~~[Draft]~~ Comment Letter

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

[XX 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 under which an entity should neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

~~However,~~ EFRAG is aware of the time constraints around the amendments. The temporary exception is urgently needed for entities in scope of Pillar Two rules. Hence, the proposed changes or clarifications should not lead to a delay in finalising the amendments considering that it will take some additional time to integrate the 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 the users 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.

~~However, at this stage it remains unclear whether this information is useful for users of financial statements.~~ EFRAG ~~will seek views from its constituents on the usefulness of the~~ proposes some improvements around the proposed targeted disclosures~~, as due~~. EFRAG is concerned that major changes in the disclosure requirements proposed by the IASB

might lead to ~~the nature of the information required,~~a delay or even the need to re-expose the ~~necessary data may~~proposals. Perfecting the disclosures should not come at the price of delaying the finalisation of the amendments.

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

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 specific requirements.

EFRAG is of the view that the IASB should enable entities to provide the disclosure requirement included in paragraph 88C (b) of the ED prepared under Pillar Two model rules using data collected from internal activities if an entity has the information readily available ~~nor easily reconcilable~~. 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 ~~the internal records.~~ 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, entities should be required to satisfy the users' information needs with the proposed disclosure requirements currently included in the ED in paragraph 88C (b) - accompanied with some clarification useful for preparation of the information - and paragraph 88C (c).

EFRAG encourages the IASB to use its 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 judgment.

EFRAG agrees with the transition provisions included in the ED.

In addition, EFRAG highlights that the timing at which the 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.

Finally, given the absence of an end date for the exception introduced by these proposed amendments, EFRAG recommends that the IASB schedules in its workplan~~, from now,~~ 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
~~President~~Chair of the EFRAG FRB

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

Question 1- Temporary exception to the accounting for deferred taxes (paragraphs 4A and 88A of 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 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 top-up tax. Qualified domestic top-up ~~tax~~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 is subject to the same concerns as potential deferred tax that arises from the other Pillar Two 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 law, 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 amendment. The temporary exception is urgently needed for entities in scope of Pillar Two rules. Hence, the proposed changes or clarifications should not lead to a delay in finalising the amendments considering that it will take some additional time to integrate the amendments into local law in various jurisdictions (including the European Union).

45 EFRAG welcomes that the 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 has to apply the exception provides transparency about the fact that the entity might be impacted by top-up tax. However, EFRAG suggests 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 rules), this being an additional requirement compared to the general disclosure requirements in other IFRS standards (e.g., IAS 1 *Presentation of Financial Statements*).

56 However, EFRAG notes that extending such a mandatory exception to the ~~disclosure~~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. The currently proposed mandatory exception can be understood that even in future periods when companies are able to provide this information, it will not be allowed to provide it in the notes to the financial statements. Therefore, EFRAG encourages the IASB to clarify whether an entity would be allowed to provide this information, when relevant and reliable, on a voluntary basis.

67 Furthermore, EFRAG supports the IASB's approach not to include a sunset clause for the application of the exception. It would grant additional time to impacted entities and tax specialists to assess the effects of the new tax law and, consequently, to provide more useful and accurate financial information. In addition, taking into account that the OECD Pillar Two 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.

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

89 EFRAG also highlights that the timing at which the 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 ~~Lastly,~~ EFRAG acknowledges that as stated in paragraph 4A of the ED IAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules. ~~However,~~However, it is unclear whether all taxes arising from Pillar Two 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.

911 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 was 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 standard would apply in such situations (or to explore alternative accounting treatments), providing that the issuance of these urgent amendments is not delayed.

Question 2 – Disclosure (paragraphs 88B-88C of the ED)

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

~~10~~12 EFRAG supports the efforts of the IASB 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. EFRAG appreciates that the IASB is trying to find a compromise, considering the urgency of the project. ~~EFRAG will seek views from its constituents on the usefulness of the proposed disclosures, as due to the nature of the information required, the necessary data may not be available nor easily reconcilable with the internal records.~~

13 ~~EFRAG encourages the IASB to clarify in paragraph 88C (a) of the ED what type of information entities should disclose when Pillar Two model rules are enacted or substantively enacted in jurisdictions in which an entity operates. The proposal~~EFRAG is concerned that major changes in the disclosure requirements proposed by the IASB might lead to a delay or even the need to re-expose the proposals. EFRAG is well aware of the time constraint, which is in many jurisdictions, including the EU, aggravated by the requirement to integrate the amendments into their legal framework. The temporary exception is urgently

needed for entities in scope of Pillar Two rules. 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 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 be always possible to follow the aforementioned approach, especially when it comes to minor amendments to older 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 judgment. Especially, the disclosure objective included in BC19 for periods before legislation is in effect should become part of the main body of the standard.

~~11~~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. ~~At this stage, we have some doubts that this is decision-useful information for the users~~We understand that the IASB's intention is not to require an extensive, but effectively boiler plate disclosure. 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.

~~12~~ EFRAG ~~also encourages the IASB to clarify the disclosure requirement included in paragraph 88C (b) is~~ of the ~~ED. In EFRAG's~~ view~~, it is unclear what~~ that the IASB ~~means by the accounting profit of~~should apply a ~~jurisdiction:~~

~~(a) Is it the sub-consolidated accounting profit, as defined by IAS 12, of all entities existing in a given jurisdiction; or~~

~~(b) is it the aggregated accounting profit of all entities existing in a given jurisdiction?~~

~~13 As this is an example of what readers of the ED might interpret, there might be other interpretations of the accounting profit of a jurisdiction. The lack of clarity on this aspect might lead~~more principle-based and less prescriptive approach to ~~diversity in the fulfilment of this disclosure requirement. It may also bring complexity depending on the interpretation made by entities.~~

~~14 EFRAG considers it useful to provide users of financial statements with~~request information ~~that tries to provide insights into an entity´s potential exposure to paying top-up as long as the benefit of providing such information outweighs its costs.~~

~~15~~16 ~~Even though EFRAG is in favour of a requirement to provide users with information that tries to provide insights about an entity´s potential exposure to paying top-up tax (considering the cost-benefit assessment), there are some doubts whether the information included in paragraph 88C (b) of the ED is useful for users of financial statements. For instance, to identify those jurisdictions that might be exposed to paying top-up tax and for which aggregate figures would then be given, the income~~

~~tax rate could be used instead of the~~ to assess an entity's ~~average effective~~exposure to paying top-up tax ~~rate~~. The IASB ~~could also~~should enable entities to provide the disclosure requirement included in paragraph 88C (b) of the ED being prepared under Pillar Two model rules ~~as~~ . This could be an alternative if an entity has the information ~~already~~ using data collected from internal assessment activities readily available~~.~~ at a sufficiently reliable level. The eligible assessment should not only be qualitative in nature and should be described in the notes. Uncertainties in the assessment should be made transparent in the notes. That would integrate the current requirements in 88C (c) into this disclosure requirement. 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, provided that these are reliable. They must also sufficiently satisfy the users' need for quantitative information. 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.

~~16 EFRAG will assess the usefulness of the disclosure requirement included in paragraph 88C (b) of the ED extensively with its constituents together with the expected costs of preparing this information during its outreach activities on the ED.~~

17 For those entities that do not have the Pillar Two information available at a sufficient and reliable level to meet the disclosure objective, EFRAG supports the proposed disclosure requirements included in paragraph 88C (b) of the ED. EFRAG is aware of the potential shortcomings in information of this proposal as there might be differences between the effective tax rate calculated in accordance with the Pillar Two rules and IAS 12. Some entities might also be required to implement additional reporting procedures as the necessary data might not be available nor easily reconcilable with the internal records. These additional efforts will result in entities applying judgment to aggregate underlying data, allocate consolidation adjustments to jurisdictions. In this regard, the introduction of the disclosure objective mentioned in paragraph 14 above should help entities to apply judgment on how to prepare the proposed information.

18 In addition, the feedback gathered from users of financial statements indicates that the proposed disclosures are useful information in that they provide some indication of the company's exposure to paying top-up tax and how this affects tax expense. This information would be indicative not only of future top-up tax outflows but also of potential local tax increases. Therefore, we consider that the disclosure requirements as proposed currently in the ED are a reasonable compromise between availability, complexity and relevance in case that an entity does not have reliable information on Pillar Two impact readily available.

19 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 suggest that the IASB clarifies the wording of this sentence to avoid misunderstandings.

~~17~~20 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. EFRAG considers this disclosure to be useful.

Under the approach described in paragraph 0 it should be part of the information provided to assess the exposure. Under the approach described in paragraph 17 where IAS 12 based information will be disclosed it should be in addition to this information being required. However, the way in which the ED is drafted may trigger that some entities may fulfil this disclosure requirement by saying 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.

~~18~~21 Additionally, EFRAG observes that under Pillar Two rules, an entity might be exposed to paying Pillar Two income tax even if the 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.

~~19~~22 Lastly, EFRAG indicates 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 of the ultimate parent (see paragraph 10 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

~~20~~23 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 needs to recognise the current tax in their financial statements anyway. 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 – Effective date and transition (paragraph 98M of the ED)

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

~~21~~24 EFRAG 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.

~~22~~25 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 (even if that date is before the date the expected amendments are approved). However, EFRAG encourages the IASB including in the body of the standard (i.e., in paragraph 98M (a) of the ED) the clarification included in paragraph BC27 highlighting that the amendments 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 concession beyond 30 June 2021* issued in March 2021).

~~23~~26 Finally, given the absence of an end date for the exception introduced by these 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 it permanent, at the appropriate moment.