

## Amendment IAS 12 – International Tax Reform – Pillar Two Model Rules Issues paper

### Objective

- 1 The objective of this session is to:
  - (a) provide a summary of the Exposure *Draft International Tax Reform – Pillar Two Model Rules* (Proposed amendments to IAS 12);
  - (b) discuss the preliminary assessment made by the EFRAG Secretariat; and
  - (c) seek EFRAG FR TEG views to inform the forthcoming draft comment letter.

### Summary of the Exposure Draft

- 2 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.
- 3 The ED would introduce:
  - (a) a temporary – mandatory - 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.

### Scope

- 4 The ED clarifies that IAS 12 *Income taxes* 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 should neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes. The IASB also proposes that an entity should disclose that it has applied the exception ([paragraph 4A of the ED](#)).

### Disclosure

- 5 In periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, the IASB proposes that an entity should disclose ([paragraph 88C of the ED](#)) 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 should 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.
- 6 To base the disclosure requirements on IAS 12 information was controversially discussed by the IASB (see BC22 of the ED). As the Pillar Two model rules include specific requirements that differ from those in IAS 12 in relation to calculating an effective tax rate for each jurisdiction, some IASB members were opposed to requiring entities to disclose information prepared in accordance with IAS 12. Those IASB members were of the view that such information would not be useful to users of financial statements because it would not be based on the requirements in the Pillar Two model rules and would relate to periods in which the rules are not yet in effect. They discussed that, such information could also be misleading or commercially sensitive.
- 7 The IASB also proposes that, in periods in which Pillar Two legislation is in effect, an entity should disclose separately its current tax expense (income) related to Pillar Two income taxes (paragraph 88B of the ED).

*Effective date and transition*

- 8 The IASB proposes that an entity should 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 of the ED for annual reporting periods beginning on or after 1 January 2023.

**Summary of feedback received during previous discussions**

*EFRAG FR TEG Discussions*

- 9 On 1 December 2022, the EFRAG FR TEG received an introduction to the project. The EFRAG FR TEG members welcomed the IASB fast track project. They provided the following preliminary comments:
  - (a) Members generally supported the temporary exception for deferred taxes arising from the enactment of Pillar Two rules. They welcomed the IASB's intention not to include a sunset clause as they acknowledged that it would take time for tax specialists to assess the effects of the law.
  - (b) Some members discussed the fact that the IASB had not concluded whether the OECD's Pillar Two model obligations would be accounted for under IAS 12. This would allow entities to apply judgment and assess whether the impact of these taxes should be accounted for as income taxes, levies, etc. The IASB Staff confirmed that it was an outstanding decision and indicated that at group level there was little doubt that the Pillar two rules should be under the scope of IAS 12. However, they noted that there might be some doubts at a sub-group or subsidiary level, that could not be clarified at that stage, as it would depend, among other things, on how countries adopted

these rules<sup>1</sup>. According to paragraph 2 of IAS 12, only taxes that are based on taxable profits are considered income tax.

- (c) A few members shared their concern on the IASB requiring entities to disclose the name of the country where the effective tax rates are below 15%. They perceived it as a way of including country by country disclosures in the financial statements. One member questioned whether it was necessary to require any disclosures as IAS 1 *Presentation of Financial Statements* already requires entities to disclose information about new significant transactions and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to disclose information when a new accounting amendment is adopted. Another member expressed the view that these disclosures should be included in the management commentary rather than in the financial statements. One member had reservations about the usefulness of providing disclosures computed in accordance with different tax rules.
- (d) A few members noted that it would be important to know what the FASB intends to do on this matter. It would not be understandable for stakeholders that the IASB and the FASB follow a very different approach.
- (e) A member asked if the IASB had considered whether this exception affects the relevance of financial statements. The IASB Staff noted that entities need more time to work through the rules and that the mandatory exception intends to avoid that entities recognise deferred taxes in different ways giving rise to divergence.

#### *EFRAG FRB Discussions*

- 10 On 21 December 2022, the EFRAG FRB received an introduction to the project and its expected timeline. They provided the following comments:
- (a) Members considered this project to be challenging, due to the complexity of the Pillar Two rules. The project was considered to be significant for European stakeholders. Members requested the EFRAG Secretariat to continue to engage with the EC Tax department to ensure a proper understanding of the general impact, how the rules are implemented in European law ([Council Directive](#)), and how the individual jurisdictions are planning to enact the related law before 31 December 2023. The law will apply in Europe for annual periods starting on 1 January 2024.
  - (b) Members generally supported the IASB proposal to introduce a temporary exception to recognising and disclosing information about deferred taxes related to the OECD's Pillar Two model rules.
  - (c) Members raised some initial concerns in relation to the proposed disclosures – they expressed concern on disclosing accounting profit before tax and underlined the need of having a cost-benefit analysis for the suggested disclosures.
  - (d) Members expressed concern related to the impact on interim reporting (or any entity with a reporting date before endorsement) as the EC already stated that the endorsement process will not get finalised shortly after the Amendments are published. Even if Pillar two rules would not be enacted or substantially enacted in Europe, they could be enacted or substantially enacted in some jurisdictions where European groups are operating in.
- 11 Furthermore, the EFRAG FRB agreed to adopt a fast-track approval process for the comment letter on the ED and for the endorsement advice.

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<sup>1</sup> See BC6 to BC7 of the ED

## EFRAG Secretariat preliminary analysis

### Question 1 – Temporary exception to the accounting for deferred taxes

- 12 BC8 of the ED indicates that stakeholders expressed some concerns about the implications for income tax accounting resulting from jurisdictions implementing the Pillar Two model rules within a short period of time. Those concerns related to:
- (a) how to account for top-up tax, especially in the separate financial statements of the group's subsidiaries which are not part of its reporting group. Furthermore, they stated that it is not clear (i) whether the Pillar Two model rules create additional temporary differences, (ii) whether to remeasure deferred taxes recognised under domestic tax regimes and (iii) which tax rate to use for their measurement;
  - (b) the usefulness of the information that could result from accounting for deferred taxes related to top-up tax, which could lead to a complex and costly calculation for the entities; and
  - (c) the urgent need for clarity in the light of the imminent enactment of tax law to implement the rules in some jurisdictions, mainly to avoid diversity in practice deriving from individual interpretation or the requirements in IAS 12.
- 13 The EFRAG Secretariat understands and shares the concern expressed by stakeholders. Therefore, the EFRAG Secretariat agrees with the IASB's proposal to provide a mandatory temporary exception to the requirements in IAS 12, that an entity should neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.
- 14 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 law as they do not have to consider future tax effects;
  - (b) avoid diversity in practice in applying IAS 12 requirements without affecting comparability between the entities' financial statements, before and after the top-up tax applies;
  - (c) provide more time for entities to better understand the implications of the new local tax law leading to more reliable and useful financial information; and
  - (d) allow to better understand users' information needs related to top-up tax.
- 15 The EFRAG Secretariat welcomes that the exception is mandatory. Making this exception mandatory ensures comparability and avoids the risk of accounting inconsistencies as referred to in paragraph BC16(b) of the ED. In addition, by disclosing that the entity has applied the exception, this makes it transparent that the entity might be impacted by top-up tax.
- 16 Furthermore, the EFRAG Secretariat welcomes the IASB approach not to include a sunset clause for the application of the exception. It would grant additional time to entities and tax specialists to assess the effects of the new tax law and, consequently, to provide more useful and accurate financial information.
- 17 The EFRAG Secretariat also highlights that the timing at which each jurisdiction will enact its new tax law is a critical aspect, as well as the timing at which the amendments will be endorsed by the EC. Indeed, this could impact interim reporting and the annual reporting ending at or before 31 December 2023.
- 18 Lastly, the EFRAG Secretariat acknowledges that although IAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules, 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 standalone financial statements where the standalone

entity is liable to pay the top-up tax, but the tax was triggered by another entity of the group. Therefore, we encourage the IASB to clarify which standard would apply in such situations.

- 19 As explained in paragraph BC7 of the ED, jurisdictions may also introduce a qualified domestic top-up tax. As this top-up tax - computed on a basis similar to the Pillar Two model rules – would be charged in the jurisdiction in which the profit arises rather than in the (ultimate) parent entity’s jurisdiction, the EFRAG Secretariat is of the view that such a top-up tax should not be exempted.

**Questions for EFRAG FR TEG members**

- 20 Do EFRAG FR TEG members agree with the EFRAG Secretariat preliminary analysis related to Question 1 as included in the ED? Do EFRAG FR TEG members share the view of the EFRAG Secretariat related to a qualified domestic top-up tax?

**Question 2 - Disclosures**

- 21 In addition to proposing the temporary exception, the IASB has proposed new disclosure requirements. The IASB differentiates between disclosure requirements after the Pillar Two legislation is enacted or substantively enacted, but not yet in effect (see paragraph 5 above) and after the Pillar Two legislation is in effect (see paragraph 7 above).

*Disclosures before legislation is in effect*

- 22 Paragraph BC19 of the ED indicates that users of financial statements need information to help them assess an entity’s exposure to paying top-up tax. However, they acknowledge that asking for detailed information on the Pillar Two legislation would either not be feasible or be likely to result in undue cost or effort. The proposed Amendments require an entity to disclose:
- (a) information about such legislation enacted or substantively enacted in jurisdictions in which the entity operates; and
  - (b) the jurisdictions in which the entity’s average effective tax rate (calculated in accordance with IAS 12) for the current period is below 15% and an aggregated tax expense, accounting profit and weighted average effective tax rate.
- 23 The EFRAG Secretariat understands the user needs as expressed in paragraph BC19 of the ED and appreciates that the IASB was trying to find a compromise. As mentioned in paragraph 6 above, the compromise was discussed controversially. The majority of the IASB members consider that these disclosures would provide users of financial statements with insights into an entity’s potential exposure to paying top-up tax but that would not involve undue cost or effort.
- 24 The EFRAG Secretariat understands the reasons of requiring the proposed disclosures and considers that the provision of such disclosures might be feasible. The EFRAG Secretariat also agrees that informing Pillar Two Rules being enacted or substantively enacted in jurisdictions in which the entity operates might be useful for users of financial statements (paragraph 88C (a) of the ED).
- 25 However, the EFRAG Secretariat has reservations about the disclosure requirements included in paragraph 88C (b) of the ED providing useful insights into an entity’s potential exposure to paying top-up tax. The reasons are the following:
- (a) The entity’s average effective tax rate calculated in accordance with paragraph 86 of IAS 12 would likely differ from the effective tax rate calculated under Pillar Two Model rules as the computation of such effective tax rate might be different.

- (b) The results of one year might be different from the results of the previous year. An entity that has earnings in a given year might have losses the year after.
  - (c) There might be corporate transactions, investments, divestments, termination of entities, etc. that make the jurisdictions of one year different from those of the following year.
- 26 The EFRAG Secretariat proposes to discuss this topic extensively during any upcoming outreach.
- 27 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 with an average effective tax rate of less than 15% based on the IAS 12 requirements (paragraph 88C (c) of the ED).
- 28 The EFRAG Secretariat's preliminary view is that this qualitative assessment is useful and would make the disclosure requirements proposed in paragraph 88C (b) of the ED more useful. Combining the two disclosure requirements, the entity would report those jurisdictions having an effective interest rate below 15% in the current year in accordance with the Pillar Two rules. Therefore, users would have some insights of which entities might be exposed to paying Pillar Two income taxes once the law is in force.
- 29 The EFRAG Secretariat also agrees that the IASB only requires entities to provide such assessments if it has been carried out. Our understanding is that this is a complex tax law being enacted in many jurisdictions in a short period of time and mandating this assessment would likely result in undue cost or effort. The EFRAG Secretariat also reminds that IAS 12 does not require entities to provide qualitative indications of how a change in a tax law or a new tax law would impact an entity's future cash flows.
- 30 Lastly, the EFRAG Secretariat observes that under Pillar Two rules, there might be a difference between the entity liable to pay the top-up tax and the entity that triggers the top-up tax. 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 (see paragraph 18 above), we have reservations on whether the disclosure requirements included in the ED are fit for purpose of standalone financial statements.

*Disclosures when legislation is in effect*

- 31 The ED proposes to require an entity to disclose separately the current tax expense related to Pillar Two income taxes.
- 32 The EFRAG Secretariat agrees with the disclosure as it would enable users of financial statements to understand the magnitude of Pillar Two income taxes relative to an entity's overall tax expense and it will not be costly because the entity needs to recognise the current tax in their financial statements.

**Questions for EFRAG FR TEG members**

- 33 Do EFRAG FR TEG members agree with the EFRAG Secretariat's preliminary analysis related to Question 2 as included in the ED?

**Question 3 - Effective date and transition**

- 34 The EFRAG Secretariat agrees with the IASB's proposal that entities should 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; and

- (b) the disclosure requirements in paragraphs 88B–88C of the ED for annual reporting periods beginning on or after 1 January 2023.
- 35 Indeed, such an approach would not lead to additional costs for preparers and would allow the entities to apply the mentioned exception retrospectively starting from the date Pillar Two legislation is enacted or substantively enacted (even if that date is before the endorsement date).
- 36 However, the EFRAG Secretariat is concerned that entities might need to account for deferred taxes for interim reporting whenever Pillar Two rules are enacted or substantively enacted in jurisdictions in which the entity operates and if the potential subsequent amendments are not finalised by the IASB or endorsed by the EC. That might lead to diversity in practice.

**Questions for EFRAG FR TEG members**

- 37 Do EFRAG FR TEG members agree with the EFRAG Secretariat’s preliminary analysis related to Question 3 as included in the ED?
- 38 Do EFRAG FR TEG members have additional comments for the EFRAG Secretariat to consider when drafting the draft comment letter?
- 39 Do EFRAG FR TEG members have any comments on EFRAG’s envisaged work plan? Are you organising any outreach activity within your organisation in which EFRAG could participate in? Are you aware of any other outreach activity in which EFRAG should participate in?