Deloitte. 德勤

Tax Newsflash

OECD Pillar Two: Side-by-side package released

A Chinese Mainland and Hong Kong SAR Perspective

China | Tax & Business Advisory | 7 January 2026

On 5 January 2026, the OECD/G20 Inclusive Framework on BEPS ("inclusive framework") published details of a "side-by-side package" in relation to the Pillar Two global minimum tax rules ("Pillar Two"). The document includes agreed administrative guidance on a permanent simplified effective tax rate (ETR) safe harbour, an extension of the transitional country-by-country (CbC) reporting safe harbour, a substance-based tax incentive (SBTI) safe harbour, and a side-by-side system.

Components of the Pillar Two rules

The Pillar Two global minimum tax rules have been agreed by more than 140 members of the inclusive framework. Jurisdictions are in the process of implementing rules in local legislation, which began to apply from January 2024. The Pillar Two rules apply to large multinational groups with annual consolidated group revenue of at least EUR 750 million, and result in "top-up" tax amounts to bring the overall tax on profits in each jurisdiction where a group operates up to a 15% minimum effective tax rate. The key components are: qualified domestic minimum top-up taxes (QDMTTs) which allow jurisdictions to charge any top-up taxes due in respect of local profits; the income inclusion rule (IIR) under which parent company jurisdictions apply the top-up tax rules on a top-down basis; and the undertaxed profits rule (UTPR) which will apply as a secondary (backstop) rule where the other rules have not been fully applied.

Simplified ETR safe harbour

The inclusive framework recognizes that requiring compliance with the full global minimum tax rules would impose compliance costs for in-scope groups and administrative burdens for jurisdictions that have adopted the rules even in cases where there is "very low risk" of there being any top-up tax due. A new permanent simplified ETR safe harbour has been developed, that seeks to reduce the compliance burden associated with Pillar Two in a "meaningful share" of jurisdictions where in-scope groups operate.

Under the new safe harbour, where the calculation of a "simplified ETR" for a "tested jurisdiction" is at least the Pillar Two minimum rate (i.e., 15%), or where it has an overall "simplified loss," the Pillar Two top-up tax for the entities will be zero. (A group may have multiple separate safe harbour tested jurisdictions for a given jurisdiction and therefore a requirement to calculate separate simplified ETRs for the safe harbour if, for example, there are entities such as joint ventures and minority-owned entities for which the group is otherwise required under the main Pillar Two rules to calculate Pillar Two ETRs separately).

The simplified ETR is calculated as the "simplified taxes" amount divided by the equivalent "simplified income" amount. Both amounts are based on financial accounting data used to prepare the group's consolidated financial statements and therefore, unlike the existing transitional CbC reporting safe harbour, no data points will be taken from a group's CbC report. The simplified ETR calculations of jurisdictions whose QDMTT rules require use of local financial accounting standards will also be based on the local standard, but jurisdictions are encouraged to allow groups to elect to use the financial accounting standards used for the consolidated financial statements. Groups may compute the simplified ETR using available jurisdictional-level data and do not need to determine all tax and income amounts on a separate entity basis first.

The calculation rules for simplified income and simplified taxes each include a small number of mandatory adjustments, alongside a variety of other adjustments, some of which are dependent on specific facts and circumstances, and others that are entirely optional at the election of the business. These adjustments are designed to allow as many groups as possible to meet the safe harbour requirement in as many jurisdictions as possible (in circumstances where there would be no top-up tax under the main rules).

Calculation of simplified income starts from aggregate jurisdictional profit before tax, defined by reference to main Pillar Two rules concepts such as the "financial accounting net income or loss" (FANIL). Three "basic" adjustments, based on equivalent main Pillar Two rules, are then required to remove "excluded dividends" and "excluded equity gains or losses," and add back policy disallowed expenses (such as fines and penalties of EUR 250,000 or more). The inclusive framework expects that, in many cases, these will be the only adjustments required.

Additional adjustment or simplification rules include industry adjustments for certain financial services and shipping entities, and conditional adjustments for "equity-reported items" and an "M&A simplification." Additional optional adjustments to better align simplified income with local tax bases are available to businesses who elect to use any or all of them, e.g., based on elections available under the main Pillar Two rules.

Simplified taxes are the current and deferred taxes accrued in the FANIL of the constituent entities in the tested jurisdiction, subject to adjustments in respect of items such as non-covered tax amounts, taxes related to amounts excluded from the simplified income calculation, uncertain tax positions, and current tax not expected to be paid within three years. Deferred tax expense movements relating to deferred tax liabilities which would need to be tracked under the main Pillar Two "recapture rule" generally are excluded. Other deferred tax-specific safe harbour adjustments include a simplified methodology to recast deferred tax expenses at 15%, simplified adjustments for negative taxes in simplified loss years, and the disregarding of any accounting valuation allowances or recognition adjustments made. A number of optional elections may also be made, including to obtain the benefit of qualified refundable tax credits (QRTCs) and marketable transferable tax credits (MTTCs), and the new substance-based tax incentive safe harbour (see below). Additional rules apply in respect of determining the Pillar Two transition year for a jurisdiction and tax adjustments after year end.

The simplified ETR safe harbour contains specific transfer pricing rules, including an election to enable the calculations to be based on the arm's length pricing used to compute taxable income in local tax returns, in line with transfer pricing policies. The safe harbour also includes a simplified approach for the cross-border allocation of income and taxes (e.g., in respect of permanent establishment amounts), and additional specific rules for tax-neutral ultimate parent entities (UPEs), tax transparent entities, stateless entities, and investment entities.

The safe harbour also includes integrity rules that may require additional adjustments to be made to produce outcomes consistent with four principles: matching intragroup income and expenses; fully allocating all income to a tested jurisdiction; deducting expenses and losses only once and in a single tested jurisdiction; and recording tax amounts only once and in a single tested jurisdiction.

The safe harbour will first be available to groups for years commencing on or after 31 December 2026 (i.e., for 2027). Jurisdictions may optionally implement the safe harbour one year earlier, for years commencing on or after 31 December 2025 (i.e., for 2026), but any such early adoption will only apply where all of the jurisdictions with Pillar Two taxing rights over the tested jurisdiction have implemented early.

A group may elect for the simplified ETR safe harbour to apply for a tested jurisdiction for the first time only if there were no top-up tax liabilities for the tested jurisdiction for all years beginning in the preceding 24 months (i.e., the previous two years). A tested jurisdiction may fall in and out of the scope of the safe harbour (i.e., the rules do not follow the "once-out always-out" approach of the transitional CbC safe harbour). A similar 24-month condition applies where a business wishes to re-enter the safe harbour rules in subsequent years.

Extension of transitional CbC reporting safe harbour

The inclusive framework has agreed a 12-month extension of the existing transitional CbC reporting safe harbour. The CbC safe harbour originally applied for the first three years of Pillar Two only, ceasing to be available from 2027 onwards. The CbC safe harbour will now be available for years beginning on or before 31 December 2027. The 17% transitional rate applicable to the CbC safe harbour's "effective tax rate test" in 2026 will also apply to the test in 2027.

SBTI safe harbour

Recognizing the role tax incentives play as a widely used tool to promote investment and economic development, the inclusive framework has adopted a new permanent SBTI safe harbour to allow groups to "benefit from certain tax incentives that are strongly connected to economic substance" in a jurisdiction.

The SBTI safe harbour will allow businesses to elect for a top-up tax amount, corresponding to "qualified tax incentives" (QTIs) used by constituent entities in a jurisdiction in a year, to be reduced to zero. The calculation of top-up tax amounts "corresponding to" a QTI is based on the reduction in total top-up tax payable that would arise for the jurisdiction if the QTIs used were treated as additional adjusted covered tax amounts paid. This calculation is subject to a "substance cap" rule, limiting the benefit where there are insufficient levels of payroll costs and tangible assets in the country.

Qualified tax incentives

To be a qualified tax incentive, an incentive must be "generally available" to taxpayers (e.g., excluding any incentives limited only to those businesses within the scope of Pillar Two and those arising from a discretionary arrangement between the group and a government).

A QTI must be either an expenditure-based or production-based tax incentive:

- An "expenditure-based tax incentive," e.g., in the form of a tax credit, an additional tax deduction, or an exemption, must be calculated directly by reference to the expenditure incurred (i.e., based on a portion of qualifying expenditure).The value of the incentive must not exceed the amount of expenditure incurred (taking into account any other tax incentives provided in respect of the same item of expenditure). Allowances for capital expenditure that give rise to timing differences only are not QTIs. However, where an allowance provides tax relief in excess of the original capital investment (e.g., a super deduction), the excess may be considered an expenditure-based tax incentive for QTI calculation purposes.

- A "production-based tax incentive" must be calculated based on volume (not value) of production of tangible property (including production of electricity and processing activities such as extraction and refining) in a jurisdiction. It must also be based on units produced in the jurisdiction providing the incentive.

Tax incentives that reduce the liability for a non-covered tax are excluded, as are tax incentives that apply only to expenditure incurred in producing income that is excluded from the scope of Pillar Two income, or incentives in the form of subsidies and grants. An election may be made to treat a QRTC or an MTTC, as defined in previous Pillar Two administrative guidance, as a QTI for Pillar Two purposes instead of a QRTC or MTTC (provided that the credit qualifies as an expenditure- or production-based tax incentive).

A QTI must be calculated based on expenditure that has been incurred (i.e., accrued or paid), or output that has been produced, by the time that the amount of the incentive is determined. Incentives based on future expenditure or production or calculated in respect of expenditure or production before the incentive was in effect, are excluded.

Substance cap

The substance cap limits the notional increase to adjusted covered taxes from the use of QTIs to an amount equal to the greater of 5.5% of eligible payroll costs of employees performing activities in the jurisdiction and 5.5% of the depreciation and depletion of eligible tangible assets located in the jurisdiction. An alternative cap, equal to 1% of the carrying value of eligible tangible assets in the jurisdiction (excluding land and other non-depreciable assets), is available via a five-year election.

Businesses can elect to apply the SBTI safe harbour in a jurisdiction for years beginning on or after 1 January 2026.

Side-by-side system

The side-by-side system consists of two new permanent safe harbours which multinational groups headquartered in jurisdictions recognized by the inclusive framework as having an eligible tax regime can elect to apply.

Side-by-side safe harbour

Under a new permanent side-by-side safe harbour ("SbS safe harbour") no top-up tax will be payable under an IIR or a UTPR in respect of any undertaxed profits of a business if the UPE is located in a jurisdiction with a qualified SbS regime. A group with a UPE located in a jurisdiction that does not have a qualified SbS regime cannot apply the safe harbour, including in respect of its operations in jurisdictions with a qualified SbS regime.

The SbS safe harbour does not apply to QDMTTs which will continue to apply, including to the overseas operations of groups headquartered in a jurisdiction with a qualified SbS regime.

A jurisdiction has a qualified SbS regime if it:

- Has an eligible domestic tax system with:
    - A nominal statutory corporate income tax rate of at least 20% (taking into account any sub-national corporate income taxes and/or preferential adjustments, e.g., generally-available tax credits, deductions, or exclusions equal to a percentage of the taxable income);
    - A QDMTT or corporate alternative minimum tax with a nominal rate of at least 15%. (A corporate alternative minimum tax must be based on financial statement income. It may be subject to appropriate adjustments consistent with the policy objectives of minimum taxation, but must be applicable to a substantial portion of the profits of in-scope multinational groups' operations in the jurisdiction); and
    - No material risk that in-scope multinational groups headquartered in the jurisdiction will be subject to an effective rate of tax below 15% on their profits in the headquarter jurisdiction;
- Has an eligible worldwide tax system that:
    - Has a comprehensive tax regime applicable to all resident companies on overseas income, including active and passive income of controlled foreign companies (CFCs) and foreign branches, regardless of whether that income is distributed. Limited exclusions consistent with the policy objectives of minimum taxation are permitted, e.g., excluding high-taxed income;
    - Incorporates substantial unilateral mechanisms to address base erosion and profit shifting (BEPS) risks, e.g., separately considering inclusions from CFCs which are subject to low taxation from those subject to high taxation in the CFC jurisdiction. The regime must preclude foreign tax credits on high tax active income from being offset against a tax liability arising from low tax passive income; and
    - Has no material risk that in-scope multinational groups headquartered in the jurisdiction will be subject to an effective rate of tax below 15% on the overall profits of their overseas operations.

- Provides a foreign tax credit for QDMTTs on the same terms as other creditable covered taxes; and
- Enacted its eligible domestic/worldwide tax system prior to 1 January 2026—in which case the inclusive framework will assess whether the jurisdiction has a qualified SbS regime by 30 June 2026. The eligibility of tax systems enacted on or after 1 January 2026 will be assessed in a timely manner once the relevant jurisdiction initiates a request in 2027 or 2028, taking into account that the inclusive framework considers that the adoption of a co-ordinated global minimum tax (particularly through the implementation of QDMTTs) is "critically important and should be the primary system."

The inclusive framework will maintain a central record of jurisdictions with a qualified SbS regime. As at 5 January 2026, the central record confirms that the United States (US) has a qualified SbS regime.

Groups with a UPE located in a jurisdiction that has a qualified SbS regime may elect for the SbS safe harbour to apply for years beginning on or after 1 January 2026 (or a later year as listed in the central record). (Jurisdictions which are constitutionally or legally restricted from adopting the safe harbour with retroactive effect must do so instead from the earliest practical date.)

Further work will be done on revisions to the GIR in respect of the SbS safe harbour, including to identify data that may not be required. A group which makes the SbS safe harbour election in a jurisdiction with an IIR or a UTPR will provide the "MNE group information" (section 1 of the GloBE information return (GIR)) to that jurisdiction but will not be required to complete the high-level summary of GloBE information (e.g., ETR ranges).

UPE safe harbour

The new permanent UPE safe harbour applies for years beginning on or after 1 January 2026 and effectively replaces the transitional UTPR safe harbour which expired at the end of 2025. Groups may elect to apply the UPE safe harbour such that no top-up tax will be payable under the UTPR in respect of any undertaxed profits of a business in its UPE jurisdiction if that jurisdiction has a qualified UPE regime. The UPE safe harbour does not affect the application of the IIR or UTPR with respect to any constituent entities located outside of the UPE jurisdiction and has no impact on the operation of QDMTTs.

A jurisdiction has a qualified UPE regime if it has an eligible domestic tax system enacted and in effect on 1 January 2026. In line with the approach for the SbS safe harbour, a qualified UPE regime must have a nominal statutory corporate income tax rate of at least 20%, a QDMTT or corporate alternative minimum tax with a nominal rate of at least 15%, and no material risk that in-scope multinational groups headquartered in the jurisdiction will be subject to an effective rate of tax below 15% on their profits in the headquarter jurisdiction.

The inclusive framework will publish a central record of jurisdictions with a qualified UPE regime.

Next steps

Work program for additional simplification

The inclusive framework has committed to a work program for further clarification and simplification of the Pillar Two rules, including:

- Completion of work on a routine profits test and de minimis test (scheduled for completion in the first half of 2026);
- Further simplification of the main Pillar Two rules, focusing on continuity issues, to ensure businesses may benefit from the ETR safe harbour simplifications even where, in a subsequent year, they may not qualify;
- Further administrative guidance on technical issues; and
- Exploring integration of the simplified calculations in the simplified ETR safe harbour into the main rules.

Further work will also be undertaken on streamlining reporting obligations, including consideration of adaptations to the GIR, to be completed in the first half of 2026, to allow jurisdictions to adopt changes for years in which the safe harbours apply.

Stocktake

Inclusive framework members will agree on a process for an evidence-based stocktake of the side-by-side system (including the level of implementation of QDMTTs), to be concluded by 2029, to ensure that any substantial risks that might be identified with respect to the level playing field or BEPS are addressed to preserve the common policy objectives of Pillar Two and the side-by-side system. The inclusive framework commits to take action to address any such substantial risks identified, as well as to consider targeted solutions to more concentrated risks. The inclusive framework will also look to identify opportunities for alignment and simplification, e.g., alignment of qualified UPE regimes with QDMTTs.

Reinforcing effectiveness of QDMTTs

The inclusive framework will continue to work on reducing compliance burdens, including identifying possible opportunities for further coordination for businesses with operations in QDMTT jurisdictions.

The inclusive framework will work on ensuring that conditional or discriminatory taxes are not recognized as covered taxes, with the qualified status of domestic minimum top-up taxes remaining dependent on their "consistent and non-discriminatory application" to businesses, regardless of whether a business has elected to apply the SbS safe harbour.

Deloitte comments

The inclusive framework's long-awaited side-by-side-package introduces a number of welcome simplifications to the Pillar Two global minimum tax regime. These are set out as safe harbours from the Pillar Two rules, an option preferred by the European Commission and considered within the scope of the existing European Union directive implementing the global minimum tax.

The safe harbours cover several key areas. Some are of broad application and apply to any group within the scope of Pillar Two, such as the permanent simplified ETR safe harbour and the substance-based incentives safe harbour. At more than 50 pages in length, the simplified ETR safe harbour contains a number of provisions that are designed to help groups reach safe harbour status in as many jurisdictions as possible, negating the need for additional data and reporting for the "full" rules. The challenge will be that groups will have to consider jurisdictions, or groups of jurisdictions, differently, as some will require more adjustments than others to qualify. There is also an extension of the existing CbC reporting safe harbour for one year, to allow time for jurisdictions to legislate for the new simplified ETR safe harbour.

The substance-based incentives safe harbour, which applies from 2026, looks to provide relief from Pillar Two top-up tax where there are tax credits that arise from incentives calculated by reference to either expenditure or production output (as opposed to those where the credit is calculated by reference to income that is then exempt). In each case, the amount is capped (at the jurisdiction level) based on the amount of payroll costs or tangible assets in the jurisdiction.

The side-by-side safe harbour and the UPE safe harbour look at jurisdictions' existing tax regimes and seek to minimize duplication where these are sufficiently similar, in policy aims and outturn, to the Pillar Two rules. The side-by-side safe harbour is particularly important to US multinationals, and was the subject of a G7 proposal from June 2025. It effectively alleviates US-headed groups from the "international" aspects of Pillar Two (the IIR and UTPR pieces) from 2026 onwards, on the basis that US groups are subject to the net controlled foreign corporation tested income (formerly GILTI) and corporate alternative minimum tax regimes in the US. It may be that other jurisdictions are able to take advantage of the side-by-side safe harbour (or UPE safe harbour) in the future, but currently only the US is listed as qualifying. It is important to note that the side-by-side safe harbour is predicated on many jurisdictions having introduced the domestic Pillar Two rules via QDMTTs, and US groups will, as with all other groups within the scope of Pillar Two, continue to have to comply with QDMTT requirements in local jurisdictions for all years.

One issue of note is that there may, subject to jurisdictions' legislative processes and timetables, be a disconnect between the timing of the new safe harbours being enacted or substantively enacted (depending on the accounting standard used) for financial statement purposes, and the years to which the safe harbours will ultimately apply. For example, the side-by-side safe harbour is intended to take effect as from 1 January 2026, but may not be substantively enacted or enacted in some, perhaps many, jurisdictions until 2027. For accounting purposes, this may mean that financial statements for periods ended prior to enactment or substantive enactment require the accrual of Pillar Two top up taxes even where these may ultimately be alleviated by enactment of legislation incorporating the new safe harbours.

The inclusive framework makes clear in the publication that further simplification work will be carried out on Pillar Two. This will include not only permanent safe harbours covering substance-based income and de minimis amounts, but also further work on simplifying and aligning compliance and reporting obligations. Further work will be undertaken with a view to publishing an updated GIR by 30 June 2026 to apply the new safe harbours and simplifications. This suggests there may be a GIR (1) that is used for compliance for 2024 and 2025 (taking into account that in accordance with the OECD timetable, the first 31 December 2024 returns are due by 30 June 2026), and a new GIR (2) that is used for 2026 onwards, but this is subject to confirmation.

The side-by-side package represents significant work by inclusive framework members to agree political positions and to accept safe harbours where possible. Perhaps inevitably, this means that other areas of uncertainty have not yet had the air time to reach agreement. This includes further work on technical areas of the Pillar Two regime, for example, possible adjustments arising from hyperinflationary environments and further work on a dispute resolution mechanism suitable for Pillar Two. It is expected that these will continue to be worked on and reports released by the OECD as soon as possible.

From a Chinese mainland perspective, the release of this package underscores the immediate need to determine Chinese mainland's approach to implementing global minimum tax. As Chinese mainland currently does not have a QDMTT or a corporate alternative minimum tax, nor a CFC regime taxing active and passive income of CFCs and foreign branches regardless of whether that income is distributed, it appears that the existing tax regime does not qualify as an eligible domestic or worldwide tax system under the side-by-side system. The assessment of the UPE safe harbour is expected to be completed by mid-2026, while the SbS safe harbour offers a later opportunity, allowing jurisdictions to amend their tax systems and apply for qualification in 2027 or 2028, which raises the question of how Chinese mainland will implement the global minimum tax along with amendments to its domestic legislation in the next few months to benefit.

US MNE groups' constituent entities (CEs) in Chinese mainland that are currently not subject to IIR or UTPR will remain protected under the SbS safe harbour unless Chinese mainland itself introduces a QDMTT in the future, which could alter the allocation of taxing rights. Chinese mainland-headquartered groups will need to wait for further clarity on Chinese mainland's potential modification of its tax regime (e.g., introduction of a QDMTT) and its eligibility for safe harbour regimes to assess the impact to group ETR and compliance requirements from 2026 onwards, while busy in addressing the imminent compliance needs of intermediate IIR and QDMTT returns for 2024 and 2025 in the jurisdictions that have already implemented these rules.

From a Hong Kong SAR (HK) perspective, the impact of the side-by-side system appears to be relatively limited, as HK has already implemented the QDMTT, which remains unaffected by the SbS safe harbour. HK CEs belonging to US MNE groups will remain subject to the HK Minimum Top-up Tax. On the other hand, US CEs under HK MNE groups may continue to be subject to the IIR in HK. It is also important to note that the SbS safe harbour applies only to fiscal years beginning on or after 1 January 2026. Depending on the holding structure, HK

CEs in US MNE groups may still be subject to intermediary IIR in 2024, given that many jurisdictions have already implemented these rules.

While the extension of the transitional CbC reporting safe harbour to the fiscal year (FY) 2027 offers some transitional relief, its benefits may be marginal for HK CEs given that the transition rate of simplified ETR for FY2027 remains at 17%, which exceeds HK's standard corporate income tax rate of 16.5%. A more meaningful relief could come from the newly introduced simplified ETR safe harbour at 15%, which is expected to take effect from FY2027 and may help alleviate compliance burdens for qualifying HK CEs. Nevertheless, HK CEs will likely still need to perform a full top-up tax calculation for FY2026 if they are unable to meet the conditions of the CbC reporting safe harbour with the 17% FY 2026 transition rate of ETR. To address this issue during the transition period, HK may explore the feasibility of opting for early adoption of the simplified ETR safe harbour (i.e. for FYs that commence on or after 31 December 2025).

On a positive note, the introduction of the SBTI safe harbour is welcomed, as it could potentially apply to both Chinese mainland's and HK's existing tax incentives for research and development, reinforcing their competitiveness as a knowledge-driven economy.

Content provided by Deloitte United Kingdom, with additional comments prepared by Deloitte China.

For more information, please contact:

Tax & Business Advisory
National Leader for Pillar Two Offering
Southern Region Tax Leader
Jennifer Zhang
Tax Partner
+852 2258 6228
jennifzhang@deloitte.com.hk

International and M&A Tax Services
National Leader
Vicky Wang
Tax Partner
+86 21 6141 1035
vicwang@deloittecn.com.cn

Business Tax Services
National Leader
Jessie Wang
Tax Partner
+86 10 85124077
jeswang@deloittecn.com.cn