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## Amendment IAS 12 – International Tax Reform – Pillar Two Model Rules Cover Note

### Objective

- 1 The objective of this session is to:
  - (a) provide a summary of the feedback received by constituents related to EFRAG's DCL; and
  - (b) to discuss and approve the EFRAG Secretariat's recommendations on a proposed final comment letter.

### Background

#### *Project Information*

- 2 In December 2022 the EFRAG FR TEG and the EFRAG FRB received an introduction to the project and provided some initial feedback. In addition, the EFRAG FRB agreed to adopt a fast-track approval process of EFRAG's comment letter in response to the IASB's ED and of the endorsement advice on the IASB's expected amendments.
- 3 On 9 January 2023 the IASB published the Exposure Draft ED/2023/1 *International Tax Reform—Pillar Two Model Rules* (Proposed Amendments to IAS 12) ("[the ED](#)") with a comment period ending 10 March 2023.
- 4 The ED would introduce:
  - (a) a (mandatory) temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules; and
  - (b) targeted disclosure requirements:
    - (i) before; and
    - (ii) after the Pillar two model rules are in effect.
- 5 EFRAG published its draft comment letter ('[DCL](#)') on the ED on 30 January 2023. In its DCL, EFRAG supported the IASB's proposal to introduce a temporary exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities arising from the OECD's Pillar Two Model Rules. However, EFRAG outlined that it would engage with its constituents during the outreach of the ED to ascertain the usefulness of the proposed targeted disclosures for users and to assess the feasibility (including costs) for preparers. EFRAG DCL's comment period ended on 27 February 2023.

*EFRAG Secretariat activities to seek constituents' view on the ED and on its DCL*

- 6 EFRAG organised closed consultations with EFRAG's consultative bodies, group of preparers from the pharmaceutical industry, professional organisations of preparers, users and auditors and participated in a public meeting with national standard setters (ASAF) and with the ASCG working group tax. EFRAG had in total 10 outreach events on the proposals included in the IASB's ED. A detailed list of such outreach events and a summary of the feedback obtained are included in the *Agenda Paper 01-02 – Feedback on outreach activities on IAS 12*.
- 7 In addition, EFRAG Secretariat analysed all the comment letters received in response to EFRAG's request for comments to its DCL. A detailed list of respondents and a summary of the responses received are included in the *Agenda Paper 01-03 – Comment letter analysis on IAS 12*.

*Summary of feedback from constituents to the ED and EFRAG DCL*

Question 1 - Temporary exception to the accounting for deferred taxes

- 8 Constituents generally agreed with the introduction of a temporary exception to the accounting for deferred taxes related to Pillar Two rules, including any qualified domestic minimum top-up tax, mainly due to the complexity of the calculation and the general uncertainty around the new rules. In addition, they also agreed with the IASB's proposal making it mandatory for all entities reducing the risk of diversity in practice and inconsistent interpretations of IAS 12 requirements.
- 9 However, some concerns were expressed in relation to:
  - (a) The usefulness of the disclosure requirements in paragraph 88A of the ED – Some preparers, one NSS and one auditor questioned the reasoning and the usefulness of such a disclosure, since the exception is mandatory (i.e., everyone must apply it) and other IFRS Standards already required entities to disclose their relevant accounting policies (e.g., IAS 1 Presentation of Financial Statements). In addition, this auditor suggested that it could be more meaningful disclosing whether the entity is in scope of Pillar Two rules rather than that the exception had been simply applied;
  - (b) Extending such an exception to disclosing information on deferred taxes – Some users and some NSS highlighted that, considering the absence of a sunset clause, potential deferred taxes could become relevant in the next years, when the uncertainty around the calculation should decrease and the information should be more reliable. Therefore, they suggested to the IASB to allow entities to disclose such an information once relevant and reliable.
  - (c) Risk of misleading interpretation of paragraph 4A of the ED in relation to the extent to which such an exception and disclosure requirements would apply – Two constituents (a NSS and an auditor) suggested the IASB to clarify (at least in the BC) how to interpret the definition of income taxes based on the proposed amendments to IAS 12.
- 10 Constituents generally agreed with the EFRAG's suggestion to encourage the IASB to:
  - (a) monitor the forthcoming enactment process and to coordinate with other standard setters, including the FASB. Some constituents also highlighted the need to monitor the potential impacts of the ED in terms of convergence with US GAAP and, therefore, in terms of comparability across different jurisdictions; and
  - (b) to clarify whether Pillar Two income taxes are in the scope of IAS 12 in situation outside the context of consolidated financial statements, where the standalone entity is liable to pay the top-up tax, but such a tax was triggered by another entity of the group. However, almost all constituents highlighted

that moving forward with the exception as proposed in the ED is more important than explicitly clarifying every single application question which might still arise in practice. Therefore, they suggested addressing such an issue in a wider scope (as similar questions related to other income tax matters already exist), separate and specific project.

Question 2 – Targeted disclosures

- 11 Constituents generally supported the IASB's efforts to define an approach that would provide information to the users to assess an entity's exposure to paying top-up tax that would not involve undue costs or effort.
- 12 Despite the general support indicated in paragraph above, there is a variety of views on whether the proposed targeted disclosures would result in a reasonable balance between costs and benefits. Some respondents fully supported the proposed targeted disclosures while a majority of respondents (mainly preparers) had doubts or did even not support all or any of the proposed targeted disclosure requirements.
- 13 The main concerns of the constituents that had doubts or did not support the proposed disclosures requirements were about cost and the usefulness of the information. They indicated that the disclosures would likely not be useful to enable users understand the effects of Pillar Two model rules since they follow other requirements than IAS 12. They also noted that the required information is as of today not available for many entities and would have to be calculated separately, resulting in an additional administrative burden and costs for such preparers
- 14 Users shared the view that the most important information that entities could provide would be some sort of forward guidance of the expected tax rate. Users considered the proposed disclosure requirements to be useful information that provide some indication of the company's exposure to paying top-up tax and how this affects tax expense. They also considered that information based on IAS 12 was a good starting point because it provides uniform and audited information. Entities should avoid making general statements about the impact of the rule without providing details. In cases where the IAS 12 information would be considered misleading by the entity, this could be clarified in the notes. The EFRAG Secretariat discussed the proposed disclosure requirements with the users based on mock up disclosures (see appendix 1 of agenda paper 01-01).
- 15 Auditors expressed the view that the proposed disclosures were a compromise between availability, complexity and relevance. Furthermore, they noticed that introducing an objective may help entities apply the materiality concept.
- 16 With regard to the national standard setters and regulators, there were mixed views. Some supported the targeted disclosure requirements as proposed by the ED while some others did not support all or any of the proposed disclosures and provided alternative suggestions.
- 17 Some constituents also highlighted the importance of avoiding any delay on this project.

Question 3 – Effective date and transition

- 18 Constituents generally agreed with the ED and the EFRAG's comments included in the DCL.
- 19 Furthermore, an auditor suggested to include also in the body of the standards (i.e., in paragraph 98M (a)) the additional clarification included in the BC27, in line with the approach used with previous amendments (e.g., paragraph C1C of the amendments to IFRS 16 - *Covid-19 Related rent concession beyond 30 June 2021*).

*EFRAG Secretariat's recommendations on the proposed final comment letter*

Question 1 - Temporary exception to the accounting for deferred taxes

- 20 Based on the feedback received about the usefulness disclosing that the entity has applied the exception (paragraph 88A of the ED), EFRAG Secretariat suggests the IASB clarifying the reason why it considered such a specific disclosure useful for users of financial statements despite the general disclosure requirement already provided for other IFRS Standards. To have a disclosure objective as part of the amendments would be useful. Please refer to change in paragraph 5 of the proposed Final Comment Letter (Agenda Paper 01-04), corresponding to the previous paragraph 12 of the DCL.
- 21 Based on the feedback received on EFRAG's additional question to constituents in paragraph 19 of the DCL, which refers to the exception extended also to disclosing information about potential deferred taxes, EFRAG Secretariat noted that this information could be useful for users especially in future years once the uncertainty should be over. There, we suggest the IASB clarifying whether an entity would be allowed to provide this information, when relevant and reliable, on a voluntary basis. Please refer to change in paragraph 6 of the proposed Final Comment Letter (Agenda Paper 01-04), corresponding to the previous paragraph 13 of the DCL.
- 22 Many constituents stressed the need to coordinate with other standard setters, including the FASB, in order to monitor and to promptly reply with their potential forthcoming action ensuring comparability across jurisdictions. In addition, some constituents also suggested to rephrase our comment in paragraph 15 of the DCL suggesting the IASB to assess whether the exception could be retained as permanent based on cost-benefit consideration. Please refer to change in paragraphs 8 and 26 of the proposed Final Comment Letter (Agenda Paper 01-04), corresponding to the previous paragraphs 15 and 43 of the DCL.
- 23 Some constituents highlighted potential misleading or different interpretations of the scoping definition as stated in paragraph 4A of the ED (i.e., "*IAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules*") asking for additional clarification to the IASB in order to avoid diversity in practice and comparability issues.
- 24 In addition, many constituents agreed with the EFRAG's suggestion to encourage the IASB to clarify whether and how paragraph 4A if the ED is applicable in situations outside the context of consolidated financial statements. However, they also highlighted that the priority should be the issuance of the amendments as soon as possible; specific application issues could be addressed by the IASB separately or at a later stage.
- 25 Therefore, EFRAG Secretariat encourages the IASB to clarify, at least in the Basis for Conclusions, such scoping matters providing that the issuance of these urgent amendments is not delayed. Please refer to changes in paragraphs 10 and 11 of the proposed Final Comment Letter (Agenda Paper 01-04), corresponding to the previous paragraph 17 of the DCL.

Question 2 – Targeted disclosures

*Disclosures before legislation is in effect*

- 26 During the outreach events some preparers raised questions to understand the disclosure objectives. In addition, other constituents suggested introducing a disclosure objective as it might help entities applying the materiality concept. The EFRAG Secretariat has sympathy with this proposal which is consistent with the middle ground approach recently discussed in one of the Disclosure Initiative projects. Therefore, the EFRAG Secretariat recommends incorporating a specific

disclosure objective that describe the needs of users of financial statements to assess an entity's exposure to paying top-up tax.

- 27 Regarding the disclosure requirement included in paragraph 88C (a) of the ED, EFRAG has received mixed responses during its consultation. Some respondents agreed with the proposed disclosure requirements while some others did not. The main reason for respondents not to agree was that an analysis of the implementation status in each individual country would result in undue cost or effort. The IASB staff explained on the 10 February ASAF meeting that the intention of this disclosure requirement was not that entities provided a two-page disclosure. They noted that entities would need to think about their specific circumstances and apply judgment.
- 28 Therefore, the EFRAG Secretariat suggest that the IASB should clarify its intentions in the Basis for Conclusions and to the extent possible in the main body of the Standard. For instance, they could say in the Basis for Conclusions that given the top-down approach of the Pillar Two legislation, it might only be relevant to disclose information about the ultimate parent entity of a group if the jurisdiction where this entity is based has enacted or substantially enacted Pillar Two Model Rules.
- 29 With regard to the disclosure requirement included in paragraph 88C (b) of the ED, The EFRAG Secretariat observes that a majority of respondents did not express support for this requirement. However, a few of them considered that timely publications of the amendments should take precedence over perfecting the disclosure requirements.
- 30 The EFRAG Secretariat points out that the feedback gathered from users indicates that it is relevant for them to have as a starting point information based on IAS 12. It will allow them to have comparable and reliable information (as audited). They would welcome if in addition to the IAS 12 assessment, entities provided qualitative information based on Pillar Two legislation. However, they would not rely solely on Pillar Two qualitative assessments. Some respondents other than the users suggested that entities should disclose Pillar Two information if it is available, and the data is reliable, instead of information based on IAS 12.
- 31 The EFRAG Secretariat is concerned that major changes in the disclosure requirements proposed by the IASB might lead to a delay or even a re-exposure of the proposals. Taking into consideration that in the EU it will take some time to endorse the amendments, there is a risk that the amendments will not be endorsed before the end of the year and entities need to account for deferred taxes arising from Pillar Two Model Rules. Bearing the time constraint in mind, the EFRAG Secretariat suggest a change in the approach that in our view should not trigger a relevant delay in the process of finalisation of the amendments. The proposed compromise would not fully satisfy the request of the users and the regulator to have a uniform starting point based on IAS 12 information in the financial statements while the preparers would receive the possibility to save some cost in case they have already assessed sufficiently the impact of Pillar Two top-up tax. However, the approach would lead to relevant information to assess the impact.
- 32 The EFRAG Secretariat proposes a more principle based and less prescriptive approach:
  - (a) to include the disclosure objective in the main body of the standard (see BC 19 - In periods before Pillar Two legislation is in effect, users of financial statements need information to help them assess an entity's exposure to paying top-up tax.);
  - (b) to allow that entities provide their assessment based on Pillar Two model rules if available instead of information based on IAS 12. Such assessment should not only be qualitative in nature and should be described in the notes. That would integrate the current requirements in 88C (c) into this disclosure requirement.

- (c) If the entity has no reliable assessment made that provides sufficient detailed (quantitative) information to fulfil the disclosure objective, entities should be required to satisfy the users information needs with the proposed disclosure requirements currently included in the ED (accompanied with some clarification useful for preparation of the information). In addition, the information proposed in 88C (c) need to be provided, if available.
- 33 The EFRAG Secretariat observed that during the outreaches there has been some confusion around the meaning of ‘these jurisdictions in aggregate’ in paragraph 88C (b) of the ED. Some constituents considered that they should provide information in aggregate for each jurisdiction while others considered that the information should be provided in aggregate for all jurisdictions. Having listened to the IASB staff discussing about this matter on the 10 February ASAF meeting we understand that the IASB’s idea is in the second camp. The EFRAG Secretariat suggest that the IASB should clarify the wording of this sentence to avoid misunderstandings.

Question 3 – Effective date and transition

- 34 The EFRAG Secretariat agreed that incorporating some of the additional clarifications already included in paragraph BC27 of the Basis for Conclusions, and, in particular, by specifying that the amendments will be applicable to any financial statements not yet authorised for issue at that date could improve the effectiveness of paragraph 98M (a) of the ED. It has to be noted that the same approach has been already used by the IASB for a similar situation in the past (e.g., amendments to IFRS 16 - *Covid-19 Related rent concession beyond 30 June 2021*). Please refer to changes in paragraph 25 of the proposed Final Comment Letter (Agenda Paper 01-04), corresponding to the previous paragraph 42 of the DCL.

**Questions for EFRAG FR TEG and FRB members**

- 35 Do EFRAG FR TEG and FRB members agree with EFRAG Secretariat’s recommendations from paragraphs 20 to 34?
- 36 Do EFRAG FR TEG and FRB members have any other comments or recommendations?

**Agenda Papers**

- 37 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 01-02 – Feedback on outreach activities on IAS 12;
  - (b) Agenda paper 01-03 – Comment letter analysis on IAS 12; and
  - (c) Agenda paper 01-04 – Proposed Final comment letter
  - (d) Agenda paper 01-05 – Proposed Final Comment Letter compared with EFRAG Draft Comment Letter