Chapter 3.2: Mandatory Adjustments

Learning Objective

After completing this chapter, you will be able to identify and apply all mandatory adjustments required to convert Financial Accounting Net Income or Loss into GloBE Income or Loss.

Introduction

While the GloBE framework takes financial accounting as its starting point, it does not accept that starting point uncritically. Article 3.2 prescribes a series of mandatory adjustments that transform Financial Accounting Net Income into GloBE Income—a measure specifically designed for minimum tax purposes. These adjustments reflect policy judgments about which items should be included in the profit base subject to the 15% floor, and which should be excluded or modified. Understanding the rationale behind each adjustment illuminates not just what to do mechanically, but why the framework treats different income types differently.

1. Overview of Article 3.2 Adjustments

Article 3.2 requires specific adjustments to Financial Accounting Net Income or Loss. These adjustments eliminate common book-to-tax differences where policy justification exists.

1.1 Complete List of Mandatory Adjustments

Reference	Adjustment	Direction
	Net Taxes Expense	Add back

Reference	Adjustment	Direction
Art. 3.2.1(a)		
Art. 3.2.1(b)	Excluded Dividends	Exclude (deduct)
Art. 3.2.1(c)	Excluded Equity Gain or Loss	Exclude
Art. 3.2.1(d)	Included Revaluation Method Gain or Loss	Include (add)
Art. 3.2.1(e)	Gains/losses from dispositions under Article 6.3	Exclude
Art. 3.2.1(f)	Asymmetric Foreign Currency Gains or Losses	Adjust
Art. 3.2.1(g)	Policy Disallowed Expenses	Add back
Art. 3.2.1(h)	Prior Period Errors and Changes in Accounting Principles	Adjust
Art. 3.2.1(i)	Accrued Pension Expense	Adjust
Art. 3.2.2	Stock-Based Compensation (elective)	Substitute

These adjustments share a common theme: they modify the financial accounting result to create a profit measure that better aligns with the policy objectives of minimum taxation. Some adjustments prevent double-counting (excluding dividends and equity method income already taxed at source). Others address timing mismatches between accounting and tax (pension expenses, stock-based compensation). Still others enforce public policy (disallowing bribes and significant fines). Together, they transform a general-purpose accounting measure into one tailored for global minimum tax calculations.

2. Adjustment 1: Net Taxes Expense *(Article 3.2.1(a))*

The Rule

The net tax expense recorded in the financial accounts must be **added back** to Financial Accounting Net Income.

Why This Adjustment Exists

Financial Accounting Net Income is an "after-tax" figure (below the line). Since GloBE Income feeds into an ETR calculation that divides Adjusted Covered Taxes by GloBE Income, the tax expense must be removed to create a "pre-tax" base.

What to Add Back

Include in Add-Back	Exclude from Add-Back
Current tax expense	Deferred tax adjustments (separate treatment)
Foreign taxes	Non-income taxes (VAT, customs, payroll)
Withholding taxes suffered	Property taxes
Tax provisions/accruals	

Worked Example

SG Germany GmbH — FY 2025

Item	Amount (€)
Financial Accounting Net Income	4,900,000
Tax expense per accounts	2,100,000
Add back: Net Taxes Expense	+2,100,000

Item	Amount (€)
Adjusted amount	7,000,000

3. Adjustment 2: Excluded Dividends *(Article 3.2.1(b))*

The Rule

Dividends and similar distributions are **excluded** from GloBE Income unless they are from "short-term portfolio shareholdings."

Definition of Excluded Dividend

A dividend is **excluded** if EITHER:

Condition	Threshold
Ownership test	MNE Group holds ≥10% of profits, capital, reserves, or voting rights
Holding period test	Ownership held for ≥12 months at dividend date

Portfolio Shareholding (Not Excluded)

A **Portfolio Shareholding** exists when: - Ownership <10%, AND - Held for <12 months

Dividends from Portfolio Shareholdings remain in GloBE Income.

Decision Tree: Dividend Treatment

```
Dividend received
        |
        ▼
```

```
┌─────────────────────────┐
│  Ownership ≥10%?        │
└─────────────────────────┘
          │
     ┌────┴────┐
    YES        NO
     │         │
     ▼         ▼
  EXCLUDED   ┌────────────────────┐
             │  Held ≥12 months?  │
             └────────────────────┘
                     │
                ┌────┴──────┐
               YES          NO
                │           │
                ▼           ▼
             EXCLUDED    INCLUDED
             (long-term  (portfolio)
              portfolio)
```

Worked Example

SG Netherlands BV — Dividend Analysis

Dividend Source	Ownership	Holding Period	Treatment
SG Ireland Ltd	60%	>12 months	**Excluded**
Listed Co. A	2%	3 years	**Excluded** (long-term portfolio)
Listed Co. B	5%	6 months	**Included** (short-term portfolio)
Listed Co. C	12%	2 months	

Dividend Source	Ownership	Holding Period	Treatment
			Excluded (≥10% ownership)

Calculation:

Item	Amount (€)
Total dividends received	3,500,000
Less: Excluded dividends (Ireland)	(2,800,000)
Less: Excluded dividends (Listed Co. A)	(400,000)
Less: Excluded dividends (Listed Co. C)	(150,000)
Dividends remaining in GloBE Income	**150,000**

Portfolio Shareholding Election

An MNE Group may elect to **include** all Portfolio Shareholding dividends in GloBE Income *(Administrative Guidance, Article 3.5)*. This is a **Five-Year Election** that simplifies compliance by avoiding the need to track holding periods.

When to consider this election: - High volume of portfolio investments - Administrative burden of tracking holding periods exceeds tax benefit - Portfolio dividends are minimal relative to total income

The dividend exclusion implements a fundamental principle of international tax: avoiding double taxation of corporate profits. When a subsidiary earns profit and pays tax, then distributes that profit as a dividend to its parent, taxing the parent on the dividend effectively taxes the same economic profit twice. The 10%/12-month tests act as filters: substantial, long-term shareholdings represent genuine investment relationships where double taxation concerns are strongest, while short-term portfolio holdings look more like trading positions where inclusion is appropriate.

This framework mirrors participation exemption systems found in many domestic tax codes.

4. Adjustment 3: Excluded Equity Gain or Loss *(Article 3.2.1(c))*

The Rule

Certain gains and losses related to equity investments are **excluded** from GloBE Income.

Three Types of Excluded Equity Items

Type	Description	Reference
Fair value changes	Gains/losses from changes in fair value of Ownership Interests (except Portfolio Shareholdings)	Art. 3.2.1(c)(i)
Equity method P&L	Profit or loss from Ownership Interests accounted for under equity method	Art. 3.2.1(c)(ii)
Disposal gains/losses	Gains/losses from disposition of Ownership Interests (except Portfolio Shareholdings)	Art. 3.2.1(c)(iii)

Portfolio Shareholding Exception

For **Portfolio Shareholdings** (<10% ownership AND held <12 months): - Fair value changes: **Included** in GloBE Income - Disposal gains/losses: **Included** in GloBE Income

Worked Example

SG Holdings Ltd — Equity Items

Item	Amount (€)	Treatment
Fair value gain on SG Netherlands shares	1,200,000	**Excluded** (subsidiary)
Share of SG Japan profit (equity method)	850,000	**Excluded** (equity method)
Gain on sale of 5% stake in TechCo (held 8 months)	320,000	**Included** (portfolio)
Loss on sale of 15% stake in StartupCo	(180,000)	**Excluded** (≥10%)

Net adjustment:

Item	Amount (€)
Total equity items per accounts	2,190,000
Less: Excluded fair value gain	(1,200,000)
Less: Excluded equity method profit	(850,000)
Add back: Excluded disposal loss	180,000
Net equity items in GloBE Income	**320,000**

Equity Investment Inclusion Election

An MNE Group may elect to **include** all excluded equity gains/losses in GloBE Income. This is a **Five-Year Election** available on a per-jurisdiction basis.

When to consider: - Simplifies tracking when equity items are immaterial - May be beneficial if losses exceed gains

5. Adjustment 4: Included Revaluation Method Gain or Loss *(Article 3.2.1(d))*

The Rule

Gains and losses from revaluation of property, plant and equipment (PPE) that are recognised in **Other Comprehensive Income (OCI)** under the revaluation model must be **included** in GloBE Income.

Why This Adjustment Exists

Under IAS 16, entities may choose the revaluation model for PPE, with gains going to OCI (not P&L). Without this adjustment, such gains would escape the GloBE Income calculation entirely.

What Gets Included

Item	In P&L?	In OCI?	GloBE Treatment
Revaluation gain on PPE	No	Yes	**Include** in GloBE Income
Revaluation loss on PPE	Sometimes	Sometimes	**Include** if in OCI
Associated deferred tax	—	—	Included in Covered Taxes

Worked Example

SG Australia Pty Ltd — PPE Revaluation

Item	Amount (A$)
Revaluation surplus on factory (in OCI)	2,500,000

Item	Amount (A$)
Deferred tax liability recognised	750,000

GloBE adjustment: - Include revaluation gain of A$2,500,000 in GloBE Income - Include deferred tax of A$750,000 in Adjusted Covered Taxes

Realization Method Election *(Article 3.2.5)*

An MNE may elect to use the **realization method** instead of fair value accounting for GloBE purposes. Under this election:

- Fair value gains/losses are **excluded** until asset disposal
- Gain/loss crystallises only on actual disposition

This is a **Five-Year Election** applicable to: - All assets and liabilities, OR - Only tangible assets, OR - Only Investment Entities

Benefit: Reduces ETR volatility from unrealised gains/losses.

6. Adjustment 5: Gains/Losses from Article 6.3 Dispositions *(Article 3.2.1(e))*

The Rule

Gains and losses from **intra-group asset dispositions** covered by Article 6.3 are **excluded** from GloBE Income.

What Article 6.3 Covers

Article 6.3 provides rules for reorganisations and asset transfers within an MNE Group, including:

- Asset transfers at book value (no gain/loss recognition)
- Carryover of tax attributes
- Certain corporate reorganisations

Practical Application

For most practitioners, this adjustment applies when:

Transaction	Treatment
Intra-group asset sale at arm's length price	Gain/loss recognised normally (not Art. 6.3)
Intra-group asset transfer at book value (qualifying reorganisation)	Gain/loss **excluded** under Art. 3.2.1(e)

7. Adjustment 6: Asymmetric Foreign Currency Gains or Losses *(Article 3.2.1(f))*

The Rule

Adjustments are required when **accounting functional currency** differs from **tax functional currency**, creating asymmetric foreign exchange gains or losses.

When Asymmetric FX Arises

Scenario	Example
Accounting in USD, tax returns in EUR	Transaction in GBP creates FX gain in USD accounts but different (or no) FX gain for tax
Functional currency mismatch	US subsidiary of UK parent with EUR tax filings

Three Scenarios

Situation	GloBE Treatment
Transaction in **accounting currency** creates taxable FX gain (tax currency different)	**Include** the FX gain in GloBE Income
Transaction in **tax currency** creates accounting FX gain	**Exclude** the accounting FX gain
Transaction in **third currency** creates accounting FX gain	**Exclude** the accounting FX gain

Worked Example

SG Singapore Pte Ltd - Accounting functional currency: SGD - Tax functional currency: SGD (no mismatch) - **Result:** No asymmetric FX adjustment required

TechStart US Inc - Accounting functional currency: USD (follows US parent) - Tax functional currency: USD - **Result:** No asymmetric FX adjustment required

Note: Asymmetric FX adjustments are uncommon for entities where accounting and tax functional currencies align.

8. Adjustment 7: Policy Disallowed Expenses *(Article 3.2.1(g))*

The Rule

Certain expenses are **added back** to GloBE Income because they are disallowed on policy grounds.

What Gets Added Back

Expense Type	Threshold	Treatment
Bribes and illegal payments	Any amount	**Add back**
Fines and penalties	≥€50,000	**Add back**
Fines and penalties	<€50,000	No adjustment

What Is NOT a Fine or Penalty

Item	Treatment
Interest on late tax payment	**Not** a fine—no add-back
Compensatory damages	**Not** a penalty—no add-back
Contractual penalties (e.g., late delivery)	**Not** policy disallowed—no add-back

Worked Example

SG Germany GmbH — Policy Disallowed Expenses

Item	Amount (€)	Treatment
Environmental fine (regulatory)	180,000	**Add back** (≥€50K)
Late filing penalty	25,000	No adjustment (<€50K)
Interest on late tax payment	45,000	No adjustment (not a fine)
Contractual penalty to customer	120,000	No adjustment (commercial)

Net adjustment: Add back €180,000

The policy disallowed expenses adjustment reflects a normative judgment: certain expenditures should not reduce the profit base against which minimum taxation is measured, regardless of their accounting or even local tax treatment. Bribes and illegal payments represent conduct that no tax system should subsidise; disallowing their deduction for GloBE purposes ensures that undertaxed profits cannot be inflated by such payments. The €50,000 threshold for fines balances the administrative burden of tracking minor regulatory penalties against the policy goal of not allowing significant sanctions to reduce taxable profits. The explicit exclusion of contractual penalties and compensatory damages recognises that these represent legitimate business costs rather than regulatory or legal sanctions.

9. Adjustment 8: Prior Period Errors and Changes in Accounting Principles *(Article 3.2.1(h))*

The Rule

Adjustments are required for: - **Prior period errors** affecting current year opening balances - **Changes in accounting principles** with retrospective application

Treatment of Prior Period Errors

Situation	GloBE Treatment
Error in prior year GloBE Income	Recalculate prior year ETR and Top-Up Tax
Error affects only current year accounts	Adjust current year GloBE Income
Error creates Additional Top-Up Tax	Include in current year per Art. 5.4.1

Treatment of Accounting Policy Changes

Change Type	Treatment
Retrospective restatement	Apply same change to GloBE Income

Change Type	Treatment
Prospective application	No adjustment to prior periods

Worked Example

SG France SAS — Prior Period Error

In FY 2025, Stratos discovered that SG France SAS had overstated revenue by €500,000 in FY 2024 due to a cut-off error.

Step 1: Restate FY 2024 GloBE Income - Original GloBE Income: €8,200,000 - Corrected GloBE Income: €7,700,000

Step 2: Recalculate FY 2024 ETR - Original ETR: 14.2% - Corrected ETR: 15.1%

Step 3: Determine impact - Original Top-Up Tax: €48,000 - Corrected Top-Up Tax: €0 (ETR now above 15%)

Step 4: Adjustment in FY 2025 - Reduce GloBE Income by €500,000 (remove overstatement) - No additional Top-Up Tax from FY 2024 correction

10. Adjustment 9: Accrued Pension Expense *(Article 3.2.1(i))*

The Rule

Adjust Financial Accounting Net Income for the difference between: - **Pension expense** recorded in accounts (accrual basis), and - **Contributions** actually paid to the pension fund

Formula

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Accrued Pension Expense Adjustment = Pension Expense (Accounts) − Contr
```

If positive (accrual > contribution): **Deduct** from GloBE Income If negative (contribution > accrual): **Add** to GloBE Income

Why This Adjustment Exists

- Aligns GloBE Income timing with tax deduction timing
- Most jurisdictions allow deduction when contributions are **paid**, not when expense is **accrued**
- Defined benefit accounting (IAS 19) can create significant accruals not reflecting cash

Worked Example

SG UK Holdings Ltd — Pension Adjustment

Item	Amount (£)
Defined benefit pension expense (per IAS 19)	2,400,000
Cash contributions paid to pension scheme	1,800,000
Accrued Pension Expense	**600,000**

GloBE adjustment: Deduct £600,000 from GloBE Income

Effect: GloBE Income reflects the £1,800,000 actually contributed, not the £2,400,000 accounting expense.

Scope Clarification

Payment Type	In Scope?
Contributions to external pension fund	**Yes**
Contributions to in-house pension fund	**Yes**
Direct payments to employees/retirees	**No** (not within Art. 3.2.1(i))

The pension adjustment addresses one of the most significant book-tax timing differences that defined benefit schemes create. Under IAS 19, pension expense reflects actuarial estimates—interest on obligations, service costs, remeasurements

—that may bear little relationship to cash actually flowing to the pension fund. Most tax systems, by contrast, allow deduction when contributions are paid rather than when accounting expense is recognised. Without this adjustment, a company with substantial IAS 19 accruals but modest cash contributions would show lower GloBE Income (due to the accrual expense) but potentially lower Covered Taxes (based on actual contributions), artificially depressing the ETR. Aligning GloBE Income with contributions paid produces a more accurate picture of taxable capacity.

11. Adjustment 10: Stock-Based Compensation *(Article 3.2.2)* — Elective

The Rule

An MNE may **elect** to substitute the tax-deductible amount of stock-based compensation (SBC) for the accounting expense.

Default vs Elected Treatment

Approach	Amount Used for GloBE Income
Default (no election)	Accounting expense (e.g., IFRS 2)
Elected	Tax-deductible amount

Why This Election Exists

SBC often creates book-to-tax timing differences: - **Accounting:** Expense recognised over vesting period - **Tax:** Deduction at exercise/vesting (often larger due to share price increase)

Without the election, these timing differences could create artificial Top-Up Tax.

Election Mechanics

- **Irrevocable** election
- Applies to **all** SBC for the Constituent Entity

- If options expire unexercised: previously deducted amounts must be added back to GloBE Income

Worked Example

SG Singapore Tech Pte Ltd — SBC Election Analysis

Item	Without Election	With Election
SBC accounting expense (IFRS 2)	€850,000	—
SBC tax deduction (local tax)	—	€620,000
GloBE Income impact	Expense €850,000	Expense €620,000

Analysis: - Without election: Higher SBC expense reduces GloBE Income - With election: Lower tax deduction increases GloBE Income

Decision: If the jurisdiction is low-taxed, a **higher** GloBE Income increases Top-Up Tax. Therefore: - In **low-tax jurisdictions**: Consider NOT electing (keep higher accounting expense) - In **high-tax jurisdictions**: Election may be neutral or beneficial

12. Complete Adjustment Checklist

Use this checklist for each Constituent Entity:

Mandatory Adjustments

#	Adjustment	Add/ Deduct	Amount (€)	Done?
1	Net Taxes Expense	Add back		☐
2	Excluded Dividends (≥10% or ≥12 months)	Deduct		☐

#	Adjustment	Add/ Deduct	Amount (€)	Done?
3a	Fair value gains on ownership interests (excl. portfolio)	Deduct		☐
3b	Equity method profit/loss	Deduct		☐
3c	Disposal gains/losses on ownership interests (excl. portfolio)	Deduct		☐
4	Revaluation gains/losses in OCI (PPE)	Add		☐
5	Gains/losses from Article 6.3 dispositions	Deduct		☐
6	Asymmetric FX gains/losses	Adjust		☐
7a	Bribes/illegal payments	Add back		☐
7b	Fines/penalties ≥€50,000	Add back		☐
8	Prior period errors/accounting changes	Adjust		☐
9	Accrued pension expense	Adjust		☐

Elective Adjustments (Document if Applied)

#	Election	Applied?	Amount (€)
A	Stock-based compensation (Art. 3.2.2)	Yes/No	
B	Portfolio shareholding inclusion (AG 3.5)	Yes/No	
C	Equity investment inclusion	Yes/No	

#	Election	Applied?	Amount (€)
D	Realization method (Art. 3.2.5)	Yes/No	

13. Stratos Worked Example: Complete Adjustment Calculation

SG Germany GmbH — FY 2025 GloBE Income Calculation

Starting Point

Item	Reference	Amount (€)
Financial Accounting Net Income	Chapter 3.1	**4,900,000**

Adjustments

#	Adjustment	Calculation	Amount (€)
1	Net Taxes Expense	Current tax + deferred tax	+2,100,000
2	Excluded Dividends	Dividend from SG France (100% sub)	(450,000)
3a	Fair value gains	None	—
3b	Equity method	None	—
3c	Disposal gains	None	—
4	Revaluation OCI	None	—
5	Article 6.3	None	—
6	Asymmetric FX	Functional currencies aligned	—
7a	Bribes	None	—

#	Adjustment	Calculation	Amount (€)
7b	Fines ≥€50K	Environmental fine	+180,000
8	Prior period	None	—
9	Pension	Accrual €320K, contribution €280K	(40,000)

Subtotal Before Elections

Item	Amount (€)
Financial Accounting Net Income	4,900,000
Add: Net Taxes Expense	2,100,000
Less: Excluded Dividends	(450,000)
Add: Policy Disallowed (fine)	180,000
Less: Pension Adjustment	(40,000)
GloBE Income (before elections)	**6,690,000**

Election Analysis

Stock-Based Compensation: - Accounting expense: €95,000 - Tax deduction: €110,000 - Germany ETR expected: ~28% (above minimum) - **Decision:** No election needed (jurisdiction is high-tax)

Final GloBE Income

Item	Amount (€)
GloBE Income	**6,690,000**

14. Common Pitfalls

Pitfall 1: Forgetting to Add Back Tax Expense

Error: Using Financial Accounting Net Income directly without adding back tax expense.

Impact: GloBE Income is understated, artificially inflating ETR.

Pitfall 2: Excluding All Dividends

Error: Excluding dividends from a 5% shareholding held for 6 months.

Correct: This is a Portfolio Shareholding—dividends are **included** in GloBE Income.

Pitfall 3: Missing the €50,000 Threshold for Fines

Error: Adding back a €30,000 regulatory fine.

Correct: Fines below €50,000 are **not** added back.

Pitfall 4: Ignoring Pension Adjustment Direction

Error: Always deducting the pension adjustment.

Correct: If contributions **exceed** accrual, the adjustment **increases** GloBE Income.

Pitfall 5: Applying SBC Election Without Analysis

Error: Automatically electing SBC substitution.

Correct: In low-tax jurisdictions, the higher accounting expense may be preferable to reduce Top-Up Tax.

The mandatory adjustments in Article 3.2 transform a general-purpose accounting measure into a tax base specifically calibrated for minimum taxation purposes. While the adjustments may seem mechanical—add this back, exclude that, adjust this timing difference—understanding their policy rationale helps practitioners apply them correctly in novel situations. The framework's architects made deliberate choices: they preserved the dividend exemption principle, aligned certain timing differences with tax treatment, and disallowed expenses that public policy considerations suggest should not reduce taxable profits. These choices reflect a tax policy framework, not merely an accounting exercise, and should be interpreted with that purpose in mind.