreed as part of the 2026 Side-by-Side Package are expected to have significant impact on the value of tax incentives.[25]

In particular, the SBTI Safe Harbour is expected to be a game changer in many cases as it allows for the value of a wider range of incentives to be protected from Pillar Two claw back. This includes permanent benefits from super deductions and non-refundable tax credits, which are offered by many jurisdictions across the globe. The SBTI Safe Harbour also enhances the treatment of production-based tax incentives and (in certain circumstances) income-based tax incentives, such as low rates or exemptions. The value of these incentives is added back to the ETR numerator to the extent sufficient substance is available in the jurisdiction (calculated on the basis of payroll or tangible assets).

Whilst this has the potential of significantly increasing the GloBE ETR compared to the pre-SBTI Pillar Two framework, the precise value of the SBTI will vary case-by-case and careful modelling may be needed.

For jurisdictions, the SBTI Safe Harbour also provides potential alternative paths to the redesign of tax incentive regimes. Notably, while incentives covered by SBTI are subject to a cap, QRTCs and MTTCs remain uncapped (unless an election is made to treat those as QTIs). As such, tax policymakers in relevant countries will likely give this detailed consideration to maintain and enhance their investment attractiveness for the years ahead. Before moving forward they may, however, await further OECD guidance that is expected to provide safeguards around use of incentives that would effectively 'hand back' Pillar Two top-up tax to in-scope MNEs (related benefits rules).

Once those remaining elements of the new Pillar Two incentives framework are available, it is expected that the second half of 2026 will see significant developments in local tax incentives policies that taxpayers may want to closely monitor.

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[25] The UK, Netherlands, France and South Africa have all revised down significantly their anticipated revenue from GMT, in consequence of the Side-by-Side Package changes, including SBTI. For the UK see Office for Budget Responsibility (2026) *Economic and fiscal outlook – March 2026*. Available at: https://obr.uk/efo/economic-and-fiscal-outlook-march-2026.

Annex

What is the general concept of Pillar Two?

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

In order to determine whether this floor has been reached, in-scope groups must determine the jurisdictional effective tax rate (ETR) for each jurisdiction they operate in. Pillar Two operates a jurisdictional blending concept, whereby the ETR is determined jointly for all the Constituent Entities located in that jurisdiction. The GloBE 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). The jurisdictional ETR is then compared to the Minimum Tax Rate of 15 percent.

The Top-up Tax percentage is determined as the positive difference between the GloBE ETR and the Minimum Tax Rate. This rate is then applied to any Excess Profits remaining after deducting the SBIE to determine the Top-up Tax due for that jurisdiction. Note that 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 Reporting Safe Harbour, Simplified ETR Safe Harbour, SbS Safe Harbour, UTPR/UPE Safe Harbour) that reduce, under certain conditions, the Top-up Tax to zero.

The individual Constituent Entities of an MNE Group within the scope of the GloBE rules are obliged to submit a GloBE Information Return (GIR) in their respective country of residence. However, if certain conditions are met, the declaration can be submitted once by the UPE in its country of residence or by a Designated Filing Entity in another jurisdiction and subsequently disseminated to all relevant Pillar Two jurisdictions. The returns must be filed within 15 months of the end of the financial year to which they relate (18 months for the transition year).

How is the GloBE ETR calculated?

Once it has been determined that an MNE Group falls within the scope of the GloBE rules, the next step is to assess whether the ETR for each jurisdiction in which the group operates falls below the 15 percent minimum rate. The GloBE ETR is calculated by dividing the Adjusted Covered Taxes (the numerator) by the GloBE Income or Loss of the Constituent Entities located in that 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 a local acceptable accounting standard that is different to the one applied by the UPE.

The GloBE Income or Loss is then determined by applying specified adjustments to the FANIL. These adjustments 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 include specific safeguards for tax credits to reduce the risk of them being used to distort the ETR calculation. As part of those safeguards, certain qualifying tax credits are treated as income for GloBE purposes:

- *Qualified Refundable Tax Credits (QTRC):* 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 the credit.
- *Marketable Transferrable Tax Credit (MTTC):* 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.

Where tax credits do not qualify as a QRTC or MTTC, they are treated as a reduction to the amount of Adjusted Covered Taxes (assuming the SBTI Safe Harbour is not applicable). Please refer to the section on the Substance based tax incentive (SBTI) Safe Harbour for details on the concept of Qualified Tax Incentives (QTIs) that benefit from a favorable Pillar Two treatment for Fiscal Years starting on or after January 1, 2026.

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. Covered Taxes include taxes recorded in respect of a Constituent Entity's net income (i.e., corporate income taxes, but also including taxes withheld at source on interest and royalties), taxes imposed in lieu of a corporate income tax, taxes imposed under eligible distribution tax systems and taxes on retained earnings and corporate equity. 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.

In order to account for temporary accounting (book) to tax differences, the amount of Adjusted Covered Taxes includes an allowance for deferred tax expenses. This way the rules accommodate timing differences (e.g., triggered by the utilization of tax losses or incentives such as accelerated depreciation and immediate expensing) 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 15 percent 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.

Furthermore, the GloBE rules 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).

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 GloBE ETR is computed by reference to all the Constituent Entities of the MNE Group located in the same jurisdiction. If the blended GloBE 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. 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 as low-taxed.

Calculating a GloBE 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 GloBE 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 GloBE ETR and Top-up Tax computation (e.g., Investment Entities, Joint Venture groups, Minority-Owned groups, Stateless Entities).[26]

[26] Note, however, that such standalone calculation for Minority-Owned Constituent Entities (MOCEs) is not required under the TCSH. Depending on the level of taxation of the MOCE, this could have a temporary upward or downward impact on the ETR.

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