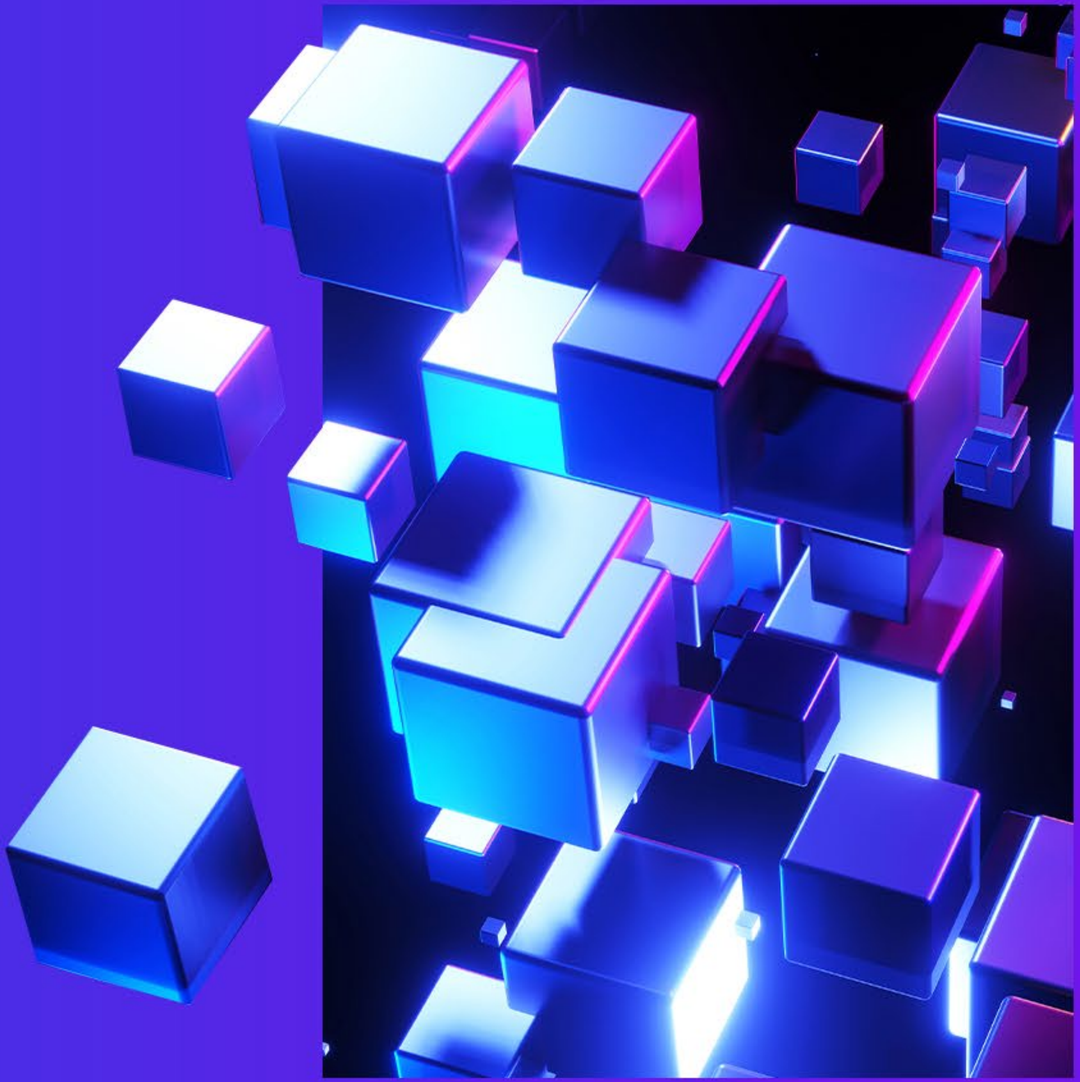
What CAO's need to know about BEPS and Pillar 2



2023 Global Financial Reporting and Valuation Conference

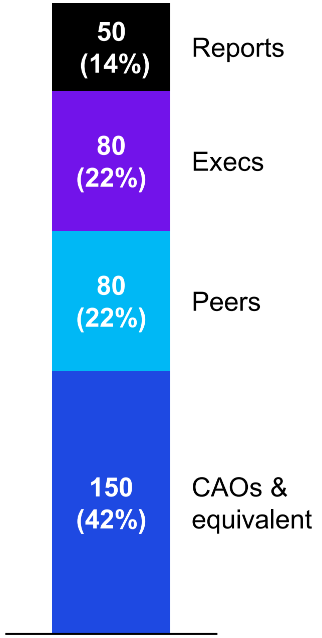
CAO Survey

CAO Survey Demographic

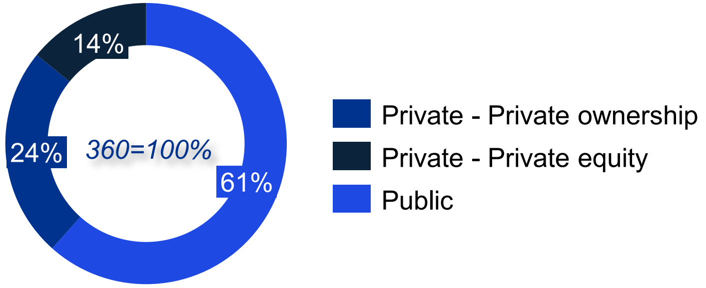
Majority of the respondents belong to the CAO and equivalent title; IM being the key industry

N=360

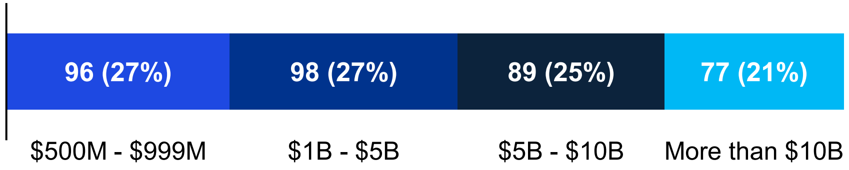
By respondent type



By organization type



By organizational annual revenue



By employee range

~27%
Work in companies with total number of employees in the range of **1,001-5,000**

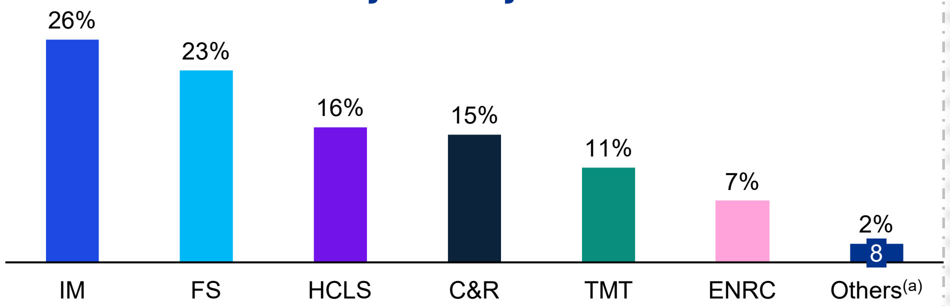
~21%
Work in companies with employees in the range of 10,001-25,000

By employee range in US Finance & Accounting Dept.

42%
51-250 employees

18%
251-500 employees

By industry



Functions that directly report to CAOs and equivalent (top 3)

91%
Accounting and Financial Reporting

76%
Financial systems

72%
Financial Planning, Reporting and Analysis

CAO PoV on Pillar 2

Majority of the CAOs are moderately prepared to comply with Pillar 2 regulations; discussions with external advisors and trainings can make them highly prepared

Level of involvement

33%	25%	15%	12%
Very involved	Somewhat involved	Not involved	Not very involved

Assessment stage

- **39%** Beginning to understand
- **35%** Awareness
- **11%** Completed an assessment
- **7%** Identified implications

Preparedness

Level of preparedness		Top reasons of preparedness
7%	Highly prepared	**70%** Appropriate data to perform calculations **50%** Feel confident in understanding the rules
67%	Moderately prepared	**41%** Have some resources to comply **41%** Have some understanding of rules
19%	Unprepared	**45%** Lack of enough understanding **38%** Insufficient resources to comply

Approach/methods to enhance preparedness

- **(~35%)** Discussions with an external advisor on best practices
- **(~32%)** Provide training on the impact of Pillar 2

Concern areas

Eliminating intercompany transactions on a jurisdictional level	35%
Converting local ledgers to parent company GAAP based on the materiality of the local entity	31%
Pushing down adjustments for share based payments and pensions to local ledgers	25%

CAO PoV on Pillar 2

CAOs who have established a methodology to address Pillar 2 also propose that their companies are highly engaged in the Pillar 2 regulations

Assessment of Pillar 2 implications based on level of involvement[a]

80% — CAOs who have developed a process to address Pillar 2 also suggest that their accounting function is **very much involved in Pillar 2**

45% — CAOs who are aware of Pillar 2 implication suggest that their accounting function is **highly involved in Pillar 2**

28% — CAOs who are beginning to understand the implications of Pillar 2 suggest that their accounting function is **somewhat involved in Pillar 2**

Level of preparedness in complying with the new Pillar 2 regulations[b]

83% — Moderately prepared CAOs believe that **discussion with the internal tax team** would help them in complying with Pillar 2 rules

27% — Unprepared CAOs believe that **training on Pillar 2 impacts** can aid in complying with its regulations

10% — Highly prepared CAOs believe that **discussions with an external advisor regarding the best practices** would assist them in complying with the rules

Overview of pillar 2 setting the stage

What is the policy objective?

Policy objective: Pillar Two is designed to ensure that large internationally operating businesses pay a 15% minimum level of tax in every jurisdiction.

Three methods of achieving the policy objective (in order):

01

Qualified Domestic Minimum top-up tax (QDMTT)

Local country measure

02

Income Inclusion Rule (IIR)

"Parent" country measure

03

Undertaxed profits rule (UTPR)

Backstop measure

Allows the local jurisdiction to collect any top-up tax that would otherwise be paid to another jurisdiction under Pillar Two

Tax paid under a QDMTT reduces top-up tax payable under IIR/UTPR.

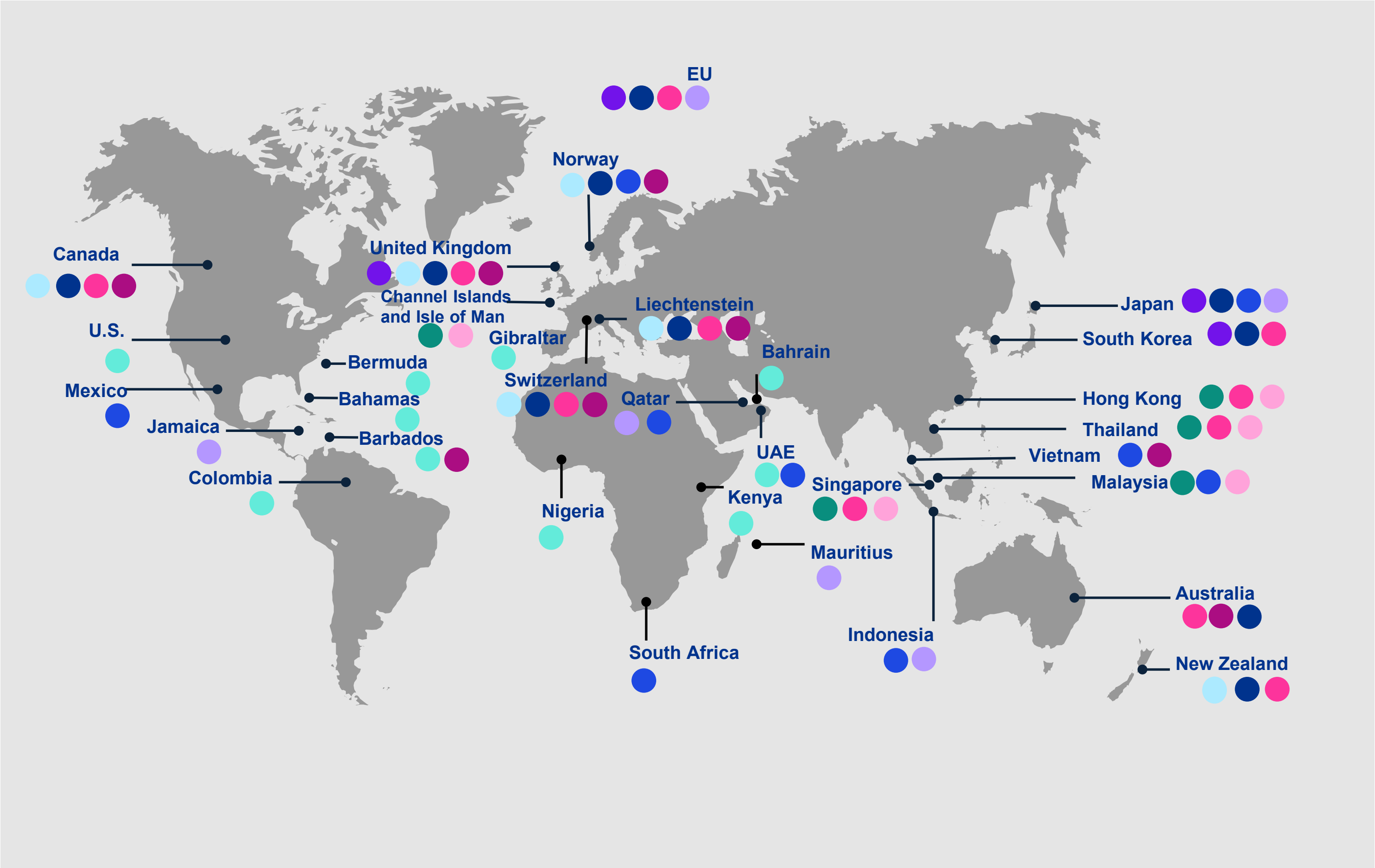
Triggers top-up at the level of the Parent where the income of a constituent entity (aggregated at the jurisdictional level) is taxed at a rate less than 15%

UTPR is a backstop; it only applies where Group income is not already subject to IIR.

It operates by denying deductions (or an "equivalent adjustment").

Applies to ultimate parent jurisdiction, including the U.S., with equal force

Pillar Two – Global overview | 1



Legend

- Legislation passed/approved
- Draft legislation released
- IIR (2024)
- IIR (2025)
- UTPR (2024)
- UTPR (2025)
- QDMTT (2024)
- QDMTT (2025)
- Intention to apply QDMTT (timing uncertain)
- Intention to apply IIR and UTPR (timing uncertain)
- Other related announcement / legislation

Who is within scope?

Scope: The IIR and UTPR apply to MNEs that have at least €750 million of consolidated group revenue. However, countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold.

€750M

Consolidated Group revenue

Country IIR application

IIR may apply even if Consolidated Group Revenue threshold is not met.

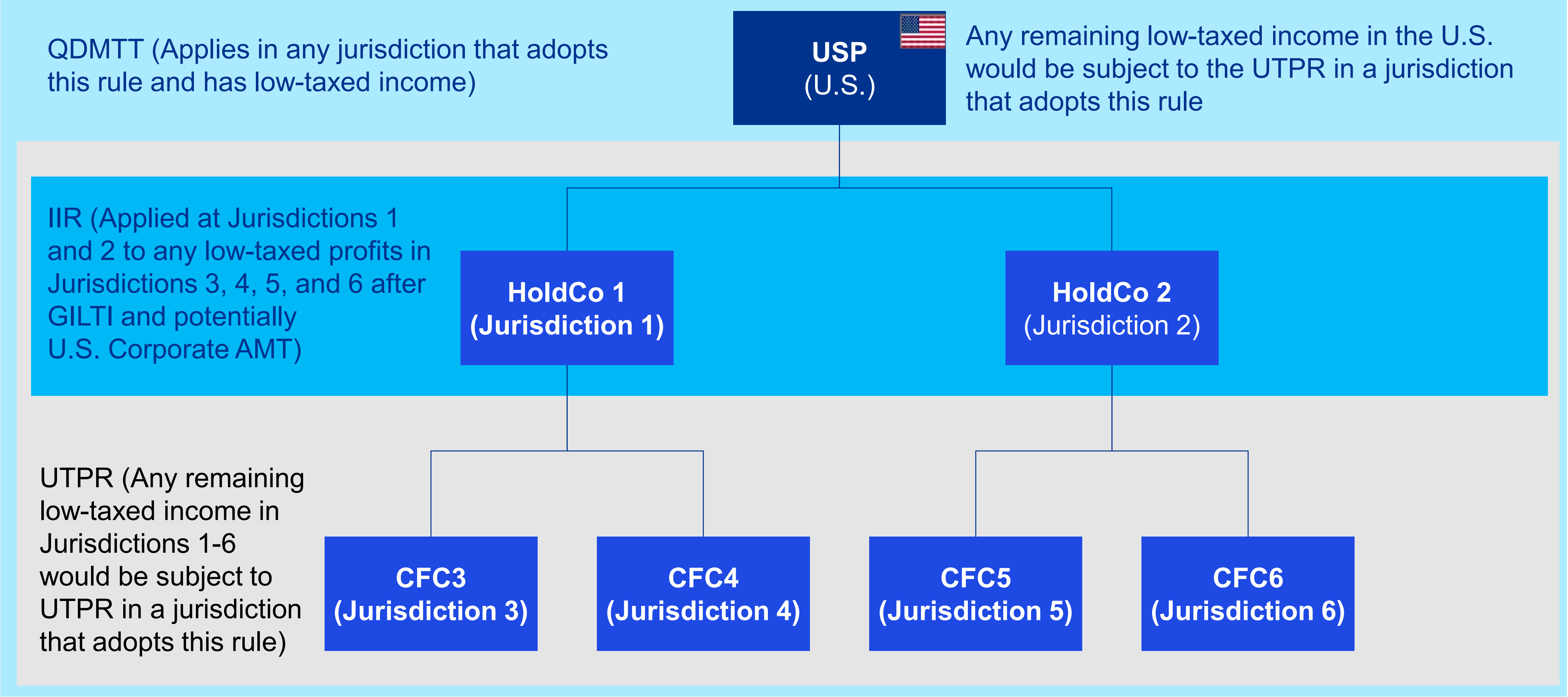
~6,000

Global MNEs within scope

Certain entities are excluded from the IIR and UTPR, including:

- Governmental entity
- International organization
- Nonprofit organization
- Pension funds
- Investment funds (that are the Ultimate Parent)
- Real estate investment vehicle (that is the Ultimate Parent)

Considering non-participation by the US, how do the Pillar Two rules apply to U.S. – Based MNEs?



Safe Harbors

	Description	When is it available?	Which jurisdictions does it apply to?	Which rules does it provide protection from?
Transitional CBCR Safe Harbor	Deems the top-up tax to be zero in respect of an eligible jurisdiction for the relevant year and provides streamlined compliance	2024 – 2026, with a one strike and you're out rule *not available in the UPE jurisdiction if the taxpayer elected Transitional UTPR Safe Harbor	All	QDMTT, IIR and UTPR
Transitional UTPR Safe Harbor	Deems top-up tax under the UTPR to be zero in respect of the UPE jurisdiction if the nominal tax rate in that jurisdiction is at least 20%	2024 – 2025	UPE Jurisdiction	UTPR
QDMTT Safe Harbor	Deactivates the IIR and UTPR in the presence of a QDMTT if that QDMTT is also eligible for the QDMTT Safe Harbor	Permanent	Jurisdictions with a QDMTT	IIR and UTPR

How does Pillar Two impact in-scope MNEs?

Financial/ tax provision impact.
Additional cash tax and higher book ETR

- Pillar Two is based on ***effective*** tax rates, thus tax credits, exemptions and special deductions reduce the ETR and can trigger top-up tax in jurisdictions with high nominal tax rates
- Many MNEs have an ETR on US income that is less than 15%

Compliance and resource impact.
Significant new compliance burden and need for tax technology

- Requires novel book-based ETR computations in every jurisdiction that the MNE has operations
- Intense data requirements to apply required adjustments
- New filing requirements

Planning impact.
Does the current structure still make sense? Are there new planning opportunities?

- Current structures were established against a different baseline and may need to be rationalized against the new Post Pillar Two baseline
- New planning opportunities focused on FTC utilization

Tax policy impact.
What does Pillar Two mean for the future of U.S. and global tax policy?

- Does Pillar Two demand a US QDMTT in the future?
- Result in trade sanctions against UTPR jurisdictions?

Resources

- **OECD Pillar Two rules**
  (link: https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm)
  - Model Rules
  - Commentary
  - Administrative Guidance
  - Safe Harbors
  - Examples
  - GloBE Information Return

- **KPMG prepared materials**
  - International Tax page includes many useful resources including go-to-market content.

Impact on the controllership function

Why does Pillar 2 matter for the controllership function?

The data required to calculate GloBE income largely come from the data that the controllership function is responsible for maintaining.

1. The starting point for calculating GloBE income is book accounting net income for each jurisdiction in U.S. GAAP and local GAAP/IFRS

2. Numerous adjustments to book net income that rely on the controllership may required such as:
   - Conversion to Ultimate Parent GAAP (i.e., U.S. GAAP) in each jurisdiction
   - Jurisdictional consolidation and intercompany eliminations
   - Allocation of group expenses to the correct jurisdiction

3. Specified Pillar 2 adjustments are required to Globe income that rely on the controllership, such as :
   - Purchase accounting
   - Adjusting for fx asymmetrical gains and losses
   - Disallowed Expenses

4. In order to ensure the accuracy and completeness of the data provided to local tax authorities, the controllership will need implement internal controls around the systems and data inputs used in the GloBE calculation

5. The FP&A function will need reliable and complete data from the controllership function in order estimate current and future year GloBE income payouts for cash flow purposes.

6. The controllership function will be responsible for drafting of and accuracy and reliability of financial statement disclosures around Pillar 2.

Pillar 2 Overview for the controllership function

$$\text{Jurisdictional ETR} = \frac{\text{Adjusted Covered Taxes for each CE located in the jurisdiction}}{\text{Net GloBE Income of the jurisdiction}}$$

The controllership function plays a key role in supplying a large portion of the data/calculations required to compute the denominator of the effective tax rate calculation (e.g., the calculation used to determine if a jurisdiction is required to pay a top-up tax)

Controllership Deliverables

- Financial accounting tax provision related to pillar 2
- Processes/controls around P2 calculation & P2 provision
- Pillar 2 IFRS/US GAAP disclosures

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GloBE Income adjustments that the controllership is responsible for:

Determining GloBE Income	Source	Calculation or Data Point	Description
Financial Accounting Net Income or Loss for the constituent entity	Controllership	Data Point	Starting point consolidated Financial Statements of the Ultimate Parent Entity
Adjustments			Description of Adjustments Below
+/- Gain/Loss from disposition of assets/liabilities under Article 6.3	Controllership	Data Point	This adjustment is required to eliminate certain gains or losses from a transfer of assets or liabilities under financial accounting that are excluded under Article 6.3 (generally, gains and losses that are tax-free).
- Excluded Dividends	Controllership/ Tax	Data Point	GloBE income is reduced for dividends related to the following: • Non-Portfolio Shareholding • Non-short-term Portfolio Shareholding • Investment Entity subject to 7.6 election
+ Accrued Pension Expense	Controllership/ Tax	Calculation	The Accrued Pension Expense is equal to the difference between: the amount of pension contributions during the year, and the book amount accrued as an expense in the computation of Financial Accounting Net Income or Loss.
+/- Asymmetric foreign currency gains and losses	Controllership/ Tax	Calculation	This adjustment for “Asymmetric Foreign Currency Gain or Losses” is required to adjust GloBE Income or Loss for differences in the treatment of foreign currency exchange gains or losses (“FXGL”) for accounting purposes and local tax purposes.

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GloBE Income adjustments that the controllership is responsible for: (continued)

Determining GloBE Income	Source	Calculation or Data Point	Description
- Policy Disallowed Expenses	Controllership	Data Point	This adjustment is necessary to align the treatment of certain “Policy Disallowed Expenses” that are generally disallowed for tax purposes, but may be allowed for financial reporting purposes. For this purpose, Article 10.1 defined Policy Disallowed Expenses to mean expenses accrued by the Constituent Entity for illegal payments, including bribes and kickbacks, and expenses accrued by the Constituent Entity for fines and penalties.
+/- Included Revaluation Method Gain/Loss	Controllership	Data Point	If local GAAP/IFRS allows PP&E to be revalued with a gain/loss to OCI, that gain/loss will need to be recorded as an adjustment to GloBE income.
- Purchase accounting related to acquisitions	Controllership	Data Point	Reverse all purchase accounting entries.
+/- Excluded Equity Gain/Loss	Controllership	Data Point	Adjustment to exclude gains and losses resulting from: a. changes in fair value of an Ownership Interest (except for an interest in an entity that is less than 10% defined as a Portfolio Shareholding); b. profit or loss in respect of an Ownership Interest that is included in Financial Accounting Net Income or Loss under the equity method of accounting; and c. gains and losses from disposition of an Ownership Interest, except a Portfolio Shareholding.
+/- Prior Period Errors and Changes in Accounting Principles	Controllership/ Tax	Calculation	Adjustment to prior period (e.g., year being filed) GloBE income for errors/changes in policy identified in year of filing.

Key accounting elections

★ **Tax will likely rely on the input of the controllership function as it seeks to determine if the following elections should be taken and how to determine the required adjustments if the election is taken:**

Election item	Description
Stock-Based Compensation – Section 3.2.2	• Election to use tax deductible amount in lieu of book expense. 5 year election made by the Filing Constituent Entity.
Realization Method – Section 3.2.5	• Election to use the “realization method” in lieu of fair value/impairment accounting for assets and liabilities. 5 year election. • In the year an election under Article 3.2.5 is revoked, the GloBE Income or Loss is adjusted by the difference in the fair value of the asset/liability at the beginning of the year and the carrying value of the asset/liability pursuant to the election, so that the net fair value gain/loss during the election period is fully recaptured. • The election generally applies with respect to all assets/liabilities, but can be limited to tangible assets of such constituent entities or assets/liabilities of such constituent entities that are investment entities.
Gains/Losses from the sale of Tangible Assets – Section 3.2.6	• Election to allocate capital gains/losses to the current year and past 4 years to match net asset gains with net asset losses. • Annual election on a jurisdiction basis.
Consolidation Election – Section 3.2.8	• Election to consolidate transactions in the same jurisdiction between entities in the same MNE group. Revokable election. - This election however requires that the entities be in the same tax consolidated group or share income/ loss via common ownership.

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Audit considerations

- Risk assessment forms the basis of the audit process
- Auditors perform risk assessment to identify specific risks of material misstatements to the financial statements, including disclosure
- Auditors respond to risks of material misstatement by performing audit procedures, including testing management's internal controls and performing substantive testing

The audit response for Pillar Two will not be the same for all companies!

Audit considerations (continued)

Given the impact of Pillar Two on the financial statements, auditors will be keen to ensure that adequate processes and controls exist over the following areas, including completeness and accuracy of information used in performing the various calculations

- Legal entity organizational chart
- Monitoring implementation status around the world
- Country-by-country reporting
- Transitional safe harbor
- Globe ETR
- Pillar Two models

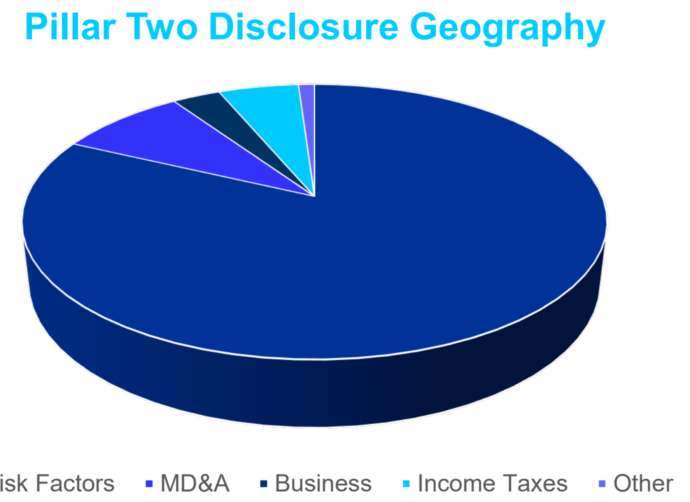
Disclosure considerations

Under U.S. GAAP, there have been no P2 specific disclosure requirements issued to date. However, we expect that entities will be required to disclose the impact of P2 as part of existing SEC disclosure requirements. IFRS (IAS 12) has introduced specific, additional P2 disclosures.

With respect to filings by SEC Registrants:

- For Annual reports, less than 200 companies included any Pillar 2 disclosures. All disclosures were qualitative.
- For Quarterly reports, less than 100 companies included any Pillar 2 disclosures. All disclosures were qualitative except for 2.

We observed the following trends in relation to p2 disclosure geography:



We did not observe a Company's auditor, size or industry having any significant correlation with the geography of the P2 disclosure

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