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RO n°2

Exposure Draft ED 2023-01--*International Tax Reform—Pillar Two Model Rules–Proposed amendments to IAS 12* Income Taxes

Dear Andreas,

I am writing to you on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above mentioned exposure draft (ED) published in January 2023.

We much welcome the publication of this ED. The IASB (Board) indeed proposes a temporary exception to the accounting for deferred tax that is a timely and pragmatic response to stakeholders' concerns. This exception will enable them to focus on the implementation of the Pillar Two rules while providing sufficient time to obtain a better grasp of how those rules affect the accounting for deferred tax in IAS 12. Once the final amendments are published, we expect the Board to still work closely with stakeholders to assess how deferred tax accounting works in the context of the Pillar Two rules and assess, if need be, whether to undertake further standard-setting.

Notwithstanding our support for the proposed temporary exception, we explain in paragraphs 2–9 of Appendix A to this letter why the Board should clarify the scope of this exception in relation to two matters.

The Board also proposes disclosure requirements.

We support specifying disclosure requirements directly related to the above-mentioned exception.

In contrast, we have mixed views about the proposed disclosures requirements that aim to provide users with insights into an entity's exposure to paying top-up taxes resulting from the Pillar Two legislation—ie the disclosures in paragraph 88C(b)-(c) of the ED. As explained in paragraphs 12–15, we are not sure that such disclosures are really needed. Furthermore, as explained in paragraphs 16–21, we question whether those requirements will result in useful information being disclosed. They may prompt entities to provide supplemental information either in the notes to the financial statements or in other

communications to ensure users do not get the wrong message and thus, do not make inaccurate forecasts. We are nonetheless cognisant of the fact that the Board tried to develop a set of informative disclosures that would be cost-effective for entities to provide—noting though the related costs may be higher than those the Board expects. **On balance, we think the benefits of the proposed disclosures are unlikely to exceed their costs and thus, do not support them**. We instead recommend the Board develop alternative disclosures—paragraph 22 includes a possible way forward in this respect.

Paragraph 23 includes recommendations that could enhance the proposed disclosures if the Board were to proceed with its initial views. Paragraphs 24–30 also include requests for clarifications about the proposed disclosures—in particular about how to (i) make materiality judgements in the context of this project and (ii) how to understand 'in aggregate' in paragraph 88C(b) of the ED.

As a final note, we observe that a number of jurisdictions are set to enact tax law to implement the Pillar Two rules, some of them even aiming to achieve such enactment in the first half of 2023. The Board is well-aware of the urgent need for having amendments finalised as soon as possible—in particular for entities publishing their financial statements in the European Union. Accordingly, we encourage the Board to continue moving expeditiously with this project.

Appendix A of this letter provides our detailed comments on the ED.

Should you need any further clarification, please do not hesitate to contact me.

Yours sincerely,

Robert Ophèle

Appendix A

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

IAS 12 applies to incomes 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 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?

Overall assessment of the Board's proposals

1. We support the proposed temporary exception as described above. We agree with the Board's observations as set out in paragraphs BC13–BC14 of the ED. The Pillar Two legislation raises a number of accounting matters (such as those listed in paragraph BC9–BC10) which will warrant collective thinking. Solving those matters within a short timeframe is not feasible. We also agree with the expected benefits of that exception as described in paragraph BC15 of the ED.

Request for clarifications in relation to the scope of the proposed exception

2. That being said, the existing wording of paragraph 4A raises, in our view, two matters about the scope of the proposed exception. We seek clarifications in relation to those matters.

- **Does paragraph 4A apply to any top-up taxes arising from the Pillar Two model without assessing whether any such taxes meet the definition of income taxes?**

3. We think that the first sentence in paragraph 4A—'*This Standard applies to income taxes arising from tax law enacted or substantially enacted to implement the Pillar Two model...*'—is equivocal:
   - a possible reading of this paragraph would be that an entity first assesses whether the top-up taxes arising from the Pillar Two legislation meet the definition of income taxes as set out in paragraph 2 of IAS 12. If so, the entity then applies the proposed exception. Otherwise, the entity would apply the requirements in other applicable IFRS Accounting Standards.
   - an alternative reading would be that the proposed exception applies to the top-up taxes arising from the Pillar Two model, irrespective of whether they meet the definition of income taxes—this would be equivalent to a 'temporary forced inclusion' of the top-up taxes in paragraph 4A which would practically respond to the matter described in paragraph BC22 of the ED.

4. The existence of two differing readings of the proposed requirements in paragraph 4A could pave the way for diversity in reporting practices, in particular when an entity prepares either (i) separate financial statements in accordance with IAS 27 *Separate Financial Statements* or (ii) consolidated financial statements at a sub-group level—ie the reporting entity is not the ultimate consolidating entity within a group. In those specific circumstances, it may not be entirely clear whether the top-up taxes for which the entity is liable meet the definition of income taxes in IAS 12 (for example because the entity pays the top-up taxes computed on a

sister entity's taxable profit)[1].

5. Accordingly, we recommend the Board clarify either (i) the wording in paragraph 4A or (ii) its intentions in the basis for conclusions on the final amendments. We recommend the Board clarify that an entity first assesses whether the top-up taxes arising from the Pillar Two legislation meet the definition of income taxes as set out in paragraph 2 of IAS 12 before applying the proposed exception.

- **Does paragraph 4A apply to the effects of the Pillar Two legislation on deferred tax assets and liabilities recognised applying domestic tax rules?**

6. Paragraph 4A specifies that '*as an exception to the requirements in [IAS 12], an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes*' (emphasis added). It is not clear whether the proposed exception would also apply to the 'indirect' effects of the Pillar Two rules on deferred tax assets and liabilities that the entity recognises and measures in accordance with its domestic tax rules. We think the exception should also capture those 'indirect effects' of the Pillar Two rules.

7. Assume that an entity operates in a jurisdiction where the tax rate is 25%. A specific 10% tax rate applies to the entity's revenues derived from licences granted to third parties. The entity has accumulated unused tax losses that can be utilised against profits subject to the 25% rate as well as the reduced 10% tax rate. The entity has assessed that the future taxable profits against which its unused tax losses can be utilised will only be derived from licence revenues, and thus, has recognised a deferred tax asset using a 10% tax rate.

8. Assume now that the Pillar Two legislation is enacted or substantially enacted in this jurisdiction. We understand that the Pillar Two rules may, in some circumstances, allow the entity to recast the deferred tax asset at the minimum rate (15%) so that, when the tax loss is utilised, the effective tax rate computed applying the Pillar 2 rules will be 15% (whereas the effective IAS 12 tax rate before consideration of Pillar Two effects will be 10%). Therefore, the possibility to recast the deferred tax asset will enable the entity to avoid the payment of a top-up tax that, absent any recast, would be due. There are questions as to whether, in those circumstances, the entity shall reassess the amount of its deferred tax asset—and thus, shall increase the applicable tax rate from 10% to 15%—to acknowledge the fact the Pillar Two rules may increase the potential benefits associated with the domestic unused tax losses.

9. In our view, the rationales for granting the proposed exemption equally apply to the circumstances in which the Pillar Two legislation affects the recognition (and measurement) of deferred tax assets and liabilities under domestic tax rules. Accordingly, we recommend the Board clarify the proposed exception also captures those circumstances.

[1] We expect no such matter to arise in an entity's consolidated financial statements when the entity is the ultimate consolidating entity.

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 requirements 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.

Paragraph BC18-BC25 of the Basis of 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 should suggest and why?

Overall assessment of the Board's proposals

10. The Board proposes disclosure requirements that apply when Pillar Two legislation (i) is in effect (paragraphs 88A and 88B) and (ii) is enacted or substantially enacted but not yet in effect (paragraphs 88A and 88C). In relation to the latter set of disclosures, the proposed information in paragraphs 88A and 88C(a) directly relates to the proposed temporary exception whereas the information in paragraphs 88C(b)–(c) aims to provide users with *insights* into an entity's exposure to paying top-up taxes.

11. We support the proposed disclosures in paragraphs 88A and 88C(a). We have mixed views on the proposed disclosures in paragraphs 88C(b)–(c). Having thought them through, we do not support them as drafted—we set out below our analysis in this respect.

- **Is there any need for specific disclosures about an entity's potential exposure to paying top-up taxes?**

12. We agree that the Pillar Two reform is a major and, to some extent, unprecedented change in the global tax landscape. It will inevitably trigger questions from users—the Board's proposed disclosures anticipate these forthcoming information needs by proposing a common disclosure framework. This may, itself, justify considering further the idea of specifying disclosures that go beyond to the information specifically related to the temporary exemption. We also agree that the disclosures proposed in paragraph 88C(b) can usefully complement—and even enhance—the information required in paragraph 81(c) of IAS 12 ('tax proof') and thus, can provide a better understanding of an entity's tax expense (income).

13. That being said, we note that the background information in paragraphs BC1–BC12 mainly describes stakeholders' concerns about the implications for income tax accounting resulting from jurisdictions implementing the Pillar Two rules. Those concerns revolve around the scope of the top-up taxes and the recognition together with the measurement of the deferred tax assets and liabilities that may result from the above-mentioned rules. This background

information does not provide much evidence of any pressing need from users to have information about entities' exposure to paying top-up taxes. We note that Agenda Paper 12A prepared for the November 2022 Board meeting did not mention any such need either—accordingly, that agenda paper included recommendations for disclosures solely related to the proposed exception. In other words, there seems to be a clear call for the temporary exception whereas the need for disclosures about the expected effects of the Pillar two rules is less obvious. This leads to question whether the disclosures in paragraphs 88(b) and (c) are really warranted.

14. We also note that IAS 12 does not include any specific *disclosure* requirements aiming to provide information about an entity's exposure to tax legislation that is not yet in effect[2]. We do not contend that any such information is not useful to users but think this touches on long-standing issues about IAS 12, issues that the Board decided not to add to its workplan further to its Third Agenda Consultation.

15. In our view, only developing new disclosure requirements specifically related to the fact that the Board is proposing to introduce the temporary exception could have been simpler, time-effective and would have focussed on what matters most for a number of stakeholders. Entities in our jurisdiction say they could develop disclosures, tailored to their facts and circumstances and their state of preparedness, to help users assess the future effects of the Pillar Two legislation instead of applying a prescriptive list of disclosures requirements whose usefulness is debatable (see below).

- **Will the proposed disclosures provide useful information and should they be considered further?**

16. In paragraph BC20 of the ED, the Board explains that it '*sought to identify what information would provide users of financial statements with insights into an entity's potential exposure to paying top-up tax…*'. We question whether the proposed disclosures, as a whole, provide any such insight—ie an *accurate* and *deep* understanding of the potential effects of the Pillar Two legislation.

17. In this regard, we question whether the proposed disclosures in paragraph 88C(b) of the ED do achieve this purpose given their limited predictive value. This is because the effective tax rate calculated applying IAS 12 is not representative of the effective tax rate that an entity will determine applying the Pillar Two rules—differences between the two rates will arise in relation to how the entity determines the 'covered taxes' and 'the GloBE income or loss' applying the Pillar Two legislation. This could result in an entity disclosing information for jurisdictions where it may not ultimately be liable for any top-up taxes and, symmetrically, not disclosing information for jurisdictions where it may be eventually liable for such taxes[3].

18. More broadly, we question whether those disclosures will provide relevant information about the future effects of the Pillar Two legislation—because of their limited predictive value—, and in turn, useful information to users. In this respect, we share some of the concerns expressed by some Board members and reflected in paragraph BC22 of the ED. As acknowledged during the Board's deliberations in November 2022, those disclosures can only be a 'starting point for a discussion with management'. In other words, those disclosures are unlikely, alone, to fully respond to users' needs. Additionally, those disclosures could inadvertently risk being misleading if users are not all well-aware of their inherent limitations. Accordingly, we think the proposed disclosures may require entities to provide supplemental information either in the notes or in

[2] Paragraph 80(b) of Agenda Paper 12A supports this observation. That being said, absent any standard-setting, applying the requirements in paragraph 22(h) of IAS 10 *Events after the Reporting Period*, the enactment (or announcement) of the Pillar 2 rules may be a non-adjusting event that would result in the information in paragraph 21 of that same IFRS Accounting Standard being disclosed. Such disclosures can be viewed as providing some insight into as entity's exposure to tax legislation that is not yet in effect.

[3] We nonetheless acknowledge that the proposed disclosure in paragraph 88C(c) partially mitigates this point.

other communications to ensure users do not get the wrong message and do not make inaccurate forecasts—thus resulting in implementation costs for entities beyond those that the Board expects.

19. We nonetheless acknowledge that the Board decided to require entities to disclose information '*...that would not involve undue costs or efforts*'. The proposed disclosures in paragraph 88C(b) of the ED build on *data* that are already available for financial reporting purpose—noting though that a number of entities will have to undertake specific works to process those *data* and prepare the *information* to disclose (in other words the proposed required information is not readily available for all entities). We also welcome the fact that the Board did not propose to require entities to disclose the amount of top-up taxes they expect to pay—we expect a number of entities to be unable to provide sufficiently reliable figures when the Pillar Two legislation is substantially enacted given (i) the scope of that legislation (worldwide operations are potentially affected) and (ii) the need for entities and other parties to get familiar with this new set of rules.

20. We also acknowledge that entities will not disclose the information in paragraph 88C on a permanent basis—the disclosures only apply in annual financial statements until the Pillar Two legislation is in effect.

21. We overall appreciate the complexity of specifying disclosures that could be useful for users and, at the same time, would not be challenging for entities to provide. That being said, we think the limitations of the proposed information as described in paragraphs 16–18 are all too important—their benefits are unlikely to exceed their related costs. Accordingly, we do not support the proposed disclosures in paragraph 88C(b)–(c) as drafted and recommend the Board not consider them further.

22. We instead recommend the Board consider developing alternative disclosures that could provide useful information—ie that do meet the disclosure objective set out in paragraph BC20 of the ED—at a reasonable cost for entities. In this respect, we note that the OECD published in December 2022 the *Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules* (accessible here). Those safe harbours are designed to relieve entities from performing full GloBE calculations for 'low-risk' jurisdictions in the initial years during which the GloBE Rules come into effect. The safe harbour described in chapter 1 of this document ('Transitional CbCR Safe Harbour') notably includes a short-term measure that would effectively exclude an entity's operations in certain lower-risk jurisdictions from the scope of GloBE in those initial years—ie the entity would not be liable for any top-up tax in those jurisdictions during the transition period. An entity would identify such jurisdictions on the basis of three criteria, including a 'simplified effective tax rate'—paragraphs 27 and 28 of the above-mentioned document includes more details about this simplified rate. We understand that an entity would determine this rate on the basis of information that is available (information from the entity's Country-by-Country Reporting and the entity's financial statements). When applying the Transitional CbCR Safe Harbour, an entity would identify the jurisdictions where it would *not* be liable for the top-up tax and, in turn, those where it would be liable for this tax. Accordingly, the Board could require the disclosures in paragraph 88C(b) of the ED to be based on the jurisdictions that would be identified applying the Transitional CbCR Safe Harbour at the reporting date. This would result in an entity providing aggregated quantitative information for a scope of jurisdictions that would align (or at least significantly align) with the scope of jurisdictions where the entity risks paying the top-up tax in the initial years during which the GloBE Rules come into effect. We think this could address the limitations we identified in paragraph 17 of this letter.

23. That being said, if the Board were to proceed with the proposed disclosures, we recommend:
    - their limited predictive value be clearly acknowledged in the basis for conclusions on the final amendments—this would make clear what users should, and should not, expect from those disclosures and help them make relevant assessments.
    - the Board require entities to disclose explanatory information in relation to the status of the assessments underpinning the requirements in paragraph 88C(c). We expect the assessment process will require much time and efforts—notably in relation to data collection. The more advanced in the process an entity is, the more reliable and the less uncertain the information is. Accordingly, background information as to the assessment process could help users understand the level of uncertainty related to the information required in paragraph 88C(c).

Request for clarifications about some aspects of the proposed disclosures

- **Whether to apply the proposed requirements when the top-up taxes do not meet the definition of income taxes and, if so, whether the proposed disclosures are relevant**

24. As explained above, we think there is uncertainty as to the scope of the proposed exception set out in paragraph 4A. If the proposed exception were to apply to any top-up taxes arising from Pillar Two legislation, regardless of whether they meet the definition of income taxes, it would notably apply to entities preparing either separate financial statements in accordance with IAS 27 or consolidated financial statements at a sub-group level. In those circumstances, there are questions as to whether the proposed disclosures in paragraph 88C are fit for purpose. Accordingly we recommend the Board develop application guidance in this respect.

- **How to apply materiality to the proposed disclosures in paragraph 88C of the ED**

25. Applying the requirements in paragraph 31 of IAS 1 *Presentation of Financial Statements*, an entity would not need to provide the proposed disclosures if the resulting information is not material. In our view, there are questions as to how to operationalise those disclosures, and ultimately as to how granular those disclosures should be.

26. Assume that the entity has no reliable assessment for the amount of top-up taxes it will be liable for when the Pillar Two legislation is in effect. When making its materiality judgement for reporting periods during which the Pillar Two legislation is enacted or substantially enacted, we expect the entity to consider (among other factors) a proxy of the total amount of additional taxes it would have to pay at the reporting date for all jurisdictions where its average effective tax rate (calculated as specified in paragraph 86 of IAS 12) is below 15%. However, it is not clear how granular the disclosures in paragraphs 88C(a)–(b) should then be. In particular should the related information include that of jurisdictions that are not individually material in the context of the proposed amendments? This question matters for groups operating in a great number of jurisdictions—for example, providing the information set out in paragraph 88C(a) for jurisdictions that are not individually material risks cluttering the notes to the financial statements. In our view, an entity should (i) provide the information in paragraphs 88C(a) only for individual jurisdictions that are material in the context of this project and (ii) solely retain those jurisdictions for the purpose of the computation required in paragraph 88(b).

27. To avoid diversity in disclosure practices, we recommend the Board provide in the basis for conclusions on the final amendments insights into how entities should assess materiality for the purpose of disclosing the required information[4].

[4] This could be achieved by including in the basis for conclusions on the final amendments observations along the lines of those in paragraph BC48EE of the Amendments to IAS 1 *Non-current Liabilities with Covenants* published in October 2022.

- **The level of aggregation that the Board intends to require for the disclosures set out in paragraph 88C(b)**

28. Paragraph 88C(b) requires an entity to disclose the tax expense (income) and accounting profit for the jurisdictions in which its average effective tax rate for the current period is below 15%. The entity shall provide that information 'in aggregate' as well as the resulting weighted average effective tax rate.

29. There is uncertainty among our stakeholders about how to understand 'in aggregate'. Some think the existing drafting of the proposed amendments could be understood to require an entity to disclose the information in paragraph 88C(b) in aggregate for *each* (material) jurisdiction in which the entity's average effective tax rate for the current period is below 15%. We understand the Board's intention was rather to require disclosures in aggregate for *all* (material) jurisdictions in which the entity's average effective tax rate for the current period is below 15%.

30. Should the Board proceed with its proposals, we recommend the Board clarify this point when drafting the final amendments.

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

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?

Overall assessment of the Board's proposals

31. We agree with the proposed effective date and transition requirements for the reasons set out in paragraphs BC28–BC27.