



Project:	Pillar Two Global Minimum Tax	Meeting:	March 2023 (M194)
Topic:	Cover memo	Agenda Item:	9.1
		Date:	20 February 2023
Contact(s):	Kim Carney kcarney@asb.gov.au	Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider the draft comment letter to the IASB

Objective of this agenda item

- The objective of this agenda item:
 - to **inform** the Board about the IASB [Exposure Draft/2023/1 International Tax Reform – Pillar Two Model Rules](#);¹ and
 - for the Board to **consider** the draft comment letter to the IASB on the Exposure Draft.

Background

- In 2021, 136 countries and jurisdictions representing more than 90% of global gross domestic product agreed to a major international tax reform introducing a global minimum tax for large multinational enterprises (MNEs).
- These countries and jurisdictions joined the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework Statement on the [Two-Pillar Solution to Address the Tax Challenges Arising from the Digitisation of the Economy](#). The two-pillar solution comprises:
 - Pillar One – which aims to ensure a fairer distribution of profits and taxing rights among countries for the largest MNEs; and
 - Pillar Two – aims to put a floor on tax competition by introducing a global minimum corporate tax rate set at 15% for large MNEs.²
- In December 2021, the OECD published its Pillar Two model rules. The Pillar Two model rules provide a template for implementing a minimum corporate tax rate of 15% that large MNEs would pay on income generated in each jurisdiction in which they operate.
- In response to stakeholders' concerns about the potential implications and imminent implementation of the Pillar Two rules on the accounting for income taxes, the IASB issued

1 ED/2023/1 was issued in Australia as AASB Exposure Draft ED 322 *International Tax Reform – Pillar Two Model Rules*.

2 The Pillar Two model rules are also known as the Global Anti-Base Erosion Model Rules (GloBE).

[Exposure Draft/2023/1 International Tax Reform—Pillar Two Model Rules](#). ED/2023/1 was issued in Australia as ED 322.

- 6 ED/2023/1 proposes amendments to IAS 12 *Income Taxes* that would introduce:
 - (a) a temporary exception to the accounting for deferred taxes arising from the implementation of the rules; and
 - (b) targeted disclosure requirements for affected companies.
- 7 At the December 2022 meeting, the Board decided to comment on the IASB’s Exposure Draft, subject to feedback from stakeholders.

Attachments

- | | |
|------------------|---|
| Agenda paper 9.2 | Draft Comment Letter to the IASB on Exposure Draft/2023/1 International Tax Reform – Pillar Two Model Rules |
| Agenda paper 9.3 | IASB Exposure Draft ED/2023/1 <i>International Tax Reform—Pillar Two Model Rules</i> [Supporting Material] |

An overview of the Pillar Two rules

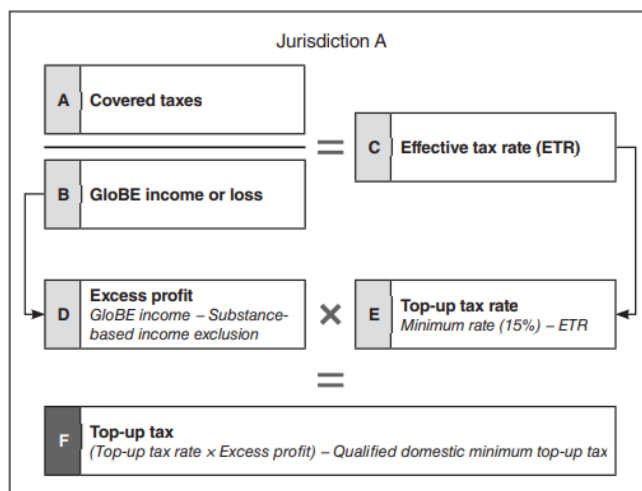
- 8 Countries that choose to introduce the Pillar Two model rules have agreed to do so in a consistent and coordinated manner. The inter-locking nature of the model rules means that their adoption by a critical mass of jurisdictions will be sufficient to ensure that MNEs are required to pay the minimum level of tax on their profits arising in each jurisdiction where they operate.
- 9 The Pillar Two model rules:
 - (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and
 - (c) typically require the group’s ultimate parent entity to pay top-up tax—in the jurisdiction in which it is domiciled—for profits of its subsidiaries that are taxed below 15%.³
- 10 The rules generally apply to multinational groups with revenue in their consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal years. The rules specify inclusion thresholds for some jurisdictions and exclude some entities from their scope.⁴
- 11 Figure 1⁵ illustrates the computation of top-up tax in a given jurisdiction.

3 See ED/2023/1 Basis for Conclusions paragraph BC2.

4 See ED/2023/1 Basis for Conclusions paragraph BC3.

5 See ED/2023/1 Basis for Conclusions paragraph BC4.

Figure 1—Computation of Top-up Tax in Jurisdiction A



12 In summary, the Pillar Two model rules specify that:

- (a) covered taxes comprise current tax expense in a jurisdiction after adjusting for tax credits and deferred taxes. These adjustments include adding deferred tax expenses capped at 15% (subject to further adjustments). The amount includes income taxes (or taxes in lieu of those) for the fiscal year.
- (b) income or loss is the profit or loss in a jurisdiction included in the consolidated financial statements of the ultimate parent entity, before eliminating intragroup items and after making other adjustments (for example, adjusting for some common differences between accounting requirements and tax rules).
- (c) the effective tax rate is calculated by dividing covered taxes by the GloBE income or loss for a jurisdiction. The resulting rate is subtracted from 15% to calculate the top-up tax rate for the jurisdiction.
- (d) excess profit is the GloBE income or loss minus the substance-based income exclusion. The substance-based income exclusion is intended to exclude a fixed return for substantive activities in a jurisdiction. Payroll costs and the carrying amount of tangible assets are used as indicators of substantive activities.
- (e) top-up tax is the product of excess profit and the top-up tax rate in a jurisdiction. An entity then reduces that top-up tax by any applicable qualified domestic minimum top-up tax.^{6,7}

13 A liability to pay top-up tax may arise under one of two rules, namely:

- (a) the income inclusion rule (IIR) whereby a parent is liable for top-up tax in proportion to its ownership interest in subsidiaries that were taxed below 15%. The ultimate parent entity is primarily liable for top-up tax under the rule, but intermediate parent entities may be liable in some circumstances.
- (b) the Undertaxed Payment Rule is a backstop mechanism for profits taxed below 15% that are not charged under the IIR.

6 Jurisdictions may also introduce a qualified domestic minimum top-up tax. This top-up tax is computed on a basis similar to the Pillar Two model rules, but would be charged in the jurisdiction in which the profit arises rather than in the ultimate parent entity's jurisdiction.

7 See ED/2023/1 Basis for Conclusions paragraph BC5.

IASB response

- 14 Stakeholders informed the IASB of concerns about the implications on income tax accounting resulting from jurisdictions implementing the Pillar Two model rules quickly. Those concerns related to:
- (a) how to account for the minimum top-up tax;
 - (b) the usefulness of the information that could result from accounting for deferred taxes related to top-up tax; and
 - (c) the urgent need for clarity in light of the imminent enactment of tax law to implement the rules in some jurisdictions.⁸
- 15 The IASB agreed with stakeholders that 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 Pillar Two model rules.
- 16 ED/2023/1 proposes that, as a mandatory temporary exception to the requirements in IAS 12, an entity neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes and disclose that it has applied the exception.
- 17 The IASB proposes that, in periods in which Pillar Two legislation is in effect, an entity discloses its current tax expense (income) related to Pillar Two income taxes separately.
- 18 The IASB also proposes that, in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity discloses for the current period only:
- (a) information about such legislation enacted or substantively enacted in jurisdictions in which the entity operates;
 - (b) the jurisdictions in which the entity's average effective tax rate (calculated in accordance with IAS 12) for the current period is below 15%. The entity shall also disclose the tax expense (income) and accounting profit for these jurisdictions in aggregate, as well as the resulting weighted average effective tax rate; and
 - (c) whether assessments the entity has made in preparing to comply with Pillar Two legislation indicate that there are jurisdictions:
 - (i) identified in applying the proposed requirement in (b) but in relation to which the entity might not be exposed to paying Pillar Two income taxes; or
 - (ii) not identified in applying the proposed requirement in (b) but in relation to which the entity might be exposed to paying Pillar Two income taxes.
- 19 The mandatory temporary exception does not have a sunset date. This is because further work is needed to determine how the principles and requirements in IAS 12 apply when accounting for Pillar Two income taxes. The IASB intends to revisit the mandatory temporary exception to determine whether it should be retained, removed or amended. This is expected to occur once some time has passed, and they can see how the law is enacted and the effect of the changes to domestic tax laws.

8 Staff understand that some jurisdictions are well advanced in operationalising the Pillar Two model rules.

Impact of the Pillar Two model rules in Australia

- 20 When the OECD issued the Pillar Two model rules, Australia was among the 136 countries that endorsed them. This endorsement was not binding. However, the Australian Government committed to the Pillar Two model rules as part of a 2022 election promise.
- 21 Staff note that Treasury recently issued a Consultation Paper, [Global agreement on corporate taxation: Addressing the tax challenges arising from the digitalisation of the economy](#) seeking feedback from stakeholders about how Australia can best engage with the new global agreement on corporate taxation that applies to large MNEs. Stakeholder feedback was sought to help inform consideration of domestic implementation issues, such as interactions with Australia's existing corporate tax system, ways to minimise compliance costs and how to implement a Domestic Minimum Tax (e.g. Pillar Two). The comment period closed in November 2022.
- 22 Staff also understand that the Australian Taxation Office is considering the operationalisation of the Pillar Two principles. Whilst the operationalisation of the principles in Australia is currently unclear, staff understand that Australian entities may be affected.
- 23 Staff are unsure how many Australian-headquartered MNEs are likely to be in scope. Further, staff are unsure how many foreign-headquartered MNEs with Australian operations are likely to be impacted.
- 24 Staff understand that because of the way Pillar Two tax is calculated it is possible that the effective tax rate for Australian entities could be below 15%.

Feedback from Australian stakeholders

- 25 Comments on ED 322 are due to the AASB by 24 February 2023. No submissions have been received to the date of this cover memo.
- 26 The draft comment letter has been prepared to reflect feedback from one regulator who expressed support for the proposals and feedback from the Chair.
- 27 Staff also intend to seek feedback from the AASB's User Advisory Committee (UAC) on 6 March 2023 about the usefulness of the proposed disclosures. Staff will provide Board members with a verbal update on any feedback received.
- 28 Regarding the proposed disclosure requirement outlined in paragraph 18(c), staff consider that the current drafting does not require an entity to disclose any information about the jurisdictions it identifies. The entity could reply 'yes' or 'no' with no additional/quantifying information being provided. Staff will seek feedback about the usefulness of this disclosure from UAC members. Subject to feedback obtained, staff suggest it might be helpful to raise this matter in our response to the IASB.

Question for Board members

Q1 Do Board members have any comments on the draft comment letter (Agenda Paper 9.2)?

Next steps

- 29 Comments to the IASB on ED/2023/1 are due by 10 March 2023. Therefore, staff will update the draft comment letter to incorporate feedback from Board members in response to Q1 following the March meeting. Due to time constraints, staff recommend the comment letter be approved via the Chair for submission to the IASB.

Question for Board members

Q2 Do Board members agree with the staff recommendation in paragraph 29 that staff will update the draft comment letter to incorporate feedback from Board members and finalise via the Chair? If not, what would Board members suggest?