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# PILLAR 2 | ADJUSTED COVERED TAXES

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# Covered Taxes – Art. 19

**Covered Taxes shall be:**

a) taxes **accrued in the financial accounts of a constituent entity** with respect to its **income or profits**, or its share of the income or profits of a constituent entity in which it owns an ownership interest;
b) taxes on **distributed profits, deemed profit distributions, and non-business expenses imposed under an eligible distribution tax system**;
c) taxes imposed **in lieu of a generally applicable corporate income tax**; and
d) taxes levied **by reference to retained earnings and corporate equity**, including taxes on multiple components based on income and equity.

**Covered Taxes shall not include:**

a) the top-up tax accrued by a parent entity under a **qualified income inclusion rule**;
b) the top-up tax accrued by a constituent entity under a **qualified domestic top-up tax**;
c) taxes attributable to an adjustment made by a constituent entity as a result of the application of a **qualified undertaxed profit rule**;
d) a **disqualified refundable imputation tax**;
e) taxes paid **by an insurance company in respect of returns to policyholders**.

➢ taxes in respect of any net gain or loss arising from the disposal of immovable property as referred to in the first subparagraph of **Article 15(7) in the fiscal year in which the election is made**

# Adjusted Covered Taxes – Art. 20

**Adjusted covered taxes are determined by adjusting the sum of the tax expense accrued in the constituent entity's financial accounting net income or loss with respect to covered taxes for the fiscal year, by:**

| (a) | (b) | (c) |
|---|---|---|
| ✓ the net amount of its additions and reductions to covered taxes for the fiscal year as set out in paragraphs 2 and 3 or Art. 20 (see next slide). | ✓ the Total Deferred Tax Adjustment Amount as set out in Article 21 | ✓ any increase or decrease in covered taxes accrued in equity or other comprehensive income relating to amounts included in the computation of qualifying income or loss that will be subject to tax. |

An amount of covered tax falling within more than on point of (a) to (c) above is to be taken into account only once for the purposes of the required adjustment to the covered taxes.

# Adjusted Covered Taxes – Art. 20

| Additions (par. 2): | | Reductions (par.3): | |
|---|---|---|---|
| a) | Covered Taxes accrued as an expense in the profit before taxation in the financial accounts | a) | Current tax expense with respect to income excluded from the computation of qualifying income or loss under Chapter 3 |
| b) | Qualifying loss deferred tax assets that has been used pursuant to **Article 22(2)** | b) | Credit or refund in respect of a Non-qualified refundable tax credit that is not recorded as a reduction to the current tax expense |
| c) | Covered taxes relating to an uncertain tax positions where that amount has been treated as a reduction to Covered Taxes | c) | Covered Taxes refunded or credited (except qualified refundable tax credits) to a CE that was not treated as an adjustment to current tax expense in the financial accounts |
| d) | Credit or refund in respect of qualified refundable tax credit that is recorded as a reduction to the current tax expense | d) | Current tax expense which relates to an uncertain tax position |
| | | e) | Current tax expense that is not expected to be paid within 3 years |

# Adjusted Covered Taxes – Art. 21

Art. 21 provides the mechanism to address temporary differences, which arise when income or loss is recognised in a different year for financial accounting and tax.

The principal mechanism that the GloBE Rules use to address temporary differences builds on deferred tax accounting, with key adjustments to protect the integrity of the GloBE Rules.

**Example**

- Company A is located in Country A which imposes a 15% CIT.
- In the first Fiscal Year, Company A purchases an asset (Asset) for 100.
- The Asset (i) must be depreciated over five years for financial accounting purposes and (ii) benefits from immediate expensing under the tax laws of Country A.
- Company A earns 100 of operating income in that same Fiscal Year.
- For domestic tax purposes, Company A has no taxable income due to the immediate expensing of Asset.
- For financial accounting and GloBE purposes, Company A has 80 of income (100 of operating income, less 20 of amortisation).
- Absent Article 21, Top-up Tax of 12 would be due in the first Fiscal Year, given the 80 of income with no tax paid. However, Article 21 operates to adjust for this timing difference by permitting the deferred tax assets and liabilities of Company A to be taken into account.
- The temporary difference amount is 80 (i.e., the amount of income that is GloBE Income in the current Fiscal Year and that will reverse as the asset is amortised for financial accounting purposes over the next four years).
- To prevent this timing difference from resulting in Top-up Tax, 80 of GloBE Income should be sheltered by the rules provided for by Article 21 rules.
- Article 21 rules, following standard tax accounting principles, will permit a deferred tax liability to be recognised in the first Fiscal Year of 12, which provides shelter for 80 of GloBE Income at the 15% Minimum Rate.

| | **Accounting** | **Tax** | **Globe** |
|---|---|---|---|
| Income | 100 | 100 | 100 |
| Expenditure | -20 | -100 | -20 |
| Total Profit (Loss) | 80 | 0 | 80 |
| Tax (15%) | | 0 | 12 |
| DTL | 12 | | |

*the deferred tax assets and liabilities must be **recast with reference to the Minimum Rate (15%)** to the extent they have been recorded at a rate in excess of the Minimum Rate

**Art. 22 - Qualifying loss election**

Optional regime: qualifying loss deferred tax asset shall be equal to the net qualifying loss for a fiscal year for the jurisdiction multiplied by the minimum rate

# Specific allocation of covered taxes – Art. 23

| Permanent establishment | Constituent entity-owner | Subsidiary | Hybrid entity |
|---|---|---|---|
| ✓ A **PE** shall be allocated the amount of any covered taxes that are included in the financial accounts of a constituent entity and that relate to qualifying income or loss of the permanent establishment (see Art. 23(7)) | ✓ It shall be allocated the amount of any covered taxes that are included in the financial accounts of a tax **transparent entity** and that relate to qualifying income or loss allocated to a constituent entity-owner | ✓ A **constituent entity** shall be allocated the amount of any covered taxes included in the financial accounts of its direct or indirect constituent entity-owners under a **CFC**, to the extent that those covered taxes relate to qualifying income or loss of the constituent entity<br><br>✓ A constituent entity that made a **distribution** during the fiscal year shall be allocated the amount of any covered taxes accrued in the financial accounts of its direct constituent entity-owners on such distributions. | ✓ A **hybrid entity** shall be allocated the amount of any covered taxes included in the financial accounts of its constituent entity-owner and which relates to qualifying income of the hybrid entity |

# (N-)QRTC | (N-)MTTC | QFTB

33. For the purposes of determining the GloBE category of a tax credit, the refundability criteria should be tested primarily, and the transferability should be tested subordinately. **Accordingly**, if a tax credit meets the refundability criteria and qualifies as a QRTC, it will be defined as a QRTC regardless of whether it could be also transferable at a marketable price. If the tax credit rather does not meet the refundability criteria (i.e., it is either a non-refundable or a non-QRTC), then the transferability criteria shall be tested in order to determine whether the tax credit could be considered a Marketable Transferable Tax Credit. [A.G. July 2023]

- ✓ **Qualified Refundable Tax Credit** means a refundable tax credit designed in a way such that it 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 under the laws of the jurisdiction granting the credit. A tax credit that is refundable in part is a Qualified Refundable Tax Credit to the extent it 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 under the laws of the jurisdiction granting the credit. A Qualified Refundable Tax Credit does not include any amount of tax creditable or refundable pursuant to a Qualified Imputation Tax or a Disqualified Refundable Imputation Tax.

- ✓ **Marketable Transferable Tax Credits** means a tax credit that can be used by the holder of the credit to reduce its liability for a Covered Tax in the jurisdiction that issued the tax credit and that meets the legal transferability standard and the marketability standard in the *hands of holder*.

# (N-)QRTC | (N-)MTTC | QFTB

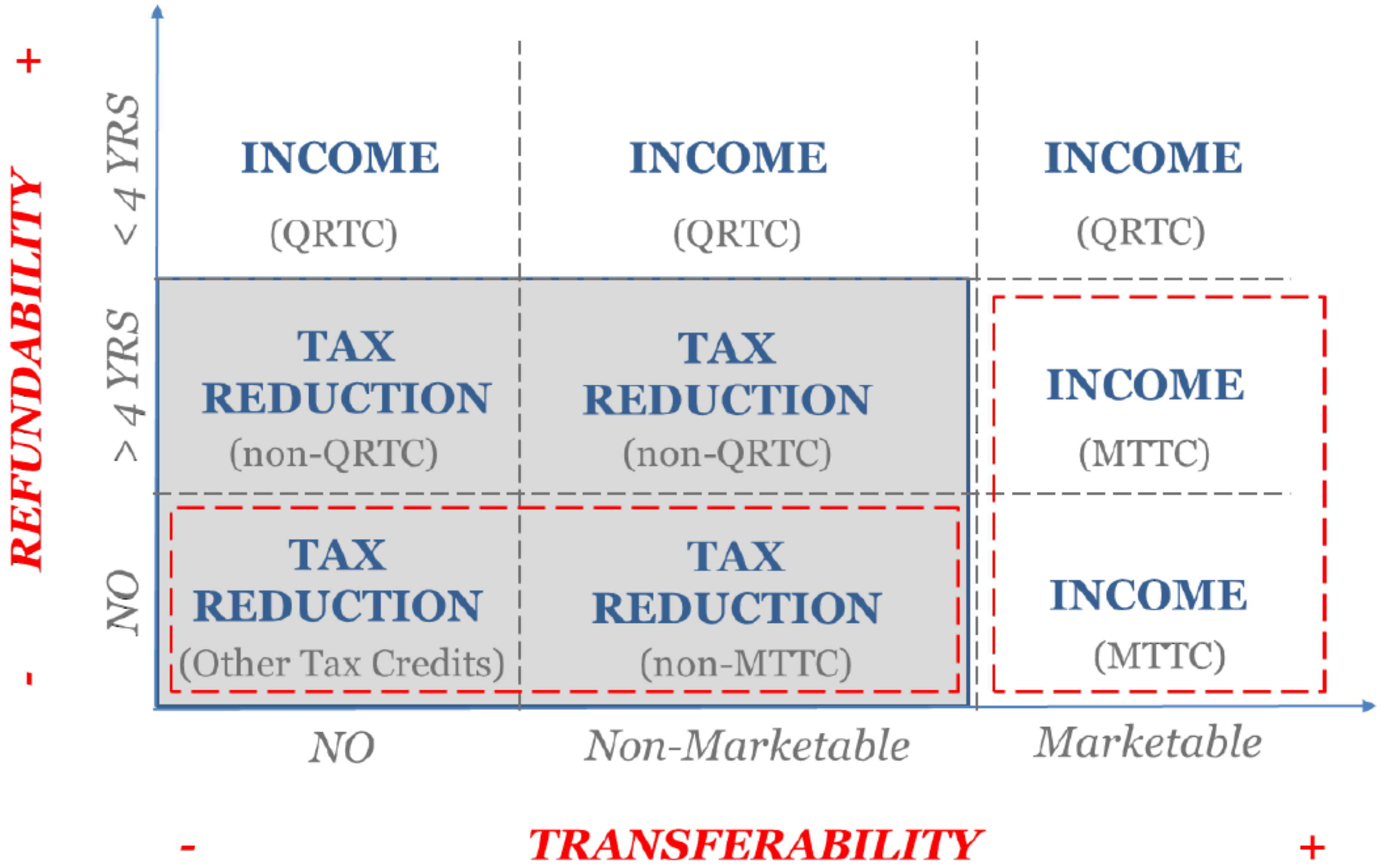
- ✓ **Legal transferability standard.** The legal transferability standard is met for the Originator of a tax credit if the tax credit regime is designed in a way that the Originator can transfer the credit to an unrelated party in the Fiscal Year in which it satisfies the eligibility criteria for the credit (Origination Year) or within 15 months of the end of the Origination Year. The legal transferability standard is met for a purchaser of a tax credit if the tax credit regime is designed in a way that the purchaser can transfer the credit to an unrelated party in the Fiscal Year in which it purchased the tax credit. If under the legal framework that applies to the credit, a purchaser of the tax credit cannot legally transfer the tax credit to an unrelated party or is subject to more stringent legal restrictions on transfer of the credit than the Originator, the tax credit does not meet the legal transferability standard in the hands of the purchaser.

- ✓ **Marketability standard.** The marketability standard is met for the Originator of a tax credit if it is transferred to an unrelated party within 15 months of the end of the Origination Year (or, if not transferred or transferred between related parties, similar tax credits trade between unrelated parties within 15 months of the end of the Origination Year) at a price that equals or exceeds the Marketable Price Floor. The marketability standard is met for a purchaser if that purchaser acquired the credit from an unrelated party at a price that equals or exceeds the Marketable Price Floor. Marketable Price Floor means 80% of the net present value (NPV) of the tax credit, where the NPV is determined based on the yield to maturity on a debt instrument issued by the government that issued the tax credit with equal or similar maturity (and up to 5-year maturity) issued in the same Fiscal Year as the tax credit is transferred (or if not transferred, the Origination Year). For this purpose, the tax credit is the face value of the credit or the remaining creditable amount in relation to the tax credit. For this purpose, the cash flow projection to be factored in the NPV calculation shall be based on the maximum amount that can be used each year under the legal design of the credit.

# (N-)QRTC | (N-)MTTC | QFTB

- ✓ **Unrelated Party**: An Originator and purchaser are considered related parties if one owns, directly or indirectly, at least 50% of the beneficial interest in the other (or, in the case of a company, at least 50% of the aggregate vote and value of the company's shares) or another person owns, directly or indirectly, at least 50% of the beneficial interest (or, in the case of a company, at least 50% of the aggregate vote and value of the company's shares) in each of the Originator and purchaser. In any case, an Originator and purchaser are considered related parties if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

# (N-)QRTC | (N-)MTTC | QFTB



# (N-)QRTC | (N-)MTTC | QFTB

| Type of Credit | Originator / Sponsor | Purchaser / Investor |
|---|---|---|
| QRTC | Income | -- |
| Non-QRTC | Tax Reduction | -- |
| Marketable Transferable TC | Income | Gain (or loss) upon use or subsequent transfer<br>Face value included in tax expense |
| Non-Marketable Transferable TC | Tax Reduction | Purchase price included in Tax Expense<br>(discount excluded from Tax Expense) |
| Restricted Transferable TC | -- | Purchase price included in Tax Expense<br>(discount excluded from Tax Expense) |
| QFTB | Income | Investment amount included in Tax Expense<br>(amounts in excess of investment excluded from Tax Expense) |
| All other tax credits | Tax Reduction | -- |

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# THANK YOU

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