Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

13 March 2023

Dear Mr Barckow,

Re: Exposure Draft International Tax Reform – Pillar Two Model Rules

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft ED/2023/1 *International Tax Reforms - Pillar Two Model Rules,* issued by the IASB on 9 January 2023 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG welcomes the IASB's efforts to address the concerns of stakeholders about the implications for income tax accounting arising from the implementation of Pillar Two model rules.

EFRAG overall supports the IASB's proposal to provide a mandatory temporary exception to the requirements in IAS 12 *Income Taxes* under which an entity should neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

EFRAG is aware of the time constraints around the proposed amendments to IAS 12 (the 'Proposed Amendments'). The temporary exception is urgently needed for entities in scope of Pillar Two model rules. Hence, the proposed changes or clarifications should not lead to a delay in finalising the Proposed Amendments considering that it will take some additional time to integrate the Proposed Amendments into local law in various jurisdictions (including the European Union).

EFRAG encourages the IASB to clarify to which extent top-up taxes meet the definition of income taxes as defined in IAS 12 and whether top-up tax based on the Pillar Two model rules are in scope of IAS 12 in situations outside the context of consolidated financial statements of the ultimate parent entity. This is especially relevant if the entity which is required to pay differs from the one that reports and could impact both consolidated financial statements at sub-group level and separate financial statements.

Furthermore, EFRAG supports the efforts of the IASB to define a disclosure approach that would provide information to users of financial statements to assess an entity's exposure to paying top-up tax that would not involve undue cost or effort. EFRAG appreciates that the IASB is trying to find a compromise, considering the urgency of the project.

EFRAG proposes some improvements around the proposed targeted disclosures that in our view would not result in a delay of the project. Perfecting the disclosures should not come at the price of delaying the finalisation of the Proposed Amendments.

In view of user needs for information on the impact of the new top-up tax, EFRAG considers disclosures as important, but would suggest some changes to the IASB's proposals.

EFRAG encourages the IASB to use the new internal guidance to drafting disclosure requirements resulting from its project "Disclosure Initiative – Targeted Standards-level Review of Disclosures" and add a disclosure objective that describes the needs of users of financial statements to assess the impact of the Pillar Two rules as it might help entities to apply appropriate judgement considering their specific circumstances.

In this regard, EFRAG generally supports the disclosure objectives expressed in the Basis for Conclusions – which should become part of the main body of the Standard - and suggests some improvements in the proposed specific requirements.

EFRAG is of the view that the IASB should apply a more principle-based and less prescriptive approach to request information to assess an entity's exposure to paying top-up tax. The IASB should enable entities to provide their own quantitative assessment of their exposure to paying top-up tax prepared under Pillar Two model rules. This should be the primary option to meet the disclosure objective if an entity has reliable information using data collected from internal assessment activities readily available.

From a cost-benefit perspective, it seems more appropriate for those entities to provide disclosures based on data that they collect (and potentially report to management and those charged with governance) while preparing to comply with the Pillar Two legislation. Even though users would not receive uniform information, it should provide them with a better, and more relevant, indication of an entity's exposure to paying top-up tax. If such information is not available or is not sufficient to meet the disclosure objective, an alternative quantitative estimate that satisfies the disclosure objective should be provided. By applying principles-based disclosures entities will avoid providing information that is not relevant or even misleading for users. In this regard, the introduction of the disclosure objective should help entities to apply appropriate judgement on how to prepare the proposed information – including when IAS 12 information has been used as a proxy to explain the Pillar Two rule impact.

EFRAG agrees with the transition provisions included in the ED.

In addition, EFRAG highlights that the timing at which the Proposed Amendments will be published by the IASB is critical. Given the timing at which some jurisdictions are expected to enact or substantively enact the Pillar Two model rules, it could impact interim reporting and annual reporting periods ending before 31 December 2023.

Finally, given the absence of an end date for the temporary exception introduced by the Proposed Amendments, EFRAG recommends that the IASB schedules in its workplan an activity of review, so that the exception may be terminated, or retained as permanent, at the appropriate moment.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Juan José Gómez, Monica Franceschini or me.

Yours sincerely,

Wolf Klinz
Chair of the EFRAG FRB

Appendix - EFRAG's responses to the questions raised in the ED

Question 1

IAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the OECD, including tax law that implements qualified domestic minimum top-up taxes described in those rules.

The IASB proposes that, as an exception to the requirements in IAS 12, an entity neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

The IASB also proposes that an entity disclose that it has applied the exception.

Paragraphs BC13–BC17 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you would suggest instead and why.

EFRAG's response

1 EFRAG overall agrees with the IASB's proposal to provide a mandatory temporary exception to the requirements in IAS 12 *Income Taxes* under which an entity should neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

2 As explained in paragraph BC7 of the ED, jurisdictions may introduce a qualified domestic minimum top-up tax. Qualified domestic top-up taxes would also be computed based on the Pillar Two model rules but would be paid in the jurisdiction in which the profit arises rather than in the (ultimate) parent entity´s jurisdiction. EFRAG welcomes the IASB's proposal to apply the exception to the accounting for deferred taxes to qualified domestic top-up tax. Such domestic top-up tax causes the same concerns as potential deferred tax that arises from the other Pillar Two model rules.

3 Based on the preliminary feedback received, this temporary exception would:

(a) provide relief to entities from applying the complex calculation as required by the new tax laws, including that related to the qualified domestic top-up tax, as they do not have to consider future tax effects;

(b) avoid diversity in practice in applying IAS 12 requirements without affecting comparability between entities' financial statements, both before and after the top-up tax applies;

(c) provide more time for entities to better understand the implications of new local tax laws leading to more reliable and useful financial information; and

(d) allow to better understand users' information needs related to top-up tax.

4 EFRAG is aware of the time constraints around the Proposed Amendments. The temporary exception is urgently needed for entities in scope of the Pillar Two model rules. Hence, the proposed changes or clarifications should not lead to a delay in finalising the Proposed Amendments considering that it will take additional time to integrate the Proposed Amendments into local law in various jurisdictions (including the European Union).

5 EFRAG welcomes that the temporary exception is mandatory. Making this exception mandatory enhances comparability and avoids the risk of accounting inconsistencies as referred to in paragraph BC16(b) of the ED. In addition,

disclosing that the entity is required apply the exception provides transparency about the fact that the entity might be impacted by top-up tax. However, EFRAG suggests that the IASB clarifies in the Basis for Conclusions or, to the extent possible, in the main body of the Standard the underlying rationale asking for such a specific disclosure (e.g., it should inform users of financial statements whether the entity is in scope or not in scope of Pillar Two model rules), in view that this is an additional requirement compared to the general disclosure requirements in other IFRS Standards (e.g., IAS 1 *Presentation of Financial Statements*).

6 EFRAG received feedback from some constituents that extending such a mandatory exception to the disclosures about deferred tax assets and liabilities related to Pillar Two income taxes could lead, in future periods, to a potential loss of some relevant information. Those constituents noted that the proposals could be understood that even in future periods when companies are able to provide this information entities will not be allowed to provide such information in the notes to the financial statements.

7 Furthermore, EFRAG supports the IASB's approach not to include a sunset clause for the application of the temporary exception. This would grant additional time to impacted entities and tax specialists to assess the effects of the new tax laws and, consequently, to provide more useful and accurate financial information. In addition, considering that the OECD Pillar Two model rules might be implemented at a different point in time in the various jurisdictions, a uniform timeline would not be appropriate. In addition, it gives time to the IASB to engage with stakeholders and to carefully consider any need for standard-setting.

8 Nevertheless, EFRAG encourages the IASB to monitor the forthcoming enactment process, coordinate with other standard setters, define a specific project in its work plan and envisage a timeline to analyse the impacts of the Pillar Two model rules and assess whether any additional standard-setting activity is required (e.g., to terminate such an temporary exception or to make it permanent).

9 EFRAG also highlights that the timing at which the Proposed Amendments will be published by the IASB is critical. Indeed, given the timing at which some jurisdictions are expected to enact or substantively enact the Pillar Two model rules, it could impact interim reporting and annual reporting periods ending before 31 December 2023.

10 EFRAG acknowledges that, as stated in paragraph 4A of the ED, IAS 12 applies to income taxes arising from tax laws enacted or substantively enacted to implement the Pillar Two model rules. However, it is unclear whether all taxes arising from Pillar Two model rules meet the definition of income taxes in IAS 12 and, therefore, the related disclosure requirements. Therefore, EFRAG encourages the IASB to clarify such a scoping matter, at least in the Basis for Conclusions.

11 Lastly, EFRAG notes that it is unclear whether Pillar Two income taxes are in the scope of IAS 12 in situations outside the context of consolidated financial statements. For example, in separate financial statements where the standalone entity is liable to pay the top-up tax, but the tax is triggered by another entity of the group. Similar questions may arise in consolidated financial statements at sub-group level. Therefore, we encourage the IASB to clarify which IFRS Standard would apply in such situations (or to explore alternative accounting treatments), providing that the issuance of these urgent Proposed Amendments is not delayed.

Question 2

The IASB proposes that, in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity disclose for the current period only:

(a) information about such legislation enacted or substantively enacted in jurisdictions in which the entity operates.

(b) the jurisdictions in which the entity's average effective tax rate (calculated as specified in paragraph 86 of IAS 12) for the current period is below 15%. The entity would also disclose the accounting profit and tax expense (income) for these jurisdictions in aggregate, as well as the resulting weighted average effective tax rate.

(c) whether assessments the entity has made in preparing to comply with Pillar Two legislation indicate that there are jurisdictions:

  (i) identified in applying the proposed requirement in (b) but in relation to which the entity might not be exposed to paying Pillar Two income taxes; or

  (ii) not identified in applying the proposed requirement in (b) but in relation to which the entity might be exposed to paying Pillar Two income taxes.

The IASB also proposes that, in periods in which Pillar Two legislation is in effect, an entity disclose separately its current tax expense (income) related to Pillar Two income taxes.

Paragraphs BC18–BC25 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you would suggest instead and why.

EFRAG's response

Disclosures before legislation is in effect

12 EFRAG supports the efforts of the IASB to define an approach that would provide information to users to assess an entity's exposure to paying top-up tax that would not involve undue costs or effort. EFRAG appreciates that the IASB is trying to find a compromise, considering the urgency of the project.

13 EFRAG is aware of the time constraint around the Proposed Amendments, which in many jurisdictions, including the EU, is aggravated by the requirement to integrate the Proposed Amendments into their legal framework. The temporary exception is urgently needed for entities in scope of the Pillar Two legislation. Bearing the time constraint in mind, EFRAG proposes some improvements around the proposed targeted disclosures that in our view would not result in a delay of the project. Perfecting the disclosures should not come at the price of delaying the finalisation of the Proposed Amendments.

14 In the context of its project "Disclosure Initiative – Targeted Standards-level Review of Disclosures", the IASB has recently decided to use a new approach to drafting disclosure requirements. The 'middle ground approach' involves, inter alia, disclosure objectives that describe the information needs of users of financial statements and explanations of the assessment that users make based on the information disclosed by the entity. We are aware that it might not always be possible to follow the aforementioned approach, especially when it comes to minor

amendments to older IFRS Standards. However, EFRAG encourages the IASB to partially use this approach and add a disclosure objective that describes the needs of users of financial statements to assess an entity's exposure to paying top-up tax as it might help entities apply appropriate judgement considering their specific circumstances. Specifically, the disclosure objective included in BC19 for periods before legislation is in effect should become part of the main body of the final Standard.

15 The proposal in paragraph 88C (a) of the ED raises the question whether this should be understood that entities should provide information on all the jurisdictions where an entity operates, and Pillar Two model rules are enacted or substantively enacted. Having listened to the 10 February 2023 Accounting Standards Advisory Forum meeting, we understand that the IASB's intention is not for entities to provide a very extensive, but effectively boiler plate disclosure, but to provide a disclosure in which they apply judgment according to their own circumstances. Therefore, EFRAG encourages the IASB to clarify its intentions in the Basis for Conclusions and, to the extent possible, in the main body of the Standard. To understand the IASB's intention would help entities to apply the requirements, including any materiality judgement. For instance, the IASB could explain that given the top-down approach of the Pillar Two legislation, where the jurisdiction of the ultimate parent entity of a group has enacted or substantially enacted Pillar Two Model Rules, it might only be relevant to disclose information about such jurisdiction.

16 EFRAG is of the view that the IASB should apply a more principle-based and less prescriptive approach to request information to assess an entity's exposure to paying top-up tax. The IASB should enable entities to provide their own quantitative assessment of their exposure to paying top-up tax prepared under Pillar Two model rules. This should be the primary option to satisfy the disclosure objective if an entity has sufficiently reliable information using data collected from internal assessment activities readily available that meet the disclosure objective.

17 From a cost-benefit perspective, it seems more appropriate for those entities to provide disclosures based on data that they collect (and potentially report to management and those charged with governance) while preparing to comply with the Pillar Two legislation. In the notes, the progress of the assessment work and resulting uncertainties should be explained. Even though users would not receive uniform information, it should provide them with a better, and more relevant, indication of an entity's exposure to paying top-up tax. This option should meet the users' need for quantitative information in order to be able to assess the impact of the introduction of the Pillar Two legislation.

18 For those entities that do not have the Pillar Two impact information available at a sufficiently reliable level to meet the disclosure objective, an alternative quantitative estimate that satisfies the disclosure objective should be provided. To base the disclosure requirements on IAS 12 information, as proposed in paragraph 88C (b) of the ED, could be a reasonable alternative. By applying a principles-based disclosure approach as described above entities would avoid providing information to users that they consider to be irrelevant or even misleading. In this regard, the introduction of the disclosure objective mentioned in paragraph 14 above should help entities to apply appropriate judgement on how to prepare the proposed information – including when IAS 12 information has been used as a proxy to explain the Pillar Two rule impact.

19 If the IASB decided to proceed with the proposed targeted disclosure requirements as included in the ED, EFRAG suggests that the IASB clarifies the following matters included in paragraphs 20 and 21.

20 During its outreach events with constituents, EFRAG has observed that there is 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. EFRAG understands that the IASB's intention is that the information should be provided in aggregate for all jurisdictions. EFRAG suggests that the IASB clarifies the wording of this sentence to avoid misunderstandings.

21 The ED also proposes to require an entity to disclose, if existing, that the entity has made assessments in preparing to comply with Pillar Two legislation and an indication of whether there are additional (or fewer) jurisdictions in which the entity might be exposed to paying Pillar Two income taxes compared to those disclosed under paragraph 88C (b) of the ED. Under the approach described in paragraph 16 this should be part of the information provided to assess the exposure to paying the top-up tax. If the information disclosed is not based on the internal assessment an additional disclosure requirement is reasonable to understand the status of the assessments. EFRAG considers this disclosure to be useful. However, the way in which the ED is drafted may result in some entities meeting this disclosure requirement by stating that they have made an assessment that leads to the situations included in paragraphs 88C (c) (i) or (ii) of the ED but without providing further details. Therefore, we encourage the IASB to be more precise on this disclosure requirement.

22 Additionally, EFRAG observes that under Pillar Two legislation, an entity might be exposed to paying Pillar Two income tax even if the respective law is in force in jurisdictions other than that of the ultimate parent entity of the group. Thus, we encourage the IASB to state explicitly in paragraph 88C of the ED that it refers to any jurisdiction in which the entity operates. Even though this is the ED's intention as reflected in paragraph 88C (a) of the ED, we are of the view that this should also be emphasised in paragraph 88C of the ED to avoid any confusion.

23 Lastly, EFRAG notes that under Pillar Two legislation, the entity liable to pay the top-up tax and the entity that triggers the top-up tax, might be a different entity. In case that the IASB clarifies that Pillar Two income taxes are in the scope of IAS 12 in situations outside the context of consolidated financial statements of the ultimate parent (see paragraph 11 above), we have reservations on whether the disclosure requirements proposed in paragraph 88C (b) in the ED are fit for purpose for separate financial statements (or the financial statements of sub-consolidated subsidiaries).

Disclosures when legislation is in effect

24 EFRAG agrees with the disclosure of an entity´s current tax expense (income) related to Pillar Two income taxes as it would enable users of financial statements to understand the magnitude relative to an entity's overall tax expense and it will not be costly. This is because the entity would, in any case, need to recognise the current tax in their financial statements. However, EFRAG encourages the IASB to clarify in the Basis for Conclusions the reason why users of financial statements are keener to understand the magnitude of Pillar Two income taxes over other types of income taxes.

Question 3

The IASB proposes that an entity apply:

(a) the exception-and the requirement to disclose that the entity has applied the exception-immediately upon issue of the amendments and retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; and

(b) the disclosure requirements in paragraphs 88B–88C for annual reporting periods beginning on or after 1 January 2023.

Paragraphs BC27–BC28 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you would suggest instead and why.

EFRAG's response

25 EFRAG agrees with the IASB's proposal that entities should apply:

(a) The temporary exception and the requirement to disclose that the entity has applied the exception immediately upon issue of the Proposed Amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and

(b) the disclosure requirements in paragraphs 88B–88C of the ED for annual reporting periods beginning on or after 1 January 2023.

26 Such an approach would not lead to significant additional costs for preparers and would allow entities to apply the mentioned exception retrospectively starting from the date Pillar Two legislation is enacted or substantively enacted. However, EFRAG encourages the IASB including in the main body of the Standard (i.e., in paragraph 98M (a) of the ED) the clarification included in paragraph BC27 highlighting that the Proposed Amendments, once effective, will be applicable to any financial statements not yet authorised for issue at that date. Such an approach would be consistent with that already applied by the IASB (e.g., paragraph C1C of the amendments to IFRS 16 '*Covid-19-Related Rent Concessions beyond 30 June* 2021' issued in March 2021).

27 Finally, given the absence of an end date for the temporary exception introduced by the Proposed Amendments, EFRAG recommends that the IASB schedules in its workplan, from now, an activity of review, so that the exception to recognise nor disclose deferred tax may be terminated, or made permanent, at the appropriate moment.