Joint Statement – Impacts of the Pillar 2 Deferred Tax Recapture Rule for Leasing companies

13 March 2024

Introduction

The Pillar 2 GloBE rules came into effect at the beginning of 2024. Under the Pillar 2 GloBE rules, certain deferred tax liabilities are subject to recapture. The Deferred Tax Recapture Rule poses a potential unreasonable and, in our view unintended disadvantage for leasing companies in the Nordics. We believe that putting one industry at a disadvantageous situation compared to others has not been the purpose of the Pillar 2 regulation, and we are of the opinion that the OECD guidelines/administrative guidance should be amended in this regard.

Below, we outline the issue that leasing companies in various Nordic countries are facing regarding the impacts of the Deferred Tax Recapture Rule as well as our proposed solution.

Pillar 2 Deferred Tax Recapture Rule for financial lease at the lessor side

According to the Article 4.4.4 of the Pillar 2 GloBE rules certain deferred tax liabilities are subject to recapture. This means that if they are not fully utilized within 5 years, the outstanding deferred tax liability is clawed back in the original years of the GloBE effective tax rate calculation. If deferred tax is recaptured, the profit and loss credit is effectively transferred to the year the deferred tax liability was created, reducing the tax charge, and potentially creating or increasing top-up tax payable for that year.

According to IFRS 16, financial leasing agreements are reported in the balance sheet as a receivable from the lessee (which decreases during the lease term). However, according to the national accounting rules (local GAAP) Finland and Sweden, as well as for small companies in Norway, and tax legislation in the Nordics (Finland, Norway and Sweden), the leased property is regarded as a fixed asset subject to depreciation. IFRS, the local accounting rules and tax rules applied to fixed assets in the Nordic countries are as follows:

Finland	Accounting	Local GAAP: Deprecation over the period the asset is used IFRS: depreciation over lease term
	Taxation	Depreciation: 25% residual value
Norway	Accounting	Local GAAP for small companies: depreciation over the period the asset is used IFRS: depreciation over lease term
	Taxation	Depreciation: 10-30% residual value
Sweden	Accounting	Depreciation over the period the asset is used
	Taxation	Simplified, 30% declining balance or 20% straight-line

The different treatment of financial leasing results in a deferred tax liability (DTL) for differences between IFRS and local GAAP, IFRS and taxation as well as local GAAP and taxation. The assets are depreciated on an aggregated basis, meaning that it is difficult – and to some extent in practice impossible – to trace a deferred tax liability to a certain asset.

Leased property is often leased for a period exceeding 5 years (20 – 40 years' lease periods are not exceptional) and in addition, a lease agreement often includes an option to extend the lease period (e.g. 5 years + an option of additional 3 years). Lease periods exceeding 5 years lead to a decrease in income tax cost in the GloBE calculation and thus very likely into top-up tax impacts. The effective tax rate calculated according to GloBE rules may decrease under 15% solely due to the use of the Deferred Tax Recapture Rule on DTL on differences in IFRS/local GAAP/taxation valuation on leased property.

Typically, leasing companies have a huge number of financial leasing contracts. There can be tens or hundreds of thousands of assets leased. At the end of each lease period, the assets are sold and typically, most of the deferred tax liability is discharged at the end of the rental period. The below examples show how the deferred tax liability is formed, reduced and then, at the end of the lease period, discharged.

Example
Asset leased for 10 years

Acquisition price	800 000 000	
Residual value	-	
Depreciation time, years	10	
Tax depreciation	24 %	residual value
Tax rate	25 %	

	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
IFRS depreciation	- 64 800 765	- 67 781 600	- 70 899 554	- 74 160 933	- 77 572 336	- 81 140 664	- 84 873 134	- 88 777 298	- 92 861 054	- 97 132 662
Tax depreciation	- 192 000 000	- 145 920 000	- 110 899 200	- 84 283 392	- 64 055 378	- 48 682 087	- 36 998 386	- 28 118 774	- 21 370 268	- 16 241 404
Changes of temp. difference	**127 199 235**	**78 138 400**	**39 999 646**	**10 122 459**	**- 13 516 958**	**- 32 458 576**	**- 47 874 748**	**- 60 658 525**	**- 71 490 786**	**- 80 891 259**
Change of DLT	31 799 809	19 534 600	9 999 912	2 530 615	- 3 379 240	- 8 114 644	- 11 968 687	- 15 164 631	- 17 872 697	- 20 222 815
Cumulative DLT	**31 799 809**	**51 334 409**	**61 334 320**	**63 864 935**	**60 485 696**	**52 371 051**	**40 402 364**	**25 237 733**	**7 365 037**	**- 12 857 778**
Tax residual value	**608 000 000**	**462 080 000**	**351 180 800**	**266 897 408**	**202 842 030**	**154 159 943**	**117 161 557**	**89 042 783**	**67 672 515**	**51 431 111**

The Deferred Tax Recapture Rule has turned out to be a severe problem for leasing companies in the Nordics. The impact of this rule threatens to create significant top-up tax impacts for these companies. We firmly believe that this was not the intention when drafting the Pillar 2 GloBE rules. It is also important to note that there is no corresponding issue on the lessee side, as the exemption to the Deferred Tax Recapture Rule applies to leased income for lessees. To avoid unintended consequences of the Deferred Tax Recapture Rule, the mentioned exemption should also apply to lessors.

<u>Suggested solution</u>

The exemption of the Deferred Tax Recapture Rule (Article 4.4.5 of the Pillar 2 GloBE rules) should be amended to also include the DTL on leased assets on the lessor side when the underlying asset constitute fixed assets.

Conclusion

We kindly request that the OECD delegates from our countries raise this issue within the OECD and advocate for changes in the GloBE regulations/OECD administrative guidance. This will help address the unreasonable and unintended consequences of the Deferred Tax Recapture Rule for leasing companies in a timely manner.

For more information, please contact:

- Marja Blomqvist, Head of Tax Regulation, Finance Finland, marja.blomqvist@financefinland.fi
- Herborg Horvei, Principal Advisor, Finance Norway, herborg.horvei@finansnorge.no
- Katrin Fahlgren, Senior Legal Advisor, Swedish Bankers' Association, katrin.fahlgren@swedishbankers.se