Think Ahead ACCA

ED/2023/1 International Tax Reform – Pillar Two Model Rules: Proposed amendments to IAS 12

Exposure draft issued by the IASB in January 2023

Comments from ACCA
9 March 2023

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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the IASB's exposure draft (ED) for International Tax Reform – Pillar Two Model Rules: Proposed amendments to IAS 12 (hereinafter referred to as the 'ED'). This was done with the assistance of ACCA's Global Forum for Corporate Reporting and Global Forum for Taxation.

ACCA believes tax should be an integrated consideration when deciding an entity's business model, overall strategy and plans. Reporting of a company's tax practices, such as tax strategy, governance and risk management enables users to understand the company's tax position and various tax considerations. Also, companies should not pursue aggressive tax avoidance that have no clear purpose other than to avoid tax by complicated schemes.

On the other hand, complex tax legislation and systems are likely to result in non-compliance and anti-avoidance measures produce complex and detailed legislation.

The Pillar Two model rules, that aim to ensure large multinational enterprises (MNEs) pay a minimum amount of tax on income arising in each jurisdiction in which they operate, are by no means simple. The top-up tax rate will be influenced by an entity and its related entities' performance and tax payments in a jurisdiction, among other factors. Applying these rules and determining the deferred tax impact are likely to be complex and very challenging in practice. The cost and effort to produce reliable information may outweigh the benefits and make this seem like an impractical exercise.

The proposed mandatory exception will give companies a temporary relief from dealing with uncertainty in accounting for deferred taxes arising from Pillar Two model rules. Companies will appreciate the breathing space. We also echo the IASB's view that it will need time to study how the rules have been implemented around the world and consider whether it needs to undertake further work.

We suggest the IASB review the exception after at least one year of application but do not remove the exception until it has studied the evolving tax implications and is able to provide guidance for practical and consistent application of IAS 12 in accounting for top-up tax recharges within individual entity's accounts and deferred tax arising from Pillar Two model rules. We encourage the IASB to consult with directly affected stakeholders to fully understand the implications. If the IASB decides to undertake standard setting activity, we suggest reviewing the effectiveness of IAS 12 as a whole, including tax disclosures.

Our detailed responses to the specific questions asked are set out below.

RESPONSES TO SPECIFIC QUESTIONS RAISED

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.

ACCA response – Question 1

The impact of Pillar Two model rules on the ultimate holding company, intermediate holding companies and individual entities within a group is still unclear due to legislation only currently being enacted by different jurisdictions. Therefore, uncertainties exist relating to an entity's ability to assess future tax consequences and in turn account for deferred tax, ie, whether there will be temporary differences, amount and the tax rate to be applied. For example, a group's performance might change from year to year, and this might change the resulting top-up tax rate. Additionally, high levels of estimation uncertainty and individual interpretation are likely to exist, resulting in unreliable information or where the cost of obtaining this information outweighing the benefit.

Therefore, we support the proposed mandatory exception as it will give companies around the world and the IASB time to assess how the Pillar Two model rules have been implemented in different jurisdictions, as well as time for the IASB to consider whether any standard setting activity is required to support the consistent application of IAS 12. We also echo the IASB's view in paragraph BC16 that a mandatory exception will eliminate the risk that entities might inadvertently develop accounting policies that are inconsistent with the principles and requirements in IAS 12, and that would reduce comparability.

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.

ACCA response – Question 2

We support these proposals. We have additional comments for each proposal as follows:

Periods before legislation is in effect (paragraph 88C)
Reporting on Pillar Two legislation that is enacted or substantively enacted in jurisdictions in which an entity operates will provide important context to users of financial statements on an entity's exposure to paying top-up tax and how the amount will be derived. However, there is a risk of information overload for users when an entity operates in many jurisdictions and discloses information about the legislation in each jurisdiction that it operates in. We suggest identifying key information that paragraph 88C(a) should comprise and requiring this for jurisdictions identified in paragraph 88C(b) only.

The information required by paragraph 88C(b) will be useful in giving users of financial statements some indication of an entity's potential exposure to paying Pillar Two top-up income taxes in specific jurisdictions. Calculating the average effective

tax rate based on paragraph 86 in IAS 12 instead of the Pillar Two legislation is pragmatic as entities would have at least some of the information needed.

Therefore, we suggest disclosing the amount of the tax expense (income) and accounting profit and the effective tax rate for each jurisdiction identified in paragraph 88C(b). This information will help users assess an entity's potential extent of top-up taxes in specific jurisdiction.

With reference to paragraph BC24(c), we suggest clarifying in the standard that the information in paragraph 88C(c) is required only if an entity has made such assessments.

If an entity has made such assessments, we suggest disclosing the jurisdictions identified by paragraph 88C(c)(i) and paragraph 88C(c)(ii). This information will be more useful than indicating whether there are or there aren't additional (or fewer) jurisdictions that might be exposed to paying Pillar Two top-up income taxes.

Periods in which the legislation is in effect (paragraph 88B)
Separating Pillar Two top-up taxes from an entity's current tax expense as proposed in paragraph 88B enables users to analyse the amount of additional taxes that the entity/group has to pay.

We suggest disaggregating the Pillar Two taxes to the respective jurisdictions where the group is paying top-up taxes. This information should be disclosed in the notes. This will provide useful information, at least in the first few years of implementing Pillar Two, for users of financial statements to assess the entity's exposure and for regulators, such as tax authorities, in gauging the effectiveness of Pillar Two model rules.

However, preparing this information will be challenging in the first few years. Internal reporting tools may need to be updated to aid collation of information for this purpose. We will only be able to gauge the lead time once we know with more certainty on what information that needs to be collected.

We also suggest clarifying if the under or over accrual of Pillar Two top-up income taxes should be disclosed separately from an entity's current tax expense in subsequent periods.

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.

ACCA response – Question 3

We agree with the proposals. As paragraph 47 of IAS 12 requires an entity to measure deferred tax based on 'tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period', the mandatory exception for accounting for deferred taxes arising from Pillar Two model rules should be available to entities immediately upon the issue of the amendments for it to be effective. We also suggest editing the proposed paragraph 98M to clarify the exception is applicable to any financial statements not yet authorised for issue at that date. This was mentioned in paragraph BC27 in the ED and we suggest including it in the standard to remove any doubt.

We also agree with the IASB's rationale in paragraph BC28 for requiring an entity to apply the disclosure requirements in paragraphs 88B – 88C for annual reporting periods beginning on or after 1 January 2023, so an entity would have time to prepare the required information.