

Take5

for business

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Base Erosion and Profit Shifting (BEPS) 2.0, Pillar Two

Aligning financial reporting to
data requirements

Overview of BEPS 2.0 Pillar Two

From 2024, BEPS 2.0 Pillar Two will fundamentally change how global enterprises are taxed. The Pillar Two Model Rules* (also referred to as the Global Anti-Base Erosion, GloBE or Global Minimum Tax Rules) released on 20 December 2021 are designed to ensure large multinational corporations (MNCs) pay a minimum level of tax in each country in which they operate.

The United Kingdom, South Korea and Japan have already enacted the BEPS 2.0 Pillar Two global minimum tax rules into their domestic tax legislation, and many other countries are working to enact similar local tax laws in 2023. The rules enacted in just these few countries alone potentially have an unintuitively global impact and MNCs, wherever headquartered, must pay close attention to Pillar Two developments wherever they operate.

In Malaysia, most MNCs are at the start of their global minimum tax journey and are assessing the impact of the new tax rules on their tax burdens, financial statements and statutory tax filings. Increased reporting obligations mean companies must develop new data collection and collation processes across a wide range of functions, including tax, finance, human resources and IT. MNCs need to re-organize their internal processes and systems to ensure their ledger and reporting systems, and data flows are ready for the new forecasting, reporting, disclosure, audit and ultimately, statutory compliance requirements.

Beyond tax provisioning and Country-by-Country Reporting (CbCR) filing, the data collected for BEPS 2.0 Pillar 2 has broader applications and could be used in areas such as environmental, social and governance or sustainability reporting.

Note:

* In addition to the GloBE, Pillar Two also proposes a tax treaty-based subject to tax rule (STTR) which may subject certain intra-group cross-border payments such as interests and royalties to increased withholding taxes.

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BEPS 2.0 kickstarts the finance transformation of companies as it provides an opportunity for MNCs to conduct comprehensive assessments on their current financial accounting and tax operating models.



Ismed Darwis
Malaysia Markets Leader,
Ernst & Young PLT

BEPS 2.0 Pillar Two highlights

- 1 Applies to all MNCs with global revenues of at least €750 mil (RM3.8 bil)
- 2 Establishes a 15% minimum Effective Tax Rate (ETR) as defined under specific complex rules. The ETR is to be calculated on a country-by-country basis, with ETR below 15% potentially resulting in a top-up tax
- 3 Many countries are expected to enact rules in 2023 that are effective from 2024
- 4 Pillar Two compliance involves collecting and tracking vast amounts of new 'data', that are not easily retrieved, from multiple sources
- 5 Both short- and long-term reporting must be aligned to data requirements

To what extent are companies prepared for BEPS 2.0?

The EY Tax and Finance Operations, 2023 Survey of 1,600 tax and finance professionals across 32 jurisdictions and 18 industries assessed their preparedness for BEPS 2.0 Pillar Two.

Key results include:



67%

of companies have started looking at the data needed to comply with the requirements and assessing where they have gaps.

But only...



30%

of companies have completed impact assessments on both the Effective Tax Rate (ETR) modeling and data requirements.

Many companies anticipate needing to make changes to their business operations, once BEPS Pillar Two is in effect, and as such will be making significant changes to how they run their business.



63%

of US\$20 billion+ revenue companies and 46% of all other companies believe BEPS 2.0 will have a significant impact on their tax and finance functions.



40%

of companies expect a significant change in tax planning strategies and business operations, once BEPS Pillar Two is in effect.

Source: EY, Tax and Finance Operations Survey, 2023

Who are impacted?

MNCs with group global turnover of at least €750 mil (RM3.8 bil) in two out of the four fiscal years immediately preceding the tested fiscal year.

Taxpayers that either have no foreign presence or less than €750 mil (RM3.8 bil) in consolidated revenues are not in scope of the Pillar Two Rules. In addition, the Pillar Two Rules do not apply to government entities, international organizations and non-profit organizations, nor do they apply to entities that meet the definition of a pension, investment or real estate fund.

Pillar Two advocates a new 15% global minimum tax framework which would give countries rights to impose top-up taxes on low-taxed income.

An MNC group's ETR in each jurisdiction it operates in will need to be calculated separately:

- ▶ where the group has an ETR of less than 15% in any jurisdiction, a top up tax will be imposed on the difference, generally charged in the jurisdiction of the ultimate parent; or
- ▶ alternatively, countries may implement rules to impose domestic top-up taxes, thereby preserving a jurisdiction's primary right of taxation over its own income

Pillar Two can result in significant additional taxation for groups operating in countries with no or low statutory taxes or for businesses that currently benefit from significant income tax incentives.

When will Pillar Two take effect?

To-date, 139 countries and jurisdictions have committed to BEPS 2.0.

Action by a critical mass of countries is not required for the GMT rules to take effect. Once one country implements the rules, it may collect top-up taxes on undertaxed profits in other countries in which the group operates.

When will Pillar Two be implemented in Malaysia?

It was previously announced that Malaysia would look to implement Pillar Two, including a Qualified Domestic Minimum Top-Up Tax (QDMTT), from 2024. Further details may be made available in the Budget 2024 announcement on 13 October 2023.

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BEPS 2.0 Pillar Two will be the catalyst for the financial transformation and realignment of an MNC's global businesses.

The immediate focus of businesses that fall within the scope of Pillar Two should be on developing a robust IT solution that can seamlessly integrate existing financial, accounting and tax reporting systems as well as facilitate compliance with Pillar Two requirements.

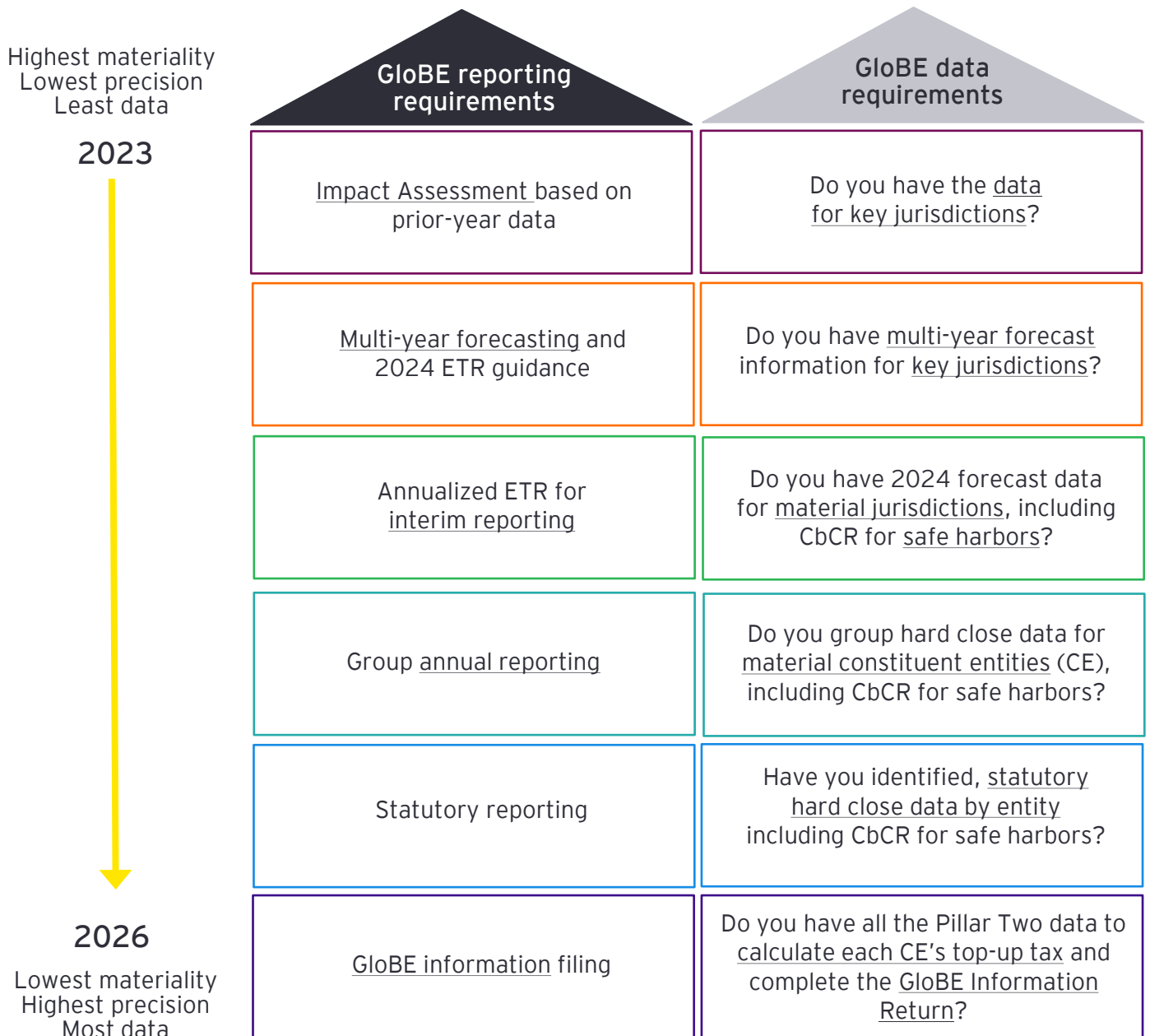


Farah Rosley
Malaysia Tax Managing Partner,
Ernst & Young Tax Consultants Sdn. Bhd.



Aligning reporting to data requirements in the short and long term

Groups preparing for future state 'business as usual' GloBE reporting need to be mindful of multiple reporting needs and that GloBE data requirements vary in volume, precision and complexity, depending on the use case.



Source: EY analysis

Impact of Pillar Two on financial reporting

Accounting guidance: IASB, MASB disclosure requirements

In May 2023, the International Accounting Standards Board (IASB) issued International Tax Reform–Pillar Two Model Rules - Amendments to IAS 12 (the Amendments). The amended IAS 12 do not currently provide an expiration date for temporary exception. Companies will be required to disclose in their financial statements that they have applied the GloBE temporary exception under IAS 12.

The Amendments introduce:

- ▶ A mandatory temporary exception to the accounting for deferred taxes arising from the jurisdictional implementation of the Pillar Two model rules; and
- ▶ Disclosure requirements for affected entities to help users of the financial statements better understand an entity's exposure to the Pillar Two income taxes arising from that legislation, particularly before its effective date.

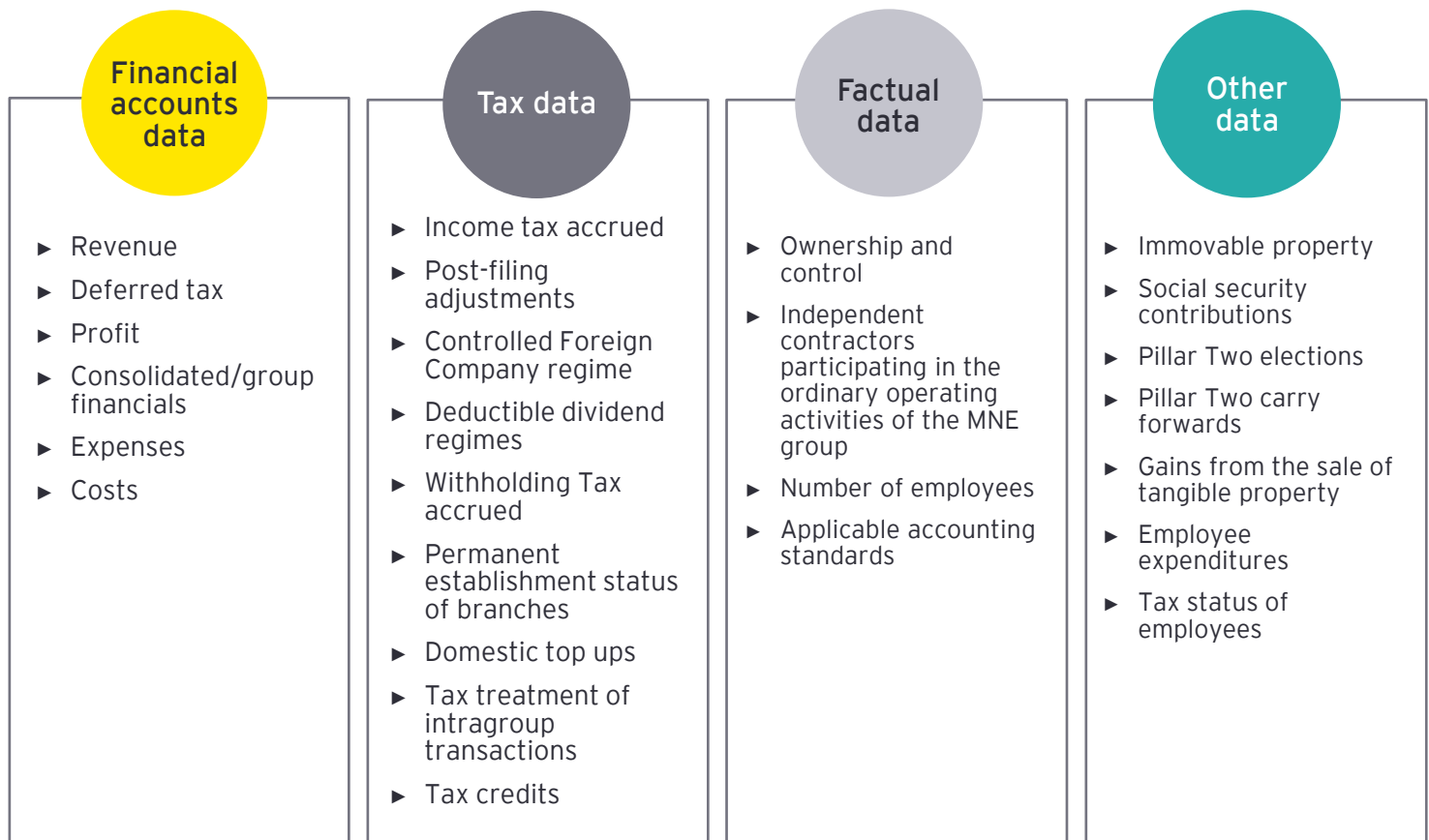
The Malaysian Accounting Standards Board (MASB) has also issued International Tax Reform - Pillar Two Model Rules (Amendments to Malaysian Financial Reporting Standards (MFRS) 112 Income Taxes) which are identical to the International Tax Reform - Pillar Two Model Rules (Amendments to IAS 12 Income Taxes) issued by the IASB.

| IASB/MASB disclosures for periods in which Pillar Two legislation is enacted or substantially enacted, but not yet in effect | Effective dates |
|--|--|
| <ul style="list-style-type: none">▶ Known or reasonably estimable, qualitative and quantitative information about the exposure at the end of the reporting period. Specific details of legislation are not required, and disclosures may be in the form of an indicative range▶ If information is not known or cannot be reasonably estimated, disclose information about the progress made to assess Pillar Two exposure | <ul style="list-style-type: none">▶ Annual report periods beginning on or after January 1, 2023, and▶ Interim reporting beginning after December 31, 2023 |

Source: EY, Amendments to IAS 12: International Tax Reform Pillar Two Model Rules, May 2023

Compliance to Pillar Two involves sourcing vast amounts of 'new' data

For Pillar Two, up to 200 different data points are required to be collected for each legal entity in the MNC group. These data points need to be extracted from various source systems, including consolidation systems and human resource systems. Given the vast amount of data points required for each legal entity, companies need to automate data extraction for BEPS 2.0.



The response should involve

Tax, finance, human resource, accounting, legal and information technology teams

Consider

- ▶ Availability of data to perform the Income Inclusion Rule (IIR), Undertaxed Payments Rule (UTPR) and Subject-to-Tax Rule ("STTR") calculations
- ▶ Materiality thresholds for provisions
- ▶ Resources
- ▶ Tools/Automation

How can companies prepare for BEPS 2.0?

Considerations for large MNCs operating in Malaysia

- ▶ While the Malaysian corporate income tax rate generally stands at 24%, Malaysia offers a wide range of tax incentives that can reduce a group's average country ETR below 15%.
- ▶ MNCs which are within the scope of Pillar Two should anticipate an increased compliance burden, potential accounting and cash tax increases, raised costs to be factored into merger and acquisition modeling, and the need to re-evaluate their holding and financing structures as well as their supply chains and operating models.
- ▶ BEPS 2.0 calculations involve vast amounts of data that tax departments do not currently collect. MNCs must review the configuration of systems, automation and additional resources, to meet the Pillar Two compliance and reporting requirements.

BEPS 2.0 Pillar Two readiness - Large MNCs need to:

Assess the impact

- 1 Assess GloBE technical risks and considerations, including transitional Country-by-Country Reporting (CbCR) safe harbors, and perform effective tax rate (ETR) impact assessments
- 2 Perform initial quantitative impact assessments based on historical data
- 3 Assess data, process and system requirements and gaps
- 4 Monitor Organisation for Economic Co-operation and Development (OECD) updates and local tax legislative developments

Prepare/plan reporting actions

- 1 Prepare for 2023 financial statement disclosures
- 2 Update multi-year business forecasts for the projected impact of global minimum tax
- 3 Prepare for potential 2023 financial statement disclosures as well as 2024 interim and annual financial statement disclosures of Pillar 2 tax provisions
- 4 Plan for potential global minimum tax estimated payments due in 2024

Note:

Data, process and system requirements and gaps may differ for:

- ▶ multi-year forecast minimum ETR and tax cash;
- ▶ single-year forecast ETR and tax cash; and
- ▶ year-end group and statutory provisions.

Companies must prepare for GloBE information return filings in 2026.

How to address the cross-functional processes in Pillar Two

| | | |
|--|----------------------------------|--|
| | Data and systems | <ul style="list-style-type: none"> ▶ Are your systems ready for the new data requirements of Pillar Two? ▶ Both require calculations using data points that tax departments likely do not currently collect. ▶ How will you manage the tax accounting data requirements resulting from the global minimum tax rules? ▶ Do your deal models factor in the potential impact of Pillar Two, including the transition rules that cover transactions now? ▶ Can the headquarter entity provide employee/contractor information for all business locations? |
| | Stakeholder communication | <ul style="list-style-type: none"> ▶ How will you communicate BEPS related financial impact and organizational changes to your Board, Audit Committee and other key stakeholders, including all elements of the new age of tax reporting? |
| | Process and governance | <ul style="list-style-type: none"> ▶ Have you identified a steering committee to monitor progress in understanding potential tax impact and adaptations to your tax/finance operating model? |
| | Advisory | <ul style="list-style-type: none"> ▶ Have you considered the location of your legacy external debt and the potential impact of Pillar Two? ▶ Have you considered the potential impact of Pillar Two on your effective tax rate, global structures and value chains? |
| | Audit readiness | <ul style="list-style-type: none"> ▶ Are the additional tax calculations and processes in-scope for internal audit? ▶ Are your systems ready for an external examination under Pillar Two? |
| | Provision and compliance | <ul style="list-style-type: none"> ▶ What is your resource plan to coordinate and execute BEPS-related impacts to changes in provision and compliance processes? ▶ How will you address needs for local country accounting and tax expertise? ▶ What resources and systems will you utilize to harmonize and consolidate local statutory, tax and BEPS 2.0 data across multiple languages, formats, currencies and rules? ▶ Do your deal models factor in the potential impact of BEPS 2.0, including the transition rules that cover transactions now? |

Source: EY, Preparing for the impact of BEPS 2.0 - CFO, Key tax considerations for your organization, 2023

Next steps: C-suite considerations

The global minimum tax rules are likely to be enacted in countries by 2023 and take effect beginning 2024, with the rollout of the global minimum tax rules continuing around the world for several years.

MNCs need to focus on the new data requirements and monitor developments in the relevant industries and sectors to prepare for the rules and compliance.

Implementing BEPS 2.0: C-suite considerations

Financial reporting

- ▶ Impact on audit
- ▶ Impact of higher tax costs: ability to invest and the need to restructure
- ▶ Impact on shareholder return: extent of disclosures to investors
- ▶ Accuracy of the year-end disclosures

Data integrity

- ▶ Reliability of new sets of data and development of new tax models to facilitate sound business decisions and monitoring
- ▶ Higher level of scrutiny of cross-border arrangements

Overall model

- ▶ Recalibration of the operating models/value chain to ensure data optimization

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Pillar Two compliance will require significant cross-functional coordination involving tax, accounting, legal, IT and relevant business areas.

More than ever before, having accurate data will be crucial to manage compliance to the global minimum tax, and financial accounting and reporting aspects.



Lee Pei Yin
Malaysia Financial Accounting
Advisory Services Leader,
Ernst & Young PLT

How EY teams can help

Connecting the dots across the new tax journey

For organizations to understand, evaluate and communicate appropriate responses to BEPS 2.0 Pillar Two, our services include the provision of detailed, high-level analysis, as well as recommendations and implementation of desired changes to existing structures, to support a coordinated approach for your Pillar Two solution.

Education and scoping*

- ▶ Learning on all aspects of Pillar Two
- ▶ Input in determining the learning needs of Pillar Two stakeholders
- ▶ Technical support to understand the rules and data requirements
- ▶ Provision of working templates
- ▶ Reviewing of outputs and conclusions

Governance and monitoring*

- ▶ Input in determining project management and reporting protocols
- ▶ Input in developing and monitoring project plans
- ▶ Input in identifying future high-level responsibility assignment (RACI) matrix for the Pillar Two process
- ▶ Provision of insights into the policy implementation status and local country legislation

Assessment of current state*

- ▶ Preliminary safe harbor calculations, including data source and qualification assessments
- ▶ ETR assessment and high-level top-up tax estimate for low tax jurisdictions
- ▶ Preliminary data readiness assessment and identification of gaps
- ▶ Input in understanding the technology solutions available for Pillar Two compliance and reporting
- ▶ Draft 2023 and preliminary 2024 financial statement disclosures for GloBE tax

Roadmap and Implementation*

- ▶ Develop a process to gather data and calculate multiyear forecasted, interim and annual GloBE provision models
- ▶ Review of data collection templates (inputs and outputs)
- ▶ Tax technical input on questions arising during the implementation phase related to processes and controls
- ▶ Independent testing of selected compliance and reporting tools
- ▶ Training materials

*Subject to local audit independence rules

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The Latest on BEPS and Beyond
(July 2023)

24 JUL 2023
Global Tax Alert



BEPS 2.0 - Pillar Two Developments
Tracker

