International Tax Reform – Pillar Two Disclosures

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What you need to know

- The amendments to IAS 12 *Income Taxes* introduce a mandatory temporary exception from the recognition and disclosure of deferred taxes arising from the implementation of the OECD's Pillar Two model rules.
- The exception applies retrospectively and immediately upon issuance of the amendments.
- Entities are required to disclose information on the potential exposure to Pillar Two income taxes for annual reporting periods beginning on or after 1 January 2023.
- The amendments do not specify what information an entity needs to disclose or how they should prepare that information. Still, developing comprehensive and insightful disclosures related to Pillar Two income taxes is not straightforward.
- Disclosure is not required in interim reports relating to periods ending on or before 31 December 2023.

1. Overview

The Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) addresses the tax challenges arising from the digitalisation of the global economy. The Global Anti-Base Erosion Model Rules (GLoBE Rules or Pillar Two model rules) apply to multinational enterprises (MNEs) with revenue in excess of EUR 750 million per their consolidated financial statements.

The Pillar Two model rules introduce four new taxing mechanisms under which MNEs would pay a minimum level of tax (the Minimum Tax):

- The Subject to Tax Rule is a tax treaty-based rule that generally proposes a Minimum Tax on certain cross-border intercompany transactions that otherwise are not subject to a minimum level of tax
- The Income Inclusion Rule (IIR)
- The Under Taxed Payments/Profits Rule (UTPR)
- The Qualified Domestic Minimum Top-up Tax (QDMTT)

The new taxing mechanisms can impose a Minimum Tax on the income arising in each jurisdiction in which an MNE operates. The IIR, UTPR and QDMTT do so by imposing a Top-up Tax in a jurisdiction whenever the effective tax rate (ETR), determined on a jurisdictional basis under the GloBE Rules, is below a 15% minimum rate (Minimum Rate).

The GloBE Rules set out the mechanics for determining which entity (or entities) in an MNE group (i.e., a group in which the ultimate parent entity has, directly or indirectly, at least one foreign subsidiary or a permanent establishment) would apply the IIR, UTPR, and/or QDMTT, and the portion of Minimum Tax that is charged to each relevant entity. While the framework for the GloBE Rules is global, the GloBE Rules would be implemented through legislation enacted in jurisdictions that adopt the rules.

The GloBE Rules raise a number of accounting questions. In particular, whether the Minimum Tax is an income tax in the scope of IAS 12 and, if so, when and how entities should account for the new taxes.

The GloBE Rules are complex and contain complicated terminology that is not discussed in detail in this publication. The OECD has published *GloBE Model Rules*, *GloBE Model Rules Commentary*, and *GloBE Model Rules Examples*, which can be found on their website. In addition, the OECD has published a summary, fact sheets, frequently asked questions, and press releases that provide additional information on the GloBE Rules. For further information, refer to our article comprising an executive summary and discussion of GloBE Model Rules, Commentary and Examples, which provides helpful context and further explanation of the GloBE Rules. There remain numerous areas of uncertainty in the application of the GloBE Rules that require additional interpretive guidance.

We provided background to the OECD's project in our publication, *IFRS Developments 203 OECD BEPS Pillar Two - Global Anti-Base Erosion Rules: Accounting implications* published in July 2022.

This document describes the amendments to IAS 12 including the effective date and transition in section 2. Section 3 explains the mandatory temporary exception introduced in the amendments. Section 4 explains the additional disclosure requirements related to Pillar Two income taxes and describes each of the disclosure requirements together with example disclosures. The example disclosures are expected to be helpful references for preparers to develop disclosures that are suitable to specific situations and fact patterns. Section 4 also explains the disclosure objectives and the considerations entities need to have when preparing disclosures to provide useful information to the users of financial statements. Lastly, section 5 discusses the implementation process and challenges expected in reporting about Pillar Two income taxes.

2. Amendments to IAS 12 *Income taxes*

On 23 May 2023, the International Accounting Standards Board (the Board) issued *International Tax Reform—Pillar Two Model Rules – Amendments to IAS 12* (the Amendments). The Amendments clarify that IAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the OECD, including tax law that implements Qualified Domestic Minimum Top-up Taxes. Such tax legislation, and the income taxes arising from it, are referred to as 'Pillar Two legislation' and 'Pillar Two income taxes', respectively. The Board amended the standard for the following reasons:

- To provide timely relief for affected entities
- To avoid diverse interpretations of IAS 12 developing in practice
- To improve the information provided to users of financial statements before and after Pillar Two legislation comes into effect

The Amendments introduce:

- A mandatory temporary exception to the accounting for deferred taxes arising from the jurisdictional implementation of the Pillar Two model rules (see section 3 below); and
- Disclosure requirements for affected entities to help users of the financial statements better understand an entity's exposure to Pillar Two income taxes arising from that legislation, particularly before its effective date (see section 4 below).

The mandatory temporary exception – the use of which is required to be disclosed (see section 3 below) – applies immediately and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The disclosure requirements, in relation to periods in which Pillar Two legislation has been enacted but is yet to take effect for the entity, apply for annual reporting periods beginning on or after 1 January 2023, but not for any interim periods ending on or before 31 December 2023.

2.1 Accounting for Pillar Two income taxes before IAS 12 amendments are endorsed

Some jurisdictions have a process of formally adopting the accounting standards, interpretations and amendments issued by the Board. In such jurisdictions the IAS 12 amendments will only take effect when endorsed by the respective local authority. Consequently, the Amendments to IAS 12 may not be endorsed until after an MNE becomes subject to Pillar Two income taxes. Entities that need to prepare IFRS annual or interim financial statements before these amendments are endorsed in their jurisdiction, will, therefore, need to develop an accounting policy to provide relevant and reliable information to the users of their annual or interim financial statements. Our publication in April 2023, *IFRS Development Issue 214, Amendments to IAS 12 International Tax Reform Pillar Two Model Rules* provides further guidance on the application of mandatory temporary exception.

3. Mandatory temporary exception

The Amendments introduce a mandatory exception in IAS 12 from recognising and disclosing deferred tax assets and liabilities related to Pillar Two income taxes. The Amendments note that the temporary exception provides entities with relief from accounting for deferred taxes in relation to this complex new tax legislation allowing stakeholders time to assess the implications. It also avoids entities developing diverse interpretations of IAS 12 that could result in inconsistent application of the standard.

The temporary exception provides entities with relief from accounting for deferred taxes in relation to this complex new tax legislation.

Extract from IAS 12

4A This Standard applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes described in those rules. Such tax law, and the income taxes arising from it, are hereafter referred to as 'Pillar Two legislation' and 'Pillar Two income taxes'. As an exception to the requirements in this Standard, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

The temporary exception from recognition and disclosure of information about deferred taxes and the requirement to disclose the application of the exception (see section 4.1 below) apply immediately and retrospectively upon issue of the Amendments.

Our publication in May 2023, *IFRS Developments Issue 218, Amendments to IAS 12: International Tax Reform - Pillar Two Model Rules* provides further guidance on the application of mandatory temporary exception.

The Amendments require an entity to provide information to users of financial statements before and after the Pillar Two legislation is in effect.

4. Disclosure requirements

The Amendments to IAS 12 require an entity to provide information to users of financial statements before and after the Pillar Two legislation is in effect. The following sections discuss each of the requirements and provide illustrations and examples.

The disclosure of the current tax expense related to Pillar Two income taxes, and the disclosures in relation to periods in which Pillar Two legislation has been (substantively) enacted but is yet to take effect for the entity, are required for annual reporting periods beginning on or after 1 January 2023, but are not required for any interim period ending on or before 31 December 2023.

4.1 Pillar Two taxes and the scope of IAS 12

The IASB did not provide further clarifications about when a Pillar Two top-up tax is considered to be an income tax in the scope of IAS 12, nor to require entities to treat all top-up taxes as if they were income taxes. An entity is, therefore, required to apply judgement in determining which top-up taxes it considers to be income taxes in the entity's circumstances.

The Board noted that stakeholders were generally of the view that Pillar Two top-up tax is an income tax and, therefore, within the scope of IAS 12 in the consolidated financial statements of the ultimate parent entity of a group subject to the Pillar Two model rules. However, stakeholders noted that this view does not necessarily apply in the financial statements of intermediate parents and subsidiaries of an MNE group that is subject to the Pillar Two model rules. For example, when those subsidiaries may need to pay top-up taxes under the UTPR mechanism in respect to a fellow subsidiary's profits and the top-up tax allocation is not necessarily in direct proportion to the intermediate parent's ownership interest in its investees.

How we see it

We believe that intermediate parents and subsidiaries of an MNE group need to apply judgement in determining whether or not in a particular situation a top-up tax meets the definition of an income tax in IAS 12 and disclose those judgements in accordance with IAS 1.

If an entity concludes that Pillar Two taxes are outside the scope of IAS 12, it needs to consider disclosing information, applying IAS 1, that is helpful to the users of the financial statements in understanding how such Pillar Two taxes have been accounted for.

4.2 Disclosure of application of the exception

The Amendments, immediately and retrospectively upon issue, require an entity to disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

Extract from IAS 12	
88A	An entity shall disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes (see paragraph 4A).

In illustration 1-1 below, BHP Group Limited discloses the adoption of the amendments to IAS 12 including the mandatory exception. BHP describes the reasons the Board amended IAS 12 to introduce the mandatory temporary exception and the fact that BHP has applied the amendments at year-end.

Illustration 1-1: BHP Group Limited (2023) Australia

BHP Group Limited [extract]
Financial Statements [extract]
Notes to the Financial Statements [extract]
1 Consolidated Financial Statements [extract]
6. Income tax expense [extract]
International Tax Reform – Pillar Two Model Rules

The Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting published the Pillar Two model rules designed to address the tax challenges arising from the digitalisation of the global economy.

It is unclear if the Pillar Two model rules create additional temporary differences, whether to remeasure deferred taxes for the Pillar Two model rules and which tax rate to use to measure deferred taxes. In response to this uncertainty, on 23 May 2023 and 27 June 2023, respectively, the IASB and AASB issued amendments to IAS 12 'Income taxes' introducing a mandatory temporary exception to the requirements of IAS 12 under which a company does not recognise or disclose information about deferred tax assets and liabilities related to the proposed OECD/G20 BEPS Pillar Two model rules. The Group applied the temporary exception at 30 June 2023.

In illustration 1-2 below, West China Cement Limited has chosen to explain that it has not applied the temporary exception in the current interim period because the Group's entities are operating in jurisdictions wherein the Pillar Two legislation has not yet been (substantively) enacted.

Illustration 1-2 — West China Cement Limited (1H 2023)	China

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
2. PRINCIPAL ACCOUNTING POLICIES
2.1 Application of amendments to IFRSs
Impacts on application of amendments to IAS 12 Income Taxes International Tax Reform-Pillar Two model rules

IAS 12 is amended to add the exception to recognising and disclosing information about deferred tax assets and liabilities that are related to tax law enacted or substantively enacted to implement the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (the "Pillar Two legislation"). The amendments require that entities shall apply the amendments immediately upon issuance. The amendments also require that entities shall disclose separately its current tax expense/ income related to Pillar Two income taxes, and the qualitative and quantitative information about its exposure to Pillar Two income taxes in periods in which the Pillar Two legislation is enacted or substantially enacted but not yet in effect in annual reporting periods beginning on or after 1 January 2023.

The Group is yet to apply the temporary exception during the current interim period because the Group's entities are operating in jurisdictions which the Pillar Two legislation has not yet been enacted or substantially enacted. The Group will disclose known or reasonably estimable information that helps users of financial statements to understand the Group's exposure to Pillar Two income taxes in the Group's annual consolidated financial statements in which the Pillar Two legislation has been enacted or substantially enacted and will disclose separately current tax expense/income related to Pillar Two income taxes when it is in effect.

How we see it

The introduction of the mandatory temporary exception from recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes introduces a new accounting policy. Hence, it is generally appropriate to present the disclosure required by paragraph 88A alongside the accounting policies for income taxes. However, entities that have included a separate note or section on Pillar Two income taxes may wish to include this disclosure there.

4.3 Disclosure of current tax expense

The Amendments require an entity to separately disclose its current tax expense (income) related to Pillar Two income taxes, as this helps users of financial statements understand the relative level of those taxes. Of course, this disclosure will only be applicable in periods for which the entity earns profits assessed under Pillar Two legislation.

Extract from IAS 12	
88B	An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.

The examples presented below show how an entity might comply with the requirements in paragraph 88B to disclose the current tax expense related to Pillar Two income taxes separately. In Example 1, the entity discloses the amount of current tax expense that relates to Pillar Two income taxes as a footnote to its analysis of the major components of tax expense as required by IAS 12. In addition, the entity also discloses comparative information although Pillar Two legislation was not effective in the previous year.

Example 1 – Disclosure of current tax expense

Income tax expense recognised in the consolidated statement of profit or loss in 2024 includes CU 489,000 (2023: not applicable) related to Pillar Two income taxes.

In Example 2, the entity goes further to inform the users of the financial statements about the jurisdictions that such current tax expenses relate to. Entities may also consider the requirements in IAS 7 *Statement of Cash Flows* and disclose cash flows arising from Pillar Two income taxes.

Example 2 – Disclosure of current tax expense

Income tax expense recognised in the consolidated statement of profit or loss in 2024 includes CU 489,000 (2023: not applicable) related to Pillar Two income taxes. This component of current tax expense mainly relates to profits earned in Country X and Country Y.

Information required by paragraph 88B could be provided by way of a narrative disclosure as demonstrated in Examples 1 and 2 above. Alternatively, the current tax expense (income) related to Pillar Two income taxes could be presented as part of the analysis of major components of tax expense (income) provided under IAS 12. Example 3 below demonstrates this alternative approach. When this approach is followed, the country-specific information illustrated in Example 2 above relating to the jurisdictions to which Pillar Two income taxes relate and the cash flow impact could be provided in a footnote.

Example 3 – Disclosure of current tax expense

The major components of income tax expense for the year ended 31 December 2024 are:

	2024 CU'000
Current income tax:	
Current income tax excluding Pillar Two income taxes	2,880
Current tax related to Pillar Two income taxes	489
Adjustments in respect of current income tax of previous year	22
Total current tax	**3,391**
Deferred tax:	
Relating to origination and reversal of temporary differences	371
Income tax expense reported in the statement of profit or loss	**3,762**

In the first year that Pillar Two legislation becomes effective, an entity is not expected to disclose comparative information of current tax expense (income). However, for subsequent reporting periods, entities need to consider the requirements in IAS 1 regarding the presentation of comparative information.

4.4 Disclosure in periods before (substantively) enacted legislation takes effect

4.4.1 Disclosure objective

The Board recognised a need for users of financial statements to have information about an entity's exposure to Pillar Two legislation.

In periods in which Pillar Two legislation is enacted, or substantively enacted but not yet in effect for the entity, the legislation could create exposures that are not yet reflected in the entity's income tax expense for the period due to the application of the mandatory temporary exception. Furthermore, users of the financial statements might be unable to understand such exposures from other information that an entity discloses in its financial statements. The Board recognised a need for users of financial statements to have information about an entity's exposure to Pillar Two legislation in the period between it being (substantively) enacted and taking effect for the entity. In this respect, the Board had initially considered requiring entities to disclose specific items of information based on the requirements in IAS 12. However, the feedback received to the exposure draft suggested the benefits of disclosing such information might not outweigh the costs of preparing it. Accordingly, the Board developed a disclosure objective based on the feedback received that considers the information needs of the users.

The Basis for Conclusions to the Amendments explains that the Board considered the following in developing the disclosure requirements:

- *Information that meets the objective of helping users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation*– The Amendments do not specify the items of information an entity need to disclose or the basis on which the entity prepares that information.
- *Known or reasonably estimable information*– This approach is similar to the existing requirements regarding the disclosure of known or reasonably estimable information relevant to assessing the possible impact that the application of a new IFRS requirement will have on an entity's financial statements in the period of initial application.[1]
- *Information that is both qualitative and quantitative in nature*– Feedback received from users of financial statements indicated need for both qualitative and quantitative information to understand an entity's exposure to Pillar Two income taxes.
- *Information based on an entity's circumstances at the end of the reporting period*– An entity is not expected to disclose information about possible future transactions and forward-looking information to meet the disclosure objective. This means that an entity is not expected to forecast future profits, reflect mitigation actions it expects to take in future periods, or consider possible future changes in tax legislation.

Based on the above considerations, the Amendments to IAS 12 introduce the following disclosure requirements:

[1] Paragraphs 30 and 31 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Extract from IAS 12

88C In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, an entity shall disclose known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.

88D To meet the disclosure objective in paragraph 88C, an entity shall disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the reporting period. This information does not have to reflect all the specific requirements of the Pillar Two legislation and can be provided in the form of an indicative range. To the extent information is not known or reasonably estimable, an entity shall instead disclose a statement to that effect and disclose information about the entity's progress in assessing its exposure.

Examples illustrating paragraphs 88C–88D

Examples of information an entity could disclose to meet the objective and requirements in paragraphs 88C–88D include:

(a) qualitative information such as information about how an entity is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist; and

(b) quantitative information such as:

- (i) an indication of the proportion of an entity's profits that might be subject to Pillar Two income taxes and the average effective tax rate applicable to those profits; or
- (ii) an indication of how the entity's average effective tax rate would have changed if Pillar Two legislation had been in effect.

How we see it

Pillar Two legislation will be (substantively) enacted in 2023 in many jurisdictions. Entities with a calendar year-end operating in those jurisdictions will, therefore, be required to disclose the information required by paragraphs 88C and 88D of IAS 12 in their 31 December 2023 annual financial statements.

Definition of the 'effective tax rate'

The illustrative examples in the Amendments to IAS 12 refer to the 'average effective tax rate', which is defined in paragraph 86 of IAS 12 as 'the tax expense (income) divided by the accounting profit'.

The Pillar Two model rules contain a detailed set of requirements on how an entity calculates the effective tax rates (i.e., Pillar Two or GloBE ETR) for the purposes of calculating the Pillar Two income tax. Disclosures about the Pillar Two effective tax rates are useful, as they are used to determine whether or not undertaxed profits exist.

How we see it

We believe that in disclosing the potential exposure to Pillar Two income taxes, an entity needs to clearly indicate when it refers to the 'effective tax rate' as per IAS 12 and when it refers to the 'effective tax rate' in accordance with the Pillar Two requirements.

4.4.2 Disclosure building blocks

As mentioned earlier, the Amendments to IAS 12 do not specify what information an entity needs to disclose or how they should prepare that information. Nevertheless, developing comprehensive and insightful disclosures related to Pillar Two income taxes is not straightforward. Disclosures to comply with the requirements in IAS 12 depend on several aspects such as the jurisdictions in which the MNE group operates, the group structure, the systems and processes the MNE group has in order to gather information to comply with the reporting requirements, and information disclosed outside the financial statements (e.g., in management commentary or investor presentations).

To fully address the complexity that exists in respect of the potential impact of Pillar Two legislation, an entity might, *where necessary for an understanding of its exposure to Pillar Two income taxes,* consider the following building blocks in developing disclosures that help users understand the impact of such taxes:

Building blocks in developing disclosures	
Scope	An entity discloses whether it is (part of) an MNE group that is within scope of Pillar Two legislation. An MNE group is expected to be in scope of Pillar Two legislation if it operates in a jurisdiction that has (substantively) enacted Pillar Two legislation and its consolidated revenue exceeds €750 million, or is expected to exceed the €750 million threshold in FY24.
Legislation	An entity discloses information about the main requirements of Pillar Two legislation that it expects to be subject to. This may include information about the effective date of the legislation, the potential effects of the (substantive) enactment of Pillar Two legislation in additional countries, the status of enabling legislation, transitional safe harbour relief, if any, and other significant requirements.

Building blocks in developing disclosures	
Complexity and challenges	The introduction of the complicated Pillar Two legislation across a large number of jurisdictions, uncertainties around the exact wording of the legislation, reliance on the Pillar Two safe harbour provisions, and uncertainties as to which charging mechanisms apply in determining the liability for top-up taxes of group companies, will give rise to complexities and challenges in determining an entity's exposure to Pillar Two income taxes. To the extent that this affects an entity's ability to reasonably estimate the impact of the (expected) Pillar Two legislation, it will need to disclose that fact and disclose information about what progress it has been able to make in assessing the impact. In addition, an entity would need to disclose information on how these complexities and challenges might affect its exposure to Pillar Two income taxes.
Stage of assessment and implementation	The implementation of Pillar Two legislation will require MNE groups to adopt structured processes and procedures for gathering information and documenting the judgements applied in the recognition and measurement of top-up taxes. This is further discussed in section 5 below. The Amendments require disclosure of the stage at which the MNE group is, at the end of the reporting period, regarding the assessment of potential exposure and implementation of Pillar Two legislation (see section 5 below). This could include, for example, that the MNE group has identified jurisdictions where the combined effective tax rate is lower than 15%, whether it meets the transitional safe harbour provisions in the relevant jurisdictions, and identifying data/system gaps in order to gather required information for financial reporting and compliance.
Basis of the assessment	The assessment of the potential exposure to Pillar Two income taxes is generally based on the most recent information available from tax filings, country-by-country reporting and financial statements, and takes into account known changes in the group and its operations. Accordingly, MNE groups are encouraged to describe the nature of the information used (e.g., tax filings, country-by-country reporting and financial statements), the period(s) to which it relates, and where relevant state that the information used may not be entirely representative to accurately predict or estimate the potential exposure to Pillar Two income taxes in the year the legislation becomes effective.

Building blocks in developing disclosures	
Results of the assessment	The disclosure needs to clearly convey the results of the assessment that has been carried out or is being carried out as at the reporting date. The MNE groups would be expected to report sufficient details of the assessment for users to comprehend the potential exposure. Such detailed information may include a list of, for example, jurisdictions identified where the Pillar Two ETR is expected to be lower than 15%, jurisdictions where the entity is still assessing whether the safe harbour relief applies, jurisdictions where the Pillar Two ETR is expected to be higher than 15%.
Judgements	In certain circumstances, prior year data that is being used may have been impacted by a one-off or discrete items. In such situations, the MNE groups might exclude such items or adjust the information in order to obtain more reasonable information that would be useful for the assessment. If assessment of the potential impact of Pillar Two income taxes relies on significant judgements, those judgements would need to be disclosed to the extent that would be necessary for the users to appreciate the potential exposure being reported.

4.4.3 Disclosure of known or reasonably estimable information

The requirements refer to the disclosure of "known or reasonably estimable information that helps users of financial statements understand the entity's exposure arising from Pillar Two income taxes". To comply with these requirements, an entity is required to disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the reporting period.

4.4.4 Examples of different disclosure scenarios

The examples presented below describe information that is required by paragraphs 88C and 88D. They cover various scenarios that could apply to an MNE group exposed to Pillar Two income taxes for the year ending 31 December 2023.

No exposure or immaterial exposure

Example 4A describes a situation wherein the MNE group is in scope of the Pillar Two legislation, has performed an assessment and has concluded that the group does not have any potential exposure (for example, because the Pillar Two ETR in all jurisdictions is expected to exceed 15%).

Example 4A – No exposure to Pillar Two income taxes

Pillar Two legislation has been enacted or substantively enacted in certain jurisdictions in which the Group operates. The legislation will be effective for the Group's financial year beginning 1 January 2024. The Group has performed an assessment of the Group's potential exposure to Pillar Two income taxes.

This assessment is based on the most recent information available regarding the financial performance of the constituent entities in the Group. Based on the assessment performed, the Pillar Two effective tax rates in all jurisdictions in which the Group operates are above 15% and management is not currently aware of any circumstances under which this might change. Therefore, the Group does not expect a potential exposure to Pillar Two top-up taxes.

Example 4B is similar to example 4A. However, in this example the entity concludes that although there is an exposure, it is not expected to be material.

Example 4B – Immaterial exposure to Pillar Two income taxes

Pillar Two legislation has been enacted or substantively enacted in certain jurisdictions the Group operates. The legislation will be effective for the Group's financial year beginning 1 January 2024. The Group is in scope of the enacted or substantively enacted legislation and has performed an assessment of the Group's potential exposure to Pillar Two income taxes.

The assessment of the potential exposure to Pillar Two income taxes is based on the most recent tax filings, country-by-country reporting and financial statements for the constituent entities in the Group. Based on the assessment, the Pillar Two effective tax rates in most of the jurisdictions in which the Group operates are above 15%. However, there are a limited number of jurisdictions where the transitional safe harbour relief does not apply and the Pillar Two effective tax rate is close to 15%. The Group does not expect a material exposure to Pillar Two income taxes in those jurisdictions.

Potential material exposure

Example 5A below presents a situation wherein the MNE group has a material potential exposure to Pillar Two income taxes. In this example, the group provides qualitative information regarding how the entity is affected and the jurisdictions subject to the exposure, as illustrated in the example in paragraph 88D of IAS 12. Further, the group has provided quantitative information regarding an indication of the proportion of an entity's profits that might be subject to Pillar Two income taxes and the average effective tax rate, as per IAS 12, applicable to those profits. In addition, the example provides ETRs, as per IAS 12, applicable to the two jurisdictions separately.

Example 5A – Information is known or reasonably estimable

Pillar Two legislation has been enacted or substantively enacted in certain jurisdictions the Group operates. The legislation will be effective for the Group's financial year beginning 1 January 2024. The Group is in scope of the enacted or substantively enacted legislation and has performed an assessment of the Group's potential exposure to Pillar Two income taxes for the year ending on 31 December 2024.

The assessment of the potential exposure to Pillar Two income taxes is based on the most recent tax filings, country-by-country reporting and financial statements available for the constituent entities in the Group. Based on the assessment, the Group has identified potential exposure to Pillar Two income taxes in respect of profits earned in Country X and Country Y. The potential exposure comes from the constituent entities (mainly operating subsidiaries) in these jurisdictions where the Pillar Two effective tax rate is below 15%. The Pillar Two effective tax rate is lower in these jurisdictions due to certain adjustments on account of tax holidays and R&D tax credits received by the subsidiary entities.

The proportion of the Group's profit before tax from continuing operations for the year ended 31 December 2023 that would have been subject to Pillar Two income taxes is approximately Z%. The average effective tax rate under IFRS applicable to those profits is R% (applicable to Country X and Y is X% and Y% respectively). Furthermore, the proportion of profit before tax and the effective tax rates in 2024 will depend on factors such as revenues, costs and foreign currency exchange rates.

Example 5B is similar to 5A except for the difference in quantitative information. In example 5B the MNE group has disclosed an indication of how the group's average effective tax rate under IFRS would have changed if Pillar Two legislation had been in effect.

Example 5B – Information is known or reasonably estimable

Pillar Two legislation has been enacted, or substantively enacted, in certain jurisdictions the Group operates. The legislation will be effective for the Group's financial year beginning 1 January 2024. The Group is in scope of the enacted or substantively enacted legislation and has performed an assessment of the Group's potential exposure to Pillar Two income taxes for the year ending on 31 December 2024.

The assessment of the potential exposure to Pillar Two income taxes is based on the most recent information available regarding the financial performance of the constituent entities in the Group. Based on the assessment, the Group has identified potential exposure to Pillar Two income taxes in respect of profits earned in Country X and Country Y. The potential exposure comes from the constituent entities (mainly operating subsidiaries) in these jurisdictions where the expected Pillar Two effective tax rate is below 15%. The Pillar Two effective tax rate is lower in these jurisdictions due to certain adjustments on account of tax holidays and R&D tax credits received by the subsidiary entities.

Example 5B – Information is known or reasonably estimable (cont'd)

Had the Pillar Two legislation been effective for the current year ending 31 December 2023, the restated effective tax rate under IFRS would be approximately X% which would have been Y% higher than the reported effective tax rate under IFRS of R%. The increase of the effective tax rate under IFRS for the Group is mainly driven by top up taxes arising on profits earned in Country X and Country Y where the Pillar Two effective tax rate is lower than 15%. Furthermore, the proportion of profit before tax and the effective tax rates in 2024 will depend on factors such as revenues, costs and foreign currency exchange rates.

Assessment is incomplete but exposure could be material

Example 6 below presents a situation wherein the assessment to identify potential exposure from Pillar Two legislation is still in progress. The MNE group has reported qualitative information based on the assessment carried out at the period end. In addition, the disclosure clarifies the group is unable to disclose quantitative information.

Example 6 – Information is partially known or reasonably estimable

Pillar Two legislation has been enacted or substantively enacted in certain jurisdictions the Group operates. The legislation will be effective for the Group's financial year beginning 1 January 2024. The Group is in the process of assessing the potential exposure arising from Pillar Two legislation.

The assessment that is being carried out is based on the latest available tax filings and country-by-country reporting for 2022, and the latest financial information for 2023. In certain jurisdictions, information required for the assessment is still being gathered and, therefore, the assessment is not complete.

Based on the assessment carried out so far, the Group has identified potential exposure to Pillar Two income taxes on profits earned in Country X and Country Y where the expected Pillar Two effective tax rate is likely to be lower than 15%. The potential exposure is expected to come from the constituent entities (mainly operating subsidiaries) in these jurisdictions. However, exposure may also exist in other jurisdictions where the assessment is in progress.

Quantitative information to indicate potential exposure to Pillar Two income taxes is currently not known or reasonably estimable. The Group continues to progress on the assessment and expects to complete the assessment in the first of half of financial year 2024.

Assessment is at an early stage

Example 7 below presents a situation wherein the MNE group is unable to obtain known or reasonably estimable information.

Example 7 – Information is not known or reasonably estimable

Pillar Two legislation has been enacted or substantively enacted in certain jurisdictions the Group operates. The Group is in scope of the enacted or substantively enacted legislation. However, the legislation was enacted close to the reporting date. Therefore, the Group is still in the process of assessing the potential exposure to Pillar Two income taxes as at 31 December 2023. The potential exposure, if any, to Pillar Two income taxes is currently not known or reasonably estimable. The Group expects to be in a position to report the potential exposure in its next interim financial statements for the period ending 30 June 2024.

How we see it

Where an MNE group is in scope of Pillar Two legislation, we would expect the MNE group to provide at least some information to the users of the financial statements that is helpful to understand the potential exposure to Pillar Two income taxes. However, in certain limited circumstances, for example, when Pillar Two model rules are (substantively) enacted close to the reporting date or the date of issuance of the financial statements, an entity might not be able to provide any known or reasonably estimable information. In such situations, the MNE group is required to disclose that known or reasonably estimable information cannot be obtained, as described in Example 7 above.

4.5 Disclosure where Pillar Two model rules do not apply

There may be instances where an MNE group operates in jurisdictions where Pillar Two model rules are (substantively) enacted. However, such legislation is not applicable due to the MNE group not meeting the threshold of €750 million, or not expecting to meet the threshold of €750 million. In such instances, the MNE group could consider stating the fact that the legislation does not apply to it as illustrated in Example 8 below.

Example 8 – Pillar Two model rules do not apply

Pillar Two legislation has been enacted or substantively enacted in certain jurisdictions in which the Group operates. However, this legislation does not apply to the Group as its consolidated revenue is lower than €750 million.

5. Implementation

The implementation of Pillar Two legislation will require MNE groups to adopt structured processes and procedures for gathering information. In addition, they need to document the judgements applied in recognition and measurement of top-up taxes and disclose information that is helpful to users of the financial statements as per the amended IAS 12. Entities may consider the following phases in the process of implementation:

- **Assessment**
  - Evaluate whether the MNE group is in scope of the application of the Pillar Two model rules (substantively) enacted in the jurisdictions in which the MNE operates, including transitional country-by-country reporting safe harbour rules
  - Perform a high-level Pillar Two ETR calculation and identification of low-tax jurisdictions
  - Identify data and systems gaps and discuss with key stakeholders in tax, accounting, and financial reporting disciplines
  - Refine roadmap, implementation plan, and key action items based upon initial results from this phase
- **Planning and readiness**
  - Evaluate tax accounting considerations of Pillar Two legislation and potential impacts of current business changes
  - Develop and update process for modelling annual and quarterly provisions of Pillar Two taxes
  - Develop and update systems and process for data collection and further refine data sources
  - Refine projected 2024 GloBE ETR impact related to Pillar Two and other management considerations
- **Validation and documentation**
  - Validate results and processes with internal and external stakeholders (including auditors)
  - Consider updates to internal controls framework
  - Continued refinements of modelling and Pillar Two processes
- **Reporting and compliance**
  - Quarterly provisioning of Pillar Two taxes in Q1 2024
  - Monitor rules and guidance and adapt modelling/processes as required
  - Consider jurisdictional Qualified Domestic Minimum Top-up Tax implementations
  - Continue refinements of modelling and Pillar Two calculations including build-out of processes to meet compliance and financial reporting requirements

- **Ongoing monitoring**
  - Monitor rules issued by OECD, local country legislative activities and the International Accounting Standards Board accounting guidance — adapt processes and models accordingly

Affected entities need to put processes and controls in place to gather the data, prepare the calculations, and determine the appropriate reporting. This may require design changes to existing tax provision processes and updates to internal control documentation. In addition, extra personnel and technology resources (i.e., IT applications) may be required. It should be noted that significant additional time is expected to be needed by tax department resources to implement the Pillar Two legislation.

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