



Snapshot

by Capital Markets & Accounting Advisory Services (CMAAS)

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Amendments to MFRS 112 : International Tax Reform - Pillar Two Model Rules



What's Pillar Two?

In October 2021, more than 130 countries (including Malaysia and representing more than 90% of global GDP) agreed to implement a minimum tax regime for multinationals - Pillar Two. In December 2021, the Organisation for Economic Co-operation and Development ("OECD") released the Pillar Two model rules (the Global Anti-Base Erosion Proposal or GloBE) to reform international corporate taxation. Large multinational enterprises within the rules' scope are required to calculate their GloBE effective tax rate for each jurisdiction where they operate. They will be liable to pay a top-up tax for the difference between their GloBE effective tax rate per jurisdiction and the 15% minimum rate.

The goal is to end the 'race to the bottom' on tax rates worldwide, under which countries had been competitively cutting corporate taxes to attract businesses with the impact that other countries felt forced to cut taxes to compete.

Top-up taxes calculated under GloBE are to be paid in the jurisdiction of the parent entity of the multinational group, rather than in the low tax territory that triggers the excess payments. Thus, the Pillar Two rules provide for the possibility that jurisdiction introduce their own domestic minimum top-up tax based on the GloBE mechanics to avoid any 'tax leakage'. If the GloBE effective tax rate domestically is 15%, no GloBE top-up tax will be payable.

The Pillar Two rules are intended to be implemented as part of a common approach, as agreed by the OECD, and to be brought into domestic legislation as from 2023. However, each jurisdiction will need to determine if and when the rules will be enacted. For example, the EU currently has plans to implement the rules in member states in 2023 with an effective date for accounting periods starting on or after 31 December 2023. At the date of publication, Malaysia has yet to announce any specific changes in tax rates and laws and effective date in implementing the Pillar Two rules.



What are the issues if to apply existing MFRS requirements on Pillar Two model rules?

Applying the GloBE rules and determining their impact on the MFRS financial statements are likely to be very complex and pose a number of practical challenges. Additionally, how to account for the top-up tax under MFRS 112 'Income Taxes' is not immediately apparent. Entities that have to pay a top-up tax (whether GloBE or a domestic minimum tax) need to consider whether these additional taxes impact the recognition and measurement of their deferred tax assets and liabilities.



What are the amendments to MFRS 112?

In response to the imminent implementation of the Pillar Two model rules and having considered all of the potential challenges and its implications discussed above, the International Accounting Standards Board issued narrow-scope amendments to IAS 12 in May 2023 and the Malaysian Accounting Standards Board had issued similar amendments to MFRS 112 in June 2023.

The amendments provide a mandatory temporary exception from the MFRS 112 requirement to recognise and disclose deferred taxes arising from enacted or substantively enacted tax law that implements the Pillar Two model rules, including tax law that implements qualified domestic minimum top-up taxes described in those rules. This essentially means affected entities do not need to recognise deferred tax arising from the top-up tax due to the Pillar Two model rules.

Disclosures

The amendments also introduce targeted disclosure requirements for affected entities, and they require entities to disclose:

- the fact that they have applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two model rules;
- their current tax expense (if any) related to the Pillar Two model rules; and
- during the period between the legislation being enacted or substantially enacted and the legislation becoming effective, entities are required to disclose known or reasonably estimable information that would help users of financial statements to understand an entity's exposure to Pillar Two model rules arising from that legislation. If this information is not known or reasonably estimable, entities are instead required to disclose a statement to that effect and information about their progress in assessing the exposure.



What is the impact of the amendments and for whom?

The amendments are applicable to entities affected by the Pillar Two model rules, i.e. large multinational enterprises that have consolidated revenues (which, as defined by the OECD, include any form of income and are therefore not limited to revenue recognised in accordance with MFRS 15 'Revenue from Contracts with Customers') of €750 million in at least two out of the last four years .

Affected entities should not recognise and disclose deferred taxes arising from the Pillar Two model rules. However, additional disclosures are required on current tax expense and known or reasonably estimated exposure to Pillar Two module rules when the rules are substantially enacted but not yet effective.



Effective date and transition

The amendments on the mandatory exception rule and the disclosure of the fact that the exception has been applied are effective immediately and are applied retrospectively in accordance with MFRS 108 'Accounting Policies, Changes in Accounting Estimates and Errors'.

However, the disclosure on current tax expense and known or reasonably estimated exposure to Pillar Two model rules are effective for financial statements with annual reporting periods beginning on or after 1 January 2023. Such disclosure is not required in interim financial reports or any interim period ending on or before 31 December 2023.

Do you need further information on this topic?

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