Chapter 4.2: Current Tax Expense Adjustments

Learning Objective

This chapter provides the methodology for adjusting the current tax expense starting point to arrive at Adjusted Covered Taxes. The current tax expense from financial accounts requires modifications to align with GloBE principles—certain items must be added, others subtracted. Mastering these adjustments prevents both overstating and understating the ETR numerator.

1. The Adjustment Framework

Article 4.1.1 establishes that Adjusted Covered Taxes begin with the current tax expense from financial accounts. Articles 4.1.2 and 4.1.3 then prescribe specific additions and subtractions.

Formula:

```
Adjusted Covered Taxes (Current) =
    Current Tax Expense (from financial accounts)
  + Additions (Article 4.1.2)
  − Subtractions (Article 4.1.3)
```

The deferred tax adjustments (covered in Chapter 4.3) are applied separately.

2. Additions to Covered Taxes (Article 4.1.2)

Five categories of additions ensure taxes that belong in the ETR numerator are captured even if not recorded as current tax expense in P&L.

2.1 Addition 1: Taxes Recorded Outside P&L (Article 4.1.2(a))

What it captures: Covered Taxes expensed in equity or Other Comprehensive Income (OCI) rather than profit before tax.

Examples: | Item | Where Recorded | Treatment | |------|----------------|-----------| | Tax on revaluation gains | OCI | Add to Covered Taxes | | Tax on hedging reserves | OCI | Add to Covered Taxes | | Tax on actuarial adjustments | OCI | Add to Covered Taxes | | Tax on foreign currency translation | Equity | Add to Covered Taxes |

Practical step: Review the tax charge reconciliation in notes to accounts. Extract any income tax recorded directly in equity or OCI and add to current tax expense.

Stratos example: SG Germany GmbH has a €45,000 tax charge on pension actuarial gains recorded in OCI. This is added to Covered Taxes.

2.2 Addition 2: GloBE Loss DTA Usage (Article 4.1.2(b))

What it captures: When the GloBE Loss Election is made (see Chapter 4.4), a notional DTA is created at 15%. When this GloBE Loss DTA is utilised in subsequent years, the utilisation amount is added to Covered Taxes.

Mechanics:

```
 Year 1: GloBE Loss of €10M → Create GloBE Loss DTA: €10M × 15% = €1.5M
Year 2: GloBE Income of €8M → Use GloBE Loss DTA: €8M × 15% = €1.2M
        → Add €1.2M to Year 2 Covered Taxes
```

Why this matters: Under the GloBE Loss Election, losses generate a deemed tax benefit at 15%. When income is earned in future years, this deemed benefit must flow through the ETR calculation.

2.3 Addition 3: UTPs Subsequently Paid (Article 4.1.2(c))

What it captures: Tax on uncertain tax positions (UTPs) that was previously excluded from Covered Taxes but is now actually paid.

The cycle: 1. **Year 1:** UTP accrued → Excluded from Covered Taxes (Article 4.1.3(d)) 2. **Year 3:** UTP resolved, tax paid → Add to Year 3 Covered Taxes

Important exclusion: Interest and penalties associated with UTPs are NOT added—only the tax principal amount.

Example:

```
 FY 2024: SG Ireland Ltd accrues €800,000 UTP provision
         → Excluded from 2024 Covered Taxes

FY 2026: Irish Revenue audit settles; €650,000 tax paid
         → Add €650,000 to 2026 Covered Taxes
         → €150,000 release goes to income (not relevant to Covered Tax
```

2.4 Addition 4: QRTC Recorded as Tax Reduction (Article 4.1.2(d))

What it captures: Qualified Refundable Tax Credits that were recorded as a reduction to current tax expense must be reversed out and treated as income instead.

The mechanics: | Step | Action | Effect | |------|---------|---------| | 1 | Identify QRTC in tax expense | Credit reduces tax expense | | 2 | Add QRTC amount back to Covered Taxes | Reverses accounting treatment | | 3 | Add QRTC to GloBE Income | Treats as income (Article 3.2.10) |

Example:

```
Financial accounts show:
  Pre-credit tax expense:     €5,000,000
  R&D tax credit (QRTC):     (€200,000)
  Net tax expense:            €4,800,000
```

```
GloBE adjustment:
  Current tax expense:        €4,800,000
  Add back QRTC:             +€200,000
  Adjusted Covered Taxes:     €5,000,000

Corresponding GloBE Income adjustment:
  Financial accounting income: €30,000,000
  Add QRTC:                     +€200,000
  Adjusted GloBE Income:      €30,200,000
```

Critical point: The QRTC adjustment is dual—add to Covered Taxes AND add to GloBE Income. Both adjustments must be made together.

2.5 Addition 5: Taxes on Distributed Profits Under EDTS (Article 4.1.2(e))

What it captures: For entities in Eligible Distribution Tax System jurisdictions (e.g., Estonia, Latvia), deemed distribution taxes expected to be paid within four years are added.

Application: Only relevant for entities in EDTS jurisdictions. See Chapter 4.1 for EDTS mechanics.

3. Subtractions from Covered Taxes (Article 4.1.3)

Five categories of subtractions ensure taxes are not counted when they relate to income excluded from GloBE or when payment is uncertain.

3.1 Subtraction 1: Taxes on Excluded Income (Article 4.1.3(a))

Principle: If income is excluded from GloBE Income, the tax on that income must also be excluded from Covered Taxes. Otherwise, the ETR would be artificially inflated.

Categories of excluded income requiring tax subtraction: | Excluded Income | GloBE Article | Tax Treatment | |-----------------|---------------|---------------| | Excluded Dividends | Article 3.2.1(b) | Subtract related tax | | Excluded Equity Gains | Article

3.2.1(c) | Subtract related tax | | International Shipping Income | Article 3.3 | Subtract related tax | | Policy Disallowed Expenses | Article 3.2.1(f) | Complex—see below |

Calculation method for excluded income tax:

```
Tax on Excluded Income = (Excluded Income ÷ Total Income) × Total Tax E
```

Worked example:

```
 Total GloBE Income:            €10,000,000
Excluded Dividend:               €2,000,000
Total Tax Expense:               €1,500,000

Tax on Excluded Dividend:
  (€2,000,000 ÷ €10,000,000) × €1,500,000 = €300,000

Adjusted Covered Taxes:
  €1,500,000 − €300,000 = €1,200,000
```

Documentation required: Maintain workpaper showing allocation methodology between included and excluded income.

3.2 Subtraction 2: Non-QRTC Recorded as Income (Article 4.1.3(b))

What it captures: If a non-qualified refundable tax credit was recorded as income (rather than as a reduction of tax expense), it must be subtracted from Covered Taxes.

Contrast with Article 4.1.2(d): | Credit Type | Accounting Treatment | GloBE Adjustment | |-------------|---------------------|------------------| | QRTC recorded as tax reduction | Add to Covered Taxes | Article 4.1.2(d) | | QRTC recorded as income | No adjustment needed | — | | Non-QRTC recorded as income | Subtract from Covered Taxes | Article 4.1.3(b) | | Non-QRTC recorded as tax reduction | No adjustment needed | — |

3.3 Subtraction 3: Refund of Non-QRTC (Article 4.1.3(c))

What it captures: Refunds of non-qualified tax credits that are recorded as a reduction to current tax expense.

Example: Entity receives refund of previously claimed investment tax credit (non-QRTC). The refund reduced current tax expense. Subtract this amount from Covered Taxes.

3.4 Subtraction 4: Uncertain Tax Positions (Article 4.1.3(d))

Principle: Tax expense related to UTPs is excluded from Covered Taxes because payment is not sufficiently certain.

Definition: A UTP exists when the entity takes a filing position that is **not more likely than not** to be sustained upon examination (i.e., less than 50% probability of being upheld).

Impact:

```
 Current tax expense per accounts:  €8,000,000
UTP provision included:            (€500,000)
Covered Taxes:                      €7,500,000
```

Subsequent treatment: When the UTP is resolved and tax is paid, add to Covered Taxes per Article 4.1.2(c).

3.5 Subtraction 5: Tax Not Expected to Be Paid Within 3 Years (Article 4.1.3(e))

Principle: Current tax expense that is not expected to be paid within three years of the fiscal year-end is excluded from Covered Taxes.

Rationale: GloBE requires a degree of certainty that taxes will actually be paid. If payment is delayed beyond three years, it should not count until paid.

When this applies: - Contested tax assessments under appeal - Tax payment deferrals granted by authorities - Instalment arrangements extending beyond three years

Example:

```
 FY 2024 current tax expense:    €6,000,000
Tax under appeal (payment suspended):  €1,200,000

If resolution expected beyond FY 2027:
  Covered Taxes for 2024: €6,000,000 − €1,200,000 = €4,800,000
```

4. CFC Tax Push-Down (Article 4.3.2(c))

When a parent entity pays CFC tax on the undistributed income of a foreign subsidiary, that tax must be **pushed down** to the subsidiary for Covered Tax purposes.

4.1 Why Push-Down Is Required

Without push-down: - Parent's ETR is inflated (tax without corresponding income) - Subsidiary's ETR is understated (income without corresponding tax)

Push-down ensures taxes are matched with the income that generated them.

4.2 The Push-Down Mechanism

Step 1: Identify CFC tax in parent's current tax expense

Step 2: Determine the subsidiary to which the CFC income relates

Step 3: Remove CFC tax from parent's Covered Taxes

Step 4: Add CFC tax to subsidiary's Covered Taxes

Diagram:

```
 BEFORE PUSH-DOWN:

┌──────────────────────────────┐
│ Parent Co (UK)               │
│ CFC Tax Paid: €300,000       │ ← Tax here
│ Income: €20,000,000          │
```

```
└──────────────────────────────┘
              │
              ▼
┌──────────────────────────────┐
│ Sub Co (Low-Tax Country)     │
│ Tax Paid: €50,000            │
│ Income: €5,000,000           │ ← Income here
│ ETR: 1.0%                    │
└──────────────────────────────┘

AFTER PUSH-DOWN:
┌──────────────────────────────┐
│ Parent Co (UK)               │
│ CFC Tax: €300,000 → REMOVED │
│ Income: €20,000,000          │
└──────────────────────────────┘
              │
              ▼
┌──────────────────────────────┐
│ Sub Co (Low-Tax Country)     │
│ Tax: €50,000 + €300,000      │ ← CFC tax pushed down
│ Income: €5,000,000           │
│ ETR: 7.0%                    │ ← Higher ETR
└──────────────────────────────┘
```

4.3 Passive Income Limitation (Article 4.3.3)

For passive income (interest, royalties, dividends), the push-down amount is capped. The cap prevents excessive push-down from artificially eliminating top-up tax.

The formula:

```
Push-Down Limit = MIN(
   Actual CFC tax on passive income,
```

```
    Top-Up Tax % × Passive income taxed under CFC
)
```

Where: - Top-Up Tax % = 15% − Subsidiary's ETR (before push-down)

Example:

```
 Sub Co (Singapore):
  Passive income taxed under UK CFC: €2,000,000
  Sub's ETR before push-down: 8%
  UK CFC tax on passive income: €500,000

Push-Down Limit:
  Top-Up Tax % = 15% − 8% = 7%
  Limit = 7% × €2,000,000 = €140,000

Push-Down Amount:
  MIN(€500,000, €140,000) = €140,000

Result:
  Only €140,000 pushed to Singapore, not €500,000
  Remaining €360,000 stays in UK parent's Covered Taxes
```

Purpose: This prevents a high-tax parent from fully shielding a low-tax subsidiary through CFC tax push-down.

5. Blended CFC Regime Rules (GILTI)

The US GILTI regime presents a unique challenge because it applies on a **blended** basis across all CFCs, not entity-by-entity.

5.1 The Issue

GILTI calculates tax on aggregate CFC income, making entity-level allocation difficult.

5.2 Temporary Allocation Rule (February 2023 Administrative Guidance)

For Blended CFC Tax Regimes: 1. Allocate GILTI tax to each CFC based on its share of total tested income 2. Apply passive income limitation separately to each CFC 3. Push down allocated amount to each CFC

Note: The June 2024 Administrative Guidance formula for regular CFC regimes does not apply to GILTI. The temporary rule continues.

6. The Three-Year Recapture Rule (Article 4.6.4)

Taxes included in Covered Taxes must be **actually paid** within three years. If not, they are recaptured.

6.1 Application Threshold

Only applies if unpaid taxes exceed **€1 million**.

6.2 Mechanics

Year 1: Include €2M current tax in Covered Taxes

Year 4 (end): Only €800,000 paid; €1.2M unpaid

Recapture: Recompute Year 1 ETR and Top-Up Tax excluding €1.2M

6.3 Practical Steps

1. Track current tax accruals by fiscal year
2. Monitor actual payment dates
3. At end of Year 3, assess unpaid amounts exceeding €1M
4. If threshold exceeded, trigger recapture calculation under Article 5.4.1

6.4 Documentation

Maintain a tracking schedule:

Fiscal Year	Tax Accrued	Paid Y1	Paid Y2	Paid Y3	Unpaid Y3 End	Recapture?
2024	€5,000,000	€4,000,000	€800,000	€100,000	€100,000	No (<€1M)
2025	€6,500,000	€3,000,000	€2,000,000	€200,000	€1,300,000	**Yes**

7. Current Tax Adjustment Checklist

Use this checklist when calculating Adjusted Covered Taxes (current portion):

7.1 Step 1: Starting Point

- [ ] Extract current tax expense from P&L
- [ ] Confirm same financial accounts as used for GloBE Income

7.2 Step 2: Additions (Article 4.1.2)

- [ ] Tax recorded in equity/OCI on GloBE items
- [ ] GloBE Loss DTA utilised (if election made)
- [ ] UTP taxes paid this year (previously excluded)
- [ ] QRTCs recorded as tax reduction (reverse to income)
- [ ] EDTS deemed distribution taxes (if applicable)

7.3 Step 3: Subtractions (Article 4.1.3)

- [ ] Tax on excluded dividends
- [ ] Tax on excluded equity gains/losses
- [ ] Tax on international shipping income
- [ ] Non-QRTC recorded as income
- [ ] UTP provisions (not yet paid)
- [ ] Tax not expected to be paid within 3 years

7.4 Step 4: Allocations (Article 4.3)

- [ ] Identify CFC taxes in parent accounts
- [ ] Push down CFC taxes to subsidiaries
- [ ] Apply passive income limitation
- [ ] Document GILTI allocation if applicable

7.5 Step 5: Recapture Monitoring

- [ ] Track current tax payments by fiscal year
- [ ] Assess unpaid amounts at Year 3 end
- [ ] Trigger recapture if unpaid exceeds €1M

8. Stratos Worked Example: Current Tax Adjustments

Scenario: SG Germany GmbH's FY 2025 current tax adjustment workpaper

8.1 Starting Data

Item	Amount (€)	Reference
Current tax expense (P&L)	11,200,000	Chapter 4.1
Tax in OCI (pension actuarial)	45,000	Note 12
R&D credit (QRTC)	(180,000)	Recorded as tax reduction
Tax on excluded dividend	—	€3.1M dividend × 0% WHT
UTP provision	280,000	Transfer pricing reserve
Prior year UTP settled	150,000	Paid in 2025

8.2 Adjustment Calculation

Step 1: Starting Point

```
Current tax expense (P&L):          €11,200,000
```

Step 2: Additions

```
Tax in OCI (Art. 4.1.2(a)):          +€45,000
Prior UTP paid (Art. 4.1.2(c)):     +€150,000
QRTC add-back (Art. 4.1.2(d)):      +€180,000
                                    ─────────
Subtotal Additions:                 +€375,000
```

Step 3: Subtractions

```
Tax on excluded dividend:              −€0
  (Dividend from 100% subsidiary; no German WHT)

UTP provision (Art. 4.1.3(d)):      −€280,000
                                    ─────────
Subtotal Subtractions:              −€280,000
```

Step 4: CFC Tax Push-Down

```
UK parent CFC charge on SG Germany: €0
  (Germany is high-tax; no UK CFC exposure)

Push-down from parent:              €0
```

Step 5: Adjusted Covered Taxes (Current)

```
Starting point:                      €11,200,000
Additions:                          +€375,000
Subtractions:                       −€280,000
```

```
Push-down:                         +€0
                                   ──────────
Adjusted Covered Taxes (Current):  €11,295,000
```

8.3 Corresponding GloBE Income Adjustment

The QRTC add-back requires a matching GloBE Income adjustment:

```
 GloBE Income (from Chapter 3.2):    €53,700,000
Add: QRTC (Art. 3.2.10):           +€180,000
                                   ──────────
Adjusted GloBE Income:             €53,880,000
```

8.4 Summary Workpaper

Line	Description	Addition	Subtraction	Net Adjustment
1	Current tax expense (starting)			€11,200,000
2	Tax in OCI	€45,000		+€45,000
3	Prior year UTP paid	€150,000		+€150,000
4	QRTC reversal	€180,000		+€180,000
5	Current year UTP		€280,000	−€280,000
6	Tax on excluded income		€0	€0
7	CFC push-down	€0		€0
8	**Adjusted Covered Taxes (Current)**			**€11,295,000**

9. Common Pitfalls

9.1 Pitfall 1: Forgetting the Dual QRTC Adjustment

Issue: Adding QRTC to Covered Taxes but forgetting to add to GloBE Income

Impact: ETR is incorrectly calculated

Solution: Always pair QRTC adjustments—Covered Taxes AND GloBE Income

9.2 Pitfall 2: Including UTP Penalties and Interest

Issue: Adding full UTP settlement (including penalties and interest) to Covered Taxes

Impact: Overstates Covered Taxes

Solution: Only include the tax principal; exclude interest and penalties

9.3 Pitfall 3: Ignoring Passive Income Limitation

Issue: Pushing down full CFC tax without applying Article 4.3.3 cap

Impact: Artificially inflates subsidiary's ETR

Solution: Always calculate and apply the passive income limitation

9.4 Pitfall 4: Missing Taxes in OCI/Equity

Issue: Only extracting current tax expense from P&L

Impact: Understates Covered Taxes

Solution: Review full tax reconciliation in notes; include taxes in equity/OCI