KPMG

Global Minimum Tax

Financial Reporting Podcast Transcript

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Intro

Welcome to the KPMG Financial Reporting Podcast series, delivering fresh insights and perspectives around major accounting and financial reporting developments across a range of timely topics.

We thank you for joining today.

John Barbagallo

Hello, I'm John Barbagallo, a Managing Director at KPMG. And in today's episode, I have the pleasure of discussing the global anti base erosion rules or GloBE with two of my colleagues from KPMG, Jenna Summer, a Partner with Washington National Tax, and Matt Drucker, a Partner in our Department of Professional Practice. Jenna and Matt have been closely monitoring this new tax legislation and I want to thank them for joining us today to share their insights.

So, Jenna, let's start with you. The Organization for Economic Cooperation and Development, or OECD, introduced global rules to ensure that certain companies pay a global minimum tax. So, tell us, what is this global minimum tax and why did the OECD introduce this new tax in the first place?

Jenna Summer

Thanks, John. The Pillar Two global anti-base erosion rules referred to as either “globe” or “globe-e” were introduced as part of the OECD Base Erosion and Profit Shifting or BEPS framework and it was designed to address concerns about uneven profit distribution. The GloBE rules require certain large multinational groups, those groups that in which revenue exceeds €750,000,000 to incur a top-up tax on excess profits in any jurisdiction in which the effective tax rate is below the minimum rate of 15%.

Top-up tax differs from income taxes that arise under traditional tax regimes. Traditional income tax regimes are generally based on a company's taxable profit, while top-up tax will arise only if a group pays an insufficient amount of income taxes at a jurisdictional level.

The top-up tax may be implemented through an income inclusion rule, or IIR, or an undertaxed profits rule or UTPR. The model rules also provide for a qualified domestic minimum top-up tax, also referred to as QDMTT, a minimum tax imposed by a country to increase taxes within that jurisdiction.

These calculations will essentially be determined based upon a pretax income and the amount of taxes incurred on a jurisdictional level. During 2022, we saw advancements in the enactment of the GloBE rules and we're expecting countries to begin enacting legislation throughout 2023.

If a single jurisdiction in which the group operates and enacts changes to its tax laws, the entire group may be impacted. So just for instance, if a UTPR for any member of your group is enacted, it will bring in the entire group into the computation of and potentially being subject to the GloBE rules.

John Barbagallo

Yeah. Thanks, Jenna. You know, it seems like this tax is a bit different than the traditional tax regime, so tell us about some of the potential challenges companies will face when accounting for this top-up tax.

Jenna Summer

And that's absolutely right, John. This is not like the traditional tax regimes we've seen in the past that are going to be based on specific rates applied to taxable profit. So, it's definitely raised some questions from shareholders related to the scope under both US GAAP and IFRS, whether it actually creates additional temporary differences and whether those temporary differences should be recognized. And to that extent, companies may not know if they will be required to pay the incremental top-up tax until they do significant further analysis.

And finally, it may also bring in questions about what rate to use when measuring existing regular tax deferred taxes.

John Barbagallo

Yeah, thanks Jenna. Very helpful. You know, Matt, turning to you, Jenna just mentioned some of the potential challenges companies might face. So, getting into the accounting and we'll start with the US GAAP first, you know, have we landed on how companies are going to account for this global minimum tax under US GAAP?

Matt Drucker

Well, John, I think we actually have landed for US GAAP purposes, but let me give you a little bit of the history of it because it is fairly complicated. You know first as Jenna mentioned GloBE top-up tax is based on financial statement income with a few adjustments. And therefore, it is included in the scope of 740 for income tax accounting for consolidated financial statements. But 740 clearly did not anticipate and specifically address this type of regime.

And therefore, there was a number of questions in practice about whether or not you needed to record deferred taxes. How do you consider that? How do you look forward when you do that? So, a number of firms approached the FASB for a technical inquiry about how to deal with this under ASC 740. And at the FASB'S meeting on February 1st, the FASB staff discussed the inquiry that was received as it relates to deferred tax accounting and the GloBE top-up tax.

And in short, the staff believes that the top-up tax imposed under the GloBE rules is an alternative minimum tax because it is a separate but parallel tax system that is imposed on a company to pay a minimum level of tax. And because of this, that it's an AMT and AMT is defined in 740. The way it works is a company will not record specific deferred taxes or remeasure its existing deferred taxes under the regular regime but will instead recognize the incremental tax as incurred. So, in the year that the tax is going to be incurred and we won't be required to set up deferreds.

In addition, companies are not required to consider GloBE top-up tax in its valuation allowance or its existing deferred tax assets. And since the GloBE rules are only a template for countries to follow, as Jenna mentioned, companies are gonna need to continually evaluate the specific laws that are enacted to determine if the facts and circumstances are consistent with the GloBE rules prior to applying the accounting.

There are some additional complexities that exist related to standalone financial statements of subsidiaries and that accounting is still going to be evolving to determine whether it's in the scope of 740 and if so, how to account for it at the subsidiary level.

John Barbagallo

Yeah. Thanks, Matt. So, continuing our accounting discussion, what about under IFRS? Will the accounting be the same as US GAAP?

Matt Drucker

Whell John, I don't have a simple yes or no for that question. Questions have been raised about whether the GloBE top-up tax is in the scope of IAS 12 for consolidated and separate financial statements and if so, how do account for that? In response to that, the IASB issued an exposure draft, International Tax Reform – Pillar Two Model Rules.

The proposed amendments to IAS 12 would specify that all Pillar Two taxes would be in the scope of IAS 12 and introduce a temporary mandatory exception from accounting for deferred tax that arise from legislation implementing the Pillar Two rules. In essence companies would be effectively prohibited from providing deferred taxes related to the top-up tax.

Additionally, the IASB proposes that companies provide new disclosures in its annual financial statements, including disclosing that the exception was applied and the additional disclosures when Pillar Two legislation is enacted and effective.

The exposure draft is actually open for public comment through March 10th, 2023, and the IASB hopes to get this finalized before the end of June and apply it retrospectively. So, in short with the exception being applied, and while the IASB continues to study it, the effect of the accounting is gonna be basically the same between US GAAP and IFRS. I would also mention, John, that there is a publication that we've released on the global minimum tax and that is available on the FRV site.

John Barbagallo

Thanks, Matt, very helpful. Matt, Jenna, thank you so much for joining us today and I appreciate you taking time to walk us through these new GloBE rules from both a tax and accounting perspective. I look forward to speaking with you again on future podcasts. Thanks again and everyone have a great day.

Outro

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