

# OECD releases further Pillar Two guidance under BEPS 2.0

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Issue 2

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## In brief

The OECD/G20 Inclusive Framework on BEPS (IF) released the following documents under Base Erosion and Profit Shifting (BEPS) 2.0 on 17 June 2024:

- (1) the fourth set of administrative guidance (Guidance) on the global anti-base erosion (GloBE) rules under Pillar Two;
- (2) a question-and-answer (Q&A) document on the mechanisms for determining the qualified status of jurisdictions' GloBE legislation under Pillar Two; and
- (3) supplementary guidance on Amount B of Pillar One<sup>1</sup>.

This news flash provides an overview of the Pillar Two documents mentioned above. For a discussion of all three items, please refer to the *PwC Global Tax Policy Alert*<sup>2</sup>.

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## In detail

### The Guidance

The Guidance provides further clarification on the operation of the GloBE rules and will be incorporated into the GloBE commentary, which was updated in April 2024 to reflect the various sets of guidance released up to the end of 2023<sup>3</sup>. The salient points of the Guidance are set out below.

### Recapture of deferred tax liabilities (DTLs)

The DTL recapture rule provides that subject to exceptions, if a DTL accrual has been included in the GloBE computations for a fiscal year (accrual year) but does not reverse within five fiscal years, the GloBE computations for the accrual year should be recomputed without such DTL.

#### Identifying and tracking categories of DTLs

The Guidance clarifies that as an alternative to tracking DTLs on an item-by-item basis or a general ledger (GL) account basis, a constituent entity (CE) of a multinational enterprise (MNE) group can track DTLs on an 'aggregate DTL category' basis, whereby multiple GL accounts under the same balance sheet or sub-balance sheet account can be grouped under a single category.

An aggregate DTL category may include both short-term DTLs (i.e. DTLs that reverse within five fiscal years) and long-term DTLs (i.e. DTLs that do not reverse within five fiscal years), subject to meeting certain requirements.

The following items are specifically excluded from applying the aggregate DTL category approach:

- (1) Specific assets and liabilities, namely (i) non-amortisable intangible assets (including goodwill); (ii) amortisable intangible assets with an accounting life of more than five years; and (iii) related party receivables and payables;

- (2) GL accounts that on a standalone basis will always generate only deferred tax assets (DTAs); and
- (3) Swinging accounts (i.e. GL accounts that may result in a net DTA or net DTL at different points of the life of the relevant assets/liabilities).

The Guidance further clarifies that if DTLs that are specifically excluded from the recapture rule (such as DTLs related to accelerated depreciation of tangible assets or fair value accounting on unrealised net gains) are included in a GL account or an aggregate DTL category for tracking purposes, such DTLs will also be subject to the recapture rule.

#### Mechanisms to recapture DTLs in an aggregate DTL category

The Guidance provides the methodologies an MNE group should use to determine DTL reversals and recaptures. Generally, the last-in, first-out (i.e. LIFO) basis should be used. However, a CE may use the first-in, first-out (i.e. FIFO) basis, generally considered to be more favourable, if specific conditions are met (e.g. the aggregate DTL category consists solely of DTLs with a similar reversal trend).

#### Simplification for short-term DTLs

The Guidance introduced a simplification mechanism whereby if a CE can demonstrate, on the basis of objective facts, that all DTLs in a GL account or an aggregate DTL category will reverse within five fiscal years of the accrual year (and as such will not be recaptured), the CE is not required to track such DTLs.

#### Unclaimed accrual election

The GloBE rules provide an annual election which allows a CE to exclude a DTL accrual from the GloBE calculations if it is not expected to reverse within five fiscal years.

The Guidance provides that the election must be consistent with the tracking approach. For instance, if the aggregate DTL category approach is adopted, the election must be made for all DTLs in the aggregate DTL category.

The Guidance also introduces a five-year election which may be made for a GL account or an aggregate DTL category irrespective of any expectations about the reversal time period for the DTLs.

In addition, the Guidance clarifies the following aspects: (i) the application of the recapture rules in relation to DTLs that accrued before the transition year; (ii) changes in the scope of an aggregated DTL category; (iii) the exception to the recapture rule in the case of a lessor of tangible assets; and (iv) the implications of the aggregate DTL category approach for the definition of qualified domestic minimum top-up taxes (QDMTTs).

### **Divergences between GloBE and accounting carrying values**

There are various circumstances under which the carrying value of assets and liabilities for accounting and GloBE purposes may be different. In this regard, the Guidance clarifies the following:

- The GloBE DTAs or DTLs must be computed based on the GloBE carrying value and adjusted in accordance with the relevant accounting standard.
- However, if the relevant accounting standard does not allow the recognition of DTA or DTL (e.g. the initial recognition exemption applies), no deferred tax will be taken into account for GloBE purposes unless otherwise specified under the GloBE rules.
- Pursuant to the GloBE rules and as already confirmed in the administrative guidance issued in February 2023, the arm's length price of cross border intra-group transactions recorded at cost is relevant for determining the GloBE income or loss of the disposing CE. The Guidance confirms that this also applies to the acquiring CE, meaning that the acquiring CE must compute its GloBE income or loss on the basis that the asset/liability was acquired at arm's length price. Therefore, any DTA or DTL in relation to the acquired asset/liability must be computed for the purposes of determining the adjusted covered taxes based on the carrying value of the acquired asset/liability for GloBE purposes. The arm's length price should be the same for the disposing CE and the acquiring CE.
- For assets and liabilities subject to impairment testing for accounting purposes, no separate testing is required for GloBE purposes. The GloBE carrying value will only be adjusted if the accounting carrying value is subject to an impairment based on the relevant financial accounting standard. In such cases, the GloBE carrying value will be reduced to match the accounting value to the extent the accounting carrying value is lower.

- The substance-based income exclusion (SBIE) is calculated based on the average carrying value of the relevant assets in the consolidated financial statements of the ultimate parent entity (UPE). As such, any adjustment to the GloBE carrying value of an asset of a CE should not affect the carrying value for SBIE purposes<sup>4</sup>.
- Subject to certain exceptions, the majority of the GloBE rules only apply from the transition year onwards, meaning that MNE groups should use the accounting carrying values for deferred tax purposes with respect to items arising in years prior to the first year a jurisdiction comes within the scope of the GloBE rules.

### **Allocation of cross-border current taxes**

The GloBE rules provide that covered taxes included in the accounts of a main entity which relates to the GloBE income of a permanent establishment (PE) should be allocated to that PE.

Some jurisdictions permit 'cross-crediting' of foreign taxes, whereby taxes paid on one source of income arising in one jurisdiction give rise to foreign tax credits which can be used against another source of income arising in another jurisdiction. The Guidance describes a four-step process for allocating current taxes of a main entity to its PEs in such cases. These principles also apply to allocations related to controlled foreign company (CFC) taxes (excluding blended CFC taxes), hybrid entities, reverse hybrid entities and taxes on distributions.

### **Allocation of cross-border deferred taxes**

Similar to current taxes, the GloBE rules allow for cross-border allocation of deferred taxes if the deferred taxes accrued by a CE in one jurisdiction relate to the GloBE income of a CE in another jurisdiction. In this regard, the Guidance sets out a five-step process applicable to CFC tax regimes (other than blended CFC tax regimes) for the allocation of cross-border deferred taxes of a parent entity to its CFC. The same principles also apply to allocation of deferred taxes from a main entity to PEs (except for the rule with respect to passive income), and from parent entities to hybrid entities and reverse hybrid entities.

Alternatively, an MNE group can make a five-year election (which applies with respect to the parent jurisdiction) to exclude the allocation of all deferred taxes in relation to all relevant CEs (including PEs, CFCs, etc.) arising in that jurisdiction. In such case, taxes arising under the relevant tax regimes will only be allocated when they are accrued in current tax expense.

### **Allocation of profits and taxes in structures including flow-through entities**

The Guidance clarifies how to allocate profits and taxes between CEs in structures including flow-through entities (i.e., broadly, entities which are treated as fiscally transparent in their jurisdiction of creation), and how to address potential double counting or non-counting of income or taxes in such structures. In particular, the Guidance provides the following clarifications on determining the status of an entity as a tax transparent entity, reverse hybrid entity or hybrid entity:

- In general, whether a flow-through entity is a tax transparent entity or reverse hybrid entity should be determined by reference to the tax law of the CE-owner that is (1) closest to that entity in the ownership chain and (2) not itself a flow-through entity. If no such owner exists, the UPE will be considered, even if the UPE itself is a flow-through entity.
- As the determination is made for each ownership interest, an entity with multiple owners in different jurisdictions could have more than one classification for GloBE purposes.
- Jurisdictions without a corporate income tax (CIT) or similar covered tax generally cannot be considered to treat an entity (whether an entity created in that jurisdiction or an entity owned by an entity created in that jurisdiction) as fiscally transparent.
- Other than as defined in the GloBE rules, the Guidance also regards an entity that is located in a jurisdiction without a CIT as a 'hybrid entity' provided that other conditions are met. The Guidance also confirms that an 'owner' of a hybrid entity includes both a direct and an indirect owner.

As regards covered taxes paid by a direct or indirect CE-owner with respect to the profits of a reverse hybrid entity, the Guidance clarifies that such taxes are allocated to the reverse hybrid entity to ensure appropriate matching with the income to which the tax relates.

### **Treatment of securitisation vehicles**

The Guidance clarifies how to determine whether special purpose vehicles used in securitisation transactions (securitisation entities) are CEs for GloBE purposes, and how to apply the GloBE rules to securitisation entities that are CEs, taking into account the special features of their income, expenses and taxes. Definitions of 'securitisation entity' and 'securitisation arrangement' will be added to the commentary to Article 10.1 (Defined Terms) of the GloBE rules.

In particular, the Guidance provides that jurisdictions adopting QDMTTs are not required to impose top-up tax liabilities on securitisation entities. In this regard, a jurisdiction adopting either of the following approaches will be able to meet the consistency standard for the purposes of the QDMTT safe harbour:

- (1) imposing the QDMTT liability in respect of the securitisation entities on other CEs in the jurisdiction; or
- (2) excluding the securitisation entities from the scope of QDMTT, such that they are not treated as CEs for QDMTT purposes.

However, if a jurisdiction adopts approach (2), the ‘switch-off rule’ would apply such that an MNE group with an excluded securitisation entity would not benefit from the QDMTT safe harbour for that jurisdiction. Conversely, under approach (1), the QDMTT safe harbour would still be available.

The IF will issue further administrative guidance on the treatment of securitisation entities. In particular, the IF will consider whether securitisation entities should be treated as being deconsolidated from the MNE group for GloBE purposes, the possibility of introducing an adjusted realisation basis election in relation to the profits of such entities, and the treatment of distributions received by the originator or any CEs in the MNE group from such entities.

### Q&A document on qualified status under the GloBE rules

For the purposes of applying the GloBE rules according to the agreed rule order, it is important to determine whether the domestic GloBE legislation implemented in a jurisdiction is qualified. The qualification mechanism is conducted via a peer review process, which includes a full legislative review and ongoing monitoring by the IF.

Since it will not be possible to conduct and finalise a full legislative review in the short term for each jurisdiction implementing the GloBE rules in 2024, the IF has developed a simplified transitional mechanism that allows jurisdictions to temporarily self-certify the qualified status of their legislation. The information will be shared with all IF members. The potential outcomes of the transitional mechanism are summarised below:

Questions or objections from IF members?	Questions / issues resolved?	Consensus reached on the qualified status?	Considered qualified for the transitional period?
×	N/A	N/A	✓
✓	✓	N/A	✓
✓	×	Agrees on a consensus-minus-one basis that the legislation is not qualified <sup>5</sup>	×
✓	×	×	✓ (but prioritise for full legislative review)

The OECD will publish a list of the jurisdictions’ legislation with a transitional qualified status on its website. The transitional qualified status is expected to apply from the effective date of the legislation until the completion of the full legislative review (which is expected to start within two years after the effective date of the legislation). If the legislation is considered not qualified under the full legislative review, the loss of the qualified status will not be retrospective.

### The takeaway

The Guidance sheds light on some areas where businesses and tax authorities have previously sought clarification and simplification. While parts of the Guidance are undoubtedly helpful, this benefit is negated by an increase in complexity. For instance, MNE groups may need to establish additional deferred tax computations specifically for GloBE purposes. Additionally, the Guidance reaffirms the need for advance planning around data identification, classification and utilisation for GloBE purposes. It is advisable for businesses to factor in the processes outlined in the Guidance in the expectation that jurisdictions will apply these rules both to the income inclusion rule (i.e. IIR) and domestic minimum top-up taxes.

The OECD has indicated that further guidance will be released, which may cover issues such as dispute resolution and a possible extension of the transitional CbCR safe harbour hybrid arbitrage rules to the full version of the GloBE rules. Affected taxpayers should closely monitor the upcoming developments in this regard.

### Endnotes

1. The documents can be accessed via these links:  
<https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-june-2024.pdf>  
<https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/qualified-status-under-the-global-minimum-tax-questions-and-answers.pdf>

[https://www.oecd.org/content/dam/oecd/en/publications/support-materials/2024/02/pillar-one-amount-b\\_41a41e1e/statement-qualifying-jurisdiction-definitions-section-5-2-section-5-3-simplified-streamlined-approach.pdf](https://www.oecd.org/content/dam/oecd/en/publications/support-materials/2024/02/pillar-one-amount-b_41a41e1e/statement-qualifying-jurisdiction-definitions-section-5-2-section-5-3-simplified-streamlined-approach.pdf)  
[https://www.oecd.org/content/dam/oecd/en/publications/support-materials/2024/02/pillar-one-amount-b\\_41a41e1e/statement-covered-jurisdiction-definition-inclusive-framework-commitment-amount-b.pdf](https://www.oecd.org/content/dam/oecd/en/publications/support-materials/2024/02/pillar-one-amount-b_41a41e1e/statement-covered-jurisdiction-definition-inclusive-framework-commitment-amount-b.pdf)

2. The *PwC Global Tax Policy Alert* can be accessed via this link:  
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-releases-guidance-relating-to-p2-globe-and-p1-amount-b.pdf>
3. The OECD on 25 April 2024 published a consolidated commentary (Commentary) to the GloBE model rules that incorporates all agreed administrative guidance that has been released by the IF from March 2022 through December 2023. The Commentary aims to provide tax administrations and taxpayers with guidance on the interpretation and application of the GloBE model rules. The OECD also released updated illustrative examples (Examples), originally published in March 2022, including the examples that were developed as part of the various pieces of administrative guidance approved by the IF before the end of December 2023. The Commentary and Examples can be accessed via these links:  
[https://www.oecd.org/en/publications/tax-challenges-arising-from-the-digitalisation-of-the-economy-consolidated-commentary-to-the-global-anti-base-erosion-model-rules-2023\\_b849f926-en.html](https://www.oecd.org/en/publications/tax-challenges-arising-from-the-digitalisation-of-the-economy-consolidated-commentary-to-the-global-anti-base-erosion-model-rules-2023_b849f926-en.html)  
<https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-erosion-model-rules-pillar-two-examples.pdf>
4. The GloBE rules provides that the net GloBE income should be reduced by the SBIE to determine the excess profit for purposes of computing the top-up tax in a jurisdiction. The SBIE is the sum of the payroll carve-out and the tangible asset carve-out for each CE (except investment entities) in that jurisdiction.
5. Under the consensus-minus-one approach, more than one dissenting participant is required to block consensus.

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## Let's talk

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For a deeper discussion of how this impacts your business, please contact:

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- Shui Jie web portal - <https://shuijie.pwconsultantssz.com>

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