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Technical Line

Accounting considerations for the global minimum tax under the Pillar Two GloBE model rules

In this issue:

What you need to know

- The Pillar Two Global Anti-Base Erosion (GloBE) model rules of the Organisation for Economic Co-operation and Development (OECD) define the scope and mechanics of a 15% global minimum tax, which is based primarily on financial reporting amounts with certain adjustments.
- Several OECD member countries have enacted tax legislation based on the GloBE rules with effective dates as early as 1 January 2024.[1] Additional countries have drafted legislation or announced an intent to implement legislation based on the GloBE rules.
- In response to a technical inquiry, the FASB staff said it believes that the GloBE minimum tax is an alternative minimum tax (AMT), as discussed in ASC 740. Because the tax in the GloBE rules is an AMT, companies will need to consider the effects beginning in the period that includes the date the laws are effective.

Overview

The OECD's Pillar Two GloBE rules issued under the OECD Inclusive Framework on Base Erosion and Profit Shifting introduce a global minimum tax of 15% to multinational enterprise (MNE) groups with consolidated financial statement revenue in excess of EUR750 million.[2]

Under the GloBE rules, an MNE group would be required to determine a combined effective tax rate for all entities located in a jurisdiction. When the combined entities' jurisdictional effective tax rate (ETR) is less than 15%, a top-up tax generally will be due to bring the jurisdictional effective tax rate to 15%.

Building a better working world

Entities located in a jurisdiction that has enacted the rules will need to determine whether the minimum tax is due for all jurisdictions where the MNE group (including the ultimate parent) operates. The model rules provide three distinct charging provisions to determine which entities are obligated to pay the top-up tax if an MNE group operates in more than one jurisdiction that has enacted the rules. If the ultimate parent is located in a jurisdiction that has enacted the rules, it will generally be obligated to pay the top-up tax to its country of domicile.

Many OECD member countries have already enacted tax legislation based on the GloBE rules, and more are expected to do so in 2024. This includes countries that have enacted, or are expected to enact, a Qualified Domestic Minimum Top-up Tax (QDMTT) and an Income Inclusion Rule (IIR), both with effective dates as early as 1 January 2024, and an Undertaxed Payment Rule (UTPR), with effective dates as early as 1 January 2025.

All companies with multinational operations should monitor the status of legislation to implement the GloBE rules in countries where they operate.

This publication provides a high-level summary of the GloBE approaches and the accounting implications for entities that will be subject to the rules, including interim reporting considerations.

Companies with multinational operations should monitor the status of legislation to implement the GloBE rules in countries in which they operate.

The OECD has published GloBE Model Rules, GloBE Model Rules Commentary, GloBE Model Rules Examples and supplementary guidance, including safe harbor rules.[3] The OECD is expected to provide additional interpretive guidance to help entities apply the rules.

We have published a summary listing of administrative and legislative developments around the world relating to the implementation of the GloBE rules.[4] It includes an overview of developments in various jurisdictions, including the dates on which the relevant authorities, institutions or legislative bodies have made public announcements or released official documents related to the GloBE rules. The document is updated periodically with recent developments. We have also published an executive summary and discussion of the GloBE Model Rules, GloBE Model Rules Commentary and GloBE Model Rules Examples.[5]

Key aspects of the GloBE rules

The GloBE rules contain the following primary charging provisions to determine how the top-up tax is assessed and which entity in an MNE group will be obligated to pay it:

- A QDMTT is a minimum tax that mimics the impact of the GloBE top-up tax on a jurisdiction's domestic companies. If a country's legislation includes a QDMTT, the amount of QDMTT owed locally reduces any top-up tax otherwise incurred by the MNE group on the subsidiaries in that jurisdiction.
- An IIR imposes the top-up tax on a parent entity for a low-taxed foreign subsidiary or subsidiaries.
- An UTPR imposes a top-up tax generally through the elimination of deductions (or other adjustments) on certain MNE group entities if low-taxed income of an entity in the MNE group is not subject to top-up tax under an IIR (e.g., when the parent entity of a low-taxed subsidiary is located in a jurisdiction that has not enacted the GloBE rules). The top-up tax would be paid by any entity in the MNE group located in a jurisdiction that has adopted the UTPR, regardless of its relationship to the low-taxed entity.

The GloBE rules address how to determine which entity or entities in an MNE group are subject to tax under an IIR or UTPR and the portion of top-up tax that is charged to each relevant entity.

Five-step process for determining the GloBE minimum top-up tax

The top-up tax under the GloBE rules is calculated and applied at a jurisdictional level using the following five steps:

- **Step 1:** Identify MNE groups in the scope of the GloBE rules
- **Step 2:** Determine GloBE income or loss for each constituent entity
- **Step 3:** Determine adjusted covered taxes
- **Step 4:** Compute the effective tax rate and top-up tax
- **Step 5:** Determine application of IIR and UTPR

Step 1 — Identify MNE groups in the scope of the GloBE Rules

Important elements

- Apply the monetary threshold (EUR750 million) to the annual revenue of the ultimate parent entity (UPE).
- Identify constituent entities located in each jurisdiction (e.g., controlled foreign corporations, permanent establishments).
- Remove any excluded entities (e.g., nonprofit entities, pension funds).
- Identify the jurisdiction of each constituent entity.

For purposes of the GloBE rules, an MNE group is generally a group of entities that are related through ownership or control, located in more than one jurisdiction and included in the UPE's consolidated financial statements.

An MNE group is in scope of the GloBE rules if the annual revenue in the UPE's consolidated financial statements is EUR750 million or more for two out of the four fiscal years immediately preceding the current fiscal year. The GloBE rules also address situations when entities join or leave MNE groups during a fiscal year as a result of transfers of direct or indirect ownership interests in the relevant entity.

The rules also address how MNE groups should consider the impact of mergers and demergers when applying the EUR750 million consolidated revenue threshold to determine whether the rules apply to the MNE group in a particular fiscal year.

Step 2 — Determine GloBE income or loss for each constituent entity

Important elements

- Identify those entities qualifying for exclusion from the calculations by virtue of one of the OECD's country-by-country reporting safe harbors.[6]
- Determine financial accounting net income or loss for each remaining constituent entity located in each jurisdiction using the ultimate parent entity's basis for its consolidated financial statements.
- Adjust financial net income or loss to GloBE basis income or loss.

The starting point to determine the GloBE income or loss is the net income or loss of each constituent entity, not excluded by one of the safe harbor thresholds, used in preparing the consolidated financial statements of the UPE, before any consolidation adjustments eliminating intra-group transactions, determined by applying the accounting standards (e.g., US GAAP) used by the UPE. The net income or loss is adjusted for certain items, including excluded dividends, accrued pension expense, excluded equity gains or losses, gains or losses from disposition of certain assets and liabilities, and other items.

If a constituent entity's financial accounting net income or loss includes amounts attributable to permanent establishments or other flow-through entities located in a different jurisdiction from that of the constituent entity, the constituent entity's GloBE income or loss is adjusted by that amount. The GloBE income attributable to the permanent establishments or other flow-through entities is reallocated to the jurisdiction of the permanent establishments or other flow-through entities in the GloBE calculations.

Step 3 — Determine adjusted covered taxes

Important elements

- Identify covered taxes for each jurisdiction.
- Adjust covered taxes for deferred expense or (benefit) associated with certain temporary differences.
- Consider adjustment of the prior-year tax liability.

Adjusted covered taxes of a constituent entity for a fiscal year would include the current tax expense recognized in its financial accounting net income or loss for the fiscal year adjusted by the net amount of certain additions and reductions (such as uncertain tax positions), total deferred tax expense/benefit, and any increase or decrease for taxes recorded in equity or other comprehensive income relating to GloBE income or loss that is subject to tax under local tax rules.

The GloBE rules limit the total deferred tax expense or benefit used in the calculation of adjusted covered taxes. When determining the deferred tax expense to be included in covered taxes, the amount reflected in the financial statements is adjusted to remeasure the deferred tax expense or benefit using a maximum rate of 15%. This deferred tax expense amount is also subject to several exclusions and adjustments.

Similar to the adjustment to GloBE income discussed above in Step 2, if a constituent entity's financial accounting net income or loss includes covered taxes attributable to permanent establishments or other flow-through entities located in a different jurisdiction from the constituent entity, the constituent entity's covered taxes are reduced by that amount, and the covered taxes of the permanent establishments or flow-through entities are reallocated to the jurisdiction of the permanent establishments or flow-through entities.

Additionally, other taxes recognized by a constituent entity that are more directly related to the income of another constituent entity under a controlled foreign company tax are allocated to the covered taxes of that other constituent entity (e.g., taxes paid by a US corporation under global intangible low-taxed income (GILTI) or Subpart F).

Step 4 — Compute GloBE excess profit, ETR and top-up tax

Important elements

- Compute GloBE effective tax rate.
- Compute GloBE excess profit.
- Compute jurisdictional top-up tax for low-taxed jurisdictions.
- Allocate top-up tax between low-taxed constituent entities.

The GloBE ETR for a jurisdiction is equal to the sum of adjusted covered taxes of each entity located in the jurisdiction, divided by the net jurisdictional GloBE income. If the calculated GloBE jurisdictional ETR is less than 15%, a top-up tax may apply.

The top-up tax for a jurisdiction is the difference between 15% and the GloBE ETR in that jurisdiction, multiplied by the excess profit in that jurisdiction. The excess profit is the total jurisdictional GloBE income, less a substance-based income exclusion. The substance-based income exclusion provides an adjustment for a fixed return on certain tangible assets and a percentage of payroll costs in the specific jurisdiction. The jurisdictional top-up tax would be reduced by any tax payable pursuant to a QDMTT if implemented by the jurisdiction.

The resulting jurisdictional top-up tax is then allocated among the constituent entities located in the low-tax jurisdiction based on the ratio of each constituent entity's GloBE income for the fiscal year to the sum of the GloBE income of all constituent entities in the jurisdiction that have positive GloBE income for the fiscal year.

Step 5 — Determine the payment of the top-up tax by applying the QDMTT, IIR and UTPR

Important elements

- Determine amounts to be paid to the constituent entity's jurisdiction under a QDMTT.
- Identify the parent entity liable for top-up tax under an IIR.
- Determine the amount of top-up tax paid by the parent entity under an IIR (i.e., excess due over QDMTT paid at the jurisdictional level).
- Identify any remaining amounts that are allocable under a UTPR.
- Determine the UTPR adjustment.

In applying an IIR, a direct or indirect parent entity pays its allocable share of any top-up tax with respect to a low-taxed constituent entity in excess of any QDMTT paid by the low-taxed constituent entity. The IIR operates on a top-down approach, starting with the UPE. If the UPE is not located in a jurisdiction that has implemented an IIR, the highest parent entity in the ownership chain located in a jurisdiction that has implemented an IIR would pay its allocable share of the top-up tax after subtracting any QDMTT paid at the lower tier entities. An exception to the top-down approach applies in certain split-ownership situations. The GloBE rules also address situations where there is a noncontrolling shareholder in the ownership chain of the MNE group.[7]

The UTPR generally imposes a top-up tax by denying deductions or other adjustments if the low-taxed income of an entity in the MNE group is not subject to top-up tax under either a QDMTT or an IIR. This may be the case when the jurisdiction in which an entity's parent operates has not enacted GloBE rules, but the jurisdiction of a brother/sister entity in the group has enacted a UTPR. Constituent entities are generally denied a deduction (or required to make an equivalent adjustment) resulting in an additional cash tax expense for the amount of the UTPR top-up tax allocated to that jurisdiction. In the UPE's jurisdiction that has enacted an IIR, the UTPR generally does not result in additional top-up tax, unless the UPE's jurisdictional ETR is below 15%.

Additionally, in July 2023 the OECD issued a safe harbor exclusion from the UTPR top-up tax of subsidiary jurisdictions that would otherwise be collected on the income of a parent entity in jurisdictions which have yet to enact the GloBE rules. The exclusion applies only to income of parent entities in jurisdictions which have statutory tax rates of 20%.

Thus, a constituent entity in a jurisdiction which has enacted a UTPR having a parent entity in a jurisdiction with a statutory rate of below 20% will trigger a top-up tax on that parent's income to be collected in the jurisdiction of the constituent subsidiary. The 20% safe harbor exclusion applies through the 2026 tax year, at which time all OECD member countries are expected to have enacted their GloBE rules, including appropriate IIR and QDMTT provisions.[8]

When constituent entities of an MNE group are not directly subject to the GloBE rules, the IIR and UTPR would be levied on them in jurisdictions that have enacted either the IIR or the UTPR. Thus, a constituent entity having no ownership in a lower-tier entity that has a calculated jurisdictional ETR below 15% could end up being the payor of any related top-up tax.

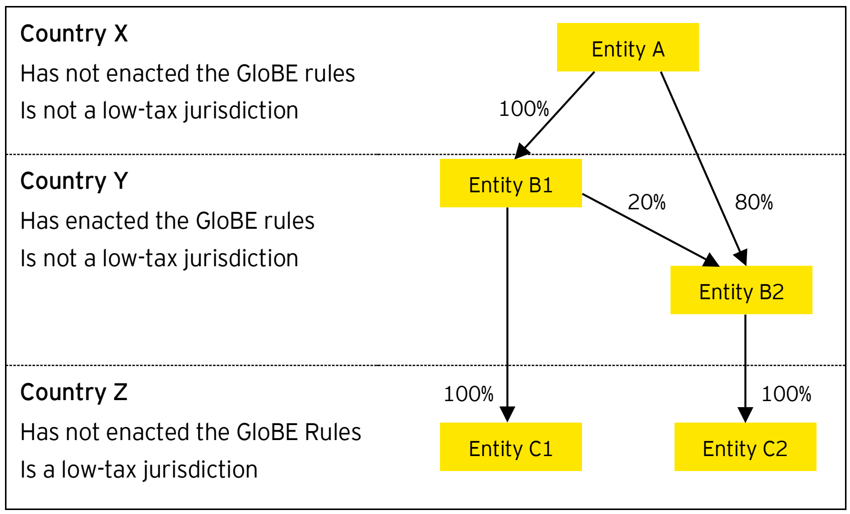
The following illustration demonstrates how the GloBE minimum tax may be determined in an MNE group.

> The UTPR imposes a top-up tax by denying deductions or other adjustments if the low-taxed income of an entity in the MNE group is not subject to a top-up tax under an IIR.

Illustration: Application of the GloBE rules to an MNE group

Facts

- The diagram below illustrates the structure and location of the members of ABC Group, which is an MNE group:



- ABC Group has consolidated revenues in excess of EUR750 million.
- All entities are constituent entities subject to the GloBE Rules.
- Entities A, B1 and B2 have GloBE ETRs above 15%.
- Entities C1 and C2 do not qualify for one of the safe harbor exceptions and collectively have a jurisdictional GloBE ETR below 15% (i.e., they are low-tax entities).
- Only Country Y has enacted an IIR.
- Assume that the MNE group does not have any substance-based income exclusions, and therefore, excess profit equals GloBE income.
- For simplicity, only those entities located in the low-tax jurisdiction are subject to the top-up tax; so, throughout this illustration, GloBE income and covered taxes are provided only for those constituent entities.

Analysis

The analysis of the GloBE rules and their application to the MNE group involve the following steps.

Step 1: Identify the MNE groups in the scope of the GloBE rules

Entity A, located in Country X, is the UPE of the consolidated group (ABC Group). ABC Group has determined that it is an MNE group within the scope of the GloBE Rules.

Accordingly, it has identified its constituent entities and their locations as illustrated above. Using a top-down approach, Entities B1 and B2 are identified as the highest-level entities in the ownership chain operating in a jurisdiction that has implemented the GloBE rules. Thus, these entities are required to determine the amount of top-up tax due for any low-tax jurisdictions included in the group.

Step 2: Determine GloBE income or loss for each constituent entity

ABC Group has determined GloBE income for each of the constituent entities in the group based on the financial reporting net income with GloBE adjustments.

GloBE income is $600 for Entity C1 and $1,800 for Entity C2.

Step 3: Determine adjusted covered taxes

ABC Group has computed adjusted covered taxes as determined under the GloBE rules for each of the constituent entities in the group.

Adjusted covered taxes are $30 for Entity C1 and $240 for Entity C2. Adjusted covered taxes include current taxes payable adjusted for deferred tax expense.

Step 4: Compute GloBE excess profit, ETR and top-up tax

The GloBE ETR of the entities located in Country Z is 11.25% (i.e., total adjusted covered taxes of $270 for Entities C1 and C2 ($30 + $240) divided by total GloBE income of $2,400 for Entities C1 and C2 ($600 + $1,800).

Therefore, the Country Z top-up tax rate is 3.75% (i.e., 15% less ETR of 11.25%), and the Country Z top-up tax is $90 (i.e., total GloBE income of $2,400 for Entities C1 and C2 ($600 + $1,800) multiplied by the top-up tax rate (3.75%)). If there were substance-based exclusions available, the exclusion amount would reduce the amount of GloBE income used to determine the amount of the top-up tax.

The Country Z top-up tax is allocated to the Country Z constituent entities C1 and C2 based on the ratio of each entities' GloBE income to total Country Z GloBE income. Therefore, Entity C1 is allocated $22.50 equal to 25% (i.e., ($600 / $2,400)) of total Country Z top-up tax, and Entity C2 is allocated $67.50 equal to 75% (i.e., ($1,800 / $2,400)) of total Country Z top-up tax.

Step 5: Determine the entities liable for payment of the top-up tax under the IIR and/or UTPR

Because only Country Y has introduced a qualifying IIR, the intermediate parent entities B1 and B2 are required to pay any top-up taxes. (Because all entities located in low-tax jurisdictions have parent entities that have implemented the IIR, the UTPR rules are not applicable in this illustration.)

Entity B1 is liable for, and will pay, 100% of the Country Z top-up tax attributable to its wholly owned subsidiary, Entity C1 (i.e., $22.50 determined in Step 4 above). Entity B1 is also liable for 20% of the top-up tax attributable to Entity C2 based on its 20% indirect ownership interest in Entity C2 through Entity B2. The top-up tax attributable to Entity B1's ownership interest in Entity C2 is $13.50 (i.e., 20% of $67.50).

Entity B2 is liable for, and will pay, 100% of the Country Z top-up tax attributable to its wholly owned subsidiary Entity C2 (i.e., $67.50 determined in Step 4 above).

Because Entity B2 is paying 100% of the top-up tax attributable to Entity C2 (i.e., $67.50), and Entity B1 is also liable for top-up tax attributable to its indirect ownership of Entity C2, without relief, the top-up tax attributable to Entity B1's indirect 20% ownership interest in Entity C2 would be paid twice. To prevent double taxation, the GloBE rules allow for an offset of taxes paid by intermediate parent entities in the MNE group. Therefore, Entity B1 reduces its top-up tax payable by $13.50 (i.e., 20% of $67.50), which is the top-up tax attributable to its indirect ownership in Entity C2 that will be paid by Entity B2.

Key accounting considerations

Applicability of ASC 740 to GloBE taxes

Accounting Standards Codification (ASC) 740 applies to taxes that are based on income. Since the top-up taxes imposed by the GloBE rules are based on income (taxable GloBE income less expenses) in an MNE group's consolidated financial statements, the taxes imposed by the GloBE rules are income taxes and, thus, in the scope of ASC 740. There are additional scoping considerations for subsidiaries that report on a standalone basis. Refer to the Standalone entity reporting section below.

Enactment dates

ASC 740 does not specify how to determine the enactment date of tax legislation. However, the enactment date is when all steps in the process for legislation to become law have been completed. MNE groups should continue to monitor when legislation implementing the GloBE rules is enacted in the jurisdictions where they operate either through wholly or partially owned subsidiaries, joint ventures, flow-through entities or permanent establishments. Different countries enacted the GloBE rules on different dates, and the provisions of the laws vary. As enactment of the GloBE rules continues, there will be additional complexity in accounting for the income tax effects.

Accounting for GloBE model rules top-up taxes

The GloBE rules establish a system of top-up taxes that intends to bring the combined effective tax rate for all entities within the consolidated MNE up to a minimum tax rate of 15%. The tax is determined on a jurisdictional basis rather than a typical direct tax on an individual entity's taxable income.

Because the determination of which entities in an MNE group are obligated to pay the top-up taxes will depend on facts and circumstances (i.e., the jurisdictions in which an entity operates and how they enact their tax laws to implement the GloBE rules), the entity that pays the top-up tax could be, among others, (1) the entity or entities located in the low-tax jurisdiction that implemented the rules, (2) a direct or indirect parent, including the UPE, or (3) an affiliated entity of the low-tax entity or entities in the consolidated reporting group.

ASC 740 does not explicitly address the accounting for income taxes based on a system like the one proposed in the GloBE rules and does not have clear guidance on how to determine whether certain adjustments to financial reporting income made to arrive at GloBE taxable income and GloBE adjusted covered taxes represent temporary differences or whether the top-up taxes are akin to taxes levied in an AMT system.

In response to a technical inquiry, the staff of the Financial Accounting Standards Board (FASB) said[1] it believes the minimum tax in the GloBE rules is an AMT, as discussed in ASC 740, and that entities should apply the guidance in ASC 740 on accounting for AMTs to taxes imposed under the GloBE rules. The staff believes the GloBE minimum tax should be viewed as a separate but parallel tax system that is imposed to make sure certain taxpayers pay at least a minimum amount of income tax.

The FASB staff believes the minimum tax in the GloBE rules is an AMT as discussed in ASC 740.

In its response, the FASB staff cited ASC 740-10-30-10 through 30-12 and 740-10-55-31 and 55-32, acknowledging that those paragraphs address accounting for an AMT and require an entity to measure deferred taxes using the statutory tax rate under the regular tax system. ASC 740-10-30-11 states:

> "… [I]t would be counterintuitive if the addition of alternative minimum tax provisions to the tax law were to have the effect of reducing the amount of an entity's income tax expense for financial reporting, given that the provisions of alternative minimum tax may be either neutral or adverse but never beneficial to an entity."

Therefore, any incremental tax an entity incurs under the GloBE rules would be recognized in the period it arises, and deferred tax assets and liabilities would not be recognized or adjusted for the estimated future effects of the minimum tax.

How we see it

Because a country may enact tax laws that differ from the GloBE rules, entities will need to evaluate provisions of laws enacted in each jurisdiction to determine whether they are consistent with the GloBE model rules to apply the accounting indicated by the FASB staff. Countries may also enact other changes to their corporate income tax laws at the same time they enact the GloBE model rules. Entities will need to analyze new tax laws to determine whether other law changes are required to be recognized in the period of enactment separately from Pillar Two. For example, entities will need to carefully evaluate whether a QDMTT enacted in a jurisdiction that does not have an existing corporate income tax regime is an AMT.[2]

Impact of GloBE taxes on realizability of existing deferred tax assets, operating loss carryforwards and tax credit carryforwards

As discussed above, ASC 740 requires deferred taxes to be measured using the regular tax rate, not the AMT rate, since the minimum tax in the GloBE rules is an AMT under ASC 740. See section 5.5, *Alternative minimum tax*, of our Financial reporting developments (FRD) publication, ***Income Taxes***, for more information.

If an entity expects to be subject to GloBE taxes in the future, the economic value of deductible temporary differences, operating loss carryforwards and tax credit carryforwards may be reduced through future payment of GloBE taxes. Although ASC 740 requires deferred taxes to be measured at the regular tax rate, it does not address whether an entity should consider the effects of being subject to an AMT in the future when evaluating the need for, and the amount of, valuation allowances on deferred taxes.

Regarding the US corporate alternative minimum tax (CAMT), the FASB stated in 2022 that it believes an entity can make an accounting policy election to either consider the effect of the CAMT system when evaluating the need for, and the amount of, a valuation allowance or account for the effects on deferred taxes, including carryforwards and tax credits, in the period they arise. See section 6.9, *Effect of AMT on deferred tax assets*, of our FRD, ***Income Taxes***, for more information.

We believe that an entity can make a similar policy election regarding the Pillar Two tax system. That is, an entity can elect to either consider the effects of GloBE taxes when evaluating the need for, and the amount of, a valuation allowance on existing deferred tax assets, or account for the effects on deferred taxes in the period they arise.

If an entity elects to consider the effect of GloBE taxes when evaluating realizability of deferred tax assets, we believe that it would be acceptable to perform this assessment on a jurisdiction-by-jurisdiction basis as each country enacts its own QDMTT tax regime (i.e., a jurisdictional approach). An alternative approach would be to incorporate the effects that all the GloBE model rule charging provisions will have on the realizability of each jurisdiction's deferred tax assets based on all enacted GloBE taxes (IIR, UTPR and QDMTT) (i.e., a global approach). While we believe a global approach would also be acceptable, entities should be aware of potential complexities in executing it, especially for those with operations in many different jurisdictions.

In summary, we believe that the following approaches are acceptable for the treatment of GloBE taxes when assessing the realizability of deferred tax assets: (1) account for the deferred tax effects of GloBE taxes in the period they arise, (2) consider GloBE taxes in valuation allowance evaluations using a jurisdictional approach or (3) consider GloBE taxes in valuation allowance evaluations using a global approach. We believe that the approach selected is an accounting policy election that should be applied consistently.

Measurement of prepaid tax on intercompany sales or transfers of inventory

When intercompany sales of inventory occur, and the inventory remains within the consolidated group as of period end, ASC 740-10-25-3(e) provides an exception to recognizing the deferred income taxes for the difference between the tax basis of inventory in the buyer's jurisdiction and the carrying amount reported in the consolidated financial statements. Further, ASC 810-10-45-8 provides that no tax effect should be recognized in earnings for income taxes paid on intra-entity profits on inventory remaining in the consolidated group.

We believe a with-and-without approach (that is, the intercompany profit should be considered the last item to enter into the seller's computation of taxes payable in the period of the sale) should generally be used to measure the amount of taxes paid related to the intercompany inventory sale. Such amount should be recorded as a prepaid (accrued) tax. See section 3.2.2.1, *Measurement of prepaid tax on intercompany sales or transfers of inventory*, of our FRD, ***Income Taxes***, for more information.

The elimination of intercompany inventory sales in the with-and-without calculation may have an impact on the GloBE taxes calculated. For example, the elimination of an intercompany inventory sale may result in the combined ETR of all entities in a seller's jurisdiction to increase to above 15% or decrease to below 15%.

Questions have arisen regarding how to incorporate GloBE tax effects from an intercompany inventory sale into the accounting requirements of ASC 740-10 and ASC 810-10. We believe companies will need to consider the effect of GloBE taxes paid related to intra-entity profits on inventory remaining within the consolidated group in determining the measurement of the prepaid (accrued) tax under the with-and-without method. We generally believe that any GloBE taxes paid by the seller (e.g., due to a QDMTT GloBE tax paid) should be included in the measurement of the prepaid (accrued) tax.

Companies that prepare interim financial statements should generally consider enacted legislation, including any enacted GloBE rules, which is effective or will become effective during the fiscal year, when determining their EAETR.

We believe companies will need to develop an approach to determine how they will incorporate GloBE taxes paid by other entities in the consolidated group (through IIR or UTPR) in the with-and-without measurement to determine the prepaid (accrued) tax. One approach would be to include all the indirect effects of the intra-company transaction, including the effect of all IIR and UTPR top-up taxes paid by other constituent entities. Another approach may be to exclude GloBE IIR and UTPR taxes paid by entities other than the seller in the measurement of the prepaid tax. Other approaches may also be acceptable. Entities should evaluate the effects of GloBE taxes and apply the approach they chose consistently to intra-entity inventory transactions. Any other indirect effects of GloBE taxes a company incorporates in its with-and-without calculation should be consistently applied.

Deferred tax liability (DTL) recapture

Article 4.4.4 of the Pillar Two GloBE model rules requires entities to recapture certain deferred tax liabilities if such amount is not paid within five subsequent fiscal years. The recapture rule requires entities to recompute the GloBE effective tax rate (ETR) for the year in which the DTL arose (i.e., year 1 of the existence of the DTL) to assess whether additional top-up tax is needed. If the DTL is paid subsequently (after the five fiscal years), adjusted covered taxes in that year are increased by the amount of the previously recaptured DTL.

As a result of the DTL recapture provision, the timing of recognition of liability for top-up tax should be included in the GloBE computation upfront in year 1 of the DTL's existence based on the amount it expects to pay upon recapture. If recapture is expected, we believe that a liability exists, and the entity has an obligation to make a payment in the period the DTL arises, as the DTL is expected to be recaptured (provided that the entity does not intend to sell or otherwise dispose of its assets). This will result in incremental tax to be paid. The entity should record a noncurrent tax liability in the year in which the DTL arises in the amount it expects to pay upon recapture. The nonconcurrent tax liability should be adjusted if new information arises at a later period indicating the DTL will reverse within the five subsequent fiscal years (such as an asset that becomes held for sale).

Interim reporting considerations

ASC 740-270 requires entities to compute interim income tax expense by applying an estimated annual effective tax rate (EAETR) to interim ordinary income. The income tax effects from activity not classified as ordinary income (e.g., significant unusual or infrequently occurring items) are not included in the EAETR calculation and instead are discretely reported in the interim period. There are additional considerations for foreign jurisdictions with ordinary losses and enactment of tax legislation that impacts prior period taxes payable (or receivable) and existing deferred tax balances. See chapter 20, *Interim Reporting*, of our FRD, ***Income Taxes***, for a comprehensive overview of interim reporting requirements under ASC 740-270.

Companies that prepare interim financial statements should generally consider enacted legislation, including any enacted GloBE rules, which is effective or will become effective during the fiscal year, when determining their EAETR. This is necessary when estimating the amount of GloBE taxes a company anticipates paying based on GloBE taxes that are effective during the year. Questions have arisen regarding the interim accounting treatment of GloBE taxes in certain situations, particularly as it relates to jurisdictions with ordinary losses and significant unusual or infrequently occurring items.

Jurisdictions with ordinary losses

ASC 740-270-30-36 indicates if an entity anticipates an ordinary loss for the fiscal year or incurs an ordinary loss for the year-to-date period for which a tax benefit cannot be realized in accordance with ASC 740, the entity should exclude the ordinary income (loss) in that jurisdiction and the related tax (benefit) from the overall computations of the estimated annual effective tax rate (EAETR) and interim period tax (benefit). See section 20.2, *Operations taxable in multiple jurisdictions*, of our FRD, ***Income Taxes***, for more information.

Taxes based on the Pillar Two GloBE model rules may be paid in a different jurisdiction than the jurisdiction triggering the top-up tax under the IIR or UTPR mechanisms. This raises the question about how Pillar Two GloBE taxes should be treated for interim reporting when the Pillar Two GloBE tax liability is incurred by a loss-making entity (via an IIR or UTPR) that is excluded from the overall EAETR calculation in accordance with ASC 740-270-30-36, but the ordinary income of the low-taxed entity triggering the GloBE tax is included in the overall EAETR calculation.

We believe there are two acceptable approaches to interim accounting for Pillar Two GloBE taxes that follow this fact pattern. The first is to include the Pillar Two GloBE taxes incurred by the loss-making entity in the overall EAETR calculation because the Pillar Two GloBE taxes owed are unrelated to the losses of the loss-making entity and, therefore, can be detached from the excluded losses in the calculation. The second is to exclude the Pillar Two GloBE taxes incurred by the loss-making entity from the overall EAETR calculation on the basis that all profit and loss items, including all income taxes incurred, of a loss-making entity are excluded from the overall EAETR.

We believe both approaches are acceptable. We believe that the approach selected is an accounting policy election that should be applied consistently.

Significant unusual or infrequently occurring items

ASC 740-270 requires the tax (or benefit) related to significant unusual or infrequently occurring items (i.e., activity not included in ordinary income) to be reported discretely in the relevant interim period. See section 20.6, *Tax (or benefit) applicable to significant unusual or infrequently occurring items, or discontinued operations*, of our FRD, ***Income Taxes***, for more information.

A significant unusual or infrequently occurring item may affect GloBE taxes, either in the same jurisdiction as the significant unusual or infrequently occurring item through a QDMTT or in a different jurisdiction through an IIR or UTPR. We believe the tax effects of a QDMTT paid in the same jurisdiction should be considered in determining the taxes related to the significant unusual item that is reported discretely in the interim period. We believe companies will need to develop an approach to either include or exclude IIR and UTPR taxes paid by other jurisdictions in the determination of the tax effect of the significant unusual item and apply the approach consistently.

Disclosure

There are no specific US GAAP Pillar Two footnote disclosure requirements. However, if the effect of the GloBE taxes materially affects an entity's financial results (e.g., material GloBE current tax expense, material impact on the effective tax rate), companies should provide disclosures to describe the impact.

Item 303 of Regulation S-K requires the disclosure in a registrant's management's discussion and analysis (MD&A) of material information relevant to an assessment of the financial conditions and results of operations. The MD&A discussion should focus on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be indicative of future operating results or financial condition.

This includes descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely to have a material impact on future operations based on management's assessment. Therefore, entities that file financial statements with the Securities and Exchange Commission should consider whether disclosure of the known or expected impact of the GloBE rules on their results of operations or financial condition is necessary in the MD&A disclosure.

Standalone entity reporting

As discussed above, the taxes imposed by the GloBE rules are income taxes and in the scope of ASC 740 in the consolidated financial statements of an MNE. A key factor in this determination is that the consolidated financials include operations and income taxes from both the entity triggering the GloBE tax and the entity liable for the GloBE tax. Standalone entity reporting requires further consideration, which will vary depending on the charging provision and actual payment of the GloBE tax.

Standalone entity reporting for the entity paying the GloBE tax

Qualified domestic minimum top-up tax (QDMTT)

The QDMTT is levied in the same jurisdiction as the income on which it is calculated. In essence, a QDMTT is a domestic AMT on income, and we believe it is within the scope of ASC 740 in the standalone financial statements of the entity liable for the QDMTT.

Income inclusion rule (IIR)

The IIR imposes the top-up tax on a parent entity for a low-taxed foreign subsidiary or subsidiaries. The standalone financial statements of the entity liable for the IIR is generally expected to include the income from the low-taxed subsidiary triggering the IIR, either through consolidation of the low-taxed subsidiary or accounting for the low-tax subsidiary as an equity method investment. Provided the standalone financial statements of the entity liable for the IIR includes the income from the low-taxed subsidiary triggering the IIR (either through consolidation or the equity method), we believe the IIR is within the scope of ASC 740 in the standalone financial statements of the entity liable for the IIR.

Undertaxed payments rule (UTPR)

A subsidiary in a jurisdiction that has enacted a UTPR will be subject to a tax liability to its jurisdiction on the income of other MNE group entities if those entities are low-taxed entities in jurisdictions within the MNE group that are not subject to the Pillar Two GloBE minimum tax rate of 15% under QDMTT or IIR provisions. The tax will be owed regardless of the subsidiary's relationship to the low-taxed entity.

In response to a technical inquiry, the FASB staff said it believes the entity liable to the jurisdiction imposing the UTPR tax should account for the tax as a liability for income taxes with a corresponding equity transaction, provided the standalone financial statements of the liable entity do not include the income of the low-taxed entity triggering the UTPR. The staff believes this view is consistent with allocating current and deferred taxes to each group member based on a separate return basis, as discussed in ASC 740-10-30-27.

The FASB staff also said that any uncertainties related to the recognition and measurement of tax positions related to the UTPR would be recorded within equity in the standalone financial statements of the liable entity in the same period and for the same amount as the uncertain tax position recorded by the ultimate parent entity (UPE) in the consolidated financial statements based on the UPE's analysis under ASC 740. The staff's view assumed the entity applied a separate return methodology to allocate income taxes and did not consider other methodologies. We believe a similar approach would be acceptable if an entity applied other allocation methodologies.

In addition, the FASB staff said that all terms and conditions of tax-sharing agreements should be considered in determining whether it is appropriate to record intercompany receivables and payables related to any UTPR liabilities. See section 17.5.3, *Standalone entity reporting when a tax-sharing agreement has been executed*, of our FRD, ***Income Taxes***, for further discussion related to standalone entity reporting when a tax-sharing agreement has been executed.

Standalone entity reporting of the low-taxed entity triggering top-up tax paid by another entity

Under the IIR and UTPR charging provisions of the GloBE rules, an entity may be liable for tax in its jurisdiction based on the GloBE ETR calculation for entities in another jurisdiction. A question, therefore, arises about whether the GloBE tax paid by the entity liable for the top-up tax should be allocated to the low-taxed entity triggering the top-up tax.

ASC 740-10-30-27 through 28 address the allocation of tax expense to separate standalone subsidiaries of a group that files a consolidated tax return. (See chapter 17, *Separate financial statements of a subsidiary*, of our FRD, ***Income Taxes***, for more information.) However, under GloBE rules, the entity in the low-tax jurisdiction triggering the top-up tax is not necessarily part of a consolidated tax return with the entity paying the top-up tax. Therefore, the rules regarding the allocation of tax expense to standalone subsidiaries of a group that files a consolidated tax return generally do not apply. Since the income tax should not be allocated to the low-taxed entity triggering the GloBE tax, we believe that it would not record income tax expense in its standalone financial statements.

Standalone entity reporting when a tax-sharing agreement has been executed

MNE groups may have tax-sharing arrangements that would obligate the entity triggering a top-up tax obligation to reimburse the entity paying it. We believe that the existence of tax-sharing agreements that reimburse GloBE taxes should not influence the accounting treatment of the GloBE tax in the standalone financial statements. The accounting for the reimbursements should generally be reflected in intercompany payable/receivable accounts and equity between the payor and payee entities.

Endnotes:

[1] Certain countries have enacted tax legislation based on Pillar Two model rules for tax years beginning on or after 31 December 2023.

[2] This test will always be a euro-denominated test with the revenue translated to euros from the reporting currency in the consolidated financial statements.

[3] https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm

[4] beps-2-0-pillar-two-developments-tracker.pdf (ey.com)

[5] https://www.ey.com/en_gl/tax-alerts/oecd-releases-commentary-and-illustrative-examples-on-pillar-two-model-rules

[6] On 22 December 2022, the OECD issued Transitional Country-by-Country Report (CbCR) Safe Harbor (TCSH) guidance exempting from additional top-up tax through 2026 constituent entities meeting certain safe harbor thresholds as evidenced by their existing CbCR. The details of the safe harbor tests and the requirements related to the CbCR reports used are outside the scope of this publication, but they should be taken into consideration.

[7] For example, the Partially-Owned Parent Entity rule, which is outside the scope of this publication.

[8] The 20% safe harbor exclusion protects US multinational UPEs from being taxed in a country that has enacted its UTPR rule since the US has not yet enacted GloBE rules. The US is expected to enact the GloBE rules in 2025.

[1] Tentative Board Decisions made on 1 February 2023 (fasb.org)

[2] Bermuda recently enacted a corporate tax that has certain consistencies with a QDMTT under the GloBE model rules. We believe the newly enacted tax is not an AMT under a parallel tax system because Bermuda did not have a corporate tax regime in place prior to enactment. The enacted Bermuda tax should be treated as the regular corporate tax rate.