

GloBE: Why a Nominal Tax Rate of More Than 15% Might Not Be Enough

This article explains why the effective tax rate for the purposes of the Global Anti-Base Erosion (GloBE) rules may deviate from the nominal corporate income tax rate and fall below 15%, even in high-tax jurisdictions. It further addresses the (non-)application of the substance-based income exclusion in loss situations.

1. Introduction

With the expected introduction of the Global Anti-Base Erosion (GloBE) rules¹ under Pillar Two to ensure a minimum level of taxation of 15%, large multinational enterprises (MNEs) should assess the effect of the new rules and calculate their effective tax rate (ETR) for each jurisdiction. While, in particular, the GloBE rules will cover activities in jurisdictions with no corporate income taxes, far-reaching exemptions or low tax rates, they do not exclude other jurisdictions from their scope. The grant of tax-free research premiums or tax credits, government subsidies (for example, due to high energy prices), investment allowances or super-deductions and other tax benefits may give rise to a top-up tax, even in high-tax jurisdictions. As the GloBE rules compare the ETR of each jurisdiction with the required 15% rate of tax, the nominal tax rate is not decisive.

Given its importance, this article focuses on the calculation of the ETR and the top-up tax.² It does not touch on many issues that the GloBE rules raise, such as their interaction with controlled foreign company (CFC) rules,³ their consistency with established principles of source and residence taxation,⁴ how domestic minimum taxes

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1. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting (OECD 2021), Primary Sources IBFD [hereinafter the *GloBE Model Rules*].
2. See also, in detail, V. Bendlinger & G. Kofler, *Computation of the Effective Tax Rate and the ‘Top-up Tax’*, in *The Global Minimum Corporate Tax* (W. Haslechner et al. eds., forthcoming); N. Jalan, *Computation of GloBE Income or Loss*, in *The Global Minimum Corporate Tax* (W. Haslechner et al. eds., forthcoming).
3. See, for example, B.J. Arnold, *An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax*, 76 Bull. Intl. Taxn. 6 (2022), Journal Articles & Opinion Pieces IBFD.
4. See, for example, B.J. Arnold, *The Ordering of Residence and Source Country Taxes and the OECD Pillar Two Global Minimum Tax*, 76 Bull. Intl. Taxn. 5 (2022), Journal Articles & Opinion Pieces IBFD.

could be designed in response to the GloBE rules,⁵ the compatibility of the GloBE rules with tax treaties⁶ and international customary law,⁷ to what extent the GloBE rules establish a floor to international tax competition for business investments,⁸ the potential effect on jurisdictions and MNEs also in connection with other initiatives,⁹ or how the European Commission intends to implement the GloBE rules without violating the EU fundamental freedoms.¹⁰ Instead, following a brief outline of the GloBE rules (*see* section 2.), it addresses some major reasons for deviations between nominal tax rates and ETRs under the GloBE rules (*see* section 3.). It further outlines why in a loss situation, permanent tax advantages are generally subject to a top-up tax without the application of the substance-based income exclusion (*see* section 4.). The article's conclusions are summarized in section 5.

2. Overview of the GloBE Rules

The aim of the GloBE rules is to ensure a global minimum corporate income tax rate of 15% for MNEs with at least EUR 750 million in consolidated revenues. In order to realize this state of affairs, a top-up tax is levied through an Income Inclusion Rule (IIR) or an Undertaxed Profits Rule (UTPR).¹¹ Further, in order to determine the amount of the top-up tax, it is necessary to calculate the ETR of all of the constituent entities located in a jurisdiction (jurisdictional blending) and to compare it to the minimum tax rate of 15%. If the ETR is lower than the minimum tax rate, and if excess profits remain after deducting the

5. See, for example, N. Noked, *Designing Domestic Minimum Taxes in Response to the Global Minimum Tax*, 50 Intertax 10 (2022).
6. See, for example, V. Chand, A. Turina & K. Romanovska, *Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the Various Challenges*, 14 World Tax J. 1 (2022), Journal Articles & Opinion Pieces IBFD.
7. See, for example, F. Debelva & L. De Broe, *Pillar 2: An Analysis of the IIR and UTPR from an International Customary Law, Tax Treaty Law and European Union Law Perspective*, 50 Intertax 12 (2022), forthcoming.
8. See, for example, J. Englisch, *GloBE Rules and Tax Competition*, 50 Intertax 12 (2022), forthcoming.
9. See, for example, W. Schön, *Internationale Steuerpolitik zwischen Steuerwettbewerb, Steuerkoordinierung und dem Kampf gegen Steuervermeidung*, 31 Internationales Steuerrecht 6 (2022).
10. See European Commission, Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, COM(2021) 823 final of 21 December 2021.
11. Historically, the abbreviation UTPR was used for the term “undertaxed payments rule”. However, in the meantime, the planned design of the UTPR deviates from the originally envisaged concept. Instead of focusing on the deduction of business expenses from payments (hence also undertaxed payments) as originally planned, the UTPR now has the effect that the top-up tax is apportioned among the jurisdictions in which the individual constituent entities are located according to the number of employees and the total value of the tangible assets. For the main changes, see V. Bendlinger, *Die OECD Model Rules für ein globales Mindestbesteuerungsregime*, 32 Steuer und Wirtschaft International 1 (2022), pp. 2-16, at p. 8. Thus, it now seems more appropriate to describe the UTPR as an undertaxed profits rule.

substance-based income exclusion, a top-up tax is levied to achieve the required minimum taxation.

The starting point for the calculation of the top-up tax is the GloBE income or loss of each constituent entity.¹² In general, the GloBE income or loss is the net income or loss for a constituent entity determined in preparing the consolidated financial statements of the ultimate parent entity (UPE), for example, based on International Financial Reporting Standards (IFRS), before any consolidation adjustments eliminating intra-group transactions.¹³ The net income or loss is then adjusted for calculating the top-up tax. For instance, the net taxes expense is added, and the excluded dividends are subtracted from the net income or loss.¹⁴ In order to determine the ETR, it is also necessary to calculate the adjusted covered taxes of each constituent entity. The adjusted covered taxes are the sum of the current tax expense¹⁵ and the deferred tax expense¹⁶ accrued in the financial accounts with regard to covered taxes,¹⁷ subject to certain adjustments.

In a next step, the ETR for a jurisdiction is calculated by dividing the adjusted covered taxes by the adjusted net income (the net GloBE income) of all of the constituent entities located in a jurisdiction.¹⁸ If the ETR is less than the minimum tax rate of 15%, the net GloBE income is reduced by the substance-based income exclusion. This exclusion is the sum of 5% of the eligible payroll costs in a jurisdiction (the payroll carve-out) and 5% of the carrying value of eligible tangible assets in a jurisdiction (the tangible asset carve-out),¹⁹ with the percentages being higher during a transitional period of ten years.²⁰

Lastly, the difference between the minimum tax rate of 15% and the ETR (the top-up tax percentage)²¹ is multiplied by the difference between the net GloBE income and the substance-based income exclusion (the excess profit).²² Then, the resulting amount is increased by any additional current top-up tax and reduced by any Qualified Domestic Minimum Top-Up Tax (QDMTT), resulting in the jurisdictional top-up tax to be levied.²³ If there is a net GloBE loss, a special rule applies that may result in a top-up tax already in the year in which the loss has occurred.²⁴ How and to whom the top-up tax is levied depends on whether and at which group level the IIR or the UTPR applies.

3. Calculation of the ETR

3.1. Permanent differences

3.1.1. Excluded differences

3.1.1.1. Dividends

As the ETR for a jurisdiction is calculated by dividing the adjusted covered taxes by the adjusted net income (the net GloBE income), an effective level of taxation of below 15% can be the result of a nominal tax rate of less than 15%, a lower tax base when compared to the net GloBE income or a combination of both factors. Accordingly, in order to estimate whether constituent entities located in a jurisdiction are at risk of falling below the minimum tax threshold of 15%, it is insufficient to focus on the nominal corporate tax rate. Rather, it is necessary primarily to examine which permanent differences arise from the respective domestic tax law in comparison to the relevant financial accounting standard (in general, the accounting standard used in the preparation of the consolidated financial statements of the UPE), and whether these have a positive or negative effect on the ETR.

Certain permanent differences are explicitly accounted for by the GloBE rules and have no effect on the ETR. For instance, dividends received are included in the financial accounting net income or loss, but, in principle, are excluded from the net GloBE income or loss due to a specific adjustment in respect of excluded dividends.²⁵ This adjustment assimilates the treatment of dividends for GloBE purposes to the (supposed) treatment for tax purposes as many jurisdictions exempt dividends from tax to avoid economic double taxation. In such cases, excluded dividends are neither part of the domestic tax base nor part of the net GloBE income or loss. Their non-taxation under domestic tax law does not lower the ETR. Example 1 illustrates this.

Example 1

In the financial accounts, the constituent entity has a profit before tax of 100. This amount includes dividends of 50 that are exempt under the domestic tax law. The nominal corporate income tax rate is 25%.

The exemption of the dividends under the domestic tax law leads to a tax base of only 50 and a current tax liability of only 12.5. In the financial accounts, the dividends are included in the profit before and after tax. For GloBE purposes, the dividends are excluded from the GloBE income. As the adjusted covered taxes amount to 12.5, the ETR for GloBE purposes remains at 25%.

Conversely, if a jurisdiction subjects excluded dividends to tax, this does not increase the ETR. Rather, the amount of current tax expense with regard to the excluded (but taxed) dividends is not part of the adjusted covered taxes.²⁶ Example 2 illustrates this.

12. OECD, *GloBE Model Rules*, *supra* n. 1, at art. 3.1.1.

13. *Id.*, at art. 3.1.2.

14. *Id.*, at art. 3.2.1.

15. *Id.*, at art. 4.1.1.

16. *Id.*, at arts. 4.1.1(b) and 4.4.1.

17. *Id.*, at art. 4.2.

18. *Id.*, at art. 5.1.1.

19. *Id.*, at art. 5.3.

20. *Id.*, at art. 9.2.

21. *Id.*, at art. 5.2.1.

22. *Id.*, at art. 5.2.2.

23. *Id.*, at art. 5.2.3.

24. *Id.*, at art. 4.1.5.

25. *Id.*, at art. 3.2.1(b). There is an exception for a short-term portfolio shareholding, i.e. a shareholding of less than 10%, which has been held for less than one year at the date of the distribution.

26. *Id.*, at art. 4.1.3(a).

Table 1 – GloBE calculation in Example 1

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Excluded dividends	-50.00	Current tax expense	-12.50	Excluded dividends (art. 3.2.1(b))	-50.00
Tax base	50.00	Profit after tax	87.50	GloBE income	50.00
Corporate income tax (25%)	12.50	Effective tax rate	12.50%	Current tax expense	12.50
				Excluded dividends (art. 4.1.3(a))	0.00
				Adjusted covered taxes	12.50
				Effective tax rate	25.00%
				Top-up tax percentage	0.00%

Table 2 – GloBE calculation in Example 2

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Tax base	100.00	Current tax expense	-25.00	Excluded dividends (art. 3.2.1(b))	-50.00
Corporate income tax (25%)	25.00	Profit after tax	75.00	GloBE income	50.00
		Effective tax rate	25.00%	Current tax expense	25.00
				Excluded dividends (art. 4.1.3(a))	-12.50
				Adjusted covered taxes	12.50
				Effective tax rate	25.00%
				Top-up tax percentage	0.00%

Table 3 – GloBE calculation in Example 3

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	50.00	Profit before tax	50.00	Profit before tax	50.00
Excluded equity loss	50.00	Current tax expense	-25.00	Excluded equity loss (art. 3.2.1(c))	50.00
Tax base	100.00	Profit after tax	25.00	GloBE income	100.00
Corporate income tax (25%)	25.00	Effective tax rate	50.00%	Current tax expense	25.00
				Excluded equity loss (art. 4.1.3(a))	0.00
				Adjusted covered taxes	25.00
				Effective tax rate	25.00%
				Top-up tax percentage	0.00%

Example 2

In the financial accounts, the constituent entity has a profit before tax of 100. This amount includes dividends of 50 that are subject to tax under the domestic tax law. The nominal corporate income tax rate is 25%.

The taxation of the dividends under the domestic tax law results in a tax base of 100 and a current tax liability of 25. In the financial accounts, the dividends are included in the profit before and after tax. For GloBE purposes, the dividends are excluded from the GloBE income. Consequently, the amount of current tax expense with regard to the excluded dividends must also be excluded for the computation of the ETR. As the adjusted covered taxes amount to 12.5, the ETR for GloBE purposes remains at 25%.

It follows that excluded dividends should neither decrease nor increase the ETR, regardless of whether they are taxed or exempted under the domestic tax law.

3.1.1.2. Participations

In addition to dividends, any gain, profit or loss arising from changes in fair value or the disposition of an ownership interest of at least 10% that is included in the financial accounting net income or loss is excluded from the net GloBE income as an excluded equity gain or loss.²⁷ An ownership interest is defined as any equity interest that carries rights to the profits, capital or reserves of an entity,²⁸ such as a company or partnership. Accordingly,

27. Id., at art. 3.2.1(b) and (c).

28. Id., at art. 10.1.1, under "Ownership Interest".

if the 10% threshold is fulfilled, gains, profits or losses should not influence the ETR under the GloBE rules. This position is clear in cases where the ownership interest of at least 10% is tax-neutral under the domestic tax law. If there is a profit or gain, it is tax-exempt under the domestic tax law. Although it generally increases the financial accounting net income, it is deducted as an excluded equity gain for GloBE purposes. If there is a loss from an ownership interest of at least 10%, it does not reduce the domestic tax base. Although it generally reduces the financial accounting net income, it is added back under the GloBE rules as an excluded equity loss. Example 3 illustrates this.

Example 3

In the financial accounts, the constituent entity has a profit before tax of 50. This amount includes a loss of 50, stemming from an ownership interest of at least 10% that is tax-neutral under the domestic tax law. The nominal corporate income tax rate is 25%.

The tax-neutrality of the equity loss under the domestic tax law results in a tax base of 100 (instead of 50) and a current tax liability of 25 (instead of 12.5). In the financial accounts, the equity loss is included in the profit before and after tax, thereby reducing the profit. For GloBE purposes, the equity loss is excluded from the GloBE income, resulting in a GloBE income of 100. As the adjusted covered taxes amount to 25, the ETR for GloBE purposes remains at 25%.

The situation becomes more complex when jurisdictions, under their domestic tax law, treat the excluded equity gain or loss as fully or partially tax-effective, meaning that they tax such gains and allow for a deduction of such

Table 4 – GloBE calculation in Example 4

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	50.00	Profit before tax	50.00	Profit before tax	50.00
Excluded equity loss 4/5	40.00	Current tax expense	-22.50	Excluded equity loss 5/5 (art. 3.2.1(c))	50.00
Tax base	90.00	Deferred tax income	10.00	GloBE income	100.00
Corporate income tax (25%)	22.50	Profit after tax	37.50	Current tax expense	22.50
		Effective tax rate	25.00%	Excluded equity loss 1/5 (art. 4.1.3(a))	2.50
				Deferred tax expense (adjusted to 15%)	-6.00
				Excluded equity loss 4/5 (art. 4.4.1(a))	6.00
				Adjusted covered taxes	25.00
				Effective tax rate	25.00%
				Top-up tax percentage	0.00%

losses. In the case of a taxable gain or profit (for example, arising from a disposition or a reversal of an impairment), the additional tax burden does not increase the ETR for GloBE purposes. Rather, the GloBE rules remove the gain or profit from the financial accounting net income or loss,²⁹ and the amount of current tax expense with regard to the excluded (but taxed) gain or profit is not part of the adjusted covered taxes.³⁰ In the case of a loss (for example, arising from a disposition or an impairment), the GloBE rules remove the loss from the financial accounting net income or loss, thereby increasing the net income or reducing the net loss for GloBE purposes. Given a literal understanding of the word “expense”, however, there is no “current tax expense” from the disposition or impairment. Rather, the (excluded) equity loss only reduces the current tax expense for other income. This understanding would lead to the result that the lower tax burden from an equity loss would lower the ETR.

Nevertheless, it is clear from the Commentary to the GloBE Model Rules³¹ that, for GloBE purposes, the word “tax expense” also includes a “negative tax expense (i.e. income tax benefit)”.³² Consequently, the GloBE provision that requires the reduction in the covered taxes by the amount of current tax expense with regard to income excluded from the computation of the GloBE income or loss (in this case, an excluded equity gain or loss) also requires the reduction in the covered taxes by a negative amount, i.e. an increase in the covered taxes. This state of affairs is confirmed by the parallel GloBE rule excluding the amount of deferred tax expense with regard to items excluded from the computation of the GloBE income or loss.³³ According to the Commentary to the GloBE Model Rules, this GloBE rule also excludes the amount of the negative deferred tax expense (the deferred tax asset) from an excluded equity loss.³⁴ Ultimately, it should not

matter whether an excluded equity loss results in a “negative deferred tax expense” or in a “negative current tax expense”. Both have to be neutralized. Accordingly, as with dividends, an ownership interest of at least 10% should not influence the ETR for GloBE purposes. Example 4 illustrates this.

Example 4

In the financial accounts, the constituent entity has a profit before tax of 50. This amount includes a loss of 50 stemming from an ownership interest of at least 10% that is tax-effective under the domestic tax law. The tax deduction of the loss is spread over a period of five years. This situation results in an addition of 40 to the tax base in the first year and in deductions of 10 a year in the following four years. The nominal corporate income tax rate is 25%.

The tax-effectiveness of the equity loss under the domestic tax law together with the spread over a period of five years leads to a tax base of 90 and a current tax liability of 22.5 in the first year. As four fifths of the equity loss will be deductible in the following four years, the financial accounts show a deferred tax income of 10 (the future tax deduction of 40 x the 25% rate of corporate income tax), thereby reducing the overall tax expense in the financial accounts to 12.5. For GloBE purposes, the equity loss is excluded from the GloBE income, resulting in a GloBE income of 100. Both the current and the deferred tax expense must be adjusted insofar as they relate to the excluded equity loss. This situation means that the (negative) amount of current tax expense of -2.5 (the deduction of -10 in the first year x the 25% corporate income tax rate) and the (negative) amount of deferred tax expense of -6 (the deduction of -40 in the following four years x the 15% adjusted rate of corporate income tax discussed in section 3.2.) must be excluded, and are neutral with regard to the ETR.³⁵ As the adjusted covered taxes amount to 25, the ETR for GloBE purposes remains at 25%.

3.1.2. Included differences

If the GloBE rules do not specifically take account of permanent differences and neutralize their effect for GloBE purposes, the permanent differences influence the ETR, and may have a positive or negative effect. Many domestic non-deductibility rules (for example, entertainment expenses, payments to non-disclosed recipients and payments to low-tax jurisdictions) increase the ETR. Conversely, tax incentives in the form of tax exemptions,

29. Id., at art. 3.2.1(b).

30. Id., at art. 4.1.3(a).

31. OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Base Erosion and Profit Shifting (OECD 2022) Primary Sources IBFD [hereinafter the *Commentary to the GloBE Model Rules*].

32. Id., at art. 4.4.1, para. 70. See also OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 4.4.1, para. 71, explaining that a deferred tax expense may be negative, and OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 3.2, para. 18, explaining that the adjustments to determine the GloBE income or loss may be positive or negative (subject to the following two exceptions: (1) policy disallowed expenses; and (2) excluded dividends), thereby conforming that the net taxes expense may produce a positive or negative adjustment.

33. OECD, *GloBE Model Rules*, supra n. 1, at art. 4.4.1(a).

34. OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 4.4.1, para. 73.

35. It should be noted that, in the examples, when explaining the tax and accounting rules, no negative numbers are used. Consequently, there may be a profit of 100 or a loss of 100. In contrast, when explaining the GloBE rules, a profit always has a positive value (for example, a profit of 100) and a loss always has a negative value (for example, a loss of -100). Similarly, a tax expense for GloBE purposes always has a positive value (for example, a tax expense of 10), and a tax income or negative tax expense always has a negative value (for example, a tax income of -10).

Table 5 – GloBE calculation in Example 5 with a QRTC

Domestic Tax Law		Financial Reporting Standard		GloBE (QRTC)	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Research premium	-20.00	Current tax expense	-20.00	GloBE income	100.00
Tax base	80.00	Profit after tax	80.00		
				Current tax expense	20.00
Corporate income tax (25%)	20.00	Effective tax rate	20.00%	Adjusted covered taxes	20.00
				Effective tax rate	20.00%
				Top-up tax percentage	0.00%

Table 6 – GloBE calculation in Example 5 with an NQRTC

Domestic Tax Law		Financial Reporting Standard		GloBE (NQRTC)	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Research premium	-20.00	Current tax expense	-20.00	Research premium	-20.00
Tax base	80.00	Profit after tax	80.00	GloBE income	80.00
				Current tax expense	20.00
Corporate income tax (25%)	20.00	Effective tax rate	20.00%	Research premium	-20.00
				Adjusted covered taxes	0.00
				Effective tax rate	0.00%
				Top-up tax percentage	15.00%

tax credits, notional interest deductions and investment allowances (deductions of investment costs in addition to regular depreciations) reduce the ETR. This position is also true for incentives that pursue legitimate goals, such as to stimulate the economy, create jobs, increase environmental-friendly investments or foster innovation as well as research and development (R&D). For instance, tax holidays granted for certain investments in a particular zone lower the ETR as the profits are included in the GloBE income, but do not give rise to a corresponding tax expense. Similarly, tax-free government subsidies and grants (for example, due to high energy prices or as a result of the crisis occasioned by the COVID-19 pandemic) reduce the ETR as long as the subsidized costs remain tax deductible.³⁶ While the jurisdictional blending and/or the substance-based income exclusion (*see* section 4.1.) may save an MNE from paying a top-up tax, depending on the circumstances, this does not need to be the case.

A tax-exempt research premium may also have a negative effect on the ETR, and even result in a top-up tax.³⁷ If the research premium is granted in the form of a tax credit, it is important to distinguish between a qualified refundable tax credit (QRTC) and a non-qualified refundable tax credit (NQRTC). A QRTC, on the one hand, is 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.³⁸ In terms of economic substance, a QRTC is equivalent to a government subsidy or grant that is available regardless of whether a constituent entity is paying taxes. As a result, it is treated as income in the com-

putation of the GloBE income or loss.³⁹ An NQRTC, on the other hand, is a tax credit that is not a QRTC, but that is refundable in whole or in part.⁴⁰ It is not treated as income but, rather, as a reduction in the current tax expense for GloBE purposes.⁴¹ Example 5 illustrates this.

Example 5

In the financial accounts, the constituent entity has a profit before tax of 100. This amount includes a tax-free research premium of 20 that is granted in the form of (i) a QRTC; and (ii) an NQRTC. The nominal corporate income tax rate is 25%.

The tax-exemption in respect of the research premium under the domestic tax law results in a tax base of only 80 and a current tax liability of only 20. If, for GloBE purposes, the research premium is a QRTC, it is included in the GloBE income, resulting in a GloBE income of 100. As the adjusted covered taxes amount to 20, the ETR for GloBE purposes is 20% (in this case still above the required 15%).

If, for GloBE purposes, the research premium is an NQRTC, it is not included in the GloBE income, resulting in a GloBE income of 80. It further reduces the current tax expense, resulting in adjusted covered taxes of only 0. The ETR for GloBE purposes is thus reduced to 0%.

While both types of credits reduce the ETR, an NQRTC influences the ETR to a greater extent. Consequently, jurisdictions may aim to transform an NQRTC into a QRTC to reduce the negative effects of such a tax credit on the ETR for GloBE purposes.⁴² In addition, they might transform tax-free research premiums (tax credits) into taxable research premiums. By increasing the research premium and making it taxable at the same time, the result for the taxpayer may be the same. For GloBE purposes, however, this change in tax treatment can remove an adverse effect of the research premium on the ETR.

36. *See also* R.H.C. Luja, *Taxing Away Foreign Subsidies: How Pillar Two and BEFIT May Interfere with National Sovereignty*, in *Taxes Crossing Borders (and Tax Professors Too) – Liber Amicorum Prof. Dr R.G. Prokisch* pp. 203-212 (J. Korving, N. Kerinc & F. Souza de Man eds., Maastriicht University Press 2022).

37. This is true as long as the tax exemption does not reduce the tax deductions of the R&D expenses.

38. OECD, *GloBE Model Rules*, *supra* n. 1, at art. 10.1.1, under "Qualified Refundable Tax Credit".

39. *Id.*, at arts. 3.2.4, 4.1.2(d) and 4.1.3(c).

40. *Id.*, at art. 10.1.1, under "Non-Qualified Refundable Tax Credit".

41. *Id.*, at arts. 3.2.4 and 4.1.3(b).

42. *See, however*, OECD, *Tax Incentives and the Global Minimum Corporate Tax* (OECD 2022), observing that changing a tax credit to fit the definition of a QRTC may lessen the impact of the GloBE rules on the incentive, but this could also lead to substantial revenue losses, as the credits would need to be paid-out to firms with insufficient tax liability.

Table 7 – GloBE calculation in Example 6

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Loss carry-forward	-100.00	Current tax expense	0.00	GloBE income	100.00
Tax base	0.00	Deferred tax expense	-25.00	Current tax expense	0.00
Corporate income tax (25%)	0.00	Profit after tax	75.00	Deferred tax expense (adjusted to 15%)	15.00
		Effective tax rate	25.00%	Adjusted covered taxes	15.00
				Effective tax rate	15.00%
				Top-up tax percentage	0.00%

In practice, hidden equity contributions to state-owned MNEs may also be a cause for concern. As they are “hidden”, such contributions may be treated as a government grant, increase the profit before tax under financial accounting standards, and, therefore, increase the GloBE income. From a domestic tax perspective, however, they may be treated as tax-neutral and not result in any tax burden. This mismatch reduces the ETR for GloBE purposes.

3.2. Temporary differences

The tax expenses accrued in the financial accounts include not only the corporate tax burden of the relevant year (the current tax expense), but also deferred taxes (the deferred tax expense). Both are relevant for purposes of calculating the adjusted covered taxes and, therefore, the ETR. Consequently, differences between tax and accounting that result in temporary differences do not generally have a positive or negative effect on the ETR. In contrast to permanent differences, temporary differences between tax and accounting are classified in general as “neutral” for GloBE purposes.

Most importantly, loss carry-forwards as such do not result in a top-up tax, but, rather, are neutralized by way of the deferred tax expense. Several GloBE provisions ensure this situation by adjusting the deferred tax asset that results from a loss. First, the GloBE rules exclude the effect of a valuation adjustment or accounting recognition adjustment with regard to such a deferred tax asset.⁴³ If the deferred tax asset stemming from a loss is not recognized for accounting purposes because no profitability is expected in the near future, a deferred tax asset, nevertheless, exists for GloBE purposes. Moreover, if the corporate income tax rate is less than 15%, the deferred tax asset can be calculated on the basis of the 15% rate.⁴⁴ This position ensures the neutrality of loss carry-forwards for low-tax jurisdictions, as, otherwise, the deferred tax expense in the year of the use of a prior loss by way of a carry-forward would be too low to reach the minimum tax rate of 15%. Transitional rules address also deferred tax assets that are derived from losses.⁴⁵

Although deferred tax expenses are part of the adjusted covered taxes, they can be considered only up to the minimum tax rate of 15%. If the domestic corporate income tax rate is higher than the minimum tax rate, the

(positive or negative) deferred tax expense for accounting purposes must be recast to the minimum tax rate of 15%.⁴⁶ For instance, when the use of a prior loss through a loss carry-forward leads to a deferred tax expense and thereby increases the adjusted covered taxes, it does so only up to the rate of 15%. No additional amount can be carried forward from loss-making years and no additional amount of tax expense can be used as a buffer for permanent tax advantages that are granted in the year in which the prior loss is utilized. Examples 6 and 7 illustrate this.

Example 6

In the financial accounts, the constituent entity has a profit before tax of 100. Under the domestic tax law, the constituent entity has a loss carry-forward of 100 that it can use in the relevant financial year. The nominal corporate income tax rate is 25%.

Given the loss carry-forward, the domestic tax base and the tax burden is 0, and there is no current tax expense in the financial accounts. However, the use of the loss carry-forward leads to a deferred tax expense of 25 (the 100 loss carry-forward x the 25% corporate income tax rate) in the financial accounts. For GloBE purposes, the GloBE income does not include any losses from previous years, and, therefore, amounts to 100. At the same time, the deferred tax expense in the financial accounts is relevant in determining the adjusted covered taxes. As the deferred tax expense has been calculated based on the corporate income tax rate of 25%, it must be recast to 15% (the 25 deferred tax expense ÷ the 25% corporate income tax rate x 15%), and amounts to 15. As a result, the ETR for GloBE purposes is exactly 15%, and does not result in any top-up tax.

Example 7

In the financial accounts, the constituent entity has a profit before tax of 100. This amount includes a tax-free research premium of 10 that is granted in the form of a QRTC. Moreover, the constituent entity has a loss carry-forward of 80 that it can use in the relevant financial year. The nominal corporate income tax rate is 25%.

46. Id., at art. 4.4.1. While the adjustment of the deferred tax expense to 15% is understandable with regard to losses (a loss carry-forward should not shelter permanent tax advantages granted in later periods; see OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 4.4, para. 68), it is not necessarily logical in other situations, such as in the case of provisions (see, critically, F. Brugger, M. Melcher & N. Wosak, *Globale Mindestbesteuerung: Ermittlung des GloBE-Steueraufwands*, 97 *Steuer- und Wirtschaftskartei* 15, pp. 657-667, at pp. 660-662 (2022)). As the deferred tax expense addresses temporary differences, the tax will be paid eventually. By limiting the relevant amount of the (positive or negative) deferred tax expense to 15%, the amount in excess of 15% is not lost for GloBE purposes. It will be considered as an adjusted covered tax in a different period, i.e. as a current tax expense which is not capped at 15%. Accordingly, the limitation of the deferred tax expense to 15% does not reduce the overall amount of adjusted covered taxes. It only changes the period of consideration. It is not clear why this period should differ from that in the financial accounts and why the ETR for GloBE purposes, therefore, should fluctuate above and below the nominal tax rate (though not dropping below 15% without permanent tax advantages or other reasons) instead of remaining constant.

43. OECD, *GloBE Model Rules*, supra n. 1, at arts. 4.4.1(c) and 4.4.2(c).

44. Id., at art. 4.4.3.

45. Id., at arts. 9.1.1 and 9.1.2.

Table 8 – GloBE calculation in Example 7

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Loss carry-forward	-80.00	Current tax expense	-2.50	GloBE income	100.00
Research premium	-10.00	Deferred tax expense	-20.00		
Tax base	10.00	Profit after tax	77.50	Current tax expense	2.50
				Deferred tax expense (adjusted to 15%)	12.00
Corporate income tax (25%)	2.50	Effective tax rate	22.50%	Adjusted covered taxes	14.50
				Effective tax rate	14.50%
				Top-up tax percentage	0.50%

Given the loss carry-forward, the domestic tax base is initially 20, and would result in a tax burden of 5. However, the tax exemption of the research premium reduces the tax base to only 10 and the tax burden to only 2.5. In the financial accounts, the use of the loss carry-forward results in a deferred tax expense of 20 (the 80 loss carry-forward x the 25% corporate income tax rate). For GloBE purposes, the GloBE income does not include any losses from previous years, but includes the research premium. It, therefore, amounts to 100. At the same time, the deferred tax expense in the financial accounts is relevant for determining the adjusted covered taxes. As the deferred tax expense has been calculated based on the corporate income tax rate of 25%, it must be recast to 15% (the 20 deferred tax expense ÷ the 25% corporate income tax rate x 15%) and amounts to 12. Together with the current tax expense of 2.5, the adjusted covered taxes amount to 14.5. As a result, the ETR for GloBE purposes is only 14.5%. It is possible to explain this ETR in the following way. The loss carry-forward as such is neutral, and does not trigger a top-up tax. However, the adjustment of the deferred tax expense from 25% to 15% for GloBE purposes reduces the buffer for permanent tax advantages to 2 (the 20 profits after loss carry-forward x (the 25% corporate income tax rate – the 15% minimum tax rate) = 2). As the tax-free research premium results in a permanent tax advantage of 2.5, which is greater than 2 (the 10 research premium x the 25% corporate income tax rate = 2.5, which is greater than 2), the ETR falls below 15% to 14.5%, and, therefore, results in a top-up tax percentage of 0.5% as well as, in principle, in a top-up tax of 0.5.

3.3. Timing of tax payments

For GloBE purposes, the ETR also depends on the date by which a tax expense is settled. The rules distinguish between the tax expense resulting from current corporate income tax and deferred taxes. A current tax expense only counts as adjusted covered taxes if it will result in a tax payment within three years of the last day of the fiscal year.⁴⁷ The concept behind this position is that no tax expense should be taken into account if it could be paid but is not expected to be paid in the near future. As the timely payment is within the control of the MNE group, from the perspective of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), there is no reason to increase the adjusted covered taxes by tax payments that will only be made after three years.⁴⁸ Rather, a current tax expense that does not result in a payment within three years is disregarded for GloBE purposes.

This three-year limitation could result in unsystematic consequences if it also applied to taxes that, by law, cannot be paid by the constituent entity within the three-year period such that it is not within the control of the MNE group to timely pay the tax. For instance, a temporary

47. Id., at art. 4.1.3(e). See also OECD, *GloBE Model Rules*, supra n. 1, at art. 4.6.4.

48. OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 4.1.3, para. 17.

deduction of losses from foreign tax group members may require a subsequent taxation of the deducted losses in later years. For accounting purposes, however, the anticipated tax burden from the subsequent taxation may constitute a current tax expense already in the year of the loss deduction and not in the year of the actual tax liability (which may be within or after the three-year period). If the three-year limitation applied to such a situation, neither the current tax expense (in the year of the loss deduction) nor the actual tax liability (in the year of the subsequent taxation after the three-year period) would be taken into account for calculating the ETR under the GloBE rules. As a result, temporary tax advantages could give rise to a top-up tax and lead to double taxation.⁴⁹

A similar regulation is provided for in relation to deferred tax liabilities. A deferred tax expense that neither reverses⁵⁰ nor results in a tax payment within the five subsequent years can be disregarded from the outset, and, therefore, would not increase the adjusted covered taxes,⁵¹ or would only do so when a tax payment is made.⁵² If this option is not exercised and there is no reversal or tax payment in the five subsequent years, the year in which the deferred tax expense was incurred must be recalculated, disregarding the deferred tax expense in question.⁵³ In contrast to the current tax expense, however, exceptions apply. These include deferred tax liabilities due to temporarily (but not permanently) higher depreciation of tangible assets under tax law⁵⁴ (for example, in the case of a shorter useful life under tax law compared to accounting law), R&D expenses⁵⁵ or the intra-jurisdictional transfer of hidden reserves from tangible to other tangible assets.⁵⁶ Whereas

49. See, in detail on the Austrian group taxation regime, K. Dziurdz, C. Marchgraber & E. Strimitzer, *Globale Mindestbesteuerung: Ist Österreich ein Niedrigsteuerland?*, 97 *Steuer- und Wirtschaftskartei* 12, pp. 564-572, at pp. 569-570 (2022) and K. Dziurdz & C. Marchgraber, *Die Berechnung der effektiven Steuerbelastung bei Pillar II aus österreichischer Perspektive*, in *Festschrift Zöchling – Gegenwart und Zukunft des Konzernsteuerrechts* pp. 382-384 (F. Fraberger, C. Plott & T. Walter eds., Linde 2022).

50. Although OECD, *GloBE Model Rules*, supra n. 1, at art. 4.4.7 explicitly requires the payment of a deferred tax expense, OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 4.4.2, para. 83 and art. 4.4.4, paras. 89-90 clarify that a reversal is sufficient. This is recognized in art. 21(7) of the proposal for a European Directive on ensuring a global minimum level of taxation for multinational groups in the Union (doc. 7495/22, FISC 82 ECOFIN 259) where the term “reversed” is explicitly used.

51. OECD, *GloBE Model Rules*, supra n. 1, at arts. 4.4.1(b), 4.4.7 and 4.4.4.

52. Id., at art. 4.4.2(a).

53. Id., at art. 4.4.4. See also OECD, *GloBE Model Rules*, supra n. 1, at art. 4.4.2(b).

54. Id., at art. 4.4.5(a).

55. Id., at art. 4.4.5(c).

56. Id., at art. 4.4.5(h).

Table 9 – GloBE calculation in Example 8

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	100.00	Profit before tax	100.00	Profit before tax	100.00
Accelerated depreciation	-10.00	Current tax expense	-22.50	GloBE income	100.00
Tax base	90.00	Deferred tax expense	-2.50		
		Profit after tax	75.00	Current tax expense	22.50
Corporate income tax (25%)	22.50	Effective tax rate	25.00%	Deferred tax expense (adjusted to 15%)	1.50
				Unclaimed accrual (art. 4.4.7)	-1.50
				Adjusted covered taxes	22.50
				Effective tax rate	22.50%
				Top-up tax percentage	0.00%

it is relatively “easy” to monitor whether, and when, a current tax expense is paid, it may be virtually impossible to determine when a deferred tax expense reverses from a practical perspective. As deferred tax expenses can be taken into account, either when they accrue, or when they are reversed, such an impracticable deferral seems questionable. Example 8 illustrates this.

Example 8

In the financial accounts, the constituent entity has a profit before tax of 100. This amount includes a depreciation of 10 of an intangible asset that was acquired in the same year (year 1) from a third party for 200 and has a useful life of 20 years. For tax purposes, however, the depreciation is granted over a period of only 10 years, resulting in an accelerated depreciation of 20 (instead of 10) a year. The nominal corporate income tax rate is 25%.

For tax purposes, the depreciation is increased from 10 to 20, resulting in an additional tax deduction of 10 and a tax base of only 90. This temporary difference results in a deferred tax expense of 2.5 in the financial accounts (the 10 additional tax deduction x the 25% corporate income tax rate), thereby increasing the overall tax expense in the financial accounts to 25. The deferred tax liability in the financial accounts also amounts to 2.5 (the difference between the 190 financial book value and the 180 tax book value x the 25% corporate income tax rate).

For GloBE purposes, it is relevant when the deferred tax liability reverses. On the one hand, it can be argued that the deferred tax liability will reverse only in year 11 after the (accelerated) tax depreciation of 20 a year has ended. In year 11, the depreciation of 10 in the financial accounts will continue, but it will no longer be considered for tax purposes, thereby reducing the deferred tax liability in the financial accounts. Accordingly, for GloBE purposes, the deferred tax expense of 1.5 in year 1 cannot be considered in that year but only in year 11. This also means that, in year 11, the (negative) deferred tax expense of -1.5 from the reduction in the deferred tax liability in year 11 will be offset for GloBE purposes by the deferred tax expense of 1.5 from year 1.

On the other hand, it can also be argued that the deferred tax liability already reverses in year 2, as the financial book value in year 2 will be the same as the tax book value is in year 1, i.e. 180. This would allow to consider the deferred tax expense of 1.5 for GloBE purposes already in year 1.

4. Calculation of the Top-Up Tax

4.1. Substance-based carve-out

Should a constituent entity have an ETR of less than 15%, this state of affairs does not necessarily mean that a top-up tax is due. Both the GloBE income or loss and the adjusted covered taxes of all constituent entities that can be allocated to a jurisdiction are to be added up (jurisdictional blending).⁵⁷ A lower ETR of a constituent entity can be

57. Id., at art. 5.1.1.

offset by a higher ETR of another entity attributable to the same jurisdiction.

In addition, a top-up tax can also be avoided through the *de minimis* exclusion. No top-up tax is due for a jurisdiction if the average annual GloBE revenue of the current and the two preceding years of all of the constituent entities located in the jurisdiction is less than EUR 10 million, and the average GloBE income is less than EUR 1 million (or there is a loss).⁵⁸

If a top-up tax is to be calculated for a jurisdiction, the excess profit is the basis of the calculation. The excess profit is the GloBE income reduced by the esubstance-based income exclusion, which is also known as the substance-based carve-out.⁵⁹ The reduction in the GloBE tax base consists of the following two components:⁶⁰

- (1) the carve-out for payroll costs corresponds to a certain percentage (reducing from 10% to 5% in the transition phase)⁶¹ of the sum of the uncapitalized wages, salaries and similar remuneration of employees (including payroll and employment taxes as well as employer social security contributions) and of independent contractors under the direction and control of the MNE group who are involved in ordinary operating activities in a jurisdiction; and
- (2) the carve-out for tangible assets corresponds to a certain percentage (reducing from 8% to 5% in the transition phase)⁶² of the sum of the average carrying values⁶³ of certain tangible assets⁶⁴ attributable to a jurisdiction that are not held for sale, lease or investment.

Although the substance-based income exclusion does not increase the ETR, it can significantly reduce the top-up tax for MNEs that engage in asset-intensive and/or personnel-intensive activities. Example 9 illustrates this.

Example 9

In the financial accounts, the constituent entity has a profit before tax of 25. This amount includes a tax-free research premium of 15 that is granted in the form of a QRTC. Based on its substance, the constituent entity can claim a substance-based income exclusion of 20. The nominal corporate income tax rate is 25%.

The tax-exemption in respect of the research premium under the domestic tax law results in a tax base of only 10 and a current tax

58. Id., at art. 5.5.

59. Id., at art. 5.2.2.

60. Id., at art. 5.3.2.

61. Id., at arts. 5.3.3 and 9.2.1.

62. Id., at arts. 5.3.4 and 9.2.2.

63. Id., at art. 5.3.5.

64. Id., at art. 5.3.4.

Table 10 – GloBE calculation in Example 9

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	25.00	Profit before tax	25.00	Profit before tax	25.00
Research premium	-15.00	Current tax expense	-2.50	GloBE income	25.00
Tax base	10.00	Profit after tax	22.50		
Corporate income tax (25%)	2.50	Effective tax rate	10.00%	Current tax expense	2.50
				Adjusted covered taxes	2.50
				Effective tax rate	10.00%
				Top-up tax percentage	5.00%
				Substance-based income exclusion	20.00
				Excess profit	5.00
				Top-up tax	0.25

liability of only 2.5. If, for GloBE purposes, the research premium is a QRTC, it is included in the GloBE income, resulting in a GloBE income of 25. As the adjusted covered taxes amount to 2.5, the ETR for GloBE purposes is 10% and the top-up tax percentage is 5%. In order to determine the excess profit, it is necessary to reduce the GloBE income of 25 by the substance-based income exclusion of 20. Then, the top-up tax percentage of 5% is multiplied by the excess profit of 5, resulting in a top-up tax of 0.25. Although the substance-based income exclusion does not increase the ETR, it reduces the top-up tax.

The unused amounts of the substance-based carve-out cannot be carried forward. This position means that the substance available in loss-making or low-profit years (for example, the initial years of an investment) does not decrease the top-up tax in later high-profit years.

4.2. Loss situations

A special rule applies if there is a GloBE loss.⁶⁵ Somewhat surprisingly, even in a loss situation a top-up tax may be due. This position is so because permanent tax advantages increase the tax loss carry forward, which can be utilized in later years. As the increased tax loss carry-forward constitutes a deferred tax asset, its use results in a deferred tax expense, thereby increasing the ETR in later periods. For GloBE purposes, however, permanent tax advantages should have a negative effect, regardless of whether they are granted in a loss or profit year. Thus, the GloBE loss (which does not take account of permanent differences unless they are specifically excluded, such as in the case with dividends) is calculated and the expected (negative) tax expense (corresponding to the GloBE loss x 15%) is determined from this computation. If the adjusted covered taxes are less than this expected amount, i.e. if a deferred tax asset arises from permanent differences in the loss carried forward, the difference is subject to an additional current top-up tax. As a result, a minimum taxation of 15% is ensured for permanent tax advantages in the loss year by the additional current top-up tax, instead of only in the year in which these tax advantages can be utilized via the loss carry-forward.⁶⁶

At the same time, the substance-based carve-out does not apply in a loss situation. The jurisdictional top-up tax is defined as the excess profit multiplied by the top-up tax

percentage plus any additional current top-up tax less any domestic top-up tax.⁶⁷ The (positive) excess profit⁶⁸ is the (positive) net GloBE income⁶⁹ less the substance-based income exclusion. When losses arise in a jurisdiction, there is no net GloBE income from which the substance-based income exclusion could be deducted, and there is no positive amount of excess profit. Instead, the jurisdictional top-up tax results only from the additional current top-up tax minus any domestic top-up tax. At the same time, the calculation of the additional current top-up tax in a loss situation does not take account of any substance that might be available in the jurisdiction.⁷⁰ This results in the situation that MNEs with sufficient substance in a high-tax jurisdiction could be subject to a top-up tax for every permanent difference (such as a tax-free research premium or investment allowance) in a loss-making year, whereas no such top-up tax would be due if a small profit existed. Example 10 illustrates this.

Example 10

In the financial accounts, the constituent entity has a loss before tax of 30. This amount includes a tax-free research premium of 10 that is granted in the form of a QRTC. The nominal corporate income tax rate is 25%.

The tax exemption of the research premium under the domestic tax law increases the losses available as a loss carry-forward from 30 to 40. This exemption also increases the deferred tax income in the financial accounts from 7.5 to 10 (the 40 losses x the 25% corporate income tax rate). For GloBE purposes, after adjusting the (negative) deferred tax expense to 15%, the adjusted covered taxes of -6 are less than zero and less than the expected adjusted covered taxes of -4.5 (the -30 GloBE loss x 15%). This computation leads to an additional current top-up tax of 1.5, i.e. the difference between the expected adjusted covered taxes of -4.5 and the adjusted covered taxes of -6.0. In a loss situation, the substance-based income exclusion does not diminish the top-up tax.

It is inconsistent, though, that the substance-based income exclusion has no effect on the amount of top-up tax in a GloBE loss year. Depending on the concrete business model, a (low margin) activity with substantial substance may result in routine returns, or in losses. According to the Commentary, by excluding a fixed return from (less mobile) substantive activities from the application of the GloBE rules, the focus is on “excess income”, such as intangible-related income, which is most susceptible to BEPS risks.⁷¹ Thus, there is no conceptual reason to deny

65. Id., at art. 4.1.5. See also OECD, *GloBE Model Rules*, supra n. 1, at art. 5.4.3.

66. An alternative approach would have been to adjust the deferred tax asset by eliminating any amount that derives from permanent tax advantages, thereby preventing a carry-forward of permanent tax advantages to later periods. See OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 4.1.5, para. 20.

67. OECD, *GloBE Model Rules*, supra n. 1, at art. 5.2.3.

68. Id., at art. 5.2.2.

69. Id., at art. 5.1.2.

70. Id., at art. 4.1.5.

71. OECD, *Commentary to the GloBE Model Rules*, supra n. 31, at art. 5.3, para. 25.

Table 11 – GloBE calculation in Example 10

Domestic Tax Law		Financial Reporting Standard		GloBE	
Loss before tax	-30.00	Loss before tax	-30.00	Loss before tax	-30.00
Research premium	-10.00	Current tax expense	0.00	GloBE loss	-30.00
Tax base	-40.00	Deferred tax income	10.00		
		Loss after tax	-20.00	Current tax expense	0.00
Corporate income tax (25%)	0.00	Effective tax rate	0.00%	Deferred tax expense (adjusted to 15%)	-6.00
				Adjusted covered taxes	-6.00
				Expected adjusted covered taxes	-4.50
				Additional current top-up tax	1.50

Table 12 – GloBE calculation in Example 11 with a profit

Domestic Tax Law		Financial Reporting Standard		GloBE	
Profit before tax	10.00	Profit before tax	10.00	Profit before tax	10.00
Research premium	-10.00	Current tax expense	0.00	GloBE income	10.00
Tax base	0.00	Profit after tax	10.00		
				Current tax expense	0.00
Corporate income tax (25%)	0.00	Effective tax rate	0.00%	Adjusted covered taxes	0.00
				Effective tax rate	0.00%
				Top-up tax percentage	15.00%
				Substance-based income exclusion	8.00
				Excess profit	2.00
				Top-up tax	0.30

the application of the substance-based income exclusion if, for example, high energy prices turn a routine return into a loss. In a profit situation, there is no top-up tax as long as the net GloBE income is not greater than the substance-based income exclusion, i.e. as long as there is no excess profit. Accordingly, in a loss situation, there should be no top-up tax as long as the net GloBE loss does not exceed (the negative amount of) the substance-based income exclusion. This position can be realized by amending the special rule for a GloBE loss⁷² and defining the additional current top-up tax as being equal to the difference between the expected adjusted covered taxes and the adjusted covered taxes multiplied by the negative amount, if any, of the “excess loss” (the GloBE loss reduced by the substance-based income exclusion),⁷³ divided by the GloBE loss. Example 11 illustrates this.

Example 11

In the financial accounts, the constituent entity has: (i) a profit before tax of 10; and (ii) a loss before tax of 10. This amount includes a tax-free research premium of 10 that is granted in the form of a QRTC. Based on its substance, the constituent entity can claim a substance-based income exclusion of 8. The nominal corporate income tax rate is 25%.

With regard to the profit situation, the tax-exemption of the research premium under the domestic tax law results in a tax base of 0 and a current tax liability of 0. For GloBE purposes, if the research premium is a QRTC, it is included in the GloBE income, resulting in a GloBE income of 10. As the adjusted covered taxes amount to 0, the ETR for GloBE purposes is 0% and the top-up tax percentage is 15%. In order to determine the excess profit, it is necessary to reduce the GloBE income of 10 by the substance-based income exclusion of 8. Then, the top-up tax percentage of 15% is multiplied by the excess profit of 2, resulting in a top-up tax of 0.3.

With regard to the loss situation, the tax exemption in respect of the research premium under the domestic tax law increases the losses available as a loss carry-forward from 10 to 20. This position

also increases the deferred tax income in the financial accounts from 2.5 to 5 (the 20 losses x the 25% corporate income tax rate). For GloBE purposes, after adjusting the (negative) deferred tax expense to 15%, the adjusted covered taxes of -3 are less than zero and less than the expected adjusted covered taxes of -1.5 (the -10 GloBE loss x 15%). This state of affairs results in an additional current top-up tax of 1.5, i.e. the difference between the expected adjusted covered taxes of -1.5 and the adjusted covered taxes of -3.0. In order to apply the substance-based income exclusion in a loss situation, the additional current top-up tax of 1.5 would have to be multiplied by 0.2, i.e. the “excess loss” of -2 (the -10 GloBE loss + the 8 substance-based income exclusion) divided by the GloBE loss of -10. This situation would result, similar as in a profit situation,⁷⁴ in an additional current top-up tax of 0.3.

5. Conclusions

The GloBE rules are a complex framework of provisions that require in-depth knowledge of both domestic tax laws and the relevant financial accounting standards, such as IFRS. They rely on the profits or losses as shown in the financial accounts, and subject them to certain adjustments to take account of common differences between tax and accounting. They further rely on the current and deferred tax expenses in the financial accounts, again subject to certain adjustments. By way of the current and deferred tax expenses, domestic tax provisions influence the ETR for GloBE purposes.

As the minimum level of taxation of 15% is determined by calculating the ETR for each jurisdiction, nominal tax rates in excess of 15% do not necessarily avoid a top-up tax. Even high-tax jurisdictions may give rise to a top-up tax by granting, for example, tax-free research premiums or investment allowances. This position is particularly true

74. It should be noted, however, that as soon as there is a positive tax base under the domestic tax law, taxation with a corporate income tax rate of 25% creates a buffer for permanent tax advantages (the profits under the domestic tax law x (the 25% corporate income tax rate – the 15% minimum tax rate)), which increases the ETR for GloBE purposes, reduces the top-up tax percentage and, consequently, reduces the top-up tax based on the excess profit. Such a buffer is not available in a loss situation, even if the substance-based income exclusion is taken into account.

72. OECD, *GloBE Model Rules*, *supra* n. 1, at art. 4.1.5.
 73. If there is no “excess loss” and, therefore, no negative amount, the multiplication by zero would result in no additional current top-up tax, as the substance would then be sufficient to prevent such a top-up tax.

Table 13 – GloBE calculation in Example 11 with a loss

Domestic Tax Law		Financial Reporting Standard		GloBE	
Loss before tax	-10.00	Loss before tax	-10.00	Loss before tax	-10.00
Research premium	-10.00	Current tax expense	0.00	GloBE loss	-10.00
Tax base	-20.00	Deferred tax income	5.00		
Corporate income tax (25%)	0.00	Loss after tax	-5.00	Current tax expense	0.00
		Effective tax rate	0.00%	Deferred tax expense (adjusted to 15%)	-3.00
				Adjusted covered taxes	-3.00
				Expected adjusted covered taxes	-1.50
				Additional current top-up tax	1.50
				Substance-based income exclusion	8.00
				Excess loss	-2.00
				Excess loss divided by GloBE loss	0.20
				Additional current top-up tax (new)	0.30

if there is no GloBE income but a GloBE loss in a jurisdiction. In such a case, permanent tax advantages generally result in a top-up tax of 15% in the loss year. As illustrated in this article, it is inconsistent that the substance-based income exclusion does not apply in a loss situation. Con-

sequently, although an unused substance-based income exclusion cannot be carried forward, it should apply symmetrically and be available every year, regardless of whether there is a profit or loss.



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