IFRS Accounting

Staff paper

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Project	**Presentation of Taxes or Other Charges that Are Not Tax Expense or Tax Income Applying IAS 12 *Income Taxes* (IFRS 18)**
Topic	**Possible ways forward**
Contacts	Stefano Tampubolon (stampubolon@ifrs.org)

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Introduction

1. As Agenda Paper 12A explains, members of the IFRS Interpretations Committee (Committee) discussed possible ways forward for the International Accounting Standards Board (IASB) to respond to concerns about applying the requirements in IFRS 18 to particular non-income tax charges. As Agenda Paper 12C notes, these comprised:

   (a) not amending IFRS Accounting Standards (Alternative I); or

   (b) amending IFRS 18 (Alternative II).

2. This paper analyses those ways forward. This paper supports the information and analysis in Agenda Paper 12A and does not include any questions for the IASB.

3. We have explored only the suggestions made by Committee members. We have not identified another feasible and narrow way to amend IFRS 18 (or another IFRS Accounting Standard) to address the concerns, and we agree with Committee members who said the IASB should not:

   (a) amend IAS 12 *Income Taxes*; or

   (b) address specifically the classification of only zakat or SA zakat.

Structure

4. This paper analyses:

   (a) Alternative I—Not amending IFRS Accounting Standards (paragraphs 6–11);

   (b) Alternative II—Amending IFRS 18 (paragraphs 12–31).

5. This paper has two appendices:

   (a) Appendix A reproduces paragraphs 6–12 of Agenda Paper 12 for the IASB's April 2023 meeting which provide a more detailed background and explanation of the Pillar Two model rules.

   (b) Appendix B reproduces excerpts from the OECD's *Consolidated Commentary to the Global Anti-Base Erosion Model Rules* (Commentary)[1] relating to the definition of 'covered taxes'; and

Alternative I—Not amending IFRS Accounting Standards

6. As noted by a few Committee members, the IASB could not amend IFRS Accounting Standards. If the IASB chooses this alternative, we also suggest the IASB consider not objecting to the agenda decision or the updates to the two related agenda decisions.

7. Applying IFRS 18—and as reinforced by agenda decision (see Agenda Paper 12A)—the entity cannot classify a non-income tax charge in the income taxes category. We understand an entity would generally classify non-income tax charges (like SA zakat) in the operating category.

8. If an entity views the outcome of applying the requirements in IFRS 18 to particular non-income tax charges as not providing useful information, the entity would be required, or able, to provide additional information to users of financial statements (users) by considering other IFRS 18 requirements—for example, those relating to:

[1] OECD (2025), *Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti Base Erosion Model Rules (2025): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/a551b351-en.

(a) aggregation or disaggregation (paragraphs 41–43 and B16–B28), particularly disaggregation of items based on dissimilar characteristics in the primary financial statements and in the notes to the financial statements (paragraph B17 of IFRS 18)—applying these requirements, an entity might be required/ able to for example, disaggregate and present SA Zakat as a separate line item;

(b) presentation of 'additional line items and subtotals if such presentations are necessary for a primary financial statement to provide a useful structured summary' (paragraphs 24 and B9 of IFRS 18)—applying these requirements, an entity might be required/ able to present, for example, an additional sub-total showing operating profit before SA zakat; and

(c) identification and disclosure of management-defined performance measures (MPMs) (paragraphs 117–125 and B113–142 of IFRS 18).

9. This alternative would avoid disrupting entities' ongoing implementation of IFRS 18, particularly given IFRS 18's imminent effective date of 1 January 2027. While feedback from users (see Agenda Paper 12B) suggests that classifying non-income tax charges that are similar to income taxes (like SA zakat) outside of the income taxes category might not provide the most useful information, entities could still provide users with information about those charges through the use of additional line items, disaggregation and MPMs.

10. However:

(a) as Agenda Paper 12C summarises, the IASB has already heard significant concerns from respondents to the tentative agenda decision about the outcome of applying IFRS 18 to particular non-income tax charges. Feedback from users also confirms that the application of the requirements in IFRS 18 to non-income tax charges might not produce the most useful information. Deciding not to amend IFRS 18 at this stage would leave those concerns unresolved.

(b) there could be costs for preparers in providing the information discussed in paragraph 8 of this paper and for users that currently consider some non-

income tax charges together with income taxes to make appropriate adjustments.

(c) stakeholders, including users we spoke with, expressed a preference for amending IFRS 18 to address this matter, while suggesting that the use of additional line items, disaggregation and MPMs would help but not sufficiently address their concerns.

11. If the IASB decides not to amend IFRS 18, it could monitor the implementation of IFRS 18, particularly in relation to the classification of non-income tax charges. If issues arise in this regard, the IASB could consider them more holistically through, for example, IFRS 18's post-implementation review.[2]

Alternative II—Amending IFRS 18

12. This section analyses suggestions for ways to amend IFRS 18. These include amending IFRS 18 to require or allow entities to classify, in the income taxes category, non-income tax charges:

(a) that are paid *in lieu of* income taxes (Alternative II.1) (paragraphs 13–14); or

(b) that meet the definition of 'covered taxes' under the Organisation for Economic Co-operation and Development's (OECD) Pillar Two model rules (Alternative II.2) (see paragraphs 15–31).

Alternative II.1—non-income tax charges paid 'in lieu of' income taxes

Background

13. As Agenda Paper 12C notes, respondents to the Committee's tentative agenda decision said SA zakat is considered to have similar economic substance to, and is an

[2] Paragraph 6.57 of the IFRS Foundation *Due Process Handbook* states '[a] board is required to conduct a post-implementation review of every new Standard or major amendment to a Standard'. Furthermore, paragraph 6.58 states '…It is expected that a post-implementation review normally begins within five years of the effective date of the new requirements. …'

alternative to, income taxes because of its characteristics. Given the similarity in economic substance, a suggestion was made to amend IFRS 18 to require or allow entities to classify non-income tax charges paid 'in lieu of' or as an alternative to income taxes in the income taxes category. It was suggested that this could be a principles-based way to amend IFRS 18 which would result in requiring or allowing an entity to classify taxes that are similar in substance to income taxes (such as SA zakat) with income taxes.

Analysis

14. We agree such an amendment could address the concerns. However, such an amendment could give rise to interpretive questions—such as the meaning of 'in lieu of' (or 'alternative to') and whether particular non-income tax charges qualify. The IASB would need to define the phrase used and/ or develop application guidance to ensure consistent application across different jurisdictions and taxes. Developing such definitions or application guidance could require significant time and effort.

Alternative II.2—'Covered taxes'

Background

15. In December 2021, the Organisation for Economic Co-operation and Development (OECD) published *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*[3], hereafter referred to as the 'Pillar Two model rules'. The Pillar Two model rules:

    (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate; and

[3] OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.

(b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%.[4]

16. Appendix A to this paper reproduces paragraphs 6–12 of Agenda Paper 12 for the IASB's April 2023 meeting which provide a more detailed background and explanation of the Pillar Two model rules.

17. As Appendix B to this paper notes, the calculation of top-up taxes requires an entity to determine its 'covered taxes'. Paragraph 2 of Chapter 4 of the OECD's *Commentary* notes that the term covered taxes is:

> …broadly defined to include Taxes imposed on a Constituent Entity's income or profits as well as Taxes that are functionally equivalent to such income taxes and Taxes on retained earnings and corporate equity. It does not include Taxes such as indirect taxes, payroll and property taxes, which are not based on a measure of income or Top-up Taxes imposed under the [Pillar Two model] Rules themselves'.

18. Given that the definition of covered taxes is designed to capture income taxes and other taxes *functionally equivalent* to income taxes, it was suggested that the IASB could amend IFRS 18 to require or allow an entity to classify any tax that meets the definition of 'covered taxes' under the Pillar Two model rules in the income taxes category, regardless of whether that tax is a tax expense or tax income applying IAS 12.

19. Our analysis below considers:

(a) the definition of 'covered taxes' (paragraphs 20–24); and

(b) incorporating the definition in IFRS 18 (paragraphs 25–28).

[4] In June 2023, the IASB amended IAS 12 to introduce a temporary exception to the accounting for deferred taxes arising from the implementation of Pillar Two model rules.

Definition of 'covered taxes'

What taxes are covered taxes

20. Article 4.2 of the OECD's Pillar Two model rules sets out the definition of covered taxes. The article states:

> Covered tax means:
>
> (a) Taxes recorded in the financial accounts of a Constituent Entity with respect to its income or profits or its share of the income or profits of a Constituent Entity in which it owns an Ownership Interest;
>
> (b) Taxes on distributed profits, deemed profit distributions, and non-business expenses imposed under an Eligible Distribution Tax System;
>
> (c) Taxes imposed in lieu of a generally applicable corporate income tax; and
>
> (d) Taxes levied by reference to retained earnings and corporate equity, including a Tax on multiple components based on income and equity.

21. The Commentary provides further information about each element of the definition and the types of taxes that element was designed to capture. Appendix A to this paper includes relevant excerpts from the Pillar Two model rules and the Commentary in relation to the definition of covered taxes. Specifically, on SA zakat, the Commentary says:

> An example of a Covered Tax with multiple components is the [SA zakat]. The Zakat operates as a tax on income or equity or both and is therefore properly considered a Covered Tax for the purposes of the GloBE Rules.

Taxes that are not covered taxes

22. Paragraph 4.2.2 of the Pillar Two model rules states:

    > Covered Taxes does not include any amount of:
    >
    > (a) Top-up Tax accrued by a Parent Entity under a Qualified IIR;
    >
    > (b) Top-up Tax accrued by a Constituent Entity under a Qualified Domestic Minimum Top-Up Tax;
    >
    > (c) Taxes attributable to an adjustment made by a Constituent Entity as a result of the application of a Qualified UTPR;
    >
    > (d) A Disqualified Refundable Imputation Tax;
    >
    > (e) Taxes paid by an insurance company in respect of returns to policyholders.

23. The Commentary further specifies types of tax that 'will generally not fall within the definition of covered taxes', namely:

    (a) consumption taxes;

    (b) excise and other taxes on inputs;

    (c) digital services taxes;

    (d) stamp duty, ad valorem taxes and other taxes that are imposed on a particular transaction;

    (e) payroll taxes and other employment-based taxes, as well as social security contributions; and

    (f) property taxes based on ownership of specified items or categories of property.

Other considerations

24. Based on informal discussions with staff at the OECD, we understand that:

    (a) in developing the definition, it was anticipated that only a few non-income tax charges would meet the definition of 'covered taxes';

    (b) although the Pillar Two model rules set out a definition of 'covered taxes', there is no global body that opines on whether a particular tax or charge meets the definition covered taxes;

    (c) there is no comprehensive global listing of taxes or charges that meet the definition of covered taxes; and

    (d) there are no immediate plans to amend the definition of covered taxes.

Incorporating the definition in IFRS 18

25. An amendment that would allow an entity to classify—in addition to income taxes—non-income tax charges that meet the definition of a covered tax as defined in the Pillar Two model rules would:

    (a) *address the concerns while avoiding the need for the IASB to develop its own definition*. This alternative would use a definition that is established, widely used and intended to capture the type of non-income tax charges that users said would be useful to classify together with income taxes. We do not have a complete list of taxes that meet the definition of 'covered taxes'. There is therefore a risk that the amendment could result in an entity classifying a non-income tax charge in the income taxes category when the IASB might otherwise consider it inappropriate to do so. However:

        (i) based on our understanding of what the definition is intended to capture—that is, income taxes and other taxes *functionally equivalent* to income taxes—and feedback from users supporting the classification of such taxes in the income taxes category, we think such an amendment could address the concerns while appropriately excluding

classification of other non-income tax charges in the income taxes category.

(ii) we also understand that many entities and jurisdictions have implemented, or are in the process of implementing, the Pillar Two model rules and have determined which non-income tax charges are covered taxes.

(b) *expedite any required standard-setting work*. By avoiding the need to develop its own definition, the IASB could expedite the required standard-setting work, thereby minimising any disruption to entities' ongoing implementation of IFRS 18.

26. However:

(a) requiring an entity to classify only income taxes in the income taxes category results in an entity classifying amounts in that category which are in some way related to the entity's profit.[5] The amendment would result in an entity classifying in the income taxes category particular non-income taxes, which, while being functionally equivalent to income taxes, may not have such a link with profit.

(b) the amendment could result in further requests for changes to the classification requirements in IFRS 18.

27. If the IASB decides to incorporate the definition of covered taxes in IFRS 18, we think it should not make further refinements to try and include or exclude particular taxes or tax credits within the income taxes category. We think doing so would introduce unnecessary complexity and begin to raise questions about (a) how to apply the requirements and (b) whether particular taxes should be classified in the income taxes category.

[5] Paragraph 2 of IAS 12 states '…income taxes include all domestic and foreign taxes which are based on taxable profits…'.

28. We accept the amendment would not resolve all concerns—for example, investors in Malaysia said Malaysian Zakat (discussed in paragraphs 25–28 of Agenda Paper 12C) should be classified in the income taxes category. However, our understanding is that Malaysian zakat does not meet the definition of 'covered taxes' and consequently, applying the amendment, an entity would not be able to classify it in the income taxes category. The amendment would not allow an entity to classify, in the income taxes category, non-income tax charges that do not meet the definition of 'covered taxes'. We think this would be an appropriate outcome of the amendment.

Our view on amending IFRS 18

29. If the IASB decides to explore amending IFRS 18 to require or allow an entity to classify particular non-income tax charges in the income taxes category, based on our analysis, we think it should explore requiring or allowing an entity to classify, in the income taxes category, non-income tax charges that meet the definition of covered taxes applying Pillar Two model rules (that is, alternative II.2). Agenda Paper 12A assesses a possible standard-standard setting project to explore amending IFRS 18 applying Alternative II.2 against the IASB's prioritisation framework.

30. If the IASB decides to explore amending IFRS 18 applying Alternative II.2 we will, at a future meeting, present our analysis of the detailed technical aspects of the potential amendments. These include considering:

    (a) whether and what elements of the definition of covered taxes to incorporate into IFRS 18; and

    (b) whether to incorporate the definition of covered taxes in IFRS 18 by (i) making a direct reference to the definition of covered tax in the Pillar Two model rules; or (ii) reproducing relevant elements of the definition and the related commentary in IFRS 18;

    (c) whether an entity should be *required* or *permitted* to classify non-income tax charges that meet the definition of covered taxes in the income taxes category;

(d) whether to explicitly require disaggregation of non-income tax charges classified in the income taxes category from income taxes (or whether the principles of disaggregation in IFRS 18 are sufficient);

(e) whether to introduce additional disclosure requirements for non-income tax charges classified in the income taxes category; and

(f) whether and how to rename the income taxes category.

31. To avoid disrupting an entity's implementation of IFRS 18, if the IASB decides to explore Alternative II.2, the IASB should also defer its decision on whether to object to the agenda decision or the proposed updates to the related agenda decisions.

Appendix A—Excerpts from Agenda Paper 12 for the IASB's April 2023 meeting

A1. This appendix reproduces paragraphs 6–12 of Agenda Paper 12 for the IASB's April 2023 meeting which provide a more detailed background and explanation of the Pillar Two model rules.

The Pillar Two Model Rules

6. In December 2021, the Organisation for Economic Co-operation and Development (OECD) published *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, hereafter referred to as the 'Pillar Two model rules'. [Footnote: See further information here.] These rules:

   (a) are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy and were agreed by more than 135 countries and jurisdictions representing more than 90% of global GDP; and

   (b) provide a template that jurisdictions can translate into domestic tax law and implement as part of an agreed common approach.

Objective and scope

7. The Pillar Two model rules:

   (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;

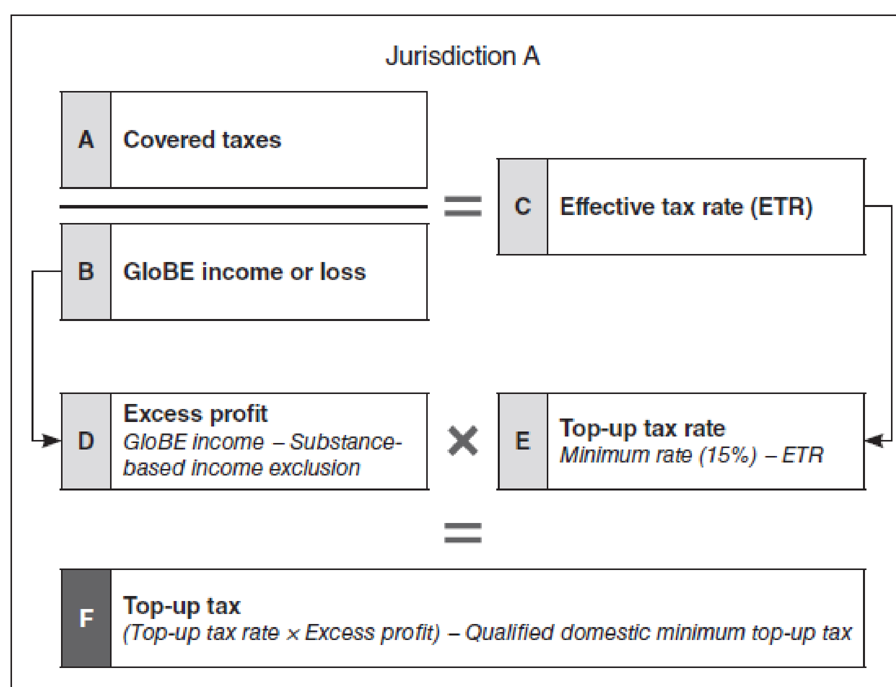
   (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and

   (c) typically require the ultimate parent entity of the group to pay top-up tax—in the jurisdiction in which it is domiciled—with respect to profits of its subsidiaries that are taxed below 15%.

8. The rules generally apply to multinational groups with revenue in their consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal years. The rules specify inclusion thresholds for some jurisdictions and exclude some types of entities from their scope.

Computation of top-up tax

9. The following figure illustrates the computation of top-up tax in a given jurisdiction:



10. In summary, the Pillar Two model rules specify that:

(a) *covered taxes* comprise current tax expense in a jurisdiction after adjusting for tax credits and deferred taxes. These adjustments include adding deferred tax expenses capped at 15% (subject to further adjustments). The amount includes income taxes (or taxes in lieu of those) for the fiscal year.

(b) *Global Anti-Base Erosion (GloBE) income or loss* is the profit or loss in a jurisdiction included in the consolidated financial statement of the ultimate parent entity, before eliminating intragroup items and after making other

adjustments (for example, adjusting for some common differences between accounting requirements and tax rules).

(c) the *effective tax rate* is calculated by dividing covered taxes by the GloBE income or loss for a jurisdiction. The resulting rate is subtracted from 15% to calculate the *top-up tax rate* for the jurisdiction.

(d) *excess profit* is the GloBE income or loss minus the substance-based income exclusion. The substance-based income exclusion is intended to exclude a fixed return for substantive activities in a jurisdiction. Payroll costs and the carrying amount of tangible assets are used as indicators of substantive activities.

(e) *top-up tax* is the product of excess profit and the top-up tax rate in a jurisdiction. An entity then reduces that top-up tax by any applicable qualified domestic minimum top-up tax (see paragraph 12).

Charging provisions

11. A liability to pay top-up tax may arise under one of two rules, namely:

(a) the *income inclusion rule* (IIR) whereby a parent is liable for top-up tax in proportion to its ownership interest in subsidiaries that were taxed below 15%. The ultimate parent entity is primarily liable for top-up tax under the rule but, in some circumstances, intermediate parent entities may be liable.

(b) the *UTPR*, which is a backstop mechanism for profits taxed below 15% that are not charged under the IIR.

12. Jurisdictions may also introduce a *qualified domestic minimum top-up tax*. This top-up tax is computed on a basis similar to the Pillar Two model rules, but would be charged in the jurisdiction in which the profit arises rather than in the ultimate parent entity's jurisdiction.

Appendix B—Excerpts from the OECD's *Commentary*

B1. This appendix reproduces excerpts from the OECD's *Commentary* relating to the definition of covered taxes.

Article 4.2 - Definition of Covered Taxes

22. Article 4.2 sets out the definition of Covered Taxes that are taken into account in the determination of Adjusted Covered Taxes under Article 4.1. The definition of Covered Taxes is developed solely for the purposes of the GloBE Rules and has no direct interaction with Article 2 (Taxes Covered) of the OECD Model Tax Convention (OECD, 2017), which defines the taxes within the scope of the Convention. Taxes that do not qualify for the definition of Covered Taxes under the GloBE Rules, such as excise taxes and payroll taxes, will be treated as deductible in the computation of the GloBE Income or Loss (i.e. as reductions to the denominator in the ETR calculation under Article 5.1) The fact that a Tax may be deducted from the tax base for another Covered Tax does not, however, mean that the Tax is not eligible to be considered as a Covered Tax.

23. In determining whether a Tax is a Covered Tax, the focus is on the underlying character of the Tax. The name that is given to a Tax or the mechanism used to collect it (such as through a withholding mechanism) is not determinative of its character. Whether a tax charge is levied under a jurisdiction's CIT rules or under a separate regime or statute does not have any bearing on its underlying character. The timing of a levy does not have any bearing on the definition of Covered Taxes. Accordingly, Taxes imposed on the income of a distributing corporation at the time it distributes the income are Covered Taxes, irrespective of whether the income distribution is attributable to current or previously accumulated earnings.

Article 4.2.1

24. The definition of Tax as set out in Article 10.1 of the GloBE Rules is a compulsory unrequited payment to General Government. This is based on the OECD's

longstanding definition of Taxes used for statistical purposes, with the same definition equally used by many International Organisations (IMF, World Bank, United Nations, European Union) (OECD, 2018). General Government is a defined term in the UNOECD National Accounts that includes the central administration, agencies whose operations are under its effective control, state and local governments and their administrations (OECD, 2018[2]). The definition of General Government in Article 10.1 is consistent with the definition in the UN-OECD National Accounts. Taxes are unrequited in the sense that any benefits provided by government to the taxpayer are not in proportion to their payments. Thus, fees and payments for privileges, services, property, or other benefits provided by government do not qualify as Taxes. Similarly, Taxes do not include fines and penalties nor do they include interest or similar charges with respect to payments of tax liabilities after the applicable due date. The definition of Covered Taxes includes four types of Taxes described in paragraphs (a) to (d).

Paragraph (a)

25. Paragraph (a) provides that any Taxes recorded in the financial accounts of a Constituent Entity with respect to its income or profits are Covered Taxes. While there is no internationally agreed definition of an income tax, income taxes are generally levied on a flow of money or money's worth that accrues to a taxpayer during a period of time. Income taxes take into account related expenses of producing the flow of money to measure the taxpayer's net increase in wealth for the period. A definition of Covered Taxes that applies to income calculated on a net (rather than gross) basis is in line with the definition of income tax used for financial accounting purposes and therefore it is expected that a Tax recognised as an income tax for financial accounting purposes should generally qualify as a Covered Tax under the GloBE Rules. However, certain income taxes are specifically excluded from the definition of Covered Taxes under Article 4.2.2.

26. The definition encompasses not only Taxes imposed on income at the time such income is derived but also to Taxes that are imposed on a subsequent distribution of profits. Moreover, the definition includes Taxes on the income of the Constituent

Entity as well as its share of income of another Constituent Entity in which it owns an Ownership Interest. Thus, Taxes imposed on the Constituent Entity's share of undistributed profits from a Tax Transparent Entity such as a partnership, Taxes imposed under a CFC Tax Regime, as well as Taxes imposed on distributions from another Constituent Entity are treated as Covered Taxes under paragraph (a). The amount of such taxes allocated in respect of an Ownership Interest in another Constituent Entity are set out in Article 4.3.

27. A Tax need not determine the taxpayer's precise change in wealth to qualify as an income tax. A definition of Covered Taxes that required taxpayers and administrators to undertake further technical analysis of the precise terms of each type of Tax in order to determine whether a particular Tax took into account an appropriate amount of relevant expenses incurred in the generation of that income would be cumbersome to apply and lead to uncertainty in the determination of the ETR. Accordingly, the definition of Covered Taxes includes Taxes that allow for a simplified estimate of net profit. For example, a Tax that allows deductions for some but not all expenses related to the relevant income would be considered an income tax, provided the deductible expenses can reasonably be considered to have been incurred in connection with deriving that income. Similarly, a Tax on income that allows a standardised deduction in place of actual expenses is generally considered an income tax if such standardised deduction is based on a reasonable method for estimating such expenses. A Tax imposed on gross income or revenue without any deductions (i.e. a tax on turnover) would not be considered an income tax. The design and substantive character of such turnover taxes generally have more similarities to consumption or sales taxes. The definition of Covered Taxes therefore does not include a Tax on a gross amount unless such a Tax is in lieu of an income tax, as discussed below in connection with Article 4.2.1(c).

28. Taxes or surcharges imposed on the net income from specific activities, such as banking, or the exploration and production of oil and gas, irrespective of whether or not they apply in addition to a generally applicable income tax, would also fall within the general definition of a Covered Tax. The definition would include a separate levy

that is imposed on the net income or profits from natural resource extraction activity (or a part of a multi-component levy that is imposed on net income or profits). However, natural resource levies closely linked to extractions, for example, those that are imposed on a fixed basis or on the quantity, volume or value of the resources extracted rather than on net income or profits, would not be treated as Covered Taxes except where these levies satisfy the "in lieu of" test described below in connection with paragraph (c) of Article 4.2.1.

29. Tax on net income of a Constituent Entity under Pillar One would be treated as a Covered Tax under the GloBE Rules as a tax with respect to income or profits. 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.

Paragraph (b)

30. Paragraph (b) provides that any Taxes on distributed profits imposed under an Eligible Distribution Tax System are Covered Taxes. These Taxes are discussed further in the Commentary to Article 3.2.8.

Paragraph (c)

31. Paragraph (c) provides that Taxes imposed in lieu of a generally applicable CIT are Covered Taxes. A generally applicable CIT could be one that applies to all resident corporations or one that typically applies to those resident corporations that are members of a large multinational group. A generally applicable CIT would also include an income tax imposed on a corporation but which also applies to other taxable persons such as individuals. The "in lieu of" test includes Taxes that are not described in the generally applicable income tax definition but which operate as substitutes for such taxes. This test, which is used in some jurisdictions in the context

of their foreign tax credit rules, would generally include withholding taxes on interest, rents and royalties, and other taxes on other categories of gross payments such as insurance premiums, provided such taxes are imposed in substitution for a generally applicable income tax. Taxes imposed in lieu of a generally applicable CIT would also include taxes arising from the Subject to Tax Rule.

32. The "in lieu of" concept also covers Taxes that are imposed on an alternative basis (i.e. other than net income), such as Taxes based on the number of units produced or commercial surface area, and which are used as substitutes for a generally applicable income tax under the laws of the jurisdiction. Where, for example, a jurisdiction imposes a simplified methodology for calculating the income on a particular category of business or investment and this Tax is imposed in substitution for a generally applicable income tax, then that Tax falls within the definition of a Covered Tax. A Tax imposed on an alternative basis levied at state or local government level, which is creditable against a generally applicable income tax levied at the national government level, would also qualify as a Covered Tax under the "in lieu of" test to the extent that it is credited against income tax in the same jurisdiction. Such local taxes can be considered as being in substitution (partially or fully) for a generally applicable income tax and an administratively efficient way of transferring resources from national to local government within the same jurisdiction. A Tax that is imposed on an alternative basis that applies in addition to, and not as a substitute for, a generally applicable income tax under the laws of the jurisdiction would not fall under the "in lieu of" test for Covered Taxes.

Paragraph (d)

33. Paragraph (d) provides that Taxes levied by reference to retained earnings and corporate equity, including a Tax on multiple components based on income and equity, are Covered Taxes. Some jurisdictions impose Taxes on the net equity of a corporation in addition to CIT. The equity or capital of a corporation is composed of its retained earnings (i.e. the undistributed portion of the after-tax income in the Profit and Loss statement) and the contributions made by shareholders. Taxes on corporate

equity may be inherently interlinked with the design of the CIT systems. For example, it may be possible under the laws of a jurisdiction to credit CIT against a corporate equity tax so that a company is allowed to reduce the corporate equity tax up to the amount of CIT that it pays in that jurisdiction. Taxes on corporate equity may also act as a supplement to CIT as part of a jurisdiction's overall approach to the taxation of a corporation's activities in that jurisdiction. For example, some Taxes on corporate equity may incorporate a minimum tax element to their design. Such Taxes on corporate equity are therefore an integral part of the overall system of corporate taxation in those jurisdictions.

34. Some jurisdictions impose Taxes that have multiple components to the base. Where all the components of the tax base fall within the definition of income or profit covered by the GloBE Rules, then the tax, as a whole, is included within the definition of Covered Taxes. Other taxes may be levied in respect of a corporation's activities in a jurisdiction, and are administratively and conceptually part of the system of corporate taxation in these jurisdictions but may include both an income and a non-income element. Where such taxes are predominately a tax on an entity's income and it would be administratively burdensome to split the Tax into separate income and non-income components then such Taxes should be treated, in full, as Covered Taxes under the GloBE Rules.

35. An example of a Covered Tax with multiple components is the corporate Zakat levied by the Kingdom of Saudi Arabia. The Zakat operates as a tax on income or equity or both and is therefore properly considered a Covered Tax for the purposes of the GloBE Rules.

36. Although the definition of Covered Taxes is broader than simply income taxes, a number of commonly encountered taxes are not included in the definition. The following types of tax will generally not fall within the definition of covered taxes.

(a) Consumption taxes, such as sales taxes and value-added taxes (VATs), are not Covered Taxes under the GloBE Rules. Such taxes are calculated by reference

to the consideration for a defined supply and are not Taxes on the net income or equity of a taxpayer.

(b) Excise and other taxes on inputs are not Covered Taxes under the GloBE Rules. Such Taxes arise in relation to a specific input which do not represent an accretion of income.

(c) Digital services taxes are generally designed to apply to the gross revenues from the provision of certain digital services and so would not be considered an income tax. Digital services taxes are generally designed to apply in addition to, and not as substitutes for, a generally applicable income tax under the laws of a jurisdiction, and so would not fall under the "in lieu of" test for Covered Taxes either.

(d) Stamp duty, ad valorem taxes and other taxes that are imposed on a particular transaction are not taxes on income, equity, or taxes in lieu of an income tax. They are therefore outside the scope of the Covered Taxes definition.

(e) Payroll taxes and other employment-based taxes, as well as social security contributions, are not Covered Taxes under the GloBE Rules. Payroll taxes and social security contributions are not imposed on the employer in respect of its income (or equity). This follows the well-established view of payroll taxes and social security contributions as being levied on labour income (i.e. wages and in some cases personal income) as opposed to business profits. Rather, payroll taxes and social security contributions are typically deductible from business profits in the same way that wages are deducted from taxable business profits.

(f) Property taxes based on ownership of specified items or categories of property are not Covered Taxes. Property taxes are based on the assessed value of the property, often without regard to whether the property is subject to a liability. Even where adjustments to the assessed value of property is made for liabilities against the property, this is more akin to a valuation method under a property tax than a tax that is predominantly on previous income. Property taxes are not based on income, retained earnings, or corporate equity. Neither

are they Taxes imposed in lieu of a generally applicable income tax. Property taxes are therefore distinguishable from taxes based on a corporation's equity and should not be Covered Taxes under the GloBE Rules.

Article 4.2.2

37. Although Covered Taxes are defined broadly, certain Taxes are specifically excluded from the definition. These excluded Taxes generally fall into two categories: Top-up Taxes and refundable taxes.

38. Paragraphs (a) through (c) exclude Top-up Taxes under the GloBE Rules from the definition of Covered Taxes. Covered Taxes are an essential element in determining the Top-up Tax, if any, under the GloBE Rules. Including GloBE Top-up Taxes in Covered Taxes would result in a circular computation in the Fiscal Year that the Top-up Taxes arise. Including them in Covered Taxes for subsequent Fiscal Years would undermine the agreed Minimum Rate because it would effectively include them in the numerator of the ETR computation which would effectively reduce the amount of Top-up Tax that would need to be paid for the jurisdiction in the subsequent year. Qualified Domestic Minimum Top-up Taxes are excluded from the definition of Covered Taxes for the same reasons. However, such taxes are creditable against GloBE Top-up Tax under Article 5.2.3. On the other hand, an ordinary domestic minimum tax that is not a Qualified Domestic Minimum Top-up Tax is a Covered Tax if it otherwise meets the definition of a Covered Tax.

39. Paragraph (d) excludes Disqualified Refundable Imputation Taxes from the definition of Covered Taxes. Because the timing of the refund of these Taxes is within the MNE Group's control, they are similar to a deposit and therefore are not properly taken into account in the ETR computation. For example, a taxpayer can make a deposit by prepaying the tax liability in a jurisdiction for a subsequent Fiscal Year, such a prepayment will not increase Covered Taxes in the Current Fiscal Year.

40. Lastly, paragraph (e) excludes tax expense incurred by an insurance company in respect of returns to a policyholder from the definition of Covered Taxes. This

paragraph (e) applies to the extent there is an adjustment under Article 3.2.9. Pursuant to Article 3.2.9, amounts charged to policy holders for tax expense incurred by an insurance company in respect of returns to a policy holder are excluded from the computation of GloBE Income or Loss. Returns to the policy holders are treated as income of an insurance company under financial accounting standards and the insurance company effectively eliminates that income with a corresponding liability to the policyholder. The liability is typically reduced by the amount of any taxes incurred by the insurance company in respect of that income such that the insurance company is effectively reimbursed by the policy holder for the taxes incurred. Tax expense incurred in respect of returns to a policy holder should not be included in the insurance company's Covered Taxes.