Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Mr Wolf Klinz
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Financial Reporting Technical Committee

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Berlin, 27 February 2023

Dear Mr Klinz,

IASB/ED/2023/1 *International Tax Reform—Pillar Two Model Rules*

On behalf of the Accounting Standards Committee of Germany (ASCG) I welcome the opportunity to contribute to EFRAG's Draft Comment Letter (herein referred to as 'DCL') on the IASB/ED/2023/1 *International Tax Reform—Pillar Two Model Rules* (herein referred to as 'ED').

We provide our response to EFRAG's questions to constituents in the appendix of this letter and attach our comment letter to the IASB, containing our detailed comments on the questions raised in the ED.

If you would like to discuss our comments further, please do not hesitate to contact Olga Bultmann (bultmann@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

Appendix – Answers to the questions in the DCL

Question 1 – Temporary exception to the accounting for deferred taxes (paragraphs 4A and 88A)

Do you support the IASB's proposal to introduce a temporary mandatory exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, including the qualified domestic minimum top-up tax?

Yes, we support the IASB's proposal to introduce a mandatory exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, including the qualified domestic minimum top-up tax. We recommend reconsidering whether the proposed additional disclosure that an entity has applied the exception is an indispensable one while the exception is foreseen to be a mandatory one and we agree with that. In our view, disclosing the current tax expense/income related to Pillar Two income taxes would already provide users of financial statement with information that Pillar Two legislation is relevant for an entity and that the entity has consequently applied the exception.

We also welcome the Board's approach to not propose a sunset clause for the application of the temporary exemption as we acknowledge that standard-setters, tax specialists and reporting entities would need time to analyse and assess the effects of the new tax law on the accounting for deferred taxes allying IAS 12.

However, we would like to encourage the Board to start a narrow-scoped project on how to apply the principles and requirements in IAS 12 to deferred taxes related to Pillar Two model rules to either propose targeted amendments to IAS 12 and if reasonable from the cost-benefit perspective, withdraw the temporary exemption or to make the exemption permanent.

Do you support the IASB's proposal to extend a temporary mandatory exception also to the disclosures about potential deferred taxes arising from the implementation of the Pillar Two model rules?

Yes, we support the IASB's proposal to apply a temporary mandatory exception also on the disclosures about potential deferred taxes arising from the implementation of the Pillar Two model rules. From our perspective the same rationale applies here as for exception provided for the recognition and measurement.

Do you think it is necessary to encourage the IASB to clarify whether and how paragraph 4A of the ED is applicable in situations outside the context of consolidated financial statements of the ultimate parent entity (e.g., subsidiary's separate financial statements level or sub-group consolidated financial statements level)?

The exception proposed in paragraph 4A refers to deferred tax assets and liabilities related to Pillar Two income taxes. In our understanding, this exception applies regardless of who triggered these taxes. Thus, we do not think it is necessary to clarify the application of paragraph 4A of the ED to situations outside the context of consolidated financial statements of the ultimate parent entity. The IASB is aware that, among other things, further work should be done

in determining the circumstances in which top-up tax is an income tax in the scope of IAS 12 (see paragraphs 45-47 and 59-61 of the Agenda Paper 12a of the IASB's November 2022 Meeting). However, it concluded that it would not be feasible to complete this work before new tax laws are expected to be enacted. We agree with the rationale that moving forward with the exception proposed in the ED (defined in a principle-based way) is more important than explicitly clarifying every single application question which might still arise in the practice.

Question 2 – Disclosure (paragraphs 88B–88C)

Do you consider that the disclosure requirements included in paragraph 88C (b) of the ED will result in providing users of financial statements with insights into an entity's potential exposure to paying top-up tax? Do you consider that the benefit of providing this disclosure requirement would outweigh the cost of preparing this information? Is there any other indication that could provide users with better insights into an entity's potential exposure to paying top-up tax but that would not involve undue cost or effort?

No, we are not convinced yet that the cost-benefit balance is already achieved. Indeed, we have significant doubts whether the disclosure requirements proposed in paragraph 88C (b) of the ED will result in providing users of financial statements with reasonable and robust insights into an entity's potential exposure to paying top-up tax. In our view, the benefits of this disclosure requirements are questionable, while incremental operational and audit efforts for preparers are expected to be significant. In this respect, please refer to our comments to question 2 in the comment letter to the IASB attached below.

Question 3 – Effective date and transition (paragraph 98M)

Are there any additional questions or issues that should be taken into consideration by EFRAG in its Final Comment Letter?

Please refer to our comments in the comment letter to the IASB attached below.

Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Berlin, 27 February 2023

Dear Andreas,

IASB/ED/2023/1 *International Tax Reform—Pillar Two Model Rules*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the Exposure Draft IASB/ED/2023/1 *International Tax Reform—Pillar Two Model Rules (Proposed amendments to IAS 12)* issued by the IASB on 9 January 2023 (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED proposals.

We agree with the Board's proposal to introduce a mandatory exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes. We acknowledge the urgent need for clarity on the income tax accounting under IAS 12 because of the expected imminent implementation of the Pillar Two model rules into the national tax law by some jurisdictions.

We support the IASB's effort to define disclosure requirements that would provide users of financial statements with insights into an entity's potential exposure to paying top-up tax without undue cost or effort for the reporting periods in which the Pillar Two legislation is not yet effective. We understand that the disclosure approach included in the ED is a compromise and that the Board did not have sufficient time to hold outreach events with its stakeholders prior to issuing the ED, considering the urgency of the project.

However, we have significant doubts that the disclosure requirements proposed in paragraph 88C of the ED would result in information that is relevant to users of financial statements, while still creating significant incremental operational efforts for preparers, i.e., producing this information will result in significant additional cost. Therefore, we recommend that the IASB reconsiders the disclosure requirements drafted in paragraph 88C of the ED. If the IASB nonetheless retains the proposed disclosure requirements, it is necessary that it investigates and explains why these disclosures will be decision-useful and that the benefits of these disclosures exceed the costs of obtaining the information.

We welcome the Board's approach to not propose a sunset clause at this point for the application of the temporary exception for the reasons provided in paragraph BC17 of the ED. We would like to encourage the Board to add a project to its active work plan on how to apply the principles and requirements in IAS 12 to income taxes and deferred taxes related to Pillar Two model rules in order to either propose targeted amendments to IAS 12 and if necessary, i.e., appropriate from a cost-benefit perspective, withdraw the temporary exception or to make the exception permanent.

We agree with the IASB's proposals to the effective date and transition.

Our detailed comments and responses to the questions of the ED are laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Olga Bultmann (bultmann@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

Appendix – Answers to the questions in the ED

Question 1 – Temporary exception to the accounting for deferred taxes (paragraphs 4A and 88A)

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.

We agree with the Board's proposal to introduce a mandatory exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes including qualified domestic minimum top-up taxes. We acknowledge the urgent need for clarity because of the expected imminent implementation of the Pillar Two model rules into the national tax law by some jurisdictions.

As explained in paragraph BC7 of the ED, jurisdictions may introduce a qualified domestic top-up tax. We understand that the proposed exception in 4A also applies to accounting for deferred taxes with respect to an implemented qualified domestic minimum top-up tax, and we agree with that.

We also welcome the Board's approach to not propose a sunset clause for the application of the temporary exception as we acknowledge that standard-setters, tax specialists and reporting entities would need time to analyse and assess the effects of the new tax law on the accounting for deferred taxes allying with IAS 12.

However, we would like to encourage the Board to add a project on its active work plan on how to apply the principles and requirements in IAS 12 to income taxes and deferred taxes related to the Pillar Two model rules to either propose targeted amendments to IAS 12 and if necessary, i.e., appropriate from a cost-benefit perspective, withdraw the temporary exception or to make the exception permanent. Consideration should be also given to the developments under US GAAP with respect to this topic.

Question 2 – Disclosure (paragraphs 88B–88C)

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.

We support the IASB's effort to define disclosure requirements that would provide users of financial statements with insights into an entity's potential exposure to paying top-up tax, without undue cost or effort, for the reporting periods in which the Pillar Two legislation is not yet effective. We understand that the disclosure approach drafted in the ED is a compromise and that the Board did not have enough time to hold outreach events with preparers and users of financial statements prior to issuing the ED, considering the urgency of the project.

However, we have significant doubts that the disclosure requirements proposed in paragraph 88C of the ED would result in information that is relevant to users of financial statements, while still creating significant incremental operational efforts for preparers, i.e., producing this information will result in significant additional cost. The reasons are the following:

1) We understand that paragraph 88C(a) requires an entity to disclose information about Pillar Two legislation enacted or substantively enacted for all jurisdictions in which the entity operates. With respect to the Pillar Two income taxes, the legislation of the country in which the **parent** company is domiciled will apply to all direct and indirect subsidiary companies within the group. According to the top-down approach of the Pillar Two rules, if the ultimate parent entity is subject to a Pillar Two regime, the legislation in all other jurisdictions of the group would then only be relevant insofar as a qualified domestic minimum top-up tax has been introduced there, or in case a 'Partially-owned Parent Entity' exists, that is located

outside the jurisdiction where the Ultimate Parent Entity is located. In this respect, the information on tax legislation in the countries in which subsidiaries of a group parent company are located appears less relevant. Thus, providing information about **all** legislations enacted or substantively enacted in jurisdictions in which an entity operates would cause undue cost or effort for entities operating in multiple jurisdictions and lead to an information overload. Furthermore, the consistency of the data across the entities cannot be ensured if, e.g., entities report a different legislative status in one and the same country. The benefit for users of financial statements seems to be questionable. Where the ultimate parent entity will be subject to Pillar Two legislation, disclosure requirements should therefore be restricted to information on the ultimate parent entity´s jurisdiction and to information with respect to applicable qualified domestic minimum top-up tax jurisdictions of the entity.

2) IAS 12 currently does not require any country-by-country disclosures. Paragraph 88 of IAS 12 only requires disclosure of any significant effect of the changes in tax rates or tax laws which are enacted or announced after the reporting period on current and deferred tax assets and liabilities. Also, the ED does not propose any country-by-country disclosures for the reporting periods when Pillar Two legislation is in effect; instead, only total current tax expense (income) related to Pillar Two income taxes is to be disclosed for the reporting entity (paragraph 88B of the ED). In contrast, the proposed disclosures for reporting periods before Pillar Two legislation is in effect shall be made on a country-by-country basis. This approach is significantly more burdensome to comply with (and the determination of the data is not clear, see below under 1)), although the IASB's intention is to actually provide a pragmatic relief for entities.

3) The IASB notes in paragraph BC21 of the ED that requiring reporting entities to disclose information prepared in accordance with IAS 12 would be less costly than requiring them to provide information based on the requirements of the Pillar Two legislation. This statement is only true for those entities that have not yet collected data based on the upcoming Pillar Two legislation. However, it is not true for entities that have already conducted their Pillar Two impact assessment or will conduct such impact assessment in the upcoming months. Those entities would have to generate information only for purposes of complying with the proposed disclosure requirements. However, the benefit of this information to users of financial statements appears highly questionable and has not been substantiated by the IASB. From a cost-benefit perspective, it seems more appropriate for those entities to provide disclosures based on data that they collect anyway while preparing to comply with the Pillar Two legislation, provided that these data are reliable. Since many companies are already in the process of assessing their tax exposure under upcoming Pillar Two legislation, the corresponding figures should either already be available or will be available in the near future. As these figures are regularly presented to the Management Board, sufficient reliability can be assumed.

4) The information of aggregated accounting profits together with the weighted average effective tax rate of all the ‘low-taxed jurisdictions’ in accordance with paragraph 88C(b) could result in material misinterpretations by the users as a top-up tax calculated under the Pillar Two model rules might substantively deviate from a calculated tax based on the aforementioned figures.

For the reasons described above, we recommend that the IASB reconsiders the disclosure requirements drafted in paragraph 88C of the ED using the 'middle-ground' approach as envisaged in its project 'Disclosure Initiative: Targeted Standards-level Review of Disclosures' to drafting disclosure requirements. We recommend that the Board requires disclosures that are best suited to provide users of financial statements with insights into an entity's exposure to paying top-up tax but do not impose undue cost or effort in preparing them. For this reason, we propose to permit disclosure of information for the current period **based on the Pillar Two assessment** if that information is available and provides users of financial statements with a better understanding of the entities' potential exposure to paying top-up tax than information prepared in accordance with IAS 12. We recognise that this procedure may affect the comparability between entities' financial statements. However, we believe that it would result in more decision-useful information for users of financial statements and avoid undue cost or effort for entities being more advanced in the process. Entities that are not capable of collecting the data points necessary to calculate the effective tax rates under the Pillar Two rules should be able to state the **nominal tax rate of a jurisdiction**. Given the differences between tax base income and financial accounting income (e.g., due to tax free items), the nominal tax rate should be more decision-useful than the (weighted) average effective tax rate calculated under IAS 12 and would not involve undue cost or effort for prepares.

If the IASB nonetheless retains the disclosure requirements as stated in paragraph 88C, i.e., using IAS 12 data, we would like to comment as follows:

1) It is necessary that the IASB investigates and explains why these disclosures will be decision-useful and that the benefits of these disclosures exceed the costs of obtaining the information.

2) We have several concerns regarding the data required in paragraph 88C (b) – accounting profit, tax expense/income – that are to be determined per jurisdiction:

    - Does an entity have to determine this data on a subgroup level per country? If so, the preparation of subgroup financial statements per country would be a new approach in accounting.
    - How should additions/deductions at group level be handled (pushdown accounting for business combinations, provisions booked at group level, etc.)?
    - How should consolidation effects be dealt with?

    Since the reporting processes are currently not designed to collect this data, the calculations for the proposed disclosures would result in significant additional compliance burdens for entities.

3) Irrespective of whether IAS 12 data or Pillar Two data will need to be disclosed with respect to the requirements of paragraph 88C we would like to emphasise that – in order to avoid undue costs and effort – the entity should have the option to use either the current year data or plan data whatever is more easily available for the entity.

4) In case an entity has already conducted a Pillar Two assessment – as assumed in paragraph 88C (c) – it seems more useful to publish information based on such assessment, if available, also for periods before the Pillar Two legislation is in effect than requiring entities to conduct additional calculations for just one relevant reporting period (assuming that the

Pillar Two legislation will enter into effect in 2024 in most of the jurisdictions intending to implement Pillar Two).

5) It is not clear from the wording in paragraph 88C ("in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect") whether the disclosures have to be made until the reporting parent company or until the last subsidiary in the group has implemented Pillar Two regulations.

6) We recommend clarifying that information about the legislation enacted or substantively enacted shall be disclosed **as of the end of the reporting period**, as various changes in local tax legislation can be made in the individual jurisdictions during a reporting year.

7) We understand that any information required under 88C shall only be disclosed at **the end of the reporting period,** i.e., no disclosure should be required in interim reporting (IAS 34), and we agree with this.

Question 3 – Effective date and transition (paragraph 98M)

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.

We agree with the IASB's proposals to the effective date and transition.