Inclusive Framework Administrative Guidance on limitation of the use of deferred tax assets under transitional rules (Article 9.1)

January 17, 2025

The Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) on January 15, 2025, released a fifth tranche of Administrative Guidance (AG5) on a specific provision dealing with the use of deferred tax assets under the global anti-base erosion (GloBE) transitional rules. Other material concerning the GloBE Information Return, the qualification process, and exchange of information were also released. This report focuses on the guidance on deferred tax assets under Article 9.1.

Background

The GloBE rules use deferred tax accounting concepts to deal with temporary differences and carryforward losses. In order to minimize distortions and for simplification, transitional rules allow pre-GloBE deferred tax assets arising from temporary differences and carryforwards to be carried into the GloBE regime (capped at 15%) and used in the calculation of the effective tax rate (ETR) of a Constituent Entity of a relevant group (CE). As those deferred tax assets reverse in an accounting period, there is a deferred tax expense which, when added to the current tax expense, lifts the ETR for that period.

However, Article 9.1.2 of the model rules "undoes" certain deferred tax assets relating to transactions that occurred after 30 November 2021 that are perceived to give rise to tax advantages which are not considered to be "economic." More specifically, Article 9.1.2 excludes deferred tax assets arising from items excluded from the computation of GloBE Income or Loss. Examples included an investment allowance which gave rise to super deductions and disposals of assets giving an uplift in tax cost without a countervailing increase in tax from a disposing entity.

KPMG observation

9.1.2 applies to deferred tax assets arising from "items excluded from the computation of GloBE Income or Loss under Chapter 3." This phrase is used in multiple instances in the GloBE rules, including as an adjustment to current tax expense and deferred tax expense in determining Adjusted Covered Taxes. While the scope of that phrase is uncertain, many have interpreted it to refer only to items that are specifically covered by a GloBE adjustment described in Chapter 3 (and not items that are excluded from GloBE Income because they do not appear in the financial accounts). However, AG5 adopts a more expansive interpretation for purposes of Article 9.1.2, noting that the phrase also includes non-economic expenses or losses. Additionally, AG5 notes that it does not include deferred tax expense that does not exist in the financial accounts of a group but is specially created under the GloBE Rules on account of a difference in carrying value of an asset or liability for financial statement and GloBE purposes. For example, a group may not reflect deferred tax expense in its financial accounts when its tax basis equals its financial statement carrying value in acquired assets due to purchase accounting. The requirement to remove purchase accounting basis in 6.2.1 creates a financial statement/GloBE carrying value difference that requires the group to take into account a deferred tax asset for GloBE purposes only. Because this deferred tax asset represents an economic expenditure relating to the acquisition of assets (directly or indirectly), 9.1.2 does not apply to this deferred tax asset.

The IF was concerned that some governments have put in place rules that gave rise to tax benefits resulting in deferred tax assets prior to a CE entering the GloBE rules. Those deferred tax assets would reverse once the GloBE regime was operating, thereby increasing deferred tax expense and the CE's ETR in a manner that other governments considered to be inconsistent with the objectives of the GloBE rules.
In response, AG5 sets out additional rules that effectively exclude such deferred tax assets from recognition under the transitional rules, including in the three scenarios outlined below. However, deferred tax assets in these three scenarios are subject to a grace period and limitation, which provide partial benefits.

Scenarios for an extension of the 9.1.2 limitation

The three scenarios are as follows:

1 When a deferred tax asset is attributable to a government arrangement concluded after November 30, 2021, and the arrangement gives rise to a tax credit or other tax relief (such as a tax basis step-up) *that does not arise independently of the arrangement*. A tax credit or relief arises independently of a government arrangement if no critical aspect of the credit or relief, such as the eligibility or amount, relies on discretion exercised by the general government. (First scenario – non-independent tax benefit).

2 When a deferred tax asset is attributable to an election or choice exercised or changed after November 30, 2021, which *retroactively changes the treatment of a transaction* in determining its taxable income in a tax year for which an assessment has been made or tax return has already been filed. (Second scenario – retroactive election).

3 When a deferred tax asset or deferred tax liability attributable to the difference in tax basis and accounting carrying value of an asset or liability arose pursuant to a corporate income tax that was enacted by a *jurisdiction that did not have a pre-existing corporate income tax* that became effective after November 30, 2021, and before the Transition Year (as defined). Carryforward losses are subject to a rule which is discussed below. (Third scenario – no preexisting corporate income tax).

Grace Period Limitation

The rules generally limit the benefit of deferred tax assets attributable to the three scenarios to a cap (the "Grace Period Limitation") equal to 20% of the amount of each deferred tax asset originally recorded (with the deferred tax asset measured at the lower of 15% or the applicable domestic tax rate).

The period in which the 20% allowable cap is eligible to be used depends on the scenario. For the first and second scenarios—non-independent tax benefit and retroactive elections—the deferred tax expense must be attributable to a reversal in fiscal years beginning on or after January 1, 2024, and before January 1, 2026, but not including a fiscal year that ends after June 30, 2027. For the third scenario—no pre-existing corporate income tax—the grace period is for fiscal years beginning on or after January 1, 2025, and before January 1, 2027, but not including a fiscal year that ends after 30 June 2028.

For the first and second scenarios, the Grace Period Limitation is not available if the government arrangement is concluded or amended, or the election or choice is made after November 18, 2024. For the third scenario, the Grace Period Limitation is not available if the corporate income tax was enacted after November 18, 2024. Also, the Grace Period Limitation does not allow for the improvement of a position, absent the new restrictions. That is, it does not undo restrictions already embedded in the rules. Further, an amount cannot be taken into account under the Grace Period Limitation if it exceeds the amount that would have reversed within the relevant period as of November 18, 2024 (e.g., a group cannot accelerate reversal into the period allowed under the Grace Period Limitation by changing its accounting methodology).

For what tests do the new rules apply?

The extension of 9.1.2 under AG5 to deny the benefit of certain deferred tax assets applies for the main Model Rules under the IIR and the UTPR and transitional country-by-country (CbC) reporting safe harbour. They will also apply to the qualified domestic minimum top-up tax (QDMTT) safe harbour, such that if the rules are breached, the switch-off mechanism will apply to undo the benefit of the QDMTT safe harbour and instead impose a credit methodology for amounts collected under the QDMTT.

Additional five-year limitation on losses where there is a new corporate tax regime

AG5 provides that Article 9.1.2 does not preclude a government that is introducing a new corporate tax regime from allowing for carryforward losses, provided the losses do not exceed the amount of losses incurred in the five fiscal years immediately preceding the effective date of the new corporate income tax.

Further work on related benefits

AG5 notes that the IF is developing further guidance on identifying benefits that must be treated as a refund of tax that reduces "Adjusted Covered Taxes" (e.g., tax credits, government grants, and other benefits that are calculated based on income or taxes). It notes that the definition of "Tax" in the GloBE Model Rules includes only compulsory "unrequited" payments to General Government.

In addition, AG5 states that the IF is developing further guidance on the concept of "Related Benefits" and the impact of such benefits on the qualified status of a jurisdiction's rules. Under previous Commentary, if there are Related Benefits in a specific jurisdiction, it may impact the qualified status of the jurisdiction's rules for the purpose of the operation of QDMTT safe harbour.

KPMG observation

Some multinational enterprises (MNEs) will welcome the fact that the carry forward of losses from the preceding five years will be allowable under the transitional GloBE rules where a new corporate income tax regime has been established. However, for some MNEs the denial of the deferred tax expense attributable to the three scenarios called out above may lead to additional top-up tax.

Possible actions for companies

MNEs may need to review the potential operation of the changes to 9.1.2, both for the purposes of the operation of the Transitional Safe Harbour and the basic operation of the Model Rules. This may involve additional calculations to utilise the benefits of the Grace Period.

Contact us

For more information, contact a KPMG tax professional:

Danielle Rolfes
T: +1 202 533 3378
E: drolfes@kpmg.com

Michael Plowgian
T: +1 202 533 4295
E: mplowgian@kpmg.com

Kevin Brogan
T: +1 202 533 3425
E: kevinbrogan@kpmg.com

Quyen Huynh
T: +1 949 885 5400
E: qhuynh1@kpmg.com

Samira Varanasi
T: +1 408 367 7196
E: samiravaranasi@kpmg.com

Alistair Pepper
T: +44 7854 011961
E: alistairpepper@kpmg.com

John DerOhanesian
T: +1 202 533 3441
E: jderohanesian@kpmg.com

Marissa Rensen
T: +1 804 363 2386
E: mrensen@kpmg.com

Marcus Heyland
T: +1 213 972 4000
E: mheyland@kpmg.com

Learn about us: | **kpmg.com**