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# Global implementation of Pillar Two: Impact on deferred taxes and financial statement disclosures

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# Key points

- In December 2021, the Organisation for Economic Co-operation and Development ('OECD') released the Pillar Two model rules to reform international corporate taxation with the aim of ensuring that applicable multinationals (global revenue exceeding EUR 750 million) pay a minimum effective corporate tax rate of 15%.
- The rules are due to be passed into national legislation based on each country's approach, and some countries have already enacted – or substantively enacted – the rules. Applying the rules and determining the impact are likely to be very complex, and this poses a number of practical challenges.
- In May 2023, the International Accounting Standards Board (IASB) issued narrow-scope amendments to IAS 12, 'Income Taxes' that provide temporary relief from accounting for deferred taxes arising from the implementation of the Pillar Two model rules. Targeted disclosure requirements were also introduced. Jurisdictions subject to an endorsement process will need to endorse the amendments.

# Contents

# 1 What is Pillar Two?

In October 2021, more than 130 countries – representing more than 90% of global GDP – agreed to implement a minimum tax regime for multinationals, 'Pillar Two'. In December 2021, the Organisation for Economic Co-operation and Development ('OECD') released the Pillar Two model rules (the Global Anti-Base Erosion Proposal, or 'GloBE') to reform international corporate taxation. Large multinational enterprises within the scope of the rules are required to calculate their GloBE effective tax rate for each jurisdiction where they operate. They will be liable to pay a top-up tax for the difference between their GloBE effective tax rate for each jurisdiction and the 15% minimum rate. If the GloBE effective tax rate domestically is 15% or more, no GloBE top-up tax will be payable. It is the ultimate parent entity of the multinational enterprise that is primarily liable for the GloBE top-up tax in its jurisdiction's territory.

The goal is to end the 'race to the bottom' on tax rates worldwide, under which countries had been competitively cutting corporate taxes to attract businesses, with the impact that other countries felt forced to cut taxes to compete.

The GloBE rules include two main components: the Income Inclusion Rule ('IIR'); and the Undertaxed Payment Rule ('UTPR'). Top-up tax is first imposed under the IIR on a parent entity with an ownership interest in a low-taxed subsidiary. The UTPR is a backstop mechanism if there is low-taxed income from an entity within the group that is not brought into charge under the IIR by applying a top-up tax in the jurisdiction that introduced the UTPR.

Top-up taxes calculated under the IIR are to be paid in the jurisdiction of the parent entity of the multinational group, rather than in the low-tax territory that triggers the excess payment. Top-up taxes calculated under the UTPR are to be paid by the entity that operates in a jurisdiction that has enacted the UTPR, even if this entity is not a parent entity of the group. The Pillar Two rules thus provide for the possibility that jurisdictions might engage in domestic tax policy reforms and introduce their own qualified domestic minimum top-up tax ('QDMTT') based on the GloBE mechanism to avoid any 'tax leakage' in anticipation of the GloBE rules becoming effective.

Notwithstanding any new local minimum tax regime that might be designed to reduce or eliminate the GloBE top-up tax, additional top-up tax under GloBE might still be due. This will depend on the local effective tax rate calculation according to the specific rules set out in the Pillar Two regulations.

**Definitions of terms used in this publication**

GloBE effective tax rate = GloBE tax expense/income ÷ GloBE profit/loss

Statutory tax rate = Enacted tax rate

IAS 12 effective tax rate = IAS 12 tax expense/income ÷ IFRS profit/loss

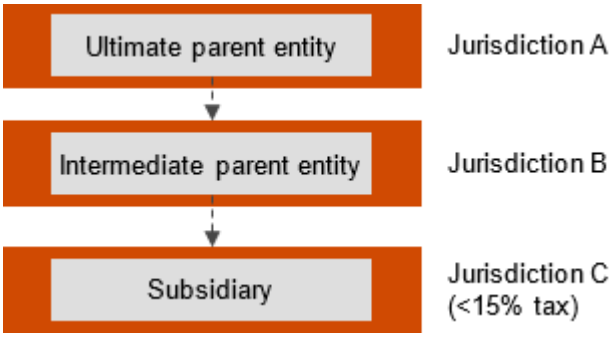
# 2 Who is impacted?

The Pillar Two rules apply to multinational enterprises that have consolidated revenues (which, as defined by the OECD, include any form of income and are therefore not limited to revenue recognised in accordance with IFRS 15) of EUR 750 million in at least two of the last four years.

Pillar Two applies if a jurisdiction in which the group operates has passed the rules into national legislation. This could be the jurisdiction of the ultimate parent entity or, if the IIR Pillar Two legislation is not yet in effect in the ultimate parent entity's jurisdiction, an intermediate parent entity in the multinational enterprise that is subject to top-up tax. For UTPR, this could even just be a subsidiary in the multinational enterprise. Enacted QDMTT rules could also increase the tax liability of the group.

A multinational enterprise might therefore be subject to Pillar Two taxes and within the scope of the IAS 12 disclosure requirements, even if the jurisdiction of the ultimate parent entity has not yet enacted the Pillar Two rules.

**Example: The jurisdiction of the ultimate parent entity has not enacted the Pillar Two rules.**




Assume that the group has recorded consolidated revenue (as defined by the OECD) of EUR 750 million in at least two of the last four years, which would result in the group being within the scope of the Pillar Two rules. The GloBE effective tax rate in jurisdictions A, B and C are 25%, 22% and 5% respectively.

The status of Pillar Two rules implementation for each of the jurisdictions is as follows:

- jurisdiction A has not enacted the Pillar Two rules.
- jurisdiction B has enacted the Pillar Two rules; and
- jurisdiction C has not enacted the Pillar Two rules.

**Question**

In this scenario, is the consolidated group in jurisdiction A considered to be impacted by the Pillar Two rules for purposes of the disclosure requirements under IAS 12?

**Answer**

Yes. The Pillar Two rules do not apply to the ultimate parent entity, and so no GloBE top-up tax is collected in jurisdiction A. Instead, the jurisdiction of the next intermediate parent entity (jurisdiction B in this example) applies the IIR and imposes top-up tax on the intermediate parent entity for the low-tax jurisdiction C.

Since the group has been impacted by the Pillar Two rules, the disclosure requirements of IAS 12 would be applicable to the consolidated financial statements prepared by the ultimate parent entity.

# 3 What is the issue?

Applying the Pillar Two rules and determining the impact are likely to be highly complex, and this poses a number of practical challenges. Additionally, how to account for the top-up tax (whether GloBE or a GloBE qualifying domestic minimum top-up tax) under IAS 12 was not immediately apparent.

On 23 May 2023, the IASB issued narrow-scope amendments to IAS 12. The amendments provide a temporary exemption from the requirement to recognise and disclose deferred taxes arising from enacted or substantively enacted tax law that implements the Pillar Two model rules published by the OECD, including tax law that implements QDMTT described in those rules.

The amendments to IAS 12 make it clear that entities subject to Pillar Two rules must ignore the deferred tax implications of enacted or substantively enacted Pillar Two legislation in their IFRS® financial statements. However, for annual reporting periods beginning on or after 1 January 2023, these entities will need to provide some additional disclosures about current taxes in their annual financial reports, as described below.

# 4 What is the impact?

As explained above, the one impact is that entities are prohibited from recognising or disclosing deferred tax implications arising from Pillar Two. A second impact is that the narrow-scope amendments to IAS 12 introduced targeted disclosure requirements for affected companies. They require entities to disclose:

- the fact that they have applied the exemption from recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes [IAS 12 para. 88A];
- their current tax expense (if any) related to the Pillar Two income taxes [IAS 12 para. 88B]; and
- during the period between the legislation being enacted or substantively enacted and the legislation becoming effective, entities will be required to disclose known or reasonably estimable information that would help users of financial statements to understand an entity's exposure to Pillar Two income taxes arising from that legislation. If this information is not known or reasonably estimable, entities are instead required to disclose a statement to that effect as well as information about their progress in assessing the exposure. [IAS 12 para 88C-88D].

Due to the complexity of the Pillar Two rules, we expect that it will take time for some entities to conduct their impact assessments following the legislation being announced. As a result, management might be unable to quantify and therefore disclose the detailed effects. However, an entity might be able to provide qualitative information – for example, if a material portion of its business operates in relatively low-tax jurisdictions that are likely to be impacted.

**Disclosure example – legislation substantively enacted but not in effect**

A parent entity might be in a jurisdiction where the Pillar Two legislation is substantively enacted, but not yet in effect at the group's reporting date. For example, as at 31 December 2023 the jurisdiction of the parent entity might have substantively enacted the Pillar Two legislation that will become effective from 1 January 2024.

To meet the disclosure requirements of IAS 12 above, an entity that is within the scope of the Pillar Two rules should disclose qualitative and quantitative information about its exposure to Pillar Two income taxes in its annual financial statements as at 31 December 2023. That information need not necessarily reflect all of the specific requirements of the legislation and could be provided in the form of an indicative range.

**Disclosure example – legislation substantively enacted but not in effect**

Disclosures that might be considered are as follows:

- Qualitative information, such as how the group is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist.
- For example, if the parent has subsidiaries that operate in low-tax jurisdictions, it might consider disclosing the name and the current legislative or average effective tax rates of those jurisdictions.
- Quantitative information such as:
  - an indication of the proportion of the entity's profits that potentially might be subject to Pillar Two income taxes and the average effective tax rate applicable to those profits; or
  - an indication of how the entity's average effective tax rate would have changed if Pillar Two legislation had been effective

To the extent that information is not known or reasonably estimable, the entity should instead disclose a statement to that effect as well as information about its progress in assessing its exposure. Management will need to be able to support any statement claiming that Pillar Two will not have a material impact.

The following scenario provides an example of what an entity might consider disclosing in its financial statements for the year ended 31 December 2023.

**OECD Pillar Two model rules**

The group is within the scope of the OECD Pillar Two model rules. Pillar Two legislation was enacted in country X, the jurisdiction in which the company is incorporated, and will come into effect on 1 January 2024. Since the Pillar Two legislation was not effective on the reporting date, the group has no related current tax exposure. The group applies the exemption from recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes, as provided in the amendments to IAS 12 issued in May 2023.

Under the legislation, the group is liable to pay a top-up tax for the difference between its GloBE effective tax rate per jurisdiction and the 15% minimum rate. All entities within the group have an effective tax rate that exceeds 15%, except for one subsidiary that operates in jurisdiction A.

For 2023, the average effective tax rate (calculated in accordance with para. 86 of IAS 12) of the entity operating in jurisdiction A is:

| | **Group entity operating in jurisdiction A TCHF** |
|---|---|
| Tax expense for year ending 31 December 2023 | 250 |
| Accounting profit for year ending 31 December 2023 | 3,000 |
| Average effective tax rate | 8.3% |

The group is in the process of assessing its exposure to the Pillar Two legislation for when it comes into effect. For jurisdiction A, this assessment indicates that the average effective tax rate based on accounting profit is 8.3% for the annual reporting period to 31 December 2023. However, although the average effective tax rate is below 15%, the group might not be exposed to paying Pillar Two income taxes in relation to jurisdiction A. This is due to the impact of specific adjustments envisaged in the Pillar Two legislation that give rise to different effective tax rates compared to those calculated in accordance with paragraph 86 of IAS 12.

Due to the complexities in applying the legislation and calculating GloBE income, the quantitative impact of the enacted or substantively enacted legislation is not yet reasonably estimable. Therefore, even for those

### Disclosure example – legislation substantively enacted but not in effect

entities with an accounting effective tax rate above 15%, there might still be Pillar Two tax implications. The group is currently engaged with tax specialists to assist it with applying the legislation.

Entities might consider disclosing the expected impact of Pillar Two if the local jurisdiction has not yet announced or enacted the changes before the financial statements are authorised for issue. [IAS 1 para. 17(c)].

### Disclosure example – legislation not substantively enacted

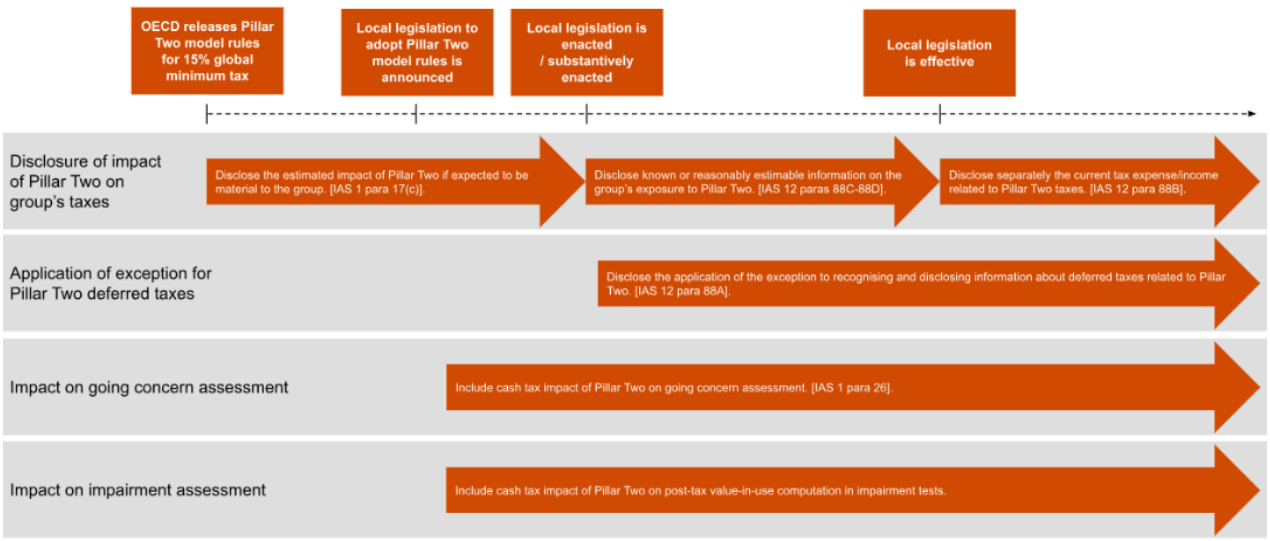
In December 2021, the Organisation for Economic Co-operation and Development (OECD) issued model rules for a new global minimum tax framework (Pillar Two), and various governments around the world have issued, or are in the process of issuing, legislation on this. In [Country X], the government released draft legislation on Pillar Two in [July 2023]. The group is in the process of assessing its full impact.

The cash tax impact of the Pillar Two rules on going concern should be reflected in that assessment once the local legislation is announced rather than from when it is substantively enacted. This is because the going concern assessment includes all 'expected' future cash outflows and takes into account all available information about the future. [IAS 1 para. 26].

Similarly, if an entity applies post-tax cash flows in a value-in-use calculation of the recoverable amount of an asset or a cash-generating unit when performing an impairment test, the cash tax impact of the Pillar Two rules should be reflected in those cash flows. The timing of this would be based on a market participant's view, which would likely be once the local legislation is announced rather than from when it is substantively enacted. Generally, the inclusion of tax cash flows would not impact the recoverable amount, because the entity would also adjust the post-tax discount rate applied.

### Timeline for impact of Pillar Two on accounting

The disclosure requirements will depend on the extent to which Pillar Two legislation has been enacted in the jurisdictions in which the group operates and whether it is in effect. The timeline below sets out the required disclosures at the various stages of the process.
It also illustrates when the impact of top-up taxes should be considered in the going concern assessment and in impairment tests.



# 5 When does Pillar Two apply?

The Pillar Two rules are intended to be implemented as part of a common approach, as agreed by the OECD members, and to be brought into domestic legislation by 2023. However, each jurisdiction will need to determine if and when the rules will be enacted and effective. In Switzerland, a constitutional amendment was the subject of a public vote on 18 June 2023, which was positive. QDMTT and IRR are therefore expected to be implemented as of 1 January 2024. The earliest expected implementation for the UTPR is currently 1 January 2025. The EU has issued a directive requiring its member states to enact domestic legislation for the IIR from 2024 and the UTPR from 2025. For the status of Pillar Two implementation in different countries and regions, visit PwC's Pillar Two Country Tracker.

The amendments to IAS 12 are required to be applied immediately (subject to any local endorsement processes) and retrospectively in accordance with IAS 8, including the requirement to disclose the fact that the exception has been applied if the entity's income taxes will be affected by enacted or substantively enacted tax law that implements the Pillar Two rules. The disclosures relating to the known or reasonably estimable exposure to Pillar Two income taxes are required for annual reporting periods beginning on or after 1 January 2023, but they are not required to be disclosed in interim financial reports for any interim period ending on or before 31 December 2023.

# 6 Considerations for Swiss GAAP FER

'Swiss GAAP FER' (FER) are Swiss financial reporting standards focusing on accounting for small and medium-sized entities and groups with a national reach,[1] but they are also applied by larger groups with international operations. The respective standard setter – the FER commission – has not published any specific guidance on the tax accounting impact of Pillar Two.

EXPERTSuisse, the Swiss Expert Association for Audit, on the other hand, has published FAQs that address the practical challenges and impact of Pillar Two on financial statements in accordance with Swiss GAAP FER. The publication is structured in three main questions/topics:

1. Are Pillar Two income taxes that are introduced by domestic tax laws in the scope of FER 11 'Income Taxes'?
2. How do the Pillar Two model rules impact accounting for deferred taxes?
3. Which related disclosures should be included in Swiss GAAP FER financial statements?

Based on all the information available to the day, according to the Q&A, top-up taxes are likely within the scope of FER 11 'Income Taxes'.

The concepts of accounting for deferred taxes in FER 11 are comparable to IAS 12. It is therefore likely that FER preparers face similar challenges when accounting for deferred taxes from Pillar Two as IFRS preparers have. EXPERTSuisse concludes that there are two ways in which affected FER preparers can approach deferred tax accounting resulting from the effects of the Pillar Two model rules.

- Approach A: Alignment with the IFRS approach
  For EXPERTSuisse, it appears reasonable that FER preparers may follow the IASB's approach exempting impacts from resulting from Pillar Two income taxes from accounting for deferred taxes in their financial statements.

[1] Swiss GAAP FER 1 – Accounting and Reporting Recommendations, Introduction 3.1

- Approach B: Assess and account for deferred taxes arising from the Pillar Two model rules considering FER 11 and the FER Framework
  FER preparers following Approach B have to assess, once the Pillar Two model rules are enacted or substantively enacted in one of the jurisdictions in which the entity operates, whether the degree of reliability of the resulting financial statement information is such that a recognition of the related deferred tax positions in the balance sheet is required. If the entity concludes that it is currently not possible reliably to determine the potential tax consequences in the future, no related deferred taxes should be recognised. Instead, according to FER FW/32, this fact should be disclosed.

FER preparers impacted by the Pillar Two model rules must add a description of the accounting policies applied. Depending on the entity's specific situation, further disclosures may be required to enable the reader of the financial statements to understand the potential future impacts of Pillar Two. To do so, FER preparers may use the disclosure requirements in the IAS 12 amendment as inspiration.

For further reading on separate financial statements prepared in accordance with Swiss GAAP FER in connection with Pillar Two, please refer to Swiss GAAP FER 'Separate financial statements: first-time adoption and BEPS Pillar Two considerations'

# 7 Frequently asked questions

### FAQ 1 – Does the scope exception for deferred tax related to Pillar Two apply to a Domestic Minimum Top-up Tax (DMTT) that has not yet been peer reviewed?

Yes, the IAS 12 scope exception can typically be applied. Each country is required to self-certify whether their DMTT is 'qualifying'. The self-certification is subject to a peer review. However, the self-certified QDMTT is generally assumed to be qualifying until there is a successful challenge to deem it non-qualifying. The expectation is that any removal of qualifying status by the peer review is prospective rather than retrospective, but this has yet to be confirmed.

A non-qualifying DMTT does not apply the exception.

### FAQ 2 – Does an entity need to disclose all its exposures relating to Pillar Two legislation, including the exposures that do not impact the Pillar Two tax expense?

No. As stated in para. BC107 of the basis for conclusions to IAS 12, the para. 88C disclosure requirement was introduced into the standard, since enacted Pillar Two legislation could create exposures that are not yet reflected in an entity's income tax expense for the period and so there was an information need. The entity's exposure to be disclosed relates only to the exposures impacting the entity's income tax expense. It does not relate to exposures  other income statement line items, such as adjustments to the measurement of assets because of reduced cash inflows. For example, an investment entity that recognises its investments on a fair value basis might not have a Pillar Two tax expense of its own to account for, but its investees might be exposed, ultimately impacting the investees' fair value. There is no requirement to disclose this exposure under paragraph 88C of IAS 12, although if the impact on the investees' fair value could be material going forward, the investment entity might choose to disclose that fact.

### FAQ 3 – Do Pillar Two rules impact the recoverability of deferred tax assets?

**Background**

A local corporate tax regime might permit certain future tax benefits (for example, tax deductions, tax credits or tax losses) that are not permitted to be deducted when determining the Pillar Two effective tax rate for the jurisdiction. The ability to take these future benefits might be recognised as a deferred tax asset under a local corporate tax regime, whereby it is probable that future taxable profit will be available against which the tax benefits can be utilised. However, in some circumstances the Pillar Two rules will not permit the related future tax benefits, and so the use of the tax benefits might lead to a Pillar Two top-up tax being levied in the year in which the deferred tax asset is recovered.

**Question**

Do Pillar Two rules impact the recoverability of deferred tax assets?

**Answer**

No, the recoverability of deferred tax assets under the local corporate income tax regime should not be affected by the Pillar Two rules.

Paragraph 4A of IAS 12 provides an exception to recognising deferred tax effects arising from the Pillar Two rules. Accordingly, even if the Pillar Two rules give rise to a taxable temporary difference, no deferred tax liability should be recognised. If an entity remeasures an existing deferred tax asset solely due to the impact of the Pillar Two rules, it would in effect be recognising a deferred tax liability for Pillar Two income taxes. This would not be permitted by the exception in IAS 12.

In addition, paragraph BC 104 of IAS 12 states:

"The IASB decided it was unnecessary to expand the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes. The IASB concluded that an entity would not remeasure such deferred taxes to reflect Pillar Two income taxes it expects to pay when recovering or settling a related asset or liability because the temporary exception applies to deferred tax assets and liabilities related to such income taxes."

Accordingly, the Pillar Two rules should not be taken into account when assessing the recoverability of deferred tax assets recognised under the corporate income tax regime.

## FAQ 4 – Should an entity recognise a Pillar Two top-up tax liability where it has a deferred tax liability subject to the recapture rule?

**Background**

When an entity computes its covered taxes to determine the extent of any additional top-up tax exposure under the Pillar Two rules, the entity typically includes its deferred tax expenses from regular income taxes. This increases the entity's effective tax rate ('ETR') and potentially reduces any Pillar Two top-up tax liability. In a future period, as the taxable temporary difference reverses (for example, on sale of the underlying asset or liability) and the carrying amount of the deferred tax liability ('DTL') decreases, the corresponding deferred tax expense is lower, potentially increasing any Pillar Two top-up tax liability.

However, the Pillar Two rules include a DTL recapture rule to effectively exclude, from covered taxes, certain DTLs that do not reverse within five years. Under the recapture rule, DTLs that are not reversed within five years from when they were originally recognised will result in a recomputation and resubmission of prior years' top-up taxes (that is, amendment of prior-year filings), excluding these deferred tax amounts from covered taxes with retrospective effect. Because this will result in a relatively lower ETR, this recalculation could trigger an additional top-up tax when the recalculation is undertaken.

This measure is intended to prevent a loss of top-up tax from DTLs that have a long-term or indefinite reversal horizon. An entity can make an annual election to exclude deferred tax expenses relating to DTLs expected to reverse after more than five years from its covered tax computation; and, if this treatment is elected, the recapture rule does not apply. Furthermore, certain DTLs are excluded from the recapture rule, so no adjustments need to be made for them, even if they take more than five years to reverse.

**Question**

An entity that is within the scope of Pillar Two recognises a DTL that is subject to the DTL recapture rule, and it includes the associated tax expense within covered taxes. It does not expect the DTL to reverse in five years. Should a corresponding top-up tax liability be recognised for the potential recapture?

**Answer**

Yes. If the entity expects that the DTL will not reverse in full within five years, a liability should be recognised for any estimated incremental top-up tax resulting from the recapture mechanism. The recapture rule is triggered at the end of the five-year period, and any incremental top-up tax will be computed in the subsequent period (that is, in year 6). Consequently, the top-up tax liability should be initially classified as non-current. [IAS 1 para. 69]. [IFRS 18 para. 101].

This top-up tax liability arises from the recomputation and resubmission of prior years' tax returns when the recapture rule is triggered. It is not a DTL, which is defined in IAS 12 as *"the amounts of income taxes payable in future periods in respect of taxable temporary differences"*. The deferred tax recognition exception in paragraph 4A of IAS 12 therefore does not apply.

However, if the entity did expect the DTL to reverse in full within five years (that is, the recapture rule is not expected to be triggered), no top-up tax liability should be recognised.

In subsequent reporting periods, if new information emerges that changes the entity's expectation regarding the reversal of the DTL within five years, the impact on the top-up tax liability should be accounted for prospectively in the period in which the new information arises. [IAS 8 para. 34].

**Example – acquisition of an intangible asset**

Entity A is a constituent entity within a multinational group subject to Pillar Two legislation. Entity A purchases an intangible asset in an asset acquisition. Initially, the carrying amount of this intangible asset is equal for financial reporting and tax purposes. The intangible asset has an indefinite useful life and is not amortised in the financial statements. However, it is fully claimed as a deduction in year 1 for corporate tax purposes. This difference in accounting and tax treatment of the amortisation will create a taxable temporary difference, leading entity A to recognise a corresponding DTL and increasing the tax expense. The DTL will be reversed on disposal (or impairment) of the intangible asset. Entity A currently has no intention to undertake such a disposal.

Entity A includes the deferred tax expense in its covered tax computations for Pillar Two purposes. Consequently, the deferred tax expense arising on recognition of the DTL will be included in the entity's Pillar Two covered tax computation in year 1. Given that entity A does not expect to dispose of the intangible asset, the DTL will not reverse within five years. This would trigger an expectation that the recapture rule will apply, requiring entity A to calculate the amount of incremental top-up tax payable that will ultimately arise when the top-up tax in year 1 is recomputed in year 6. If the recomputation of the top-up tax is expected to result in a required payment based on the revised ETR, this should be accrued for as a non-current tax liability in year 1.

## FAQ 5 – Should an entity recognise a non-current top-up tax liability in the year in which excess negative tax originates?

**Background**

Pillar Two rules contain provisions that, if relief was not provided, could require a top-up tax to be paid in a year in which the entity is making a loss for Pillar Two purposes. Having rules that require companies to pay additional taxes in a year in which they are making losses is not consistent with the operation of many income tax systems worldwide, and so the OECD guidance was modified to alleviate some of the concerns arising from the adverse impact on entities arising from this. The OECD introduced guidance that, as an option, allowed entities to carry forward a negative tax attribute ('excess negative tax' or 'ENT') into future Pillar Two top-up tax computations instead, thus reducing the ETR in future years and, potentially, leading to additional top-up tax payments in the future.

Pillar Two rules allow unutilised tax losses calculated in accordance with local tax rules to be carried forward and included in the adjusted covered taxes computed for Pillar Two purposes in the year in which the entity has positive Pillar Two taxes and the local deferred tax asset reverses. This inclusion increases the ETR in the year in which the losses brought forward are included in the computation of adjusted covered taxes, and so it reduces the probability of Pillar Two top-up taxes being incurred in that year.

In certain situations, losses computed in accordance with local tax rules could be higher than losses computed for Pillar Two purposes, since there are items that are allowed for deduction or are not taxable for local tax purposes, but which are treated differently for the Pillar Two computation. For instance, a super-deduction associated with research and development ('R&D') expenses that is permitted for local tax purposes might not be allowed for the Pillar Two computation. Where an entity is loss-making, the Pillar Two loss would be smaller than the local tax loss when these items arise.

In such a scenario, the entity will obtain a relatively greater benefit in the adjusted covered tax computation in future years, because the loss carry-forward is based on the local tax computation. In an attempt to avoid this occurring, Article 4.1.5 of the GloBE rules imposes an additional top-up tax charge on the difference between carry-forward losses computed in accordance with local tax and Pillar Two purposes in the year in which such carry-forward losses arise. This additional top-up tax liability is referred to as 'ENT'.

However, as a result of the relief introduced, entities have the options of:

- paying the ENT in the year in which it arises; or
- in subsequent years, adjusting the ETR where there is GloBE income and positive adjusted covered taxes. If the GloBE ETR after adjustment for ENT is below the minimum tax rate, a top-up tax liability arises in that year. Conversely, if the GloBE ETR equals or exceeds the minimum tax rate, no top-up tax liability arises. Note that, once an ENT carry-forward amount is used to adjust covered taxes in a given year, it is considered 'used' and is no longer carried forward, even if it does not result in an incremental tax payment.

The example below illustrates the calculation and carry-forward of ENT:

| | | Year 2 | | |
|---|---|---|---|---|
| **Description** | | **Year 1** | **Scenario 1*** | **Scenario 2**** |
| GloBE income/ (loss) | A | (100) | 300 | 300 |
| Taxable profit/ (loss) | B | (300) | 300 | 500 |
| Expected adjusted covered taxes (assuming that the tax rate is 15%) | C = A * 15% | (15) | 45 | 45 |
| | | | | |
| Adjusted covered taxes before brought-forward ENT | D = B * 15% | (45) | 45 | 75 |
| ENT originated in the period (applicable only when there is a negative tax charge in excess of negative expected adjusted covered taxes) | E = D – C | (30) | n/a | n/a |
| Adjustment for ENT brought forward | F | - | (30) | (30) |
| Adjusted covered taxes (income tax charge plus ENT adjustment) | G = D + F (for year 1, G = ENT originated) | 30 | 15 | 45 |
| GloBE ETR after carry-forward of ENT (%) | H = G / A | - | 5% | 15% |
| Top-up tax rate | I = 15% – H | - | 10% | 0% |
| Top-up tax liability | J = A * I% | - | 30 | 0 |
| | | | | |
| *Movement in ENT* | | | | |
| ENT brought forward | K | 0 | -30 | -30 |
| Movement | L | 30 | 30 | 30 |
| ENT carried forward | M | -30 | 0 | 0 |

## FAQ for interim financial statements

### FAQ 6 – Should an entity accrue Pillar Two current income taxes in interim financial statements?

Yes. Paragraph 4A of IAS 12 confirms that Pillar Two taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules are income taxes in the scope of IAS 12. Paragraph B13 of IAS 34 states that the same accounting and recognition measurement principles are applied in an interim financial report as those applied in annual financial statements. Pillar Two income taxes should therefore be accounted for in interim periods.

### FAQ 7 – How should an entity account for Pillar Two income taxes in interim periods?

Paragraph B12 of IAS 34 requires the interim period income tax expense to be accrued using the tax rate applicable to expected total annual earnings. In other words, the estimated average annual effective income tax rate is applied to the pre-tax income of the interim period. Taxation is assessed based on annual results and accordingly, determining the tax charge for an interim period will involve making an estimate of the likely effective tax rate for the year.

Paragraph B14 of IAS 34 requires, to the extent practical, a separate estimated average annual effective income tax rate to be determined for each taxing jurisdiction and for that rate to be applied individually to the interim period pre-tax income of each jurisdiction.

To apply these requirements an entity will need to estimate its annual effective tax rate for each jurisdiction, including Pillar Two. The calculation of the effective tax rate should be based on an estimate of each jurisdiction's income tax charge for the year (which includes Pillar Two) expressed as a percentage of the jurisdiction's expected accounting profit. This percentage is then applied to the jurisdiction's interim result, and the tax is recognised ratably over the year as a whole.

Set out below is an illustration of how a jurisdiction's effective tax rate (ETR) is calculated.

| **Jurisdiction A** | |
|---|---|
| **Estimated annual accounting profit** | **C1000.0** |
| Estimated total income tax charge (current and deferred) excluding Pillar Two | C130.0 |
| Estimated Pillar Two top up tax (see below for illustrated calculation) | C91.0 |
| **Total estimated annual tax charge** | **C221.0** |
| **ETR for interim purposes (C221/C1000) (income tax component 13% Pillar Two component 9.1%)** | **22.1%** |
| | |
| Interim accounting profit | C500.0 |
| Interim tax charge (22.1% x C500) | C110.5 |
| Balance sheet liability | C110.5 |
| **Comprises** | |
| Corporation tax (500 x 13%) - to be split between current and deferred as appropriate | C65.0 |
| Pillar Two tax (500 x 9.1%) | C45.5 |
| | |
| **Illustration of the Pillar Two top up tax calculation** | |
| **Estimated annual accounting profit** | **C1000** |
| Estimated Pillar Two adjustments | C300 |
| **Estimated Pillar Two income (a)** | **C1300** |
| | |
| Estimated total accounting tax charge (current and deferred) | C130 |
| Estimated Pillar Two covered taxes adjustments | -C26 |
| **Estimated covered taxes (b)** | **C104** |

| | |
|---|---|
| P Pillar Two ETR (b/a) | 8% |
| Minimum rate | 15% |
| **Estimated Pillar Two top up tax rate (15%-8% = 7%)** | **7%** |
| | |
| Estimated Pillar Two income (a above) | C1300 |
| Less substance based income exclusion (assumed zero for illustration) | C0 |
| Estimated Pillar Two top up tax income | C1300 |
| Estimated Pillar Two top up tax 7% x C1300 | C91 |

## FAQ 8 – If a trading loss is incurred in a low tax jurisdiction in the first interim period but a trading profit overall is expected on which Pillar Two top up taxes will be levied, how should Pillar Two income taxes be accrued for in that first interim period?

EX 35.23.4 explains the approach to adopt when estimating the interim period tax charge or benefit when there are intra-period losses. It notes that expected annual effective tax rates should be applied to both interim losses and profits.

When there are intra-period losses, the general approach for estimating the effective tax rate (ETR) for the year should be applied as explained in Question 5 above. However, there are two acceptable approaches to recognising the Pillar Two component of the estimated tax charge.

The first approach is to recognise the tax benefit and income tax asset that arises from the application of IAS 34's simplified ETR methodology. Recognition of the asset allows users an insight into the expected tax rate for the full year. In subsequent interim periods the income tax asset recognised in the first interim period reverses.

The second approach is to consider the tax benefit and tax asset that arises in relation to the Pillar Two component of the ETR to be a deferred tax asset for a loss carried forward. However, IAS 12 prohibits the recognition of deferred tax for Pillar Two. Therefore, no asset (or related tax benefit) is recognised in the first interim period. In subsequent interim periods the annual estimated Pillar Two tax charge is recognised on a catch-up basis whereby the overall year-to-date accounting profit becomes positive – that is, by multiplying the Pillar Two ETR component by the cumulatively positive trading profits at that point.

Extending the example in Question 5, Jurisdiction A's estimated annual accounting profit is C1000 but in H1 there is an accounting loss of C5000. Using Jurisdiction A's estimated ETR of 22.1%, the following tables set out the interim tax accounting under the two approaches.

| **Approach 1** | | |
|---|---|---|
| | **H1** | **H2** |
| Accounting result | -C5000 | C6000 |
| **Tax (credit)/charge (22.1%)** | -C1105 | C1326 |
| **Comprises** | | |
| Corporation tax (credit)/charge (13%) | -C650 | C780 |
| Pillar Two tax (credit)/charge (9.1%) | -C455 | C546 |
| | | |
| **Balance sheet asset/(liability)** | C1105 | -C221 |
| **Comprises:** | | |
| Corporation tax asset/(liability) excluding Pillar Two (to be split between current and deferred as appropriate) | C650 | -C130 |
| Pillar Two tax asset/(liability) | C455 | -C91 |

| Approach 2 | | |
|---|---|---|
| | **H1** | **H2** |
| Accounting result | -C5000 | C6000 |
| **Tax (credit)/charge** | -C650 | C871 |
| **Comprises** | | |
| Corporation tax (credit)/charge (13%) | -C650 | C780 |
| Pillar Two tax (credit)/charge | C0 | C91 |
| | | |
| **Balance sheet asset/(liability)** | C650 | -C221 |
| **Comprises:** | | |
| Corporation tax asset/liability excluding Pillar Two (to be split between current and deferred as appropriate) | C650 | -C130 |
| Pillar Two tax liability | C0 | -C91 |

FAQ 9 – If a significant one-off item of expense that affects the estimated annual Pillar Two top up tax calculation is incurred in a low tax jurisdiction in the interim period, how should the Pillar Two tax effect of the one-off item be accounted for when using IAS 34's simplified ETR methodology for interim reporting?

EX 35.23.5 notes if there are expense items that are disallowed for tax purposes, these will increase the effective tax rate. Where the disallowable items have a distortive effect on the effective tax rate these items are excluded from the effective tax rate calculation and instead dealt with in the interim periods in which they arise. This is consistent with the approach in paragraph B19 of IAS 34 for tax benefits that relate to a one-time event.

The Pillar Two tax effect of the one-off item of expense should therefore be dealt with in the interim period in which the one-off item is recognised.

One approach to measuring the tax effect of the one-off item is to perform the calculations set out in Question 5 and determine what the interim period tax charge and liability would be with and without the one-off item. The difference between the two amounts is recognised in the interim period during which the one off item is recognised. There may be other acceptable approaches.

## FAQ for separate financial statements

FAQ 10 – Is Pillar Two top-up tax an income tax expense within the scope of IAS 12 in the separate financial statements of the entity liable to pay the taxes (the parent)?
Is Pillar Two top-up tax expense recognised as a tax expense in the parent or in the entity giving rise to the top-up tax (the low-taxed subsidiary)?

The Pillar Two top-up tax expense is an income tax within the scope of IAS 12 and is recognised as an income tax expense in the separate financial statements of the entity liable to pay the top-up tax expense. If the jurisdiction where a parent of a multinational enterprise is headquartered has enacted IIR Pillar Two rules, the parent is the primary obligor of such top-up taxes.

In our view, the subsidiary entity that gives rise to the top-up taxes should not recognise an expense. This is because the IFRS accounting framework does not generally allow push-down accounting.

In the absence of such a requirement, push-down accounting is not a permissible accounting policy. An analogy to the requirements in IFRS 2 for group share-based payment arrangements is not appropriate because the subsidiary does not receive any goods or services as a consequence of the parent paying the top-up tax and the tax is not settled by the parent on the subsidiary's behalf.

**Alternative possible approaches may be possible.**