KPMG

HOT TOPIC

Global Minimum Tax

Complexities abound

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Model rules on the GloBE top-up tax require complex calculations and raise US and international accounting issues.

The Organisation for Economic Cooperation and Development (OECD) continues to implement the Base Erosion and Profit Shifting (BEPS) 2.0 framework, an international tax reform initiative designed in part to address concerns over uneven profit distribution. Its release of model rules in December 2021 provides a template for countries to implement a top-up tax on profits, known as the 'global anti-base erosion' (GloBE) rules.

Under the model rules, multinational enterprises (MNEs) with consolidated group revenue exceeding €750 million in at least two out of the last four years would be required to pay a top-up tax on excess profits in any jurisdiction in which the GloBE effective tax rate (ETR) for the jurisdiction is below a 15% minimum rate.

Top-up tax differs from taxes that arise under 'traditional' income tax regimes. Traditional income taxes are generally based on specified tax rates applied to a company's taxable profit; top-up tax would arise only if a group pays an insufficient amount of income taxes at the jurisdiction level. The top-up tax may be implemented through an income inclusion rule (IIR) or an undertaxed profits rule (UTPR).

IIR	UTPR
The IIR is the primary rule to impose this top-up tax. The ultimate parent entity or an intermediate parent entity within the MNE group would pay the top-up tax, in its jurisdiction of tax residence, with respect to the low-taxed income of its group entities included in the consolidated financial statements.	The UTPR would operate as a backstop to the IIR where a parent entity jurisdiction has not adopted an IIR. The UTPR would deny deductions or provide for a similar adjustment for group entities to the extent that there is top-up tax that has not been taxed under an IIR.

The determination of whether top-up tax is required – either through an IIR or a UTPR – is based on a complex calculation of the GloBE ETR for a jurisdiction.

The model rules also provide for a qualified domestic minimum top-up tax (QDMTT), a minimum tax imposed by a country to increase taxes within that jurisdiction.

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Calculating the top-up tax

The top-up tax would be computed using the following steps.

1. **Determine qualifying taxes** for all group companies in the same jurisdiction.
2. **Determine the GloBE income** for all group companies in the same jurisdiction based on the same accounting framework used for the consolidated financial statements (e.g. US GAAP or IFRS® Accounting Standards).
3. **Calculate the GloBE ETR** by dividing qualifying taxes (step 1) by GloBE income (step 2).

$$\frac{\text{Qualifying taxes (Step 1)}}{\text{GloBE Income (Step 2)}} = \text{GloBE ETR (Step 3)}$$

If the GloBE ETR is less than 15%, then:

4. **Determine excess profit** as GloBE income (step 2) minus qualifying deductions.
5. **Determine the top-up tax rate,** which is the minimum 15% rate minus the GloBE ETR (step 3).
6. **Calculate the top-up tax** by multiplying the excess profit (step 4) by the top-up tax rate (step 5).

$$\text{Excess profit (Step 4)} \times \text{Top-up tax rate (Step 5)} = \text{Top-up tax (Step 6)}$$

If a jurisdiction has a QDMTT, the amount owed under the IIR or UTPR is reduced by the domestic top-up tax.

Complexities in the accounting for the top-up tax

Unlike traditional income tax regimes, the GloBE top-up tax calculation is an additional tax based on the difference between a minimum 15% rate and the jurisdiction's GloBE ETR. Additionally, because the tax is based on the accounting framework used in the consolidated financial statements, it may result in basis differences that are different than those existing under local tax law.

Implementing the new rules and determining their tax and accounting impact may be challenging and stakeholders have raised questions, such as the following.

- Is the top-up tax in the scope of Topic 740 or IAS 12?
- Do the GloBE model rules create additional temporary differences and, if so, should deferred taxes be recognized for those temporary differences?
- If there are temporary differences, how would a company determine the rate for measuring the deferred tax impacts of top-up tax?
- Does a company remeasure deferred taxes for its existing local tax law temporary differences?

Accounting for the top-up tax

US GAAP

Because the GloBE top-up tax is based on financial statement net income with certain adjustments, the top-up tax is in the scope of Topic 740.

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Consistent with the FASB staff's comments at the February 1, 2023 Board meeting, we believe the GloBE top-up tax, including a QDMTT, is an alternative minimum tax (AMT) because it is a separate but parallel system for a company to pay a minimum level of tax. A company can never pay less than it would under local regular income tax systems.

Because the GloBE top-up tax is an AMT, companies will not record GloBE-specific deferred taxes or remeasure existing deferred taxes under local regular income tax systems to the GloBE rate. Instead, they will recognize the incremental effect of the GloBE top-up tax as incurred. Further, companies are not required to consider the GloBE top-up tax in its valuation allowance determinations. For a general discussion of AMT and the effect of AMT status on the valuation allowance, see sections 3 and 4 of KPMG Handbook, Accounting for income taxes.

Companies may consider whether to include disclosures related to the GloBE top-up tax in their management's discussion and analysis.

IFRS Accounting Standards

IFRS Accounting Standards do not specifically address the accounting for alternative minimum taxes including the GloBE top-up tax. Stakeholders have questioned whether top-up tax is in the scope of IAS 12 and, if so, how to account for its deferred tax impacts.

In response to the challenges in accounting for the top-up tax, the International Accounting Standards Board issued *International Tax Reform – Pillar Two Model Rules* to amend IAS 12. The amendments to IAS 12 provide a temporary mandatory exception from accounting for deferred tax that arises from legislation implementing the GloBE model rules. Companies are effectively prohibited from providing for deferred tax related to top-up tax. The temporary exception is effective as of May 23, 2023 and applies retrospectively.

Further, the amendments require that companies provide new disclosures in their financial statements for reporting periods ending on or after December 31, 2023. Once the tax law is enacted by a country, but prior to top-up tax being effective, a company must disclose information that is known or can be reasonably estimated that helps users of its financial statements to understand its exposure to top-up tax at the reporting date. Disclosures by a company may include:

- qualitative information related to its GloBE top-up tax exposure by jurisdiction; and
- quantitative information about the proportion of profits that may be subject to GloBE top-up tax and the average effective tax rate applicable to those profits, or how the average effective tax rate would have changed if the legislation had been effective.

If the information is not known or cannot be reasonably estimated at the reporting date, then a company discloses a statement to that effect and information about its progress in assessing the GloBE top-up tax exposure.

After the top-up tax is effective, the only required disclosure is the current tax expense related to top-up tax.

Companies may consider whether to include disclosures related to the GloBE top-up tax in their management's discussion and analysis.

For further discussion and updates, refer to KPMG publication, Global minimum top-up tax: Relief from deferred tax accounting under IFRS Accounting Standards.

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