

Substance-based tax incentive safe harbour for Pillar Two Groups

7 January 2026

In brief

What happened?

On 5 January 2026, the OECD announced that 147 members of the Inclusive Framework (IF) on BEPS have agreed to a new package of administrative guidance under the Pillar Two global minimum tax rules (the 'GloBE rules'). The agreed Side-by-Side Package ('the Package') includes a substance-based tax incentive safe harbour (SBTI SH). The favourable treatment of Qualifying Tax Incentives (QTIs) applies for fiscal years starting on or after 1 January 2026.

Why is it relevant?

The SBTI SH defines QTIs as those based on eligible expenditures or on the volume of tangible in country production, subject to a Substance Cap (defined below). QTIs are added to Covered Taxes (or Simplified Taxes) to compute the ETR but are excluded from GloBE Income. As a result, the treatment of an incentive as a QTI could be more beneficial to an MNE Group than the treatment provided for Qualified Refundable Tax Credits (QRTCs) and Marketable Transferable Tax Credits (MTTCs). For parity, groups may elect to treat QRTCs and MTTCs as QTIs.

Actions to consider

MNE Groups should review the Package to understand which aspects they can or must apply, in which jurisdictions, and what the SBTI SH means for the purposes of computing GloBE ETRs in select jurisdictions. Businesses should be aware that the SBTI SH included in the OECD's Administrative Guidance is not self-executing and must now be legislated domestically by each Inclusive Framework

member in accordance with their own processes and timelines (subject to possible European Union (EU) guidance related to the EU minimum tax Directive).

PwC is hosting a webcast at 12:00pm ET on 13 January that will cover the new GloBE Package (register [here](#)).

In detail

QTI treatment applies to certain expenditure-based tax incentives, as well as certain production-based tax incentives. A Filing Constituent Entity may also elect to treat a QRTC or a MTTC as a QTI, if the credit qualifies as an expenditure- or production-based tax incentive. Notably, as the QTI is added to Adjusted Covered Taxes (or Simplified Taxes) without increasing income, no dilution of the respective ETR is expected (unlike QRTCs and MTTCs, which are generally dilutive to the ETR).

Observation: *No rationale is given for the more taxpayer-friendly treatment of QTIs versus QRTCs and MTTCs under the Model Rules. However, the positive treatment can be significantly limited in cases where the Substance Cap applies, as described in more detail below.*

Expenditure-and production-based tax incentives

Expenditure based tax incentives reduce the marginal cost of investment (for example, R&D, productivity enhancing, or environmental activities). They qualify as QTIs only where the amount of the tax benefit is mechanically and directly linked to qualifying expenditure incurred — meaning the value of the incentive is determined by applying a fixed rate or formula to the expenditure itself (such as credits, super deductions, enhanced allowances, or expenditure based exemptions). Pure timing benefits, such as immediate expensing or accelerated depreciation are not treated as QTIs because they affect only the timing of deductions rather than the quantum of the tax benefit. Production-based tax incentives must be related to measurable output (e.g., units produced, emissions reduced) and qualify as QTIs only when based on the volume of tangible production within the respective jurisdiction (e.g., manufacturing within country). Incentives based on the value of production are explicitly excluded (i.e., the incentive must be tied to the quantum of output (e.g., units produced, tons extracted, kilowatt hours generated, emissions reduced) versus the value of the output). The incentive is tied to tangible, jurisdictionally located activity, and not to fluctuating prices or profits, which could distort effective tax rates or shift tax benefits based on market dynamics rather than substance.

General conditions

To qualify for the SBTI SH, incentives must be generally available and not bespoke (i.e., not arising from a specific governmental arrangement). They are out of scope if tied to non GloBE income or reduce non Covered taxes. A QTI must be calculated on expenditure already incurred or output already produced at the time of determination, subject to certain exceptions. Further OECD guidance on identifying QTIs as 'Related Benefits' is expected (i.e., whether QTIs provided by jurisdictions could be viewed to undermine QDMTTs).

Calculating the amount of QTIs used

QTI amounts comprise, as related to the Fiscal Year:

- (i) the reduction in the Covered Tax liability from credits actually utilised;
- (ii) the amount of any enhanced allowance or super-deduction claimed multiplied by the applicable statutory rate (or, if applicable, multiplied by the preferential rate), and;

(iii) the income attributable to eligible expenditure that is exempt, multiplied by the statutory rate or, where a preferential rate applies, by the difference between the statutory and preferential rates.

If a claim results in a loss, the QTI adjustment is recognised in the Fiscal Year in which the super-deduction or exemption is claimed (i.e., the year in which the loss arose).

Substance Cap

The Substance Cap limits QTI adjustments in a jurisdiction by comparing the QTI to the economic activity in the jurisdiction (i.e., payroll and tangible assets). It can be calculated in two ways:

- i. the greater of 5.5% of Eligible Payroll Costs or the depreciation/depletion of Eligible Tangible Assets, with payroll capitalised into assets included in Eligible Payroll Costs (as the computation would not provide double counting) and depreciation used instead of carrying value for stability.
- ii. if the MNE Group makes a Five-Year Election for the jurisdiction, 1% of the carrying value of Eligible Tangible Assets located in the jurisdiction (excluding land and other non-depreciable assets) for that Fiscal Year. If the Five-Year Election is later revoked, depreciation is excluded to avoid double counting.

Observation: *Consistent with the OECD's long-standing approach to tax credits, the design of the substance-based tax incentive safe harbour is neither particularly generous nor especially straightforward. It is noteworthy that there was no opportunity for stakeholders to provide input into this part of the Package, resulting in unexpected outcomes relative to QRTCs and MTTCs, and in terms of which jurisdictions might be able to benefit from this safe harbour. The various qualifications and caps mean that the benefits are more likely to accrue in jurisdictions with higher payroll costs and more significant manufacturing activity, limiting its relevance for many developing economies.*

Let's talk

For a deeper discussion of how the SBTI SH might affect your business, please contact:

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