Pillar Two Technical Series – Session 4

# Tax Accounting Overview & Impact

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# Tax Accounting Overview & Impact

## Meet Today's Presenters


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# Agenda

1. Tax Accounting Basics
2. Computation of Effective Tax Rate & Top-Up Tax
3. Computation of GloBE Income or Loss
4. Adjusted Covered Taxes
5. Reporting Obligations

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# 01

## Tax Accounting Basics

# Tax Accounting Basics

## Income Tax Accounting Knowledge Forms Is the Foundation for Pillar 2

Generally, financial accounting's matching principle requires the timing of the revenue and the expenses incurred to produce income be recognized in the same period.

However, different rules govern the timing of when items of revenue and expenses are recorded for accounting and tax purposes.

Thus, income tax accounting must bridge the timing of taxes paid in the period – Current taxes, and the recognition of tax expenses related to current period book income that are recognized in future periods for tax purposes – Deferred taxes.

Part of the disclosure includes the reconciliation of book tax expense to the statutory rate in the company's primary jurisdiction.

Additional disclosure provides qualitative information regarding material items that impact taxes.

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# Tax Accounting Basics

## Income Tax Accounting Knowledge Forms Is the Foundation for Pillar 2

- **Before 2024**

  Separate Entity Accounting (Statutory Reports)

  Consolidated Group Financials (Group Financials)

  Accounting to Support Tax statements

  Income Tax Accounting

- **After 2024**

  Pillar Two accounting (an additional set of books?)

  Based on the June 2024 Administrative Guidance, MNE Groups should now think about implementing separate books/overviews to document and trace:

  - The underlying Pillar 2 book value of assets and liabilities, and;
  - The underlying Pillar 2 deferred taxes.

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# Tax Accounting Basics

## Income taxes in the financial statements

- Current tax receivable/payable balance sheet
- Current tax expense/benefit income statement
- Deferred tax assets and liabilities balance sheet
- Deferred tax expense/benefit income statement
- Current and deferred tax in discontinued operations
- Income taxes paid as reflected in the cash flow statement
- Current and deferred tax allocated to equity components
- Liability for uncertain tax positions
- Disclosure notes
- Accounting policies (description)

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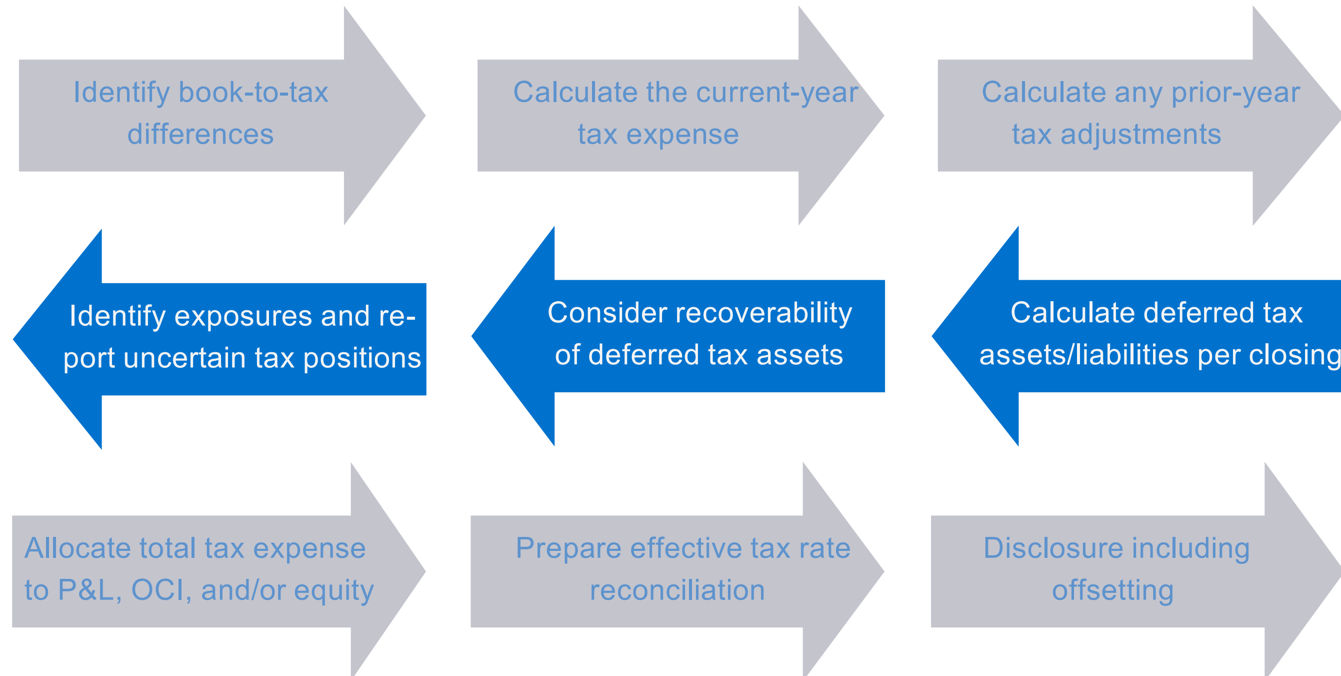
# Tax Accounting Basics

## Nine-step tax accounting process





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# Tax Accounting Basics

## Permanent items

| Item | Reason |
|---|---|
| Meals and entertainment expenditures | Permanently non-deductible |
| Fines and penalties | Permanently non-deductible |
| Non-deductible interest | Permanently non-deductible |
| Excess executive compensation | Permanently non-deductible |
| Dividends | Dividend Received Deduction/ Participation exemption |
| Tax-exempt interest | Permanently not includible |
| R&D incentives | Tax-exempt and/or lower tax rate applies |


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# Tax Accounting Basics

## Temporary differences

- **Deferred Tax Asset**
  Book basis > tax basis → Deferred tax liability
  Book basis < tax basis → Deferred tax asset

  Deductible temporary difference

  Results in a future tax benefit

- **Liability**
  Book basis > tax basis → Deferred tax asset
  Book basis < tax basis → Deferred tax liability

  Taxable temporary difference

  Results in a future tax detriment


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# Tax Accounting Basics

## The effect of a temporary difference – example without TD

| | | Year 1 | Year 2 |
|---|---|---|---|
| | Pre-Tax Book Income | 200 | 100 |
| +/- | Permanent Differences | | |
| +/- | Temporary Differences | -100 | 100 |
| = | Taxable amount | 100 | 200 |
| X | Tax rate | 25% | 25% |
| = | Current tax expense | 25 | 50 |
| + | Deferred tax expense | 0 | 0 |
| = | Total tax expense | 25 | 50 |
| | | | |
| | ETR | 12,5% | 50% |

Journal entries:

**Y1**

| | | |
|---|---|---|
| Current tax expense P&L | 25 | |
| @/Current tax liability BS | | 25 |

**Y2**

| | | |
|---|---|---|
| Current tax expense P&L | 50 | |
| @/Current tax liability | | 50 |


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# Tax Accounting Basics

## The effect of a temporary difference – example

| | | Year 1 | Year 2 |
|---|---|---|---|
| | Pre-Tax Book Income | 200 | 100 |
| +/- | Permanent Differences | | |
| +/- | Temporary Differences | -100 | 100 |
| = | Taxable amount | 100 | 200 |
| X | Tax rate | 25% | 25% |
| = | Current tax expense | 25 | 50 |
| + | Deferred tax expense | 25 | -25 |
| = | Total tax expense | 50 | 25 |
| | | | |
| | ETR | 25% | 25% |

Journal entries:

**Y1**

| | | |
|---|---|---|
| Current tax expense P&L | 25 | |
| @/Current tax liability BS | | 25 |
| | | |
| Deferred tax expense P&L | 25 | |
| @/Deferred tax liability | | 25 |

**Y2**

| | | |
|---|---|---|
| Current tax expense P&L | 50 | |
| @/Current tax liability | | 50 |
| | | |
| Deferred tax liability | 25 | |
| @/Deferred tax benefit | | 25 |


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## Effective tax rate – Illustration

| Description | Amount | ETR |
|---|---|---|
| Income/(loss) after tax | - | |
| Tax at statutory rate | - | 25,80% |
| **Corrections from profit before tax to taxable amount** | | |
| Non-deductible costs | - | |
| Exempt income from participations | | |
| Benefit of incentives | | |
| Non-deductible interest | - | |
| **Other reconciling items** | | |
| PY adjustments current and deferred | | |
| Tax rate adjustments | | |
| Movement uncertain tax positions | | |
| Movement outside basis differences | | |
| Impairment deferred tax assets | | |
| Reversal impairment deferred | | |
| Use of not recognized losses | | |
| Other reconciling items | | |
| **Total tax expense/(benefit)** | **-** | **25,80%** |


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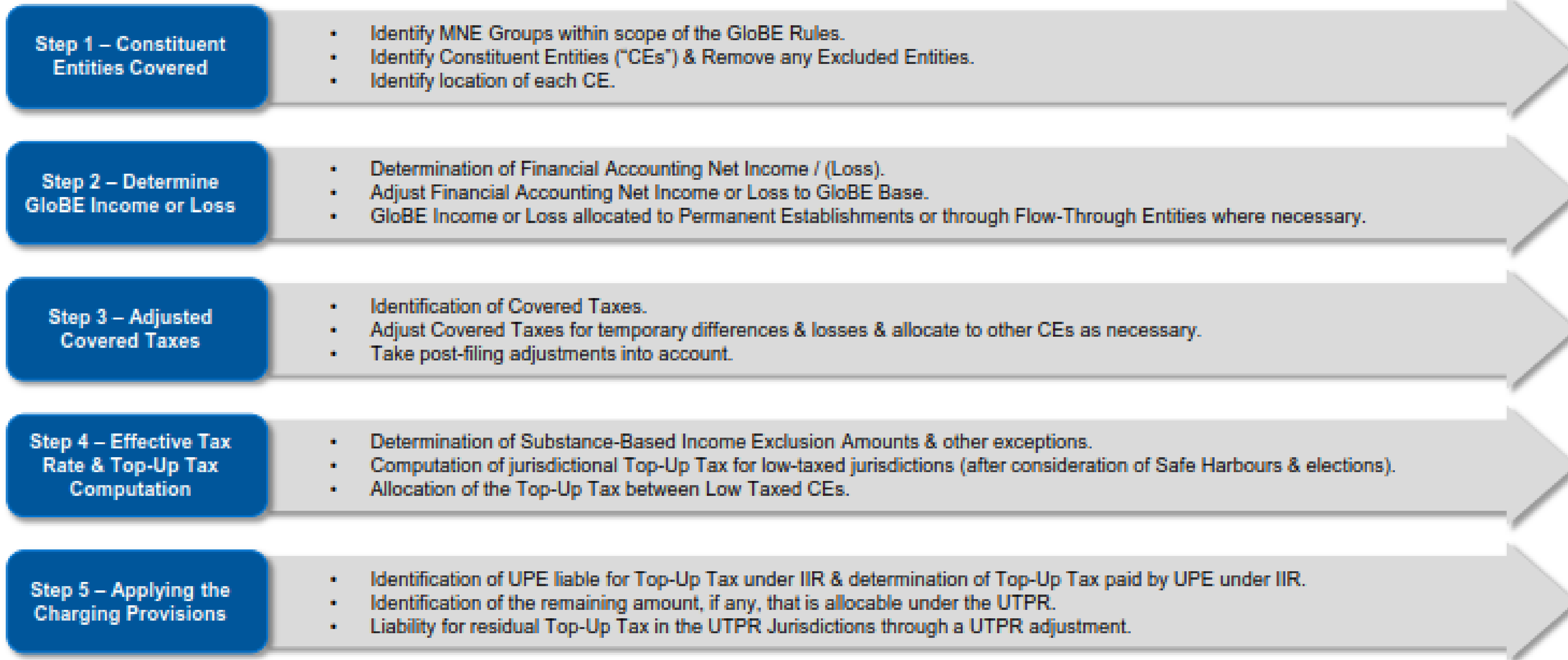
# 02

## Chapter 5 – Computation of Effective Tax Rate & Top-Up Tax

# Chapter 5 – Computation of Effective Tax Rate & Top-Up Tax

## Calculation steps





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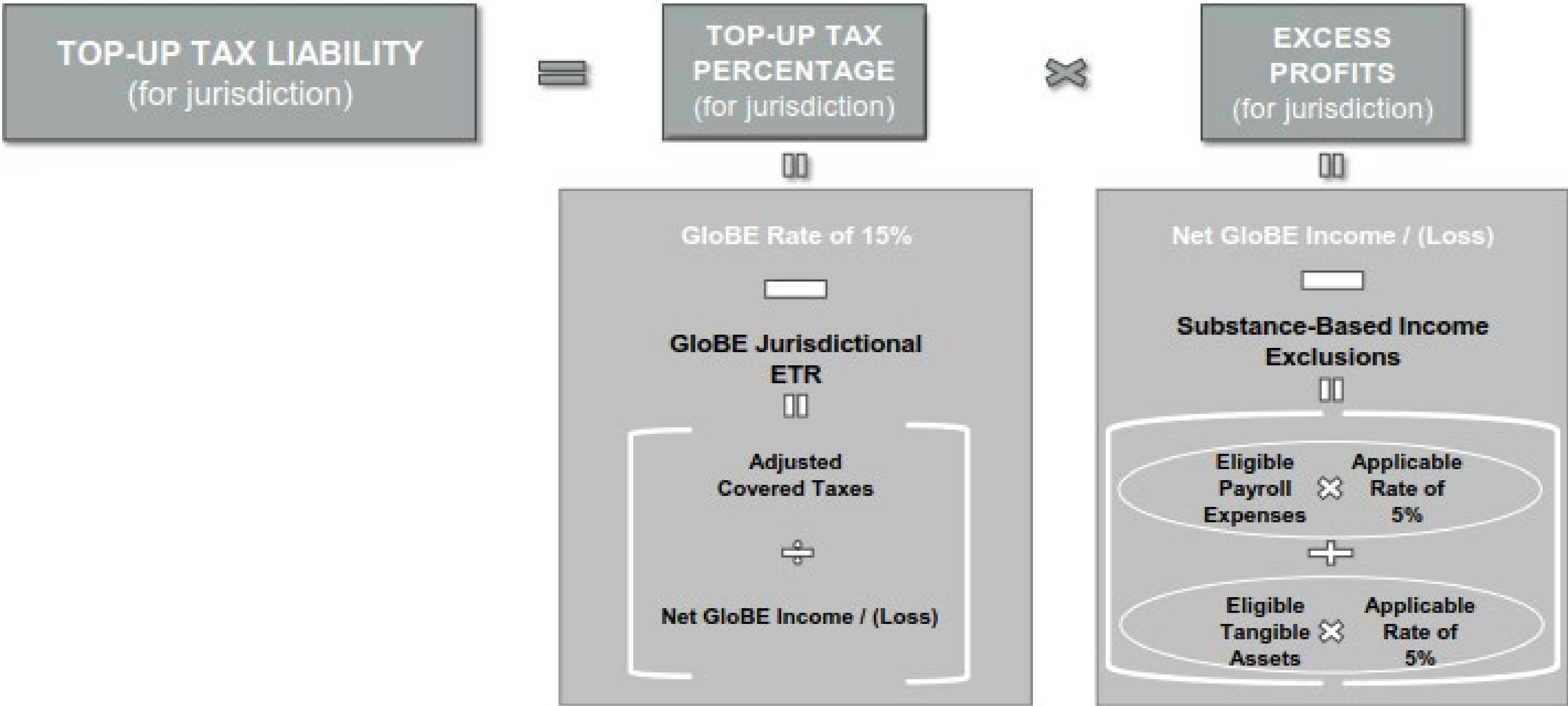
# Chapter 5 – Computation of Effective Tax Rate & Top-Up Tax

## Computation of the Top-Up Tax calculation for a jurisdiction





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# Chapter 5 – Computation of Effective Tax Rate & Top-Up Tax

## Article 5

**Step 1 – Computation of jurisdictional Top-Up Tax for low-taxed jurisdictions**

1. The amount of Covered Taxes with respect to a jurisdiction are divided by the GloBE Income in such jurisdiction to determine the Effective Tax Rate (ETR) for such jurisdiction (Article 5.1)
2. When the ETR is below the Minimum Rate, the Top-Up Tax percentage for the jurisdiction must be calculated. This is computed by subtracting the ETR from the Minimum Rate (*e.g.*, if the ETR is 10%, the Top-Up Tax percentage is equal to 15% - 10% = 5%) (Article 5.2.1)
3. The Top-Up Tax percentage is then multiplied by the Excess Profit (Article 5.2.2) in the jurisdiction to determine the amount of Top-Up Tax. The Excess Profit for the jurisdiction is equal to the GloBE Income less the Substance-Based Income Exclusion (*i.e.*, an excluded routine return on tangible assets and payroll) (Article 5.3)
4. Finally, the Top-Up Tax for the jurisdiction is reduced by any applicable Qualified Domestic Minimum Top-Up Tax (Article 5.2.3)

**Step 2 – Allocation of the Top-Up Tax between Low-Taxed Constituent entities**

The Jurisdictional Top-Up Tax is allocated to Constituent Entities (CEs) in the Low Tax Jurisdiction that have GloBE Income for the Fiscal Year (and in proportion to such income) in order to determine which entities trigger a charge to Top-Up Tax under the IIR or to other CEs located in an UTPR jurisdiction (Article 5.2.4)


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# 03

## Chapter 3 – Computation of GloBE Income or Loss

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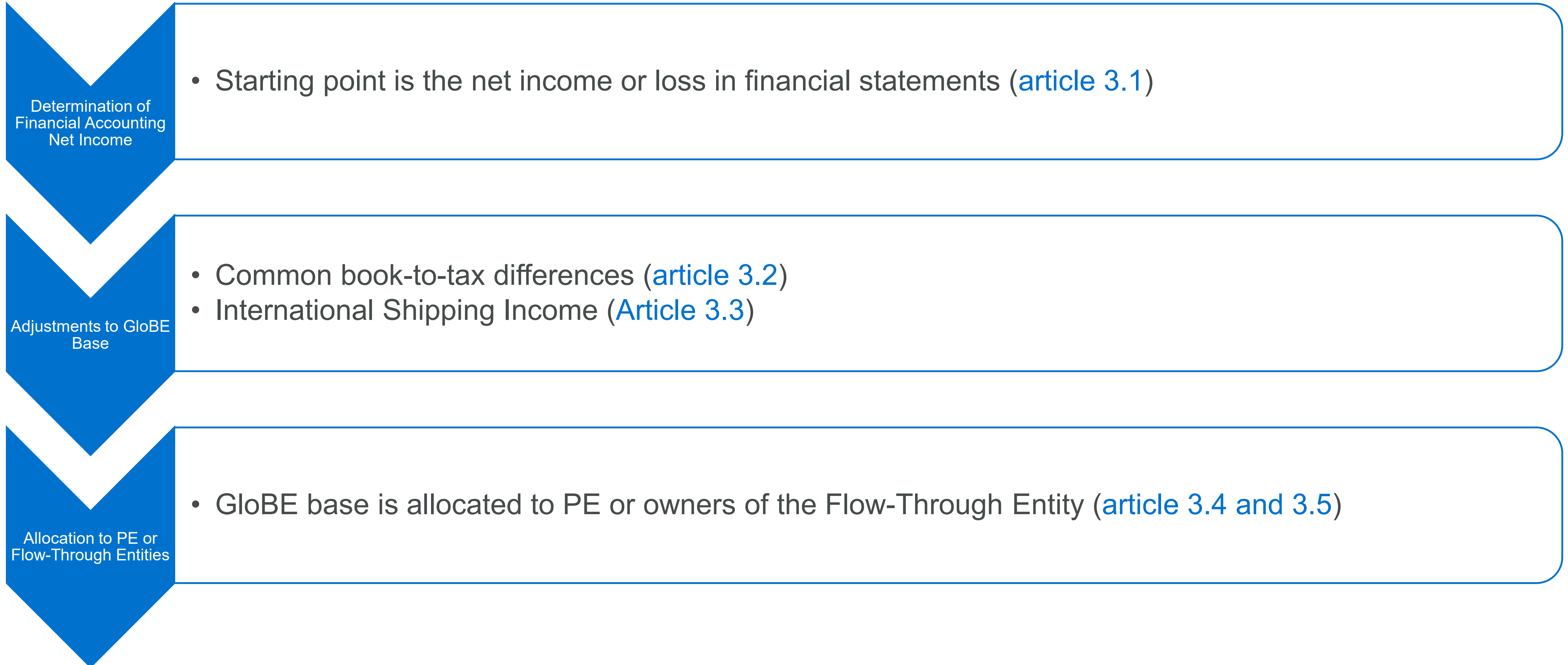



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# Chapter 3 – Computation of GloBE Income or Loss

## Article 3.2 – Adjustments to determine GloBE Income or Loss

a. Net Tax Expenses;
b. Excluded Dividends;
c. Excluded Equity Gain or Loss;
d. Included Revaluation Method Gain or Loss;
e. Gain or loss from disposition of assets and liabilities excluded under article 6.3;
f. Asymmetric Foreign Currency Gains or Losses;
g. Policy Disallowed Expenses;
h. Prior Period Errors and Changes in Accounting Principles; and
i. Accrued Pension Expense.


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# 04

## Chapter 4 – Adjusted Covered Taxes

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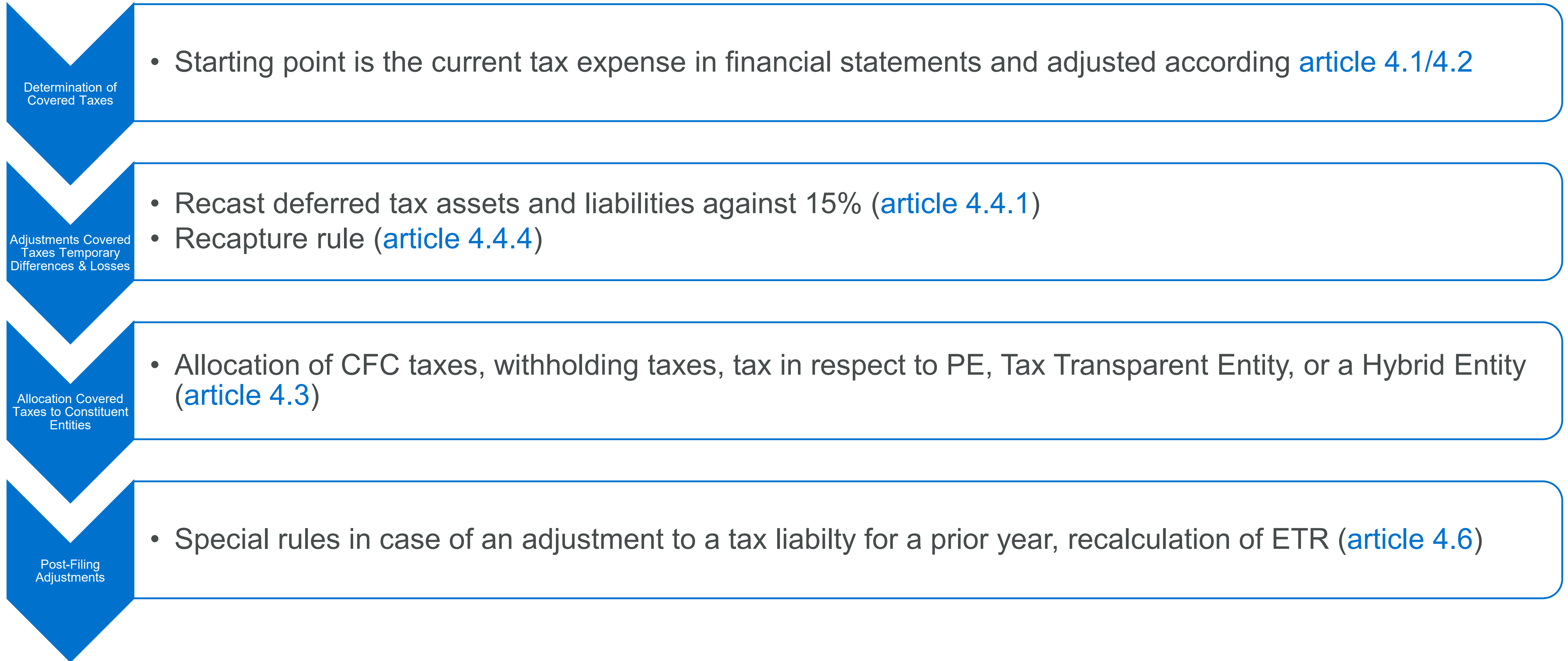



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# Chapter 4 – Adjusted Covered Taxes

## Article 4.1.2 & 4.1.3

Additions to Covered Taxes:

a. Covered Taxes accrued as expense in the profit before taxation in the financial accounts;
b. Any amount of GloBE Loss Deferred Tax Asset used under article 4.5.3;
c. Any amount of Covered Taxes that is paid in relation to uncertain tax positions;
d. Any amount of credit or refund in respect of a Qualified Refundable Tax Credit that is recorded as a reduction to the current tax expense;

Reductions to Covered Taxes:

a. Amount of current tax expense with respect to income excluded from the computation of the GloBE Income or Loss;
b. Any amount of credit or refund in respect of a **Non**-Qualified Refundable Tax Credit that is **not** recorded as a reduction to the current tax expense;
c. The amount of current tax expense which relates to an uncertain tax position;
d. Any amount of current tax expense that is not expected to be paid within three years.


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# Chapter 4 – Adjusted Covered Taxes

## Example – withholding taxes interest and royalties (article 4.1.2 (a))

**Financial accounting**

- In practice, we see some inconsistency where withholding taxes on interest and royalties are included in the P&L, above or below the line (=tax line)

**Pillar 2 accounting**

- Withholding taxes on interest and royalties are considered Covered Taxes at the level of the recipient
- An adjustment is required in case withholding taxes are recorded above the tax line

**Example:**

| | Tax accounting | Pillar 2 |
|---|---|---|
| Revenue | 150 | 150 |
| OPEX | 50 | 45 |
| Proft before tax | 100 | 105 |
| Current /Deferred tax expense | 12,5 | 17,5 |
| Net income | 75 | 87,5 |
| ETR | 12,5% | 16,67% |

**Data**: aware of any withholding taxes above the tax line in the financial statements?


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# Chapter 4 – Adjusted Covered Taxes

## Example – uncertain tax positions (article 4.1.2 (c) and 4.1.3 (d))

### Pillar 2 accounting

- An uncertain tax position is not recognized for Pillar 2 purposes
- Only actual payments are taken into account

**Example:**

| | Tax accounting | Pillar 2 |
|---|---|---|
| Revenue | 150 | 150 |
| OPEX | 50 | 50 |
| Proft before tax | 100 | 100 |
| | | |
| Current tax expense | 20 | 15 |
| Deferred tax expense | 5 | 5 |
| Total tax expense | 25 | 20 |
| | | |
| Net income | 75 | 80 |
| | | |
| ETR | 25,0% | 20,0% |

**Data**: aware of any taxes related to uncertain tax positions in the tax line in the financial statements?


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# Chapter 4 – Adjusted Covered Taxes

## Example – tax losses (article 4.4.1 (c) and 4.4.2 (c))

- **Pillar 2 accounting**
  - In case no deferred tax asset is recognized for financial accounting purposes, a deemed Pillar 2 deferred tax asset must be taken into account against a rate of 15%.
  - In case a deferred tax asset is recognized against a higher rate, the deferred tax asset will be re-casted against 15%

**Example**:

| Year 1 | Tax accounting | Pillar 2 |
|---|---|---|
| Proft before tax | -100 | -100 |
| Total tax expense | 0 | 0 |
| Net income | -100 | -100 |
| Deemed DTA | | 15 |
| ETR | 0,0% | 15,0% |

| Year 2 | Tax accounting | Pillar 2 |
|---|---|---|
| Proft before tax | 100 | 100 |
| Loss compensation | -100 | -100 |
| Taxable income | 0 | 0 |
| Total tax expense | 0 | 0 |
| Deemed DTA | | -15 |
| ETR | 0,0% | 15,0% |

**Data**: breakdown of deferred tax asset available?


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# Chapter 4 – Adjusted Covered Taxes

## Recapture rule (article 4.4.4 and 4.4.5)

**Pillar 2 accounting**

- The accrual of a DTL that is claimed in the Adjusted Covered Taxes for the relevant year shall be subject to recapture if it does not reverse within the subsequent five years (the DTL recapture rule).
- Not for all DTL (exceptions mentioned in article 4.4.5), **Recapture Exceptions Accruals (REAs)**
- Nor does it apply to an **Unclaimed Accrual** under article 4.4.7.
- DTL recapture means that the Adjusted Covered Taxes and the ETR for the year in which the DTL was accrued and claimed are re-computed without such DTL.
- If the ETR is below 15%, an Additional Top-Up Tax is computed for that year.

The purpose of the DTL recapture rule is to ensure that the ETR is not overstated by giving credit for DTLs that will actually not reverse within 5y.

*Administrative Guidance June 2024 for examples*

**Data:** breakdown of deferred tax liability available? Separate tracking of Pillar 2 deferred tax liabilities in order determine if the DTL reverses within five years.


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# 05

## Reporting Requirements

# Reporting Requirements

## FY24 disclosure note – IAS 12 relevant paragraphs

12.4A – ‘As an exception to the requirements in this Standard, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.’

12.88A – An entity shall disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes (see paragraph 4A).

12.88B – An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.

12.88C – In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, an entity shall disclose known or reasonably estimable information that helps users of financial statements understand the entity’s exposure to Pillar Two income taxes arising from that legislation.

12.88D – To meet the disclosure objective in paragraph 88C, an entity shall disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the reporting period. This information does not have to reflect all the specific requirements of the Pillar Two legislation and can be provided in the form of an indicative range. To the extent information is not known or reasonably estimable, an entity shall instead disclose a statement to that effect and disclose information about the entity’s progress in assessing its exposure.


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# Pillar Two – Tax Accounting

- FASB Staff announced in February 2023 that they view the GloBE Minimum Tax as an alternative minimum tax, subject to AMT accounting as outlined in ASC 740
  - Current inclusion approach (period cost)
  - No deferred tax accounting
- At interim periods, Top-Up Tax should generally be part of EAETR
  - Consider any exclusion related to discrete items
  - Consider intraperiod allocation
- Differences in practice beginning to emerge with respect to valuation allowance considerations (regular tax DTAs that may be impacted by Pillar II inclusions)
  - Future guidance may come from FASB
  - Most firms considering accounting policy election
- Disclosure should be included in tax footnotes for material impacts. Some companies are providing updates as to expected future impact in qualitative terms and identifying jurisdictions they have material operations in that may trigger GloBe tax liability.


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# Reporting Requirements

## How to prepare?

- Safe Harbour Rules can apply for 2024, 2025 and 2026!
- Does the MNE have a Pillar Two implementation roadmap?
- Is the MNE aware of the required information to determine and compute amounts under the GloBE rules?
- Not all jurisdictions will implement the rules, reviewing the enactment status per jurisdiction will be necessary.
- How will the MNE collect data? Is there a data strategy available? Complete data gap analysis.
- Determine whether computations will be carried out at local or group level. Also, are the data owners identified?
- Which engine is used to calculate the Top-Up tax liability?
- Identify whether there are benefits to applying for any of the GloBE elections.
- Is the MNE able to complete the GloBE return?


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# Meet Your Presenters

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Neil has over 25 years of professional experience of advising international insurance groups on their taxation affairs both in practice and in industry. He has 15 years of Big 4 experience including at Associate Partner level advising insurance groups on capital and tax optimization, reinsurance transfer pricing, restructuring, M&A, tax compliance and audit. Neil spent 12 years at Swiss Re and associated firms prior to joining Mazars with a range of finance and tax roles including divisional Head of Finance and Tax M&A, Head of Tax and also as CFO of one of the three Swiss Re insurance companies regulated in Switzerland Since joining Forvis Mazars UK as Head of Insurance Tax in September 2021, Neil has continued to advise multinational insurance groups on all relevant tax and cross line of service issues. Neil is a member of the Forvis Mazars Pillar 2 – GloBE Executive Committee covering FS and non-FS clients and is responsible for the technical and training workstream along with Justin Metcalfe in the US. Neil's clients value the combination of his very strong technical ability and his commercial awareness. As a result, he has been able to develop and create new tax practice areas at Forvis Mazars in Pillar 2 and in Bahamas Corporate Income Tax over the last 2 years. One of Neil's main strengths is the ability to convert legislation as enacted into a pro-forma calculation, an agreed position and then to help clients (or historically Swiss Re in industry) turn that new legislation into an operational calculation with appropriate controls.

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Scott is a member of the International Tax practice unit and the leader of Forvis Mazars' Global Tax Integration practice. He has more than 25 years of tax experience in the manufacturing, distribution, software, and service industries, and has worked closely with privately held and publicly traded corporations. He joined the firm in 2021 after serving as the vice president of corporate tax for a Fortune 500 company for 12 years and as an international tax partner with a multinational professional services network for four years. His experience includes advising companies on tax strategy, acquisition, and divestiture transactions, quarterly and annual tax provision and related financial statement disclosures, and global tax compliance reporting. As the vice president of corporate tax, Scott rebuilt a tax department to remediate a material weakness. His team implemented tax technology solutions that integrated the provision and compliance functions while assimilating business acquisitions and managing a variety of business divestitures, resolving federal, foreign, and state income and direct tax audits. Scott also led a tax planning function that assisted with the tax efficient financing of the organization and its foreign subsidiaries including tax efficient IP ownership, and relocation of digitally provided services. His experience in accounting for income taxes and global tax compliance coupled with his planning experience in areas such as foreign tax credits, Subpart F, global intangible low-taxed income, foreign-derived intangible income, withholding taxes, and income tax treaties allows him to ensure proper, timely, and efficient integration of tax and business changes into the required tax reporting strategies. He has presented to the Kansas City and Omaha chapters of Tax Executives Institute and is a member of The Missouri Bar. Scott is a graduate of Missouri State University, Springfield, with a B.S. degree in accounting, and a graduate of Emory University, Atlanta, Georgia, with a J.D. degree.

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Reshma has over 24 years of experience and she specialized in tax accounting more then 10 years ago while working for PwC and EY. She is a registered tax advisor. Reshma (re)joined Forvis Mazars in March 2024 with the goal to further strengthen the existing global tax accounting proposition within Forvis Mazars. She's an expert when it comes to IAS 12, ASC 740 and the RJ 272, regardless the sector.



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