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Comment on the ICAI Exposure Draft

International Tax Reform—Pillar Two Model Rules

In December 2021, the Organisation for Economic Co-operation and Development (OECD) published its Pillar Two model rules. The rules are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy and were agreed by more than 135 countries and jurisdictions representing more than 90% of global GDP.

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; and

(b) to 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%.

But there are Pertinent Issues in regard to the aforementioned subject some of which are:

1. Temporary exception to the accounting for deferred taxes
2. Disclosure
3. Effective date and transition

Let us examine each of the following in detail as to what can be the best method to apply.

Temporary exception to the accounting for deferred taxes

It is beneficial to introduce a temporary exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

Introducing such a temporary exception would:

(a) provide affected entities with relief from accounting for deferred tax assets and liabilities in relation to a complex new tax law to be enacted in multiple jurisdictions in a short period of time;

(b) avoid entities developing diverse interpretations, which could result in the Standard being applied inconsistently.

Disclosure

The IASB proposes to require an entity to disclose separately the current tax expense related to Pillar Two income taxes. Disclosing such information would:

(a) help users of financial statements understand the magnitude of Pillar Two income taxes relative to an entity's overall tax expense ;

and

(b) not be costly because an entity will be required to recognise current tax related to Pillar Two income taxes

Effective date and transition

For the temporary exception to be effective, it would need to be available to entities immediately upon the issue of the amendments and applicable to any financial statements not yet authorised for issue at that date. The IASB decided to propose retrospective application of the temporary exception because such application would result in:

(a) entities applying the exception from the date Pillar Two legislation is enacted or substantively enacted, even if that date is before the date on which the IASB issues final amendments; and

(b) no additional costs.

The IASB proposes to require an entity to apply the disclosure requirements in paragraphs 88B–88C for annual reporting periods beginning on or after 1 January 2023. The IASB concluded that entities would need time to prepare the required information.

Determination of the group entity liable for the top-up tax

In addition to the aforementioned issues, we have analysed the liability of the group to the top up tax in 5 Steps.

Step 1 – Constituent Entities within scope

•Identify Groups within Scope and the location of each Constituent Entity within the Group

Step 2 – Globe Income

•Determine Income of each Constituent Entity

Step 3 – Covered taxes.

•Determine taxes attributable to Income of a Constituent Entity

Step 4 – Effective Tax Rate and Top-up Tax

•Calculate the Effective Tax Rate of all Constituent Entities located in the same jurisdiction and determine resulting Top-up Tax

Step 5 – IIR and UTPR

•Impose Top-up Tax under IIR or UTPR in accordance with agreed rule order