

IFRS Developments

IASB project on International Tax Reform – Pillar Two Model Rules

What you need to know

- ▶ The IASB tentatively decided to amend IAS 12 to introduce a mandatory temporary exception from accounting for deferred taxes arising from the implementation of the OECD's GloBE Model Rules (including any Qualified Domestic Minimum Top-up Tax).
- ▶ The Board tentatively decided to require disclosures for the impact of the GloBE Model Rules, which are expected to apply for annual reporting periods beginning on 1 January 2023.
- ▶ The Board tentatively decided to require an entity to apply retrospectively the proposed temporary exception immediately upon their issuance.
- ▶ An ED with a 60-day comment period will be published in January 2023 and the final amendments in Q2 2023.

Introduction

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. To restore confidence in the international tax system and ensure profits are taxed where economic activities take place and value is created, the Inclusive Framework on BEPS proposes two "pillars":

- ▶ Pillar One applies to multinational enterprises (MNEs) with revenue in excess of EUR 20 billion and profitability above 10% (i.e., profit before tax/revenue)
- ▶ Pillar Two applies to MNEs with revenue in excess of EUR 750 million per their consolidated financial statements

The Pillar Two Global anti-Base Erosion rules (GloBE Model Rules) represent the first substantial overhaul of the international tax rules in almost a century. We provided background to the OECD's project in [IFRS Developments 203 OECD BEPS Pillar Two - Global Anti-Base Erosion Rules: Accounting implications](#).

At its November 2022 meeting, the International Accounting Standards Board (IASB or the Board) made significant progress in its response to the potential financial reporting issues associated with Pillar Two model rules. In this publication, we summarise the tentative decisions taken by the IASB and our views on the issue.

The GloBE Rules

The OECD notes 'The GloBE Rules apply a system of Top-up Taxes - that is, an IIR and a UTPR - that brings the total amount of taxes paid on an MNE's Excess Profit in a jurisdiction up to the Minimum Rate. This Top-up Tax does not operate as a typical direct tax on income of an Entity. Rather it applies to the Excess Profits calculated on a jurisdictional basis and only applies to the extent those profits are

subject to tax in a given year below the Minimum Rate. Rather than a typical direct tax on income, the tax imposed under the GloBE Rules is closer in design to an international alternative minimum tax, that uses standardised base and tax calculation mechanics to identify pools of low-taxed income within an MNE Group and imposes a co-ordinated tax charge that brings the Group's ETR [Effective Tax Rate] on that income in each jurisdiction up to the Minimum Rate.¹

The GloBE Rules propose three new taxing mechanisms under which MNEs would pay a minimum level of tax: the Income Inclusion Rule (IIR); the Under Taxed Payments Rule (UTPR); and the Qualified Domestic Minimum Top-up Tax (QDMTT) generally propose a minimum tax on the income arising in each jurisdiction in which an MNE operates. Additionally, Pillar Two proposes a Subject to Tax Rule, a tax treaty-based rule that generally proposes a withholding tax levied at source on certain cross-border intercompany transactions that otherwise are not subject to a minimum level of tax in the income recipient jurisdiction.

At the simplest level, the GloBE Model Rules impose a Top-up Tax that is calculated and applied at a jurisdictional level involving five steps: 1) determine whether an MNE group is in scope of the GloBE Model Rules; 2) calculate GloBE income or loss for each constituent entity in the MNE group; 3) calculate adjusted covered taxes for each constituent entity in the MNE group; 4) based on constituent entities' GloBE income and adjusted covered taxes, compute the GloBE ETR and Top-up Tax at a jurisdictional level, taking into account QDMTT (if any); and 5) determine the entity's liable to pay Top-up Tax under the IIR or UTPR.

The proposed GloBE Model Rules raise a number of accounting questions. In particular, the IASB staff identified the following questions:

- ▶ Is the Top-Up Tax is an income tax in the scope of IAS 12 *Income tax*?
- ▶ Do the Pillar Two model rules create additional temporary differences?
- ▶ Would an entity remeasure deferred taxes recognised for existing temporary differences?
- ▶ How is the rate used to measure deferred taxes determined?

Temporary exception from accounting for deferred taxes

The IASB staff paper presented at the November 2022 meeting notes 'it is not immediately apparent how an entity would apply the principles and requirements in IAS 12 in accounting for top-up tax arising from the [Global Model Rules]' and that 'IAS 12 was not designed to apply to income tax law such as that enacted to implement the rules. Although income tax regimes vary significantly around the world – and entities have been able to apply IAS 12 in these circumstances – in our view, the rules are sufficiently different from traditional tax regimes and will be applicable to a sufficiently large number of entities to require specific consideration by the IASB'.² Based on its analysis, the IASB staff recommended that the IASB introduce a mandatory temporary exception from accounting for deferred taxes with respect to Pillar Two Top-up Tax.

The Board tentatively decided to introduce a mandatory temporary exception from accounting for deferred taxes arising from legislation enacted to implement the GloBE Model Rules, including any QDMTT. The temporary exception would not have a sunset date but would apply until the IASB either removes the temporary exception or makes the temporary exception permanent.

The Board tentatively agreed to introduce a mandatory temporary exception from accounting for deferred taxes.

¹ Tax Challenges Arising from the Digitalisation of the Economy - Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), Page 8, OECD (2022), Paris.

² IASB Staff Paper 12A, Project: *International Tax Reform—Pillar Two Model Rules*, Paper topic: *Potential standard-setting project*, IASB meeting, November 2022, paragraphs 59 and 60.

IASB staff recommended that any new disclosure requirements be simple, narrow in scope and specifically related to the temporary exception.

Required disclosures

The IASB staff also considered whether entities should be required to disclose information to compensate for the potential loss of information that would result from the mandatory temporary exception. Given the urgency to finalise any narrow-scope amendments, the IASB staff recommended any new disclosure requirements be simple, narrow in scope and specifically related to the temporary exception.

The Board deliberated the proposed disclosure requirements. A few Board members expressed concerns about the lack of clarity on how an entity would determine whether it operates in low-tax jurisdictions in pre-effective date periods, and about requiring an entity to disclose its expectations about whether it will be operating in low-tax jurisdictions in future periods before it has completed its assessment of new legislation enacted. However, entities would be able to disclose factual information about legislation enacted to implement the GloBE Model Rules, as well as information about work already undertaken by management in preparing to comply with such legislation.³

The Board tentatively decided to amend IAS 12 to require an entity, in periods before the GloBE Model Rules are in effect, to disclose for the current period only:

- ▶ Information about legislation enacted, or substantively enacted, to implement the GloBE Model Rules in jurisdictions in which the entity operates;
- ▶ Whether the entity operates in jurisdictions in which:
 - ▶ It reasonably expects to be taxed below the minimum rate in accordance with the specific requirements of the GloBE Model Rules; or
 - ▶ Its effective tax rate - calculated based on IAS 12 requirements - is below 15% for the current period;
- ▶ The jurisdictions in which the entity's effective tax rate (calculated based on IAS 12 requirements) for the current period is below 15% (the 'Identified Jurisdictions');
- ▶ For the Identified Jurisdictions in aggregate: i) the accounting profit before tax, ii) the income tax expense, and iii) the resulting weighted-average effective tax rate. This information could be derived by disaggregating information disclosed in the reconciliation required by paragraph 81(c) of IAS 12;
- ▶ Whether the work it has already done in preparing to comply with the GloBE Model Rules indicates that there are jurisdictions in relation to which the entity:
 - ▶ Might be exposed to paying top-up tax and that *are not* included in the Identified Jurisdictions; or
 - ▶ Might not be exposed to paying top-up tax and that *are* included in the Identified Jurisdictions.

The Board also tentatively decided to amend IAS 12 to require an entity to disclose that it has applied the temporary exception (effective immediately), and its current tax expense related to Pillar Two Top-up Tax.

Transition and effective date

The IASB staff paper noted for the temporary exception to be effective, 'it would need to be: (a) available to entities immediately upon the issue of the amendments, such that it can be applied to any financial statements not yet authorised for issue; and (b) applied retrospectively', particularly if the amendments were finalised after legislation to implement the GloBE Model Rules have been (substantively) enacted.⁴

³ IASB Staff Paper 12A (Addendum), Project: *International Tax Reform—Pillar Two Model Rules*, Paper topic: *Potential standard-setting project*, IASB meeting, November 2022, paragraph 4.

⁴ IASB Staff Paper 12A, Project: *International Tax Reform—Pillar Two Model Rules*, Paper topic: *Potential standard-setting project*, IASB meeting, November 2022, paragraph 81.

The Board tentatively decided to require an entity to apply the proposed amendments to introduce the temporary exception immediately upon their issuance and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Board also tentatively decided to require an entity to disclose the fact that it has applied the exception immediately upon the issue of the amendments, while the remaining proposed disclosure requirements (as described in the section 'Required disclosures' above) apply for annual reporting periods beginning on 1 January 2023.

Next steps

An exposure draft (ED) is expected to be published in January 2023. Due to the urgent nature of the project, the Board tentatively decided on a 60-day comment period subject to approval by the Due Process Oversight Committee. The Board plans to issue the final amendments, which would be effective immediately, in the second quarter of 2023.

How we see it

At its November 2022 meeting, the IASB took a significant step forward in providing entities temporary relief from the application of IAS 12 to account for deferred taxes arising from the implementation of the proposed GloBE Model Rules. The mandatory temporary exception avoids inconsistent application of IAS 12 that would not result in useful information for the users of the financial statements.

The proposed disclosure requirements, which are intended to compensate for the potential loss of information that would result from the temporary exception, would require an entity to apply judgement and collate information that it has not previously produced. The Board is expected to specifically ask for feedback on the proposed disclosure requirements. The proposed disclosures would provide an indication of the progress made by entities to prepare for the application of GloBE Model Rules and an indication of the potential impact of the GloBE Model Rules on the entity.

Entities need to monitor the developments around the implementation and enactment of the GloBE Model Rules in the relevant jurisdictions and, if appropriate, engage with advisors to determine the impact of GloBE Model Rules on their financial statements, audit and tax filings. We encourage entities to start considering whether they have established appropriate processes and procedures to obtain information necessary to present disclosures required in the proposed amendment on a timely basis.

If the GloBE Model Rules have not yet been (substantively) enacted in the jurisdictions in which an MNE operates, there is no specific IFRS disclosure requirement. However, entities may consider whether to provide additional information on the potential impact of the GloBE Model Rules. In particular, entities may consider whether to provide some or all of the information described in the section 'Required disclosures' above in financial statements for annual periods ending before the issuance of the proposed IAS 12 amendments if it is helpful to understand the financial statements.

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