



Overview of Pillar Two side-by-side package

KPMG analysis and observations

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Overview

On January 5, 2026, the OECD / G20 Inclusive Framework on Base Erosion and Profit Shifting (the Inclusive Framework) published an 88-page [package of documents](#) (the Side-by-Side Package) that modifies key aspects of the Pillar Two Global Minimum Tax (GMT) framework.

Side-by-side (SbS) system

- **SbS Safe Harbour** – By far the most anticipated item in the SbS Package, the SbS Safe Harbour has been under negotiation since April of last year. The SbS Safe Harbour, set out in a compact 7 pages, will turn off the application of the Income Inclusion Rule (IIR) and Undertaxed Profits Rule (UTPR) if the Ultimate Parent Entity (UPE) of a Multinational Enterprise (MNE) Group is located in a jurisdiction that imposes minimum taxation requirements with respect to both domestic and foreign income, and provides a foreign tax credit for Qualified Domestic Minimum Top-up Taxes (QDMTTs), subject to any generally applicable limitations under its domestic law (a Qualified SbS Regime). The only jurisdiction currently eligible for the SbS Safe Harbour is the US. The Global Anti-Base Erosion (GloBE) Information Return (GIR) filing requirements for MNE Groups electing the SbS Safe Harbour will also be consequently modified. The SbS Safe Harbour will be available for fiscal years commencing on or after January 1, 2026, subject to local implementation.
- **UPE Safe Harbour** – Separately, the existing Transitional UTPR Safe Harbour is set to be replaced with a new, permanent UPE Safe Harbour. For a given MNE Group, the UPE Safe Harbour will protect UPE jurisdiction profits from foreign UTPRs if the UPE is located in a jurisdiction that imposes minimum taxation requirements with respect to domestic income (a Qualified UPE Regime), but will not protect profits of foreign subsidiaries or permanent establishments (PEs) from the application of the IIR or the UTPR (nor would it protect profits of a subsidiary located in the UPE jurisdiction from the application of the IIR). The UPE Safe Harbour would be relevant for MNE Groups with their UPE located in jurisdictions that do not meet the requirements for the SbS Safe Harbour. The UPE Safe Harbour will be available for fiscal years commencing on or after January 1, 2026, subject to local implementation.
- **Stocktake** – The Inclusive Framework has committed to a stocktaking exercise on the effect of the GMT and SbS system, including the implementation of QDMTTs, to be concluded by 2029.
- **Reinforcing effectiveness of QDMTTs** – The Package notes that the SbS System will not interfere with the application of QDMTTs to all MNE Groups, including those subject to the SbS or UPE Safe Harbour. Importantly, the Package notes that domestic minimum top-up taxes that discriminate between MNE Groups (i.e., that exclude MNE Groups subject to the SbS Safe Harbour) will imperil their status as a QDMTT and conceivably even their treatment as Covered Taxes.

Substance-based tax incentives (SBTI)

- **SBTI Safe Harbour** – As set out in nine pages of guidance, an increased variety of tax incentives are to be protected, at least to some extent, from having their value clawed back under the GMT. Under the existing rules, temporary tax incentives, and permanent tax incentives taking the form of Qualified Refundable or Marketable Transferable Tax Credits (QRTCs and MTTCs) were protected to some extent. Now eligible expenditure-based incentives (e.g., tax credits, super deductions), together with certain production-based incentives, are also to be given a measure of protection. The protection takes the form of a SBTI Safe Harbour and follows a different calculation approach compared to QRTCs and MTTCs (e.g., increase of the Effective Tax Rate (ETR) numerator only, limited by a substance cap). The SBTI Safe Harbour is not a traditional safe harbour, as where an MNE Group elects to apply it, it applies as a variation to the full GloBE rules.

Material simplifications

- **Simplified ETR Safe Harbour (SESH)** – The majority of the SbS Package (58 pages) is focused on the SESH, which represents a permanent simplification to the GMT framework. Under the SESH, MNE Groups will be required to calculate their Simplified ETR, which comprises Simplified Taxes over Simplified Income, on a jurisdictional basis. Where the Simplified ETR exceeds 15%, the MNE Group shall be deemed to have no top-up tax liability in respect of that jurisdiction. The SESH will apply for fiscal years beginning on or after December 31, 2026, but can be implemented by jurisdictions for fiscal years beginning on or after December 31, 2025.
- **Extension of the Transitional CbCR Safe Harbour (TCSH)** – The existing TCSH has been extended for an additional year, with the Simplified ETR test continuing to apply at 17%.
- **Work programme for additional simplification** - The SbS Package also highlights a number of future simplification initiatives, notably, work on a routine profits test and de minimis test that is scheduled to be completed in the first half of 2026.

The changes agreed in the Package will not be effective until jurisdictions that have implemented the GMT implement the Package, a process that prior experience suggests will take significant time to complete.

The Package involves many important changes to the GMT framework, the implications of which will take time for MNE Groups to examine and fully understand. We highlight below some of the key details for each part of the Package, along with our initial observations.

SbS system

SbS Safe Harbour eligibility criteria

An MNE Group may elect SbS Safe Harbour treatment if its UPE is located in a jurisdiction with a Qualified SbS Regime. If the safe harbour applies, the top up tax amount in the MNE Group's UPE and overseas jurisdictions is deemed to be zero, for IIR and UTPR purposes, though not for QDMTT purposes.

A jurisdiction will have a Qualified SbS Regime if it:

- 1) Has an eligible domestic regime,
- 2) Has an eligible worldwide regime,
- 3) Provides a foreign tax credit for QDMTTs on the same terms that apply to other foreign income taxes, and
- 4) Enacted such domestic and worldwide regimes prior to January 1, 2026, or a later date in accordance with procedures set out in the SbS Package.

An eligible domestic regime is one in which the UPE jurisdiction taxes residents on a comprehensive measure of income, at a rate of 20% or more, and has either a financial statement income based corporate alternative minimum tax at a rate of 15% or more, or a QDMTT.

An eligible worldwide regime is one in which the UPE jurisdiction imposes tax on UPE jurisdiction resident corporations in respect of the profits of overseas subsidiaries and branches, if the taxing regime covers a comprehensive measure of income (both active and passive income) and includes mechanisms to address base erosion and profit shifting (BEPS) risks.

Furthermore, both an eligible domestic and worldwide regime must present no material risk that in-scope MNE Groups headquartered in the jurisdiction will be subject to an effective rate of tax (evaluated



considering incentives) on the overall profits of their domestic and foreign operations, respectively, below 15%.

The Inclusive Framework will assess pre-existing tax regimes (enacted and effective as of December 31, 2025) against the SbS eligibility criteria by the end of the first half of 2026. Jurisdictions having qualified regimes are to be placed on a central record with the OECD, and the US has been so listed.

KPMG observation

The SbS Package does not provide for retroactive application of the SbS Safe Harbour to fiscal years 2024 or 2025. As a result, the foreign profits of a US-parented MNE Group will be subject to IIRs in 2024 and 2025, and to UTPRs in 2025. The domestic profits of a US-parented MNE Group will also be subject to the UTPR in 2025; however, the Transitional UTPR Safe Harbour is available to deem the top-up tax for the US jurisdiction to be zero in 2025 for purposes of the UTPR.

US-parented MNEs Groups with a 52 / 53 week December year-end may have one year where their domestic profit is subject to the UTPR because there may be a fiscal year that is not be eligible for the SbS Safe Harbour or the Transitional UTPR Safe Harbour given the effective dates for those safe harbours.

KPMG observation

The SbS Safe Harbour does not apply to a non-US parented MNE Group that has a subgroup with a US intermediate parent entity; as such, IIRs and UTPRs will still apply to the US entity and its subsidiaries in all years.

KPMG observation

While the SbS Package provides no explicit discussion of MNE Groups whose UPE is a US Flow-through entity, such MNE Groups should qualify for the SbS Safe Harbour on the basis it applies to UPEs "located in" the US and Article 10.3.2(a) provides that a Flow-through entity that is the UPE of an MNE Group is located in the jurisdiction in which it was "created."

KPMG observation

The SbS Package provides that additional countries may request an assessment by the Inclusive Framework as to whether their tax system meets the requirements of a Qualified SbS Regime in 2027/28. It remains to be seen whether countries that have not adopted the GMT will seek to qualify for SbS treatment at this later point. Alternative actions for such countries could be to adopt the GMT rules, or at least the QDMTT.

UPE Safe Harbour eligibility criteria

The UPE Safe Harbour, which deems top up tax for the UPE jurisdiction to be zero for purposes of the UTPR only, requires solely that the eligible domestic regime condition (described above) be satisfied in order for a jurisdiction to have a Qualified UPE Regime (and thereby MNE Groups with UPEs located in such jurisdiction be eligible for such safe harbour). Similarly to the SbS assessment process, an evaluation of pre-existing tax regimes, enacted and effective as of December 31, 2025, will be made by the end of the first half of 2026. At present, no jurisdiction is listed as being eligible for the UPE Safe Harbour.



GIR requirements

MNE Groups availing themselves of the SbS or UPE Safe Harbours will elect on the face of an updated GIR. When the SbS Safe Harbour is elected, only high-level group structure information will need to be set out in Section 1 of the GIR, with computation details in Sections 2 and 3 completed only for QDMTT jurisdictions. The SbS Safe Harbour does not affect the reporting obligations for Fiscal Years prior to 2026.

KPMG observation

As a result of the SbS Safe Harbour not applying retroactively, US MNEs will be required to complete a full GIR for 2024 and 2025. Starting in 2026, a streamlined GIR is envisioned for US-parented MNEs in view of the SbS Safe Harbour, including minimizing the data points in Part 1 of the form and only requiring Parts 2 and 3 be completed in respect of jurisdictions with a QDMTT.

KPMG observation

As a result of the SbS Package and the introduction of the new SbS Safe Harbour provision, the GIR template and related XML schema will require changes. From a reporting dissemination perspective, for MNE groups covered by the SbS Safe Harbour, QDMTT-only jurisdictions (where the MNE Group has Constituent Entities (CEs)) will continue to receive Section 1 of the GIR (without the high-level summary of GloBE information in section 1.4) and the Jurisdictional Section for that jurisdiction. Similarly, jurisdictions that apply the IIR or UTPR (and where the MNE Group has CEs) will receive Section 1 of the GIR (without the high-level summary of GloBE information in section 1.4) and the Jurisdictional Section for that jurisdiction for QDMTT purposes – the form will indicate to them that their IIR / UTPR taxing rights have been nullified through the SbS election. As such, those IIR / UTPR jurisdictions would not receive Jurisdictional Sections for other jurisdictions as they would not have taxing rights as a result of the SbS Safe Harbour. There remains an open question whether the jurisdiction of a designated filing entity would receive the full GIR.

Simultaneously, groups will need to monitor and adapt to additional local filing obligations, beyond the GIR, that QDMTT countries might require. It appears that countries are taking varied approaches to the amount of information required in the local tax returns. Some require extensive local filings, similar to the GIR, whilst others are considering more condensed returns with reliance on the exchange of GIR information.

QDMTT and SbS interactions

The SbS Safe Harbour eligibility criteria require that the US provide a foreign tax credit for QDMTTs (subject to generally applicable limitations that apply to other foreign income taxes), and the SbS Package covering statement notes that other Inclusive Framework members are also committed to do so. The SbS Package states, in line with current QDMTT design, that QDMTTs will continue to be calculated without pushdown of Controlled Foreign Company (CFC) or other owner-level taxes in the QDMTT ETR computation.

In the context of the QDMTT, it is noted that “conditional or discriminatory taxes” will not be recognized as Covered Taxes (for purposes of IIR and UTPR computations of in-scope MNE Groups) and the Inclusive Framework will consider further work on how this will be consistently applied. Moreover, the qualified status of domestic minimum top-up taxes remains dependent on their consistent and non-discriminatory application to MNE Groups, regardless of whether an MNE Group has elected to apply the SbS Safe Harbour.

KPMG observation

The SbS Package includes several measures to support the rollout and retention of QDMTTs across jurisdictions, e.g., parent jurisdiction relief, no owner tax pushdown, planned integrity measures, with more potentially to follow after the 2029 stocktake.

At present, over 60 jurisdictions have either adopted the GMT or taken steps to adopt at least one of the rules. A key point to monitor is whether individual countries look to adopt minimum taxes that vary from the QDMTT design, with a view to having these treated as Covered Taxes in relation to other countries' GMT regimes, rather than as QDMTTs per se. This could conceivably involve rules that permit owner tax pushdown, or conditional minimum taxes.

In this regard, it is notable that the SbS Package provides that "conditional or discriminatory" taxes will not be treated as Covered Taxes for purposes of the GMT. This is tied to consistent application of taxes to MNE Groups, regardless of whether they avail themselves of the SbS Harbour or not. As such, countries looking to adopt variant minimum taxes may need to be cognizant of developments in this space. In addition, it also remains to be seen how existing QDMTT jurisdictions assess the retention of their rules under the new GMT framework.

Many smaller developing countries are yet to adopt the rules, and it remains to be seen whether the planned simplifications to QDMTT design and compliance features, noted in the SbS Package, might support further QDMTT adoption in these countries.

Substance-based Tax Incentives (SBTI)

A substance-based tax incentive (SBTI) Safe Harbour is now provided for Qualified Tax Incentives (QTIs), which is intended to cover tax incentives that the Inclusive Framework views as tied to economic substance within a jurisdiction.

Scope

The QTI definition is intended to apply broadly to different forms of incentives, including tax credits, super deductions, exemptions or preferential rates, subject to a number of conditions.

- QTIs must be calculated based on eligible expenditures or, in the case of production-based incentives, on the basis of the amount of tangible property produced in a jurisdiction.
- QTIs must be generally available to taxpayers (not limited to certain classes of taxpayers or granted on a discretionary basis).
- QTIs must reduce the liability of a Covered Tax (incentives such as subsidies, grants or incentives that give rise to timing differences do not qualify as QTIs even if these are related to expenditure or production outcomes).
- QTIs must meet generosity conditions (expenditure-based tax incentives are excluded from the QTI definition where the value of the tax benefit of the incentive exceeds the expenditure).

A QRTC or a MTTC may qualify as a QTI provided that the credit qualifies as an expenditure- or production-based tax incentive and an annual election is made to treat the QRTC or MTTC (partly or in full) as a QTI.

Treatment of QTIs

Where MNE Groups elect to apply the SBTI Safe Harbour, QTIs are treated as an increase to the ETR numerator (Adjusted Covered Taxes) in the amount of their deemed tax value (e.g., reduction of tax expense resulting from a tax credit or amount of super deduction multiplied by statutory tax rate). At the same time, QTIs are not to be included in the ETR denominator (GloBE Income).

Substance cap

The increase to the ETR numerator is subject to a cap equal to the higher of 5.5% of the payroll costs or depreciation on tangible assets in the jurisdiction. Alternatively, MNE Groups can make a five-year election to apply a cap equal to 1% of the carrying value of tangible assets in the jurisdiction (excluding land and other non-depreciable assets).

Safe Harbour

The SBTI Safe Harbour eliminates an amount of Top-up Tax attributable to QTIs, subject to the applicable substance cap.

Applicability date

MNE Groups can make the SBTI Safe Harbour election for Fiscal Years beginning on or after January 1, 2026.

KPMG observation

The SBTI Safe Harbour offers some optionality for MNE Groups. They will have to decide whether to treat eligible QRTCs and MTTCs (partly or in full) as QTIs given the differences in treatment (impact on ETR numerator / denominator, substance cap).

For example, the treatment of QRTCs and MTTCs as QTIs might be favourable where the tax credits reduce the jurisdictional ETR below 15% and substantial payroll costs or tangible assets are available in the tested jurisdiction. As such, MNE Groups may be incentivised to treat QRTCs and MTTCs as QTIs until either the substance cap or the 15% rate is reached.

With respect to the substance cap, MNE Groups will also have to consider which of the two approaches (5.5% payroll costs / depreciation or 1% carrying value of tangible assets) is more beneficial. In this context, MNE Group need to take into consideration the limitations provided in relation to switching between the two methods.

KPMG observation

Many jurisdictions have already taken steps to modify their tax incentive regimes to retain their attractiveness under the GMT. Others, while not yet modifying their regimes, have announced plans to study the potential adoption of refundable tax credits. See the KPMG article [Pillar Two and tax incentives](#) for more detailed observations.

This being said, some countries may be wary of the potential fiscal pressures and administrative challenges of refundable credits. The SBTI Safe Harbour provides potential alternative paths to the redesign of tax incentive regimes. Notably, while incentives covered by SBTI are subject to a cap, QRTCs and MTTCs remain uncapped (unless an election is made to treat those as QTIs). As such,

tax policymakers in relevant countries will need to give this detailed consideration over coming months.

KPMG observation

The guidance notes the ongoing work in relation to Related Benefits, which would ensure that the GMT is not undermined by governments effectively 'passing back' GMT or other tax amounts to in-scope MNE Groups.

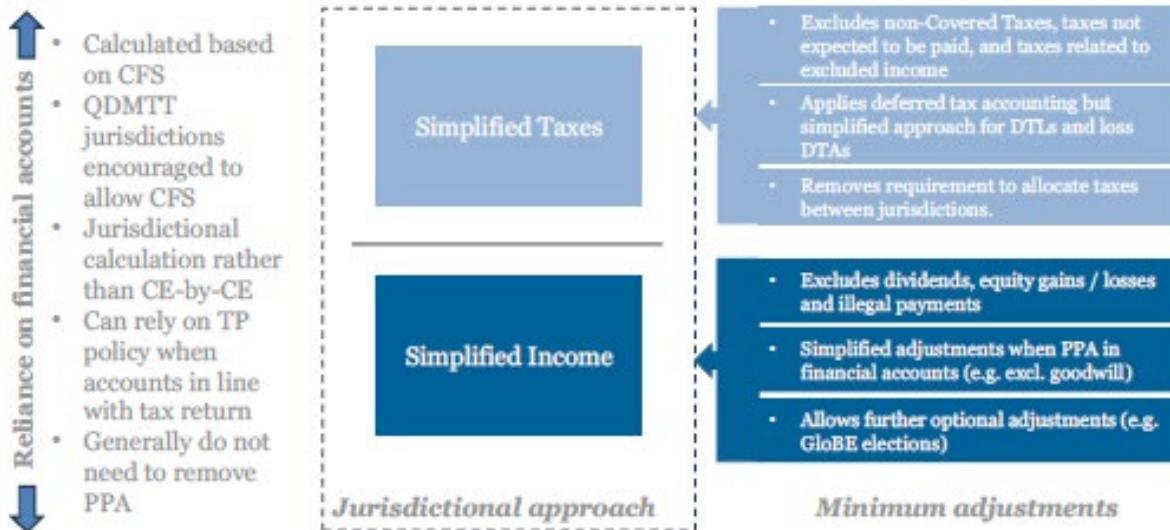
In particular, the new guidance highlights that the Inclusive Framework intends to exclude incentives from the scope of QTIs where they are determined to be Related Benefits.

Material Simplification

Simplified ETR Safe Harbour

Under the SESH, MNE Groups will be required to compute their Simplified Income and Simplified Taxes for each Tested Jurisdiction, with the Simplified ETR calculated by dividing Simplified Taxes by Simplified Income. If the Simplified ETR is above a safe harbour rate of 15%, then the MNE Group will be deemed to have no-top tax liability for that Tested Jurisdiction.

FIGURE 1: OVERVIEW OF THE SESH CALCULATION¹



KPMG observation

The SESH can be described as a halfway house between the simplicity of the TCSH and the complexity of the full GloBE rules, though it is closer to the latter than the former. The SESH will be

¹ OECD (2026), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), Side-by-Side Package: Inclusive Framework on BEPS*.

welcomed by some businesses, but others may see limited benefit. This is because when an MNE Group is not eligible for the SESH in a Tested Jurisdiction, it will be required to undertake a full GloBE computation to determine its potential top-up tax liability. Some groups may find it easier to automate the full GloBE computation for all jurisdictions, rather than prepare two computations in some instances.

Some of the key features of the SESH are described below. This is not an exhaustive list and does not seek to describe every aspect of the SESH.

Tested Jurisdiction

The SESH will apply on a Tested Jurisdiction basis. Tested Jurisdiction is the group of CEs for which separate ETR calculations are required. This means that for a given jurisdiction an MNE Group may have more than one Tested Jurisdiction, e.g., one for all its regular CEs and one for a separate Joint Venture (JV) Group.

Financial accounts

The SESH will generally apply based on the financial accounts used to prepare an MNE Group's Consolidated Financial Statements (CFS). In jurisdictions that have adopted a QDMTT with the Local Financial Accounting Standard (LFAS) Rule, the SESH will by default be applied based on accounts prepared under the local financial accounting standard, where the relevant conditions to use such accounts are met. However, jurisdictions are encouraged to permit the use of accounts used to prepare the CFS, where these are prepared under a widely used Acceptable Financial Accounting Standard, e.g., International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (US GAAP).

KPMG observation

The provision of optionality for jurisdictions with QDMTTs that adopt the Local Financial Accounting Standard (LFAS) Rule is somewhat inconsistent with the design of the LFAS Rule itself, which does not permit jurisdictions to provide optionality in the accounts used. MNE Groups will need to monitor whether countries that have adopted the LFAS Rule, such as Brazil and Ireland, permit the SESH to be applied based on financial accounts used to prepare the MNE Group's CFS.

Jurisdictional aggregate data

Simplified Income and Simplified Taxes (see below) will be computed on an aggregated basis at a Tested Jurisdiction level with no requirement to calculate Simplified Income or Taxes at an entity-level.

Simplified Income

In computing Simplified Income, MNE Groups will make four types of adjustments to the profit (or loss) before tax reported in the relevant financial accounts:

- **Basic Adjustments** remove Excluded Dividends, Excluded Equity Gains or Losses, and add back bribes, kickbacks and other illegal payments and fines and penalties over €250,000.
- **Industry Adjustments** make specific adjustments for the financial services and shipping industries.
- **Any applicable Conditional Adjustments** provide rules for the treatment of Equity-reported items and merger and acquisition (M&A) simplifications.



- **Any Optional Adjustments elected by the MNE Group** enable MNE Groups to make any of the elections provided under Chapter 3 of the GloBE Model Rules, but require adjustments for Asymmetric Foreign Exchange Currency Gain or Loss and Accrued Pension Expense (unless a five-year election is made not to make such adjustments)

KPMG observation

The Basic Adjustment addresses a challenge that some MNE Groups faced with the TCSH, where the inability to make such adjustments led them to fail the TCSH and forced them to prepare a computation under the full GloBE Rules even when they ultimately owed no top-up tax.

KPMG observation

The Conditional Adjustments are relatively complex. The conditional adjustments generally do not require (or in some cases permit) beneficial adjustments but require adjustments that generally reduce a Tested Jurisdiction's Simplified ETR. Notably, these adjustments seek to limit when MNE Groups are required to remove the effects of purchase accounting from their computation of Simplified Income.

Simplified Taxes

The starting point for computing Simplified Taxes, as for the full GloBE rules, is current and deferred income tax expense as reported in the relevant financial accounts.

Mandatory adjustments

There are four categories of adjustments that MNE Groups will be required to make:

- **Policy-based adjustments** (e.g., removing non-Covered Taxes and aligning the treatment of tax refunds and credits with full GloBE rules);
- **Adjustments to ensure correlation between Simplified Taxes and Simplified Income** (i.e., reducing tax expense associated with income not included in Simplified Income);
- **Adjustments for uncertain taxes and taxes that are not payable promptly**; and
- **Deferred tax adjustments**, which retains the requirement to recast deferred taxes based on the minimum rate and which excludes deferred tax liabilities that are not Recapture Exception Accruals (REA).

KPMG observation

There has been simplification to the computation of Simplified Taxes; however, these simplifications are generally taxpayer unfavourable. For example, the requirement to track the reversal of deferred tax liabilities has been eliminated by excluding deferred tax expense attributable to deferred tax liabilities from the calculation unless they are recapture exception accruals (REA) (and hence where the recapture rules did not apply).

Optional adjustments

MNE Groups may elect to apply various other provisions included in the full GloBE Rules, such as including expenses that are not accrued as income tax expense in the financial accounts or the SBTI Safe Harbour (see above).



Tested jurisdictions with a simplified loss

In Tested Jurisdictions with a Simplified Loss, MNE Groups will be required to determine if their Simplified Taxes exceed the Simplified Loss multiplied by 15%. Any excess must then be carried forward as Simplified Adjustment for Negative Taxes, reducing Simplified Taxes in an equivalent way to the Excess Negative Tax Carry-forward.

Transition year

Unlike the TCSH, eligibility for the SESH does not delay a Tested Jurisdiction's Transition Year. The Transition Year is relevant for determining how a Tested Jurisdiction's deferred tax assets and liabilities that arose prior to the Transition Year are treated under the SESH and the full GloBE Rules.

KPMG observation

The requirement to determine a Tested Jurisdiction's deferred tax assets and liabilities for the purposes of the Transition Year is an additional compliance burden, as compared to the TCSH.

Tax adjustments after year end

Changes in tax expense recognized after year-end, commonly referred to as return-to-provision adjustments, are to be accounted for in the year the increase or decrease is recognized, rather than the year to which they relate. There is a mandatory exception to this rule for decreases to tax expense related to a prior period that are accrued more than 12 months after the end of a fiscal year, where if the decrease had been recognized in the prior period the MNE Group would have failed the SESH and have had a GloBE ETR below the 15% minimum rate.

There is an elective exception to including the adjustments in the year they are recognized, if an MNE Group makes a five-year election to account for such increases or decreases in the year to which they relate when they are accrued within 12 months of the end of the relevant fiscal year. This election does not apply to transfer pricing adjustments (see below).

KPMG observation

It is feasible that MNE Groups could be required to recompute and pay a top-up tax for fiscal years that are initially deemed to be eligible for the SESH, if there is a subsequent reduction to the Covered Tax expense for the Tested Jurisdiction that means it would not have been eligible for the SESH and would have had a GloBE ETR below 15%. This requirement may impose significant additional compliance costs on MNE Groups and should be factored into how groups approach compliance.

Simplified treatment of cross-border income and taxes

Cross-border allocation of income and taxes

The approach to the cross-border allocation of income and taxes is broadly consistent with that adopted by QDMTTs (e.g., taxes allocable from a Main Entity to a PE or from a CE-owner to a subsidiary are generally excluded from the SESH). However, two elective alternatives are provided, which enable the income and tax with respect of a PE to be recognized at the level of the Main Entity (the PE Simplification Election) and to enable the taxes allocated to non-QDMTT Tested Jurisdictions to be recognized in such jurisdictions.

Transfer pricing adjustments

The SESH includes specific rules for transfer pricing adjustments for transactions between Tested Jurisdictions. The income and tax effects of such adjustments are generally reflected in the year that they are accrued, addressing concerns that the income and tax effects of such adjustments could be accounted for in different periods. Where there is an adjustment to income in a Tested Jurisdiction and no corresponding adjustment in the counterparty jurisdiction, then an adjustment to income must be made in the counterparty jurisdiction. A five-year election, which applies at the level of the MNE Group, is available to include the income and tax effects of transfer pricing adjustments that are accrued within 12 months of the end of the fiscal year to which they relate, in the fiscal year to which they relate rather than the year they are accrued.

The SESH requires that prices of transactions between CEs that are accounted for at cost, notably US GAAP, are priced based on the amount used to determine taxable income (or the arm's length price if the transaction is not taxable) in the seller's jurisdiction. In the buyer's jurisdiction, assets are accounted for based on their carrying value, except for intangible assets which are accounted for based on the arm's length price.

KPMG observation

The rules on transfer pricing adjustments provide much greater clarity than the full GloBE rules and should help to mitigate the risk of MNE Groups facing top-up tax that is inconsistent with the objectives of the GloBE rules due to mismatches in when income and tax expenses are recognized. The Package notes that these clarifications may be brought into the full GloBE Rules.

Tax-Neutral Entities

The SESH includes specific rules on its potential application to tax neutral UPEs, Tax Transparent Entities and entities subject to the Investment Entity Tax Transparent Election.

Eligibility restrictions

Ineligible tested jurisdictions

The SESH cannot be applied to certain Stateless CEs, Investment Entities, and Tested Jurisdictions with CEs in respect of which an MNE Group has made an Eligible Distribution Tax System election.

Entry and re-entry criteria

In contrast to the TCSH, the SESH does not operate on a "once-out-always-out" basis. An MNE Group will be eligible to elect the SESH for Tested Jurisdiction if it did not have a Top-up Tax Liability in respect of that jurisdiction for every fiscal year beginning within 24 months of the first day of the fiscal year for the which the SESH is elected (e.g., a MNE Group would be eligible to elect the SESH in 2027, if it did not have a Top-up Tax Liability in respect of a jurisdiction in 2025 or 2026).

Integrity rules

The SESH includes four integrity principles, with adjustments required where these principles are not met:

- 1) **Matching** – intragroup income is not recognized in a fiscal year later than the fiscal year when the corresponding expense is recognized and the amount of income matches the amount of the corresponding expense;
- 2) **Full allocation** – all income is allocated to a Tested Jurisdiction;

- 3) **Single expense and loss** – expenses and losses are only deducted once and in a single Tested Jurisdiction; and
- 4) **Single tax** – taxes are only recorded once and in a single Tested Jurisdiction.

The SESH also requires that financial instruments issued by one constituent entity (CE) and held by another CE in the same MNE Group are classified consistently as debt or equity, consistent with the full GloBE Rules.

The Package also notes that the Inclusive Framework will monitor whether further refinements are necessary to address integrity concerns and states affirmatively that the Inclusive Framework will develop an anti-arbitrage rule to prevent MNE Groups from entering into arrangements that avoid top-up tax by shifting GloBE Income and Covered Taxes between jurisdictions.

Applicability dates

The SESH is applicable for all Tested Jurisdictions for fiscal years beginning on or after December 31, 2026 (i.e., all jurisdictions that have implemented the GloBE Rules must incorporate the SESH into their domestic legislation and make it available from that date). Jurisdictions may make the SESH available for fiscal years beginning on or after December 31, 2025, but it can only be applied by an MNE Group if all jurisdictions with a taxing right over a Tested Jurisdiction under a QDMTT, IIR or UTPR makes the SESH available for this earlier period.

Incorporation into the GloBE Model Rules

The SbS Package notes that some of the features of the SESH could be incorporated into the GloBE Model Rules. This could be relevant where groups are eligible for the SESH in some years, but not others, but may also reflect an effort to simplify the rules more broadly.

Extension of the transitional CbCR Safe Harbour

The Inclusive Framework has agreed to extend the TCSH to fiscal years beginning on or before December 31, 2027, and ending on or before June 30, 2029. For calendar-year companies, this means the TCSH will now apply for 2027, a one-year extension of the TCSH.

The Transition Rate (i.e., the tax rate for the Simplified ETR) for years beginning in 2027 will remain at 17% (the rate that applies for 2026). If an MNE Group applies the TCSH in respect of a Tested Jurisdiction in 2027, it will also have the effect of deferring its Transition Year in respect of such jurisdiction.

Work programme for additional simplification

The SbS Package Executive Summary identifies a number of additional areas where further work on simplification will be undertaken:

- Finalizing the routine profits test and a de minimis test, which seem intended to form part of a permanent safe harbour alongside the SESH;
- Continuing work on continuity issues to ensure that MNE Groups can benefit from simplifications where they may not qualify for a safe harbour in a subsequent period and hence are required to undertake a calculation under the full GloBE Rules;
- Developing administrative guidance on technical issues relating to the GloBE Rules;
- Exploring integration of elements of the SESH into the GloBE Rules; and
- Streamlining reporting obligations.

KPMG observation

The work programme for “additional simplification” is expected to go beyond pure simplification and address technical issues where the current GloBE Rules do not work as intended.

Next steps and matters to watch

The SbS Package might well be the most significant release since the original 2021 agreement on the GloBE Rules, because the SbS Package significantly reworks the original political compromises underlying the GMT. The intent is clearly to stabilize the GMT framework, as the rules fully enter into the compliance and enforcement phase in 2026. The release of the package also ‘frees up’ Inclusive Framework members to focus on the many technical interpretative and administrative elements of the rules, which are highlighted at various points throughout the package. The following paragraphs highlight key next steps in the process.

Jurisdictional responses

In comments made on the release of the package, Manal Corwin, Director of the OECD Centre for Tax Policy and Administration, noted the months of intense negotiations that preceded the agreement. Countries will now need to consider their next steps, in light of what was finally agreed. Some jurisdictions may find themselves well placed with their current suite of incentives to attract investment and just make further refinements. Others, particularly those primarily offering income-based incentives, may now determine the time has arrived for a more thorough overhaul. Some countries, previously hesitant on GMT adoption, may now forge ahead, while others reconsider their earlier plans to adopt the rules. Apart from the US, countries have yet to state publicly whether they will seek eligible SbS or UPE regime status. These jurisdictional responses will be key to track over the next half year.

Timing and financial statement tax provisions

The intensity of the negotiations was such that several self-imposed deadlines were passed, including a December target for agreement. There is a question whether the components of the SbS Package may have direct effect in certain countries or regions. Where this is not the case (i.e., countries that need to legislate for the SbS Package), it is expected that the rules will not be transposed into national law before the second half of 2026 or even 2027, given that many require extensive time to work through domestic processes. This raises the question whether in particular for quarterly financial reporting purposes in 2026, MNE Groups may still have to report a Pillar Two tax liability in their financial statements based on the rules as they stand in domestic law as of at the relevant reporting date (i.e. without taking into consideration the SbS Package). In addition, it raises the question whether countries will apply the rules retroactively from 2026.

Section 899

The potential for section 899 legislation, or a variant, was key to jumpstarting the intense negotiations of the past eight months. The threat of section 899 could reemerge if jurisdictions are perceived to delay implementation. Furthermore, many digital service taxes, the other focus of section 899, have not gone away. As such, the threat of section 899 remains to be monitored.

Continued work on the package deliverables

The package highlights many instances where further work will be done in the first half of 2026, and beyond, such as integrity rules for QDMTTs in the context of SbS, guidance on Related Benefits and on what may



be treated as a Covered Tax, various initiatives on simplifying calculations and reporting, as well as plans to integrate some of the SESH provisions back into the main rules.

Unlocked work streams

Additional guidance has previously been flagged for future release, only for it to be parked pending completion of the SbS Package. It seems possible that at least some of these items might now be back on the table. Substance-based income exclusion (SBIE) on mobile assets is one example, but others include scope questions, joint venture (JV) technicalities, ownership interest and dispute resolution mechanisms, among others. Many of these are issues on which taxpayers have long sought further guidance, and the agreement of the SbS Package should finally enable the Inclusive Framework to focus attention on them.

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