

Amendment IAS 12 – *International Tax Reform – Pillar Two Model Rules*

EFRAG FR TEG-CFSS

6 February 2023



DISCLAIMER

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OVERVIEW

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Overview of the Pillar Two Model Rules

OVERVIEW OF THE PILLAR TWO MODEL RULES

Background (1/3)

In December 2021, the Organisation for Economic Co-operation and Development (OECD) published its [Pillar Two model rules](#). The rules are part of a two-pillar solution to address the **tax challenges arising from the digitalisation of the economy** and were agreed by more than 135 countries.

In the European Union the Directive ([here](#)) has been approved in December 2022 and it is planned that the individual jurisdictions enact the related law before 31 December 2023. The law will apply in Europe **for annual periods starting on 1 January 2024**.

The rules specify **inclusion of a thresholds** for some jurisdictions and **exclude some types of entities** from their scope.

OVERVIEW OF THE PILLAR TWO MODEL RULES

Background (2/3)

The Pillar Two rules:

- a) aim to ensure that **large multinational groups** - which meet some specified requirements (e.g., a consolidated turnover exceeding €750 million) - pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
- b) would achieve that aim by applying a system of **top-up taxes** that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the **minimum rate of 15%**; and
- c) typically require the **ultimate parent entity** of the group to pay top-up tax—in the jurisdiction in which it is domiciled—with respect to profits of its subsidiaries that are taxed below 15% or by an intermediate parent entity if the ultimate parent entity's jurisdiction has not yet implemented the Pillar Two model rules.

OVERVIEW OF THE PILLAR TWO MODEL RULES

Background (3/3)

Jurisdictions may also introduce a **qualified domestic minimum top-up tax**. This top-up tax is computed on a basis similar to the Pillar Two model rules, but would be charged in the jurisdiction in which the profit arises rather than in the ultimate parent entity's jurisdiction.

Useful links for more detailed information on the project can be find below:

- ❑ [Fact sheet](#) developed by the OECD which summarises the operation of the model rules;
- ❑ Full text of the model rules, including an overview, and FAQs <https://oe.cd/pillar-two-model-rules>.
- ❑ Further information on the two-pillar solution for addressing the tax challenges arising from digitalisation and globalisation of the economy is available at <https://oe.cd/bepsaction1>.

OVERVIEW OF THE PILLAR TWO MODEL RULES

Potential implications for income tax accounting

Stakeholders informed the IASB of concerns about the implications of the imminent implementation of the Pillar Two model rules for income tax accounting.

Stakeholders' concerns relate to:

- a) How to apply IAS 12 to account for top-up tax → Is top-up tax in the scope of the IAS 12 – Income taxes? How to account for the deferred taxes? Do Pillar Two model rules create additional top-up tax? If so, which tax rate has to be used? Is it necessary to remeasure existing deferred tax?
- b) What if the paying entity differs from the one that causes top-up tax (tax not based on the accounting profit)?
- c) the usefulness of the information that could result from accounting for deferred taxes related to top-up tax → Does costly and complex calculation of deferred tax effects as required in accordance with IAS 12 outweigh the benefits of such information? Is such information really an indication of the future tax impact?
- d) the urgent need for clarity in the light of the imminent enactment of tax law to implement the rules in some jurisdictions → Could the short time available lead to diversity in practice and not useful information for users?



ED: proposed amendments to IAS 12

ED: PROPOSED AMENDMENTS TO IAS 12

On 9 January 2023 the IASB published the ED of the [Proposed Amendments to IAS 12](#) with a comment period ending 10 March 2023.

The proposals in the ED would :

- a) introduce a **temporary and mandatory exception to the accounting for deferred taxes** arising from the implementation of the Pillar Two model rules (IASB's Question 1); and
- b) introduce **targeted disclosure requirements before and after** the Pillar Two model rules will be enacted (IASB's Question 2);

The IASB expects the proposed amendments to:

- i. provide timely relief for affected entities and avoid inconsistent interpretations of IAS 12; and
- ii. provide specific information to users of financial statements before and after the Pillar Two model rules are in effect.

ED: PROPOSED AMENDMENTS TO IAS 12

Temporary exception to the accounting for deferred taxes

The IASB proposes to:

- a) introduce a temporary exception to the requirement to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes (including any qualified domestic minimum top-up tax).
- b) require an entity to disclose that it has applied the exception.

The exception:

- i. would apply until the IASB either removes the exception or makes it permanent (e.i., temporary exception).
- ii. is mandatory and not optional.

ED: PROPOSED AMENDMENTS TO IAS 12

Disclosures

Before legislation is in effect

The IASB proposes – by considering undue cost or effort - to require an entity to disclose:

- a) information about legislation enacted (or substantively enacted) to implement Pillar Two model rules in jurisdictions in which the entity operates;
- b) the jurisdictions in which the entity's effective tax rate - calculated based on IAS 12 (which is normally different from the Pillar Two tax basis) - for the current period is below 15%. An entity would also disclose the tax expense and accounting profit for these jurisdictions in aggregate, and the resulting weighted average effective tax rate; and
- c) whether there are jurisdictions 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 (and vice versa), only if the assessment in preparing to comply with Pillar Two legislation is already available.

ED: PROPOSED AMENDMENTS TO IAS 12

Disclosures (continued...)

After legislation is in effect

The IASB proposes to require an entity to disclose separately its current tax expense (income) related to Pillar Two income taxes.

Effective date and transition

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 (question 2 above) for annual reporting periods beginning on or after 1 January 2023.

QUESTIONS - see ASAF Papers

Q1: Is your country or jurisdiction expected to implement the Pillar Two model rules?

Q2: Can you share information about the status of implementation in your country or jurisdiction, including when legislation implementing the rules is expected to be enacted (or substantively enacted)?

Q3: Do EFRAG FR TEG-CFSS members have any questions about the proposals in the ED that EFRAG should raise in the ASAF meeting?



EFRAG's preliminary views on the ED

EFRAG'S PRELIMINARY VIEWS ON THE ED

- EFRAG published its [draft comment letter](#) on 30 January 2023. EFRAG has provided a preliminary response to the 3 questions raised by the IASB.

Question 1 – Temporary exception to the accounting for deferred taxes

- EFRAG welcomes the IASB's efforts to address rapidly the concerns raised by stakeholders.
- EFRAG agrees with the IASB's proposal to provide a temporary exception that applies to Pillar Two model rules, including qualified domestic to-up tax.
- EFRAG welcomes that the exception is mandatory as it ensures comparability and avoids the risk of accounting inconsistencies. In addition, by disclosing that the entity has applied the exception makes it transparent that the entity is active in relevant jurisdictions and might be impacted by top-up tax.
- However, EFRAG notes that extending such a mandatory exception also to the disclosure about deferred taxes related to Pillar Two rules could lead in future periods to a potential loss of some relevant information. In future periods - when such information will be available on a reliable basis - the exception could be understood in a way that it is not allowed to disclose such information.

EFRAG'S PRELIMINARY VIEWS ON THE ED

Question 1 – Temporary exception to the accounting for deferred taxes

- To clarify the accounting and the regulation itself might be complex – so EFRAG welcomes the IASB approach not to include a sunset clause for the application of the exception.
- However, EFRAG encourages the IASB to monitor the forthcoming enactment process and to already schedule in its work plan an activity of review, so that the exception may be terminated at the appropriate moment.
- EFRAG encourages the IASB to clarify whether Pillar Two income taxes are in the scope of IAS 12 in situations outside the context of consolidated financial statements (for instance, standalone financial statements or consolidated FS when the paying entity differs from the entity that causes top-up tax).

QUESTIONS included in the EFRAG DCL

Q1: Do EFRAG FR TEG-CSS members 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 (which is paid in the local jurisdiction but has the same taxable basis as if the top-up tax is paid in the jurisdiction of the parent or intermediate-parent)?

Q2: Do EFRAG FR TEG-CSS members support the IASB's proposal to extend a temporary mandatory exception also to the disclosure of information about potential deferred taxes arising from the implementation of the Pillar Two model rules?

Q3: Do EFRAG FR TEG-CSS members 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)?

EFRAG'S PRELIMINARY VIEWS ON THE ED

Question 2 – Disclosures

When legislation is enacted or substantively enacted but not yet in effect

- 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 costs or effort and appreciates to find a compromise, considering the urgency of the project.
- However, there are some doubts on:
 - The type of information to be provided in accordance with paragraphs 88C (a)
The proposal 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.
 - 88C (c); 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.
 - 88C (b); the definition of accounting profit of a jurisdiction. Is it the sub-consolidated accounting profit of all entities in an existing jurisdiction, the aggregation of entities before consolidation adjustments..?
 - 88C (b) whether the disclosure requirements proposed are a useful proxy for users of financial statements (please see BC21-BC23 of the ED why the IASB decided to request this type of information).

EFRAG'S PRELIMINARY VIEWS ON THE ED

Question 2 – Disclosures

- EFRAG will concentrate its outreach activities on the cost benefit considerations of such proposal and to understand potential alternatives.
- EFRAG encourages the IASB to specify in paragraph 88C that it refers to any jurisdiction in which the entity operates.
- EFRAG has reservation on whether the disclosure requirements included in the ED are fit for purpose of standalone financial statements (or the financial statements of sub-consolidated subsidiaries).

When legislation is in effect

- EFRAG agrees with the disclosure but 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 type of income taxes.

QUESTIONS included in the EFRAG DCL

Q4: Do EFRAG FR TEG-CSS members consider that the disclosure requirements included in the ED (paragraph 88C(b)) 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?

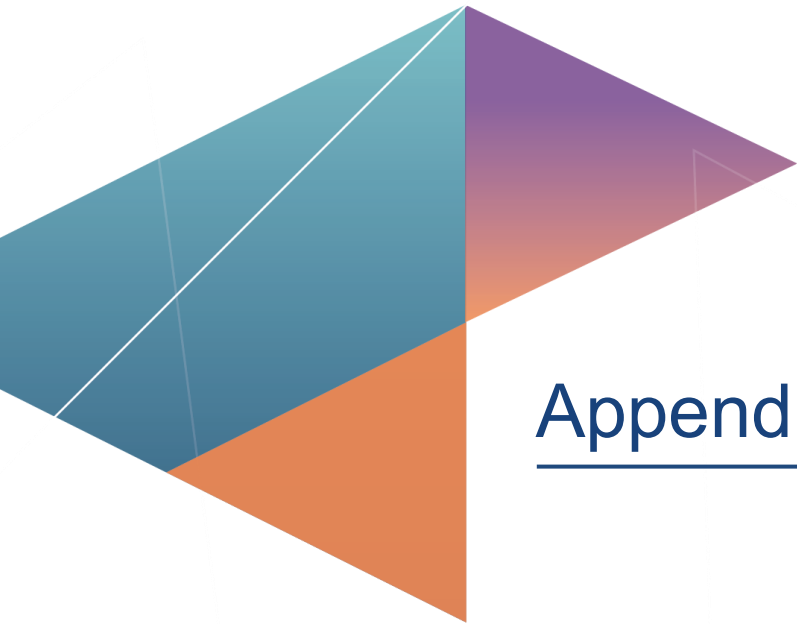
EFRAG'S PRELIMINARY VIEWS ON THE ED

Question 3 – Effective date and transition

- EFRAG agrees with the IASB's proposal
- The 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 date the expected Amendments are approved).
- 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.
- 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 at the appropriate moment.

QUESTIONS included in the EFRAG DCL

Q5: Would EFRAG FR TEG-CSS members like to raise additional questions or issues that should be taken into consideration by EFRAG in its Final Comment Letter?



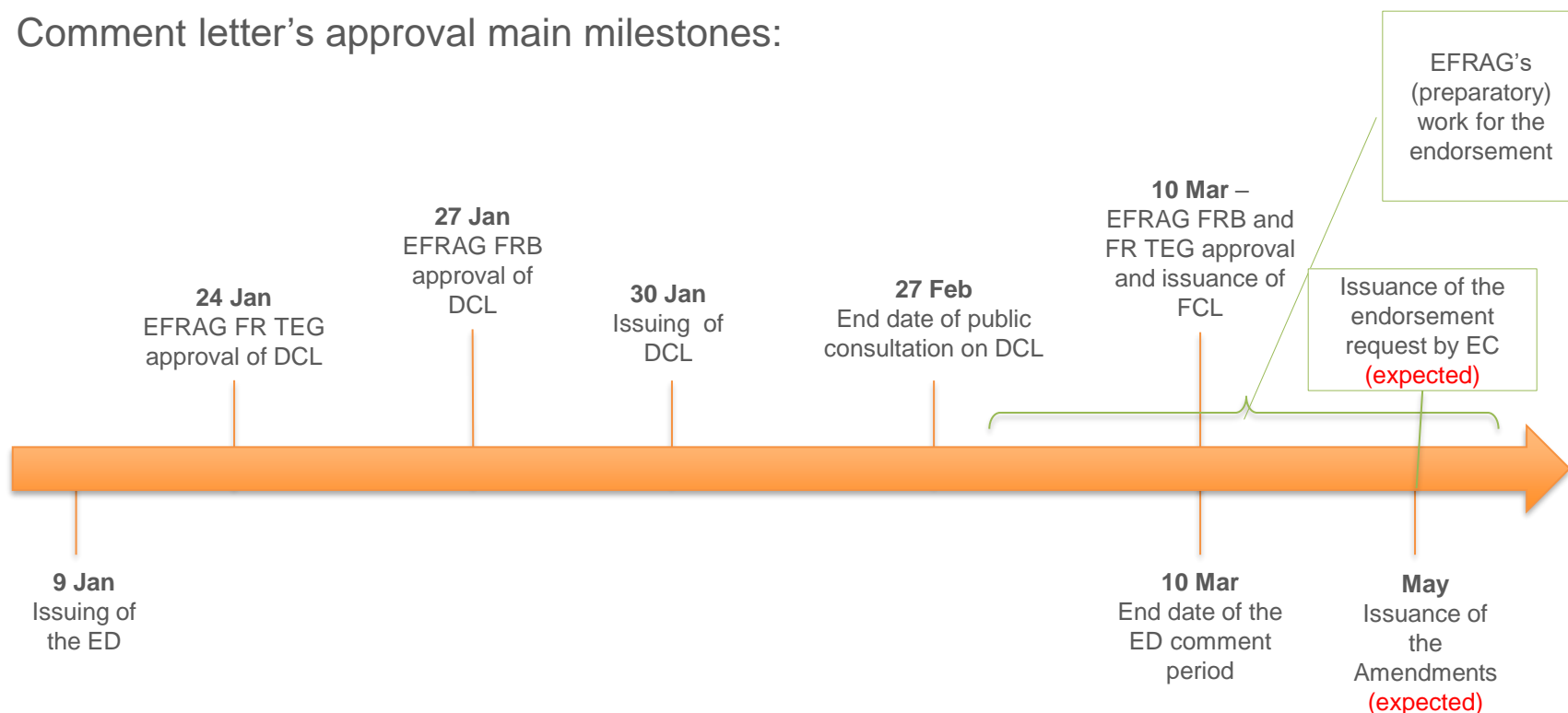
Appendix: EFRAG's work plan

APPENDIX: EFRAG'S WORK PLAN

Issuance of the comment letter, the Amendments and Endorsement request

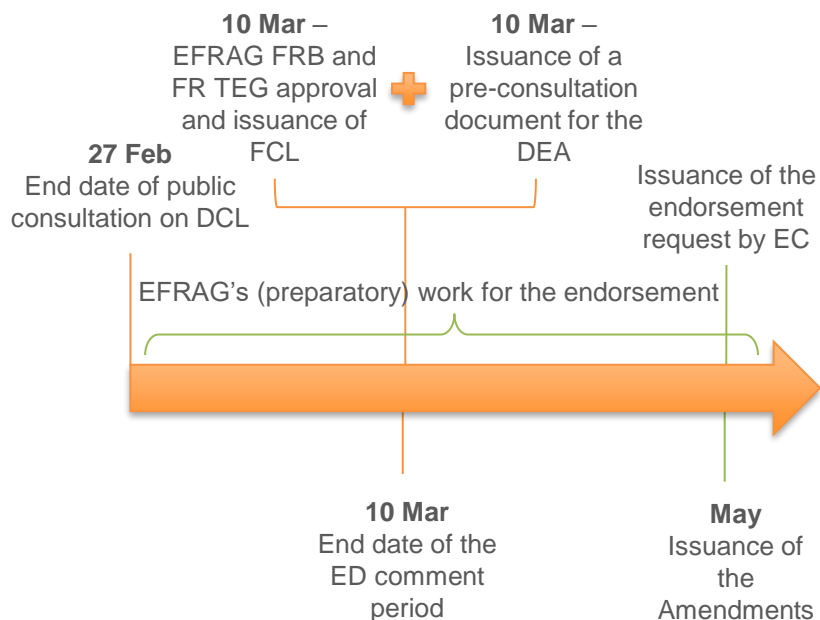
EFRAG FRB agreed to adopt a fast-track approval process of EFRAG's comment letter in response to the IASB's ED and of the endorsement advice on the IASB's expected amendments.

Comment letter's approval main milestones:



APPENDIX: EFRAG'S WORK PLAN

Endorsement advice on the Amendments



Based on the assumption of supportive feedback and no major changes to the ED to ensure a fast endorsement process, the EFRAG Secretariat would:

- start its preparatory work for the endorsement at the end of the public consultation on the DCL
- publish a pre-consultation document for the DEA together with (or shortly after) the publication of the FCL in March 2023.

The pre-consultation document will be updated and approved shortly after the publication of the Amendments (May)

The EC expects – based on this timeline - to endorse the amendments in Oct 2023

APPENDIX: EFRAG'S WORK PLAN

Issuance of the comment letter – basis for the endorsement

In order to obtain feedback from a wide range of stakeholders the EFRAG Secretariat has discussed or plans to discuss the topic with the following stakeholders:

- EFRAG Working Groups (EFRAG User Panel (3 February), EFRAG FIWG (30 January), EFRAG IAWG (1 February));
- EFRAG TEG CFSS (6 February);
- EC and potentially with ESMA's representatives (EC 13 January);
- EFRAG's member organisations (e.g., AccountancyEurope, ASCG tax working group, Business Europe) and large audit firms;
- ASAF members (10 February);
- EFRAG FRB FR TEG Joint Meeting to approve the FCL.



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THANK YOU



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