IAS 12: Consideration of Organisation for Economic Co-operation and Development (OECD) Pillar Two GloBE Rules When Accounting for Deferred Tax Assets

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BACKGROUND

At its September 2022 meeting, the Group discussed the financial reporting implications of OECD Pillar Two GloBE Rules, including:

- the scope of top-up taxes in IAS 12 *Income Taxes*;
- when changes in tax laws are considered to be substantively enacted;
- preliminary accounting considerations for deferred taxes arising from GloBE Rules; and
- preliminary disclosure considerations.

In December 2021, the OECD published the Pillar Two model rules (also known as the Global Anti-Base Erosion rules, or GloBE rules) as part of an international tax reform to respond to taxation challenges in the digital economy. “Pillar Two income taxes” are income taxes arising from tax laws enacted, or substantively enacted, requiring the application of Pillar Two model rules.

Pillar Two aims to ensure that qualifying multinational enterprises (MNEs) pay a minimum level of tax of 15 per cent on income arising in each jurisdiction where they operate. It does this by requiring qualifying MNEs to pay a top-up tax when they have an effective tax rate of less than 15 per cent in any given jurisdiction. Qualifying MNEs are those with consolidated revenues in excess of €750 million (approximately $1 billion) in at least two out of the last four years.

Under Pillar Two, jurisdictions adopt mechanisms that affect how the top-up taxes are collected. Common mechanisms are:

1. Domestic minimum tax (DMT) – a top-up tax is levied in the jurisdiction where it is triggered. This is also known as the qualified domestic minimum top-up tax.
2. Income inclusion rule (IIR) – a top-up tax is generally paid by the ultimate parent entity if foreign subsidiaries are taxed less than 15 per cent.
3. Undertaxed payment rule (UTPR) – if the ultimate parent entity does not pay top-up tax under the IIR, then deductions may be denied, or additional tax may be charged to the subsidiary.

Amendments to IAS 12

In May 2023, the IASB amended IAS 12 to introduce a mandatory temporary exception from recognizing and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes. Entities need to disclose that they applied the exception. These amendments became effective immediately when issued. The exception will apply until the IASB decides to remove it or make it permanent.

The IASB also introduced disclosure requirements for periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect, and for periods when it is enacted and effective. These additional disclosure requirements were effective for annual reporting periods beginning on or after January 1, 2023.

Status of Pillar Two

Pillar Two has been enacted or substantively enacted in several jurisdictions. Many jurisdictions passed legislation in 2023 and certain mechanisms to collect top-up tax (DMT, IIR, or UTPR) are effective in 2024. Jurisdictions may have different effective dates for DMT, IIR, and/or UTPR.

MNEs will need to monitor the enactment or substantive enactment of Pillar Two rules in all jurisdictions where they operate, including through wholly owned or partially owned subsidiaries, joint ventures, flow-through entities, and permanent establishments. In addition, transitional rules, commonly referred to as “safe-harbour provisions”, may apply. These provisions deem the top-up taxes to be nil for jurisdictions that meet certain conditions. The Pillar Two rules and calculations, and application of safe-harbour provisions, are complex.

A question has arisen in practice as to whether the impact of Pillar Two should be considered when assessing the recoverability of deferred tax assets arising under an entity’s existing corporate tax regime. This is illustrated in the fact pattern below.

Fact Pattern

- Entity B prepares consolidated financial statements for the year ended December 31, 2024, in accordance with IFRS Accounting Standards.
- Entity B is an MNE with multiple subsidiaries, including Sub 1 located in Country G.
- Country G enacted Pillar Two legislation in 2024. The DMT top-up tax mechanism is effective in 2024.
- Entity B is the ultimate parent entity and has consolidated revenues in excess of the €750 million threshold under Pillar Two. It is a qualifying MNE in scope of the Pillar Two legislation. For simplicity, no safe-harbour provisions apply.
- Sub 1 has tax losses carried forward arising under the corporate/domestic tax regime of 100 currency units (CU). The corporate tax rate is 15 per cent, giving rise to a deductible temporary difference of CU 15 (100 x 15%).

- The GloBE effective tax rate in Country G is 10 per cent and top-up tax will be due in Country G in 2024. GloBE income in Country G is CU 200, and a top-up tax of CU 10 is payable (200 x (15% – 10%)). As the DMT is effective, the top-up tax will be collected in Country G.
- **Without** considering Pillar Two, Entity B determines that the deductible temporary difference arising from Sub 1 is fully recoverable. This is because Entity B assessed that it is probable there will be sufficient taxable profits available in the future to recognize the benefits of the tax losses (paragraph 29 of IAS 12). A deferred tax asset of CU 15 would be recognized in Entity B's consolidated financial statements.
- **When** considering Pillar Two, Entity B identifies that it will lose some benefits of the tax losses carried forward as it will have to pay a top-up tax in Country G. Therefore, when considering Pillar Two, Entity B would recognize nil or a partial amount as a deferred tax asset based on forecasts of taxable profits.

The Group's discussion focused on deferred tax assets arising from tax losses carried forward. However, the question remains applicable to the recoverability assessment of all deferred tax assets arising under the corporate tax regime.

Issue 1: Should Entity B consider the impact of the Pillar Two legislation when assessing the recoverability of the deferred tax asset for the tax losses carried forward?

Analysis

View 1 – Pillar Two is ignored when assessing the recoverability of the deferred tax asset arising under the corporate tax regime.

Proponents of this view focus on the IAS 12 amendments issued in response to concerns about accounting for deferred taxes related to top-up tax under Pillar Two. Paragraph BC99(b) of the Basis for Conclusions on IAS 12 summarizes these concerns. These include concerns about whether to remeasure deferred taxes recognized under domestic tax regimes to reflect potential top-up tax payable under Pillar Two, and which tax rate to use to measure deferred taxes related to top-up tax.

In response to these concerns, the IASB amended IAS 12 to introduce a new temporary mandatory exception in paragraph 4A of IAS 12 that states, "an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes." Paragraph 4A of IAS 12 is clear that the exception applies to DMT, as it specifies that "qualified domestic minimum top-up taxes" are Pillar Two income taxes.

Paragraph BC104 of the Basis for Conclusions on IAS 12 explains that the IASB did not expand the scope of the exception to include the measurement of deferred taxes recognized under domestic tax regimes. This is because 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.

Proponents of this view think that if Entity B were to derecognize an otherwise recoverable deferred tax asset under the corporate regime due to Pillar Two, this would be considered recognizing information about deferred tax assets and liabilities related to Pillar Two income taxes.

This is consistent with Staff Paper 12A *Temporary Exception to Deferred Tax Accounting* from the April 2023 IASB meeting. IASB staff thought that it is unnecessary that the temporary exception cover measurement to address questions about whether domestic deferred taxes should be remeasured. The staff paper provides the following example: "[I]f an entity were to remeasure an existing deferred tax liability to reflect additional Pillar Two income taxes it expects to pay when recovering (or settling) the related asset or liability, it would in effect be recognising a deferred tax liability related to Pillar Two income taxes, which is covered by the temporary exception—the liability would relate to future payments of top-up tax, not future payments of domestic income taxes."

While the staff paper is not authoritative guidance, this example, in conjunction with paragraph BC104 of the Basis for Conclusions on IAS 12, supports why the impacts of Pillar Two are ignored when assessing the recoverability of deferred tax assets that arise under the corporate tax regime.

Proponents of this view note that considering the impacts of Pillar Two in the recoverability of existing deferred tax assets would be inconsistent with the IASB's rationale for introducing the exception. Per paragraph BC101 of the Basis for Conclusions on IAS 12, the IASB concluded that the exception would:

- provide affected entities with relief from accounting for deferred tax assets and liabilities in relation to complex new tax legislation to be enacted by multiple jurisdictions in a short period of time;
- avoid the development of diverse interpretations of IAS 12 and the resulting inconsistent application of the Standard; and
- allow time for stakeholders to assess how the Pillar Two model rules have been implemented in different jurisdictions, for entities to assess how they are affected and for the IASB to consider whether to do further work.

As a result of the exception, the impacts of Pillar Two are not considered in the recoverability assessment of existing deferred tax assets that arise under the corporate tax regime. This would include DMT, UTPR, and IIR. As this is a mandatory exception to regular deferred tax accounting, proponents of this view think there is no alternative view.

In the fact pattern presented, proponents of this view think Entity B would recognize the deferred tax asset of CU 15 in 2024, and account for the impact of Pillar Two taxes as a current tax when incurred. Entity B would consider disclosure requirements as applicable related to Pillar Two impacts. Such disclosures are outside the scope of this discussion.

View 2 – Pillar Two is considered when assessing the recoverability of the deferred tax asset arising under the corporate tax regime

Proponents of this view think the temporary mandatory exception is not available because this is not a deferred tax asset related to Pillar Two income taxes as described in paragraph 4A of IAS 12. Rather, the deferred tax asset arises from the corporate tax regime and must be assessed for recoverability considering applicable requirements in IAS 12, including an assessment of future taxable profits. When assessing whether a deferred tax asset should be recognized based on the availability of future taxable profits, an entity considers all factors, both favourable and unfavourable, concerning expected future taxable profits. Paragraphs 27-31 and 34 of IAS 12 provide further guidance.

If the benefits of the deferred tax asset will no longer be realized because of Pillar Two, then this is evidence that some or all of the deferred tax asset should not be recognized.

In the fact pattern presented, proponents of this view think the deductible temporary difference may not be fully recoverable; that is, the deferred tax asset would have a value between nil and CU 15. Entity B would not recognize a deferred tax liability for any future taxable amounts, as recognizing a deferred tax liability arising from Pillar Two is prohibited under the exception.

Note that under this view, a different assessment may be required for UTPR and IIR systems. This is because the taxes may be levied outside the jurisdiction where the temporary difference arises, and potentially by an entity outside the boundaries of the reporting entity. This matter is outside the scope of this discussion.

The Group's Discussion

Most Group members agreed with View 1 based on the intent of the exception and the explanation provided in the Basis for Conclusions. Several Group members thought the intent of the temporary mandatory exception was clear in that no Pillar Two impacts should be reflected in the accounting for deferred tax assets or liabilities. They noted that this intent is supported by paragraphs BC99, BC101, and BC104 in the Basis for Conclusions on IAS 12 as cited in View 1 above. They thought View 2 would not be consistent with this intent as it involves considering some Pillar Two impacts. They noted that once entities start considering *some* Pillar Two impacts, it is not clear where they should stop. One Group member also emphasized that the temporary exception is mandatory (i.e., not optional). Therefore, an entity cannot elect to recognize or measure its deferred tax assets and liabilities taking some Pillar Two income taxes into account while other Pillar Two income taxes are recognized when incurred.

One Group member agreed with View 2. That is, entities would typically consider all factors affecting the recoverability of deferred tax assets, and Pillar Two impacts could be one such factor. View 1 would result in recognizing a deferred tax asset for which the benefits are not fully realizable. However, other Group members noted that this is a direct result of applying a temporary mandatory exception to the requirements of IAS 12 related to Pillar Two.

A few Group members added that entities are still assessing the impacts of Pillar Two. The Pillar Two calculations are complex. Entities may need to implement new financial reporting controls and system changes to deal with the calculations and data requirements. Some entities may also choose to make changes to the structure of their organization ahead of implementing Pillar Two, which could also impact the calculations.

Overall, the Group's discussion raised awareness as to whether an entity considers Pillar Two GloBE Rules when evaluating the recoverability of existing deferred tax assets. They noted that Pillar Two is an evolving area, as many jurisdictions are still in the process of enacting or substantively enacting Pillar Two legislation. The Group recommended that the AcSB continue to monitor developments with respect to Pillar Two, including discussions with other national standard-setters to understand what additional accounting issues are emerging in their jurisdictions relating to the implementation of Pillar Two and the related temporary mandatory exception.