Chapter 4.3: Deferred Tax Adjustments

Learning Objective

This chapter provides the methodology for calculating the Total Deferred Tax Adjustment Amount (DTAA) that modifies the current tax expense to produce total Adjusted Covered Taxes. Deferred tax accounting creates timing differences between financial accounting and tax—the DTAA ensures GloBE captures the economic reality of when taxes will ultimately be paid.

Introduction

Deferred tax accounting presents one of the most technically complex areas of GloBE compliance. Financial statements recognise deferred tax assets and liabilities to reflect timing differences between accounting and tax bases—accelerated depreciation creates DTLs; accrued provisions create DTAs; losses generate DTAs that will reduce future taxes. These deferred items tell an important story about future tax payments and benefits. The GloBE framework must decide how much weight to give this story. Including all deferred tax movements at face value would allow high-tax jurisdictions to claim excessive benefits; ignoring them entirely would penalise entities with legitimate timing differences. Article 4.4 strikes a balance: deferred tax movements are included, but subject to significant modifications. The 15% rate cap prevents high-rate jurisdictions from generating disproportionate benefits. Exclusions remove movements that reflect accounting judgments rather than economic tax changes. The five-year recapture rule ensures that claimed DTL benefits actually materialise. These safeguards transform deferred tax from a potentially manipulable accounting construct into a disciplined measure of genuine future tax consequences.

1. The Deferred Tax Adjustment Framework

The GloBE approach to deferred taxes differs significantly from financial accounting. Three key principles govern:

1. **15% Rate Cap:** All DTAs and DTLs are valued at the lower of 15% or the applicable domestic rate
2. **Exclusions:** Several categories of deferred tax movements are ignored
3. **Recapture:** DTLs claimed in Covered Taxes must reverse within five years or be recaptured

Formula:

```
Total Deferred Tax Adjustment Amount (DTAA) =
   Deferred Tax Expense (from financial accounts)
 ± Adjustments for 15% rate cap
 − Excluded deferred tax items
 + DTL recapture adjustments (if applicable)
```

2. The 15% Rate Cap (Article 4.4.1)

2.1 The Rule

All deferred tax assets and liabilities must be valued at the **lower of:** - The 15% minimum rate, OR - The applicable domestic tax rate

2.2 Why This Matters

Without the cap, a high-tax jurisdiction could create excess deferred tax benefits that inflate Covered Taxes beyond what will actually be paid.

Example:

```
Jurisdiction with 25% tax rate:
 DTL in financial accounts:    €1,000,000 (at 25%)
```

```
For GloBE purposes:
  DTL recast to 15%:          €600,000 (€1M × 15/25)

Difference:                   €400,000 reduction in DTAA
```

2.3 Practical Application

Step 1: Extract deferred tax expense from financial accounts

Step 2: Identify the applicable domestic tax rate

Step 3: If domestic rate > 15%, recast deferred tax balances at 15%

Step 4: Calculate the adjusted deferred tax movement

2.4 Rate Cap Calculation Template

Item	Accounts Rate	GloBE Rate	Accounts Value	GloBE Value	Adjustment
DTL on intangibles	30%	15%	€2,000,000	€1,000,000	−€1,000,000
DTA on provisions	25%	15%	€500,000	€300,000	−€200,000
DTA on losses	20%	15%	€800,000	€600,000	−€200,000

Key point: DTAs in low-tax jurisdictions (rate < 15%) can be **recast upward** to 15% if attributable to a GloBE Loss (Article 4.4.3).

The 15% rate cap reflects a deliberate policy choice to limit the benefit that high-tax jurisdictions can derive from deferred tax items. Without the cap, a 30% jurisdiction could generate €300,000 of Covered Tax benefit from €1M of DTL, even though the minimum rate is only 15%. This would effectively give high-tax jurisdictions a permanent advantage in meeting the minimum rate threshold—their deferred tax items would count double relative to the policy objective. The cap ensures that

deferred tax contributes to Covered Taxes at a rate consistent with the minimum tax target. The asymmetry—capping high rates but allowing low-rate loss DTAs to be recast upward—creates parity: losses in zero-tax jurisdictions receive the same 15% benefit as losses in 30% jurisdictions. This prevents the framework from disadvantaging groups that structure losses in low-tax locations.

3. GloBE Loss DTA Recasting (Article 4.4.3)

3.1 The Exception

While the general rule caps deferred tax at 15%, loss-related DTAs in low-tax jurisdictions can be increased to 15% if: 1. The DTA arose from a loss, AND 2. The loss would have been a GloBE Loss

3.2 Why This Exists

Without this provision, losses in zero-tax or low-tax jurisdictions would provide no GloBE benefit, creating an asymmetry with profits.

3.3 Example

```
 Jurisdiction: Singapore (17% rate)
Entity: SG Singapore Pte Ltd

Year 1 (Loss):
  GloBE Loss: €5,000,000
  Accounting DTA: €5M × 17% = €850,000
  GloBE DTA: €5M × 17% = €850,000 (rate < 15%, no recast needed)

Jurisdiction: Cayman Islands (0% rate)
Entity: SG Cayman Ltd

Year 1 (Loss):
  GloBE Loss: €3,000,000
```

```
  Accounting DTA: €0 (no tax rate)
  GloBE DTA (recast): €3M × 15% = €450,000 ← Benefit created at 15%
```

4. Excluded Deferred Tax Items (Article 4.4.1(b)-(e))

Several categories of deferred tax movements are **excluded** from the DTAA to prevent distortions.

4.1 Exclusion 1: Deferred Tax on Excluded Income (Article 4.4.1(b))

Deferred tax relating to income excluded from GloBE Income is excluded from DTAA.

Examples: - Deferred tax on excluded dividends - Deferred tax on excluded equity gains - Deferred tax on international shipping income

Rationale: If the income isn't in GloBE Income, the tax shouldn't be in Covered Taxes.

4.2 Exclusion 2: Valuation Allowances (Article 4.4.1(c))

Movements in deferred tax arising from valuation adjustments or recognition criteria are excluded.

What this covers: - US GAAP valuation allowances on DTAs - IFRS recognition adjustments (probability of future profits) - Write-downs of DTAs due to uncertainty

Rationale: These are accounting judgments, not actual tax payments or deferrals.

Example:

```
 Year 1: DTA of €1M recorded; no valuation allowance
Year 2: Entity reassesses; records €300,000 valuation allowance
        Deferred tax expense in P&L: €300,000

For GloBE:
  Exclude the €300,000 from DTAA
```

4.3 Exclusion 3: Rate Change Effects (Article 4.4.1(d))

Deferred tax expense arising from changes in domestic tax rates is excluded.

What this covers: - Remeasurement of DTAs when rate decreases - Remeasurement of DTLs when rate increases - One-time charges/credits from enacted rate changes

Rationale: These reflect future tax rates, not current-year income taxation.

Example:

```
 Country X announces rate reduction: 25% → 21%

Financial accounting impact:
  DTL revaluation: €2M × (25% − 21%) = €80,000 credit to P&L

For GloBE:
  Exclude the €80,000 from DTAA
```

4.4 Exclusion 4: Tax Credit Effects (Article 4.4.1(e))

Deferred tax arising from the generation and use of tax credits is excluded.

What this covers: - Creation of deferred tax assets for unused credits - Utilisation of credit-related DTAs - Changes in credit carryforward balances

Rationale: Tax credits receive separate treatment (QRTC vs non-QRTC); deferred tax on credits would double-count.

Important exception: This exclusion does NOT apply in the Transition Year under Article 9.1—credit-related deferred tax is included in opening balances.

4.5 Exclusion 5: Uncertain Tax Positions (Article 4.4.1(b))

Deferred tax movements related to UTPs are excluded (consistent with current tax treatment).

4.6 Exclusion Summary Checklist

Exclusion	Article	Exclude from DTAA?
DT on excluded dividends	4.4.1(b)	Yes
DT on excluded equity gains	4.4.1(b)	Yes
Valuation allowance movements	4.4.1(c)	Yes
Rate change remeasurement	4.4.1(d)	Yes
Tax credit generation/use	4.4.1(e)	Yes
UTP-related deferred tax	4.4.1(b)	Yes

The exclusions share a common theme: they remove deferred tax movements that do not represent genuine changes in future tax payments. Deferred tax on excluded income is irrelevant because the income itself is excluded—counting the deferred tax would mismatch numerator and denominator. Valuation allowances reflect management's judgment about recoverability, not changes in the underlying tax position—recording or releasing an allowance doesn't change the taxes that will actually be paid when the temporary difference reverses. Rate change remeasurements are accounting adjustments to reflect newly enacted rates—they don't represent current-year income taxation. Tax credit movements receive separate treatment elsewhere in the framework; including them in deferred tax would create double-counting. Each exclusion ensures that the DTAA measures real tax consequences, not accounting artifacts.

5. DTL Recapture Rule (Article 4.4.4)

5.1 The Five-Year Reversal Requirement

Deferred tax liabilities claimed in Covered Taxes must reverse (i.e., the underlying tax must be paid) within **five fiscal years**. If not, the DTL is **recaptured**.

5.2 How Recapture Works

Year 1: DTL of €500,000 included in DTAA (increases Covered Taxes)

Year 6 (end): DTL has not fully reversed; €300,000 still outstanding

Recapture: Year 1 ETR and Top-Up Tax are recomputed excluding the €300,000 DTL

5.3 Tracking Requirement

MNE Groups must track DTLs by fiscal year of origination and monitor reversal. Two methods are permitted:

Method	Description	Use When
FIFO	First DTLs in are first to reverse	Homogeneous DTL categories
LIFO	Last DTLs in are first to reverse	Default method

5.4 The Unjustified Balance

The recapture amount is determined by the "Unjustified Balance"—the portion of the DTL that has not reversed by the end of the five-year testing period.

```
 Year 1: DTL accrued         +€1,000,000
Year 2: DTL reversal        −€200,000
Year 3: DTL reversal        −€300,000
Year 4: DTL reversal        −€100,000
Year 5: DTL reversal        −€150,000
Year 6 (end):
  Unjustified Balance:      €250,000 ← Recapture this amount
```

6. Recapture Exception Accruals (Article 4.4.5)

Certain DTLs are **exempt** from the five-year recapture rule. These "Recapture Exception Accruals" (REAs) do not need tracking.

6.1 Qualifying Categories

REA Category	Description
Cost recovery on tangible assets	Depreciation timing differences on PP&E
Leased tangible assets	DTLs on right-of-use assets (per June 2024 guidance)
R&D expenditure	DTLs from capitalised R&D amortisation
Decommissioning/ remediation	DTLs on environmental provisions
Fair value accounting	DTLs on unrealised gains from fair value
Foreign exchange	DTLs on unrealised FX gains
Insurance reserves	DTLs on insurance technical provisions
Deferred acquisition costs	Insurance DAC-related DTLs
Reinvestment gains	DTLs on deferred gains from asset reinvestment

6.2 Practical Benefit

If a DTL falls within an REA category, no tracking is required—the DTL can be included in DTAA without monitoring for reversal.

Example:

```
SG Germany GmbH has:
  DTL on accelerated depreciation (tangible assets): €800,000
  DTL on intangible amortisation: €400,000

REA Analysis:
  Tangible asset DTL: REA (cost recovery) → No tracking required
  Intangible DTL: NOT an REA → Track for 5-year recapture
```

The REA categories reflect a practical recognition that certain DTL categories almost always reverse within reasonable timeframes—or that tracking them would impose disproportionate compliance burdens relative to the risk they present. Depreciation timing differences on tangible assets will inevitably reverse as the assets are depreciated or sold; the DTL simply reflects a timing difference, not a permanent benefit. R&D capitalisation follows similar logic. Environmental provisions represent genuine future costs that will generate tax deductions when incurred. These categories were not chosen arbitrarily—they represent the result of extensive consultation and negotiation during the GloBE development process. Groups should be conservative in applying REA treatment, documenting the specific category under which each DTL qualifies and being prepared to justify the classification if challenged.

7. Unclaimed Accrual Election (Article 4.4.7)

7.1 The Election

If a DTL is **not expected to reverse** within five years, the entity can elect to treat it as an "Unclaimed Accrual."

7.2 Effect of Election

- The DTL is **excluded** from DTAA in the year of origination
- No recapture tracking is required
- When the DTL eventually reverses, it is added to DTAA in that year

7.3 When to Use

Scenario	Election Recommended?
DTL will clearly reverse within 5 years	No—include normally
DTL may or may not reverse within 5 years	Consider—avoids recapture risk
DTL expected to be long-term (>5 years)	Yes—prevents recapture complexity

3.3 Example

```
 Year 1: DTL of €600,000 on indefinite-life intangible
        Expected reversal: 10+ years (asset unlikely to be sold/impaire

Without election:
  Include €600,000 in DTAA → Track for 5 years → Recapture in Year 6

With Unclaimed Accrual election:
  Exclude €600,000 from DTAA → No tracking needed
  When asset eventually sold (Year 12): Include €600,000 in Year 12 DTA
```

8. The GloBE Loss Election (Article 4.5)

8.1 Overview

The GloBE Loss Election provides an **alternative** to standard deferred tax accounting. When elected, Article 4.4 rules are replaced by a simplified loss carryforward mechanism.

8.2 When to Consider

Situation	GloBE Loss Election Beneficial?
Zero/low-tax jurisdiction with losses	**Yes**—creates 15% DTA where none exists
High-tax jurisdiction with complex DT	**Maybe**—simplifies but ignores other timing differences
Jurisdiction with EDTS	**No**—election not available

8.3 How It Works

Step 1: Calculate Net GloBE Loss for the jurisdiction

Step 2: Create GloBE Loss DTA = Net GloBE Loss × 15%

Step 3: Carry forward GloBE Loss DTA to future years

Step 4: In profit years, use GloBE Loss DTA = MIN(GloBE Income × 15%, Available DTA)

Step 5: Add usage amount to Covered Taxes (Article 4.1.2(b))

8.4 Worked Example

```
 SG Cayman Ltd (0% tax jurisdiction):

Year 1: GloBE Loss €10,000,000
        Accounting DTA: €0 (no tax)
        GloBE Loss DTA: €10M × 15% = €1,500,000

Year 2: GloBE Loss €5,000,000
        Accounting DTA: €0
        GloBE Loss DTA addition: €5M × 15% = €750,000
        Cumulative GloBE Loss DTA: €2,250,000
```

```
Year 3: GloBE Income €8,000,000
        GloBE Loss DTA usage: MIN(€8M × 15%, €2,250,000) = €1,200,000
        Add to Covered Taxes: +€1,200,000
        ETR: €1,200,000 ÷ €8,000,000 = 15.0% ← No Top-Up Tax!
        Remaining GloBE Loss DTA: €2,250,000 − €1,200,000 = €1,050,000
```

8.5 Key Trade-Off

Aspect	Standard DT (Art. 4.4)	GloBE Loss Election (Art. 4.5)
Loss recognition	Per accounting DTA	At 15% rate
Other timing differences	Included	**Ignored**
DTL recapture tracking	Required	Not applicable
Complexity	Higher	Lower

Warning: Once elected, all other deferred tax attributes in the jurisdiction are ignored. Only the GloBE Loss DTA is tracked.

8.6 Election Mechanics

- **When:** File with first GIR including the jurisdiction
- **Scope:** Applies to entire jurisdiction, not individual entities
- **Revocation:** Permitted, but GloBE Loss DTA balance is reduced to zero

9. Transition Year Rules (Article 9.1)

9.1 Opening Balance Recognition

In the first year the MNE Group is subject to GloBE (the "Transition Year"), existing deferred tax balances are brought into the GloBE system.

Rule: Recognise DTAs and DTLs at the **lower of 15% or the domestic rate**

9.2 Loss DTA Recasting

Pre-existing DTAs from losses can be **recast upward** to 15% if: 1. The DTA arose from losses 2. The losses would have been GloBE Losses

Example:

```
 Transition Year opening balance:
   DTA from losses at 10% rate: €500,000 (losses of €5M)

Recast to 15%:
   GloBE DTA: €5M × 15% = €750,000

Increase to DTAA: +€250,000
```

9.3 Pre-Transition DTL Treatment

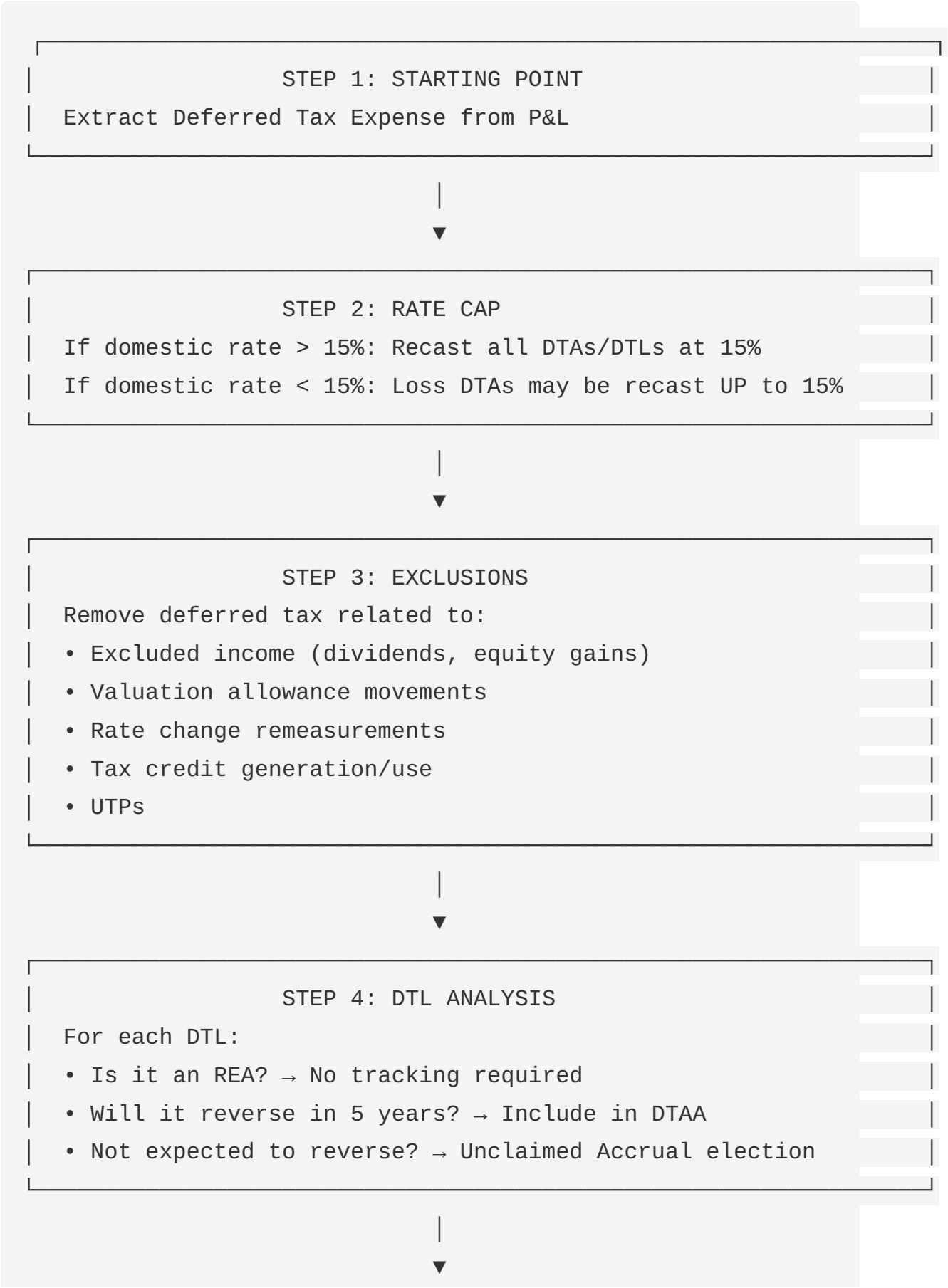
DTLs imported into GloBE in the Transition Year are **not subject to the five-year recapture rule**.

Practical benefit: No need to track pre-existing DTLs for recapture.

9.4 Excluded Items

The following cannot be brought into the GloBE system: - DTAs arising from excluded income transactions after 30 November 2021 - DTAs from government tax benefits created after 30 November 2021 - Basis step-ups from intra-group transfers after 30 November 2021

10. Deferred Tax Adjustment Process Flowchart



```
┌─────────────────────────────────────────────────────────────┐
│                  STEP 5: RECAPTURE CHECK                    │
│  For non-REA DTLs claimed in prior years:                   │
│  • Has 5-year period ended?                                 │
│  • Calculate Unjustified Balance                            │
│  • Trigger recapture adjustment if required                 │
└─────────────────────────────────────────────────────────────┘
                              │
                              ▼
┌─────────────────────────────────────────────────────────────┐
│                  STEP 6: CALCULATE DTAA                     │
│  Total Deferred Tax Adjustment Amount =                     │
│    Adjusted Deferred Tax Expense after all modifications    │
└─────────────────────────────────────────────────────────────┘
```

11. Stratos Worked Example: Deferred Tax Adjustments

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

11.1 Starting Data

Item	Amount (€)	Rate	Notes
Deferred tax expense (P&L)	1,600,000	30%	German combined rate
DTL on intangibles (FY 2025 increase)	900,000	30%	Goodwill amortisation
DTL on PP&E (FY 2025 increase)	400,000	30%	Accelerated depreciation
	(250,000)	30%	Accrued expenses

Item	Amount (€)	Rate	Notes
DTA on provisions (FY 2025 increase)			
Valuation allowance movement	150,000	—	Write-down of Irish DTA
Rate change impact	(80,000)	—	German rate adjustment
DT on excluded dividend	50,000	30%	Tax on €167K dividend

11.2 Step-by-Step Calculation

Step 1: Starting Point

```
Deferred tax expense (P&L):      €1,600,000
```

Step 2: 15% Rate Cap

German rate (30%) > 15%, so recast all movements:

Item	At 30%	At 15%	Adjustment
DTL intangibles	€900,000	€450,000	−€450,000
DTL PP&E	€400,000	€200,000	−€200,000
DTA provisions	(€250,000)	(€125,000)	+€125,000

```
Rate cap adjustment:             −€525,000
```

Step 3: Exclusions

```
 Valuation allowance movement:    −€150,000 (exclude)
Rate change impact:               +€80,000 (exclude, was negative)
DT on excluded dividend:          −€50,000 (exclude)
                                  ──────────
Exclusions adjustment:            −€120,000
```

Step 4: DTL Analysis

DTL	Amount (at 15%)	REA?	Treatment
Intangibles	€450,000	No	Track for recapture
PP&E	€200,000	Yes (tangible asset)	No tracking needed

Step 5: Recapture Check

No prior-year DTLs have reached five-year anniversary in FY 2025. No recapture required.

Step 6: Calculate DTAA

```
 Starting deferred tax expense:   €1,600,000
Rate cap adjustment:             −€525,000
Exclusions:                      −€120,000
Recapture:                        €0
                                 ──────────
Total DTAA:                       €955,000
```

11.3 Summary Workpaper

Line	Description	Original	Adjustment	GloBE Value
1	DT expense (P&L)	€1,600,000		
2	Rate cap (30% → 15%)		−€525,000	

Line	Description	Original	Adjustment	GloBE Value
3	Valuation allowance		−€150,000	Excluded
4	Rate change		+€80,000	Excluded
5	DT on excluded dividend		−€50,000	Excluded
6	DTL recapture		€0	None required
7	**Total DTAA**			**€955,000**

12. Total Adjusted Covered Taxes Calculation

Combining Chapter 4.2 (current) and Chapter 4.3 (deferred):

Component	Reference	Amount (€)
Adjusted Covered Taxes (Current)	Chapter 4.2	11,295,000
Total Deferred Tax Adjustment (DTAA)	Chapter 4.3	955,000
Total Adjusted Covered Taxes		**12,250,000**

12.1 ETR Calculation Preview

```
 GloBE Income (from Part 3, adjusted for QRTC): €53,880,000
Adjusted Covered Taxes:                          €12,250,000

Jurisdictional ETR = €12,250,000 ÷ €53,880,000 = 22.7%

Since 22.7% > 15%, no Top-Up Tax for Germany.
```

13. DTL Recapture Tracking Template

For non-REA DTLs, maintain a tracking schedule:

DTL Category	FY Originated	Original Amount	Y1 Reversal	Y2 Reversal	Y3 Reversal	Y4 Reversal	Y5 Rev
Intangibles	2024	€450,000					
Intangibles	2025	€450,000					

Update annually with actual reversals. If balance remains at Y5 end, calculate Unjustified Balance for recapture.

14. Common Pitfalls

14.1 Pitfall 1: Forgetting Rate Cap on High-Tax Jurisdictions

Issue: Including DTAs/DTLs at domestic rates above 15%

Impact: Overstates DTAA and Covered Taxes

Solution: Always recast to MIN(15%, domestic rate)

14.2 Pitfall 2: Missing Exclusions

Issue: Including all deferred tax movements without applying Article 4.4.1(b)-(e) exclusions

Impact: DTAA includes items that should be excluded

Solution: Systematically review each movement for exclusion categories

14.3 Pitfall 3: Inadequate DTL Tracking

Issue: Failing to track non-REA DTLs for five-year recapture

Impact: Recapture surprises in Year 6

Solution: Establish DTL tracking schedule from Year 1, maintained annually

14.4 Pitfall 4: Misclassifying REA Categories

Issue: Treating all DTLs as REAs without verifying qualification

Impact: Potential recapture if DTL doesn't actually qualify

Solution: Document specific REA category for each DTL with supporting analysis

The deferred tax adjustment process represents one of the most technically demanding aspects of GloBE compliance. Unlike current tax expense—which derives from a single P&L line with defined adjustments—the DTAA requires detailed analysis of every deferred tax item in the balance sheet. Groups must understand their deferred tax positions at a granular level: what each item represents, what rate it's measured at, whether it falls within an exclusion category, whether it qualifies as an REA, and if not, whether it will reverse within five years. This granularity often reveals gaps in underlying tax accounting that may not have mattered for financial reporting but become critical for GloBE. Building the systems and processes to generate, track, and maintain this information is a significant undertaking—but one that cannot be deferred once GloBE obligations begin.