International Tax Policy

The New Pillar 2 Side-by-Side Framework

Overview of Key Updates and Implementation Guidance

Effective Date
January 2026

Scope
Global MNEs

Framework Overview

Executive Overview

The New Framework at a Glance

Effective Date

1 January 2026

Applies to **fiscal years beginning on or after** this date. MNEs must assess qualification and prepare compliance frameworks immediately.

Core Purpose

A Side-by-Side (SbS) System

Allows certain qualifying domestic tax regimes to operate alongside the Pillar Two rules, creating a dual-framework approach.

Three Key Outcomes

01 **Simplifications**

Through **enhancement and extension** of existing safe harbours, reducing compliance burden for qualifying MNEs.

02 **Extended Treatment**

Favorable Pillar Two treatment extended to **more types of tax incentives**, particularly those tied to substance.

03 **US MNE Carve-Out**

Effectively carves out US MNEs from Pillar Two scope through Qualified SbS regime recognition.

Core Framework

Qualified SbS & UPE Regimes

The Dual-System Design

Qualified SbS Regime

United States Recognised

A jurisdiction must have a **dual-system design** that minimizes the risk of an ETR below 15%. For FYs starting on or after 1 January 2026, the IIR and UTPR may not apply to US MNEs.

Domestic System

- ✓ Statutory CIT rate ≥ **20%**
- ✓ **QDMTT or CAMT** (nominal rate ≥15%)
- ✓ No material risk of ETR <15%

Worldwide System

- ✓ Covers **foreign branches & CFCs**
- ✓ Mechanisms to address **BEPS risks**
- ✓ **FTC availability** for QDMTTs paid

All-or-Nothing Application: If elected by the UPE, applies to **all Constituent Entities** including Stateless Entities, MOCEs, POPEs, and Joint Ventures.

Qualified UPE Regime

For MNE Groups with their **Ultimate Parent Entity (UPE)** in a jurisdiction with a Qualified UPE regime, the Top-up Tax under the UTPR is deemed to be zero for that UPE jurisdiction.

Qualification Criteria

- ✓ Nominal CIT Rate: **At least 20%**
- ✓ **QDMTT or CAMT** with nominal rate ≥15%
- ✓ No material low-tax risk on domestic operations

Replaces: Expired Transitional UTPR Safe Harbour (ended 31 Dec 2025)

Status: As of 5 January 2026, **no jurisdiction** has been recognised

Note: GloBE Information Return (GIR) still required

Tax Incentives

Substance-Based Tax Incentives (SBTI) Safe Harbour

Eliminating Top-up Tax for Real Economic Activity

Objective & Mechanism

Eliminate Top-up Tax (TuT) attributable to **Qualified Tax Incentives (QTIs)** that support real economic activity. QTIs are treated as an increase to Covered Taxes, limited by a Substance Cap.

Expenditure-Based

- ✓ Tax credits linked to **incurred costs**
- ✓ **Super-deductions** for eligible expenditure

Production-Based

- ✓ Incentives based on **volume of tangible goods**
- ✓ Produced **within the jurisdiction**

Substance Cap

Default Method

5.5%

× greater of eligible payroll or tangible asset depreciation

Elective (5-year)

1%

× carrying value of eligible tangible assets

Election for QRTCs/MTTCs

MNEs can elect to treat certain **QRTCs/MTTCs as QTIs**, excluding them from GloBE Income and treating as an increase to Covered Taxes (subject to cap).

Industry Impact

Benefits **manufacturing and asset-intensive industries**. Service-oriented sectors may face challenges due to capital expenditure focused design.

Key Takeaway

A **narrow, conditional framework** recognising only incentives demonstrably linked to sustained economic substance. Ongoing monitoring and ETR modelling essential.

Compliance Simplification

Simplified ETR Safe Harbour

Streamlined Compliance Using Financial Statement Data

Core Concept

Calculate jurisdictional ETR using **Consolidated Financial Statement (CFS)** data with minimal adjustments. Top-up Tax is deemed zero if ETR ≥15% .

Simplified ETR Formula

Simplified Taxes / Simplified Income

Derived from JPBT & JITE in the CFS

Timing & Election

2027 Mandatory — All jurisdictions must offer it

2026 Optional — Early adoption available

Flexible Election: Unlike "once-out, always-out", MNEs can **opt-in or out annually**

Key Adjustments

Simplified Income

- Remove excluded dividends, equity gains/losses
- Add fines; conditional equity items

Simplified Taxes

- Remove non-Covered Taxes
- Include DTLs for asset recovery/R&D

Four Integrity Principles

Single Tax
No double counting

Matching
Same period recognition

Full Allocation
All profit/loss allocated

Single Expense
No double deduction

Entry/Re-entry Test: Requires **no Top-up Tax liability in the jurisdiction for the preceding two fiscal years**

Strategic Planning

Implementation Roadmap & Strategic Implications

Extended CbCR Safe Harbour

New Applicability Period

Applies to FYs beginning **on or before 31 December 2027**. Does not include any FY that ends **after 30 June 2029**.

ETR Threshold

The safe harbour ETR threshold remains at 17% for this extended year, consistent with FY 2026.

Implementation Timeline

Jan 2026 — **SbS Framework Effective**
US MNEs carved out; QDMTTs become primary enforcement

2026 Optional — **Early Adoption**
Simplified ETR Safe Harbour available in select jurisdictions

2027 Mandatory — **Simplified ETR Mandatory**
All jurisdictions must offer the safe harbour

Jun 2029 — **CbCR Safe Harbour Ends**
Transitional period concludes

Strategic Implications for MNEs

Assess Qualification

Evaluate eligibility for SbS, UPE, SBTI, and Simplified ETR safe harbours based on jurisdictional operations.

Model ETR Impact

Conduct scenario analysis on QTI benefits, substance cap limitations, and safe harbour applicability.

Ensure DTA Tracking

Maintain robust deferred tax asset tracking systems for Simplified ETR calculations and recapture rules.

Monitor Changes

Track jurisdictional regime changes, new incentive programs, and Inclusive Framework guidance updates.