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Emerging ASC 740 Issue Related to OECD Pillar Two

Background

In October 2021, more than 135 countries and jurisdictions agreed to participate in a "two-pillar" international tax approach developed by the Organisation for Economic Co-operation and Development (OECD), which includes establishing a global minimum corporate tax rate of 15 percent. The OECD published the "Pillar Two"[1] rules in December 2021 and issued additional commentary clarifying several aspects of the rules in March 2022.

The Pillar Two rules are intended to ensure that large multinational enterprise groups pay a minimum level of tax on the income arising in each of the jurisdictions in which they operate. The rules do so by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the 15 percent minimum rate. The Pillar Two rules include:[2]

- "[A]n Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity."
- "[A]n Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR."

As of December 31, 2022, South Korea has taken steps to enact the Pillar Two rules, and it is expected that other jurisdictions will enact tax laws that conform to them in the future. For more information about Pillar Two, see Deloitte's International Tax Alert, "Pillar Two: OECD Inclusive Framework Global Minimum Tax Model Rules" (available to subscribers only).

[1] OECD (2021), Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm.

[2] Quoted text is from OECD/G20 Base Erosion and Profit Shifting Project, Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, October 2021.

Accounting Considerations

Under U.S. GAAP, entities are required to adjust deferred tax accounts for the effect of a change in tax law or rates in the period of enactment. However, Pillar Two is based on financial accounting net income, with limited adjustments ("GloBE[3] income"). In addition, Pillar Two is designed to be an incremental tax to ensure that entities are paying 15 percent of GloBE income on a jurisdictional basis, and whether incremental tax will be due under Pillar Two depends on future events, such as income earned or losses generated in a jurisdiction, permanent items, and a substance-based exclusion. As a result, an entity may not know whether it will always be required to remit an incremental tax under the Pillar Two rules. These characteristics make the Pillar Two rules similar to the pre-2018 corporate alternative minimum tax (AMT) system for which guidance exists in ASC 740.[4]

At the FASB's February 1, 2023, meeting, the FASB staff announced that the global minimum tax imposed under the Pillar Two rules, as published by the OECD,[5] is an AMT and that deferred taxes would not be recognized or adjusted for the effect of global minimum taxes that conform to such Pillar Two rules. As support for its conclusion, the FASB staff cited the guidance in ASC 740-10-30-10 and 30-12 as well as ASC 740-10-55-31 and 55-32. Accordingly, the incremental effects of such taxes would be accounted for as a period cost (i.e., the increase in tax payable would only be reflected in an entity's financial statements after a law is actually effective).

Disclosure Considerations

While ASC 740 does not explicitly require disclosure of new tax laws,[6] entities must provide certain forward-looking information under SEC Regulation S-K, Item 303(a),[7] related to "material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition."

Before the enactment of proposed tax laws or revisions to existing tax rules, entities should consider whether the potential changes represent an uncertainty that management reasonably expects could have a material effect on the results of operations, financial position, liquidity, or capital resources. Entities should consider disclosing information about the scope and nature of any potential material effects of tax law proposals or changes to existing tax rules. Similarly, management should consider providing disclosures related to the new tax law if (1) enactment occurs after the balance sheet date but before the financial statements are issued or available to be issued, (2) management believes that such tax law could have a material future financial effect on the entity, and (3) failure to do so might cause the financial statements to be misleading.

[3] "Global anti-base erosion tax."

[4] FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*.

[5] As jurisdictions enact laws in response to the Pillar Two rules, each jurisdiction's enacted law will ultimately need to be separately evaluated for consistency with the framework.

[6] ASC 740-10-50-9(g) does require as separate disclosure of the component of income tax expense attributable to continuing operations the adjustments to deferred tax liabilities and assets due to enacted changes in tax law.

[7] SEC Regulation S-K, Item 303(a), "Management's Discussion and Analysis of Financial Condition and Results of Operations: Objective."

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