KPMG

Thinking About Tax Attributes and Tax Reserves

June 11, 2024

Ahead of the wave

2024 U.S. Cross-Border Tax Conference

Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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Agenda

01

Accounting for Pillar Two

Do I need to account for the deferred tax impact?

Accounting for pillar two

US GAAP Accounting for Pillar Two

- Based on comments at a February 1, 2023 FASB Board meeting, we believe that the top-up taxes included within the Global Anti-Base Erosion (GloBE) regime, including qualified domestic minimum top-up taxes, are alternative minimum taxes as discussed in ASC 740.
- Recognize the incremental effect of GloBE top-up taxes as incurred.
- Existing deferred tax assets and liabilities are measured at the regular tax rate and are not adjusted for the estimated future effects of the minimum tax.
  - Deferred taxes are not recognized for GloBE specific temporary differences.
  - Entities are not required to consider GloBE top-up taxes in its valuation allowance assessment.
- Consider disclosure related to GloBE top-up taxes in management's discussion and analysis.

IFRS Accounting for Pillar Two

- On May 23, 2023, the IASB issued International Tax Reform – Pillar Two Model Rules, which amended IAS 12, Income Taxes.
- The amendments introduced a mandatory application of a temporary exception to recognising deferred taxes related to Pillar Two income taxes
- The amendments apply to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules, including tax law that implements qualified domestic minimum top-up taxes.
  - The amendments provide that, as an exception to the requirements in IAS 12, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.
- Targeted disclosure requirements

02

Pillar Two Deferred Taxes

How is deferred tax relevant for Pillar Two?

More than (just) tax accounting

01 Current tax expense with adjustments

02 Other covered taxes

03 Deferred tax adjustment amount

04 Allocation of taxes between constituent entities

Adjusted Covered Taxes

01 Financial accounting net income or loss for the constituent entity (FANIL)

02 Adjustments

03 Allocation / Reallocation of GloBE income

04 Exceptions

GloBE Income or Loss

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GloBE ETR

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Deferred tax adjustment amount: Model rules vs. Safe harbor

No.	GloBE Model Rules	Transitional CbCR Safe Harbor	Impact for Transitional CbCR Safe Harbor
1.	Starting point deferred tax expense accrued in Financial Accounts	-	-
2.	Ignore uncertainties in tax benefits in determining deferred tax items	-	-
3.	Exclude deferred tax expense for items excluded from the computation of GloBE Income or Loss (incl. SBC election)	X	Beneficial for deferred tax expense, detrimental for deferred tax benefit
4.	Recast at 15% where the applicable rate exceeds 15%	X	Beneficial for deferred tax expense, detrimental for deferred tax benefit
5.	Exclude deferred tax expense that relate to distributions (Disallowed Accruals)	X	Deferred tax expense for distributions (e.g., APB 23) beneficial
6.	Exclude impact of valuation adjustment or accounting recognition adjustments	X	Recognition of DTA previously subject to valuation allowance detrimental
7.	Exclude deferred tax expense arising from a re-measurement of the applicable domestic tax rate	X	Could affect safe harbor eligibility (e.g., reducing rate increases risk of failure)
8.	Exclude deferred tax expense with respect to the generation and use of tax credits	X	Simplified ETR reduced by deferred tax benefit from generation, but increased by deferred tax expense from utilization of tax credits
9.	Recapture rules (5 years) to ensure DTL is actually paid	X	Recapture rule does not apply for jurisdictions eligible for the safe harbor
10.	Special rule for losses and permanent differences (4.1.5)	X	No additional top-up tax in jurisdictions with losses

GloBE ETR must be recomputed in jurisdictions that fail the Transitional CbCR Safe Harbor, potentially reversing any detrimental outcome identified above

Purchase price accounting

GloBE Model Rules

- In general PPA is ignored for purposes of the GloBE Model Rules.
- However, if a constituent entity is located in a jurisdiction which treats a stock acquisition or "GloBE Reorganisation" as a taxable event (either mandatorily or as the result of an election) giving rise to gain/loss and resetting of asset basis to fair value, then, if the filing constituent entity for the group makes an election, the GloBE rules similarly require recognition of asset/liability level gain/loss by target constituent entity (even if GAAP does not recognize asset/liability level gain/loss at the target constituent entity) and generally consistent with PPA.

Transitional CbCR Safe Harbor

- PPA can be taken into account in the Transitional CbCR Safe Harbor where it is included in the accounts used to prepare the CbC Report (e.g. local statutory accounts) and the (1) consistency reporting condition is met and (2) goodwill impairment adjustment is applied.
- Where PPA adjustments are taken into account, additional guidance states that there must be symmetry in the treatment of deferred tax expense.
- For example, if PPA adjustments that arose in connection with the acquisition of a CE's stock are taken into account when computing an entity's profit before tax, the associated deferred tax expense must be taken into account when computing its Simplified Covered Taxes.

Book DTAs/DTLs and GloBE DTAs/DTLs are not the same

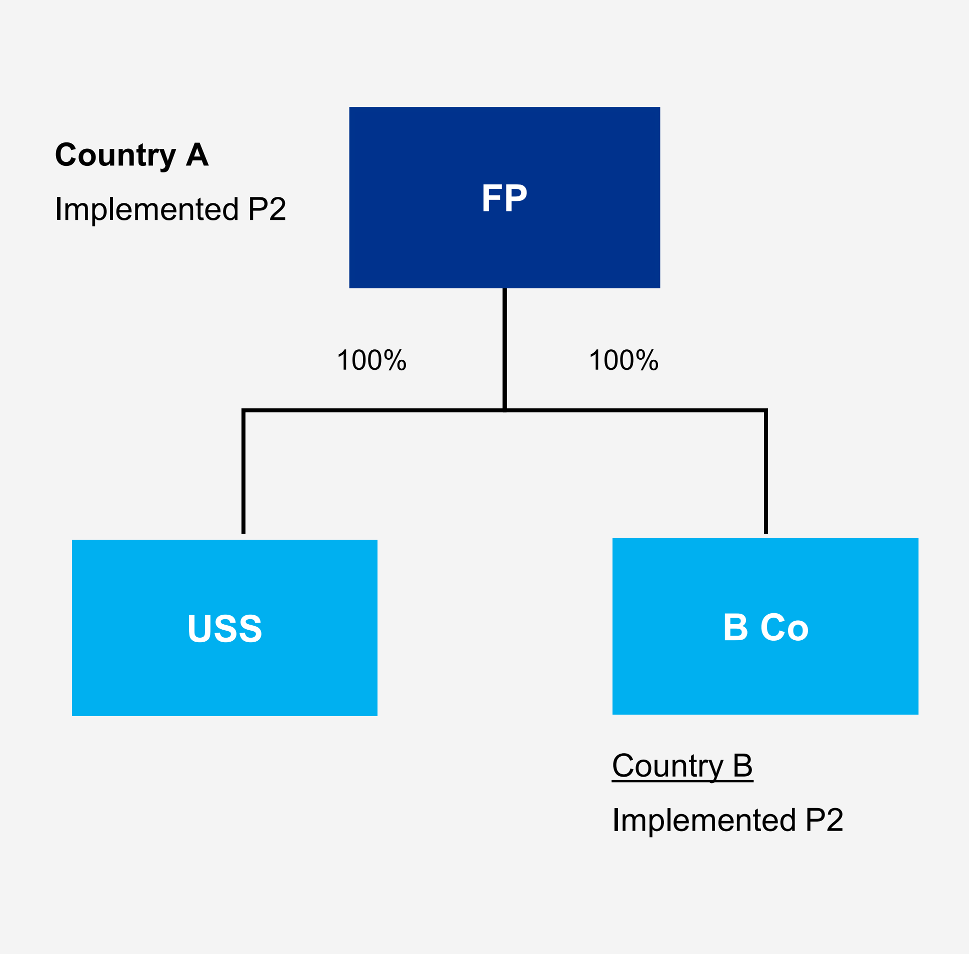
Owner level taxation

- In the case of a fully transparent entity, both financial accounts and GloBE will generally report the deferred taxes at the owner level
- However, if a constituent entity pays tax in its own jurisdiction but the owner is also subject to tax on the entity's income, then any deferred items reflected on the owner's books must be pushed down for purposes of computing an ETR for purposes of an IIR/UTPR (but not QDMTT) under the GloBE Rules.
  - CFC taxes such as subpart F (or GILTI for those taxpayers who book GILTI deferreds)
  - Hybrid entities and unincorporated branches
  - Distribution taxes (withholding taxes are pushed down for a QDMTT as well, but not until a distribution is made and the tax comes due)
- No reallocation for the purpose of the Transitional CbCR Safe Harbor

Transition issues

- DTAs for pre-effective date credits ***can*** be taken into account
- Transition period intragroup step-up transactions generating DTAs
- Country-by-Country Reporting (which can be relied on as a safe harbor during the transition period) does not push-down owner level taxation of CFCs and hybrid entities.

Example – reversal of DTL



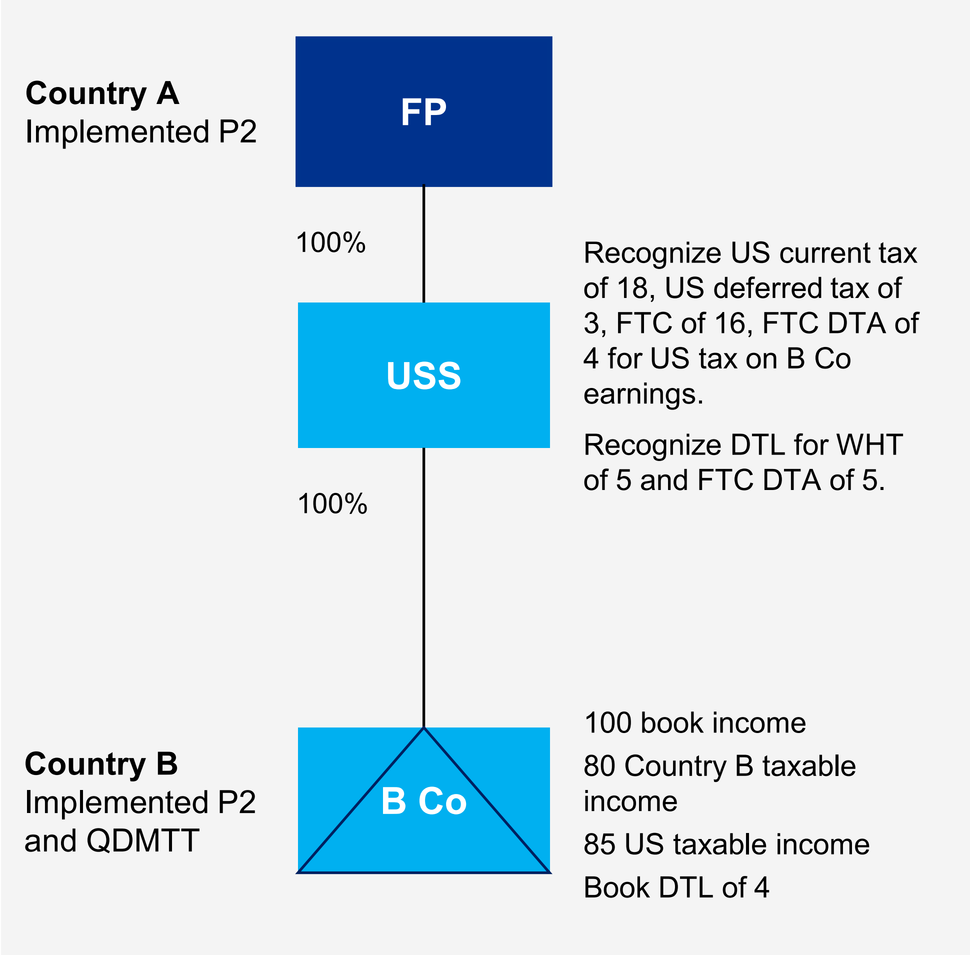
Facts

- FP is the UPE of the FP MNE Group consisting of FP, USS, and B Co. Both Country A and B have implemented Pillar 2.
- USS has $100 of GloBE income and 0 SBIE. Additionally, USS has a book-tax difference from amortizing ($50) for USFIT purposes in respect of a patent with an indefinite life. USS thereby has $50 of income for USFIT purposes and pays $10.5 of USFIT. USS records a DTL of $10.5 for US GAAP.
- USS's DTL does not reverse within 5 years.

Analysis

- Initially, USS takes its DTL in respect of patent into account in computing its GloBE ETR (but recast at 15%).
  - ETR = ($10.5 current tax expense + $(10.5)(15%/21%)) DTL)/$100 GloBE income, or 18%
- Assuming none of the DTL has reversed within five years, Art. 4.4.4 requires recomputing the Year 1 ETR without taking into account the DTL.
  - Recomputed ETR = $10.5/$100 = 10.5%
  - Top-up Tax owing (w/r/t Year 1) = (15% - 10.5%) * 100 = 4.5%
- Recapture rule not part of the Transitional CbCR Safe Harbor

Example – where do deferred items live



Facts

- FP is the UPE of the FP MNE Group consisting of FP, USS, and B Co. Both Country A and B have implemented Pillar 2. Country B has a corporate tax rate of 20% QDMTT
- USS owns 100% of B Co, which is checked open for US tax purposes as a disregarded entity.
- On a pre-tax basis, B Co earns 100 of book income but reports taxable income of 80 for Country B tax purposes and 85 of income for US tax purposes (all differences due timing issues).
- Country B imposes a 5% withholding tax on distributions to USS

Analysis

- For financial statement purposes, B Co's deferred tax items will relate solely to the Country B (non-QDMTT) corporate tax, those items will generally be taken into account in computing B Co's ETR for QDMTT (B Co) and IIR (FP) purposes
- For financial statement purposes USS's deferred tax items may reflect the following aspects of B Co's operations:
  - Consider USS tax consequences of B Co operations (taxes pushed down to B Co for IIR purposes ***but not*** QDMTT.
  - Although creating a book DTL for USS (assuming no indefinite reinvestment assertion is made), the 5 of expected withholding tax on distributions from B Co to USS is taken into account for IIR ***and*** QDMTT purposes only by B Co and only when reflected in current tax expense

Pillar two tax attributes

Excess Negative Tax Expense

- Attribute that is generated when a group has a GloBE Loss in a jurisdiction and the deferred tax benefit exceeds the Expected Adjusted Covered Taxes Amount.
- This enables a group to avoid an Additional Current Top-up Tax in a year when it is loss-making.

GloBE Loss Deferred Tax Asset

- Attribute that is generated when a group GloBE Loss Election provides an alternative to the Deferred Tax Adjustment Amount (Article 4.4) that is most likely to be beneficial in jurisdictions that have no corporate income tax (and hence where no deferred tax expense / benefit is recognized)

Substitute Loss Carry-forward DTA

- Introduced to enable the recognition (and unwinding) of a DTA for FTCs, where the following conditions are met:
  - The jurisdiction requires that FSI offset domestic source losses before FTCs may be applied against tax imposed on FSI;
  - The Constituent Entity has a domestic tax loss that is fully or partially offset by FSI; and
  - The domestic tax regime allows FTCs to be used to offset a tax liability in a subsequent year in relation to income that is included in the computation of the Constituent Entity's GloBE Income or Loss.

Pillar Two Tax Attributes will need to be tracked as part of the Pillar Two Computation

Pillar two deferred tax attributes on transition

- Deferred Tax Assets arising from items excluded from the computation of GloBE Income or Loss are excluded when generated from transactions that take place after November 30, 2021.
  - Necessary to review / identify any impacted deferred tax assets (e.g., deferred tax assets from super deduction on fixed assets).

- Deferred Tax Asset for Intra-Group Asset Transfers that take place after November 30, 2021, where the transaction is accounted for at cost, to the extent the disposing entity paid tax on the transfer
  - Necessary to review / identify any in-scope transactions and determine associated DTA.

- Deferred Tax Assets with respect to tax credit carry-forwards must be recast at the minimum rate (i.e., 15%)
  - Based on a formula $\frac{Deferred\ tax\ assets\ reflected\ in\ the\ financial\ accounts}{Applicable\ domestic\ tax\ rate} \times Minimum\ Rate$
- Necessary to revise calculation if the applicable domestic tax rate changes in a subsequent year

Pillar Two Tax Attributes will need to be determined upon Transition Year, generally the first year the full GloBE Rules apply (i.e., not Transitional CbCR Safe Harbor)

03

Data, Systems & Technology

How can technology help?

One data set – multiple uses

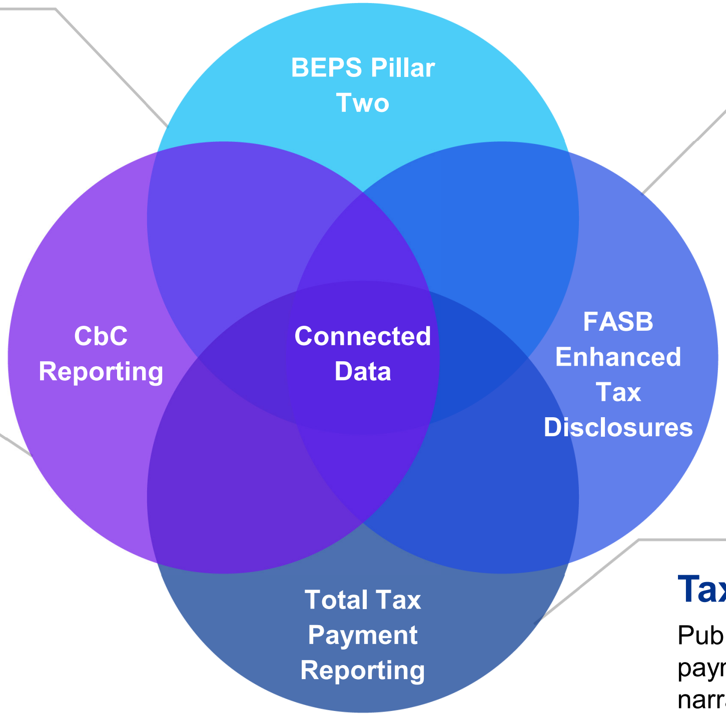
For many MNE groups, the CbC reporting process has been on autopilot for several years with the CbCR being regarded as simply "another information return." BEPS Pillar Two and Public CbCR have cast a significantly greater focus on CbC data and related disclosures. MNE groups are revisiting their data collection and reporting processes with the view of collecting data once and using it for multiple use cases.

BEPS Pillar Two

Transitional safe harbor calculations will rely on CbC data and, going forward, country-level GAAP consolidations will be the starting point for Pillar Two calculations and compliance obligations.

Public & Non-public CbC

CbC data will have to be publicly disclosed. This will form the basis for future Action 13 reporting.



FASB Disaggregation

FASB is expected to require companies to disclose, quarterly, the total income tax paid to federal, state, and foreign tax authorities and, annually, tax payments to countries or states. It is expected that FASB will also require rate reconciliation.

Tax Impact Reporting

Public CbC reporting will be a catalyst for total tax payment reporting to develop an accurate and holistic tax narrative around disclosed tax amounts.

Critical pillar two data components

Financial Accounts

Starting point of the GloBE Income computations, CbC reporting (for safe harbor analysis), and local country compliance

Tangible Assets & Payroll

To compute substance-based income exclusion (SBIE) for jurisdictions relying on routine profits safe harbor test, and for GloBE computations to assess top-up tax

Foreign Currency Data

Necessary to make GloBE Income adjustment for any entity with differing functional currency for book and tax or that transacts (e.g., via intercompany note) in a currency other than its functional currency

Income Tax Expense

Income taxes in the financial accounts of each constituent entity, “in lieu of” taxes such as withholding taxes, and DTA/DTL information by entity to make deferred tax adjustment to Covered Taxes

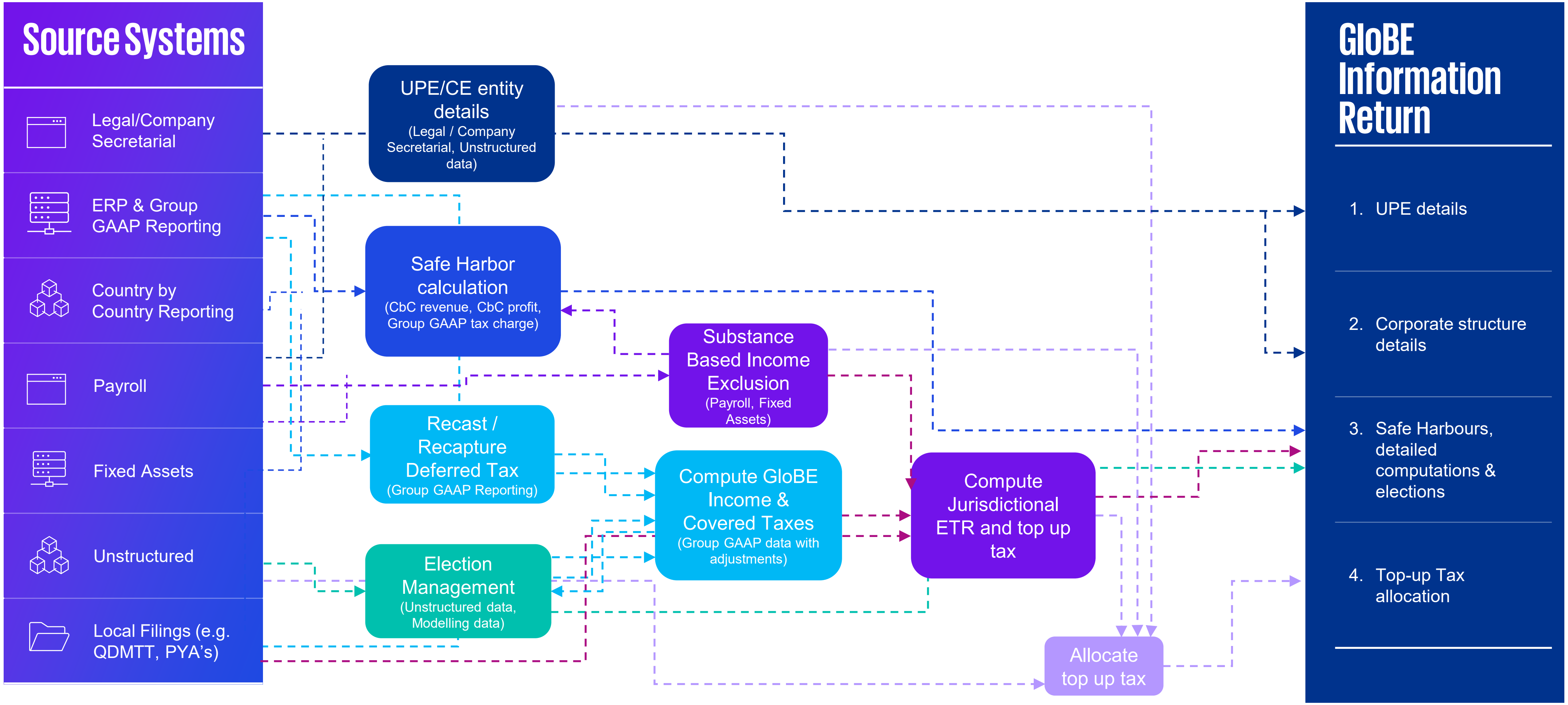
GloBE Elections

Obtain the data and support necessary for Rockwell to efficiently assess the 20+ Pillar Two elections and determine whether beneficial on an annual basis (e.g., stock-based compensation election)

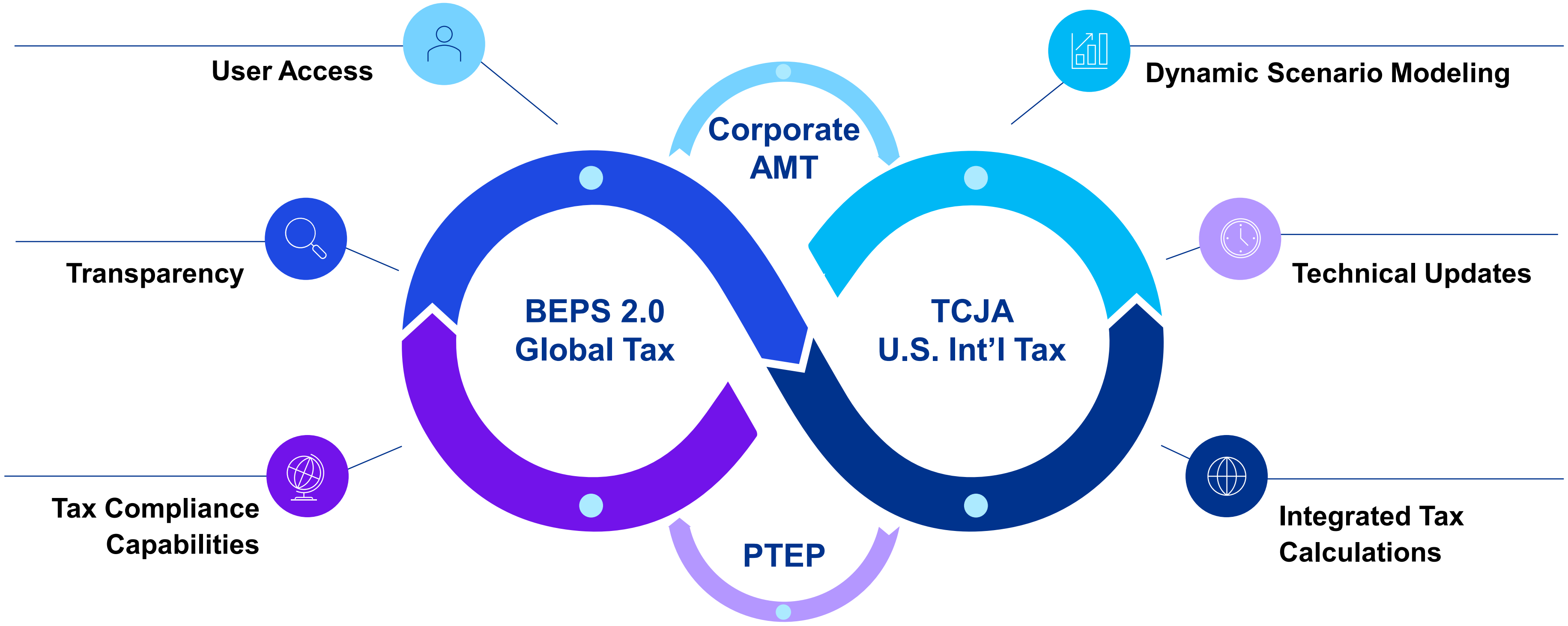
Branch & PE Data

Proper accounting for branches, rep offices, and permanent establishments will be necessary to properly complete GloBE computations

Components of the GloBE information return



Integrated tax modeling – overview



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