

Pillar II and IFRS Implications



Pillar II forms a crucial part of the OECD's Base Erosion and Profit Shifting (BEPS) initiative, aimed at establishing a more equitable global tax framework by ensuring that large multinational enterprises (MNEs) pay a minimum level of tax, irrespective of their operational locations. This pillar targets profit-shifting practices that allow MNEs to minimize tax liabilities by transferring profits to low-tax jurisdictions. The implementation of a global minimum tax curtails incentives for countries to engage in harmful tax competition, fostering a more balanced and fairer global economic environment.

In December 2021, the Organization for Economic Cooperation and Development (OECD) published its GloBE Rules or Pillar Two model rules to address challenges arising from countries race to bottom with respect to corporate tax rate. The intent has been that criteria to attract foreign investment in a territory should not be lower tax rate but instead such decision be on infrastructure, professional and educational standards, ease of operations, etc. To address concerns related to global tax competition, a global minimum tax rate of 15% for MNEs with consolidated revenue of 750 million euros (MNEs groups required to comply with CbC reporting) will be implemented under the series of following taxes:

Under the new taxing mechanism of Pillar II, minimum tax rate of 15% will be paid by MNEs at each jurisdictional level under the following taxes if effective tax rate (ETR) falls short of 15%. GloBE rules have some exceptions and special income computation rules. OECD has no power to implement the GloBE rules at country levels – so each member country would be enacting them in its jurisdiction and adopt the rules. So far 136 countries have agreed to implement Pillar II. However, Pakistan, Sri Lanka and Nigeria have not agreed to Pillar Two rules in their jurisdictions.

Pillar II rules impose a top-up tax when the jurisdictional effective tax rate falls below 15%, through the following mechanisms:

Qualified Domestic Minimum Top-up Tax (QDMTT)

This allows the jurisdiction itself to impose the top-up tax. However, if QDMTT cannot be applied – for instance, in

cases where jurisdictions like the UAE do not impose top-up taxes on their tax-free zones – other territories where the MNE operates will collect the top-up tax under the following provisions:

- Income Inclusion Rule (IIR)
- Undertaxed Profit Rule (UTPR)



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Computation of top-up tax

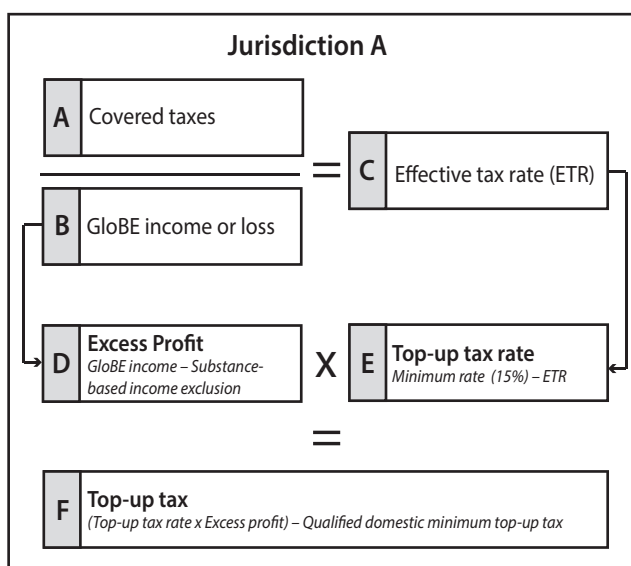


Figure 1: Snapshot of Jurisdiction A

GloBE Rules Development & Progress

Local legislation has been adopted by countries which include Austria, Germany, UK, Hungary, Ireland, Vietnam, etc. Countries having draft legislation so far include Australia, Kenya, Singapore, Indonesia, UAE, Mauritius and others. However Saudi Arabia, US, India, China and others have not so far made official announcement yet relating to Pillar II implementation.

As the local legislation and adoption is under progress in many countries during 2024. So CY 2025 & CY 2026 is believed to be transition period for GloBE Rules implementation. However, year 2027 is believed to have full implementation of Pillar II implementation.

Development by IASB relating to GloBE Rules (Pillar II)

Amendments have been introduced requiring entities to disclose information related to Pillar II. To prevent potential information gaps for users, companies must include new disclosures in their financial statements starting December 31, 2023. Once tax legislation is enacted in at least one jurisdiction where the group operates, a company is required to disclose that it has applied the “mandatory deferred tax accounting relief,” indicating that the newly enacted tax legislation is only effective from January 1, 2024, and that there is no current tax impact for the tax year ending December 31, 2023. [IAS 12 Para 88A].

Additionally, the entity must separately disclose its current tax expense related to Pillar Two income taxes. [IAS 12 Para 88B] The entity should also provide information about the main requirements of the Pillar Two legislation to which it expects to be subject. This disclosure may include details on the following [IAS 12 Para 88C]:

- 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 harbor relief
- Other significant requirements

Exposure Determination

Potential exposure to Pillar Two tax will be based local government announcements relating Qualified Domestic Top-up Tax (QDMTT), most recent information available from tax filings, country-by-country (CbC) Reporting considering current & future MNEs group structure & its operations.

Information Gathering required by MNEs

The implementation of Pillar Two will require MNEs to adopt structured processes and procedures for gathering information and documenting the judgements applied in the recognition and measurement of top-up taxes.

The stage an which the MNE Group is, at the end of the reporting period, regarding the assessment of potential exposure and implementation of Pillar Two local legislation.

Identifying system gaps and / or limitations to gather required information for reporting and compliance

Challenges and Hinderances

The implementation of Pillar Two legislation across numerous jurisdictions, coupled with uncertainties surrounding the precise wording of the legislation and reliance on safe harbor provisions, will present significant challenges in determining an entity's exposure to Pillar Two tax. If these factors hinder an entity's ability to reasonably estimate the impact of the Pillar Two legislation, the entity must disclose this uncertainty and provide information on the progress made in assessing the impact. Additionally, the entity should disclose how these complexities and challenges may influence its exposure to Pillar Two taxes.

Observations on IASB work relating to Pillar II

Given the lack of detailed information available on Pillar II, the IASB has adopted mandatory deferred tax accounting relief for the year 2023, which is justified as the subject is still evolving at the OECD level. However, IAS 34 Interim Financial Reporting has not been simultaneously amended in line with the adoption under IAS 12 Para 88A. Additional clarification will be required for countries that do not adopt Pillar II.

For example, UK subsidiaries operating in countries like Pakistan, Sri Lanka, and Nigeria—where the effective tax rate (ETR) may be less than 15% for certain GloBE rule applications—may be subject to a top-up tax by UK tax authorities. In such cases, there is a question of whether the separate financial statements of these subsidiaries should disclose this expense. Furthermore, for reporting purposes, the top-up tax would be levied from the UK jurisdiction. Therefore, it must be clarified whether this tax should be treated as a UK jurisdiction tax expense or as an expense attributable to the respective subsidiary's jurisdiction.

References:

<https://www.oecd.org/tax/beps/international-community-strikes-aground-breaking-tax-deal-for-the-digital-age.htm>

<https://www.ifrs.org>

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