IASB ISSUES AMENDMENTS TO IAS 12 – *INTERNATIONAL TAX REFORM – PILLAR TWO MODEL RULES*

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BACKGROUND

In December 2021, the Organisation for Economic Co-operation and Development (OECD) published *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (Pillar Two model rules). In March 2022, the OECD released commentary and illustrative examples that elaborate on the application and operation of the rules and clarify certain terms.

The Pillar Two model rules aim to ensure that large multinational groups (generally with revenue exceeding €750 million) pay a minimum amount of tax on income arising in each jurisdiction in which they operate. This would be achieved 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%.

Stakeholders raised concerns with the IASB about the potential implications on income tax accounting, especially accounting for deferred taxes, arising from the Pillar Two model rules. The stakeholders emphasised an urgent need for clarity given the imminent enactment of tax law to implement the rules in some jurisdictions.

In response to stakeholder concerns, the IASB proposed amendments to IAS 12 *Income Taxes*. It issued Exposure Draft *International Tax Reform—Pillar Two Model Rules (Proposed Amendments to IAS 12)* on 9 January 2023. Given the urgent requirement for clarity, a shorter comment period of 60 days was provided. The IASB issued the final Amendments (the Amendments) *International Tax Reform – Pillar Two Model Rules* on 23 May 2023.

The Amendments introduce a temporary exception to entities from the recognition and disclosure of information about deferred tax assets and liabilities related to Pillar Two model rules. The Amendments also provide for additional disclosure requirements with respect to an entity's exposure to Pillar Two income taxes.

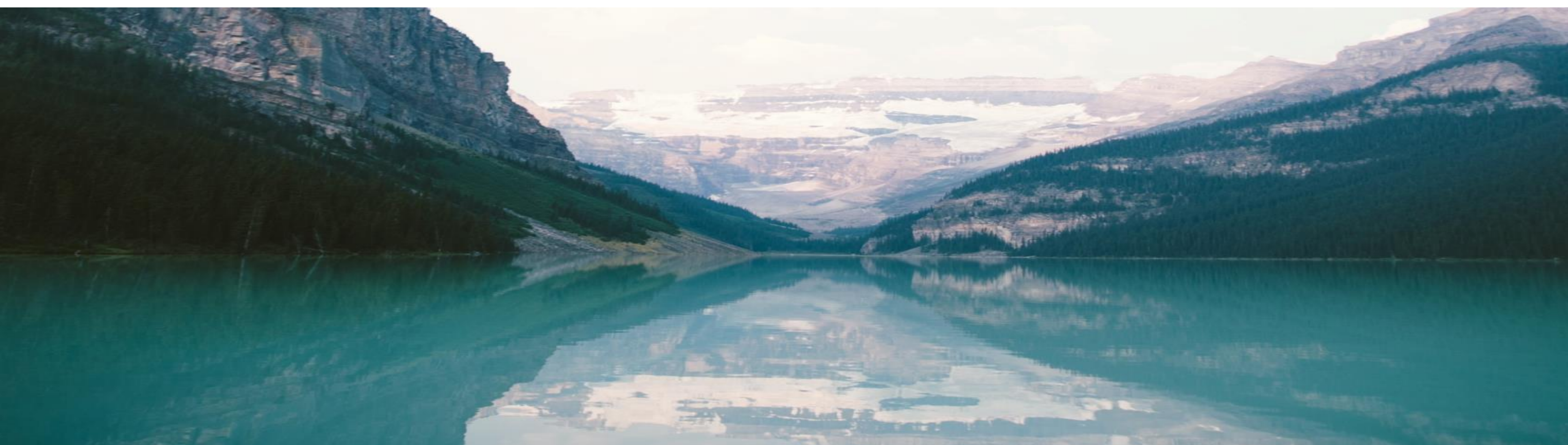
STATUS
Final amendments

EFFECTIVE DATE
Effective immediately and retrospectively

ACCOUNTING IMPACT
The Amendments create a temporary mandatory exception to the requirements of IAS 12 *Income Taxes* from recognition and disclosure of information about deferred tax assets and liabilities related to Pillar Two income taxes. The Amendments also provide for additional disclosure requirements with respect to an entity's exposure to Pillar Two income taxes.

Which entities will benefit from the Amendments?

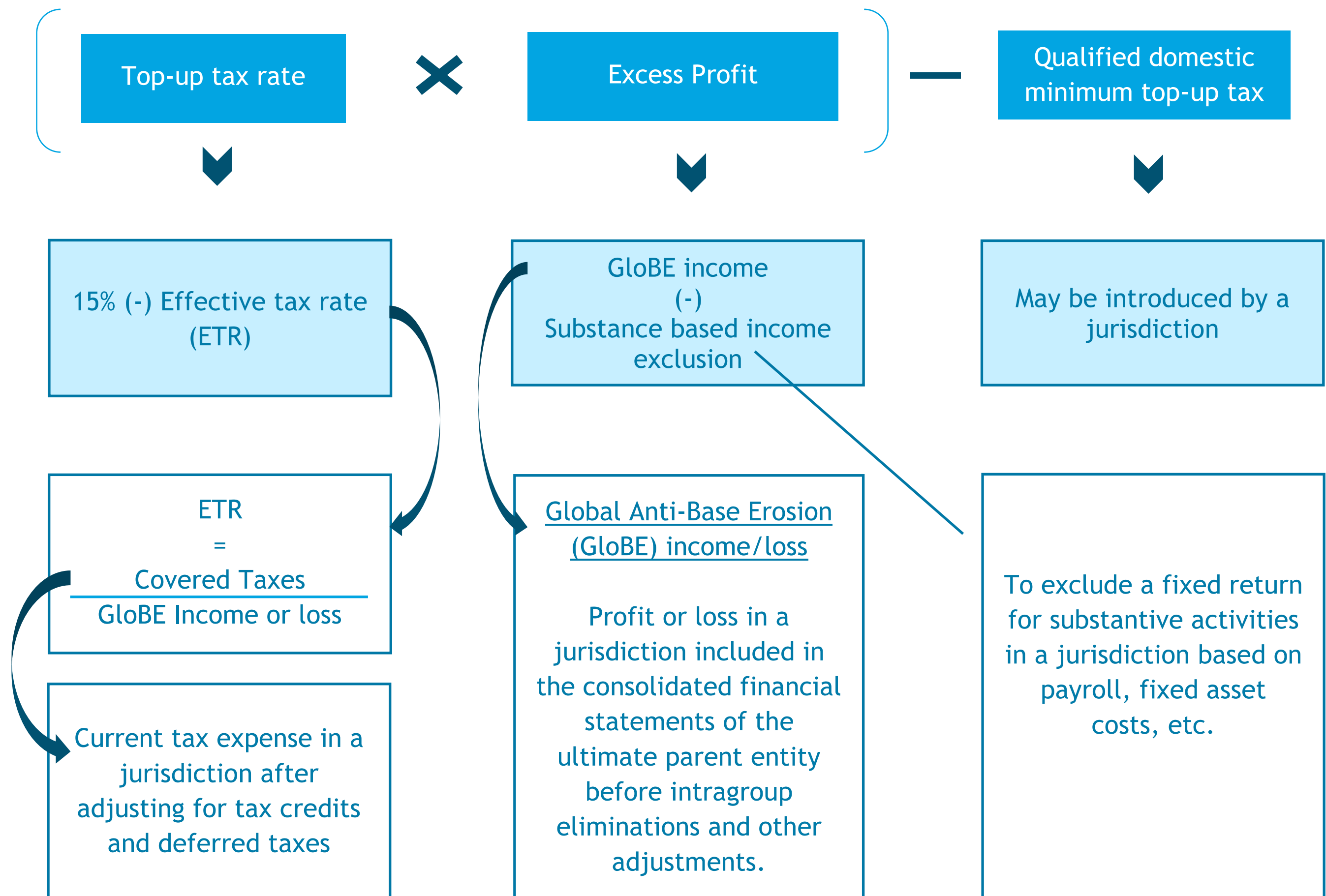
Pillar Two model rules generally apply to multinational groups with revenue in their consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal years. These entities (and entities that are a part of such groups) will benefit from the relief provided by the Amendments.



PILLAR TWO MODEL RULES

The Pillar Two model requires payment of top-up tax by multinational entities within its scope.

Top-up tax is calculated as below:



What were the concerns raised with respect to the accounting implications?

The following are some of the main concerns raised by stakeholders about the implications for income tax accounting of Pillar Two income taxes:

- Scope of IAS 12:

  The stakeholders noted that it was not clear whether top-up tax is an income tax in the financial statements of a group’s subsidiaries. For example, if an entity is liable to pay such tax with respect to profits of entities that are not part of its reporting group (for example, with respect to a fellow subsidiary's profits).

- Lack of clarity on deferred tax accounting, for example:

  - Whether the Pillar Two model rules create additional temporary differences?
  - Whether to remeasure deferred taxes recognised under domestic tax regime to reflect potential top-up tax payable?

- Tax rate to be used to measure deferred taxes: The tax rate that will apply to an entity's excess profit in future periods depends on a number of factors that are difficult to forecast reliably.

As some jurisdictions are expected to enact laws to implement the Pillar Two model rules in the first half of 2023, the stakeholders highlighted an urgent need for clarity on these issues.

In response to stakeholder concerns, the Amendments were issued after a short comment period for the related exposure draft.

THE AMENDMENTS

The Amendments amend the scope of IAS 12 and provide for additional disclosure requirements.

Amendment to the Scope of IAS 12

The Amendments have inserted paragraph 4A in the scoping requirements of IAS 12 as below:

IAS 12.4A

This Standard applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes described in those rules. Such tax law, and the income taxes arising from it, are hereafter referred to as 'Pillar Two legislation' and 'Pillar Two income taxes'. As an exception to the requirements in this Standard, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

The following are some key points to note with regards to the Amendments:

1. Income taxes arising from Pillar Two legislation scoped in:

   The Amendments bring income taxes arising from Pillar Two legislation, including tax laws that implement qualified domestic minimum top-up taxes, within the scope of IAS 12. However, the IASB has neither provided further clarification or guidance on the circumstances in which Pillar Two top-up tax is considered to be an income tax nor provided a requirement to consider all Pillar Two top-up taxes as income tax (Basis for Conclusions BC103). Therefore, an entity is required to apply judgement to determine whether, in its circumstances, a top-up tax is an income tax. Once it determines a top-up tax to be income tax, it applies IAS 12, including the Amendments, to that top-up tax.

2. Temporary exception created to the accounting for deferred tax:

   The IASB has introduced a temporary exception to the requirements in IAS 12 by which entities will not be required or permitted to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

   This exception provides affected entities with relief from accounting for deferred tax assets and liabilities in relation to Pillar Two income taxes to be enacted in a short period of time. The exception also avoids inconsistent application of the requirements of IAS 12.

3. Mandatory application of the exception:

   The exception is mandatorily applicable, which results in greater comparability between financial statements and eliminate the risk of entities inadvertently developing accounting policies that are inconsistent with the requirements of IAS 12.

4. Duration for the exception not specified:

   The Amendments do not specify an end date to the exception.

   As noted by the IASB in the Basis for Conclusions (BC106) to the Amendments, at present, it is not possible to determine how much time will be required to complete the work needed to determine how entities apply the principles and requirements of IAS 12 to account for deferred taxes related to Pillar Two income taxes. Therefore, the IASB decided not to specify the duration of the exception.

Disclosure requirements

The Amendments require an entity to disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

Disclosure requirements when Pillar Two legislation is in effect:

In periods when Pillar Two legislation is in effect, the Amendments require an entity to disclose separately its current tax expense (income) related to Pillar Two income taxes.

Disclosure requirements when Pillar Two legislation is enacted or substantively enacted but not yet in effect:

In the periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, the Amendments require an entity to disclose known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.

Disclosure requirements to meet the above disclosure objective:

Information about the entity's exposure to Pillar Two income taxes at the end of the reporting period	Example
a. Qualitative information	• Information about how an entity is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist.
b. Quantitative information	• An indication of the proportion of an entity's profits that might be subject to Pillar Two income taxes and the average effective tax rate (ETR) applicable to those profits; • An indication of possible change in the entity's ETR had the Pillar Two legislation been in effect.

The above information may be provided in the form of an indicative range and need not reflect all the specific requirements of the Pillar Two legislation.

The IASB observed that legislation in some jurisdictions is expected to be effective as early as 1 January 2024. Therefore, it expected many entities to have some information about their exposure available to them by the time the disclosure requirements are applicable. However, to the extent information is not

known or reasonably estimable, an entity is required to disclose a statement to that effect and disclose information about the entity's progress in assessing its exposure.

Effective date and transition

The scope exception and disclosure of the fact of application of the exception are applicable immediately upon issue of the Amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Other disclosure requirements are applicable for annual reporting periods beginning on or after 1 January 2023. These disclosures are not required for any interim period ending on or before December 2023.

As the Amendments on scope exception are effective retrospectively, an entity would apply the exception even if the date Pillar Two legislation is enacted or substantively enacted is before the date on which the IASB issued the Amendments.

Example of retrospective application of the exception:

An entity's annual reporting period end is 31 March. In one of the jurisdictions that the entity operates in, Pillar Two legislation is enacted in March 2023.

By May 2023, the entity is yet to issue its annual financial statements for the year ended 31 March 2023.

As the Amendments are effective retrospectively, the entity would apply the scope exception in its annual financial statements for the year ended 31 March 2023 and disclose that fact. The entity would not be required to make the other disclosures as they are only required for annual reporting periods beginning on or after 1 January 2023.

Jurisdictional endorsement requirements: Accounting if Pillar Two legislation is enacted or substantively enacted prior to the Amendments being endorsed

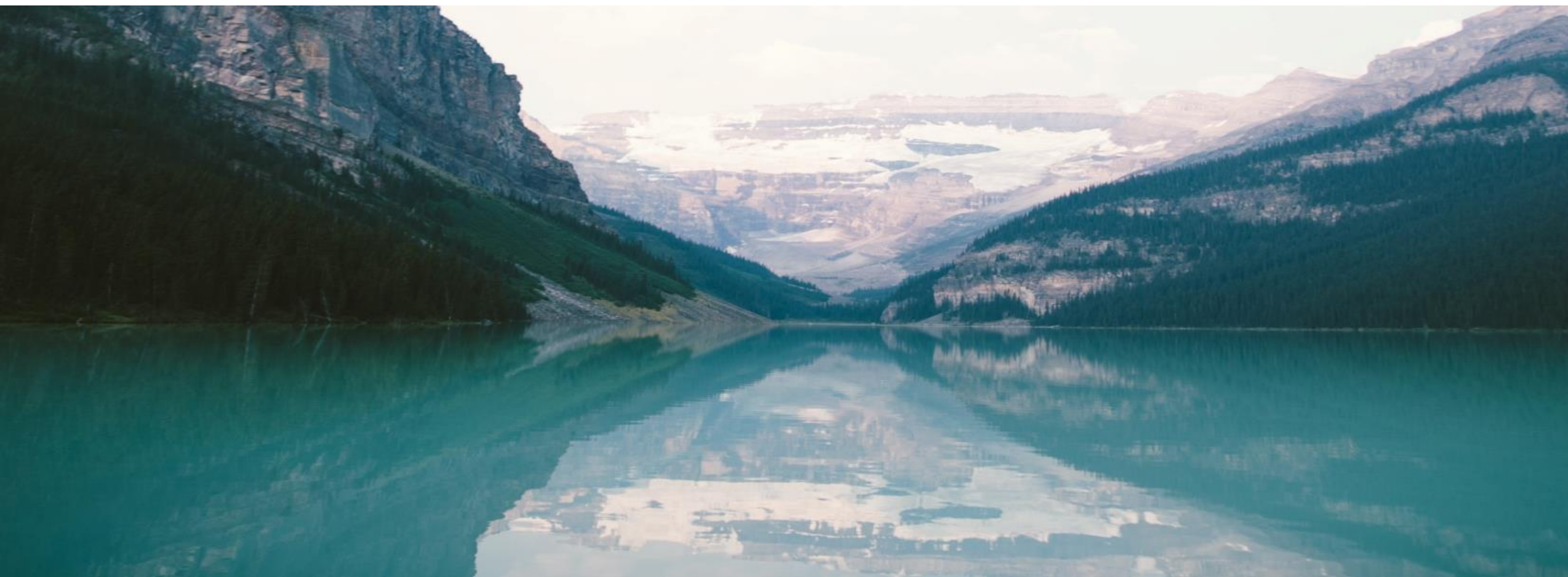
The Amendments are effective immediately for entities that apply IFRS Accounting Standards as issued by the IASB. However, in jurisdictions that have endorsement requirements, the Amendments will be effective only after they are endorsed, which may require some time. For example, the European Union is not expected to endorse the Amendments until late in 2023.

An issue arises in these cases that if a jurisdiction enacts or substantively enacts Pillar Two model rules prior to the IAS 12 amendments being endorsed for that jurisdiction, should the entities affected by the Pillar Two model rules recognise deferred taxes relating to the Pillar Two model rules.

The IASB has noted in the Basis for Conclusions (paragraph BC99) that stakeholders said it was unclear how an entity would account for deferred taxes related to top-up tax. The IASB also noted the requirement raised by stakeholders for an urgent need for clarity on how to apply IAS 12 in accounting for top-up tax. Therefore, it is not clear whether the Pillar Two model rules have deferred tax measurement consequences. The Amendments are issued in response to these concerns, among others. The exception to the recognition and disclosure requirements of IAS 12 for deferred taxes is intended to create consistent information for users of financial statements while the matter is investigated further.

Therefore, prior to the IAS 12 amendments being effective in a jurisdiction, in our view, it is supportable for an entity in the jurisdiction to develop a judgement that in applying the existing requirements of IAS 12, the Pillar Two model rules do not result in deferred tax recognition and disclosure consequences. This judgement would be made in accordance with IAS 8.10, in that an IFRS does not specifically apply to the transaction, other event or condition; therefore, the entity must develop an accounting policy that meets the criteria in IAS 8.10(a)-(b).

If an entity is affected by Pillar Two model rules being enacted in a particular jurisdiction, the entity should clearly disclose this judgement and the accounting policy it has applied in the financial statements. Once the IAS 12 amendments are effective in the entity's jurisdiction and are therefore adopted by the entity, these disclosures will need to be revisited.



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