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IFRS Developments

# OECD BEPS Pillar Two - Global Anti-Base Erosion Rules: Accounting implications

**What you need to know**

- The Pillar Two GloBE Model Rules define the scope and key mechanics for the Pillar Two system of global minimum tax, which includes among other topics the Income Inclusion Rule and the Under Taxed Payments Rule, referred to collectively as the GloBE Rules.
- Enactment of the GloBE Rules is being discussed by national governments worldwide.
- The GloBE Rules propose effective dates beginning in 2023/24, but the effective date depends ultimately on tax laws (substantively) enacted in a jurisdiction.
- The accounting implications are still uncertain.
- Significant data collection efforts will be required by multinational groups affected by the GloBE Rules.

## 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. To restore confidence in the international tax system and ensure that 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 global turnover above 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 Rules) represent the first substantial overhaul of the international tax rules in almost a century. The GloBE Rules propose four new taxing mechanisms under which MNEs would pay a minimum level of tax (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 Rule (UTPR); and the Qualified Domestic Minimum Top-up Tax (QDMT) generally propose a Minimum Tax on the income arising in each jurisdiction in which an MNE operates. The IIR, UTPR and QDMT 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(ies) 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, the UTPR, and/or the QDMT, and the portion of Minimum Tax that is charged to each relevant entity. While the

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framework for the proposed GloBE Rules is global, the GloBE Rules would be implemented through legislation enacted in jurisdictions that adopt the rules.

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

There remain numerous areas of uncertainty in the application of the GloBE Rules that require additional interpretive guidance.

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.[1] In addition, the OECD has published a summary, fact sheets, frequently asked questions, and press releases that provide additional information on the GloBE Rules. EY has published an executive summary and discussion of GloBE Model Rules, Commentary and Examples, which provides helpful context and further explanation of the GloBE Rules.[2] There remain numerous areas of uncertainty in the application of the GloBE Rules that require additional interpretive guidance.

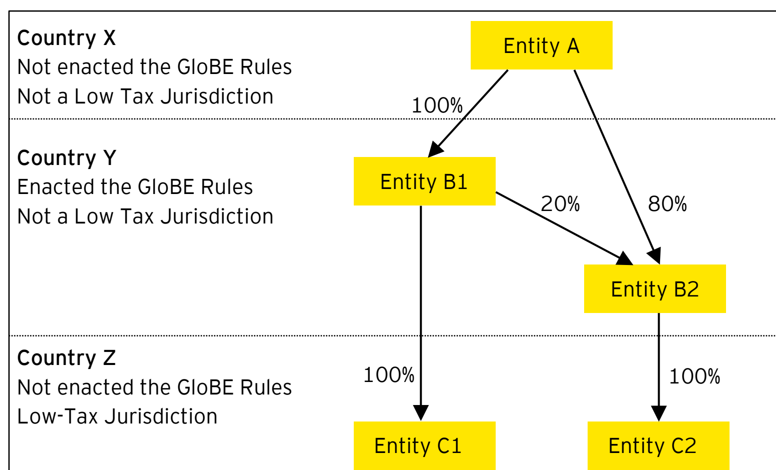
## The GloBE Rules

The OECD notes that '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 on that income in each jurisdiction up to the Minimum Rate.'[3]

## Five step process to apply the GloBE Rules – Illustration

At the simplest level, the GloBE Rules impose a Top-up Tax that is calculated and applied at a jurisdictional level involving five steps: 1) identify MNE Groups in scope of the GloBE Rules; 2) determine GloBE income or loss for each constituent entity; 3) determine adjusted covered taxes; 4) compute GloBE ETR and Top-up Tax; and 5) determine the entities liable to pay taxes under the IIR, UTPR and/or QDMT.

The diagram below sets out the holding structure and location of the members of the ABC Group and illustrates the application of GloBE Rules.




[1] https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm.
[2] https://www.ey.com/en_gl/tax-alerts/oecd-releases-commentary-and-illustrative-examples-on-pillar-two-model-rules.
[3] Page 8, OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), OECD, Paris.

Entities A, B1 and B2 have a GloBE ETR above the 15% Minimum Rate, but Entities C1 and C2 are located in a low-tax jurisdiction with a GloBE ETR below 15%. Only Country Y has enacted an IIR.

**Step 1: Identify MNE groups in scope of the GloBE Rules**

Entity A, located in Country X, is the ultimate parent entity (UPE) of the consolidated group (ABC Group). ABC Group has determined it is an MNE Group in scope of the GloBE Rules. Accordingly, ABC Group has identified its constituent entities and their locations according to the diagram above. As Countries X and Z have not enacted GloBE Rules, any Top-up Taxes due by the entities located in those jurisdictions will be payable by entities in Country Y to Country Y (see Step 5).

**Step 2: Determine GloBE income or loss for each constituent entity**

ABC Group has determined GloBE income for each constituent entity in the MNE Group based on the group financial accounting net income of each constituent entity adjusted to the GloBE tax base. Only the results for C1 and C2 are given in this example, as they operate in a low tax jurisdiction. Assume GloBE income is CU600 for C1 and CU1,800 for C2.

**Step 3: Determine adjusted covered taxes**

ABC Group has determined adjusted covered taxes for each constituent entity in the MNE Group based on group financial accounting tax expense/benefit adjusted to the GloBE covered taxes. Assume adjusted covered taxes are CU30 for Entity C1 and CU240 for Entity C2.

**Step 4: Compute GloBE ETR and Top-up Tax**

The GloBE ETR of the constituent entities located in Country Z is (CU30+CU240) / (CU600+CU1,800) = 11.25% and thus, the Top-up Tax rate is 3.75% (i.e., minimum rate of 15% *less* GloBE ETR of 11.25%). The Excess Profit (amount of profit upon which the Top-up Tax is levied) is assumed to be equal to GloBE income, so the Top-up Tax is (CU600+CU1,800) * 3.75% = CU90. The example assumes the Group does not have any substance-based income exclusion (i.e., exclusion of a fixed return for substantive activities within a jurisdiction from the application of the GloBE Rules).

**Step 5: Determine the entities liable for payment of the Top-up Tax**

The taxes imposed by the GloBE Rules are not typical direct taxes, which raises the question whether these are in the scope of IAS 12.

In applying the IIR, a parent entity pays its allocable share of the Top-up Tax with respect to a low-taxed constituent entity. The IIR operates on a top-down approach, starting with the UPE. If the UPE is not located in a jurisdiction that has enacted an IIR, the highest parent entity in the ownership chain that is located in a jurisdiction that has enacted an IIR pays its allocable share of the Top-up Tax. (Note: an exception to the top-down approach applies in split-ownership situations.)

In this example, only Country Y has enacted an IIR and thus, the intermediate parent Entities B1 and B2 are required to pay any Top-up Taxes. Entity B1 is liable for 100% of any Top-up Tax attributable to its wholly-owned subsidiary C1 and 20% of the Top-up Tax for C2, as a result of its 20% indirect shareholding interest in C2. Entity B2 is liable for 100% of any Top-up Tax attributable to its wholly-owned subsidiary C2.

As Entity B2 is liable for 100% of any Top-up Tax of C2, Entity B1's allocable share (i.e., 20%) of C2's Top-up Tax due to its indirect interest in C2 via B2 would result in double-taxation. To avoid double taxation, Entity B1 reduces its Top-up Tax attributable to its indirect ownership in C2 that is paid by B2.

In summary, Entity B1 pays Top-up Tax of CU22.5, calculated as follows: Entity C1: CU22.5 (i.e., 3.75%*CU600), plus Entity C2: CU13.5 (20% of 3.75%*CU1,800), less CU13.5 paid by Entity B2. Entity B2 pays Top-up Tax of CU67.5, calculated as follows: Entity C2: CU67.5 (i.e., 3.75%*CU1,800).

The above simple example demonstrates the application of only an IIR. In practice, if a UTPR and QDMT are enacted with an IIR, an MNE Group would first calculate the Top-up Tax under QDMT, then apply the IIR to capture residual Top-up Tax not included in the QDMT, and finally apply the UTPR to capture residual Top-up Tax not included in the IIR.

## Key accounting considerations

The financial accounting impact of the GloBE Rules on IFRS financial statements is still being discussed as their application remains uncertain. This section highlights key accounting considerations, but the financial impact can only be determined once the application of the GloBE Rules is clarified and legislation is (substantively) enacted in the various jurisdictions.

### IIR, UTPR and QDMT - Scope of IAS 12

IAS 12 applies to taxes which are based on taxable profits. As described above, taxes imposed by the GloBE Rules are not typical direct taxes, which raises the question whether these are in the scope of IAS 12, particularly in the case of taxes under the UTPR. Also, the IIR, UTPR and QDMT may not apply to all entities of an MNE. Hence, a detailed assessment of these taxes and understanding how these rules ultimately are enacted in each jurisdiction is necessary before concluding whether and how IAS 12 may apply to group financial statements and separate entity financial statements.

### Substantive enactment

Under IAS 12, a new tax law is effective when it is enacted or substantively enacted in a particular jurisdiction. MNEs need to monitor the regulatory developments in respect of (substantive) enactment of the GloBE Rules in all of the jurisdictions where they operate either through wholly- or partially-owned subsidiaries, joint ventures, flow through entities or permanent establishments. Different countries may (substantially) enact the rules on different dates and with variations to the GloBE Model Rules, which will result in additional complexity in accounting for the income tax effects of the GloBE Rules.

### Accounting for future tax effects

Determining the future tax effects of the GloBE Rules is expected to be complex since the application of IAS 12 is still unclear. The Top-up Tax is calculated at the jurisdictional level and is allocated to the entities in that jurisdiction as an intermediate step in determining which entity is obligated to pay such taxes. Consequently, under the IIR and UTPR rules, GloBE income adjustments that find their origin in one entity may affect the Top-up Tax allocated to another entity. Additionally, the Top-up Tax rate applicable to the reversal of GloBE adjustments may be contingent on future events, including permanent differences related to local tax laws and other items that cannot be forecast.

### Disclosure

If the GloBE 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 Rules if it is helpful to understand the financial statements.

**How we see it**

Entities need to monitor the developments around the implementation and enactment of the GloBE Rules in the relevant jurisdictions and, if appropriate, engage with advisors to determine the impact of GloBE Rules on their financial statements, audit and tax filings.

Entities need to begin planning for the implementation of the processes and internal controls necessary to gather information at the jurisdictional level that will serve as inputs for the calculations required by Steps 1 to 5 of the GloBE Rules. Entities also need to consider the transition rules that are laid out in Chapter 9 of the GloBE Model Rules.

As the application of the GloBE Rules is still unclear and their financial impact is being assessed, entities may not be able to quantify the financial impact of the GloBE Rules. However, entities may consider whether to provide additional information on the potential impact of the GloBE Rules if it is helpful to understand the financial statements.

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