SLAUGHTER AND MAY/

MULTINATIONAL TOP-UP TAX

FINANCE (NO.2) ACT 2023
PART 3 AND SCHEDULES 14 TO 17

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 1 - INTRODUCTION AND CHARGE

COMMENTARY ON SECTION 121

This section provides an overview of Part 3 explaining in subsection (1) that the multinational top-up tax ('MTT') implements the Pillar Two rules (as defined in section 255) relating to top-up tax under the income inclusion rule ('IIR'). The MTT applies to multinational enterprises for accounting periods beginning on or after 31 December 2023 (section 264).

The IIR is the primary charging rule under the Global Anti-Base Erosion ('GloBE') Rules of Pillar Two. The UK legislation implements the requirement for top-up tax to be paid in the UK where a 'responsible member' of a 'qualifying multinational group' is located in the UK (see section 126 for the meaning of 'multinational group', section 129 for details of who is a responsible member, section 129 for the conditions to be satisfied for a multinational group to be qualifying and section 239 for location of an entity).

A multinational group with annual revenue in excess of €750m (in at least two of the previous four accounting periods) with at least one group member in the UK is referred to as a 'qualifying multinational group' (see section 129 for details of the revenue threshold test).

Subsection (2) of section 121 provides that the MTT is payable in respect of members of multinational groups located outside the UK where their effective rate of tax ('ETR') in another jurisdiction is less than 15%.

The rest of Chapter 1 sets out the charge to the MTT and describes how it is to be calculated. Further details of the new tax are set out in Chapters 2-11 and Schedules 14-17. Schedule 17 (Index of Expressions Defined or Explained in Parts 3 and 4) is useful to keep handy when working through the legislation.

It can also be useful, when looking at Part 3 to refer to the 'Tax Challenges Arising from Digitalisation of the Economy - Global Anti-Base Erosion Model Rules (Pillar Two) Model Rules' (the 'Model Rules') and to the OECD documents that supplement them, such as 'Tax Challenges Arising from the Digitalisation of the Economy - Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)' (the 'Commentary'), 'Tax Challenges Arising from the Digitalisation of the Economy - Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)' (the 'Administrative Guidance '), and 'Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two)' (the 'Safe Harbours Guidance') to provide further context and explanation of the Finance Act. References to 'Articles' are to Articles of the Model Rules.

At the time of enacting the legislation, discussions are ongoing on how to resolve several issues with the Pillar Two rules so in anticipation of changes being required to align the legislation with

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

the Pillar Two rules to ensure consistency, section 262 provides a time-limited power to amend the legislation by regulations. The power may not be exercised after 31 December 2026. Indeed, on 18 July 2023, shortly after Finance (No. 2) Act 2023 was enacted, draft legislation for a number of amendments and new provisions was published for consultation before inclusion in the next Finance Bill. These potential amendments and new provisions are not dealt with in this commentary which focuses on the Finance (No.2) Act 2023 as originally enacted.

There was some criticism during the Finance Bill debates of the inclusion of the MTT legislation in a Finance Bill rather than a stand-alone piece of legislation:

> 'I have, constitutionally, an extreme disquiet, not about the proposal itself, but about what such a major international treaty commitment is doing within a Finance Bill. This has far-reaching consequences for UK corporation tax rules, yet it has been barely mentioned before today, and it is in a Finance Bill when it should be standing alone as an international treaty.' (Craig Mackinlay, Hansard 29 March 2023 Column 1065)

HMRC published draft guidance ('HMRC's draft guidance') on 15 June 2023 for consultation until 12 September, which will form part of a new HMRC Manual (the Multinational top-up tax manual). This initial draft guidance covers just three of the chapters that will be in the Manual: Introduction, Scope and Administration. Further draft guidance will follow in due course. HMRC's draft guidance puts Part 3 in context:

> 'The legislation adapts the Model Rules into the style and structure of UK legislation, and provides further details on the steps that businesses must take to calculate their liabilities under the MTT. Additionally, there are some parts of the legislation that are particular to the UK legislation and do not have their origin in the OECD documents – for example, Schedule 14, which provides the rules for administration.'
> (MTT00120)

'The OECD documents do not have legal effect. Nonetheless, section 121 (1) establishes that the purpose of MTT is to implement those documents into domestic law. Consequently, HMRC officers may consult the OECD documents as an aid if the application of the law to a particular set of facts is unclear. For example, as with the Model Rules, the MTT legislation does not define certain terms, and these terms should take their ordinary meaning. The OECD documents may provide additional understanding of the purpose of the rules which they set out (and by extension, the MTT legislation, which is intended to give effect to those rules).'
(MTT00120)

COMMENTARY ON SECTION 122

This section sets out the UK nexus for the MTT to apply. The person chargeable to the MTT is the person who at any time in the accounting period of the multinational group is a responsible member (defined in section 128) if they are a body corporate or a partnership located in the UK. Where a partnership that is not a body corporate is chargeable to MTT, the UK partners are 'responsible partners' and are jointly and severally liable to pay the tax (section 122(4)). On change of membership of partnerships, the draft HMRC guidance says:

> 'For the purpose of chargeability, a partnership will be viewed as continuing to be the same partnership, regardless of a change in membership, if at least one member before the change in membership remains a member after the change.'
> (MTT05100)

Where a responsible member located in the UK is not a body corporate or a partnership, subsection (2) provides that another person can be chargeable to MTT in respect of that

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

responsible member if that other person is resident in the UK and the profits of the responsible member would be the profits of that other person for the purposes of income tax or corporation tax. Responsible members that are not bodies corporate or partnerships would be trusts or 'other arrangements' as specified in section 231(1)(d). Where more than one person is chargeable to tax under subsection (2) in relation to the same responsible member, each of those persons is jointly and severally liable to the MTT (subsection (7)).

COMMENTARY ON SECTION 123

This section sets out the 4-step process to see how much the responsible member (or a person chargeable in respect of a responsible member) must pay:

Step 1 - determine which group members that the responsible member is responsible for have top-up amounts/additional top-up amounts for the period and how much those amounts are;

Step 2 - determine how much of each Step 1 amount is to be attributed to the responsible member;

Step 3 - add together the amounts attributed to the responsible member; and

Step 4 - convert the result of Step 3 into sterling if not already in sterling.

This looks deceptively simple, but it becomes more complex when read with the rest of Part 3 which drills down into these steps. It is further complicated by the fact that Part 3 requires a mix of entity-based and territory-based calculations.

COMMENTARY ON SECTION 124

The general rule set out in section 124(1) is that a group member in a territory will have a top-up amount for an accounting period if the ETR of the members of the group in that territory is less than 15%. But only if the member has profits for that period. The rest of section 124 explains how each of the other chapters feeds into the calculation and attribution of top-up amounts:

- Chapter 3 explains how the ETR is calculated by requiring total covered taxes in a territory to be divided by total adjusted profits in that territory.
- Chapter 4 sets out how profits are calculated.
- Chapter 5 explains which taxes are covered taxes feeding into the ETR and how to determine the amount of covered taxes allocated to members of a group.
- Chapter 6 sets out how to use the ETR and profits to determine the top-up amounts of those members.
- Chapter 7 sets out how to attribute the top-up amounts to a responsible member.
- Chapter 8 contains provisions about additional top-up amounts and further adjustments that may be required (including adjustments for restructuring multinational groups).
- Special provisions are made in Chapter 9 for investment entities, joint venture groups and minority owned members.
- Chapter 10 contains a number of definitions and other provisions relevant to calculations and determinations for the purposes of the MTT (for example, defining particular types of entities and setting out rules related to location of entities and ownership of entities).

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

- Chapter 11 contains general and miscellaneous provisions (namely Schedule 16 (transitional provisions), Schedule 17 (index of defined or explained terms), the power granted until 31 December 2026 to amend the legislation by regulations (section 262) and the commencement date (section 264).

COMMENTARY ON SECTION 125

See Commentary under Schedule 14.

COMMENTARY ON SCHEDULE 14

- Schedule 14 contains provisions for administrative matters including information returns, assessments and penalties. See MTT50100.

Part 2: Meaning of 'filing member'

Part 2 of Schedule 14 explains the meaning of 'filing member' and sets out the filing member's obligations to:

- register with HMRC (and notify HMRC when details of the filing member have changed);
- submit information returns or overseas return notifications to HMRC;
- submit a self-assessment return to HMRC;
- make or revoke elections; and
- keep and preserve records.

By default, the filing member of a multinational group will be the ultimate parent of the group unless the ultimate parent has nominated in writing another person in the group to act as the filing member. The person nominated must be a company and if the domestic top-up tax applies (see Part 4) the same person must be nominated as the filing member for domestic top-up tax too.

The ultimate parent must provide the nominated filing member with everything that person reasonably requires to comply with the obligations of the filing member (paragraph 2(5)).

An officer of HMRC may revoke a nomination if the officer considers the ultimate parent is not complying with its obligation under paragraph 2(5) or if the person nominated does not comply with the filing member obligations.

Where the ultimate parent is the filing member but is not a company, paragraph 3 specifies who may meet the obligations of the entity depending on what type of person the ultimate parent is.

Paragraph 4 provides that, in the case of a multinational group that is part of a multi-parent group, where a specific filing member has not been nominated, the default is that every ultimate parent in the multiparent group will be the filing member and will bear the filing member obligations. However, each obligation of the filing member only needs to be met by one of the ultimate parents. In order for the obligations to be met by a nominated filing member, each ultimate parent must authorise the nomination in writing.

Paragraph 5 applies where there is a change of filing member. To ensure continuity, the new filing member steps into the shoes of the old filing member and anything done by the old filing member (e.g. elections made) are treated as having been done by the new filing member. This means a penalty can be imposed on the new filing member in respect of anything done or omissions before the new filing member took over. The old filing member is not off the hook

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

either as HMRC can impose a penalty, exercise a power or do anything else in relation to the old filing member in respect of anything done before the new filing member took over (see paragraph2(9)(a)).

Part 3: Registration

Part 3 sets out the requirement of the filing member to register with HMRC if the group becomes a qualifying multinational group. If, after registration, the group ceases to be a qualifying multinational group (for example where the group ceases its UK operations), the filing member can apply for a notice of de-registration. MTT51450 suggests that where a registered group has ceased to be a qualifying group, but maintains a UK presence, a below-threshold notification may be more appropriate than a de-registration notice (see MTT53900).

Registration is effected by providing HMRC with the information specified in paragraph 6(4) in the form HMRC will specify in a notice. Notification must be provided to HMRC of any changes to the information provided (which includes a change of filing member).

Part 4: Information returns

Part 4 sets out details of the obligation of the filing member to submit an 'information return' to HMRC for each accounting period in which the group is a qualifying international group. There is no obligation to submit an information return to HMRC if an information return has already been submitted for the same period to another authority with whom HMRC has an agreement to share information contained in information returns. In that case, the filing member must submit an 'overseas return notification' (defined in paragraph 10(6)) to HMRC.

'Information return' is defined in paragraph 10(2) by reference to the information it should contain. Paragraph 10(3) further provides that HMRC may specify by notice particular items of information that must be submitted as part of the return. It must normally be submitted within 15 months of the end of the accounting period to which it relates (paragraph 10(9)) but a longer period applies where a group has first registered for MTT (paragraphs 10(10) and 10(11)). After submission, an information return may be amended, or further amended, by notice to HMRC (paragraphs 11(1) and 11(2)). No amendment may be made more than 12 months after the latest date the return or notification was required to be submitted (paragraph 11(3)). Elections and revocations of elections must be made in the information return.

Part 5: Self-assessment returns

Part 5 sets out details of the obligation of the filing member of a registered group to submit a 'self-assessment return' (defined in paragraph 13(2)) or a 'below-threshold notification' (defined in paragraph 13(4)) to HMRC for each accounting period within the same time limit as applies for information returns (paragraphs 13(8)-(10)). After submission, amendments or further amendments to a return may be made (paragraphs 14(1) and 14(2)) but not after 12 months from the latest date by which the return or notification was required to be submitted (paragraph 14(3)).

A below-threshold notification should be made where the filing member considers that the group is not a qualifying multinational group in the specified accounting period and is not expected to become a qualifying group again in the next two accounting periods (paragraphs 13(4) and 13(5)). MTT53900 explains that once submitted the notification will remain valid for each period in which the group is not a qualifying multinational group and the group is not likely to become qualifying in the two subsequent periods.

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

MTT53100 explains that the detailed information on the calculations made to determine the amount of MTT payable will be contained in the information return. The self-assessment return will contain information on the group's charge to MTT and DTT. The structure and format of the self-assessment return has not yet been finalised.

Part 6: Enquiries into a self-assessment return

Part 6 deals with enquiries into a self-assessment return including making provision for the timing of an enquiry (paragraph 16) and the scope of an enquiry (paragraph 17). Paragraph 21 provides that any question arising in connection with the subject-matter of an enquiry may be referred to the tribunal for determination provided that notice of the referral is given jointly by an officer of HMRC and the filing member. Paragraph 22 provides for the issuance of partial and/or final closure notices.

Part 7: Determinations where self-assessment return not submitted

Part 7 deals with determinations by HMRC where the filing member has not submitted a self-assessment return for an accounting period but should have done so, or the group is not a registered group and the officer has grounds to believe it should be.

Part 8: Discovery assessments

Part 8 deals with discovery assessments.

Part 9: Record-keeping requirements

Part 9 sets out the record-keeping and preserving obligations of a filing member. Records must generally be preserved in any form and by any means until the later of the 9th anniversary of the end of the accounting period to which the records relate and, in the case of an enquiry into a self-assessment return, six months after the enquiry is completed so long as notice of the enquiry into the return has been given before the 9th anniversary of the end of the accounting period to which the records relate (paragraph 31(3)(a)). HMRC may specify in a notice a shorter time for preservation of records and may specify different times for different cases (paragraph 31(3)(b)). HMRC may by notice set particular conditions for, or exceptions to, how records and the information in them should be preserved.

Part 10: Payments of multinational top-up tax

Part 10 deals with the payment of MTT. Paragraph 32 sets out the normal due date for payment (15 months after the end of the accounting period) but this is extended to 18 months if it is the first accounting period in which the group is a qualifying multinational group. Paragraph 33 provides for interest to be charged on late payment.

If any MTT is unpaid more than three months from when it was due, HMRC may issue a group payment notice to any person (other than a ring-fenced entity unless the responsible member that was originally liable is also a ring-fenced entity) (see paragraph 35(1))) who is a member, or who was a member of the group at the time the MTT liability arose. The effect of the notice is that the recipient is treated as having a deemed liability which became due and payable when the relevant MTT liability became due and payable. The group payment notice may not be issued more than three years and six months after the 'relevant date' which is defined in paragraphs 34(7)-(9). MTT54200 explains how HMRC will select a recipient for a group payment notice in the most cost-effective way and states:

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

'The group payment notice may be issued to any member of the group. The member does not need to be resident in the UK, nor an incorporated company. However, ring-fenced entities cannot be issued with a group payment notice.'

On ring-fenced entities, see MTT54230: 'A group payment notice can only be issued to a ring-fenced entity if the responsible member that was originally liable is also a ring-fenced entity.'

Paragraph 36(3) gives the recipient of the notice a right to appeal against the group payment notice within 30 days on the ground that the 'person in respect of which the notice is given' is not a member of the group, or was not a member of the group at the time the liability arose. HMRC's draft guidance on this is that 'the recipient may only appeal against the group payment notice itself on the grounds that it is not a member of the group' (MTT54210) implying it is the recipient's group status that is the ground for appeal and not that of the person who was originally liable to pay MTT. This interpretation is not entirely clear from the legislation - 'person with respect of which the notice is given' would seem to read more naturally as a reference to the person who has the primary liability rather than the person to whom the notice is given (especially given that this person is referred to at the start of paragraph 36(3) simply as 'the recipient').

The liability to pay MTT is a liability of the chargeable person (see section 122) and of any person to whom HMRC issues a group payment notice under paragraph 36 but this liability may be discharged by another group member in which case the amount can be recovered by the payer from the person who was liable to make the payment and any such recovery payment is tax neutral (see paragraph 37). The effect of paragraph 38 is that the liability for MTT and/or penalties is recoverable as a debt due to the Crown.

Paragraph 39 gives the Treasury the power to make regulations for further provisions which may in particular include provisions deeming payment by one group member to have been made by another and for deeming a payment in respect of MTT to have been made in respect of domestic top-up tax (see Part 4).

Part 11: Penalties

Paragraph 40 sets out the penalties payable under paragraphs 41 to 46 if the filing member does not meet its obligations or provides inaccurate information to HMRC. See the commentary on Schedule 15 and Table 1 - (Penalties) below for the description of and amounts of penalties.

Table 1 - (Penalties)

Paragraph	Action/omission of filing member	Amount of penalty
41	Failure to register or otherwise notify HMRC under Part 3 of Schedule 14	This penalty will be imposed under FA 2008, Sch 41 para 1. The standard amount of the penalty is a percentage of the potential lost revenue (ranging from 100% for deliberate and concealed failure, to 70% for deliberate but not concealed and 30% for any other case). See FA 2008, Sch 41, para 6.
42	Late submission of information return or overseas return	• Three months or less: £100 • Six months or less: £200

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

	notification (unless reasonable excuse applies)	• Any other case: £200 plus £60 per day from the six-month mark For a third successive failure, the £100 and £200 figures are increased to, respectively, £500 and £1000
43	Late submission of self-assessment return or overseas information return or below-threshold notification (unless reasonable excuse applies)	• Three months or less: £100 • Six months or less: £200 • 12 months or less: higher of £200 and 10% of the unpaid tax • Any other case: higher of £200 and 20% of the unpaid tax For a third successive failure, the £100 and £200 figures are increased to, respectively, £500 and £1000
45	Providing inaccurate information to HMRC in an MTT notification/return or any information provided with that notification/return	This penalty is imposed under FA 2007, Sch 24, para 1. The standard amount of the penalty is a percentage of the potential lost revenue (ranging from 100% for deliberate and concealed action, to 70% for deliberate but not concealed action and 30% for careless action). See FA 2007, Sch 24 para 4.
46	Failure to keep or preserve records under Part 9 of Schedule 14 (unless relevant facts can be proved satisfactorily by other means)	£3000 per accounting period

Paragraphs 47-49 provide administrative and supplemental provision for penalties payable under paragraphs 42, 43 or 46 (including discretion for HMRC to reduce the penalty in special circumstances). This is not necessary for penalties under paragraphs 41 and 45 as these are imposed by way of inclusion in existing penalty provisions and so will be subject to the administrative provisions of that other legislation. Appeals against penalties payable under paragraphs 42, 43 or 46 are part of the general appeals provisions in Part 12 discussed below. Appeals against penalties under paragraphs 41 and 45 will follow the appeals provisions in their respective Finance Acts.

Part 12: Appeals and claims

Claims in relation to overpaid tax

Paragraphs 51-54 deal with claims in relation to overpaid MTT. A claim must be made by the person who overpaid the MTT in a separate form from the self-assessment return within four years (paragraph 51(3)) after the end of the accounting period in respect of which the MTT was paid. A repayment must be made if the conditions are satisfied but the Commissioners also have discretion (paragraph 51(6)) to repay an amount of overpaid MTT where the conditions are not met, for example if the claim is out of time.

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Paragraph 52 sets out the scenarios A to D where the Commissioners *do not* have to give effect to the claim:

- Case A is where a member of the claimant's group has an unpaid liability to MTT.
- Case B is where relief by taking other steps is, or can, be sought under Part 12 of Schedule 14.
- Case C is where the claimant has run out of time to seek relief and knew or ought to have known by the expiry of the time limit that such relief was available.
- Case D is where the MTT paid is excessive because of a mistake in the calculations of tax payable where the amount was calculated in accordance with practice generally prevailing at the time.

Paragraph 53 provides for HMRC to enquire into the claim and sets out the timing and procedure for such an enquiry and the consequences of the enquiry.

Paragraph 54 deals with overpaid repayments and gives the Commissioners the right to recover the excess repayment and to make a supplementary assessment of the amount of tax due within a four-year time limit.

Appeals of decisions: general

Paragraph 55 lists the assessments and amendments against which an appeal may be brought. An appeal must be made in writing by the filing member within 30 days after the specified date although an appeal may be allowed after the expiry of the time limit if HMRC agrees or where the tribunal gives permission.

Paragraph 56 sets out the effect of a notice of appeal being given including that a review may be conducted by HMRC.

Reviews by HMRC

Paragraphs 57-70 deal with the procedure and consequences of a review including setting out when an HMRC review is to be conducted, how the review is to be conducted, and the possible outcomes of a review.

Settlement agreements

Paragraph 61 provides for the procedure for and consequences of an appeal to the tribunal.

Postponement of payment pending appeal

Paragraph 63 provides that although generally an appeal does not postpone any liability to pay MTT, a liability to pay may be postponed if:

- HMRC make a determination to postpone (see paragraph 64 for the procedure for applying to HMRC for a determination);
- A direction to postpone is made by the tribunal (see paragraph 65 for the procedure for the appellant applying to the tribunal for a direction if it does not agree with HMRC's direction); or
- HMRC and the appellant agree to a postponement (see paragraph 65).

INDEX

CHAPTER 1 - INTRODUCTION AND CHARGE, AND SCHEDULE 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Special provisions as to penalties

Paragraph 67 makes special provisions in relation to certain penalty appeals (where the penalty is under paragraphs 42, 43 or 46) including that payment of such penalties is always postponed pending determination of the appeal.

Part 13: Other amendments

This makes certain amendments to existing legislation consequential to the introduction of MTT, for instance to add the MTT to the definition of 'tax' for the purposes of Schedule 36 (Information and Inspection Powers) to Finance Act 2008.

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 2 – QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS

COMMENTARY ON SECTION 126

The MTT does not apply to purely domestic groups: in order to be a multinational group at least one of the members must be located in a different territory from the others but a standalone entity which otherwise would not be a member of a multinational group, but which has one or more permanent establishments ('PEs') will be treated by virtue of section 232 (which treats a PE as separate from the main entity) as a group.

A multinational group comprises the 'ultimate parent' (defined as an entity in which no other entity has a controlling interest (see section 242(4)) and which has a controlling interest in other entities) and you look to the consolidated financial statements of the ultimate parent to determine which other entities are included in the group. However, the entities whose assets, liabilities etc. have been left out of the consolidated financial statements only because of size/materiality, or because the entity is held for sale, are still part of the multinational group.

COMMENTARY ON SECTION 127

This section is based on Article 1.5 of the Model Rules and defines excluded entities and what effect this has on Part 3. The following are excluded entities (with references in parenthesis to the section which explains the term):

- a governmental entity (section 234(1))
- an international organisation (section 234(2))
- a pension fund (section 235(1)) – this is defined so as to include a pension services entity (section 235(2))
- a non-profit subsidiary (section 127(5))
- a qualifying service entity (section 127(6))
- a qualifying exempt income entity (section 127(7))
- an investment fund (section 236), a UK REIT (section 259) or an overseas REIT equivalent (section 259) but only if they are the ultimate parent of a multinational group (or would be but for the fact they do not produce consolidated financial statements including the entities in which they have ownership interests).

Section 127(9) introduces Schedule 15 which makes provision about the elections a filing member can make including the long-term election (provided for in subsection (8)) that an entity that would otherwise be an excluded entity of the type in subsections (5)-(7) (qualifying non-profit subsidiary, qualifying service entity or qualifying exempt income entity) is not to be treated as an excluded entity. An election cannot be made in respect of an investment fund, a UK REIT or an overseas REIT equivalent. MTT10200 explains why this election might be made:

> 'A group can elect for …. a member of a group that is a qualifying non-profit subsidiary, a qualifying service entity, or a qualifying exempt income entity is not an excluded entity. This can allow a group to choose to be subject to multinational top-up tax (or a foreign equivalent of the IIR) in their preferred territory.'

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Unless an election is made where applicable, excluded entities are treated as not being members of a multinational group for the purposes of Part 3 except for the purpose of section 127 and with two other notable exceptions:

- for the purpose of section 126, an excluded entity that is the ultimate parent of a multinational group remains the ultimate parent of that group; and
- excluded entities are taken into account in determining whether a multinational group is qualifying for the purpose of section 129 - so their revenue will count towards the €750m threshold for the group.

Section 127(1) provides that, although it is provided in section 232(3) that PEs are treated as distinct from the main entity, for the purposes of being a qualifying service entity or a qualifying exempt income entity, the conditions in subsections (6)(b) and (7)(b) as applicable must be met by the main entity and all its PEs as if they were a single entity.

If a group is entirely constituted of excluded entities, the MTT would be inapplicable.

COMMENTARY ON SCHEDULE 15

Paragraph 1 (Long term elections) applies to the elections marked 'long term' in Table 2 - Elections below. A long term election applies until revoked but cannot be revoked until it has applied for five accounting periods. Once revoked a long term election cannot be made again for another five periods. The election or revocation should be made in the information return submitted to HMRC, or to a qualifying authority (defined in paragraph 10(5) of Schedule 14), in respect of the relevant period.

Paragraph 2 (Annual elections) deals with the elections marked 'annual' in Table 2 - Elections below which will apply for a single accounting period and have to be made annually in the information return submitted to HMRC, or to a qualifying authority, in respect of the relevant period.

In respect of some elections that fall within the scope of either paragraph 1 or paragraph 2 of Schedule 15, the application of these paragraphs is modified. These are marked 'Long-term (*)' or 'Annual (*)' (as applicable) in Table 2 - Elections and are accompanied by an explanation of the modification in the 'Comments' column. Most of the elections listed in Table 2 - Elections are listed in either paragraph 1 or paragraph 2 but there are some elections in Part 3 omitted from the lists in Schedule 15, which have been included below for completeness and where applicable this is noted in the Comment section.

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Table 2 - Elections

Type	Section	Member (M) or Territory (T)	Effect of election	Comment
Long term	127(8)	M	Treats member that would otherwise be excluded entity (as result of being a qualifying non-profit subsidiary, a qualifying service entity or a qualifying exempt income entity) as not an excluded entity	This election can allow a group to choose to be subject to MTT (or a foreign equivalent of the IIR) in their preferred territory.
Long term	141(7)	M	Treats, for the purposes of section 141, all portfolio holdings held by a specified member as short-term portfolio holdings. Including short-term portfolio dividends in underlying profits eliminates the need to exclude the related expenses and to have rules to determine the scope and amount of those related expenses. The requirement to differentiate short-term portfolio holdings from longer term portfolio holdings may be burdensome, particularly for insurance companies so this election will achieve simplification.	Expected to be used mostly for members that are insurance companies but election can be made for any member. This election is missing from the list of long term elections in Schedule 15.
Long term	161	T	Enables all members in the territory (or all members there that are investment entities) to use of the realisation principle in determining gains or losses in relation to: • assets/liabilities subject to fair value or impairment accounting, or • tangible assets subject to fair value accounting	Gains or losses are deferred until the asset/liability is disposed of. The carrying value is at the later of the time the asset was acquired/liability was incurred or the beginning of the first accounting period of the multinational group to which the election applied.

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

			or impairment accounting (e.g. see section 143)	
Long term	162	T	Instead of using the amount in the accounts shown as an expense for stock-based compensation, each member in the territory subject to the election, will substitute the amount allowed as a deduction for that expense in the calculation of the member's taxable income. The disparity between the amount of expense allowed in the financial accounts and the local tax base would depress ETR and so this election brings the adjusted profits more into line with local tax rules. If an election is made in respect of an option that expires without exercise, the member must increase its underlying profits for the accounting period in which the option expires by the amount that was treated as an expense in determining its adjusted profits for a previous accounting period. This prevents the member from retaining the benefit of a deduction for an item that is never paid.	There is no definition in Part 3 of 'stock-based compensation' but the Commentary explains 'The scope of the election is limited to compensation expenditures in the form of stock, stock options, stock warrants (or an equivalent) where the amount allowed as an expense is computed differently for local tax purposes than for financial accounting purposes.' Section 162(3) prevents a member getting a double deduction for the same amount where an election is made in an accounting period after some of the stock-based compensation expense has already been included in underlying profits on the basis of the expenses allowed for financial accounting purposes. Revocation of the election before all of the stock-based compensation has been paid will trigger an adjustment to the member's adjusted profits for the excess tax deductions taken under section 162(2) for options not yet exercised which will be treated as if it were income.
Annual	163	T	Capital gains realised by standard members in the territory on the disposal of immovable property in the same territory are spread over 5 years (election year and 4 preceding years) by way of an 11-step procedure set out in section	This is based on Article 3.2.6. According to the paragraph 119 of the Commentary on Article 3.2.6, this election mitigates the effect on the ETR for the jurisdiction of

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

			163(2). Applies to gains and losses from the disposal by standard members of local tangible assets (immoveable property in the same territory as the member disposing of it is located) (section 163(8)). Gains or losses arising from the transfer of assets between standard members of the group are to be ignored for the purposes of section 163 (see subsection (3)). Where an election is in place, any tax with respect to gains or loss in respect of the disposal in the election year is to be excluded from the calculation of the member's covered tax balance (subsection (6)).	recognising the entire gain in a single year. Where application of the election results in an adjustment to underlying profits of a member of the group, recalculations are required of the ETR for that member and the other members of the group located in the same territory and of the top-up amounts those members would have. See section 206 for provision about the consequences of a recalculation. This election can be combined with a section 161 election (see paragraph 120 of the Commentary on Article 3.2.6).
Long term	164	T	Consolidated accounting treatment of the ultimate parent applies to eliminate income, expenses, gains and losses arising from transactions between standard members of the group located in the territory and included in a 'tax consolidation group' where, under the relevant domestic law, the income, expenses, gains or losses of the members may for tax purposes be aggregated, surrendered to each other or otherwise shared or transferred as a result of a connection between those members.	This is based on Article 3.2.8 to permit consolidated accounting treatment to be applied to transactions between members of a multinational group located in the same jurisdiction. This is intended to prevent unintended consequences where domestic intra-group transactions are treated as tax-neutral under local law. This election comes with a compliance burden as it requires the filing member to distinguish between transactions between standard members in the same territory and other intra-group transactions. The Commentary points out, however, that this compliance burden may be preferable to determine arm's length prices for transactions between

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

				members in the same territory if such arm's length standard is not applied as a matter of course. Where an election under section 164 is made or revoked, adjustments are required to the underlying profits of the affected members to ensure there is no duplication or omissions of items of income, gains or losses arising from the making or revocation of the election.
Long term	165	T	Equity gains and losses of standard members in the territory that are subject to covered taxes are treated as not being 'excluded equity gains or losses' for the purposes of section 142. The effect of this election is that such gains and losses would be included in underlying profits and therefore there is no need to exclude the covered taxes on such gains and losses.	Section 165(4) provides that revocation of this election does not have effect if a member's adjusted profits have included a loss as a result of the election and the loss would otherwise have been excluded from the adjusted profits as a result of section 142(1). In this case the election will continue to apply to equity gains and losses even after revocation.
Long term	166	M	Excludes from the underlying profits of a member gains or losses arising from exchange rate fluctuations to the extent they are attributable to hedges against currency risks in non-portfolio investments and certain other conditions are met. One of the conditions is that the gain or loss on the hedging instrument is recognised in other comprehensive income at the level of the consolidated financial statements of the ultimate	According to paragraph 2.2.2 of the Administrative Guidance this election is designed to align the treatment of a net investment hedge with the treatment of the equity investment it is hedging. Where domestic tax rules do not exempt the gain/loss from the net investment hedge, the election would be disadvantageous and should not be made because any covered taxes on hedging gains would also have to be excluded.

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

			parent. If, instead the gain or loss is reported in P&L it would already be properly taken into account in the computation of underlying profits (see changes to the Commentary made by the Administrative Guidance - new paragraph 57.3 to Commentary on Article 3.2.1). Another condition relates to the economic and accounting effect of the hedge. Where another entity (for example, a group treasury or finance entity) issues the net investment hedge but does not itself own the investment being hedged, sub-section 166(2)(e) requires the issuing entity to have transferred the economic and accounting effect of the hedge (e.g., through intercompany loans or other instruments) to the member which holds the hedged investment.	
Annual	182(8)	M	Unclaimed accrual will not be included in the total deferred tax adjustment for that period. Unclaimed accrual is the increase in a deferred tax liability reflected in the member's underlying profits for an accounting period that is not expected to be reversed before the 5th accounting period after that period and in respect of which an election not to include it has been made.	According to paragraph 75 of the Commentary on Article 4.4.7: 'The principal reason for excluding such amounts until paid is the speculative nature as to […] when the amounts will be paid in the case of an Unclaimed Accrual'
Annual	186	M	Specified deferred tax assets of a member recorded at less than 15% are treated as valued at 15%.	This election will increase the value of the deferred tax asset. 'This rule preserves the basic tenet that a GloBE Loss of EUR 1 should offset GloBE Income

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

				of EUR 1' (paragraph 87 of the Commentary on Article 4.4.3).
Long term (*)	187	T	For losses of standard members in the territory to be effectively carried forward as special loss deferred tax assets (referred to in Article 4.5 as 'deemed deferred tax assets' instead of the modified deferred tax accounting rules in section 182 applying (Article 4.4). According to paragraph 113 of the Commentary on Article 4.5, the election is generally expected utilised most as a simplification in jurisdictions that do not impose a corporate income tax or impose one at a very low rate given that when the election is made, Article 4.4 (section 182) no longer applies and temporary differences may result in top-up tax. But the election may be made for any jurisdiction.	One-off election must be made by filing member with effect for first accounting period to which the Pillar Two rules apply. MTT52200: 'Where a group qualifies for the transitional safe harbour for a territory for a period, it does not need to make a section 187 election in that period. It can make the election in the return for the first period for which it has to complete the full calculations for that territory. See MTT15900 for further guidance on the transitional safe harbour.' Election cannot be made for a territory that has an eligible distribution system. Section 188 provides there is no restriction on revoking the election but if revoked, an election under section 187 cannot be made again (Schedule 15 paragraph 1(4)-1(5) treated as if omitted for purposes of section 187)
Annual	189	T	Section 190 (deemed distribution tax) applies to all standard members in a particular territory for an accounting period.	Election can only be made in relation to a territory which has an eligible distribution tax system (defined in section 189(3)). If this election has been made it is not possible to make the Schedule 16 paragraph 3 safe harbour election for that territory for the same accounting period (see Schedule 16 paragraph 3(1)(d)).
Annual	195(2)	T	Not to calculate SBIE for the standard members for a	This election saves a filing member from having to do

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

			territory for a period - the consequence of this is that the exclusion is nil.	SBIE calculations where the benefit of relief for that period is not enough to make it worthwhile.
Annual	199(1)	T	Top-up amount for accounting period for a territory is treated as nil.	Election may only be made if less than €10m average revenue for standard members in the territory for an accounting period and less than €1m average adjusted profits (section 199(2)). Cannot make an election in respect of the nominal territory of a stateless member (section 199(8)). Complexities of a full ETR computation can be avoided by making this election where the amount of any top-up tax would not seem to justify the associated compliance and administrative costs. This election is missing from the list of annual elections in Schedule 15.
Annual	205(1)	T	For all or part of a collective additional amount to be subtracted from the combined covered tax balance for the standard members of the group in the relevant territory in the next accounting period in which those members do not have a collective loss and only the part not so subtracted will be a collective additional amount for the current period. This has the effect of reducing the top-up tax payable for the current year.	This election corresponds to the election under Article 4.1.5 to carry forward 'excess negative tax expense'.
Long term	213	M	For investment entity to be treated as tax transparent (based on Article 7.5.1).	This election may not be made if an election to use the taxable distribution

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

	Election applies to the investment entity and any member-owners of the investment entity specified in the election. Allows the group to include the member-owner's share of the investment entity's results as income of the owner. This matches the timing and location of income earned through an investment entity under the Pillar Two rules and the domestic tax rules where the owner is subject to a mark-to-market or similar regime (see Commentary paragraph 92 on Article 7.5.1).	method under `` is in effect in relation to the investment entity and member owner. Requires the member-owner of the investment entity to be subject to tax in its location at a rate of 15% or more under a mark-to-market or similar regime based on the annual changes in the fair value of its ownership interest in the Investment Entity and the tax rate applicable to the Constituent Entity-owner with respect to such income that equals or exceeds the Minimum Rate. Paragraph 91 of the Commentary is amended by the Administrative Guidance to states that for the purpose of the election, 'a Constituent Entity that is a policyholder-owned, regulated insurance Entity (a 'regulated mutual insurance company') and that owns an Ownership Interest in an Investment Entity or an Insurance Investment Entity is considered to be subject to tax under a mark-to-market or similar regime based on the annual changes in the fair value of its Ownership Interest in the Investment Entity or Insurance Investment Entity at a rate that exceeds the Minimum Rate.' Part 3 has taken a slightly different approach, although the result is the same, and ensures the election can be made for an owner which is a regulated mutual insurance company. The election applies to all of a member-owner's

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

				interests in the Investment Entity.
Long term	214	M	Permits the use of the taxable distribution method by a member with direct ownership interests in an investment entity that is a member of the group.	Cannot make this election if a tax transparency election is in effect in relation to the owner under section 213, or if the owner is itself an investment entity or if the owner cannot reasonably be expected to be subject to tax where located on distributions from the entity at a rate equal to or exceeding 15%.
Annual	216	M	Adjusts assets and liabilities of a member to fair value for tax purposes either in the adjustment period or spread evenly over the adjustment period and subsequent 4 accounting periods (section 216(5)). Applies in relation to a 'relevant tax adjustment' in relation to that member (excludes adjustments in connection with transfer pricing or in connection with the sale of assets in the course of carrying on a trade).	Exit charge under section 216(6) if adjustment amount spread and member leaves the group before the end of the 4 subsequent accounting periods. Any remaining adjustment amount is picked up in the final accounting period in which it was a member of the group. This election is missing from the list of annual elections in Schedule 15.
Annual	217(8)	M	Treats decrease in liability to covered taxes in prior period as insignificant with the consequence that the covered tax balance of the member is adjusted for the current period and no recalculations of amounts for the prior period are required (section 217(4)).	In order for an election to be made, the aggregate decrease in liability for covered taxes for the prior period must be less than €1m.
Annual	221(4)	T	Not to calculate SBIE for investment entities in a territory for the accounting period	It is odd that section 221(4) refers to the election being in a self-assessment as Schedule 15 paragraph 2 states that this election (specified in paragraph 2(1)(h)) must be made in an information return. Further, MTT53100 explains that the

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

				detailed information on the calculations made to determine the amount of MTT payable will be contained in the information return. The self-assessment return will contain information on the group's charge to MTT and DTT.' The reference to 'Schedule 12' in section 221(4) is a mistake.
Annual	Schedule 16 paragraph 2(9)	M	Paragraph 2(3) (which sets the asset carrying value and deferred taxes) will not apply to an intra-group transfer of assets if the conditions for the election are satisfied and an election is made.	
Annual (*)	Schedule 16 paragraph 3	T	Transitional safe harbour election that the standard members* in the territory do not have top-up amounts or additional top-up amounts for an accounting period if that period commences on or before 31 December 2026 and ends on or before 30 June 2028 and certain other conditions are met (Schedule 16 paragraph 3(2)). See discussion of Schedule 16 for more detail about the conditions for this election. *Standard members for the purposes of Part 2 of Schedule 16 includes minority-owned members (paragraph 12) and investment entities if they are in the same territory as owners (paragraph 11).	The election has to be made for each accounting period commencing on or after 31 December 2023 in respect of a territory from the start of the application of the Pillar Two rules to members in that territory in order to be made in later accounting periods. HMRC's draft guidance states: 'If the group has already completed the full multinational top-up tax calculations for a territory, they cannot make the election again for subsequent periods. This 'once out, always out' approach applies because the purpose of the safe harbour is to reduce the compliance obligations of the group when preparing systems for MTT compliance when first entering the regime.' (MTT15910) Paragraph 3(6) provides that the information return

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

	in which the election is made must set out which of the tests in paragraph 3(2)(e) are being relied on and include evidence of how any that is relied on is met.

COMMENTARY ON SECTION 128

Following the Model Rules, section 128 takes a 'top down' approach to identifying who is the responsible member. This term corresponds to what the Model Rules refer to as the 'parent entity'. The starting point (subsection (1)) is the ultimate parent of a multinational group if that person is not an excluded entity and is located in a territory which has an IIR in force (such as the UK or another Pillar Two territory (see section 241)).

If the ultimate parent (defined in section 126) is the responsible member, subsection (2) provides that it is responsible for all of its members that are not located in the territory it is in.

If there is no such ultimate parent, the highest intermediate parent member (see section 237(2)) of a multinational group will be the responsible member if that person is not an excluded entity and is located in a territory which has an IIR in force (such as the UK or another Pillar Two territory) and it has an ownership interest (see section 242(3)) in a group member which has a top-up amount. The intermediate parent member is responsible for all of the members of the group it has an ownership interest in that are not located in the same territory as it.

Subsections (5)-(6) make provision for a partially-owned parent member (POPM) of a multinational group (see section 237). The Model Rules refer to this as a partially owned parent entity ('POPE'). In the case of a POPM, there is a departure from the top-down approach, so a POPM that is a responsible member is required to apply the MTT notwithstanding it is in a lower-tier of the chain and then the ultimate parent or highest intermediate parent member, as applicable, will reduce its top-up tax liability with respect to any portion of the top-up tax attributed to a POPM.

The effect of the various definitions is that:

- an excluded entity (see section 127) cannot be a responsible member;
- an investment entity cannot be an intermediate parent member or a POPM (as they are carved out of the definition of intermediate parent member and POPM in section 237);
- an insurance investment entity can be a responsible member if it is the ultimate parent; and

a PE cannot be a responsible member.

COMMENTARY ON SECTION 129

This section defines when a multinational group is 'qualifying' so as to come within the scope of the MTT. In order to be a qualifying multinational group, at least one of the members must be located in the UK and the group's members (including members which are excluded entities) must have revenue exceeding €750m in at least two of the previous four accounting periods. The threshold is proportionately reduced if the accounting period is less than a year and increased if it is longer than a year. The consolidated financial statements of the ultimate parent are used to determine the annual revenue of the members. Special rules apply to ensure the revenue

INDEX

Chapter 1 - Introduction and Charge, and SCHEDULE 14

CHAPTER 2 - QUALIFYING MULTINATIONAL GROUPS AND THEIR MEMBERS, AND SCHEDULE 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

threshold test applies correctly where there has been a merger or demerger in the tested period or the prior four periods (see MTT11010).

COMMENTARY ON SECTION 130

Section 130 is based on Article 6.1 of the Model Rules and provides how the financial threshold test in section 129 (which defines when a multinational group is 'qualifying' so as to come within the scope of the MTT) is to be applied in an accounting period in certain circumstances where there has been a change to the composition of a group in the accounting period or during the previous four accounting periods (the 'testing period') including where a group is formed by one entity acquiring ownership interests in another that was not a member of a consolidated group in one or more of the periods in the testing period.

'The revenue of the entity or entities that have joined the group is combined with the group's revenue for those periods in the testing period. This remains the case even if the group did not exist in one of those periods and all the group members in the testing period existed separately in the testing period.' (MTT11010)

COMMENTARY ON SECTION 131

This section is based on Article 6.1 of the Model Rules and modifies the financial threshold test to be applied to a de-merged group formed where a multinational group that meets the threshold condition in section 129(2) is separated into two or more consolidated groups such that the members are no longer consolidated by the same ultimate parent. In these circumstances the financial threshold test in section 129(2), which considers previous accounting periods, is substituted for a test that applies separately in respect of each new group that resulted from the demerger and is satisfied if, in the first accounting period ending after the de-merger, the demerged group's revenue exceeds the threshold. For the second to fourth accounting periods ending after the de-merger, the revenue threshold is met if the de-merged group has annual revenues exceeding the threshold in at least two accounting periods ending on or after the demerger.

- 'The demerged group will pass the revenue threshold test if it exceeds the revenue threshold in the first period following the demerger. In the following three periods (the second to fourth periods following the demerger), the demerged group will pass the revenue threshold test if it exceeds the revenue threshold in that period and any other period following the demerger and prior to the tested period.' (MTT11010)

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

CHAPTER 3 - EFFECTIVE TAX RATE OF MEMBERS OF A MULTINATIONAL GROUP IN A TERRITORY

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 3 – EFFECTIVE TAX RATE OF MEMBERS OF A MULTINATIONAL GROUP IN A TERRITORY

COMMENTARY ON SECTION 132

The ETR is a key concept of the Model Rules and it is the need for a standardised calculation that has resulted in complex rules about what profits and taxes are taken into account.

Section 132 introduces the concept of a 'standard member' which means any member of a multinational group other than an investment entity or minority owned member (see subsection (3)(a)). The reason for the distinction is to allow special provisions for the members that are not standard members.

The seven steps set out in section 132 are the basis for the calculation of the ETR of the standard members in a territory. In summary, the 'combined covered tax balance' (see subsection (2)) of standard members in a territory is divided by the net adjusted profits of the standard members of the group in that territory and this fraction is multiplied by 100 to get the ETR. If the combined covered tax balance is nil, the ETR is 0%. If the net adjusted profits are nil or negative, the ETR is treated as 15% (so no top-up required). The ETR will be negative if the combined covered tax balance is negative.

Concepts introduced in this section are then expanded on later in the legislation. The main provisions for calculating adjusted profits are in Chapter 4 (but Chapter 8 provides for certain adjustments and Chapter 9 and Schedule 16 may also need to be considered). Chapter 5 contains the main provisions on the combined covered tax balance.

The calculations must be done on a territory by territory basis, which is problematic for a stateless member, so subsection (3)(b) treats a stateless member as a sole member of a group located in a nominal territory – so you would calculate the ETR for just that nominal territory looking at the profits and taxes of the stateless member on its own.

> 'A group that consisted solely of entities located in the same territory and a stateless member would therefore be a multinational group.' (MTT10100)

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 4 – CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

COMMENTARY ON SECTION 133

Section 133 is based on Article 3.1.1 and Article 3.2.1 of the Model Rules and explains the concept of 'adjusted profits'. The starting point is generally the accounting profits (referred to in this section as 'underlying profits') as they would be determined for the purpose of the consolidated financial statements for the ultimate parent. In some cases, a member's underlying profits will have to be determined on the basis of hypothetical statements or accounts because there will not be any actual ones.

Once the underlying profits are identified in accordance with sections 134 to 137, a number of adjustments are required to be made under Chapter 4. The general rules are set out in sections 138 to 158. Further special rules apply to adjust the profits of permanent establishments (sections 159 and 160) and transparent and hybrid entities and entities subject to a 'qualifying dividend regime' (sections 167 to 171). A filing member may also make certain elections which impact on the calculations of profits pursuant to sections 161 to 164 (See the commentary under Schedule 15 and Table 2 - Elections (Elections)).

Chapter 8 (further provision) and Chapter 9 (investment entities) may require further adjustments. Another significant adjustment is provided for in Schedule 16 (transitional provision) which provides for relief for the substance-based income exclusion at rates that vary over time.

COMMENTARY ON SECTION 134

The general rule is that, other than for PEs, the underlying profits are determined from the consolidated financial statements of the ultimate parent but, if certain conditions are satisfied, the underlying profits can be determined on the basis of information in a member's separate financial accounts and on the basis of the alternative accounting standard used for those accounts. But where the use of such an alternative accounting standard creates a permanent difference of more than €1m in the treatment of an amount in the financial accounts of the member and the ultimate parent's consolidated financial statements, the member's underlying profits have to be adjusted to eliminate that difference.

COMMENTARY ON SECTION 135

Section 135 explains how to calculate the underlying profits of a PE and ensures that there is no double counting of profits for both the PE and the main entity. If the PE has separate financial accounts, its underlying profits are the profits as shown in these accounts. If it does not, one has to look at the main entity's 'underlying profits accounts' (see section 136). Special rules apply in respect of a PE falling within section 232(2)(d).

Subsection (4) provides that a PE's profits are not taken into account in the main entity's adjusted profits (and vice versa), but this is overridden where profits are excluded under section 159 (Permanent establishment income and expense attribution) or where section 160 applies (Attribution of losses between permanent establishment and main entity).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 136

Section 136 explains the term 'underlying profits accounts'. In some cases, a member's underlying profits will have to be determined on the basis of hypothetical statements or accounts because there will not be any actual ones. See for example section 201(2) (for determining the inclusion ratio). Accordingly, the term 'underlying profits accounts' means the statements or accounts (hypothetical or real) that are the basis for the determination of the underlying profits of that member.

COMMENTARY ON SECTION 137

The general rule is that amounts outside the P&L account are not reflected in underlying profits, unless specifically provided for. An example of amounts outside P&L which are specifically included in underlying profits is section 143 (revaluation method gain or loss picks up changes reflected in other comprehensive income (OCI)).

COMMENTARY ON SECTION 138

Sections 138 to 160 specify certain adjustments to be made to underlying profits; other provisions may require further adjustments.

Section 138 is based on Article 3.2.1(a) of the Model Rules. Certain 'tax expense amounts' (including deferred tax expenses) are to be added back, or if credit has been given, the credit should be excluded so that the adjusted profits are gross of the following amounts: covered taxes (see section 173), MTT or equivalent, QDTT (see section 256) and QUPT (see section 257). There are also two other amounts specified as tax expense amounts to be added back: amounts reflected in underlying profits which are charged to policyholders by an insurance company which carries on life assurance business (see section 152) and disqualified refundable imputation tax (see section 253).

COMMENTARY ON SECTION 139

The general rule is that underlying profits are adjusted to include profits from intragroup transactions unless an election is made under section 164 to exclude profits from intra-group transactions. This is subject to section 137 (amounts outside P&L are generally excluded).

COMMENTARY ON SECTION 140

The underlying profits must generally be adjusted to exclude purchase accounting adjustments made to the ultimate parent's consolidated financial statements as a result of an entity becoming a member of the group through a share acquisition. But if the shares were acquired before 1 December 2021 and it is not reasonably practicable to identify the purchase account adjustment made, no adjustment is required.

COMMENTARY ON SECTION 141

Section 141 provides that 'excluded dividends' received or accrued by a member must be excluded from the underlying profits and thereby implements Article 3.2.1(b) which, in order to ensure consistency and avoid complexity given the number of different ways Pillar Two jurisdictions have constructed participation exemptions, adopts a bright-line test for which dividends are excluded based on components found in the participation exemptions applied by a number of Pillar Two jurisdictions (paragraph 35 of the Commentary on Article 3.2.1(b)). So, the

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

purpose of this section is to ensure that generally, where dividends are not taxable, they will not be taken into account in underlying profits.

Pursuant to subsection (2), distributions resulting from a 'qualifying interest in a flow-through entity' (see section 168) are 'excluded dividends'. Distributions resulting from a 'qualifying interest' (defined as a direct ownership interest (see section 242(2)) or an entitlement to exercise voting rights) in another entity are also 'excluded dividends', unless they fall within one of the categories specified in subsection (3). These categories include distributions treated by the payor as an expense for the purposes of its underlying profits and distributions in respect of a short-term portfolio holding (subsection (3)(a)).

Portfolio holdings are those carrying rights to less than 10% of the entity's profits, capital, reserves or voting rights (subsection (4)). 'Short-term' means held for less than one year before the distribution is made, or before the entitlement to receive the dividend arises, if earlier (subsection (5)), the filing member may elect that all portfolio holdings held by a member of the group specified in the election are to be treated as short-term portfolio holdings (and therefore included in adjusted profits). This election is a long-term election falling within paragraph 1 of Schedule 15 (See the commentary and Table 2 - Elections under Schedule 15 for details). Including short-term portfolio dividends in underlying profits eliminates the need to exclude the related expenses and to have rules to determine the scope and amount of those related expenses. The requirement to differentiate short-term portfolio holdings from longer term portfolio holdings may be burdensome, particularly for insurance companies. The election is not restricted to members which are insurance companies but it is expected that mostly insurance companies will make the election. According to the Administrative Guidance:

> 'An MNE Group that elected to include all dividends from Portfolio Shareholdings in its computation of GloBE Income or Loss would not need to adjust for movements in insurance reserves that are related to securities held on behalf of policyholders. Consequently, this proposal could also be a simpler alternative to the Excluded Dividend provision' (paragraph 3 of 3.5 'Simplification for Short-term Portfolio Shareholdings (Article 3.2.1(b))').

Where dividends are excluded dividends and therefore not included in underlying profits, any tax expenses relating to those dividends will be excluded from the covered tax balance under section 175(2)(a).

COMMENTARY ON SECTION 142

Section 142 is based on Article 3.2.1(c) of the Model Rules. The general rule is that an 'excluded equity gain or loss' must be excluded from the underlying profits but an election may be made by the filing member under section 165 to treat it as not excluded.

There is a distinction again between equity gains or losses in respect of portfolio shareholdings (not excluded) and those in respect of non-portfolio shareholdings (excluded). But there is no distinction between short-term and non-short term holdings unlike in section 141 as the period of holding is not relevant for section 142.

> 'Excluded equity gain or loss' is defined in subsection (2) by reference to fair value changes, impairments, amounts recognised under equity method accounting and gains or losses on a disposal, in each case, in respect of a qualifying interest (as defined in section 141) carrying rights to 10% or more of the entity's profits, capital, reserves and voting rights. So, section 142 draws a similar distinction between portfolio and other holdings as section 141, but without using that term and there is no further distinction between short-term and longer-term holdings; the period of holding is not relevant for section 142.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

> Whether or not the 10% threshold has been met is tested at the end of the relevant accounting period in respect of fair value changes, impairments and amounts recognised under equity method account and immediately before the disposition in relation to gains or losses on a disposal.

COMMENTARY ON SECTION 143

Section 143 is based on Article 3.2.1(d) of the Model Rules. Certain accounting standards, e.g. IAS 16, allow depreciation of property, plant and equipment based on the revaluation model. Paragraph 58 of the Commentary on Article 3.2.1(d) explains that these revaluation increases are generally recognised in OCI rather than P&L and that it is necessary to eliminate the effect on underlying profits of the reporting in OCI of revaluation method gains or losses where those amounts are not subsequently reported through P&L. Section 143 is, therefore, one of the exceptions to the rule that only amounts in P&L are taken into account in underlying profits.

It is possible to make an election with respect to tangible property subject to the revaluation model so that gains or losses in the OCI would not be included in the adjusted underlying profits as they arise but would be deferred until the asset is disposed of (see section 161).

COMMENTARY ON SECTION 144

Section 144 is based on Article 3.2.1(f) of the Model Rules which requires that, in certain circumstances, adjustments are made to underlying profits in respect of foreign currency exchange gains or losses (FXGL) where an entity's tax and accounting currencies are different.

Where FXGL resulting from fluctuations in the exchange rate between the tax and accounting currencies are reflected differently for local tax and accounting purposes, the underlying profits are adjusted to bring them in line with the tax position. An adjustment to underlying profits would also be required under this provision 'where an asset or liability denominated in the accounting functional currency is retranslated in the tax functional currency so that a tax FXGL arises, despite no FXGL arising for accounting purposes' (Commentary, paragraph 70 of Chapter 3).

In addition, FXGL resulting from fluctuations in the exchange rate between a third currency and the accounting currency must be excluded from underlying profits where it is not reflected (or reflected to a different extent) in the entity's taxable income. In contrast, FXGL resulting from fluctuations in the exchange rate between a third currency and the tax currency must be reflected in underlying profits even where it is not reflected in the entity's taxable income for local tax purposes.

No adjustments to underlying profits for FXGL are envisaged where an entity's tax and accounting currencies are the same:

> 'The GloBE Rules do not make any adjustments for FXGL when the functional currencies are the same. In those circumstances, any FXGL reflected in the financial accounts are included in the GloBE Income or Loss computation, irrespective of whether the local tax rules impose tax on FXGL. If FXGL is exempt under local tax rules, there will be a permanent difference that does, and should, affect the ETR of the jurisdiction' (Commentary, paragraph 67 of Chapter 3).

COMMENTARY ON SECTION 145

This section is based on Article 3.2.1(g) of the Model Rules dealing with expenses disallowed as a matter of policy. Section 144 adds back to underlying profits any expenses (however small)

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

accrued for illegal payments (such as bribes) and expenses accrued for fines or penalties of €50,000 or more. Fines/penalties for the same offence are aggregated for the purposes of the €50,000 materiality threshold. So, for instance, daily penalties would have to be aggregated, but the Commentary (paragraph 78 of Chapter 3) indicates that 'separate fines that are for the same type of offense committed upon multiple occasions, such as traffic tickets' would not have to be aggregated.

COMMENTARY ON SECTION 146

Section 146 is based on Article 3.2.1(h) of the Model Rules concerning adjustments to opening equity due to a change in accounting principle or policy or a correction of prior period errors. It generally provides that a member's underlying profits for the current accounting period must be adjusted to take account of any change in its net assets and liabilities at the start of that period if the change is attributable to a change in accounting policy or the correction of an error which would have changed the accounting figures that fed into the calculation of the member's adjusted profits for a prior period. So, for instance, an error in respect of illegal payments expressly excluded from adjusted profits under section 145 would not result in an adjustment under section 146.

Section 146 is switched off where the correction of an error 'results in a material decrease to the member's liability to covered taxes such that section 217 (post-filing adjustments of covered taxes) applies'. Section 217, however, uses different terminology - the treatment of a decrease in a liability to covered taxes varies depending on whether it is 'treated as insignificant' - and it applies to all decreases in a liability to covered taxes: section 217(5) applies unless a decrease is to be treated as insignificant in which case section 217(4) applies. Based on the Commentary (paragraph 81 of Chapter 3), the intention must be to switch off section 146 specifically where section 127(5) applies so as to require a recalculation of the ETR, top-up amounts and, where relevant, adjusted profits for the relevant prior period (as well as certain other adjustments). But it is unfortunate that this has not been made clearer on the face of section 146.

To the extent that an error is attributable to a period before the application of Part 3 to the multinational group, no adjustment is required under section 146.

COMMENTARY ON SECTION 147

This section is based on Article 3.2.1(i) of the Model Rules and essentially ensures that adjusted profits are calculated on the basis of cash contribution (not accounting accruals). Where underlying profits reflect expenses for pension liabilities, an adjustment is required equal to the difference between the amount of pension contributions made to the pension fund (as defined in section 235(1)) by the member in the period and the annual accrued pension expense or income. If the annual accrued pension expense is equal to the annual contribution amount, no adjustment to underlying profits is required. If the amount accrued as an expense in the financial accounts exceeds the contributions for the year, the underlying profits will be increased, if the contributions exceed the expense accrued in the financial accounts the underlying profits will be decreased. According to paragraph 85 of the Commentary to Article 3.2.1(i) as revised by the Administrative Guidance, section 147 is not intended to apply to expenses for direct pension payments from member to retiree but only to pension funds. Direct payments would be taken into account as per accounting accruals.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 148

This section is based on Article 3.2.4 of the Model Rules, dealing with government incentives delivered via the tax system which effectively mean the government pays to incentivise certain activities similar to a grant.

Qualifying refundable tax credits (QRTC) are treated as income rather than a reduction in covered taxes whereas all other tax credits, whether non-QRTC or non-refundable, are not treated as income but are treated as reductions of covered taxes. Adjustments to underlying profits will be required under section 148 to secure this treatment if the financial accounts do not reflect this.

A tax credit is a QRTC if:

- it is payable in cash or cash equivalents after any liability to covered taxes has been reduced or discharged by it, or in the absence of liability to covered taxes; and
- it entitles the person to receive it (by payment or discharge of liability) within four years of meeting the conditions for receiving it.

The effect of treating QRTC as income is to include them in the denominator of ETR rather than reducing the numerator (covered tax balance) so QRTCs will reduce the ETR less than other tax credits. See section 175(2)(c) for the corresponding provision excluding the QRTC from the covered tax balance.

COMMENTARY ON SECTION 149

This section is based on Article 3.2.3 of the Model Rules and requires that, in certain circumstances, transactions between members of a multinational within the same country are reflected at an arm's length price. Generally, additional adjustments in respect of wholly domestic transactions will not be required as the effect of them would be eliminated under the territorial blending rules for calculating ETR. However, where any of conditions (A)-(D) are met, arm's length adjustments are required to be made to the underlying profits of the relevant member and counterparty. Each of conditions A to D identify particular scenarios (explained in paragraphs 106-109 of the Commentary on Article 3.2.3) where failure to make adjustments would cause a distortion. For example, Condition A is intended to prevent a multinational group from manufacturing losses in a territory through sales or other transfer at non-arm's length prices. See section 150 for the adjustments required where transactions are between members in different territories.

COMMENTARY ON SECTION 150

This section is based on Article 3.2.3 of the Model Rules and requires adjustments to underlying profits for certain cross-border transactions where necessary to prevent double taxation or double non-taxation. This section applies where transactions between group members in different territories are not recorded at the same price in their respective underlying profits, or they have not used an arm's length basis, and there is then a transfer pricing adjustment of taxable income which leads to one or both members experiencing a difference between the treatment of an amount for the purposes of covered taxes and for accounting purposes that is not eliminated over time and so does not give rise to deferred tax (a 'permanent difference'). According to paragraph 98 of the Commentary on Article 3.2.3 'These differences may arise in the local tax return as filed or later when the tax return is audited by the local tax authority of one or more counterparties'. There is a distinction between where both parties have the same

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

permanent difference (subsection (3) applies) and where they do not (subsection (5) may apply).

The effect of this section is that:

- Where both parties have the same permanent difference, they both get their underlying profits adjusted to match the pricing reflected in their taxable income rather than the pricing in the financial accounts. This is where both tax authorities agree on transfer pricing.
- If both parties do have a permanent difference but it is not the same, there is no adjustment to underlying profits under the UK legislation or the Model rules. Further consideration is being given by the Inclusive Framework to the appropriate adjustments where the tax authorities disagree as to whether or to what extent TP adjustments are required (see paragraph 105 of the Commentary on Article 3.2.3).

Where only one party (A) has a permanent difference (e.g. because of a unilateral TP adjustment) there will only be an adjustment to underlying profits if A is a 'high tax member' (defined in subsection (6)) in which case subsection (5) requires A's underlying profits to be adjusted so the transaction price reflects the amount in A's taxable income and counterparty B's underlying profits to be adjusted to correspond with the amount of adjustment made to A's profits. Paragraph 102 of the Commentary on Article 3.2.2 explains why adjustments to B's underlying profits are required in this scenario to prevent double-taxation or double non-taxation of the same income. This seems to assume that B is in an under-taxed jurisdiction. There is nothing in the UK legislation stipulating B has to be an under-taxed member. If B is also a high-tax member but has no permanent difference subsection (5) would still apply.

COMMENTARY ON SECTION 151

This section is based on paragraph 2.4 of the Administrative Guidance which addresses the concern that the purpose of local tax exemptions for release credits on a corporate rescue could be undermined if the credits were included in adjusted profits so as to potentially give rise to an MTT charge (as there would be no corresponding liability to covered taxes). The UK Government was amongst those who raised concerns around debt releases within the Inclusive Framework (see paragraph 5.62 of the July 2022 Summary of Responses).

Pursuant to this section, profits arising on debt releases will be excluded altogether from the underlying profits of the member if the member meets an insolvency condition in CTA 2009, s 322(6)(a)-(e) or, subject to certain additional conditions, if it is reasonable to suppose that, within 12 months, the member will be unable to pay its third-party debts as they fall due. In any other case where a member's liabilities exceed its assets, profits arising on a debt release may be excluded wholly or partially, depending on the amount of those profits, the extent to which they are offset by deferred tax assets and the amount by which the member's liabilities exceeded its assets.

This provision mitigates the top-up tax exposure on credits from a release of debt in certain corporate rescue scenarios. Profits arising on debt releases will be removed altogether from the underlying profits of the member if certain circumstances apply (subsections (3) and (4)) or may be partially removed (if subsection (6) applies).

COMMENTARY ON SECTION 152

This section is based on Article 3.2.9 of the Model Rules and applies where a member of a multinational group carries on life assurance business. Adjustments to the underlying profits are required to exclude certain amounts charged to the member's policyholders for taxes payable by the member (subsection (2)) and to reflect returns to the policyholders where the financial

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

accounts have not treated the returns as income of the insurance company but the charge of tax to policyholders has been reflected in underlying profits as corresponding increases or decreases in policyholder liabilities. See section 173(2)(e) which excludes taxes in respect of which amounts were charged to policyholders from covered taxes as required by Article 4.2.2(e).

COMMENTARY ON SECTION 153

This section deals with two cases where movements in insurance reserves are economically matched. The underlying profits of an insurance company are to be adjusted to exclude expenses resulting from the movement of its insurance reserves where the movement is economically matched (ignoring the investment management fee) by excluded dividends (subsection (1)) or by an excluded equity gain or loss (subsection (2)). This section is based on the changes to the Commentary agreed in the Administrative Guidance (paragraph 36 on Article 3.2.1(b) (excluded dividends) and paragraph 54 on Article 3.2.1(c) (excluded equity gain and loss)).

COMMENTARY ON SECTION 154

This section is based on Article 3.2.7 of the Model Rules which is an anti-avoidance provision which:

> 'prevents MNE Groups from engaging in transactions that are intended to increase the ETR in a jurisdiction that is below the Minimum Rate by reducing the GloBE Income or Loss in such jurisdiction without increasing the taxable income of the counterparty to the arrangement' (paragraph 127 of the Commentary on Article 3.2.7).

This section requires a member's underlying profits for the period to be adjusted to exclude expenses in the circumstances set out in (a) to (c) of subsection (1).

COMMENTARY ON SECTION 155

This section is based on Article 3.2.10 of the Model Rules which provides a special rule for what is referred to in the Model Rules as 'Additional Tier One Capital' although the term used in this section is 'qualifying tier one capital'. This type of capital is generally treated as equity for accounting purposes but in many Inclusive Framework jurisdictions it is treated as debt for tax purposes, with interest expense treated as deductible for the payer and as income for the recipient. This represents a permanent difference between income for accounting purposes and for tax purposes. This section provides a special rule to adjust underlying profits to deduct interest expense and add interest income. Section 154 does not apply to deny deductions for distributions treated as an interest expense as a result of section 155 (section 154(1)(c)).

COMMENTARY ON SECTIONS 156 -158

Profits from international shipping (transportation of passengers or cargo by ship between different territories) are excluded from underlying profits under section 156 which is based on Article 3.3 of the Model Rules.

The exclusion applies only where there is an economic link between the shipping company and the jurisdiction of the shipping tax regime which applies to the member. Section 156(3) is based on Article 3.3.6 and imposes a substance criterion requiring the strategic and commercial management of the ship giving rise to international shipping profits to be carried on within the territory in which the member is located.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

International shipping profits are comprised of core international shipping profits (see section 157) and ancillary international shipping profits (see section 158). Ancillary activities qualify for the exclusion where they are providing necessary support to the primary activity of the international shipping operation, so section 158 effectively caps the exclusion for ancillary international shipping profits for a jurisdiction at 50% of the core international shipping profits for that jurisdiction with the excess being included in underlying profits of the members in proportion to each member's ancillary international shipping profits. See 158(8) for the 12 steps to calculate the ancillary international shipping profit cap adjustment.

To the extent that an adjustment under section 155 excludes an amount of income from underlying profits, any covered tax expense associated with that income should also be excluded from covered tax balance under section 175(2)(a).

See paragraphs 146-185 of the Commentary on Article 3.3.6 for further explanation of the exclusion for international shipping profits.

COMMENTARY ON SECTION 159

As paragraph 186 of the Commentary on Article 3.4 explains, a PE is a tax concept and not an accounting concept and financial reporting information may not always be separately maintained in respect of a PE. So a special rule is required to ensure, for the purposes of calculating underlying profits, that income or loss is allocated between the PE and the main entity. The accounting treatment is followed as far as possible, subject to the income and expense allocation rules as applicable under: a tax treaty (subsection (1)); domestic tax law (subsection (2)); or the OECD tax model (subsection (3)).

Adjustments to underlying profits are required to ensure, in the case of an entity treated as a PE under a tax treaty, only amounts of income and expenses attributable to it under the tax treaty are reflected. In the case of a PE taxed on a similar basis to residents in the absence of a tax treaty, underlying profits are to be adjusted to reflect only income and expenses attributable to it under the domestic law of the territory in which the PE is located. Where a PE is located in a territory without corporate income tax, section 159(3) requires its underlying profits to be adjusted to reflect only amounts of income and expenses that would have been attributed to it in accordance with Article 7 of the OECD Model Treaty.

According to paragraph 192 of the Commentary on Article 3.4.2 the words '(regardless of whether an amount of income is subject to tax or not, or an amount of expenses are deductible or not)' are intended to distinguish between the tax rules for attributing income to the PE and the tax rules, including timing rules, for computing its taxable income.

COMMENTARY ON SECTION 160

Section 160 is based on Article 3.4.5 of the Model Rules which provides for the allocation of losses of a PE to the main entity under certain circumstances. This is to ensure that the ETR of the main entity is not understated where a PE loss is taken into account for the main entity for domestic tax purposes but not for the purposes of calculating underlying profits. Section 160 enables the domestic tax treatment to be preserved with the necessary corresponding adjustments.

Where section 160(2) applies, the loss of the PE is to be treated as an expense of the main entity and excluded from the adjusted profits of the PE for the relevant period. If in an accounting period after the relevant period the PE makes a profit, it is to be treated as income of the main entity for the purpose of determining the main entity's adjusted profits for that period (subsection (5)) until the total amount treated as income of the main entity as a result of

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

subsection (5) is equal to the relevant amount treated as an expense of the main entity. Profits of a PE treated as income of the main entity for a period are excluded from the adjusted profits of the PE for that period (subsection (7)). The covered taxes on the profits of a PE which are treated as income of the main entity as a result of subsection (5) are then allocated to the main entity under section 177(2).

COMMENTARY ON SECTIONS 161-166

Sections 161-166 provide that a number of elections may be made by the filing member to treat certain amounts differently. See the commentary and Table 2 - Elections under Schedule 15 for details.

COMMENTARY ON SECTION 167

Sections 167-172 deal with transparency and entities subject to qualifying dividend regimes to ensure that the appropriate adjustments are made to underlying profits of the appropriate members. Sections 167 and 168 allocate the underlying profits of a member, M, of a multinational group to owners of M who are members of the multinational group in specified situations. See section 178 for the corresponding reallocation of tax expense in respect of those profits.

Subsection (1) reflects the definition of a hybrid entity in Article 10.2.5 of the Model Rules. Subsection (2) provides that the profits of 'M', a hybrid entity that is treated as a taxable person in the territory where it is located but as tax transparent in a territory in which a member 'G' is located, are to be included in the adjusted profits of M and excluded from the adjusted profits of G. Table 3 (Income allocation) in the commentary under section 169 summarises the allocation of profits to M and/or to owners depending on whether M is transparent or not and/or the tax treatment of M's owners.

COMMENTARY ON SECTION 168

See Table 3 (Income allocation rules) under section 169.

COMMENTARY ON SECTION 169

Table 3 below sets out the income allocation rules.

Table 3 - Income allocation rules where hybrid entity, flow-through entity, tax transparent entity

Entity name	Section	Description	Income or loss allocated to entity M	Income or loss of M allocated to owner(s)
Hybrid Entity	167(1)	M not tax transparent where located but is tax transparent where an owner who is a group member (G) is located and adjusted profits of G reflect profits of M because of this tax transparency.	Yes	No allocation to G - exclude from adjusted profits of G to the extent G's adjusted profits reflect profits of M (section 167(2)).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Flow-through entity (including where treated as a flow-through entity by section 169)	168(2)	M is tax transparent where created and not subject to covered tax on its profits in another territory (section 168(2)) Or M is treated as tax transparent by virtue of section 169(2) (certain non-tax resident entities treated as flow-through) to the extent that it is tax transparent where its owners are located and its income, expenditure, profits and losses are not attributable to a PE (based on Article 10.2.4).	Only in respect of proportion of underlying profits of M not allocated to owners (section 168(10)).	Yes - in proportion to ownership interests to owners (O) who meet condition A (which requires O to not be regarded as tax transparent where located) or condition B (which requires O to be a reverse hybrid). Both conditions A and B require M to be regarded as tax transparent in the territory in which O is located. Section 168(7) prevents double counting of the same profits of M.
Reverse hybrid entity (part of Condition B)	168(11)	R is tax transparent where it is located and is regarded as not being tax transparent either in a territory in which an entity with a direct ownership in R is located or in which an entity with an indirect ownership interest in R is located if each entity through which that indirect ownership interest is held is regarded in that territory as tax transparent	Only in respect of proportion of underlying profits of M not allocated to owners (section 168(10))	If Condition B is satisfied, the underlying profits of M will be allocated to R in proportion to R's ownership interest subject to section 168(7) which provides that if R is owned by an entity which satisfied Condition A in respect of the same underlying profits of M the profits of M to be allocated to R are to be reduced by the profits of M allocated to the owner of R.

COMMENTARY ON SECTION 170

Where the ultimate parent of a multinational group is a flow-through entity, this section, based on Article 7.1 of the Model Rules, excludes 'qualifying profits' from the adjusted profits of the ultimate parent in order to preserve tax neutrality. Profits are qualifying in certain situations (Conditions A, B or C)). Where profits are excluded, a corresponding adjustment is made to the covered tax balance of the ultimate parent (subsection (6)). If the ultimate parent has made a loss for the period, subsection (8) requires a further adjustment to the ultimate parent's adjusted profits to exclude any amount of that loss (a disqualified loss) that a holder of an ownership interest in the ultimate parent is allowed to use in computing their taxable income.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

CHAPTER 4 - CALCULATION OF ADJUSTED PROFITS OF MEMBERS OF A MULTINATIONAL GROUP

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 171

This section is based on Article 7.2 of the Model Rules and allows a deduction from adjusted profits of an ultimate parent for qualifying dividend distributions and a corresponding adjustment to the covered tax balance, if certain conditions (some relating to the recipient of the dividend) are satisfied. This section applies only where the ultimate parent is subject to a qualifying dividend regime designed to result in a single level of tax on the owners of an entity specified in subsection (9) and the ultimate parent distributes a qualifying dividend within 12 months of the end of its accounting period and its adjusted profits show a profit for that period. The rules in this section do not apply where the ultimate parent is an excluded entity (see section 127).

COMMENTARY ON SECTION 172

This section is based on Article 7.2.3 of the Model Rules and extends the qualifying dividend rules in section 171(1)-(6) to other members of the multinational group located in the same territory as the ultimate parent, subject to the same qualifying dividend regime if certain conditions are satisfied.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 5 - COVERED TAX BALANCE

COMMENTARY ON SECTION 173

The denominator of the ETR fraction is the combined adjusted profits of the standard members of a multinational group in a territory as explained in Chapter 4. The combined covered tax balance of the standard members of the multinational group in that territory is the numerator of the ETR fraction and is dealt with in Chapter 5 which determines the amount of taxes to be associated with the adjusted profits. The intention of the rules is to achieve symmetry between profits and taxes so that if profits are not included in the adjusted profits, the corresponding tax on those profits should be excluded from the covered tax balance.

Section 173 lists what is (based on Article 4.2.1 of the Model Rules), and what is not (based on Article 4.2.2 of the Model Rules), covered taxes. Subsection (1) lists four types of covered taxes. Type (a) is taxes on profits of a member including its share of profits of another member. The words in brackets extend type (a) to include taxes imposed under a CFC regime, taxes imposed on distributions from another member and taxes imposed on a member's share of undistributed profits from a tax transparent entity such as a partnership. According to the Commentary on Article 4.1.2(a), taxes imposed on net income under Pillar One would also be treated as covered taxes:

> 'Because Pillar One applies before the GloBE Rules, any income tax with respect to Pillar One adjustments will be taken into account by the Constituent Entity that takes into account the income associated with such Tax for purposes of calculating its GloBE Income or Loss. The treatment of Pillar One taxation will be further addressed through Administrative Guidance to be developed as part of the Implementation Framework.'

Type (b) is taxes on distributed profits imposed under an eligible distribution tax system (defined in section 189(3) as a system of tax on company profits that meets conditions (a)-(c)). See sections 189-192 for further details on eligible distribution tax systems.

Type (c) is taxes imposed in lieu of a generally applicable tax on profits. According to the Commentary on Article 4.2.1, this includes withholding taxes on interest, rents and royalties and taxes arising from the Subject to Tax Rule (STTR). Part 3 does not refer to the STTR which the Inclusive Framework is still working on but the OECD/G20 statement of 8 October 2021 explains the STTR is:

> 'a treaty-based rule …..that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GloBE rules.'

Type (d) is taxes charged by reference to the capital of a company (e.g., retained earnings or contributions made by shareholders) or by reference to a combination of capital and profits.

According to the Commentary on Article 4.2.1, covered taxes does not include: consumption taxes (such as VATs or sales taxes), excise and other taxes on inputs, digital services taxes, transaction taxes (such as stamp taxes), payroll taxes and other employment-based taxes (such as social security contributions) or property taxes based on ownership (such as business rates). Some taxes which are not covered taxes will be deductible from business profits (such as excise taxes and payroll taxes) and so will be taken into account in underlying profits (so reducing the denominator in the ETR calculation rather than increasing the numerator).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Covered taxes excludes the taxes listed in subsection (2)(a)-(e) which is based on Article 4.2.2. Subsections (2)(a)-(c) provide that certain top-up taxes are not included in covered taxes. According to the Commentary, this is because to include them could result in circular computations or undermining the minimum tax rate by distorting the ETR. Qualifying domestic top-up taxes will reduce the top-up-amount (see section 194(2)). A domestic minimum tax that does not meet the definition of 'qualifying domestic top-up tax' (see section 256) will be a covered tax if it otherwise satisfies the covered taxes definition. Subsection (2)(c) excludes a 'qualifying undertaxed profits tax' specified in regulations made under section 257.

Subsection (2)(d) excludes certain refundable taxes and (2)(e) excludes taxes incurred by a member carrying on life assurance business in respect of returns to policyholders (see section 138(2)(e) and section 152(2) which also apply in respect of such taxes on returns).

COMMENTARY ON SECTION 174

This section sets out four steps to calculate the covered tax balance of a member of a multinational group for an accounting period. There were five steps in the original bill but Government amendment 12 omitted the original Step four as an unnecessary duplication of the effect of sections 175(2)(e) and 176(2)(i).

The starting point is the amount of 'qualifying current tax expense' reflected in the member's underlying profits to the extent that the expense relates to covered taxes. Section 259(4) provides that 'current tax' has the same meaning as for accounting purposes. Certain amounts (listed in section 175) are then excluded from the qualifying current tax expense and the tax expense is then adjusted to reflect certain amounts (listed in section 176). The final step is to remove any duplication of amounts of covered taxes taken into account in the covered tax balance. As the draft HMRC guidance explains in its overview of the covered tax balance:

> 'Adjustments are made for some permanent differences, such as amounts relating to income excluded from the adjusted profits. Temporary differences are adjusted for by using deferred tax accounting.' (MTT05000)

COMMENTARY ON SECTION 175

This section is based on Article 4.1.3 of the Model Rules by excluding from a member's qualifying current tax expense several amounts of covered taxes. The covered tax balance for the ETR calculation must be adjusted to reflect only taxes that arise in respect of amounts reflected in that member's adjusted profits (subsection (2)(a)) and that are expected to be paid within three years (subsection (2)(d)). Any amount of covered taxes allocated under Part 3 to another member of the group is excluded to avoid double counting (subsection (2)(e)) as section 176(2)(i) provides that such amount is included in the qualifying current tax expense of the member to which it is allocated.

An 'uncertain tax position' (defined in section 259) exists where the amount reflected in underlying profits differs from how it is/will be reflected in a tax return because of uncertainty over whether the tax authority in question will accept the basis on which it is reflected in that return. In the case of an uncertain tax position, any amount relating to that position must be excluded from the member's qualifying current tax expense under subsection (2)(b). In the accounting period in which an amount relating to an uncertain tax position is then paid or refunded, that amount is to be reflected in a member's qualifying current tax expense under section 176(2)(c).

As explained under section 148 above, QRTCs (defined in section 148(4)) are treated as income taken into account in calculating adjusted profits rather than as covered taxes. Section

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

175(2)(c) therefore excludes from qualifying current tax expense any credit or refund in respect of QRTCs that are recorded as a reduction of qualifying current tax expense.

Subsection (2)(f) excludes amounts of CFC taxes allocated to blended CFC entities that are non-members of the multinational group under section 180(3)(b) from the covered tax balance of the member which has an ownership interest in the CFC entity.

COMMENTARY ON SECTION 176

To the extent that they are not already reflected in a member's qualifying current tax expense, the amounts listed in subsection (2) are to be reflected. This follows Article 4.1.2 of the Model Rules and is intended to ensure that all covered taxes are properly captured and attributed to the correct member. Although there are only four 'additions' specified in Article 4.1.2 there are nine amounts 'to be reflected' in section 176 which helpfully consolidates in one place other rules which require amounts to be reflected in a member's qualifying current tax expense.

Subsection (2)(a) (based on Article 4.1.2(a)) deals with where a covered tax has not been recorded as a tax expense in the member's underlying profits but has instead been recorded as an ordinary expense (the definition of covered taxes is broader than the scope of taxes that qualify as income taxes for financial accounting purposes). In this scenario, section 138 will adjust the underlying profits of the member to add back the tax expense, section 176(2)(a) then includes the tax expense in the determination of the covered tax balance.

Subsection (2)(b) (based on Article 4.1.2(b)) brings in the 'total deferred tax adjustment amount' which is calculated in accordance with section 182 (based on Article 4.5.3). Subsection (2)(c) (based on Article 4.1.2 (c)) brings in any amounts of covered taxes that are paid or refunded relating to an uncertain tax position (which were accordingly excluded under section 175(2)(b) for a previous accounting period). Subsection (2)(d) includes in the member's qualifying current tax expense any amount of credit or refund in respect of a tax credit that is not a QRTC and which has not been reflected in a member's qualifying current tax expense in the current, or previous, accounting period. This is consistent with section 148(1) which provides that the only tax credit to be treated as income is a QRTC.

Section 176(2)(e) ensures that amounts of covered taxes refunded or credited to the member are to be reflected in the covered tax balance in the accounting period in which the credit or refund is accrued or received, even if those amounts were not treated in the financial accounts as an adjustment to current tax expense. QRTCs, on the other hand, are not to be reflected in the covered tax balance because they are taken into account as income instead. Subsection (2)(f) includes the amount of 'special loss deferred tax assets' used by the member for the current accounting period (see section 187 for details of the election for losses to be treated as special loss deferred tax assets and how they are to be used).

Subsection (2)(g) is based on Article 4.1.1(c) and brings in covered taxes recorded in other comprehensive income (OCI) relating to amounts included in adjusted profits for the accounting period (see for example section 143 (revaluation method gain or loss) which picks up changes reflected in OCI). Subsection (2)(h) brings in covered taxes relating to an amount reflected in the member's adjusted profits as a result of section 146 adjustments for changes in accounting policies and prior period errors. Subsection (2)(i) requires the qualifying current tax expense to reflect any amount of current tax expense allocated to the member from another member (see sections 177-181 which provide for such allocations). This dovetails with section 175(2)(e) to prevent double counting.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 177

Sections 177-181 are based on Article 4.3.2 of the Model Rules which provides special allocation rules for PEs, tax transparent entities, hybrid entities, CFC taxes and distribution taxes. These rules are necessary to align the covered tax balance with the adjusted profits to which the tax expense relate, subject to some limitations.

Section 177 is based on Article 4.3.2(a) and Article 4.3.4 to ensure that, generally, qualifying current tax expense included in the underlying profits of a main entity that is in respect of profits of a PE is to be allocated to the PE. This achieves consistency between allocation of profits to the PE (see section 159) and allocation of tax expense to the PE. The exception to this is where under section 160(5) profits of a PE are treated as income of the main entity, in which case subsection (2) provides that the covered taxes on those profits are also allocated to the main entity subject to the cap imposed by subsection (3). Where a loss of a PE is treated as an expense of a main entity under section 160(5), section 177(4) provides that any deferred tax asset with respect to that loss is to be ignored and will not reduce the covered tax balance of either the main entity or the PE.

COMMENTARY ON SECTION 178

This section generally reallocates the tax expense to the member (O) which has been allocated the profits under section 167 (hybrid entities) or 168 (transparent and reverse hybrid entities) (see Table 3 (Income allocation) under the commentary to section 169).

Subsections (2)-(4), based on Article 4.3.3 of the Model Rules, impose a cap on the amount of tax expense to be allocated in respect of 'mobile income' which is basically passive income in respect of which a member is subject to tax either under a CFC regime (see section 179(4)) or as a result of an ownership interest in a hybrid entity. Paragraph 62 of the Commentary on Article 4.3.3 explains:

> 'Article 4.3.3 imposes a limitation on the 'push-down' of Taxes from a Constituent Entity-owner that are attributable to Passive Income of the subsidiary Constituent Entity. This rule is designed to maintain the integrity of the jurisdictional blending rules in relation to mobile income'.

COMMENTARY ON SECTION 179

This section, based on Article 4.3.2(c) of the Model Rules, allocates CFC taxes in most cases to the territory of the CFC rather than to the territory of the member that has an ownership interest in the CFC, subject to the limitation on the amount of tax expense in respect of mobile income (as defined in section 178(3)). In the case of a blended CFC regime (defined in section 179(4)), however, a special allocation time-limited methodology applies under section 180 instead of section 179(1).

COMMENTARY ON SECTION 180

Section 180 is based on the new paragraphs 58.1-58.7 added to the Commentary by the Administrative Guidance to improve tax certainty and administrability of the Pillar Two rules in the first years of application. This section applies to accounting periods commencing on or before 31 December 2025 that end on or before 30 June 2027. 'Blended CFC regime' is defined in section 179(4) and is basically a CFC regime that aggregates income, losses and creditable taxes of all the CFCs of a member for the purposes of calculating that owner member's tax liability under the regime and that operates by reference to a rate which reflects a 'threshold for low

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

taxation'. Paragraph 58.2 of the Commentary of Article 4.3.2 specifies a rate of less than 15% but this is not explicit in the UK legislation. The definition of 'blended CFC regime' excludes a regime that takes into account income of the CFC owner or group arising in the location of the CFC owner, although the use of losses by the CFC owner member to reduce the CFC income inclusion is permitted. The US GILTI regime is considered to be a blended CFC regime.

The special allocation methodology proportionately allocates blended CFC taxes incurred by the owner member to low-tax territories using an allocation key. If taxes are allocated to CFCs that are not members of the multinational group under subsection (3), they are excluded from covered taxes of the owner member by section 175(2)(f).

COMMENTARY ON SECTION 181

This section is based on Article 4.3.2(e) of the Model Rules and allocates qualifying current tax expense (which includes withholding tax) in respect of covered taxes in respect of an intra-group distribution to the member that made the distribution rather than the member that received the distribution. Subsection (2) extends the application of subsection (1) to certain deemed distributions.

COMMENTARY ON SECTION 182

Sections 182-187 deal with deferred tax assets and are based on Article 4.4 of the Model Rules which provides the mechanism to address temporary differences arising where income or loss is recognised in a different year for financial accounting purposes and tax purposes. According to the Commentary on Article 4.4, the mechanism builds on deferred tax accounting to simplify compliance, with adjustments then being required to 'protect the integrity of the GloBE Rules'.

Section 176(2)(b) requires the 'total deferred tax adjustment amount' ('TDTAA') to be reflected in the covered tax balance. Section 182 is based on Article 4.4.1 and sets out the mechanism to get from the deferred tax expense relating to covered taxes reflected in the member's underlying profits to the TDTAA. Subsection (2) excludes certain amounts from the deferred tax expense. The first excluded amount (subsection(2)(a)) ensures that to the extent that items are not reflected in adjusted profits, deferred tax expenses on those items are excluded. This mirrors the exclusion from qualifying current tax expense in section 175(2)(a) and avoids an overstatement of the territorial ETR.

Subsection (2)(b) excludes deferred tax expense that reflects 'disallowed accruals' or 'unclaimed accruals' (both defined in subsection (8)) because of the speculative nature of whether disallowed accruals would be paid, and when unclaimed accruals would be paid.

Subsection (2)(c) excludes valuation adjustments or accounting recognition adjustments with respect to deferred tax assets in order to ensure that a deferred tax asset relating to a domestic loss is recorded in the same year as such loss for Part 3.

Subsection (2)(d) excludes deferred tax expense arising from a change in the applicable domestic tax rate because such amounts are simply changes to amounts already accrued rather than relating to income and so should not be included in the covered tax balance. But see section 218 which ensures that appropriate credit is given for tax paid.

Subsection (2)(e) excludes the deferred tax expense that reflects the generation, or use, of tax credits to avoid distortions to the ETR. Qualifying foreign tax credits, on the other hand, are not excluded, see section 183 which is based on the Administrative Guidance which added paragraphs 82.1-82.4 to the Commentary on Article 4.4.1.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Subsection (3) provides that when a deferred tax liability treated as an unclaimed accrual in a previous accounting period (which requires an election to have been made - see subsection (8)) is reversed, the deferred tax expense is to be increased by the amount of the reversal in the accounting period in which the liability is reversed. According to the Commentary on Article 4.4.2 (on which subsection (3) is based), disallowed accruals are taken into account in the accounting period when the corresponding deferred tax liability reverses but there is deliberately no equivalent rule in the context of unclaimed accruals which is explained in paragraph 83 as follows:

> 'However, while the exclusions of deferred tax expense in Article 4.4.1 [section 182(2)(b)] apply equally to exclude both increases and decreases in deferred tax expense, an Unclaimed Accrual is defined solely by reference to an increase in a deferred tax liability, and thus any subsequent decrease will not be captured by the exclusion in Article 4.4.1(b) [s182(2)(b)], making the rule in Article 4.4.2(a) [s182(3)] necessary for Unclaimed Accruals.'

Subsection (4) is the corollary to subsection (2)(c) which excludes accounting recognition adjustments. Subsection (4) ensures that the deferred tax asset is reflected in the year of the loss and (2)(c) then subsequently disregards the generation of the deferred tax asset when the recognition criteria is met.

'This aligns the generation of the attribute with the loss to ensure that Top-up Tax is not triggered under Article 4.1.5 [section 203] simply due to the fact that the recognition criteria has not been met' (paragraph 85 of the Commentary).

There is a special rule in section 186 which makes an adjustment to the value of a deferred tax asset in certain circumstances where an election is made. If a section 186 adjustment has been made, section 182(5) provides an amount equal to the adjustment must be reflected in the TDTAA. Amounts in respect of the reversal during the accounting period of a 'recaptured deferred tax liability' (see section 184) determined for a previous accounting period are to be reflected in the TDTTA (section 182(6)).

If the tax rate applied in the financial accounts to the deferred tax expense exceeds 15%, subsection (7) recasts the deferred tax expense at the rate of 15%. When the corresponding deferred tax liability reverses, the amount of the reversal will also be on the basis of a 15% rate. Deferred tax assets must also be recast at the 15% rate to the extent they have been recorded at a higher rate. According to the Commentary on Article 4.4 (paragraph 68), the reason for recasting deferred tax assets and liabilities at the lower of 15% or the applicable tax rate is 'in order to prevent deferred tax amounts from sheltering unrelated GloBE Income'.

COMMENTARY ON SECTION 183

Section 183 follows the Administrative Guidance which adds paragraphs 82.1-82.4 to the Commentary on Article 4.4.1 to achieve parity of outcome where there is a domestic source loss and foreign source income in the same year between territories which permit a loss carry forward, and those which permit a foreign tax credit carry-forward or equivalent. The Administrative Guidance uses the term 'Substitute Loss Carry-forward DTA' and this corresponds to the term 'qualifying foreign tax credit' in section 183. Subsection (2) sets out the conditions that must be satisfied for a foreign tax credit to be qualifying. Subsection (3) limits the amount that may be included in the TDTA to the lesser of the foreign tax paid and the amount of the domestic loss offset against the relevant foreign income multiplied by the tax rate in respect of

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

which the foreign tax was calculated. The qualifying foreign tax credit is subject to the same restriction in section 182(7) and where applicable must be recast at the 15% rate.

COMMENTARY ON SECTION 184

This section is based on Article 4.4.2(b) of the Model Rules which deals with recaptured deferred tax liabilities which occur where a deferred tax liability (other than an excluded liability listed in subsection (4)) taken into account in its TDTTA for an accounting period (the initial period) is not reversed within the time limit. Subsection (2) requires a recalculation of the ETR for the member with the recaptured deferred tax liability and for other members of the group in that territory and a recalculation of top-up tax for those members on the basis that the amount recorded in the TDTTA in the initial period in relation to the recaptured deferred tax liability is excluded from the covered tax balance for the member for that initial period. Any additional top-up amounts resulting from these recalculations are dealt with under section 206. The 'excluded liabilities' listed in subsection (4) correspond to the list of 'Recapture Exception Accruals' in Article 4.4.5. Paragraph 91 of the Commentary on Article 4.4.5 explains that this list sets out the temporary differences that are generally material to MNE groups and that are common in Inclusive Framework jurisdictions.

'Such temporary differences are typically tied to substantive activities in a jurisdiction or are differences that are not prone to taxpayer manipulation. Accordingly, to reduce compliance burdens, these low-risk items that are certain to reverse over time are not required to be monitored under the rules in Article 4.4.4 for recapture.'

COMMENTARY ON SECTION 185

This section is based on the transition rules in Article 9.1 of the Model Rules and sets out a general rule about the deferred tax assets and deferred tax liabilities pre-existing before the Pillar Two rules (see section 255) which may be utilised in calculating ETR in the accounting period of entry into the Pillar Two regime and subsequent accounting periods. The Commentary (paragraph 4) on Article 9.1 explains:

> 'Consistent with the general mechanism to address temporary differences contained in Article 4.4, these transition rules build on deferred tax accounting concepts. The transition rules allow existing deferred tax accounting attributes, including deferred tax assets resulting from prior year losses, to be used in the calculation of the ETR to prevent distortions upon entry into the GloBE regime of a Constituent Entity of a MNE Group.'

This section uses a simplified approach to allow the multinational group to take into account the deferred tax accounting attributes of a member (other than those relating to tax credits see subsection (4)) rather than requiring complex calculations as if the member had been subject to the Pillar Two rules in prior years. Pre-entry deferred tax assets and deferred tax liabilities are generally brought into the regime at the lower of 15% and the nominal rate at which the attribute was recorded in the financial accounts (subsection (2)). However, if the nominal rate is less than 15% and the member demonstrates the deferred tax asset is a loss which would, had the Pillar Two rules applied at the relevant time, been a loss to be taken into account in determining adjusted profits, it may be recast at the 15% rate (subsection (3)).

Subsection (5) ensures that the same rate is used to calculate the amount on reversal as was used to calculate the amount of the deferred tax asset.

Subsection (6) is based on Article 9.1.2 which the Administrative Guidance (paragraph 118.49) explains is 'an anti-abuse rule to prevent a taxpayer from triggering tax losses that would be excluded from the GloBE base in a pre-GloBE year and then carrying the deferred tax benefit of

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

such loss carry forward into the GloBE regime'. The draft HMRC guidance explains that one effect of the transitional safe harbour (see Schedule 1) is that: 'Any deferred tax assets arising in that period that would be excluded under MTT under subsection 185(6) will be ignored in the first period for which the group performs the full calculations for that territory.' (MTT15900)

Subsection (7) provides that a deferred tax asset to which section 185 applies, is to be ignored in determining the member's deferred tax expense.

COMMENTARY ON SECTION 186

This section is based on Article 4.4.3 of the Model Rules to ensure that where a deferred tax asset, attributable to an accounting period in which the member's adjusted profits were a loss, has been recorded at a value based on a tax rate lower than 15%, the value of the asset may be recast at the 15% rate if an election has been made under subsection (2). This will increase the value of the deferred tax asset. 'This rule preserves the basic tenet that a GloBE Loss of EUR 1 should offset GloBE Income of EUR 1' (paragraph 87 of the Commentary on Article 4.4.3). This is subject to the limitation in subsections (5)-(7) which ensures that the value of the deferred tax asset cannot be increased to more than the loss established on determining the member's adjusted profits for the accounting period.

See the commentary and Table 2 - Elections under Schedule 15.

If a section 186 adjustment has been made, section 182(5) provides that an amount equal to the adjustment must be reflected in the TDTAA. So, to the extent that a deferred tax asset is increased under section 186, the TDTTA is decreased by the amount of incremental deferred tax asset generated.

COMMENTARY ON SECTION 187

Section 187 derives from Article 4.5 of the Model Rules and permits an election for the loss arising where the total adjusted profits of the standard members of a territory calculated under Step 2 of section 132(1)) is nil or negative to be carried forward (or used in the current accounting period) as a 'special loss deferred tax asset' (referred to in Article 4.5 as 'a deemed deferred tax asset') instead of the modified deferred tax accounting rules in section 182 (Article 4.4) applying. The amount of the special loss deferred tax asset is 15% times the amount of the loss (expressed as a positive number).

Where a valid election has been made, none of the standard members of the group has a TDTAA (see section 182) for the accounting period. If any of the standard members has a profit for the accounting period in which the TDTAA arises, they can use their proportion of it (as calculated under subsection (7)) in that accounting period to increase their covered tax balance (the amount of the SLDTA used by that member is added to that member's current tax expense for the accounting period under section 176(f)). Any remaining SLDTA can be carried forward and used in subsequent accounting periods where one or more of the relevant members has made a profit.

See the commentary under Schedule 15 and Table 2 - Elections for further detail about the election under 187, including the effect of section 188.

COMMENTARY ON SECTION 188

See the commentary and Table 2 - Elections under Schedule 15.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 189

Sections 189-192 are based on Article 7.3 of the Model Rules which 'allows certain distribution tax regimes to be accommodated within the structure of the GloBE Rules, subject to certain safeguards and recapture rules.' Section 173(1)(c) provides that 'taxes imposed on the member under an eligible distribution tax system' are covered taxes but absent a distribution or a deemed distribution tax will not be reported in the accounts in the year in which the income is earned and such deferred tax liability payable on a distribution is not generally included in the total deferred tax adjustment amount under section 182 so it will not get into the covered tax balance under section 176(2)(b). The section 189 election mitigates the difference between the time the income accrues in the financial accounts and the time it is subject to distribution tax to the extent that distributions are made within the prescribed four-year period.

Section 189 is based on Article 7.3.1 which permits an election to be made in relation to a territory which has an 'eligible distribution tax system' (defined in section 189(3)) to add the 'deemed distribution tax amount' (see section 190) to the combined covered tax balance of the standard members of the group in a territory for an accounting period. In order to be an eligible distribution tax system, the three conditions in subsection (3) must be met. The last of these is that the system was in force on or before 1 July 2021. According to paragraph 17 of the Commentary on Article 10.1:

> 'The final requirement for an Eligible Distribution Tax System is that it has been continuously in force since on or before 1 July 2021. This is the date of the first Inclusive Framework Statement on the Digitalisation of the Economy that agreed the special treatment of Eligible Distribution Tax Systems. This requirement does not prevent changes to a jurisdiction's distribution tax system that are in line with its existing design'.

See the commentary under Schedule 15 and Table 2 - Elections for further details of this election.

COMMENTARY ON SECTION 190

Section 190, based on Articles 7.3.2, 7.3.3 and 7.3.5 of the Model Rules, determines the deemed distribution tax amount and provides for this amount to be added to the combined covered tax balance at Step 4 of section 132(1). The deemed distribution tax amount is the lesser of the amount that would result in the ETR of the standard members in the territory of the election being increased to 15% and the amount of tax that would have been due in that territory if all those standard members had distributed all of their profits of that period (subsection (2)).

Subsections (4)-(6) can best be explained with an example. If there is a deemed distribution tax amount in an accounting period (AP1), the effect of subsection (4) is that in the next accounting period (AP2) the standard members of the territory subject to the section 189 election have a 'recapture amount' equal to the deemed distribution tax amount for AP1. This recapture amount is monitored over time until 'the end of the fourth accounting period after the period in which the recapture amount first arose' or, if earlier, until it has been reduced to nil. The ways that it can be reduced are set out in section 191.

The natural reading of the legislation would seem to be that 'the period in which the recapture amount first arose' refers to AP2 when members have a recapture amount. So, the fourth period after that would be AP6, meaning the deemed dividend tax recapture would operate over a five-year period under section 190. This would seem to put the MTT legislation at odds with the Model Rules. Article 7.3.3 provides that a recapture amount is established for each year for which the relevant election (i.e., an election under section 189 with respect to the MTT legislation) is in place. This would seem to refer to the year during which the deemed

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

distribution amount arises, i.e., AP1. Article 7.3.5 then provides for a recapture long-stop date falling on the last day of the fourth year after the year for which the recapture amount was established which would mean the end of AP5. It is doubtful that such a difference is intentional.

If a recapture amount from AP2 has not been reduced to nil by the end of AP6, recalculations of ETR and top-up amounts are required for AP2 with the remaining recapture amount being subtracted from the combined covered tax balance for AP2 (after the addition of the deemed distribution tax amount for AP2).

COMMENTARY ON SECTION 191

Section 191 is based on Article 7.3.3 of the Model Rules. There are three ways the recapture amount can be reduced as set out in subsections (3)-(5). First, as provided by subsection (3), it may be reduced by distribution taxes accrued by the members as a result of distributions or deemed distributions. Second, as provided by subsection (4), where the standard members in the territory have a collective loss (where the result of Step 2 in section 132(1) is less than nil), this loss (expressed as a positive number) is multiplied by 15% and subtracted from the recapture amount. This effectively permits a carry-back of losses in a distribution tax system according to paragraph 60 on Article 7.3.3. Thirdly, as provided by subsection (5), if the members have a qualifying carried forward loss (which is a collective loss remaining available after making reductions in accordance with (2)-(7) (see subsection (7)), it can be applied to reduce the recapture amount. Subsection (5) is based on Article 7.3.4 and ensures that the multinational group is not taxed under Part 3 in excess of its economic income earned through members subject to an eligible distribution tax system. The qualifying carried forward loss can be carried forward indefinitely, but the filing member bears the burden of proof in respect of any qualifying carried forward loss used in a territory in an accounting period and so must comply with the record keeping obligations (see paragraph 31 of Schedule 14).

If there is more than one recapture amount, the reductions are to be applied first to the recapture amount in respect of the earliest accounting period, and then the next in chronological order (subsection (2)). Each type of reduction can reduce the recapture amount to nil but not to below nil. To avoid double counting, taxes of a member used to reduce a recapture amount are excluded from that member's covered tax balance (subsection (8)).

COMMENTARY ON SECTION 192

Section 192 is based on Article 7.3.7 of the Model Rules and requires a recalculation of ETR and top-up amounts for standard members in a territory where a standard member (D) in the territory leaves the multinational group or transfers substantially all of its assets to outside the group or, within the group but outside the relevant territory, and there are 'recapture amounts' (defined in section 190(4)) in the relevant territory in previous accounting periods. The purpose of section 192 is to recapture the section 190 deemed distribution tax to the extent that it is attributable to D because D ceases to be in a position to distribute assets that would yield distribution tax to eliminate the recapture amounts.

For the purpose of the recalculations of ETR and top-up amounts, subsection (3) requires the covered tax balance of the members for the 'recapture periods' (defined in subsection (1)(b)) to be reduced by recapture amounts still outstanding in the recapture period. In the accounting period in which section 192 is triggered, the standard members in the relevant territory (including D) will have special additional top-up tax amounts (see sections 206 and 207)).

The 'disposition recapture ratio' for each recapture period (see subsection (5)) is multiplied by the incremental top-up for each recapture period (see subsection (4)(a)) to calculate the special

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

CHAPTER 5 - COVERED TAX BALANCE

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

additional top-up tax amounts. The disposition recapture ratio is the adjusted profits of D in the period divided by the total adjusted profits of the standard members in that territory for the period. If either D's adjusted profits for that period were nil or negative, or the total adjusted profits of the standard members in the territory for the period were nil or negative, the disposition recapture ratio is nil (subsection (6)) and there will be no special additional top-up tax amount under subsection (4) for the relevant period.

The adjustments provided for in subsections (8)-(10) which reduce certain amounts in proportion to the disposition recapture ratio are explained in paragraph 71 of the Commentary on Article 7.3.7 as necessary to:

> 'ensure that subsequent adjustments to the Deemed Distribution Tax Recapture Accounts [recapture amounts] pursuant to Article 7.3.3 [section 191] are given full effect in the computation of the ETR and Top-up Tax at the end of the four-year period under Article 7.3.5 [section 190].'

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

CHAPTER 6 - CALCULATION OF TOP-UP AMOUNTS

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 6 – CALCULATION OF TOP-UP AMOUNTS

COMMENTARY ON SECTION 193

Chapter 6 sets out the rules for determining the calculation of top-up amounts for each standard member for an accounting period and for determining the total top-up amount for a territory for an accounting period. Chapter 6 contains two important exclusions: the substance-based income exclusion and the de minimis exclusion which requires an election to treat the total top-up amount for a territory as nil provided that the average revenue and average adjusted profits meet certain thresholds. Chapter 6 also provides for credit for qualifying domestic top-up tax against total top-up amounts.

Section 193 is based on Article 5.2.4 of the Model Rules to allocate the top-up amount due for an accounting period with respect to a territory (calculated under section 194) to the standard members of the multinational group in that territory on the basis of the proportion each member's adjusted profits is of the total adjusted profits of all the standard members in that territory that have profits. Section 193 does this calculation in nine steps. Importantly, Step 4 provides that a member whose adjusted profits show a loss for the period in question will not have a top-up amount allocated to it.

COMMENTARY ON SECTION 194

Section 194 is based on Article 5.2 of the Model Rules to determine the total top-up amount for the accounting period for a territory. Step 1 calculates the top-up tax percentage by subtracting the ETR of the standard members of the group in that territory (see section 132) from 15%. If this results in nil or a negative number, there is no top-up amount for that territory. Step 3 calculates the net adjusted profits of the standard members of the group in that territory for the accounting period and Step 4 subtracts from the net adjusted profits the 'substance-based income exclusion' (SBIE) calculated in accordance with section 195. Any profits remaining after Step 4 are described as the 'Excess Profit' in Article 5.2.2 although this term is not used in section 194. If there is any excess profit remaining after Step 4, Step 6 requires it to be multiplied by the top-up tax percentage calculated at Step 1 to get the total top-up amount which, after being increased by any collective additional amount in respect of top-up tax computed in the current accounting period attributable to recalculations of the top-up tax in previous years (see section 206), may then be eliminated or reduced by a QDT credit.

According to subsection (3) the standard members in a territory have a QDT credit for a territory for an accounting period if qualifying domestic top-up tax (QDTT) is accrued by one or more standard members. Section 256 provides that the UK's DTT (see Part 4) is a qualifying domestic top-up tax. Domestic top-up taxes of other countries that are considered 'equivalent in substance' to the UK's DTT will also be qualifying domestic top-up tax if specified in regulations.

Discussions are ongoing at the Inclusive Framework to move from a credit method for qualifying domestic top-up tax to an exemption method in which case Part 3 will require amendment to reflect this change.

The effect of subsections (4)-(7) is that a QDT credit can only reduce the total top-up amount (including any collective additional amounts where applicable) to nil, it cannot reduce the top-up tax amount below zero, or result in a refund or credit against future top-up tax. This is consistent with the Commentary on Article 5.2.3.

Subsection (7) restricts the amount of QDT credit which can be used against the total top-up tax where standard members have a collective additional amount (see section 206) which is added

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

CHAPTER 6 - CALCULATION OF TOP-UP AMOUNTS

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

to the total top-up tax resulting in an amount equal to or greater than the QDT credit. Subsection (7) applies a formula to work out the proportion of QDT credit that has not already reduced the collective additional amount in the calculation in section 206(8). This proportion of the QDT credit can then be used to reduce the total top-up amount for the territory under section 194(7). This is necessary to avoid double counting of the same QDT credit.

COMMENTARY ON SECTIONS 195-198

The SBIE is a formulaic way of excluding a fixed return for substantive activities within a territory. Payroll and tangible assets are taken as indicators of substantive activities as they tend to be less mobile and less likely to lead to 'tax-induced distortions' (see paragraph 25 of the Commentary on Article 5.3).

The SBIE for a territory is calculated by adding together the payroll carve-out and the tangible asset carve-out for the period for each standard member of the group in that territory (section 195(1)).

The SBIE applies by default, but a filing member may elect not to calculate the SBIE for the period for a territory in which case the exclusion will be nil. (See the commentary and Table 2 - Elections under Schedule 15). This election saves a filing member from having to do SBIE calculations where the benefit of relief for that period is not enough to make it worthwhile.

Although the amount of the payroll carve-out is set in section 195(4) at 5% of the eligible payroll costs incurred by the member in the period, the rate will only be as low as 5% in 2033. For the transitional period from 2023 to 2032 inclusive, Schedule 16 (transitional provision) provides for a sliding scale starting from 10% in 2023 and decreasing to 5% by 2033.

A sliding scale of relief also applies to the tangible asset carve-out amount. The amount is set in section 195(5) at 5% of the eligible tangible asset amount of the member in the period, Schedule 16 paragraph 2 provides it will be 8% for 2023, reducing each year to reach 5% in 2033.

COMMENTARY ON SECTION 196

Section 196 is based on Article 5.3.3 of the Model Rules. Section 196(1) defines eligible payroll costs of a member. The costs must be paid in connection with the employment of an employee of that member primarily in respect of work done in the course of the ordinary operating activities of the member or the group and the activities must be substantially performed in the territory in which the member is located.

The employee must be an individual and either be regarded as an employee under domestic law in the territory of the member or be acting exclusively under the direction or control of the member or the group. The definition in subsection (3) is wide enough to pick up part-time employees and independent contractors. This avoids the need to distinguish an employee from an independent contractor which we know under UK law can be tricky.

Subsection (2) lists some costs which may be included in eligible payroll costs. Subsection (2) adopts the broad approach to determining eligible payroll costs taken by Article 5.3.3. In line with the Commentary on Article 5.3.3 Subsection (2) includes costs such as salaries, employee benefits and certain taxes payable by the member. Certain costs are excluded by Section 196(4) to avoid double counting (e.g., costs taken into account in determining the underlying profits of a PE of a member (Section 196(4)(a)) and costs taken into account in a carrying value used to calculate the eligible tangible asset amount (Section 196(4)(b)) and there are particular rules

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

CHAPTER 6 - CALCULATION OF TOP-UP AMOUNTS

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

about excluding costs that apply to international shipping costs (sections 196(4)(c) and (d) and Section 196(6)).

COMMENTARY ON SECTION 197

Section 197 is based on the tangible asset carve-out in Article 5.3.4 of the Model Rules. Section 197 defines the eligible tangible asset amount as the average of the carrying value recorded for the purposes of preparing the consolidated financial statements of the ultimate parent, at the beginning of, and at the end of, the period of each eligible tangible asset held by the member. An eligible tangible asset must be of a specified type listed in subsection (6) and must not be an excluded asset listed in subsection (7). Increases in carrying value solely attributable to a revaluation are not included in the amount.

The tangible assets must be located in the same territory as the member who holds them (e.g., for property, plant, equipment or natural resources), or in the case of a right to use a tangible asset, the tangible asset must be located in the same jurisdiction as the member who has the right to use it. A license or similar right to use a tangible asset is included in the Section 197(6) list if it is granted by a government of that territory and it is expected that the member will incur significant expenditure in using that right in enhancing the value of tangible assets in the territory whether or not those assets are subject to the right. Examples in this category include an oil license for a member to extract and sell oil from a reserve owned by a government, or a license to use infrastructure assets to build something as part of the member's business that is already owned by a government or that will be owned by a government once it has been built or improved.

Property that is held for sale, lease or investment is an excluded asset as these categories of assets do not act as proxy for substantive activities, or, in the case of investment, if not excluded would allow a multinational group to generate a large carve-out by purchasing investment property in a territory. Certain assets used in the course of international shipping activities are also excluded assets.

COMMENTARY ON SECTION 198

Section 198 is based on Article 5.3.6 of the Model Rules and provides a restriction on these carve-outs for PEs and flow-through entities. The only amounts to be taken into account for a PE or for a flow-through entity are those that would be taken into account in determining the adjusted profits of that PE or entity, respectively, (subsections (1) and (3)). However, if (1) would exclude the value of an eligible tangible asset used in the business of the PE, the value of that asset is to be taken into account under subsection (2).

COMMENTARY ON SECTION 199

Section 199 provides for a jurisdictional de minimis exclusion following Article 5.5 of the Model Rules. Paragraph 74 of the Commentary on Article 5.5 explains that the policy behind the de minimis exclusion is that the complexities of a full ETR computation can be avoided where the amount of any top-up tax would not seem to justify the associated compliance and administrative costs.

Section 199(1) provides that a filing member may make an election for the total top-up amount for a territory for an accounting period be treated as nil. See the commentary and Table 2 - Elections under Schedule 15.

Subsection (2) sets out the conditions for the election: the average revenue for an accounting period of the standard members in that territory (determined in accordance with subsection (3))

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

CHAPTER 6 - CALCULATION OF TOP-UP AMOUNTS

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

must be less than €10m; and the average of the adjusted profits of those standard members for an accounting period must be less than €1m (determined in accordance with subsection (4)).

Subsection (8) provides that the election may not be made in respect of the nominal territory of a stateless member of a multinational group (see section 132(3)(b)).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14
Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15
Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory
Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group
Chapter 5 - Covered Tax balance
Chapter 6 - Calculation of top-up amounts
CHAPTER 7 - ALLOCATING TOP-UP AMOUNTS TO RESPONSIBLE MEMBERS
Chapter 8 - Further adjustments
Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members
Chapter 10 - Definitions etc.
Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 7 – ALLOCATING TOP-UP AMOUNTS TO RESPONSIBLE MEMBERS

COMMENTARY ON SECTION 200

Chapter 7 is based on Article 2.2 of the Model Rules which provides a formula for attributing the top-up tax to the relevant responsible member based on its interest in the low-taxed member's income.

Section 200 provides that the top-up amount of a member to be attributed to a responsible member (as defined in section 128) is based on the responsible member's inclusion ratio (see section 201) for that member. There may be more than one responsible member (see section 128) so subsection (2) is necessary to avoid double allocation of the same amount. The effect of Section 200(2) is that where there is more than one responsible member in a chain of ownership, it is only the responsible member closest in the chain to the low-taxed member that gets attributed the top-up amount.

COMMENTARY ON SECTION 201

This looks more complicated in the legislation than it actually is. In the simple case of a multinational group with one responsible member which owns directly or indirectly 100% of the member that has a top-up amount, the inclusion ratio will be 1 which means that under Section 200 all of the top-up amount will be allocated to that responsible member. Where the responsible member has less than 100% of ownership interests in a member (the 'relevant member'), the inclusion ratio is determined by subtracting from the adjusted profits of the relevant member the amount of those profits attributable to ownership interests held by entities other than the responsible member and dividing the result by the adjusted profits of the relevant member. For example, where a responsible member owns 80% of the ownership interests in X and the other 20% is owned by other entities, where the adjusted profits of X are 100, the inclusion ratio will be (100 – 20)/100 which is 0.8. The responsible member will be attributed 80% of the top-up amount of the relevant member. Subsections (2) and (3) explain how to calculate the amount of adjusted profits attributable to ownership entities other than the responsible member and the assumptions that are required to be made. Different rules apply where the relevant member is a flow-through entity (see section 168) so section 201(4) provides that any such entity is to be ignored for the purposes of section 201.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 8 – FURTHER ADJUSTMENTS

COMMENTARY ON SECTION 202

Covered taxes may be less than nil for a variety of reasons (for example, where domestic tax rules permit super deductions or notional interest deductions). Sections 202-205 deal with the consequences of a negative covered tax balance. According to Chapter 2.7 of the Administrative Guidance on Articles 4.1.5 and 5.2.1 of the Model Rules on which sections 202-205 are partly based, safeguards are required to prevent deferred tax expense from shielding permanent differences from liability to MTT and to ensure MTT is not payable in respect of collective loss-making members in a territory because of permanent differences between the taxable profits for domestic tax purposes and the adjusted profits for Part 3 purposes.

Section 202 applies where members in a territory have a collective profit and the combined covered tax balance is less than nil. The Administrative Guidance makes changes to the Commentary on Articles 5.2.1 to deal with this scenario. Section 202(2) mandates the carry forward of excess negative tax expense in line with the 'Negative Tax Expense administration procedure' described in paragraphs 15.3-15.4 of the Commentary as amended. The combined covered tax balance for the standard members in the relevant territory for the current period is treated as nil rather than negative (which means the ETR for the current period will be 0% rather than in excess of 15%) and the negative combined covered tax balance is then carried forward to reduce the combined covered tax balance for the next period in which those members have a profit. The reason for mandating this procedure is explained in paragraph 15.2 of the Commentary on Article 5.2.1:

> 'The rationale justifying Negative Tax Expense administrative procedure set out in the Commentary to Article 4.1.5 apply equally in the context of Article 5.2.1. However, the procedure is mandatory under Article 5.2.1 to ensure that the Substance-based Income Exclusion for the Fiscal Year eliminates only the Top-up Tax attributable to the GloBE Income that the exclusion removed from Excess Profits and does not also eliminate the Top-up Tax attributable to the permanent difference that caused the excess negative tax expense.'

COMMENTARY ON SECTION 203

Section 203 is based on Article 4.1.5 of the Model Rules and addresses the situation where the standard members have a collective loss in a territory and there is a negative covered tax balance for the current period. In this scenario, additional top-up tax, a 'collective additional amount', arises to the extent that the collective negative covered tax balance is less than 15% of the collective loss. Section 203(1)(c) requires the calculation of the 'expected covered tax amount' (15% of the collective loss expressed as a positive number). The difference between the expected covered tax amount and the combined covered tax balance forms the 'collective additional amount' (subsection (2)). The collective additional amount may then be reduced by a QDT credit in accordance with subsection (4)-(7). According to the Commentary (see paragraph 69 under Article 5.4.3) Article 4.1.5:

> 'essentially requires that attributes resulting from permanent differences be paid for with additional Top-up Tax arising in the Fiscal Year in which the attribute is generated. This facilitates the continued alignment of GloBE deferred tax accounts with the accounts used for financial reporting purposes.'

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 204

Section 204 is based on Article 5.4.3 of the Model Rules which the Commentary explains requires the allocation of the additional top-up amount arising as a result of a permanent difference to the member that generated the attribute resulting in the permanent difference (see paragraph 69 of the Commentary on Article 5.4.3). Once a collective additional amount has been calculated under Section 203, an amount must be allocated to each standard member that has a negative tax balance of less than 15% of its adjusted profits (subsection (1)). The collective additional amount allocated to a member under Section 204 is an 'additional top-up amount' (subsection (3)) and is allocated to responsible members under Chapter 7 as if the adjusted profits of that member were the amount given by dividing the additional top-up amount by 15% (subsection (4)). Subsection (4) creates an amount of adjusted profits for each member to which the Section 203 top-up amount is allocated in order to determine the correct allocation to the responsible members.

COMMENTARY ON SECTION 205

The effect of section 205 is that, where an election is made for an accounting period, all or part of a collective additional amount may be subtracted from the combined covered tax balance for the standard members of the group in the relevant territory in the next accounting period in which those members do not have a collective loss and only the part not so subtracted will be a collective additional amount for the current period. The amount of the collective additional amount that cannot be carried forward in this way corresponds to the amount of any deferred tax asset deemed to arise under section 217(7) for the period.

Section 205 does not specify that the election can be made only in respect of a collective additional amount calculated under Section 203 so, on the face of it, the election could also apply to a collective additional amount calculated under section 206. According to the Commentary, however, the election is only for the Section 203 amounts and not for section 206.

According to paragraph 21.8 of the Commentary on 4.1.5 which was added by the Administrative Guidance, if this election is made and then the group (the 'transferor group') disposes of one or more members in the territory to whom the election applies, the collective additional amount carried forward should remain an attribute of the transferor group. If the transferor group disposes of all the members in a territory for which this has been made and in a subsequent accounting period re-acquires or establishes members in that territory, the balance of the additional carried forward collective additional amount should be taken into account in determining the combined covered tax balance for the territory beginning with the accounting period of the reacquisition or establishment. This is not clear in Part 3 currently. Record keeping of the outstanding balance is therefore essential.

See the commentary and Table 2 - Elections under Schedule 15 for more details about the section 205 election.

COMMENTARY ON SECTION 206

Section 206 applies where members have a special additional top-up tax amount under section 192 for the period or where a recalculation is required for a prior period under the specified sections and the sum of the top-up amounts determined in accordance with the recalculation exceeds the sum of the top-up amounts the members had for the prior period. Section 206 results in a collective additional amount for the current period to the extent that it is not reduced by a QDT credit in accordance with subsections (5)-(8).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 207

Section 207 allocates any section 206 collective additional amounts for a territory for an accounting period to the standard members in proportion to their increase in their own top-up amounts divided by the total increase for all the standard members in that territory.

There is a special rule in subsection (2) (explained in paragraph 68 of the Commentary on Article 5.4.2 on which section 207(2) is based) where section 206 has resulted in a collective additional amount allocated to the standard members of a territory but there is a no net profit under Step 2 of section 132(1) for those members for the current period. In this scenario, subsection (2) provides that for the purpose of the Chapter 7 allocation of top-up amounts of members to responsible members, the adjusted profits of a standard member is increased by an amount equal to the additional top-up tax allocated to that member divided by 15%. This is necessary in order for the Chapter 7 mechanism to allocate top-up tax to responsible members to work.

COMMENTARY ON SECTION 208

Paragraph 44 of the Commentary on Article 6.2 of the Model Rules on which sections 208 and 209 are based states:

> 'The GloBE Rules and Commentary are generally drafted on a steady-state basis that assume the MNE Group is comprised of the same Constituent Entities throughout the entire Fiscal Year. When an acquisition or disposition of a Controlling Interest in a Constituent Entity (referred to in Article 6.2 as the target) takes place during the Fiscal Year, Article 6.2 modifies or clarifies the operation of the GloBE Rules in order to ensure the appropriate outcomes for both the buyer and seller. The rules are intended to produce a smooth separation of the target from the seller Group and a smooth integration of the target into the acquiring MNE Group. Article 6.2.1 includes provisions that apply in the Fiscal Year the Entity leaves or joins the Group (i.e. the acquisition year) as well as rules that apply for the purposes of determining the ongoing tax attributes of an Entity that joins the Group in the years following the acquisition year. In relation to a target, it addresses the question of when the target is treated as joining or leaving a Group and apportions its income and expenses, including its Covered Taxes, between the Groups for the purposes of the GloBE Rules.'

Section 208 is based on Article 6.2.1 of the Model Rules. Special rules apply in the accounting period when an entity (the target) joins or leaves a multinational group (referred to in section 208(1) as the 'transfer period'). The effect of section 208(2) is that the target can be treated as a member of more than one group during the transfer period because it will be treated as a member of a group for the whole of the transfer period if any portion of its assets, liabilities, income, expenses or cash flows are included in a line-by-line basis in the ultimate parent's consolidated financial statements for that period.

Only the amounts taken into account in the consolidated financial statements of the ultimate parent are used to calculate the profits, covered taxes and eligible payroll costs (if applicable). 'Thus, each MNE Group takes into account the Eligible Payroll Costs arising during its period of ownership and that it bears economic responsibility for.' (paragraph 53 of the Commentary on Article 6.2.1(d))

There are specific rules about ignoring purchase accounting consolidation adjustments which means there is no change in the historic carrying value of assets held by a target (subsection (4)) and determining the eligible tangible asset amount (where applicable) based on at what point in the transfer period the transfer occurs (subsections (5)-(8)).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Where a target moves to group A from group B, subsections (10) and (11) provide how much of the deferred tax assets and tax liabilities (not including a special loss deferred tax asset) are to be taken into account in relation to that target as a member of group A. According to the Commentary on Article 6.2.1(f) on which subsection (10) is based, the rule generally provides that deferred tax assets and liabilities of a target are taken into account by group A 'in the same manner and to the same extent as they would have been taken into account if [group A] had controlled [the target] when they arose.

Special loss deferred tax assets arise because of an election made under section 187 by a filing member of a multinational group and remain attributes of the electing group, rather than an attribute of the members located in the territory for which the election was made. Special loss deferred tax assets cannot be transferred to another multinational group and so are excluded from section 208(11). They will continue to be available to Group B for the remaining standard members in the relevant territory to use to increase their covered tax balances in accounting periods in which they make a profit in accordance with section 187(5).

Subsection (11) is based on Article 6.2.1(g) which the Commentary explains in paragraph 57 'is intended to relieve the disposing MNE Group of the need to recapture deferred tax liabilities that do not reverse (through payment or otherwise) within the five-year period required by Article 4.4.4'.

Section 208(11)(a) deems the deferred tax liability of the target which was included in the TDTAA for the target in group B (see section 187) to have reversed but with no need for the reversal to be taken into account for group B. The five-year period in section 184(1) is restarted for group A by section 208(11)(b) by treating the deferred tax liability as arising in the transfer period. This means the target will not be required to recapture any deferred tax liabilities under section 184 when it leaves group B. The effect of section 208(11)(c) is that at the end of the new five-year period, in respect of any deferred tax liability that is recaptured under section 184, there will be a reduction in the covered tax balance of the target as a member of group A in the accounting period in which the deferred tax liability is recaptured rather than following section 182(2) to make adjustments/recalculations for the first accounting period of the target in group A. The Commentary on Article 6.2.1(g) on which section 208(11)(c) is based explains this is because group A will not have done an original calculation of the ETR and top-up tax for the relevant year based on the deferred tax liabilities of the target.

COMMENTARY ON SECTION 209

Section 209 is based on Article 6.2.2 of the Model Rules and provides an exception to section 208 where there is an acquisition or disposal of a controlling interest (defined in section 242(4)) in a member of a multinational group where the territory of the member treats the transaction as a transfer of assets and liabilities by that member (rather than as a transfer of the ownership interests in it) and imposes a covered tax on the seller of the controlling interest on the basis set out in subsection (1)(b). In this scenario, section 208 does not apply because section 209(2) treats the transaction as an acquisition or disposal of the assets and liabilities of the member and any covered tax arising as described under subsection (1)(b) is included in the covered tax balance of that member.

COMMENTARY ON SECTION 210

Section 210 is based on Articles 6.3.2 and 6.3.3 of the Model Rules and applies where there is a transfer from a member of a multinational group to another entity of assets or liabilities in the course of a 'qualifying reorganisation' (defined in Section 212). In this scenario, the transferor member excludes any gain or loss on the transfer from its adjusted profits, except to the extent it is a 'non-qualifying loss' defined in subsection (2) as the gain or loss of the transferee which is

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

the lesser of the amount of the gain or loss subject to tax where the transferee is located and the amount of the gain or loss reflected in the underlying profits accounts of the transferee. As the Commentary on Article 6.3.2 explains, this is intended to align the GloBE Rules with the tax deferral treatment of reorganisations under domestic provisions.

Section 211(4) provides that any non-qualifying gain or loss is to be included in the adjusted profits of the transferor.

COMMENTARY ON SECTION 211

Section 211(1) looks at the transfer from the perspective of the transferee. The value of the assets or liabilities in the hands of the transferee, for the purposes of determining its adjusted profits, depends on whether the transfer forms part of a qualifying reorganisation (in which case section 211(1)(a) applies and the value is the carrying value in the hands of the transferor immediately before the transfer) or otherwise (in which case section 211(1)(b) applies and the value is the carrying value immediately after the transfer determined under the accounting standard used to determine underlying profits of the transferee and subject to adjustments under Chapter 4).

Where subsection (1)(b) applies to an intra-group transfer and neither a gain nor loss is recorded in the underlying profits accounts of the transferor in respect of that transfer, subsection (3) provides that the adjusted profits of both the transferor and transferee are to be adjusted to an arm's length basis (as defined in section 149(7)).

Subsection (4) provides that any non-qualifying gain or loss (see section 210) is to be included in the adjusted profits of the transferor and that where the transferee is a member of a multinational group it must exclude the non-qualifying gain or loss from the value of the assets and liabilities for the purposes of calculating its adjusted profits.

COMMENTARY ON SECTION 212

Section 212 defines qualifying organisation and is based on the broad definition of a 'GloBE Reorganisation' in Article 10.1 of the Model Rules. It covers the types of restructuring transactions listed in subsection (1) provided that Conditions A-C are met. Condition A requires that the consideration for the transfer complies with subsection (2)(a) or (b) or that the reorganisation does not result in a change in the ownership of an entity. Subsection (5) provides that the change in company ownership provisions in CTA 2010, ss 719-724A apply, subject to various modifications as set out in subsection (5)(a)-(f), for the purposes of determining whether there has been a change in ownership of an entity.

Investment entities (other than insurance investment entities) are excluded entities (see section 127) if they are the ultimate parent of a multinational group. An investment entity which is an insurance investment entity or is not an ultimate parent, however, is subject to special rules rather than the rules which apply to 'standard members' of the group (see section 132(3)). This is because the income of investment entities is often subject to little or no tax at the entity level. If the investment entity is not subject to a transparency election under section 213, the ETR and top-up tax will be calculated for that investment entity on a standalone basis to prevent a multinational group from blending the low-taxed income with income of the standard members.

COMMENTARY ON SECTION 213

Section 213 is based on Article 7.5.1 of the Model Rules and provides for an investment entity transparency election. The effect of such an election is that for the purposes of section 168

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

(underlying profits of transparent entities) and section 178 (covered taxes of transparent entities) an investment entity (M) may be treated as a flow-through entity regarded as tax transparent in the territory of a member of the group (O) which has ownership interests in M and O is to be treated as having direct ownership interests in M. The definition of investment entity (see section 236(3)) includes an insurance investment entity as defined in section 236(2).

This election allows the group to include O's share of M's results as profits of O. This matches the timing and location of income earned through an investment entity under the Pillar Two rules and the domestic tax rules where the owner is subject to a mark-to-market or similar regime (see Commentary paragraph 92 on Article 7.5.1).

Such an election cannot be made if a section 214 taxable distribution election is in effect in relation to M and O (subsection (5)(a)). One of the two conditions in subsection (5)(b) must also be met: O is subject to tax at a rate of 15% or more on increases in the fair value of its ownership interests in M; or O is a regulated mutual insurance entity as defined in section 214(6). The latter condition is necessary because, as the Administrative Guidance (under the heading '3.6 Application of Article 7.5 to Mutual insurance companies') explains, there is some uncertainty whether mutual insurance companies meet the first condition although delegates agreed they should be eligible to make the election with respect to investment entities they control. The Administrative Guidance amends paragraph 91 of the Commentary on Article 7.5 to ensure the election can be made in respect of an investment entity owned by a regulated mutual insurance entity.

When the election is revoked subsections (8)-(11) apply to determine the adjusted profits of M for the first accounting period in respect of which the election no longer applies and subsequent accounting periods.

See the commentary and Table 2 - Elections under Schedule 15 for more detail about this election.

COMMENTARY ON SECTION 214

Section 214 is based on Article 7.6 of the Model Rules, the Commentary on which explains it provides an alternative to the rule in Article 7.4 (ETR and top-up computation for investment entities on a standalone basis) (see sections 220-225) where an investment entity makes distributions of its income within a four-year period. This election may not be made if an election under section 213 is in effect in relation to the owner or if the owner is not itself an investment entity. The owner must be taxable on the distributions at or above the 15% rate (section 214(2)).

The taxable distribution method is intended to match both the timing and location of the income earned by a multinational group through the investment entity with the tax on that income in the location where the owner-member is subject to tax on the distributions. Distributions and deemed distributions (see commentary on section 215) are taken into account in the adjusted profits of the owner under section 214(3)(a).

The Commentary points out (in paragraph 101 on Article 7.6.2) that this is a departure from the rule that applies to owners who are standard members where distributions from other members are excluded from their adjusted profits. Credit the owner receives to reflect tax of the investment entity paid or payable in the accounting period will be included in the owner's adjusted profits (section 214(3)(b)), and, if the owner receives credit under (b), the tax paid or payable by the investment entity in the accounting period will be taken into account in the covered tax balance of the owner (section 214(3)(c)).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Subsection (4) provides that an undistributed income amount for an investment entity must be determined under section 215 and any positive undistributed income amount must be added to the top-up amount of the investment entity (see section 220(3)).

When an election is revoked, adjusted profits of the investment entity fall to be determined under section 220 for the first accounting period in which the election no longer applies (subsection (6)) and those profits will include any positive undistributed income amount for the entity for the previous period (subsection (7)).

See the commentary and Table 2 - Elections under Schedule 15.

COMMENTARY ON SECTION 215

Section 215 is based on Article 7.6.3 of the Model Rules. If the investment entity fully distributes its profits to its member-owners over the course of the four-year period, no top-up tax would be imposed on the investment entity under the taxable distribution method. The starting point for calculating the undistributed income amount for an accounting period is the investment entity's adjusted profits for the income period (defined in section 215(4)(a) as the third accounting period before the accounting period for which the undistributed income amount falls to be determined). The amounts listed in subsection (2)(a)-(d) are then subtracted from those adjusted profits. Subsection (3) prevents double counting of an amount already deducted from the undistributed income amount for a previous period.

'Deemed distribution' is defined in section 215(4) as an amount arising for the transfer of an ownership interest in the investment entity to a person outside the group. The amount of a deemed distribution is based on the proportional decrease in the value of the owner's ownership interest. The Commentary on Article 7.6.5 (in paragraph 117) explains that without this provision for deemed distributions, the undistributed income amount attributable to the disposed investment entity would continue to be deferred until the end of the four-year period.

COMMENTARY ON SECTION 216

Section 216 is based on Article 6.3.4 of the Model Rules. Where there is a 'relevant tax adjustment' (as defined in subsection (2) and excluding transfer pricing adjustments or adjustments in connection with sales of inventory (see subsection (3)) made in the accounting period in relation to a member, the filing member may make an election for the adjustment amount (as calculated under subsection (7)) to be included in the adjusted profits of the member for that accounting period, or split into even amounts to be included in the adjusted profits of the member in that accounting period and the four subsequent accounting periods (section 216(5)).

Note the exit charge which arises under section 216(6) if the adjustment amount has been spread and the member leaves the group before the end of the four subsequent accounting periods. In that case, any remaining adjustment amount would be picked up in the final accounting period in which it was a member of the group.

Where the triggering event for the relevant tax adjustment is a qualifying reorganisation, section 217(7)(b) prevents duplication of gains and losses that have already been included in the calculation of a non-qualifying gain or loss in section 210(2).

See the commentary under Schedule 15 and Table 2 - Elections for further details.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 217

Section 217 is based on Article 4.6.1 of the Model Rules dealing with the scenario where, after the relevant return has been filed for a prior period, the liability of a member to covered taxes for that prior period has increased or decreased.

This section distinguishes between two scenarios. The first is where there is an increase in tax expense or an insignificant decrease in tax expense (the latter requires an election made under subsection (8)(b) for amounts less than €1m to be treated as insignificant). In this scenario, subsection (4) applies to adjust the covered tax balance for the current period to reflect the increase/decrease in tax expense for the prior period.

The second scenario is where there is a significant decrease in tax expense and a number of recalculations are required under subsection (5). In addition to recalculation of the ETR and top-up amounts for the prior period, section 217(5)(a)(iii) requires recalculation of adjusted profits for the prior period but 'only to the extent necessary to prevent the ETR from decreasing'. This is intended to ensure the recalculation of adjusted profits cannot lead to an increase in the ETR as this might mean there would be a refund of top-up taxes for a prior period and the Model Rules do not permit such refunds. Further adjustments are required under 217(5)(b) for subsequent accounting periods and subsection (5)(c) requires the covered tax balance for the current year to be adjusted to exclude the amount of the decrease (if it has been reflected in the covered tax balance). Any further top-up amounts required as a result of the section 217(5) recalculations are collected under section 206 as additional top-up amounts.

Section 217(7) deals with the decrease in liability to covered taxes as a result of a tax loss from a later period being carried back to a prior period triggering a refund of tax for that prior period. The Commentary on Article 4.6.1 explains (in paragraphs 124-126) that this refund of covered taxes must be matched with a corresponding adjustment to make the treatment of carried back losses consistent with the treatment of carried forward losses. Therefore, the domestic tax loss is treated as giving rise to a deferred tax asset in the same way it would have done had it been set up as a carry-forward. Section 217(7) accordingly provides for a deferred tax asset to be established in the year in which the domestic tax loss is incurred. The amount of the deferred tax asset is the amount of the loss offset against profits in the prior period multiplied by the lower of 15% and the tax rate applied to the profits against which the loss was offset. The effect of section 182 is that the deferred tax asset will reduce the covered tax balance in the period in which the loss is generated. The deferred tax asset will be treated as reversed, thereby increasing the covered tax balance in the accounting period to which the domestic tax loss has been carried back. This will be simultaneous with the carry-back of the refund under section 217 to the prior period.

COMMENTARY ON SECTION 218

Section 218 is based on Article 4.6.2 (reduction in tax rate) and Article 4.6.3 (increase in tax rate) of the Model Rules although it jumbles the two together with both subsections (1) and (2) applying to 'changes' of tax rate. Subsection (1) applies where certain rate changes would (if recalculated) lead to a reduction of the member's covered tax balance in a previous accounting period, whereas subsection (2) applies to certain rate changes that would (if recalculated) increase the member's covered tax balance for a prior period. Section 218 provides that section 217 applies to these reductions of, or increases to, the covered tax balance for a prior period in consequence of the change of tax rate as it applies to decreases/increases in liability to covered taxes.

Subsection (1) deals with the scenario where the rate of tax changes in an accounting period and this would have the effect of reducing the member's covered tax balance in a prior period if

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

CHAPTER 8 - FURTHER ADJUSTMENTS

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

the deferred tax expense were recalculated. Section 217 applies to so much of the reduction as reflects the extent of the rate change that is relevant (see subsection (3)). In the case of an increase in tax rate, the effect of subsection (3)(a) is that the previous rate must be less than 15% and the increase in tax rate will be relevant up to 15%. So if the rate increases from 14% to 16%, it is only a reduction of the covered tax balance in the prior period in respect of the 1% increase to 15% that would be relevant and dealt with under section 217. In the case of a decrease in tax rate, the effect of subsection (3)(b) is that if the previous rate was 16% and the rate goes down to 14% it is only so much of the reduction in covered tax balance that reflects the drop from 15% to 14% which is taken into account under section 217, whereas if the previous rate had been 14% and it decreased to 12%, the full reduction of covered tax balance would be relevant.

When such reduction in covered tax balance for the prior period is insignificant, there will be an adjustment to the covered tax balance for the current period to reflect the amount of the reduction under section 217(4). When such reduction is not insignificant, section 217(5) will require recalculations for the prior period and any additional top-up amounts due would be collected under section 206 as a collective additional amount.

Subsection (2) deals with the scenario where the change of tax rate occurs after the deferred tax expense was taken into account in the covered tax balance for a prior period and then, in the current accounting period, the member's deferred tax expense reflects the reversal of deferred tax assets or liabilities recognised in that prior period. In this scenario, if the deferred tax expense in the prior period were to be recalculated to reflect the rate change and the result would be to increase the member's covered tax balance in that prior accounting period, section 217 applies to so much of the increase in covered tax balance as reflects the extent of the rate change that is relevant (in accordance with subsection (3)). Section 217(4) then applies to reflect in the covered tax balance of the member for the current period that amount of the increase in covered tax balance for the prior period.

COMMENTARY ON SECTION 219

Section 219 is based on Article 4.6.4 of the Model Rules and requires a recalculation of top-up tax and ETR for a prior accounting period for a territory to exclude an amount of current tax expense in excess of €1m which was previously included in the covered tax balance of a member for that prior accounting period but which has not then been paid within the three-year period from the end of that prior accounting period. Section 206 applies to the recalculation so there will be a collective additional amount for the current period to the extent that it is not reduced by a QDT credit in accordance with section 206(5)-(8).

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

CHAPTER 9 - SPECIAL PROVISION FOR INVESTMENT ENTITIES, JOINT VENTURE GROUPS AND MINORITY-OWNED MEMBERS

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 9 - SPECIAL PROVISION FOR INVESTMENT ENTITIES, JOINT VENTURE GROUPS AND MINORITY-OWNED MEMBERS

COMMENTARY ON SECTION 220

The earlier chapters often refer to 'standard members'. 'Standard members' is defined in section 132(3)(a) as not including investment entities (as defined in section 236(3)) or minority owned members (as defined in section 228). Chapter 9 explains the special rules which apply to these entities and the modifications to Part 3 which are made for the purposes of applying Part 3 to joint venture groups (as defined in section 226).

'Many multinationals will include entities that are not wholly owned. This means that they need specific rules, which are set out in clauses 226 to 229. Clauses 220 to 225 set out how the rules work for investment entities, which was a key ask for the insurance sector.' Victoria Atkins, Hansard 18 April 2023 Column 169.

Section 220 is based on Articles 7.4.1, 7.4.4 and 7.4.5 of the Model Rules. Subsection (1) sets out the steps for calculating the top-up amount of an investment entity. Subsection (2) provides that where a taxable distribution method election has been made under section 214, any positive undistributed income amount for the entity for the period is to be added to the top-up amount determined under subsection (1). Subsection (3) makes modifications to Chapter 4 for the purposes of determining the adjusted profits of the entity. The effect of subsection (3) is that although the ETR of an investment entity is calculated separately from the standard members in the territory, if there are several investment entities located in the same jurisdiction, a single ETR is computed for all investment entities in that territory (see paragraph 80 of the Commentary on Article 7.4.2).

COMMENTARY ON SECTION 221

Step 3 of the steps in section 220 to calculate the top-up amount of an investment entity is to determine the SBIE for the entity for the period. Section 221 explains how to determine the SBIE for an investment entity which is basically the same method (under section 195) as for determining the SBIE for a member that is not an investment entity. Step 4 then adjusts the SBIE in accordance with certain adjustments made to the SBIE for an investment entity under section 223. If the filing member has made an election not to calculate the SBIE for a period for the investment entities in a territory, the SBIE amount will be nil.

COMMENTARY ON SECTION 222

Section 222 is based on Articles 7.4.2 and 7.4.3 of the Model Rules and sets out the steps for calculating the investment entity ETR. The investment entity ETR is the combined covered tax balance of the investment entities in a territory divided by the total adjusted profits of the investment entities. Both the covered tax balances and the adjusted profits are subject to adjustments under section 223.

COMMENTARY ON SECTION 223

Section 223 makes adjustments to an investment entity's adjusted profits, SBIE and covered tax balance. There are two types of adjustment: an external holding adjustment if the investment entity is not wholly owned by members of the multinational group and no section 213

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

CHAPTER 9 - SPECIAL PROVISION FOR INVESTMENT ENTITIES, JOINT VENTURE GROUPS AND MINORITY-OWNED MEMBERS

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

transparency election has been made in relation to the entity (subsection (2)), and an election adjustment if an election has been made under section 213 or 214 in relation to the entity (subsection (3)).

Section 223(10) was inserted as Government amendment 13 to prevent adjustments being made twice. It provides that where an investment entity has an allocation of CFC tax which is included in the covered tax balance, the CFC amounts are not subject to adjustment under this section.

COMMENTARY ON SECTION 224

Section 224 makes modifications to sections 202 to 207 so they apply to a member of a multinational group that is an investment entity. This enables an investment entity to have additional top-up amounts.

COMMENTARY ON SECTION 225

Section 225 provides that section 200 (top-up amounts multiplied by inclusion ratio) applies to the attribution to a responsible member of top-up amounts and additional top-up amounts of an investment entity. Section 201 also applies but is modified in the ways prescribed by section 225(3).

COMMENTARY ON SECTION 226

Specific rules are required for joint ventures (JVs) the financial results of which are reported using the equity method in the consolidated financial statements of the ultimate parent because they would not normally be picked up by the MTT rules as the concept of multinational group includes only entities which are consolidated on a line-by-line basis in the financial statements of the ultimate parent (see section 126). Section 226 is based on Article 6.2 of the Model Rules which extends the application of the rules to JVs in which the ultimate parent of a multinational group subject to Pillar Two owns 50% or more of the JV. All of the income of a 50:50 JV where each JV partner is a multinational group subject to Pillar Two will be subject to the MTT rules whereas in a 51:49 JV, only 51% of the income will be subject to the Pillar Two rules, assuming the 51% is owned by a multinational group subject to Pillar Two.

A JV group is treated as a separate multinational group for the purposes of the MTT calculation. Section 226(2) takes the top-down approach to locate the JV parent of a multinational group and then that entity together with its JV subsidiaries are the 'joint venture group'. Certain entities are listed in subsection (2) as those that cannot be the JV parent.

COMMENTARY ON SECTION 227

The effect of treating the JV group as a separate group from the multinational group in which it sits is that the underlying profits and covered taxes of the JV group are not blended with those of entities in the multinational group and the accounting standard used in preparing the financial statements is the accounting standard of the JV not the UPE.

Once the top-up tax amounts of the members of the JV group are calculated, it is the responsible member of the multinational group of which JV group is under (or responsible members if it is 50:50) which is liable to MTT based on its allocable share of the top-up amounts and it is the filing member of the multinational group which has the responsibility to file returns and pay the MTT.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

CHAPTER 9 - SPECIAL PROVISION FOR INVESTMENT ENTITIES, JOINT VENTURE GROUPS AND MINORITY-OWNED MEMBERS

Chapter 10 - Definitions etc.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 228

Section 228 is based on Article 5.6 of the Model Rules. The effect is that minority-owned members (those in whom the ultimate parent holds no more than 30% of the ownership interests and which are not investment entities) are not included in the ETR and top-up tax computations of the multinational group. Instead, they compute their ETR and top-up tax separately from the rest of the multinational group, either as a minority owned subgroup or, if there is no subgroup, just the minority-owned member by itself.

The Commentary (page 134) explains the reason for the different rule:

> 'Special rules are needed for Minority-Owned Constituent Entities because a UPE may have several Minority-Owned Constituent Entities with operations in the same jurisdiction but with different groups of owners that are not Group Entities. If the income and taxes of these different Constituent Entities were blended in the jurisdictional ETR computations, low-tax outcomes in one Entity could result in a Top-up Tax for the jurisdiction, some of which would be borne by non-Group Entity owners of a different Constituent Entity. While this can occur to some extent under the normal jurisdictional blending rules, the magnitude of the effect in the context of Minority-Owned Constituent Entities and the potential detrimental impact on these investment structures justifies a different rule.'

COMMENTARY ON SECTION 229

Section 229 is based on Article 6.5 of the Model Rules and applies to modify how the general rules apply to multi-parent groups, as defined in subsection (6) as where the ultimate parents of two or more groups are party to a stapled structure or a dual-listed arrangement and at least one of the controlled entities of those groups is in a different territory as another controlled entity.

Subsection (1) provides that the constituent groups are to be treated as a single multinational group with MTT being charged in relation to that single group. The scope of membership of a multi-parent multinational group is broader than the section 126 definition of members and includes entities that would not be regarded under section 126 as members of any constituent group but in which a controlling interest is held by one or more members of the constituent groups.

Subsection (5) provides that unless a filing member has been nominated, the ultimate parents are jointly the filing member of the multi-parent group and are jointly and severally liable for a penalty for failure to comply with the obligations of the filing member. The ultimate parent of each constituent group must authorise the nomination of the filing member (see Schedule 14 paragraph 4(4)).

HMRC's guidance in (MTT15920) on the transitional safe harbour states that the CbC Report for multi-parent groups must cover all of its constituent groups to be qualifying (paragraph 3(8) of Schedule 16). See the coverage of Schedule 16 for more details on the transitional safe harbour election.

COMMENTARY ON SECTION 230

Section 230 introduces Chapter 10 which explains terms used in Part 3.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14
Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15
Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory
Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group
Chapter 5 - Covered Tax balance
Chapter 6 - Calculation of top-up amounts
Chapter 7 - Allocating top-up amounts to responsible members
Chapter 8 - Further adjustments
Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members
CHAPTER 10 - DEFINITIONS ETC.
Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

CHAPTER 10 - DEFINITIONS ETC.

COMMENTARY ON SECTION 231

Section 231 adopts a broad definition of entity based on Article 10.1 of the Model Rules including separate legal persons such as a company, as well as arrangements that prepare separate financial accounts in respect of the activities carried out under the arrangement, such as partnerships or trusts. It is because of this broad definition that it is necessary to provide in section 122 for another person to be chargeable to tax where the responsible member is not a body corporate or partnership.

Subsection (2) provides that an entity which is, or is part of, a government is not to be regarded as an entity for the purposes of Part 3. On the other hand, an entity which is wholly owned by a government will be an entity and, if within the scope of a 'governmental entity' (defined in section 234(1)), will be an excluded entity under section 127(3)(a).

COMMENTARY ON SECTION 232

It is an important part of the Model Rules that a PE of a main entity is treated as a separate and distinct entity from the main entity. This is reflected in section 232(3). The effect of this is that a qualifying multinational group could comprise a main entity and a PE.

Section 232(1) defines a PE as a place of business of the main entity located in a different territory to where the main entity is located and meeting any of the conditions in subsection (2). These conditions are based on the four limbs of the definition of PE in Article 10.1 of the Model Rules.

HMRC's draft guidance at MTT10120 explains: '"Place of business" takes the same meaning as it does in the OECD Model Tax Convention. It includes a deemed place of business for the purpose of the Model Tax Convention, a tax treaty, or the domestic law of a territory.'

COMMENTARY ON SECTION 233

This is not derived from the Model Rules but is specific to the UK's implementation of the rules. A protected cell company (PCC) as defined in section 233(3)) is not to be regarded as an entity but rather each part of the protected cell company is to be treated as an entity distinct from others and the accounts of a PCC are not regarded as consolidated financial statements for MTT purposes.

HMRC's draft guidance (MTT10130) explains what a PCC is and states that the tax treatment in section 233:

> 'reflects the economic reality that the core and each cell of a PCC are economically independent. Each constituent part of the PCC, being treated as a separate entity, will only be in scope of MTT if it is a member of a qualifying group. They are not to be treated as members of the same group simply by reason of their legal status as part of the same PCC. Consequently, a cell of a PCC may be a member of one qualifying group, while other cells are members of other groups (or not in scope at all). Two or more cells could be members of the same qualifying group if they share a common majority owner, though in practice this would be highly uncommon.'

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

COMMENTARY ON SECTION 234

Section 234 is based on Article 10.1 of the Model Rules and defines 'governmental entity' (an entity which meets the conditions set out in subsection (1)(a)-(f)), 'international organisation' (an entity which meets the conditions in subsection (2)(a)-(c) and 'non-profit organisation' (an entity which meets either of the conditions in subsection 3(a)(i) or (ii) and all of the conditions in subsection (4)).

See the draft guidance in MTT10230 although this uses the term 'government entity' rather than 'governmental entity' and the draft guidance in MTT10210 on the definition of 'non-profit organisation' which also includes guidance on 'qualifying non-profit subsidiary' which is defined in section 127(5).

Paragraph 26 of the Commentary on Article 10.1 explains that governmental entities are excluded entities as they are sovereign entities that are not typically subject to tax in their own territories and often benefit from exclusions from tax under foreign law or tax treaties. The condition that the governmental entity does not carry on a trade or business, other than an investment business managing or investing the assets of the government through investment activities (subsection (1)(d)) is intended to differentiate commercial enterprises owned by a government from entities limited to the activities set out in subsection (1)(b). For example, a commercial bank owned by the Government would not comply with subsection (1)(d) as it would be engaged in a trade or business.

COMMENTARY ON SECTION 235

A pension fund is an excluded entity. Section 235 defines pension funds and pension services entities and provides that a pension services entity is also considered to be a pension fund. The Commentary on Article 10.1 explains in paragraph 95 that the phrase 'exclusively or almost exclusively' is a test that depends on the facts and circumstances and requires that all, or almost all, of the activities of the pension services entity are those referred to in subsection (2)(a) and (b).

COMMENTARY ON SECTION 236

A key difference in form between the definition of investment entity in section 236 and the definition in Article 10.1 of the Model Rules is that the section 236(3) definition also includes an 'insurance investment entity' (defined in section 236(2)). This appears to be a simplification to avoid having to refer to insurance investment entities separately each time where the same rules are intended to apply to insurance investment entities as to investment funds, REITs and certain subsidiaries of investment funds or REITs. For example, following the agreement in the Administrative Guidance (see 3.2 'Exclusion of Insurance Investment Entities from the definition of Intermediate Parent Entity and Partially-Owned Parent Entity [AG22.04.T11]', insurance investment entities are treated the same as other investment entities and excluded from being a POPM of a group or an intermediate parent member of the group.

HMRC draft guidance (MTT10250) explains the definition of investment fund and REIT.

COMMENTARY ON SECTION 237

Section 237 is based on Article 10.1 of the Model Rules as amended by the Administrative Guidance to exclude insurance investment entities from the definition of intermediate parent entity and partially-owned parent entity. Subsection (1) defines a POPM as a member of a multinational group which is not a PE, investment entity (note the definition of investment

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

entity includes an insurance investment entity) or the ultimate parent and it has an ownership interest in another group member and more than 20% of the ownership interests entitling the owner to a share of profits are held by non-group members. Subsection (2) defines an intermediate parent member as a member of a multinational group which is not a PE, investment entity, a POPM or the ultimate parent and it has an ownership interest in another member of the group. See section 128 (Responsible members) for the implications of an entity being an intermediate parent member or a POPM.

COMMENTARY ON SECTION 238

The definition in section 238 is relevant to sections 167-171 (Dealing with transparency and entities subject to a qualifying dividend regime), section 209 (When transfer of controlling interest treated as acquisition of assets and liabilities) and section 213 (Investment entity tax transparency election). An entity is treated as tax transparent in a territory if that territory does not impose covered taxes on the entity and treats the direct owners of the entity as earning their respective shares of the entity's income, expenditure, profits and losses directly in proportion to their interest in the entity for the purposes of covered taxes.

COMMENTARY ON SECTION 239

Generally, an entity is located where it is tax resident or, failing that, in the jurisdiction where it was created. A special rule applies to a flow-through entity or a PE (see section 240). If an entity is taxed as resident in more than one territory a tie-breaker will locate the entity in one territory (under subsection (3) on the basis of a determinative tax treaty, or, where there is no determinative tax treaty, under the series of tie-breakers set out in subsection (4) taken in order.

A stateless entity is treated as not being located in any territory under subsection (7)(a) but is treated as located in its own separate nominal territory under section 132(3)(b). This ensures there is no jurisdictional blending between stateless entities. Instead, each stateless entity will perform a separate calculation to determine the top-up tax charge.

Subsection (7)(b) ensures that where the location of an entity changes during an accounting period it is treated as located in the territory where it was located at the start of the accounting period.

Subsection (6) overrides the location determination for entities treated as not located in the UK as a result of a tie-breaker in order to treat them as located in the UK where conditions (a)-(d) are met, but only for the purposes of chargeability (section 122) and determining whether a group is a multinational group (section 126).

> 'This ensures that groups with an entity that is UK tax resident will not avoid being charged MTT as a result of dual residency.' (MTT18010)

See MTT18000.

COMMENTARY ON SECTION 240

If the flow-through entity is a responsible member of a multinational group, it is located in the territory where created, otherwise it is a stateless entity. The location of a PE depends on which of the four conditions in section 232(2) it meets as shown in Table 4 - PE location below.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Table 4 - PE location

Section 232 condition		Location determined by	Section 240 reference
(a)	(treated as PE in accordance with tax treaty)	Relevant tax treaty	240(3)
(b)	(PE taxed on similar basis to residents in absence of tax treaty)	Where subject to net basis taxation based on business presence	240(4)
(c)	(PE located in territory without corporate income tax)	Where situated	240(5)
(d)	(any other PE)	Stateless entity	240(6)

COMMENTARY ON SECTION 241

Section 241 provides that the UK is a Pillar Two territory and that there will be regulations which specify other Pillar Two territories. In order to be included in the list, a territory must have provisions equivalent to Part 3 in effect, or which will be in effect, on or before the date of the specification in the regulations has effect. Subsection (3) provides that territories can be specified as a Pillar Two territory from a date before the regulations are made, but regulations cannot remove a specification retrospectively.

COMMENTARY ON SECTION 242

In Part 3 'ownership interest' may be a direct ownership interest (see subsection (2)) or an indirect ownership interest (see subsection (3)). A 'controlling interest' is defined in subsections (4)-(6). An ownership interest that R has in S will be a 'controlling interest' if S is a PE of R or, as a result of the ownership interest, R must consolidate the assets, liabilities, income and expenses of S on a line by line basis in accordance with an acceptable financial accounting standard, or R would have been required to do so if it had prepared consolidated financial statements (the deemed consolidation rule). According to MTT17020, if S is not required to be consolidated with R according to any applicable authorised accounting standard, R will not have a controlling interest in S through the deemed consolidation rule: 'For example, an authorised accounting standard may not require, or may specifically not permit, the consolidation of investment entities.'

The draft HMRC guidance explains that for MTT purposes a tax transparent entity such as a partnership is an entity. The partners in a partnership accordingly have indirect ownership interests in entities owned by the partnership. It is the partnership itself that is regarded as the holder of the direct ownership interests in the entities owned by the partnership (see MTT17020).

COMMENTARY ON SECTION 243

Section 243 ensures that where it is necessary to determine the percentage ownership interest, including direct and indirect interests, that a specific person holds in an entity, both types of interest are considered and the double counting of interests is prevented. See MTT17040 for a worked example of how section 243 applies.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

Section 243 does not apply where a provision requires the calculation of direct ownership interests (subsection (2)).

COMMENTARY ON SECTION 244

Where it is necessary to determine the aggregate percentage ownership interest that a certain class of entity holds in an entity section 244 applies. MTT17050 gives the example of section 236(3)(c)(i) which tests whether an entity is an investment entity. Section 244 ensures that both the direct and indirect interests held by the relevant entities are considered and prevents the double counting of interests. Section 244 does not apply where only direct interests are considered or when assessing the percentage ownership interest held in an entity by excluded entities (see section 245).

COMMENTARY ON SECTION 245

A different rule is required from section 244 for determining the tests for two of the excluded entities: whether an entity is a qualifying service entity (section 127(6)(a)) or qualifying exempt income entity (section 127(7)(a). These tests require that indirect interests are not disregarded if held through a chain of qualifying service entities and qualifying exempt income entities. Section 245 prevents double counting in this scenario. See the example in MTT17060. The draft HMRC Guidance explains:

> 'The effect of this rule is that, for the purposes of the tests, we look through all ownership interests held by qualifying service entities and qualifying exempt income entities. The total interests recognised will always add up to 100%.'

COMMENTARY ON SECTION 246

Subsections (1) and (2) provide the rules for calculating the percentage of direct ownership interest. Subsections (3)-(5) provide the rules for calculating the percentage of indirect ownership interest.

See MTT17030 for a worked example of calculating direct interests. For indirect interests, the draft HMRC Guidance explains:

> 'Indirect interests are calculated in the same way as for many other tests of this type, such as the level of ownership for corporation tax group relief. Determine the direct interests held by each entity in the chain of entities (using the averaging process [set out in the example for direct interests] above in each case) and multiply these percentages for each entity up the chain in turn to determine the indirect ownership for each entity. If an entity has indirect interests in another entity via multiple ownership chains, its total indirect interest will be the aggregate of these interests.'

COMMENTARY ON SECTION 247

Section 247 provides that transfers of ownership interests in an entity are to be treated as effective at the earlier of the times in subsection (1)(a) and (b) rather than at any earlier time when the transfer is effective. See MTT17010.

COMMENTARY ON SECTION 248

MTT17030 explains that the reason for ignoring interests arising solely as a result of the ownership interest in the ultimate parent is that, in some cases, for example when determining

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

whether an entity is a POPM, it is necessary to test the ownership interest held in an entity by persons who are not members of the group.

> 'The ownership interest includes direct and indirect interests, so if indirect interests held through the ultimate parent were not excluded, even a wholly-owned subsidiary of the ultimate parent would be considered to have ownership interests held outside of the group.'

COMMENTARY ON SECTION 249

Section 249 explains what consolidated financial statements of an entity means in different scenarios. As the consolidated financial statements are the starting point for the amounts to be fed into the MTT calculations it is important that they meet the authorised accounting standards and in certain cases, adjustments are required to prevent material competitive distortions (see subsection (5)) where these standards are not met. See MTT17010.

COMMENTARY ON SECTION 250

Section 250 defines 'acceptable accounting standards' as meaning UK GAAP (defined in subsection (2)), acceptable overseas GAAP (defined in subsection (3)) or international financial reporting standards (defined in section 259).

Subsection (3) lists the territories which are considered to have 'acceptable overseas GAAP'. This initial list is comprised of 13 territories and any EEA state, but regulations may be made under subsection (4) to add or remove territories. Such regulations do not require prior approval of the House of Commons (see section 263(4)).

COMMENTARY ON SECTION 251

Section 251 sets out the general rule in subsection (1) that accounting period means the accounting period for which the ultimate parent member prepares its consolidated financial statements. If there are no consolidated financial statements prepared, references to 'accounting period' mean the period of a year beginning 1 January, subject to the rules in subsection (3).

COMMENTARY ON SECTION 252

Section 252 is based on Article 1.4.1 of the Model Rules and the amendments to the Commentary reflecting the Administrative Guidance to ensure that a sovereign wealth fund cannot be the ultimate parent of a multinational group and will not be considered part of a multinational group. A sovereign wealth fund means a governmental entity within the definition of section 234(1)(b)(ii). (Note that subsection 252(3) uses the term 'government entity' but it is clear it is supposed to refer to 'governmental entity' as that is the term used in section 234 and throughout the legislation.) Where, apart from section 252, a sovereign wealth fund would be the ultimate parent, subsection (2) provides that entity A, in which the sovereign wealth fund has a controlling interest as a result of direct ownership interests, will be regarded as the ultimate parent of a consolidated group consisting of A and the entities in which A has a controlling interest. Paragraph 36.4 added to the Commentary on Article 1.4.1 by the Administrative Guidance explains that this is intended to avoid a group with less than a €750m threshold on its own being treated as part of a larger group that is within the scope of the GloBE Rules just because the group was owned by a government through a sovereign wealth fund rather than being owned directly by the government. Section 252 ensures that a sovereign wealth fund that qualifies as a Governmental Entity under section 234(1)(b)(ii) receives

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

equivalent treatment to that of the government and the separate multinational groups would not have been considered as a single multinational group for purposes of the GloBE Rules if they had been held directly by the government.

COMMENTARY ON SECTION 253

The definitions in this section are used in the following places of Part 3: section 138(2)(f) provides that a disqualified refundable imputation tax (see section 253(1)) is a tax expense amount to be added back to the underlying profits of a member but is not to be regarded as covered taxes (see section 173(2)(d)). A refundable tax credit cannot be a QRTC if it is creditable or refundable pursuant to a qualified refundable imputation tax (see section 253(2)) or a disqualified refundable imputation tax (section 148(3)).

COMMENTARY ON SECTION 254

Where Part 3 requires currency to be converted, the exchange rate to be used is the average exchange rate for the accounting period to which the amount relates.

COMMENTARY ON SECTION 255

The term 'Pillar Two rules' is used throughout Part 3 and the definition in section 255 takes into account that the rules are continuing to evolve. The starting point is the Model Rules themselves but they are to be interpreted in accordance with, and supplemented by, the Commentary and any further commentaries and guidance published at any time by the OECD (including the Pillar Two Examples). This would also include the Administrative Guidance and the Safe Harbours Guidance.

COMMENTARY ON SECTION 256

The UK's domestic top-up tax (see Part 4) is a qualifying top-up tax. Domestic top-up taxes of other countries that are considered 'equivalent in substance' to the UK's domestic top-up tax will also be qualifying domestic top-up tax if specified in regulations. The specification may have effect retrospectively but if a tax ceases to be qualifying, the regulations cannot specify that it has ceased to be qualifying before the regulations are made. Certain differences in the calculations of the tax are permitted by subsection (3).

COMMENTARY ON SECTION 257

The UK has not yet implemented an undertaxed profits rule ('UTPR') but some territories have. Regulations will specify taxes which are a 'qualifying undertaxed profits tax' (they must be an appropriate means of implementing the UTPR under the Pillar Two rules) or which cease to be such.

COMMENTARY ON SECTION 258

'Connected' means 'closely related' within the meaning of Article 5(8) of the OECD Model Tax Convention. The term 'connected' is used in section 151 (Adjustments for companies in distress), section 212 (Meaning of 'qualifying reorganisation') and section 236 (Investment Funds and investment entities). In summary, this means that where according to the relevant facts and circumstances one person or entity has control of the other or both are under the control of the same persons or entities they will be connected. Based on the second limb of Article 5(8) of the

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

CHAPTER 10 - DEFINITIONS ETC.

Chapter 11 - General and miscellaneous provision, and Schedules 16 and 17

OECD Model Tax Convention, persons or entities will automatically be connected where one person or entity:

> 'possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or [a third party] possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the [entity] or in the two [entities].'

COMMENTARY ON SECTION 259

Section 259 contains a number of definitions for Part 3 (including 'uncertain tax position') and sets out the test for tax residence of an individual (subsection (2)). Unless the context otherwise requires it, terms which have a meaning for accounting purposes (defined as for the purposes of accounts drawn up in accordance with acceptable accounting standards) also have that meaning for the purposes of Part 3. Examples of such terms are given in subsection (4) and include 'deferred tax' and 'tax expense'.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

CHAPTER 11 - GENERAL AND MISCELLANEOUS PROVISION, AND SCHEDULES 16 AND 17

CHAPTER 11 – GENERAL AND MISCELLANEOUS PROVISION

COMMENTARY ON SECTION 260

This section introduces Schedule 16 which makes transitional provisions.

COMMENTARY ON SCHEDULE 16

Part 1: General transitional measures

Part 1 contains general transitional measures. Paragraph 1 provides for relief for the substance-based income exclusion at rates that decrease over time (see sections 195–198 for details). Paragraph 2 is an anti-avoidance provision dealing with intra-group transfers on or after 1 December 2021 and before entry into the regime and is based on Article 9.1.3 of the Model Rules which disallows a basis step-up when a taxpayer transfers assets during the transition period to ensure the gain does not escape inclusion in the GloBE base. Paragraph 2 was amended during the passage of the Finance Bill by Government amendments 15-20. According to Hansard (column 169) amendments 15-20 are to 'ensure that the transitional rules work effectively'. The explanatory statement on amendment 15 states it is to ensure the anti-avoidance rule applies in relation to intra-group transfers from a member of a multinational group until that member is fully subject to the Pillar Two regime. See MTT15900.

Part 2: Transitional safe harbour

Part 2 contains the transitional country-by-country safe harbour rule as agreed in the Safe Harbours Guidance to ensure that the GloBE Rules do not impose a disproportionate compliance burden in the first years of the regime on multinational groups in respect of their operations in high-tax and other low-risk jurisdictions. Paragraph 9 of that document explains:

> 'The design of the safe harbour is focused on bright-line rules that use readily available and easily verifiable data rather than seeking to achieve a high degree of precision by undertaking the full GloBE calculations for a jurisdiction.'

MTT15900 explains that the scope of MTT is intended to align as closely as possible to that of Country-by-Country Reporting (CbCR) and that in most instances, multinational groups that qualify for MTT will also be obliged to complete a report for CbCR. The safe harbour permits groups to use the figures from CbCR to assess if MTT is likely and, if the simplified calculations show non top-up tax chargeable, the group can make an election to be treated as having no top-up tax amount for that period (including, according to MTT15900, additional top-up tax amounts that may be calculated in respect of that period in subsequent periods). This avoids the group having to undertake full ETR calculations.

> 'The calculations required by the safe harbour mainly rely on the figures already determined for the CbC Report, so most groups will not suffer significant additional compliance obligations when assessing whether they qualify for the safe harbour.' (MTT15900)

Chapter 1 contains the transitional safe harbour election which may be made under paragraph 3 on an annual basis by the filing member of a multinational group to specify that all the standard members of the group located in a particular territory do not have top-up amounts or additional top-up amounts for an accounting period. For the purposes of the transitional country-by-

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

CHAPTER 11 - GENERAL AND MISCELLANEOUS PROVISION, AND SCHEDULES 16 AND 17

country safe harbour, 'standard members' is to be read in Part 2 of Schedule 16 as including 'minority owned members' and some investment entities are also covered by the safe harbour (see paragraph 11 (discussed below) which treats some investment entities as standard members for the purposes of part 2).

> 'In the main rules, minority owned members are ring fenced, but they are undifferentiated in the CbCR rules. As a simplification, there is no separate treatment of minority owned members for safe harbour purposes. Minority owned members are included in the safe harbour calculations for their territory and are covered by the safe harbour where the entities in the territory have qualified for it altogether.' MTT15960

In order for an election to be made, conditions (a)-(e) of sub-paragraph (2) must be satisfied. Condition (a) limits the time when an election can apply to accounting periods commencing on or before 31 December 2026 and ending on or before 30 June 2028. Condition (b) requires a qualifying country-by-country report (QCBCR) to have been prepared in relation to the territory for the period. The effect of condition (c) is that the election has to be made for each accounting period commencing on or after 31 December 2023 in respect of a territory from the start of the application of the Pillar Two rules to members in that territory in order to be made in later accounting periods. Condition (d) denies an election for a territory where a deemed distribution election (under section 189) has been made for members in that territory for the accounting period. Condition (e) sets out three tests, only one of which need be met: the threshold test (paragraph 7), the simplified ETR test (paragraph 8) or the routine profits test (paragraph 9).

HMRC's guidance on condition (c) states:

> 'If the group has already completed the full multinational top-up tax calculations for a territory, they cannot make the election again for subsequent periods. This "once out, always out" approach applies because the purpose of the safe harbour is to reduce the compliance obligations of the group when preparing systems for MTT compliance when first entering the regime.' (MTT15910)

The threshold test is basically a de minimis test similar to the Section 199 election de minimis test. It is met if the revenue of standard members in the territory for the period as shown in the QCBCR is less than €10m and the aggregate profit (loss) before income tax of those members for the period is less than €1m (paragraph 7(1)). Paragraph 7(2) ensures that where the group includes members held for sale which may not be included in CbCR an adjustment is required to include the revenue of those members for the purposes of the revenue test. See MTT15930.

The simplified ETR of the standard members of a group in a territory for an accounting period is calculated by dividing the total qualifying income tax expense (defined in paragraph 5 to mean income tax expense adjusted to exclude any amount that does not relate to covered taxes and any amount relating to an uncertain tax position) of those members for the period by the total profit (loss) before income tax of those members for that period and expressing the result as a percentage. The simplified ETR test is met if it is equal to or greater than the transition rate (15% for an accounting period beginning before 1 January 2025, 16% for an accounting period beginning in 2025 and 17% for an accounting period beginning on or after 1 January 2026) (paragraph 8). The simplified ETR is not used to calculate any top-up liabilities, it is solely used to determine whether this test for the transitional safe harbour is met.

The routine profits test is met for a territory for an accounting period if the qualified SBIE amount (defined in paragraph 9(2)) for that territory for that period is equal to or greater than the total profit (loss) before income tax for that period of the standard members of the group located in that territory, or the total profit (loss) before income tax of those members is nil or

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

CHAPTER 11 - GENERAL AND MISCELLANEOUS PROVISION, AND SCHEDULES 16 AND 17

reflects an overall loss (paragraph 9(1)). The SBIE amount must be calculated according to the rules required under the full MTT calculation (see section 195 and paragraph 1 of Schedule 16) except that the payroll and tangible asset carve-out amounts are ignored for any member that, for CbCR purposes, is not regarded as located in the territory or being a constituent entity of the group.

Paragraph 3(3) prevents the safe harbour election being available in the territory of the ultimate parent if it is a flow-through entity unless its adjusted profits after the application of section 170 would be nil or all of the adjusted profits of the ultimate parent would be attributed to one of more PEs, and no income or expense of any PE would be attributed to the ultimate parent in accordance with section 160. In both these cases the ultimate parent would have no adjusted profits in the main MTT calculation. According to MTT15960:

> 'Because the ultimate parent that is a flow-through entity is stateless for CbCR purposes, there is effectively an alignment between the CbCR and MTT rules in such cases.'

The election must be made in the information return specifying which of the tests referred to in condition (e) of paragraph 3(1) are being relied on and including any evidence of how that test is met (paragraph 3(6)).

See the commentary and Table 2 - Elections under Schedule 15 for further details about the election.

Paragraph 4 explains the basis of the calculations for Part 2 of Schedule 16. Paragraph 4(3A) was inserted (as Government amendment 20) to make it clear that when determining whether the transitional safe harbour provisions apply for the purposes of MTT, revenue and profits are to be as stated in a CbC Report or adjusted as if they were included in such a report.

Paragraph 6 requires adjustments where the ultimate parent is subject to a deductible dividend regime (paragraph 6(1)-(2)), where there are net unrealised fair value losses (paragraph 6(3)-(6)), where an investment entity tax transparency election has been made under section 213 (paragraph 6(7)) and where a taxable distribution method election has been made under section 214 (paragraph 6(8)). See MTT15925 for details of these adjustments.

Chapter 2 of Part 2 contains provisions to modify the rules for joint venture groups (paragraph 10), investment entities in the same territory as owners (paragraph 11) and minority owned members (paragraph 12). The intention of these modifications is to align the safe harbour tests to the main rules of MTT, whilst ensuring as much simplicity as possible (MTT15960).

Entities in a joint venture group (defined in section 226) are not included in a CbCR and so the first modification is to remove the requirement for a QCBCR (paragraph 10(a)) and to require the figures to be taken from financial statements which meet the same requirements imposed under CbCR (paragraph 10(c)). The effect of paragraph 10(c) is that the qualified SBIE for a joint venture group is calculated in the normal way for a joint venture group as ring-fenced from the rest of the group.

The only investment entities to be included in the safe harbour calculations and to be covered by the safe harbour are those where all the members of a multinational group with a direct ownership interest in an investment entity are located in the same territory as the investment entity (paragraph 11). The full MTT calculation would need to be made for other investment entities in the group.

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

CHAPTER 11 - GENERAL AND MISCELLANEOUS PROVISION, AND SCHEDULES 16 AND 17

COMMENTARY ON SECTION 261

Part 3 is peppered with defined terms. Section 261 introduces Schedule 17 which is a list of defined terms and where they are defined or explained. It is not a comprehensive list however, as some terms are not included in this list (such as 'reverse hybrid entity' (section 168(11)) 'accounting period' (section 251) and 'sovereign wealth fund' (section 252)).

COMMENTARY ON SECTION 262

At the time of enacting the legislation, discussions are ongoing on how to resolve several issues with the Pillar Two rules so in anticipation of changes being required to align the legislation with the Pillar Two rules to ensure consistency, section 262 provides a time-limited power to make regulations to make further provision about the application of Part 3 or Schedules 14-16 (subsection (1)(a)) or to amend the legislation (subsection (1)(b)). The power may not be exercised after 31 December 2026. Past experience shows (for example, in the context of the hybrid mismatch rules which the UK adopted early) that we are likely to see many amendments as the rules bed down and issues are spotted with how they work in practice.

Section 262 does not state that the regulations may have retrospective effect but it is expected that certain changes, for example to correct errors under section 262 (1)(b), would be made retrospective unless they are to the detriment of taxpayers. Any further provisions made under section 262 (1)(a) would likely follow whatever timing is agreed by the Inclusive Framework.

Regulations made under section 261(b) are subject to prior approval by the House of Commons but those made under section 261(a) are subject to the negative resolution procedure (section 263(3)).

COMMENTARY ON SECTION 263

Regulation-making powers are granted under five sections as shown in Table 5 - Regulations below. Section 263 provides that the power to make regulations under Part 3 may also be used to make other necessary changes (see subsection (1)) and that the regulations are to be made by statutory instrument (subsection (2)). Regulations made under section 261(b) (to amend Part 3 or Schedules 14-17) are subject to prior approval by the House of Commons but other regulations under Part 3 are subject to the negative procedure (subsections (3) and (4)).

Table 5 - Regulations

Section	Effect of regulations
241	Specify a territory as a 'Pillar Two' territory
250	Add or remove territories to the list of those with 'Acceptable overseas GAAP'
256	Specify a tax as a 'qualifying domestic top-up tax'
257	Specify a tax as a 'qualifying undertaxed profits tax'
262	Make further provisions to Part 3 or Schedules 14-16 or amend Part 3 or Schedules 14-17

INDEX

Chapter 1 - Introduction and Charge, and Schedule 14

Chapter 2 - Qualifying Multinational Groups and their members, and Schedule 15

Chapter 3 - Effective Tax Rate of members of a Multinational Group in a Territory

Chapter 4 - Calculation of adjusted profits of Members of a Multinational Group

Chapter 5 - Covered Tax balance

Chapter 6 - Calculation of top-up amounts

Chapter 7 - Allocating top-up amounts to responsible members

Chapter 8 - Further adjustments

Chapter 9 - Special provision for Investment Entities, Joint Venture Groups and Minority-owned members

Chapter 10 - Definitions etc.

CHAPTER 11 - GENERAL AND MISCELLANEOUS PROVISION, AND SCHEDULES 16 AND 17

COMMENTARY ON SECTION 264

This section sets the commencement date for Part 3. It applies to accounting periods (defined in section 251) commencing on or after 31 December 2023.

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