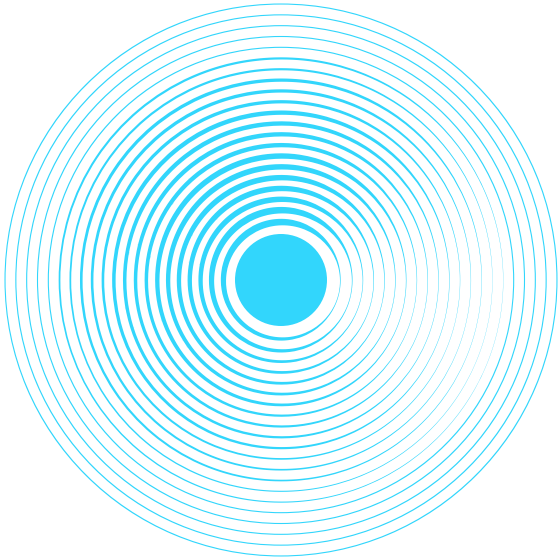
Deloitte.

Financial Reporting Alert 24-1
March 5, 2024; Updated April 15, 2024



Contents

Frequently Asked Questions About "Pillar Two"

This publication was updated on April 15, 2024, to address a number of additional questions. Changes include updates to Topic 5 (uncertain tax positions) and Topic 6 (other tax impacts) as well as the addition of Topic 8, which addresses the accounting for certain aspects of the GloBE rules in the separate financial statements of constituent entities that are members of a multinational enterprise group subject to such rules. Text that has been added or amended since this publication's initial issuance has been marked with a ***boldface italic date*** in brackets.

Introduction

In October 2021, more than 135 countries and jurisdictions agreed to participate in a "two-pillar" international tax approach developed by the Organisation for Economic Co-operation and Development (OECD), which includes establishing a global minimum corporate tax rate of 15 percent. The OECD published *Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*[1] in December 2021 and subsequently issued additional commentary and administrative guidance[2] clarifying several aspects of the model rules (collectively the "GloBE" rules).

Since that time, certain countries have enacted Pillar Two–related laws, some of which became effective January 1, 2024, and we anticipate that many more will follow suit. Accordingly, this alert provides responses to some frequently asked questions (FAQs) about how an entity should account for the tax effects of the GloBE rules in accordance with ASC 740[3] in interim

[1] OECD (2021), *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.

[2] The OECD periodically publishes commentary, administrative guidance, and information about the GloBE rules on its Web site.

[3] FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*.

and annual periods. It also incorporates guidance from certain previously issued Deloitte publications. While the answers to the FAQs reflect our current positions, these views are subject to change (e.g., on the basis of additional guidance, new information, or changes in practice). Consultation with an entity's accounting advisers is encouraged.

We plan to continue to update this publication as developments occur or additional questions arise.

Background

The GloBE rules apply to constituent entities (CEs), which are members of a multinational enterprise (MNE) group that has annual revenue of EUR 750 million or more in the consolidated financial statements of the ultimate parent entity (UPE) in at least two of the four fiscal years immediately preceding the tested fiscal year. The objective of the rules is to ensure that large MNEs pay a minimum level of tax on the income arising in each jurisdiction in which they operate. To achieve this goal, the rules impose a top-up tax on excess profits arising in a jurisdiction whenever the GloBE effective tax rate (ETR), determined on a jurisdictional basis, is below the 15 percent minimum rate.

Whether a top-up tax is due under the rules is assessed on the basis of a jurisdictional GloBE ETR calculation in which the numerator is the sum of adjusted covered taxes for each CE located in the jurisdiction. The denominator is the net GloBE income of the jurisdiction. If the jurisdictional GloBE ETR is less than the 15 percent minimum rate, the difference is the top-up tax percentage, which an entity applies to the excess profits in determining the jurisdictional top-up tax. Adjusted covered taxes are generally equal to the current tax expense and deferred tax expense of each CE accrued in the UPE's financial statements, adjusted for certain items described in the GloBE rules. GloBE income is the financial accounting net income or loss determined for the CE, adjusted for certain items described in the GloBE rules. Financial accounting net income or loss is the net income or loss determined for the CE (before any consolidation adjustments eliminating intragroup transactions) in the preparation of consolidated financial statements of the UPE.

The rules also provide additions to, reductions to, and exclusions from the jurisdictional top-up tax such as:

- Additional current top-up tax, which includes but is not limited to amounts due as a result of the deferred tax liability (DTL) recapture rule (see further discussion in Topic 6).
- A reduction for a domestic minimum top-up tax under a qualified domestic minimum top-up tax (QDMTT).[4]

[4] Article 10.1 of the GloBE rules defines a QDMTT as follows:

> A "Qualified Domestic Minimum Top-up Tax means a minimum tax that is included in the domestic law of a jurisdiction and that:
>
> (a) determines the Excess Profits of the Constituent Entities located in the jurisdiction (domestic Excess Profits) in a manner that is equivalent to the GloBE Rules;
>
> (b) operates to increase domestic tax liability with respect to domestic Excess Profits to the Minimum Rate for the jurisdiction and Constituent Entities for a Fiscal Year; and
>
> (c) is implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary, provided that such jurisdiction does not provide any benefits that are related to such rules.
>
> A Qualified Domestic Minimum Top-up Tax may compute domestic Excess Profits based on an Acceptable Financial Accounting Standard permitted by the Authorised Accounting Body or an Authorised Financial Accounting Standard adjusted to prevent any Material Competitive Distortions, rather than the financial accounting standard used in the Consolidated Financial Statements."

- Safe harbors (e.g., the QDMTT safe harbor[5]), which, at the election of the filing CE,[6] deem the top-up tax for a jurisdiction to be zero for a fiscal year when the CEs located in the jurisdiction are eligible for the safe harbor.

The GloBE rules include:

- An income inclusion rule (IIR), which imposes top-up tax on a parent entity that owns an ownership interest in a low-taxed CE (LTCE) with respect to the CE's low-taxed income.
- An undertaxed profits rule (UTPR), which denies deductions (or requires an equivalent adjustment to be made under domestic law) in an amount resulting in a cash tax expense equal to the top-up tax amount on the low-taxed income of any CE in the MNE group to the extent that such low-taxed income is not subject to tax under an IIR.

The IIR is applied by a parent entity in an MNE group by using an ordering rule that generally gives priority of the rule's application to the entity or entities closest to the top in the chain of ownership. The UTPR is applied by other entities in the MNE group when the income of low-tax entities is not subject to tax under an IIR and serves as a backstop to the IIR. Finally, the QDMTT is applied in the jurisdiction in which the income is generated. Taxes paid under the GloBE rules do not affect the jurisdictional GloBE ETR calculations described above nor do they create a tax credit carryforward to be applied against taxes due under the regular tax system in future years.

Frequently Asked Questions and Answers

Topic 1: Scope

Question 1.1

Is the top-up tax imposed under an IIR regime within the scope of ASC 740 in the consolidated financial statements of the UPE?

Answer

Yes, the IIR is within the scope of ASC 740 in the UPE's consolidated financial statements. ASC 740-10-20 defines income taxes as "[d]omestic and foreign federal (national), state, and local (including franchise) taxes based on income," and it defines taxable income as "[t]he excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority." Although ASC 740 provides no further guidance on this matter, the term "taxes based on income" implies a tax system in which the tax payable is calculated on the basis of the entity's revenue minus the expenses allowed by the jurisdiction being considered. The IIR is based on GloBE income, which is determined by taking into account taxable revenues over tax deductible expenses. In addition, the starting point for calculating GloBE income is the financial accounting net income or loss reported in the consolidated financial statements.

[5] In accordance with the OECD's administrative guidance on the GloBE rules, "a QDMTT must meet an additional set of standards to qualify for the safe harbour. In particular, and given the ability of a QDMTT to depart from the design of the GloBE Rules, a QDMTT that qualifies for a safe harbour must meet following three standards:
   a. the **QDMTT Accounting Standard** which requires a QDMTT to be computed based on the UPE's Financial Accounting Standard or a Local Financial Accounting Standard subject to certain conditions;
   b. the **Consistency Standard** which requires the QDMTT computations to be the same as the computations required under the GloBE Rules except where the Commentary to the QDMTT definition in Article 10.1 as modified by the Administrative Guidance (hereafter the QDMTT Commentary) explicitly requires a QDMTT to depart from the GloBE Rules or where the Inclusive Framework decides that an optional variation that departs from the GloBE Rules still meets the standard; and
   c. the **Administration Standard** which requires the QDMTT jurisdiction to meet the requirements of an on-going monitoring process similar to the one applicable to jurisdictions implementing the GloBE Rules."

[6] Entity filing the GloBE information return.

Question 1.2

Is the top-up tax imposed under a UTPR within the scope of ASC 740 in the consolidated financial statements of the UPE?

Answer

Yes, the UTPR is within the scope of ASC 740 in the UPE's consolidated financial statements. In a manner consistent with the discussion above related to the IIR, the revenue and expenses on which the UTPR is determined, which are calculated according to an income metric, are included in the consolidated financial statements of the UPE.

Question 1.3

Is the domestic minimum top-up tax imposed under a QDMTT within the scope of ASC 740 in the consolidated financial statements of the UPE?

Answer

Unlike the IIR and UTPR, there is no mathematical formula prescribed under the GloBE rules for calculating a QDMTT; therefore, there may be variations between an enacted QDMTT and the GloBE rules. However, if (1) the QDMTT is consistent with the GloBE rules and is based on a measure of taxable revenues less tax-deductible expenses and (2) the income on which the tax is calculated is included in the consolidated financial statements of the UPE, the QDMTT is within the scope of ASC 740.

Question 1.4

Is deferred tax accounting required for the IIR, UTPR, or QDMTT?

Answer

IIR and UTPR

At the FASB's February 1, 2023, meeting, the FASB staff responded to a technical inquiry related to the deferred tax accounting for a minimum tax that is consistent with the GloBE rules. The staff stated "the GloBE minimum tax as illustrated in the inquiry is an alternative minimum tax (AMT)" and that deferred tax assets (DTAs) and DTLs "would not be recognized or adjusted for the estimated future effects of the minimum tax." In addition, the staff noted that "[t]he GloBE minimum tax should be viewed as a separate but parallel tax system that is imposed to ensure that certain taxpayers pay at least a minimum amount of income tax." In support of its conclusion, the FASB staff cited the guidance in ASC 740-10-30-10 through 30-12 as well as ASC 740-10-55-31 and 55-32 regarding AMT systems. The staff observed that "the potential obligation for GloBE taxes in future years is dependent on the generation of future adjusted net income." Accordingly, deferred taxes for temporary differences that will reverse in the regular tax system should continue to be recorded at the regular statutory tax rate.

The staff did note, however, that its view was based on the specific details outlined in the inquiry and that an entity would therefore need to evaluate any enacted tax law to determine whether the facts and circumstances were consistent with those addressed in the inquiry (i.e., are consistent with the GloBE rules).

QDMTT

While domestic top-up taxes under a QDMTT were not addressed in detail in the technical inquiry submitted to the FASB staff, we believe that in circumstances in which a QDMTT is consistent with the GloBE rules, the QDMTT may qualify as an AMT and be accounted for as such. This is consistent with the staff's response to the technical inquiry at the February 1, 2023, FASB meeting. We believe that a question continues to exist, however, related to whether a QDMTT could still be considered an AMT in situations in which the jurisdiction does not have an existing domestic income tax aside from a QDMTT (e.g., there is no parallel tax system). In these scenarios, if it is determined that the QDMTT does not qualify as an AMT, deferred tax accounting may be appropriate. Consultation with an entity's accounting advisers is encouraged.

Question 1.5

Must a QDMTT qualify for the QDMTT safe harbor to be accounted for as an AMT?

Answer

No. It is not necessary for a QDMTT to qualify for the QDMTT safe harbor to be accounted for as an AMT; however, it must function as an AMT within the jurisdiction to be accounted for as such.

Topic 2: Valuation Allowance

Question 2.1

If an entity expects to be subject to a top-up tax (e.g., IIR, UTPR, QDMTT) and, as a result, the incremental economic benefit it expects to realize for certain DTAs is less than the recorded amount of the DTAs, should the entity factor in the effects of the top-up tax when evaluating the realizability of its DTAs?

Answer

We believe that there are two acceptable approaches. Under the first approach, the entity would assess the realizability of its DTAs solely on the basis of the regular tax system without taking into consideration amounts due under a Pillar Two AMT system (i.e., any incremental impact of the Pillar Two taxes would be accounted for in the period in which the Pillar Two tax is incurred).

Under the second approach, the entity would assess the realizability of its DTAs on the basis of all available information. If, for example, the expected tax benefit of a DTA is less than the reported amount because the utilization of the DTA will result in incremental Pillar Two taxes (e.g., if the DTA is more likely than not to be disregarded under the GloBE rules),[7] the DTA would be reduced by a valuation allowance to reflect the actual amount of tax benefit that will be realized with respect to the DTA.

These approaches are the same as those used to assess the realizability of DTAs in the regular tax system that interact with the corporate AMT (CAMT), as addressed in Section 5.7.1 of Deloitte's Roadmap *Income Taxes*.

[7] Certain DTAs are disregarded for GloBE purposes, including but not limited to those subject to Articles 9.1.2 and 9.1.3 of the GloBE rules. Article 9.1.2 states, "Deferred tax assets arising from items excluded from the computation of GloBE Income or Loss under Chapter 3 must be excluded from the Article 9.1.1 computation when such deferred tax assets are generated in a transaction that takes place after 30 November 2021." Article 9.1.3 states, "In the case of a transfer of assets between Constituent Entities after 30 November 2021 and before the commencement of a Transition Year, the basis in the acquired assets (other than inventory) shall be based upon the disposing Entity's carrying value of the transferred assets upon disposition with the deferred tax assets and liabilities brought into GloBE determined on that basis."

Example

Assume the following:

- Company A operates in Jurisdiction A, which has a 20 percent tax rate.
- Jurisdiction A has enacted a QDMTT.
- Forecasted GloBE income is equal to pretax book income of $5,000.
- Company A has a DTA of $900 (deductible temporary difference of $4,500) that is disregarded for GloBE purposes. The DTA reverses in year 2 when the QDMTT is effective.
- Company A has no other permanent or temporary differences.
- On the basis of projections, utilization of the DTA in year 2 would result in incremental top-up tax of $650 as follows:

	Temporary Difference	
	With	Without
Pretax book income/GloBE income	$ 5,000	$ 5,000
Temporary difference	(4,500)	—
Taxable income	500	5,000
Tax rate	20%	20%
Current tax expense	100	1,000
Deferred tax expense	900	—
Total tax expense	1,000	1,000
Adjustment to deferred tax expense*	(900)	—
Total adjusted covered taxes	100	1,000
GloBE ETR	2%	20%
Top-up tax percentage	13%	—
Top-up tax	650	—
Total payable	750	1,000

* Deferred tax recast to 15 percent has been ignored since the entire DTA is disregarded for GloBE purposes.

Approach 1

The incremental top-up tax would be accounted for in the period in which it arises, and no valuation allowance would be recorded against the $900 DTA because sufficient regular taxable income is expected in future years.

Approach 2

The reversal of the temporary difference reduces the regular tax to $100 but results in $650 of top-up tax. Accordingly, the temporary difference only results in a reduction of future cash outflows of $250, necessitating a $650 valuation allowance against the $900 DTA.

Question 2.2

If an entity has already adopted a valuation allowance accounting policy for the CAMT, must the entity apply a consistent policy for the QDMTT, IIR, and UTPR?

Answer

If it is assumed that the QDMTT qualifies as an AMT, both the QDMTT and CAMT would function as AMTs that are due in the *same* jurisdiction as the regular tax. Accordingly, if an entity has already adopted an accounting policy for the CAMT, we believe that the entity should apply a consistent policy for any QDMTTs that qualify as AMTs.

However, we believe that the nature of the IIR and UTPR is different from that of the QDMTT and CAMT because the IIR and UTPR are AMTs that are due in jurisdictions that are *different*

from those in which the regular tax is due. Accordingly, if an entity operates in a low-taxed jurisdiction and the regular deferred taxes in that jurisdiction will reverse and affect the amount of top-up tax paid under an IIR or UTPR (or both) in a different jurisdiction, the entity could make a separate policy choice for the IIR and UTPR. While an entity does not need to elect the same accounting policy for the UTPR and IIR as it elects for the CAMT and any QDMTTs that qualify as AMTs (i.e., the entity could choose the second approach for the CAMT and QDMTT and the first approach for the UTPR and IIR), if it elects to assess the realizability of its DTAs under the second approach for the IIR and UTPR, it will also need to choose the second approach for any QDMTTs that factor into the calculation of the IIR and UTPR (e.g., a QDMTT that does not qualify for the QDMTT safe harbor[8] would reduce the amount of the tax due under an IIR or UTPR). In various circumstances, complexities may arise. Consultation with an entity's accounting advisers is encouraged.

Question 2.3

[Added April 15, 2024]

If an entity applies the second approach described in Question 2.1 for assessing the realizability of its DTAs in a jurisdiction with a QDMTT, will it need to determine whether the QDMTT meets the QDMTT safe harbor criteria?

Answer

Generally, yes. If the QDMTT does not (or is not expected to) meet the QDMTT safe harbor criteria, an entity would need to consider the incremental impact of any tax due under an IIR or UTPR, in addition to the QDMTT, to determine whether the expected tax benefit of a DTA is less than the reported amount.

Topic 3: Interim Reporting

Question 3.1

How should top-up taxes incurred under Pillar Two be treated on an interim basis in the consolidated financial statements?

Answer

Top-up taxes on ordinary income that an entity expects to incur should be included in the numerator of the entity's estimated annual ETR (AETR) computation in the same manner as other taxes within the scope of ASC 740.

Question 3.2

If an entity in a jurisdiction that would normally be excluded from the overall AETR under ASC 740-270-30-36(a) (i.e., a loss jurisdiction for which no benefit can be recognized) is required to pay a top-up tax (e.g., an IIR or UTPR within the scope of ASC 740) related to the ordinary income of another entity in the reporting group that is not excluded from the overall AETR, should the top-up tax expense to be paid by the entity in the loss jurisdiction be excluded from the overall AETR?

Answer

The top-up tax expense to be paid by the entity in the loss jurisdiction should not be excluded from the overall AETR if such tax is "related to" ordinary income (or loss) of an entity that is not excluded from the overall (worldwide) AETR. ASC 740-270-30-36(a) states, in part, that when a loss jurisdiction is excluded from the AETR, "the entity shall exclude ordinary income (or loss)

[8] An entity must apply judgment in determining whether it is more likely than not that the QDMTT qualifies for the QDMTT safe harbor.

in that jurisdiction and the **related tax (or benefit)** from the overall computations of the estimated annual effective tax rate and interim period tax (or benefit)" (emphasis added). In this case, the top-up tax is not "related to" the ordinary income (or loss) of the excluded entity.

Example

Assume the following:

- Parent's jurisdiction has enacted an IIR. Parent has two consolidated subsidiaries, Sub A (in Jurisdiction A) and Sub B (in Jurisdiction B).
- There are no differences between forecasted pretax ordinary income, taxable income, GloBE income, and excess profit.
- Parent is a loss entity with a full valuation allowance. Therefore, no tax benefit can be recognized related to Parent's forecasted ordinary loss.
- Parent is excluded from the worldwide AETR.
- A separate AETR is computed for Parent under ASC 740-270-30-36(a).
- Jurisdiction B has a 0 percent statutory rate. Regular tax and top-up tax are calculated as follows:

	Parent	Sub A (Jurisdiction A)	Sub B (Jurisdiction B)
Pretax ordinary income/loss	(500)	100	100
Tax rate	20%	25%	—
Current tax under regular tax system	—	25	—
Top-up tax on Jurisdiction B ordinary income	15	—	—

The estimated overall AETR would include the $15 top-up tax due in Parent's jurisdiction related to the income in Jurisdiction B, resulting in an overall AETR of 20 percent ($25 Jurisdiction A tax + $15 top-up tax related to Jurisdiction B ÷ $200 pretax ordinary income for Jurisdictions A and B).

Question 3.3

If a significant unusual or infrequently occurring ("SUI") item that is excluded from the AETR affects the amount of top-up tax due under an IIR, UTPR, or QDMTT within the scope of ASC 740, should the incremental effect on the top-up tax also be excluded from the AETR and accounted for discretely in the quarter in which the SUI item is reported?

Answer

ASC 740-270-30-8 states, in part, that in the determination of the estimated AETR, "no effect shall be included for the tax related to . . . significant unusual or infrequently occurring items that will be reported separately." Therefore, all tax effects of the SUI item should be reported separately from the AETR. Questions exist, however, related to what constitutes "all tax effects." One acceptable approach to computing the discrete tax effects of the SUI item would be to perform a full ASC 740 "with-and-without" computation. Under this approach, the total forecasted tax expense (including top-up tax expense) for the year would be computed both with and without the SUI item. The difference between the two computations would be the amount of tax associated with the SUI item to be recorded discretely in the quarter in which the transaction or event occurs. Other approaches may be acceptable.

Topic 4: Intraperiod Allocation

Question 4.1

How should top-up taxes be allocated among the components of comprehensive income?

Answer

Top-up taxes should be allocated among the components of comprehensive income in accordance with the intraperiod allocation with-and-without approach under ASC 740-20.

Example

Assume the following:

- Parent is a UPE and operates in a jurisdiction with an IIR.
- Parent consolidates Entity A, which is presented as discontinued operations and operates in a 0 percent tax rate jurisdiction (Jurisdiction A).
- There are no differences between pretax book income, taxable income, GloBE income, and excess profit.
- Top-up tax will be paid in Parent's jurisdiction with respect to income in Jurisdiction A, as follows:

	Parent	Entity A
Pretax ordinary income	500	1,000
Tax rate	20%	—
Current tax under regular tax system	100	—
Top-up tax on Entity A income	150	—

	Parent	Entity A	Total (With Discontinued Operation)	Total (Without Discontinued Operation)	Difference
Pretax book income	500	1,000	1,500	500	—
Tax expense			250	100	150

The $150 incremental tax (i.e., difference between the results under the "with" calculation and the "without" calculation) is allocated to discontinued operations notwithstanding the fact that the tax is paid by Parent to Parent's jurisdiction and not by Entity A (the entity classified as a discontinued operation).

Topic 5: Uncertain Tax Positions

[Updated April 15, 2024]

Under U.S. GAAP, an entity must analyze all uncertain tax positions (UTPs) by using a two-step approach (recognition and measurement) that is based on a more-likely-than-not threshold. It must accrue an unrecognized tax benefit (UTB) for the portion of the UTP that does not meet the more-likely-than-not threshold. Often, the accrual of the UTB and subsequent changes are recorded to income tax expense. While the accrual for a UTB would often result in an increase in the entity's ETR, current and deferred tax expense related to UTBs are excluded from adjusted covered taxes under Articles 4.1.3(d) and 4.4.1(b) of the GloBE rules. However, under Articles 4.1.2(c) and 4.4.2(a), such amounts can be included in adjusted covered taxes in the year in which they are paid.

Question 5.1

Is an entity required to apply the two-step model (recognition and measurement) to UTPs taken in the computation of top-up taxes in the consolidated financial statements?

Answer

UTPs taken in the computation of top-up taxes within the scope of ASC 740 are subject to the same two-step recognition and measurement principles in ASC 740-10 as other taxes within the scope of ASC 740, including any UTPs taken with respect to assertions related to meeting any applicable safe harbor requirements. See Chapter 4 of Deloitte's Roadmap *Income Taxes* for additional information about the two-step process.

Example

Assume the following:

- Company A operates in Jurisdiction A, which has a 15 percent tax rate.
- Jurisdiction A has enacted a QDMTT.
- GloBE income is equal to pretax book income of $5,000.
- At the start of the year, Company A had a DTA of $675 (deductible temporary difference of $4,500), which reverses during the current year, resulting in the inclusion of $675 of deferred tax expense in the calculation of the GloBE ETR. However, Company A believes that it is more likely than not that the DTA and the corresponding deferred tax expense should be disregarded for GloBE purposes.
- Company A has no other permanent or temporary differences.

	As Included on Return	More Likely Than Not
Pretax book income/GloBE income	$ 5,000	$ 5,000
Temporary difference	(4,500)	(4,500)
Taxable income	500	500
Tax rate	15%	15%
Current tax expense	75	75
Deferred tax expense	675	675
Total tax expense	750	750
Deferred tax adjustment under Article 9.1.3*	—	(675)
Total adjusted covered taxes	750	75
GloBE ETR	15%	1.5%
Top-up tax percentage	—	13.5%
Top-up tax	—	675

* Deferred tax expense is included in the computation of the top-up tax as reported on the GloBE information return; however, it does not satisfy the more-likely-than-not requirement under the GloBE rules.

Because it is more likely than not that the deferred tax expense should have been disregarded for Pillar Two purposes, a UTB liability of $675 should be recorded to reflect the difference between the amount paid and the amount due on a more-likely-than-not basis.

Question 5.2

[Added April 15, 2024]

If an entity takes a UTP and records in the consolidated financial statements the impact of a UTB (e.g., by recording a liability, reducing a DTA, or increasing a DTL) that is expected to increase adjusted covered taxes when paid, should the entity record an asset in the consolidated financial statements before settling the UTB for the impact of such payment on future top-up taxes?

Answer

No. As noted above, under Articles 4.1.2(c) and 4.4.2(a) of the GloBE rules, tax expense related to a UTP can only be included in adjusted covered taxes when paid, resulting in both lower adjusted covered taxes in the period in which the effect of the UTB is recorded in the financial statements and the potential for higher adjusted covered taxes in a future period. Whether the taxes paid related to the UTP will actually result in a reduction in top-up taxes, however, will depend on various factors (e.g., future GloBE income, permanent items). Accordingly, we do not believe that the entity should record an asset with respect to the potential future increase in adjusted covered taxes. Instead, it would reflect the benefit related to the potential future increase in adjusted covered taxes, if any, in the fiscal year the taxes are paid.

Example

Assume the following:

- Company A operates in Jurisdiction A, which has a 15 percent regular statutory tax rate.
- Jurisdiction A has also enacted a QDMTT that is consistent with the GloBE rules.
- Company A has annual pretax book income, taxable income, and GloBE income of $5,000.
- Company A has no permanent or temporary differences.
- In year 1, Company A generated and utilized $500 of R&D tax credits. On a more-likely-than-not basis, Company A expects only $300 of the R&D tax credits to be accepted by the taxing authority. There is no carryover from the prior year.
- In the year in which the credit is generated, the GAAP tax expense is $450, consisting of $250 of tax expense due with the tax return ($5,000 × 15% = $750 – $500) and $200 of tax expense related to the UTB.
- The UTB would result in the following top-up tax in year 1:

Total tax expense	450
Article 4.1.3(d) adjustment	(200)
Total adjusted covered taxes	250
GloBE ETR	5%
Top-up tax percentage	10%
Top-up tax	500

Example (continued)

As shown above, a top-up tax of $500 ($5,000 × 10%) is due in the year in which the UTB is recorded in the financial statements. Assume, then, that in year 5, a payment of $200 was made to the taxing authorities to settle the UTP. Top-up tax in year 5 is computed as follows:

	With Article 4.1.2(c) Adjustment	Without Article 4.1.2(c) Adjustment
Pretax book income/GloBE income	$ 5,000	$ 5,000
Permanent difference	—	—
Taxable income	5,000	5,000
Tax rate	15%	15%
Current tax expense	750	750
Tax credits	—	—
Current tax expense after tax credits	750	750
Deferred tax expense	—	—
Total tax expense	750	750
Article 4.1.2(c) adjustment	200	—
Total adjusted covered taxes	950	750
GloBE ETR	19%	15%
Top-up tax percentage	0%	0%
Top-up tax	—	—

As shown above, the payment of the UTB did not reduce the top-up tax due when paid.

Topic 6: Other Tax Impacts

DTL Recapture Rule

When a DTL arises, the corresponding deferred tax expense increases the adjusted covered tax amount used to calculate the GloBE ETR,[9] which could reduce the amount of top-up tax paid in that year. However, if the DTL has not been paid within the five subsequent fiscal years and is not a recapture exception accrual, the GloBE rules require the entity to recompute its GloBE ETR for the year in which the DTL arose to determine whether additional top-up tax is due. The entity would do so by excluding from covered taxes the amount of deferred tax expense associated with the DTL that was previously taken into account in adjusted covered taxes but is not paid within the five subsequent fiscal years. If the recaptured DTL is paid in a subsequent year, adjusted covered tax in that year is increased by the amount of the recaptured DTL (referred to below as the reversal of the recaptured DTL).

Question 6.1

If an entity takes into account a DTL (i.e., includes the deferred tax expense) that is not a recapture accrual exception in determining adjusted covered taxes but does not have the intent and ability to avoid the DTL recapture and, accordingly, ultimately expects to pay additional current top-up tax upon recapture, should the entity accrue a liability equal to the additional top-up tax it expects to pay?

[9] Alternatively, an entity could make an annual election **not** to include the deferred tax expense related to the increase in the DTL in adjusted covered taxes for such fiscal year.

Answer

We believe that a company's decision to include the deferred tax expense in adjusted covered taxes postpones payment of the incremental top-up tax but does not absolve the entity of its obligation to make such a payment on the basis of its expected manner of recovery (i.e., it is expected to be due upon the mere passage of time). We note that recognition of a liability in the year in which the DTL arises is consistent with the requirement in the GloBE rules that in the event of recapture, the entity will have to recompute its GloBE ETR for the year in which the DTL arose rather than including it in adjusted covered taxes when the recapture is triggered in the fifth subsequent year. While we acknowledge that the liability is contingent on the DTL's not being paid during the five subsequent fiscal years, we believe that if a DTL is expected to be recaptured, the entity should record a noncurrent tax liability in the year in which the DTL arises equal to the additional current top-up tax that it expects to pay upon recapture. Consultation with an entity's accounting advisers is encouraged.

Example

Assume the following:

- Company A has $1,000 of pretax book income.
- Company A purchases an indefinite-lived intangible asset and records $100 of tax amortization in year 1.
- Company A's local tax rate in Jurisdiction A is 15 percent.
- With the exception of the originating DTL, there are no other differences between pretax income, taxable income, GloBE income, and excess profit.
- Company A does not have the intent and ability to avoid the DTL recapture and expects to pay additional top-up tax in the year in which the DTL is recaptured.

	Year 1	Year 1 (With Recapture)
Pretax book income/GloBE income	1,000	$ 1,000
Year 1 amortization	100	100
Taxable income	900	900
Tax rate	15%	15%
Current tax expense	135	135
Deferred tax expense	15	15
Article 4.4.4 recapture	—	(15)
Adjusted covered taxes	150	135
GloBE ETR	15%	13.5%
Top-up tax percentage	—	1.5%
Total top-up tax		15

Company A records a DTL of $15 with respect to the tax amortization taken in year 1 and includes the corresponding $15 deferred tax expense related to the DTL in its adjusted covered taxes for Jurisdiction A. In year 1, there is a 15 percent GloBE ETR in Jurisdiction A and no top-up tax was paid. Under the recapture rule, if the DTL has not been paid within the five subsequent fiscal years, Company A would be required to recompute its year 1 GloBE ETR. Because the GloBE ETR for year 1 was 15 percent, the recapture of the DTL would result in a recomputed year 1 GloBE ETR of less than 15 percent. In this case, because Company A does not have the intent and ability to avoid the recapture provisions, a noncurrent tax liability of $15 should be recorded in year 1.

Question 6.2

If an entity records a noncurrent tax liability as a result of the DTL recapture provision, should that noncurrent tax liability be discounted?

Answer

Although ASC 740-10-30-8 clearly prohibits the discounting of DTAs and DTLs, it does not address income tax liabilities payable over an extended period. In the absence of explicit guidance in ASC 740, we believe that an entity would need to consider ASC 835-30.[10] Specifically, we note the following:

- ASC 835-30 generally applies to "exchange transactions" rather than nonreciprocal transactions.
- ASC 835-30-15-3(e) notes that the guidance in ASC 835-30 does not apply to "[t]ransactions where interest rates are affected by the tax attributes or legal restrictions prescribed by a governmental agency (for example, industrial revenue bonds, tax exempt obligations, government guaranteed obligations, income tax settlements)."
- While not expected, because certain transactions could occur that would result in the DTL's being "paid" and hence the DTL recapture event's being avoided, the amount of the top-up tax represents a contingent obligation rather than a contractual obligation to pay money on fixed or determinable dates that is consistent with the types of instruments described in ASC 835-30-15-2.

Accordingly, we do not believe that the top-up tax that is expected to be due upon a DTL recapture event should be discounted.

We believe that this position is consistent with that taken by the FASB staff in its Q&A stating that the deemed repatriation transition tax liability that resulted from the Tax Cuts and Jobs Act of 2017 would not be discounted.

Question 6.3

[Added April 15, 2024]

If an entity records a noncurrent tax liability as a result of the DTL recapture provision, should it record a corresponding asset for the future increase in adjusted covered taxes upon the eventual reversal of the recaptured DTL?

Answer

An entity may realize a future benefit associated with the reversal of the recaptured DTL when the DTL eventually reverses (e.g., upon the sale of the intangible asset). However, in a manner similar to the discussion in Question 5.2, whether the corresponding increase will result in a reduction in top-up taxes paid in the future period depends on various factors (e.g., future GloBE income, permanent items). Unlike the scenario in Question 6.1, in which the effects of the recapture result in the recalculation of the year 1 tax, the potential top-up tax impacts of the eventual reversal of the recaptured DTL will not be known until the reversal actually occurs in a future period. Accordingly, we believe that even though a company may record a liability associated with the DTL recapture in year 1, it should not record a corresponding asset. Instead, it would reflect the impact to the top-up tax in the fiscal year in which it pays the previously recaptured DTL.

[10] FASB Accounting Standards Codification Subtopic 835-30, *Interest: Imputation of Interest*.

Excess Negative Tax Expense Carryforward

[Added April 15, 2024]

As defined in the GloBE rules, an excess negative tax expense (ENTE) carryforward can arise in situations in which Article 4.1.5[11] of the GloBE rules applies as well as in cases in which the top-up tax percentages are in excess of the minimum rate under Article 5.2.1.

Article 4.1.5 applies when (1) there is no net GloBE income in a jurisdiction and (2) the adjusted covered taxes are less than zero and less than the amount of expected adjusted covered taxes. For example, if an MNE group had a GloBE loss of $100 in Jurisdiction A in year 1 and adjusted covered taxes of negative $45, the MNE group would compare the adjusted covered taxes of negative $45 with the expected adjusted covered tax amount of negative $15, resulting in a top-up tax of $30. In this instance, the MNE group may elect to apply the ENTE administrative procedure,[12] to create an ENTE carryforward of $30, as described further below.

An ENTE can also arise in situations in which the top-up tax percentage exceeds the minimum rate (Article 5.2.1), which would arise in jurisdictions that have a negative GloBE ETR. For example, if CEs in Jurisdiction B had GloBE income of 100 and adjusted covered taxes of negative 5, the GloBE ETR would be negative 5 percent, resulting in a top-up tax percentage of 20 percent. Application of the ENTE administrative procedure is mandatory in this instance.

An MNE group that elects or is required to apply the ENTE administrative procedure must exclude the ENTE from its aggregate adjusted covered taxes computed for the fiscal year and establish an ENTE carryforward. The ENTE for a fiscal year in which the MNE group realizes no GloBE income for the jurisdiction is equal to the amount computed under Article 4.1.5 for that fiscal year. The ENTE for a fiscal year in which the MNE group realizes positive GloBE income for the jurisdiction is equal to the negative adjusted covered taxes for that fiscal year. In the examples above, the ENTE carryforward related to Jurisdiction A (if it is assumed that the election was made) and Jurisdiction B would be $30 and $5, respectively.

In each subsequent fiscal year in which the MNE group has positive GloBE income and adjusted covered taxes for the jurisdiction, the MNE group must decrease (but not below zero) the aggregate adjusted covered taxes by the remaining balance of the ENTE carryforward. The MNE group must then reduce the balance of the ENTE carryforward by the same amount.

Question 6.4

If an entity has an ENTE carryforward, should it record a noncurrent tax liability in the year in which the ENTE is created for the potential future top-up tax expected to be due as a result of the future decrease in adjusted covered taxes related to the ENTE?

Answer

Although an entity may have an ENTE, the ENTE's effects when it reduces future adjusted covered taxes may not result in a future tax obligation. This is because the ENTE, in the year in which it actually reduces covered taxes, may still not reduce the GloBE ETR below the minimum rate. Therefore, we do not believe that the establishment of an ENTE creates a present obligation or the need to record a noncurrent tax liability in the year in which the ENTE is generated. Rather, the entity would record the impact of the ENTE if or when the ENTE results in an increase in top-up tax.

[11] Article 4.1.5 states, "In a Fiscal Year in which there is no Net GloBE Income for a jurisdiction, if the Adjusted Covered Taxes for a jurisdiction are less than zero and less than the Expected Adjusted Covered Taxes Amount the Constituent Entities in that jurisdiction shall be treated as having Additional Current Top-up Tax for the jurisdiction under Article 5.4 arising in the current Fiscal Year equal to the difference between these amounts. The Expected Adjusted Covered Taxes Amount is equal to the GloBE Income or Loss for a jurisdiction multiplied by the Minimum Rate."

[12] See Section 2.7 of the February 2, 2023, administrative guidance on the GloBE rules.

Topic 7: Disclosure Considerations

Question 7.1

Are there incremental footnote disclosure requirements specific to Pillar Two taxes?

Answer

While ASC 740 does not explicitly require entities to disclose new tax laws, disclosure may be appropriate in certain circumstances. For example, ASC 740-10-50-12 requires entities to disclose the nature and effect of any significant matters affecting comparability of information for all periods, if not otherwise evident.

Question 7.2

Are there required MD&A disclosures specific to Pillar Two?

Answer

SEC Regulation S-K, Item 303(a),[13] requires entities to provide certain forward-looking information related to "material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition." Accordingly, entities should consider disclosing, when material, the anticipated future impact of newly enacted laws, as well as those expected to be enacted (e.g., laws conforming with the Pillar Two framework), on their results of operations, financial position, liquidity, and capital resources. Such impacts include, but are not limited to, expected increases in income tax expense as a result of newly enacted tax laws, any corresponding increase in cash outflows related to increases in income taxes, and the anticipated results of any restructuring activities initiated as a result of the newly enacted legislation.

Topic 8: Separate Financial Statements

[Added April 15, 2024]

Within this topic, the "separate financial statements" refer to both separate company financial statements as well as the consolidated financial statements of a subgroup of an MNE. Because the income on which a top-up tax is calculated may be outside the subgroup or the separate company, the accounting for the top-up tax may be different from the accounting reflected in the consolidated financial statements.

Question 8.1

If an entity included in separate financial statements pays a top-up tax under an IIR related to the income of an LTCE subsidiary that is also included in such separate financial statements, is the top-up tax within the scope of ASC 740 for the purposes of separate financial statements?

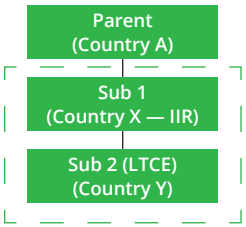
Answer

Yes, the IIR is within the scope of ASC 740 in separate financial statements that include both the payor of the top-up tax and the LTCE subsidiary. In a manner similar to the discussion in Question 1.1, because the IIR is based on a measure of income included in the separate financial statements, the IIR is within the scope of ASC 740.

[13] SEC Regulation S-K, Item 303(a), "Management's Discussion and Analysis of Financial Condition and Results of Operations: Objective."

Example

Sub 1 issues separate financial statements and consolidates Sub 2, which is an LTCE. The dotted lines below delineate the scope of the separate financial statements.



Because the income of Sub 2 is reported in Sub 1's separate financial statements, the tax due under Country X's IIR is accounted for in accordance with ASC 740 for the purposes of separate financial statements.

Question 8.2

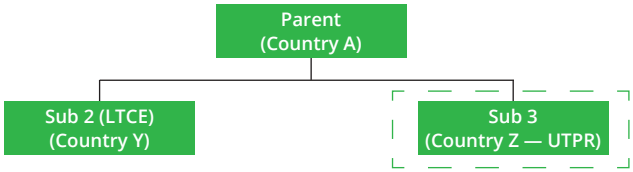
If an entity included in separate financial statements pays a top-up tax under a UTPR related to income of an LTCE that is not included in the separate financial statements, is the top-up tax within the scope of ASC 740 for the purposes of separate financial statements?

Answer

In this case, the taxes due under the UTPR would generally be outside the scope of ASC 740 for the purposes of separate financial statements because the top-up tax is not based on income included in the separate financial statements.

Example

Sub 3 issues separate financial statements. Country Z has enacted a UTPR. Country A and Country Y have not enacted an IIR or a QDMTT, respectively. Accordingly, Sub 2's income is subject to tax under Country Z's UTPR (Sub 3 is not required to pay a top-up tax on Country A's income because Jurisdiction A's GloBE ETR exceeds the minimum rate). The dotted lines below delineate the scope of the separate financial statements.



Because the income of Sub 2 is not reported in Sub 3's separate financial statements, the top-up tax that Sub 3 pays under Country Z's UTPR is accounted for outside the scope of ASC 740 for the purposes of separate financial statements

Question 8.3

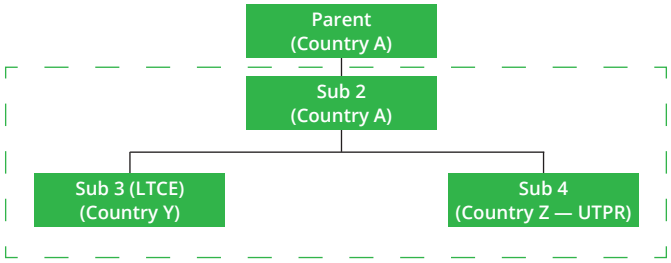
If the LTCE and the entity required to pay the UTPR are both included in the same set of separate financial statements, would the tax due under the UTPR be within the scope of ASC 740 for the purposes of separate financial statements?

Answer

In a manner similar to the discussions in Questions 1.2 and 8.1, if both the LTCE and the entity obligated to pay the UTPR are included in the same set of separate financial statements, the UTPR is within the scope of ASC 740 for the purposes of separate financial statements.

Example

Sub 2 issues separate financial statements and consolidates Subs 3 and 4. Country A and Country Y have not implemented an IIR or QDMT, respectively; however, Country Z has enacted a UTPR under which Sub 4 is required to pay a top-up tax on Sub 3's income. (Sub 4 is not required to pay a top-up tax on Country A's income because Jurisdiction A's GloBE ETR exceeds the minimum rate.) The dotted lines below delineate the scope of the separate financial statements.



Because Sub 2 consolidates Subs 3 and 4, both the income and the tax are reported in the separate financial statements of Sub 2. As a result, in this scenario, Sub 2 would account for the tax paid under Country Z's UTPR within the scope of ASC 740 in the separate financial statement in the same manner as a UPE would report the taxes due under the UTPR as tax expense in the consolidated financial statements.

Question 8.4

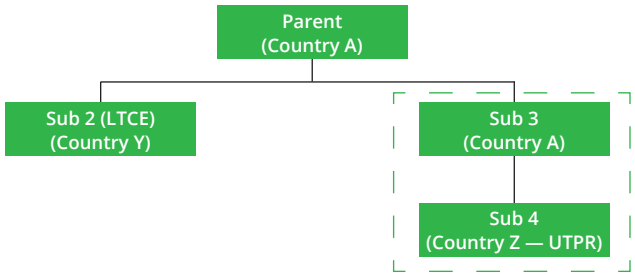
If a UTPR is not within the scope of ASC 740, as discussed in Question 8.2, how should an entity account for the tax due under a UTPR in the separate financial statements?

Answer

If a tax due under a UTPR is outside the scope of ASC 740 in the separate financial statements, we believe that the payment is deemed to be made on behalf of the parent because the tax due under the UTPR is a result of the parent entity's organizational structure (i.e., if not for the parent's investment in affiliated entities, the reporting entity would have no liability). As a result, we believe that this amount, although paid by an entity included in the separate financial statements, does not represent a cost of the separate financial statement group's business and may be reflected as an equity transaction.

Example

Sub 3 issues separate financial statements and consolidates Sub 4. Country A and Country Y have not implemented an IIR or QDMTT, respectively; however, Country Z has enacted a UTPR under which Sub 4 is required to pay a top-up tax on Sub 2's income (Sub 4 is not required to pay a top-up tax on Country A's income because Jurisdiction A's GloBE ETR exceeds the minimum rate.) The dotted lines below delineate the scope of the separate financial statements.



Because the income on which the UTPR is calculated is outside the scope of Sub 3's separate financial statements, the UTPR is outside the scope of ASC 740 in the separate financial statements. Accordingly, we believe that the payment is made on behalf of the parent and may be reflected through equity in Sub 3's separate financial statements.

Question 8.5

If a top-up tax due under an IIR, a UTPR, or a QDMTT is determined to be within the scope of ASC 740 in the separate financial statements, is deferred tax accounting required in the separate financial statements?

Answer

IIR/UTPR

In a manner consistent with the discussion in Question 1.4, a tax due under an IIR or a UTPR is an AMT, and DTAs and DTLs would not be recognized or adjusted for the estimated future effects of the minimum tax.

QDMTT

In a manner similar to the discussion in Question 1.4, in circumstances in which a QDMTT is consistent with the GloBE rules, the QDMTT may qualify as an AMT and be accounted for as such (i.e., no deferred tax accounting). We believe that a question continues to exist, however, related to whether a QDMTT could still be considered an AMT in situations in which the jurisdiction does not have an existing domestic income tax aside from a QDMTT (e.g., there is no parallel tax system). If it is determined that the QDMTT does not qualify as an AMT, deferred tax accounting may be appropriate. Consultation with an entity's accounting advisers is encouraged.

Question 8.6

An LTCE may be included in separate financial statements and have an agreement to reimburse, for taxes due under an IIR or a UTPR related to the income of the LTCE, a parent or brother/sister entity that is not included in the separate financial statements. Should the LTCE record the amount due to the parent or brother/sister entity as income tax expense in the separate financial statements?

Answer

No. In this case, the amounts due under the intercompany arrangements should not be accounted for as an income tax expense within the scope of ASC 740 in the separate financial statements. The entity in the low-tax jurisdiction has no liability for the top-up tax because the top-up tax is levied on an entity that is excluded from such separate financial statements. Therefore, any amounts due as a result of an agreement between the LTCE and entities not included in the separate financial statements should not be considered an income tax in the separate financial statements.

Contacts

Matt Himmelman
Audit & Assurance
Partner
Deloitte & Touche LLP
+1 714 436 7277
mhimmelman@deloitte.com

Patrice Mano
Partner
Deloitte Tax LLP
Washington National Tax
+1 415 783 6079
pmano@deloitte.com

Krystle Kort
Partner
Deloitte Tax LLP
Washington National Tax
+1 415 783 6917
kkort@deloitte.com

Marla Lewis
Audit & Assurance
Partner
Deloitte & Touche LLP
+1 203 708 4245
marlalewis@deloitte.com

Christina Benvenuti
Audit & Assurance
Senior Manager
Deloitte & Touche LLP
+1 469 417 2349
cbenvenuti@deloitte.com

Dbriefs for Financial Executives

We invite you to participate in Dbriefs, Deloitte's live webcasts that give you valuable insights into important developments affecting your business. Topics covered in the Dbriefs for Financial Executives series include financial reporting, tax accounting, business strategy, governance, and risk. Dbriefs also provide a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to Dbriefs, or to receive accounting publications issued by Deloitte's Accounting and Reporting Services Department, please visit My.Deloitte.com.

The Deloitte Accounting Research Tool

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and powerful search features that enable users to quickly locate information anytime, from any device and any browser. Users can also work seamlessly between their desktop and mobile device by downloading the DART by Deloitte mobile app from the App Store or Google Play. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. DART subscribers and others can also subscribe to *Weekly Accounting Roundup*, which provides links to recent news articles, publications, and other additions to DART. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.

Download the DART by Deloitte Mobile App

Download on the App Store

GET IT ON Google Play

Follow us @DeloitteAcctg