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PILLAR TWO DISCLOSURES UNDER COMPANY LAW: ANALYZING MODERN ACCOUNTING STANDARDS AND DISCLOSURES CONCERNING DEFERRED TAX LIABILITIES AND INTERNATIONAL TAX REGULARIZATION

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INTRODUCTION

As the world of business has become more global, governments are facing pressure to coordinate their tax policies to tackle tax avoidance by multinational corporations (MNEs). The most important contribution to international taxation has been the efforts of the Organisation for Economic Co-operation and Development (OECD) to put in place a Global Anti-Base Erosion (GloBE) regime that would require a minimum effective tax rate of 15% in each jurisdiction in which a large multinational group does business.[1] Pillar Two is mainly a tax policy issue, but it also has significant company law, financial reporting and corporate governance implications.[2]

Businesses will need to review their accounting processes, including deferred tax assets and liabilities, tax disclosures and transparency of the financial statements, in the wake of the implementation of Pillar Two. The accounting principles have thus been adapted to reflect these changes, and companies are now obligated to present shareholders with more transparent information about their Pillar Two exposure. While governments everywhere are rushing to

[1] Organisation for Economic Co-operation and Development (OECD), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) (2021).

[2] Organisation for Economic Co-operation and Development (OECD), Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (2021).

enact laws that apply to compliance, corporate compliance has come a long way from tax planning and is now more than ever required to follow company law and accounting regulation.

UNDERSTANDING THE PILLAR TWO FRAMEWORK

The Pillar Two proposal is part of the inclusive framework on base erosion and profit shifting (BEPS 2.0) developed by the OECD/G20. It aims at multinational enterprise groups with consolidated annual revenues exceeding €750 million and aims to create a uniform global minimum tax rate.[3]

The framework includes a series of interdependent rules: the Income Inclusion Rule (IIR), the Under Taxed Profits Rule (UTPR) and the Qualified Domestic Minimum Top-up Tax (QDMTT).[4] Together these mechanisms provide the possibility for more taxation towards the minimum tax rate set in the jurisdiction in which income is generated.

These new rules have a substantial impact on the calculation of corporate taxes and will call for business entities to keep track of their effective tax rates in various jurisdictions and ensure uniformity of accounting.

RELATIONSHIP BETWEEN PILLAR TWO AND COMPANY LAWS

Pillar Two is a global tax reform but it will have a direct impact on compliance of company law. In many jurisdictions the corporate legislation requires that companies prepare financial statements that are a true and fair representation of the company's financial position.[5] Pillar Two could introduce new tax requirements, which companies will need to be able to properly account for in their financial statements.

Boards of Directors are being given a greater say in the governance of taxes, which is a part of their fiduciary duties.[6] A good corporate tax risk disclosure is a vital element of corporate

[3] OECD, Tax Challenges Arising from Digitalisation – Global Anti-Base Erosion Model Rules (Pillar Two) arts. 1.1–1.3 (2021).
[4] OECD, Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two) (2023).
[5] Companies Act, No. 18 of 2013, §§ 129–134 (India).
[6] Companies Act, No. 18 of 2013, § 166 (India).

governance at companies listed on the stock exchange, especially those that have a high concentration of investors who use financial statements to make investment decisions.

DEFERRED TAX LIABILITIES UNDER MODERN ACCOUNTING STANDARDS

One of the most difficult parts of implementing Pillar Two is deferred tax accounting. Deferred tax liabilities will occur if there are taxable temporary differences between the carrying amount of assets or liabilities and the corresponding tax bases that are expected to be recognized in the future.[7]

The accounting principles that have been generally accepted in the industry (GAAP) dictate that deferred taxes are recognized when tax laws are enacted or substantively enacted. But Pillar Two brings a whole new way of calculating taxes which is not always aligned with their home corporate taxes.

In view of these, the International Accounting Standards Board (IASB) made temporary changes to IAS 12 (Income Taxes).[8] The changes offer a temporary mandatory exception from accounting for deferred tax assets and liabilities that are created by the Pillar Two rules, and mandate detailed disclosure in qualitative and quantitative terms about the exposure of the entity to the legislation. The aim of these amendments is to prevent the double accounting of these changes and to provide sufficient information for investors to consider future tax implications.[9]

ENHANCED FINANCIAL STATEMENTS DISCLOSURES

The accounting standards in use have become more transparent than they are only about compliance. The new disclosure regime will necessitate the provision of explanations on:

- Whether Pillar Two legislation has been enacted or substantively enacted in relevant jurisdictions.[10]
- The jurisdictions in which entity could be subject to top-up taxes.

[7] Int'l Acct. Standards Bd., International Accounting Standard (IAS) 12 – Income Taxes (2023).
[8] Int'l Acct. Standards Bd., International Tax Reform—Pillar Two Model Rules (Amendments to IAS 12) (2023).
[9] IFRS Foundation, Effects of International Tax Reform—Pillar Two Model Rules (2023).
[10] IAS 12, supra note 7, ¶¶ 88A–88D.

- Management's estimate of possible financial effects.
- Where applicable, the present tax expense based on Pillar Two rules.
- Significant judgments and assumptions relating to determining tax exposure.

These disclosures will help investors, creditors, auditors and regulators assess the financial risks arising from international minimum taxation.[11] Multinational companies with operations in multiple countries face a challenge of coordination between their finance, legal, tax and compliance teams for the preparation of these disclosures.

ISSUES IN CORPORATE GOVERNANCE AND COMPLIANCE

Pillar Two impacts more than just accounting departments and needs to be implemented through organization-wide governance. Systems need to be established to ensure the collection of accurate tax information from subsidiaries in various countries.

Boards of directors are increasingly taking on the role of monitoring the tax governance frameworks and making sure that the management has in place sufficient internal controls on the gathering of data, the computation of taxes and the reporting to regulators. Audit committees also are crucial in conducting a review of the underlying assumptions that the company uses for tax disclosures and ensure adherence to the appropriate accounting standards.[12]

IMPLICATIONS FOR INDIA

India has always been a staunch supporter of the OECD Inclusive Framework for the counteraction of aggressive tax avoidance.[13] While a full rollout of Pillar Two in India is still underway, multinational companies with substantial cross-border operations are gearing up for increased reporting requirements.

[11] IFRS Foundation, IAS 12 Educational Material on Pillar Two Disclosures (2023).
[12] Securities & Exchange Bd. of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, regs. 17–18.
[13] Ministry of Finance, Government of India, India Joins OECD/G20 Inclusive Framework on BEPS (official press release).

As regulatory guidance emerges, Indian companies preparing financial statements in accordance with Ind AS (which has converted to a large extent with International Financial Reporting Standards (IFRS)) are likely to take the disclosure requirements as guidance.[14]

CONCLUSION

But the concept of Pillar Two is one of the most groundbreaking international tax reforms in recent decades, and it is effective far beyond tax to issues of corporate governance, financial reporting and company law.[15] The adoption of new accounting standards that include a deferred tax liability and an expanded disclosure area for deferred tax liability is testament to a newfound trend toward transparency in multinationals taxation.

Although there is some relief in the implementation, companies will still find it important to make substantive disclosures about exposure to Pillar Two taxes. This demands strong governance systems, effective internal controls and strong interaction between the legal, accounting, and tax advisors.[16]

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[14] Companies (Indian Accounting Standards) Rules, 2015 (India).
[15] OECD, Pillar Two in a Nutshell (2024).
[16] Organisation for Economic Co-operation and Development (OECD), Implementation Handbook for the Global Minimum Tax (Pillar Two) (2023).