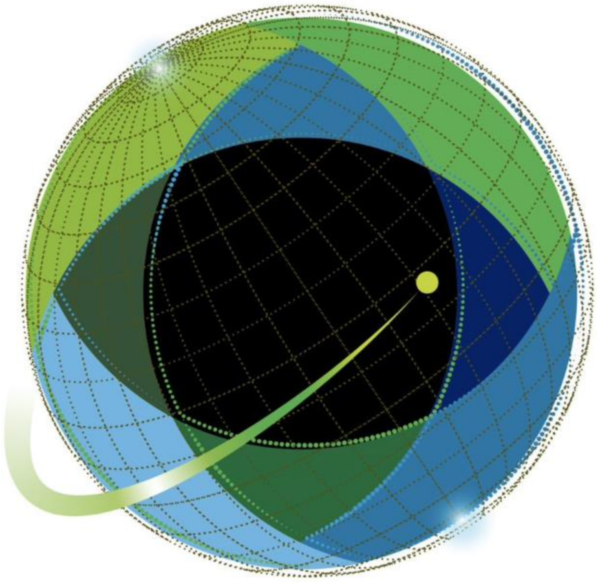
Clarity in corporate reporting
June 2023
(Updated December 2023 and April 2025)



Responding to Pillar Two

Financial reporting considerations of Pillar Two in its first years of implementation

The Pillar Two 'top up' tax seeks to impose a minimum 15% tax on multinational entities with global revenues exceeding €750 million. The Pillar Two reforms commenced in most countries which have enacted legislation for income years beginning on or after **1 January 2024**.

The top up tax is based on accounting information of the global parent entity and the calculation process resulted in numerous financial reporting issues, including scope and **deferred tax** questions under AASB 112 *Income Taxes*.

In response to these financial reporting challenges, the International Accounting Standards Board (IASB) and Australian Accounting Standards Board (AASB) introduced amendments that prohibit the recognition and disclosure of deferred taxes arising from Pillar Two taxes. The amendments also require **disclosure** of the use of the exception and introduce **new disclosures**.

In this publication, we consider many of frequently asked questions about the corporate reporting impacts of Pillar Two in its initial implementation periods.

"Pillar Two represents compliance and financial reporting challenges even where tax liabilities are expected to be immaterial"

David Watkins
Partner – Tax Insights & Policy

Background

What is Pillar Two?

In October 2021, Australia and over 130 other countries endorsed proposed international corporate tax reforms to address the challenges arising from the digitalisation of the economy. The reforms consist of two 'pillars' that were developed by the Organisation for Economic Co-operation and Development (OECD) Inclusive Framework on Base Erosion and Profit Shifting (BEPS).

Pillar One would reallocate taxing rights to countries where goods and services are consumed. This reallocation would only apply where a multinational has global revenues exceeding €20 billion per annum and also has a profit-before-tax to revenue ratio exceeding 10 per cent. Extractives and regulated financial institutions would not be subject to this pillar. It was originally anticipated the Pillar One reforms would be implemented in 2024 but implementation has been delayed[1].

Pillar Two is designed to operate to ensure a minimum rate of taxation of 15% and applies to entities that have global revenues of €750 million or more. Broadly, where entities have operations in low tax jurisdictions, the ultimate parent entity is subject to additional 'top up' tax on low or zero taxed profits.

Pillar Two consists of three components:

1. The Income Inclusion Rule (IIR), which is the default rule, applied at the ultimate parent level
2. Undertaxed Profits Rule (UTPR), applied where an entity's ultimate parent is domiciled in a jurisdiction that doesn't have an Income Inclusion Rule (IIR)
3. An optional qualifying domestic minimum top-up tax (QDMTT), which effectively applies the top up tax at the country level.

There are numerous complexities and exceptions, and many of the tax calculations rely on accounting information included in the ultimate parent entity's financial statements.

Pillar Two quick facts

- Model rules being implemented by more than 130 countries globally
- Applies where global revenue exceeds €750 million
- Imposes top up tax on jurisdiction profits with less than 15% effective tax rate
- Based on accounting information in the ultimate parent's financial statements

[1] A Treasury consultation paper on the implementation of the BEPS pillars released for comment in October 2022 noted that "Treasury estimates that no Australian headquartered multinationals currently fall into the scope of Amount A" (i.e. the amount of taxing rights to be redistributed under Pillar One). On 13 January 2025, the OECD announced the release of a statement from the co-chairs of the OECD/G20 Inclusive Framework on BEPS providing an update on the progress made in developing a final package relating to Pillar One of the two-pillar solution to address the tax challenges arising from the digitalization of the economy, as negotiations continue. Pillar One taxes are not considered further in this publication.

Australian implementation

The Federal Government legislated the IIR, UTPR and QDMTT during the second half of 2024. The IIR and a QDMTT apply to income years beginning on or after 1 January 2024, and the UTPR applies a year later (income years beginning on or after 1 January 2025).

The final part of the overall legislative package to implement Pillar Two in Australia was the registration of the rules on 23 December 2024. The Pillar Two legislation is substantively enacted in Australia from that date and so must be taken into account when measuring current taxes for financial reporting periods ending on or after that date.

A broad group of entities may be within the scope of the regime, including foreign controlled (50% ownership or consolidated) entities and Australian based multinationals with a global footprint, although a smaller subset of Australian entities are expected to pay top up tax amounts under Pillar Two in Australia. However, entities would be expected to document their assessment to meet tax law requirements and need to consider what disclosures are appropriate.

The €750m revenue threshold captures many ASX listed entities, large privately held entities and investment entities

Understanding financial reporting perspectives

Problematic interaction with accounting standards

The Pillar Two top up taxes are based on accounting information included in the consolidated financial statements of the ultimate parent entity, and apply a top up tax based on effective tax rates in each jurisdiction in each year based on those numbers. The base accounting information is adjusted for various rules, exceptions and requirements in deriving the ultimate amount of top up tax payable.

Because of the linkage to accounting information and the complexity of the top up tax calculation methodology, constituents raised concerns with the IASB about the application of IAS 12 *Income Taxes* to Pillar Two taxes. In response, the IASB introduced fast-tracked amendments to IAS 12 *Income Taxes* to:

- Introduce an **exception to the recognition and disclosure of deferred taxes** arising from Pillar Two taxes (with a requirement to disclose that the exception has been applied)
- Require disclosure of **known or reasonably estimable** information that helps users understand the entity's exposure to Pillar Two top up taxes. This applies in the period between substantive enactment of the legislation and when the Pillar Two taxes are in effect
- Require **separate disclosure of the current tax expense** arising from Pillar Two taxes.

The prohibition on recognition and disclosure of deferred taxes is accompanied by additional disclosure requirements

The AASB made equivalent amendments to AASB 112 *Income Taxes* and similar amendments to AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*[2].

Financial reporting considerations

Entities need to consider the following in their financial reports:

- Separate disclosure of the amount of any current Pillar Two tax expense arising in respect of the period
- State that the Pillar Two deferred tax exception has been applied. This applies even if enabling legislation has not been substantively enacted in all of the participating jurisdictions where the entity operates
- Update any relevant accounting policy disclosure to be consistent with the exception being applied
- Consider if additional disclosure about the impact of Pillar Two is warranted.

We have included answers to frequently asked questions about these considerations in the next section.

[2] AASB 2023-2 *Amendments to Australian Accounting Standards – International Tax Reform – Pillar Two Model Rules* was made in June 2023, and AASB 2023-4 *Amendments to Australian Accounting Standards – International Tax Reform – Pillar Two Model Rules: Tier 2 Disclosures* was made in September 2023.

Frequently asked questions

Set out below are frequently asked questions about the financial reporting perspectives of Pillar Two tax.

Questions in this section

Do the Accounting Standard amendments apply to all entities?

Technically, yes.

It is important to note that the new Accounting Standard requirements are not limited to entities exposed to Pillar Two taxes. Accordingly, all entities should consider whether to disclose at least some information about Pillar Two, unless the nature of the entity is such that such information is clearly not material. In other words, investors may expect to know that an entity is *not* expected to be impacted by Pillar Two as much as knowing that it is expected to be impacted, and the extent of those impacts.

Investors and other stakeholders may appreciate understanding that there is no exposure to Pillar Two taxes

For groups that are clearly below the €750 million threshold to fall into the Pillar Two regime, there may be limited benefit in including substantial disclosure in financial reports[3].

Illustrative disclosure – no current tax impact from Pillar Two

Pillar Two top up tax

The Group is within the scope of the Pillar Two tax that that has been substantively enacted in Australia and many of the jurisdictions in which the Group operates. The current financial year is the first period for which a Pillar Two return is required. The Group has no exposure to Pillar Two taxes in respect of the current year *[and, subject to further analysis and results, is not expected to be exposed to material Pillar Two tax liabilities in subsequent periods]*. The Group has also applied the mandatory exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

[3] See also *Is separate disclosure of the Pillar Two current taxes amount required where the amount is small?* on page 8 for discussion on disclosures where Pillar Two exposures are expected to be minimal.

What detail should be included in the narrative disclosures?

Both qualitative and quantitative information about the impacts of Pillar Two taxes should be disclosed. Quantitative information is not required to reflect all of the specific requirements of Pillar Two and can be provided in the form of an indicative range. AASB 112 includes the following examples illustrating how the overall disclosure objective might be met:

- Information about how the entity is affected by enacted or substantively enacted legislation and the main jurisdictions in respect of which Pillar Two exposures might exist
- An indication of the proportion of an entity's profits that might be subject to Pillar Two top up taxes, and the average effective tax rate applicable to those profits
- An indication of how the entity's average tax rate would have changed if Pillar Two legislation had been in effect.

Disclosure of the impact of Pillar Two legislation is not required once the Pillar Two legislation is effective and is being applied by the entity. Instead, the entity is required to separately disclose the current tax amount arising from Pillar Two legislation in each reporting period.

Because the IIR and QDMTT became effective in Australia for annual income years beginning on or after 1 January 2024, most Australian entities would not fall within the scope of these specific disclosures with respect of IIR and QDMTT.

However:

- Entities may need to make disclosures about the potential impact of the Undertaxed Profits Rule (UTPR), as the UTPR is effective for income years beginning on or after 1 January 2025
- Disclosures may be necessary where jurisdictions in which the entity operates do not have substantively enacted Pillar Two legislation or where the jurisdiction has a deferred effective date. A number of countries have announced plans to implement the rules from income years beginning 1 January 2025, meaning there may be changes in precisely where the exposure is disclosed in the transition years
- Additional disclosures may be needed where the amount of Pillar Two taxes in future periods may change materially, or where the expiry of any applied transitional safe-harbour provisions could impact Pillar Two tax exposure.

Illustrative disclosure – Australian company with some current exposure and no future exposure expected based on current status

Pillar Two top up tax

The Group is within the scope of the Pillar Two tax that that has been substantively enacted in Australia and many of the jurisdictions in which the Group operates. The Australian Pillar Two legislation (which applies to the company as the ultimate parent entity) applies the Income Inclusion Rule (IIR) and Qualifying Domestic Minimum Top-up Tax (QDMTT) to income years commencing on or after 1 January 2024 and the Undertaxed Profits Rule (UTPR) to income years commencing on or after 1 January 2025.

The current tax arising under the IIR and QDMTT for the current year *[are not material / amounted to $ ___]*. As the company is not controlled by any other entity, the Group has no exposure to the UTPR in future periods.

The Group has also applied the mandatory exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

Illustrative disclosure – Australian company with no current IIR and QMDTT exposure but possible future UTPR exposure

Pillar Two top up tax

The Group is within the scope of the Pillar Two tax that that has been substantively enacted in Australia and many of the jurisdictions in which the Group operates. The Australian Pillar Two legislation (which applies to the Group) applies the Income Inclusion Rule (IIR) and Qualifying Domestic Minimum Top-up Tax (QDMTT) to income years commencing on or after 1 January 2024 and the Undertaxed Profits Rule (UTPR) to income years commencing on or after 1 January 2025.

There is no current tax arising under the IIR and QDMTT in the current year and, based on analysis of forecast information, none is expected in future periods.

As the company is controlled by an entity incorporated in *[Country A]* which has not enacted Pillar Two legislation, there is potential exposure to Pillar Two taxes arising under the UTPR in future periods.

The Group has performed the necessary analysis in preparation for complying with the UTPR rules for the income year ending on 30 June 2026. Based on the analysis derived from information in respect of the financial year ended 30 June 2025, the Group *[does not expect any potential exposure to Pillar Two top up taxes / expects an immaterial exposure to UTPR liabilities in the future]*.

We will not know our final Pillar Two liability until we finalise our Pillar Two return. What impact does this have on the financial statements?

The recognition exception introduced into AASB 112 does not apply to the recognition and measurement of current taxes. Accordingly, for financial reporting periods where Pillar Two taxes are effective, entities need to recognise the best estimate of their Pillar Two current tax amount in their financial statements.

Additional disclosures may be needed where significant judgements are made in the estimation of Pillar Two taxes, or where major sources of estimation uncertainties around the Pillar Two amount exist.

Once the Pillar Two liability is finalised, any difference from the amount originally recognised would be treated as a prior period adjustment, in a similar way to how post-reporting changes in other income taxes are treated. However, should a material error in the calculation be discovered after the financial statements are issued, this may require the correction and disclosure of a prior period error.

Is separate disclosure of the Pillar Two current taxes amount required where the amount is small?

It depends.

Separate disclosure of the Pillar Two current tax is a specific disclosure required by AASB 112. However, under AASB 101 *Presentation of Financial Statements*, an entity need not provide a specific disclosure required by an Australian Accounting Standard if the information resulting from that disclosure is not material.

AASB 101 explains that materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

As a result, an entity with an immaterial amount of Pillar Two taxes will need to apply judgement as to whether this information is material. For example, an entity may consider separate disclosure is material where:

- Previous communications about the likely impact of Pillar Two indicated a potential exposure (whether quantified or not)
- The entity's peer group or competitors have a material Pillar Two exposure
- The nature of the entity's operations suggests that Pillar Two exposures might be material
- Analysts and other stakeholders have made enquiries about likely Pillar Two tax exposures.

Are Pillar Two current taxes recognised in half-year financial statements?

Yes, if a Pillar Two tax year includes some or all of the interim period, Pillar Two income taxes should be recognised in the half-year financial statements.

Consistent with the calculation of other income taxes in financial reports in accordance with AASB 134 *Interim Financial Reporting*, the amount recognised is determined based on the expected effective tax rate that will apply for the annual period. This rate is determined based on estimated 'adjusted covered taxes' and the estimated 'net GloBE income' for the year, each calculated in accordance with the Pillar Two rules.

Additional disclosures may be needed where significant judgements are made in the estimation of Pillar Two taxes, or where major sources of estimation uncertainties around the Pillar Two amount exist.

Complications can arise where Pillar Two legislation has not been substantively enacted in jurisdictions where the entity operates by the end of the half-year, as this can impact the entity recognising any Pillar Two current tax[4].

[4] For more information, see iGAAP Chapter A32 Section 5.6.10.11 (Deloitte credentials or DART subscription required to access).

Are Pillar Two taxes allocated to group entities in a similar way to tax amounts within Australian tax consolidated groups?

No.

There is an essential difference between Pillar Two and Australian tax consolidation:

- Under Pillar Two, the legislation operates to impose taxation on a particular entity in the corporate group, depending on whether a liability arises under the IIR, UTPR or QDMTT. There is no direct or indirect liability imposed on the entity in a low taxed jurisdiction
- Under Australian tax consolidation, each of the entities are seen as effectively being a branch of the head entity (under the single entity rule) and also retain the tax bases of their assets and liabilities on exiting the tax-consolidated group. Accordingly, in substance each member of the group is essentially subject to tax as a result of being part of the tax-consolidated group.

Pillar Two taxes are accounted for as an income tax in the consolidated financial statements of a group. Accounting for Pillar Two taxes in individual entities within the group depends on whether the entity is liable for Pillar Two taxes, and whether there is a recharge in place within the group. However, it should be noted that a special mechanism exists for imposing the liability to pay any top-up tax under the Australian QDMTT or UTPR onto the head company of a tax consolidated group.

In summary:

- There is no 'push-down' of Pillar Two liabilities or expenses to entities giving rise to a Pillar Two top-up tax liability elsewhere in the broader group
- There are accounting policy choices in the separate financial statements of an entity with a Pillar Two liability[5].

[5] For more information, see iGAAP Chapter A13 Section 5.13 (Deloitte credentials or DART subscription required to access).

Our group is owned by a foreign entity that has a different financial year (and Pillar Two tax year) to the Australian group. What impact does this have on the Australian group's financial statements?

Where the Pillar Two tax year is different to the financial reporting period, the calculation of Pillar Two current taxes may require the bifurcation of the reporting period into non-taxable and taxable periods, or into periods to align with the global Pillar Two tax year.

Example

X Pty Limited is part of a global group that is headquartered in Japan. X's financial year ends on 31 December, whereas the global group has a 31 March financial year. The global group's tax year for Pillar Two purposes also ends on 31 March.

Where X has a Pillar Two tax liability (e.g. under the QDMTT) it will be required to perform two calculations:

- For the three month period from 1 January to 31 March. In the first year of Pillar Two applying, this period may have no Pillar Two exposure and no current taxes would be recognised. In subsequent periods, the current tax amount will reflect the allocation of the Pillar Two liability for the year beginning on the previous 1 April and ending on 31 March (so the Pillar Two top-up tax rate for that period will be applied to the Pillar Two taxable income arising in the first quarter)
- For the nine month period from 1 April to 31 December. The calculation for this period may require the estimation of the effective tax rate for the year to 31 March of the following year (in much the same way as in interim financial statements as discussed above).

What disclosures are included in Tier 2 financial statements?

AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* was amended by AASB 2023-4 to require a Tier 2 entity to disclose:

- It has applied the exception to recognising and disclosing deferred taxes relating to Pillar Two income taxes (AASB 1060:178A)
- Its current tax expense (income) related to Pillar Two income taxes (AASB 1060:178B).

These requirements are equivalent to those applying to Tier 1 entities.

In addition, paragraph 176 of AASB 1060 was amended to clarify that the requirement to disclose information about the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events includes enactment or substantive enactment of new tax rates and new tax laws, such as Pillar Two legislation. This requirement is not as specific as that applying in Tier 1 financial statements and provides some flexibility in the level of disclosures in Tier 2 financial statements.

Accordingly, Tier 2 entities that may be impacted by Pillar Two legislation must consider appropriate disclosures to include in their financial reports. The amendments made to AASB 1060 were based on equivalent amendments made by the IASB to the *IFRS for SMEs* Accounting Standard, but were finalised before the IASB's amendments were published. The wording of the AASB and IASB amendments are slightly different, in particular, the IASB's amendments clarify that the requirement for an entity to disclose that it has applied the exception to the recognition and disclosure of deferred taxes relating to Pillar Two taxes is limited to entities within the scope of Pillar Two legislation.

Based on the IASB's amendments, it would appear reasonable not to make any disclosures about Pillar Two in Tier 2 financial reports where it is clear that the entity is outside the scope of Pillar Two legislation.

However, where disclosures would be useful to the overall understanding of the financial statements, they should be included in order to meet the disclosure requirements of AASB 1060.

For example, an entity preparing Tier 2 financial statements may wish to provide disclosures where an entity that is a subsidiary of a foreign entity is subject (or expected to be subject) to the Undertaxed Profits Rule as a result of its foreign parent operating in a jurisdiction that has not implemented Pillar Two.

Contacts

David Watkins
Partner – Tax and Legal
dwatkins@deloitte.com.au

Amelia Teng
Partner – Tax and Legal
amteng@deloitte.com.au

Tracey Rens
Partner – Tax and Legal
trens@deloitte.com.au

Frank Betkowski
Principal
fbetkowski@deloitte.com.au

Alison White
Partner
aliswhite@deloitte.com.au

Anna Crawford
Partner
acrawford@deloitte.com.au

Moana Overton
Partner
moverton@deloitte.com.au

Carol Warden
Partner
cwarden@deloitte.com.au