Feedback on outreach activities on IAS 12 ED International Tax Reforms – Pillar Two model rules

Objective

1 The purpose of this paper is to provide feedback to EFRAG FR TEG on outreach activities conducted on the IASB's Exposure Draft ED/2023/1 International Tax Reform – Pillar Two Model Rules (the ED). Such a feedback received will be used to form the EFRAG position to be reflected in its final comment letter (FCL) on the ED's proposals.

Background

2 The IASB published its ED in January 2023. The ED would introduce a temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules and targeted disclosure requirements before and after the Pillar two model rules are in effect. The ED's comment period ends on 10 March 2023.

3 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 2022.

Feedback obtained from the outreach events

4 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 at the IASB's Accounting Standards Advisory Forum and with the ASCG working group on taxes. EFRAG had 10 outreach events in total on the proposals included in the ED;

5 Appendix 1 provides a detailed list of outreach conducted.

6 The feedback obtained from the outreach activities is summarised below following the order of questions included in the IASB's ED.

Temporary exception to the accounting for deferred taxes

7 Participants unanimously 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 the IAS 12 requirements. One auditor pointed out that the OECD's Pillar Two rules might lead to changes in local tax requirements which might trigger discussions on whether the changes in local tax law are covered by the exception.

8 However, some users highlighted that complexity alone could not justify the exception as well managed large multinational entities affected by the Pillar Two rules should be able to estimate the impact on their future tax payments, which should be one of the critical elements to be considered before establishing a subsidiary in a new jurisdiction.

9 Some participants raised various questions and expressed some concerns with reference to the disclosure requirements in paragraph 88A of the ED. In particular:

(a) Some participants questioned the rationale 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 material accounting policies (e.g., IAS 1 Presentation of Financial Statements);

(b) Some preparers also noted that the disclosure requirements included in paragraph 88C of the ED already provide an indication that an entity is exposed to Pillar Two legislation and therefore is applying the exception; and

(c) An auditor suggested that it could be more meaningful to disclose whether the entity is within scope of Pillar Two rules (e.g., by explaining that the quantitative and qualitative requirements defined in the Pillar Two rules had been met) rather than that the exception had been simply applied.

10 In the ASAF meeting – which was organised to discuss the application of Pillar Two rules in different jurisdictions and to allow to ask questions related to the proposals – the IASB explained the intended disclosure objective. According to the IASB the intention is to disclose that the entity is impacted by Pillar Two. As not every entity is impacted by Pillar Two rules the IASB considers this being useful information. Several standard setters noted that it could be beneficial to explain better the disclosure objective.

11 Most participants agreed with the need to ask for clarifications on how the proposed amendments would apply in the context outside the consolidated financial statements. However, these participants highlighted that this was not a completely new issue and some accounting practices for similar circumstances already existed. They acknowledged the urgent need of having the exception. From their point of view, this issue should not delay the whole project. Few standard-setters also suggested that this topic should be part of a broader discussion related to the scoping of IAS 12.

12 Most participants acknowledged the underlying reasons included in the Basis for Conclusions and agreed with the IASB's decision not to include, at this stage, a sunset clause for the application of the exception, including disclosing information about potential

deferred taxes. However, some participants expressed some concerns about potential future implications arising from the absence of a sunset clause considering that the uncertainty and the resulting complexity should decrease over the time, leading to more reliable information on potential deferred taxes (even when not accounted for). Therefore, these participants suggested that the IASB should consider whether an entity could provide such information in future periods.

13 Some participants highlighted the recent FASB's tentative decision concluding that Pillar Two rules income tax is an Alternative Minimun Tax ('AMT') for which ASC 740 *Income Taxes* provides a permanent exception to the accounting for deferred taxes. These participants noted that this approach was more pragmatic than the IASB's and some of them suggested that the IASB should adopt the same approach due to the complexity of the computation of (deferred) taxes. Convergence with US GAAP would be important but not essential. However, one auditor warned to be cautious in this respect considering that under IFRS Standards there is no specific guidance for an AMT, unlike under US GAAP.

14 In addition, participants generally suggested that the IASB should monitor the developments on Pillar Two model rules implementation and review the exception on a regular basis in order to remove it, make it permanent or make other changes to IAS 12 as appropriate. Furthermore, they highlighted the need to monitor the future tax laws developments around the world and to coordinate with local standard setters.

15 One auditor noted the need for more clarity in relation to the first sentence of paragraph 4A of the ED, which stated "this Standard applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules [...]". This participant noted that it was not clear whether it applies to all Pillar Two model rules which are therefore income taxes, or if it applies to Pillar Two model rules which also are income taxes. Another participant highlighted that the general understanding is that the IASB's intention was to scope in all Pillar Two model rules as income taxes avoiding inconsistency and ensuring more comparability. These participants suggested including a sentence in the Basis for Conclusion to prevent any misunderstanding.

Targeted disclosure requirements before the legislation is in effect

General

16 The feedback gathered on the targeted disclosures varies depending on the background of the constituents.

17 While all preparers recognised the information needs of the users of financial statements, nearly all of the preparers did not support the targeted disclosure requirements included in the ED as proposed. Those that did not support the proposed disclosures provided the following reasons:

(a) Disclosures are too prescriptive. It is not necessary for the IASB to require detailed disclosures on the impact of Pillar Two model rules. IAS 1 already requires entities to communicate on any significant event that might be material;

(b) Disclosures might be commercially sensitive. They might be more interesting for tax authorities than for users;

(c) Disclosures will likely not be useful to enable users understand the effects of Pillar Two model rules. They could even be misleading if users are not aware that Pillar Two Rules follow other requirements than IAS 12.

(d) Disclosures might be costly to provide.

18 Specifically, preparers raised questions to understand the disclosure objectives. In this context, how the materiality concept was to be applied in the context of the disclosures was discussed.

19 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. They 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. It could be complemented with a qualitative assessment from the entity of whether the impact is relevant under the Pillar Two rules. For instance, to point out that the IAS 12 disclosure is not a good proxy and to explain the reasons for that. Users stated that Pillar two rules can have two effects: one is to pay top-up tax and the other is to have local tax increases in low tax regions. A user indicated that having the impact from equity method investments, associates and minority interests would also be useful as well as having country-by-country disaggregation.

20 Auditors expressed the view that the proposed disclosures were a compromise between availability, complexity and relevance. They pointed out that perfectioning disclosures should not come at the price of delaying the exception. They also noted that stakeholders should be reminded that materiality is a principle universally present in IFRS, the specific disclosure in the ED are not exception from this. Therefore, preparers needed to apply judgment and the objective of providing relevant informations when it comes to apply the disclosure requirements. Furthermore, they noticed that introducing an objective may help entities apply the materiality concept.

21 An auditor suggested three potential approaches to move forward:

(a) To request disclosure requirements similar to those requested in paragraph 24I of IFRS 7 in the context of the Interest Rate Benchmark Reform (i.e., to request the nature and extent of risks to which an entity is exposed arising from the implementation of the Pillar Two model rules and an entity's progress on the implementation)

(b) To separate the exception itself from the disclosure requirements. However, it was noted that by the time that the disclosures were agreed, Pillar Two legislation would be in force in many jurisdictions.

(c) To proceed with the current approach but with some clarifications. The nature of some transactions may be different if they take place in a group of entities of the same jurisdiction instead of in the consolidated financial statements of the ultimate parent entity. For instance, a transaction could give rise to a liability rather than to equity. In this regard, as there is no time to provide extensive application guidance, the ED could clarify that an entity does not need to determine what the accounting of those transactions is in a group different than the ultimate parent entity group.

22 A few standard-setters also highlighted the importance of avoiding any delay on this project.

23 Some participants highlighted the need to clarify if and how to apply the ED disclosure requirements in separate financial statements or at sub-consolidated level.

Disclosure requirement outlined in paragraph 88C (a) of the ED

24 Preparers indicated that information about Pillar Two legislation is publicly available. In addition, Information about countries and regions in which an entity operates is usually presented as an integral part of the financial reporting. Hence, they did not support this disclosure requirement because users have the possibility to obtain this information through different channels. They also noted that they should not provide information on the applicable tax law given its high dynamic environment.

25 One preparer who did not support the disclosure shared the view that disclosing the jurisdictions where an entity operates should suffice as users could find out whether Pillar Two rules are applying to those jurisdictions.

26 A standard-setter questioned the level at which this disclosure requirement should be provided (i.e. at the parent entity level or at a lower level).

27 During the ASAF meeting the purpose of the disclosure requirement was requested. The IASB explained that such a disclosure could be useful informing the users of financial statements whether the entity would be impacted by the Pillar Two rules and therefore has applied the exception. Indeed, not all entities could fall in scope of the Pillar Two rules. Furthermore, the IASB highlighted that the IASB's intention was not to ask for the entities providing a list of jurisdictions where they operate but to require an entity to exercise judgment to assess what information would be material and that therefore should be provided for.

Disclosure requirement outlined in paragraph 88C (b) of the ED

28 Nearly all preparers do not support this disclosure requirements because of the following reasons:

(a) The information does not give a faithful representation of the potential impact of Pillar Two legislation and are, therefore, not useful for users. The information could even be misleading:

(i) The calculation of the effective tax rate according to IAS 12 is significantly different from Pillar Two legislation;

(ii) IAS 12 tax expense is just the starting point for Pillar Two purposes and must be adjusted for several items, resulting in different numbers;

(iii) the accounting profit of a jurisdiction might contain some information such as dividend incomes that must be eliminated of the GloBE income; and

(iv) The effective tax rate is highly volatile. Information on year 2023 could not reflect the impact of Pillar Two rules on year 2024.

(b) The proposed 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. Entities may require implementing additional reporting procedures, especially if there are several entities in each jurisdiction. Their reporting packages (and consolidation process) might not be organised by jurisdictions (e.g., it could be organised by businesses instead);

(c) The disclosure will only be applicable for a short period of time (perhaps only one year);

(d) The disclosures are similar to country-by-country reporting; and

(e) Providing forward looking information on potential future top-up tax is not within the remit of the financial statements.

29 The country-by-country reporting concern was discussed with the IASB during the ASAF meeting. The IASB clarified that they proposed to provide information in aggregate (not country by country).

30 One preparer supported the proposed disclosures. It explained that due to the structure of their group and due to the consolidation system and consolidation approach the information would be available and could easily be aggregated to fulfil the disclosure requirements.

31 Several preparers acknowledged the benefit of using audited information to provide the information to the users. Nevertheless, they stated that this disclosure requirement could be prepared in different ways. Additional guidance could be helpful.

32 Some standard-setters shared some concerns on the cost versus benefit assessment of this disclosure as there are some interpretation questions and it will only be applicable for a short period of time. One of them was unclear about the definition of accounting profit by jurisdiction.

33 On the contrary, users considered that it was very relevant that entities provided those jurisdictions having an effective tax rate below 15% as well as the aggregated figures because this information enabled them to assess the impact on future tax expense.

34 Some preparers suggested to provide a qualitative assessment rather than the current quantitative disclosure requirements proposed in the ED.

Disclosure requirement outlined in paragraph 88C (c) of the ED

35 An organisation of preparers did not support the disclosure requirement. They noted that an entity must make 2 different calculations to comply with the requirements of 88C (b) and 88C (c) to provide the required information. There might also be an expectation gap between this disclosure requirement and the fact that entities might not be able to collect the necessary information and make an assessment until later. In addition, the requirement does not specify any time horizon for this assessment.

36 Similarly to EFRAG, this organisation noted that a literal reading of the requirement is that an entity must disclose if it has assessed the potential impact on jurisdictions without providing any supporting information or calculations. In their view, this should be clarified, if this disclosure is finally adopted.

37 During the ASAF meeting questions were raised. The IASB generally highlighted that in the BC (paragraphs BC19-BC24) the IASB already provided additional information about the

rational underlying such disclosure requirements, especially with reference to paragraph 88C.

Targeted disclosure requirements after the legislation is in effect

38 An organisation of preparers was not sure about the added value of this information. An auditor questioned why there is a disclosure proposed for this tax legislation but not for others.

39 Conversely, user panel members considered this information to be useful.

Effective date and transition

40 Participants unanimously agreed with the IASB's proposal in paragraph 98M of the ED.

41 One auditor suggested including in the body of the standard what is already included in paragraph BC27 with reference to the effective date of the temporary exception. In particular, this participant suggested to include "immediately upon the issue of the amendments and applicable to any financial statements not yet authorised for issue at that date". Another participant noted that the same approach had been used for the amendments to IFRS 16 - *Covid-19 Related rent concession beyond 30 June 2021* issued in March 2021 (paragraph C1C of the amendments).

42 Some participants, especially preparers, highlighted the need of having more clarity for interim reporting purposes, considering that the endorsement of the potential amendments in the EU would not be earlier than Q4 2023. In particular a preparer suggested asking ESMA to clarify whether the exception could be applied in the June 2023 interim reporting, before the amendments' endorsement.

Question for EFRAG FR TEG and FRB members

43 Does EFRAG FR TEG and FRB members have any comments/ questions on the feedback included in this agenda paper?

Appendix 1: List of outreach events where feedback has been taken into consideration in this paper

No	Participant	Description	Outreach event	Date

1	EFRAG FIWG	Financial instruments working group	Closed consultation	30 January 2023
2	EFRAG IAWG	Insurance working group	Closed consultation	1 February 2023
3	EFRAG UP	User panel	Closed consultation	3 February 2023
4	EFRAG FR TEG CFSS	Consultative group of standard-setters	Public meeting	6 February 2023
5	Group of pharma entities	Preparers	Closed consultation	7 February 2023
6	ASCG tax working group meeting	National Standard Setter	Closed consultation - ASCG preparation for the comments	10 February 2023
7	ASAF meeting	National Standard Setter Forum	IASB's public consultation	10 February 2023
8	Business Europe	Organisation of preparers	Closed consultation	21 February 2023
9	CRUF	Organisation of users	Closed consultation	28 February 2023
10	Large Audit Firms	Auditors	Closed meeting	9 January / 27 February 2023

Appendix 2: Mock-up disclosure requirements discussed with EFRAG user panel

Slides n.18 and 19 summarised the main assumptions and data used by the Group for the purpose of the mock-up disclosures (i.e., this information will be not disclosed in the notes to the consolidated financial statements)

Mock-up disclosures – Main assumptions (1/2)

Consolidated financial statements of the parent entity based in country A and its subsidiaries based in countries B and C ("the Group"). The internal data used to prepare the ED's intended disclosures is as follows (IFRS figures):

(Amounts in million euros)	Country A	Country B	Country C
Accounting profit before tax [a]	**1000**	**500**	**200**
Permanent differences [b]	-	(250)	(50)
Temporary differences [c]	(200)	-	(50)
Taxable income [d = a-b-c]	**800**	**250**	**100**
Local Tax rate [e]	*25%*	*20%*	*5%*
Current tax expense (income) [f = d*e]	200	50	5
Deferred tax expense (income) [g = c*e]	50	-	2.5
Tax expense (income) [h = f+g]:	**250**	**50**	**7.5**
Effective tax rate [i = h/a]	**25%**	**10%**	**3.75%**

Based on the figures included in the table above, Country B and C have an effective tax rate calculated in accordance with IAS 12 guidance below 15%

Meeting with EFRAG UP 2023-02-03 – ED/2023/1 International Tax Reform – Pillar Two Model rules 18

Mock-up disclosures – Main assumptions (2/2)

For the purpose of the mock-up disclosures we assume that:

- the Group has not made sufficient progress in assessing the potential exposure to paying Pillar Two income tax to disclose relevant information in the financial statements (Paragraph 88C(c) is not applicable); and
- the parent entity's jurisdiction (Country A) has implemented the Pillar Two rules. Country B and C have not implemented the Pillar Two rules.

The table below summarised the information related to the jurisdictions with an effective tax rate below 15%.

(Amounts in million euros)	Country B	Country C	Aggregate
Accounting profit before tax [a]	500	200	700
Taxable income [d]	250	100	350
Tax expense (income) [h]	50	7.5	57.5
Effective tax rate [i = h/a]	10%	3.75%	8.21%

Meeting with EFRAG UP 2023-02-03 – ED/2023/1 International Tax Reform – Pillar Two Model rules

19

Based on the main assumptions included in slides n.18 and 19, the Group would provide the following disclosures in the notes to the consolidated financial statements for the year ending 31-12-200X

Mock-up disclosures – Resulting disclosures

Consolidated financial statements of the Group – year ended 31-12-200x

Par 88A

The Group has applied the exception to recognizing and disclosing information about deferred taxes and liabilities related to Pillar Two income taxes.

Par 88C (a)

As of 1st July, 200X country A enacted OECD's Pillar Two Model Rules. These rules will come into force in 200X+1.

Par 88C (b)

The average effective tax rate of country B and country C are below 15% for the year ended 31-12-200x. The aggregated relevant figures of these jurisdictions for the year ended 31-12-200x are as follows:

- *Tax expense (income): 57.5 million euros*
- *Accounting profit:700 million euros*
- *Weighted average effective tax rate: 8.2%*

Meeting with EFRAG UP 2023-02-03 – ED/2023/1 International Tax Reform – Pillar Two Model rules

20