

Chapter 7.5: Transition Year Adjustments

Learning Objective

After completing this chapter, you will be able to apply the opening balance rules for deferred tax attributes under Article 9.1, calculate SBIE using transition rates under Article 9.2, understand the DTL recapture mechanism and tracking methodologies, and identify key first-year compliance considerations.

1. Overview: Why Transition Rules Matter

When an MNE Group first enters the scope of GloBE Rules, special transition rules prevent distortions:

THE TRANSITION CHALLENGE

Without transition rules:

- Historical deferred tax attributes would be ignored
- Prior-year losses couldn't reduce GloBE income
- Opening DTLs would create immediate recapture issues
- ETR calculations would be distorted

THE SOLUTION (Article 9):

- Article 9.1: Bring in opening deferred tax balances
- Article 9.2: Phase-in SBIE rates over 10 years
- Recapture rules start from Transition Year

| → Grace periods for certain pre-existing arrangements

2. Article 9.1: Opening Deferred Tax Adjustments

2.1 The Transition Year

The **Transition Year** is the first fiscal year that an MNE Group comes within the scope of the GloBE Rules.

Scenario	Transition Year
MNE in scope from 1 Jan 2024	FY 2024
MNE crosses €750M threshold in 2025	FY 2025
New acquisition joins Group mid-2025	FY 2025 (for acquired entities)

2.2 Article 9.1.1: General Transition Rule

At the beginning of the Transition Year, MNE Groups may take into account existing deferred tax attributes:

OPENING BALANCE RULE

Deferred Tax Assets (DTAs):

- Can be used to reduce Adjusted Covered Taxes
- Must be reflected in financial accounts
- Measured at LOWER of:
 - 15% (minimum rate), OR
 - Domestic tax rate

Deferred Tax Liabilities (DTLs):

- Opening DTLs included in Adjusted Covered Taxes

- Subject to 5-year recapture rule from Transition Year
- Measured at LOWER of 15% or domestic rate

2.3 Measurement Rule: Lower of 15% or Domestic Rate

Domestic Rate	Measurement Rate	Impact
25% (UK)	15%	DTA/DTL reduced to 15% equivalent
21% (US)	15%	DTA/DTL reduced to 15% equivalent
12.5% (Ireland)	12.5%	Full amount (rate already ≤15%)
9% (Hungary)	9%	Full amount (rate already ≤15%)

2.4 Example: Opening DTA Adjustment

Scenario: German entity has €1,000,000 DTA at 30% domestic rate (FY 2024 Transition Year).

Opening DTA (German books): €1,000,000 at 30%
 Implied timing difference: $€1,000,000 \div 30\% = €3,333,333$

GloBE measurement (lower of 30% or 15%):
 GloBE DTA = $€3,333,333 \times 15\% = €500,000$

Result: Only €500,000 DTA usable for GloBE purposes
 (€500,000 reduction from accounting DTA)

2.5 Article 9.1.2: Excluded DTAs

Certain DTAs are **excluded** from the transition rule if they arise from:

Exclusion	Description	Date Threshold
Permanent differences	DTAs from items included in taxable income but not GloBE Income	Any date
Post-30 Nov 2021 transactions	DTAs created from transactions after this date (anti-abuse)	After 30 Nov 2021
Government tax benefits	Certain DTAs from government-granted tax attributes	After 30 Nov 2021

Purpose: Prevents MNEs from engineering DTAs to shelter future GloBE income.

2.6 Article 9.1.3: Intragroup Asset Transfers

For assets transferred between Constituent Entities **after 30 November 2021** but **before the Transition Year**:

INTRAGROUP TRANSFER RULE

Transfer: SubCo A sells asset to SubCo B (Dec 2022)

Transition Year: FY 2024

Rule:

- SubCo B's basis = SubCo A's carrying value at transfer
- NOT the transfer price
- Deferred tax calculated on original basis

Purpose: Prevents step-up basis from generating additional DTAs

Grace Period (January 2025 Guidance)

The January 2025 Administrative Guidance provides a **Grace Period** for certain pre-existing tax benefits:

Type	Grace Period	Cap
Government-granted DTAs (pre-transition)	2-3 years	Subject to limits
Certain tax incentive arrangements	2-3 years	Subject to limits

During the Grace Period, affected deferred tax expenses can be included in: - Total Deferred Tax Adjustment Amount (Article 4.4), OR - Simplified Covered Taxes (Transitional CbCR Safe Harbour)

3. Article 9.2: SBIE Transition Rates

10-Year Phase-In Period

The Substance-Based Income Exclusion (SBIE) uses **transition rates** that phase down over 10 years:

SBIE TRANSITION RATES			
Year	Payroll Rate	Asset Rate	Notes
2024	10.0%	8.0%	Initial rates
2025	9.8%	7.8%	
2026	9.6%	7.6%	
2027	9.4%	7.4%	
2028	9.2%	7.2%	
2029	9.0%	7.0%	
2030	8.2%	6.6%	Last 4 years: steeper decline
2031	6.4%	5.6%	
2032	5.2%	5.2%	
2033+	5.0%	5.0%	Permanent rates

Impact of Declining Rates

As SBIE rates decline, **Excess Profit increases**, leading to higher potential Top-Up Tax:

Example: Singapore (€4M GloBE Income, Payroll €1.2M, Assets €850K, ETR 10%)

Year	Payroll Carve-out	Asset Carve-out	Total SBIE	Excess Profit	Top-Up Tax (5%)
2024	€120,000 (10.0%)	€68,000 (8.0%)	€188,000	€3,812,000	€190,600
2025	€117,600 (9.8%)	€66,300 (7.8%)	€183,900	€3,816,100	€190,805
2033	€60,000 (5.0%)	€42,500 (5.0%)	€102,500	€3,897,500	€194,875

Trend: Top-Up Tax increases by ~€4,000 over transition period due to declining SBIE.

Planning Consideration

MNEs with significant substance should: - Maximise SBIE claims during early transition years - Track payroll and asset data rigorously - Model future Top-Up Tax exposure as rates decline

4. DTL Recapture Rules (Article 4.4.4)

The 5-Year Recapture Mechanism

DTLs included in Adjusted Covered Taxes are subject to **recapture** if they don't reverse within 5 years:

DTL RECAPTURE RULE

Year 1: Book DTL of €100,000 → Included in Adjusted Covered Taxes
→ ETR calculation benefits from this DTL

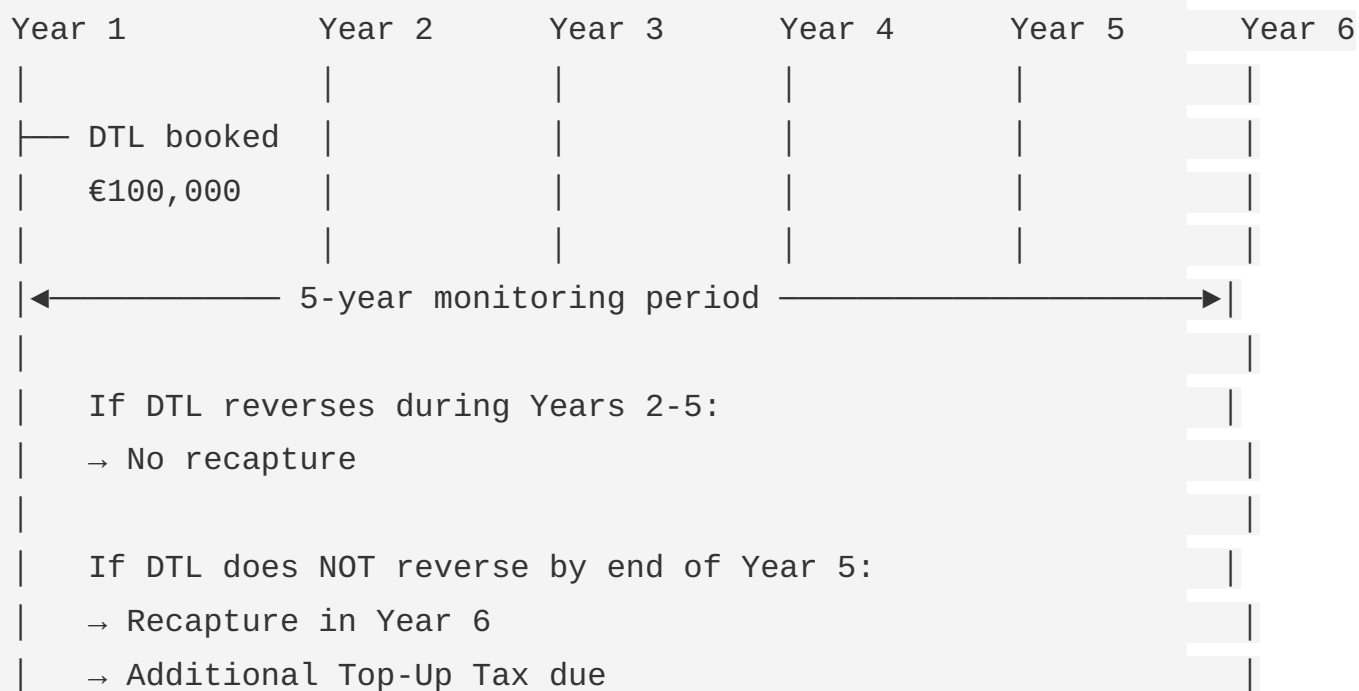
Year 2-5: DTL should reverse (timing difference unwinds)
→ If it reverses: No recapture
→ If it doesn't reverse: Recapture in Year 6

Year 6 (if not reversed):

- Re-compute Year 1 ETR WITHOUT the €100,000 DTL
- If ETR falls below 15%: Additional Top-Up Tax due
- "Recapture amount" = Additional Top-Up Tax

Visual: DTL Recapture Timeline

DTL RECAPTURE TIMELINE



Recapture Exception Accruals

Certain DTLs are **exempt** from the recapture rule:

Exception	Description
Accelerated depreciation	DTLs on tangible assets (depreciation timing differences)
Cost recovery allowances	Similar to accelerated depreciation
Fair value accounting	DTLs on unrealised gains (mark-to-market)
Certain pension liabilities	As specified in guidance

These DTLs are expected to reverse over extended periods and are excluded from recapture.

3.3 DTL Tracking Methodologies

The June 2024 Administrative Guidance provides three tracking approaches:

Method	Description	Best For
Item-by-item	Track each DTL individually	Small number of DTLs
GL account basis	Track by general ledger account	Medium complexity
Aggregate DTL category	Track by DTL type category	Large volume of DTLs

FIFO vs LIFO Methodology

For DTL reversals, MNEs may use:

Method	Assumption	Effect
FIFO	Reversals relate to oldest accruals	Earlier recapture trigger
LIFO	Reversals relate to newest accruals	Later recapture trigger

Choice depends on: DTL characteristics and administrative preference.

5. Stratos Worked Example: Transition Year Adjustments

5.1 Background

Stratos Holdings plc enters GloBE scope in FY 2024 (Transition Year). Analyse transition adjustments for Irish operations.

Opening Deferred Tax Position (SG Ireland Ltd)

Item	Amount (€)	Tax Rate	DTA/DTL
Tax losses carried forward	2,000,000	12.5%	DTA €250,000
Accelerated depreciation	(500,000)	12.5%	DTL €62,500
Provisions (timing)	300,000	12.5%	DTA €37,500
Net DTA			€225,000

Step 1: Apply Article 9.1.1 Measurement Rule

Irish domestic rate (12.5%) is **below** 15%, so full amounts are used:

Item	Accounting Amount	GloBE Amount	Adjustment
Loss DTA	€250,000	€250,000	None (12.5% < 15%)
Depreciation DTL	€62,500	€62,500	None
Provisions DTA	€37,500	€37,500	None
Net	€225,000	€225,000	None

Result: Full opening deferred tax balances carried into GloBE.

Step 2: Check Article 9.1.2 Exclusions

DTA	Created	Post-30 Nov 2021?	Excluded?
Loss DTA	FY 2019-2022	Partially	Check each year
Provisions DTA	Ongoing	Mixed	Review

Assumption: All DTAs arose from normal business operations, not excluded arrangements.

Step 3: SBIE Calculation Using Transition Rates (FY 2025)

Component	Amount (€)	Rate (2025)	Carve-out (€)
Payroll	8,400,000	9.8%	823,200
Tangible Assets	12,000,000	7.8%	936,000
Total SBIE			1,759,200

Step 4: DTL Recapture Setup

Opening DTL (accelerated depreciation): €62,500

Year	DTL Booked	Reversal	Cumulative
2024 (Transition)	€62,500	—	€62,500
2025	—	€12,500	€50,000
2026	—	€12,500	€37,500
2027	—	€12,500	€25,000
2028	—	€12,500	€12,500
2029	—	€12,500	€0

Result: DTL fully reverses within 5 years → No recapture.

Step 5: Compare with Higher-Rate Jurisdiction (Germany)

SG Germany GmbH Opening Position:

Item	Amount (€)	Tax Rate	Accounting DTA
Tax losses carried forward	5,000,000	30%	DTA €1,500,000

GloBE Adjustment:

Accounting DTA: €1,500,000 at 30%

Implied timing difference: $€1,500,000 \div 30\% = €5,000,000$

GloBE measurement (lower of 30% or 15%):

GloBE DTA = $€5,000,000 \times 15\% = €750,000$

Reduction: €1,500,000 - €750,000 = €750,000 (50% reduction)

Impact: German loss DTA is halved for GloBE purposes due to rate cap.

6. First-Year Compliance Considerations

Transition Year Checklist

TRANSITION YEAR CHECKLIST

MNE Group: _____

Transition Year: _____

SECTION A: OPENING DEFERRED TAX BALANCES

For each jurisdiction:

Jurisdiction: _____

☐ Identify all opening DTAs and DTLs:

- | | |
|---|-----------|
| <input type="checkbox"/> Loss carryforwards: | € _____ |
| <input type="checkbox"/> Depreciation timing differences: | € _____ |
| <input type="checkbox"/> Provisions timing differences: | € _____ |
| <input type="checkbox"/> Other DTAs: | € _____ |
| <input type="checkbox"/> Other DTLs: | (€ _____) |
| <input type="checkbox"/> **Net DTA / (DTL):** | € _____ |

☐ Apply measurement rule (lower of 15% or domestic rate):

- | | |
|--|---------|
| <input type="checkbox"/> Domestic tax rate: | _____ % |
| <input type="checkbox"/> Measurement rate (lower of above or 15%): | _____ % |
| <input type="checkbox"/> GloBE-adjusted DTA/DTL: | € _____ |

☐ Check Article 9.1.2 exclusions:

☐ Any DTAs from post-30 Nov 2021 transactions? YES / NO

☐ Any DTAs from government tax benefits? YES / NO

☐ Excluded amount: € _____

☐ **Net GloBE opening deferred tax:** € _____

(Repeat for each jurisdiction)

SECTION B: SBIE TRANSITION RATES

☐ Transition Year: _____

☐ Applicable rates:

☐ Payroll carve-out rate: _____ %

☐ Asset carve-out rate: _____ %

☐ SBIE calculations prepared for all jurisdictions? YES / NO

SECTION C: DTL RECAPTURE TRACKING

☐ DTL tracking methodology selected:

☐ Item-by-item

☐ GL account basis

☐ Aggregate DTL category

☐ FIFO or LIFO methodology selected:

☐ FIFO

☐ LIFO

☐ Opening DTLs documented and tracking established? YES / NO

☐ Recapture exception accruals identified:

- | | |
|---|---------|
| <input type="checkbox"/> Accelerated depreciation DTLs: | € _____ |
| <input type="checkbox"/> Fair value DTLs: | € _____ |
| <input type="checkbox"/> Other exempt DTLs: | € _____ |

SECTION D: DOCUMENTATION

- | | |
|---|----------|
| <input type="checkbox"/> Opening balance reconciliation prepared? | YES / NO |
| <input type="checkbox"/> Article 9.1.2 exclusion analysis documented? | YES / NO |
| <input type="checkbox"/> DTL tracking system implemented? | YES / NO |
| <input type="checkbox"/> SBIE data collection process established? | YES / NO |

7. Common Pitfalls

Pitfall 1: Ignoring the 15% Measurement Cap

Error: Using full accounting DTAs at domestic rates above 15%.

Consequence: Overstated DTAs for GloBE purposes.

Correct approach: Apply the lower of 15% or domestic rate to all opening deferred tax balances.

Pitfall 2: Missing Article 9.1.2 Exclusions

Error: Including DTAs from post-30 November 2021 transactions.

Consequence: Invalid DTAs inflate Adjusted Covered Taxes.

Correct approach: Review DTA creation dates; exclude those from specified post-2021 transactions.

Pitfall 3: Forgetting DTL Tracking from Day One

Error: Not establishing DTL tracking in the Transition Year.

Consequence: Unable to demonstrate reversals; unexpected recapture.

Correct approach: Implement DTL tracking system from the Transition Year. Select methodology (FIFO/LIFO) and document consistently.

Pitfall 4: Using Wrong SBIE Rates

Error: Using permanent 5% rates instead of transition rates.

Consequence: Understated SBIE; overstated Top-Up Tax.

Correct approach: Apply transition rates based on fiscal year (9.8%/7.8% for 2025, etc.).

Pitfall 5: Overlooking Grace Period Benefits

Error: Not claiming Grace Period relief for qualifying pre-existing arrangements.

Consequence: Missed opportunity to include certain deferred tax expenses.

Correct approach: Review January 2025 guidance; identify qualifying arrangements and apply Grace Period rules.