
IASB[®] meeting

Date **November 2022**
Project **International Tax Reform—Pillar Two Model Rules**
Topic **Potential standard-setting project**
Contacts **Gustavo Olinda** (golinda@ifrs.org)

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS[®] Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB *Update*.

Introduction and purpose

1. On 22 November 2022, the IASB discussed a potential standard-setting project in response to the imminent implementation of the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD). At that meeting the IASB tentatively decided to:
 - (a) introduce a temporary exception from accounting for deferred taxes arising from legislation enacted to implement the OECD's Pillar Two model rules (including any qualified domestic minimum top-up tax). The exception would apply until such time that the IASB decides to either remove it or make it permanent.
 - (b) require an entity to disclose:
 - (i) the fact that it has applied the exception; and
 - (ii) its current tax expense related to Pillar Two top-up tax.
 - (c) require entities to apply the amendments to IAS 12 *Income Taxes*:
 - (i) immediately upon their issuance; and
 - (ii) retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
2. The IASB also discussed our recommendation to require an entity to disclose whether it is in the scope of the Pillar Two model rules and whether it operates in low-tax jurisdictions.¹ The purpose of this paper is to explore alternatives to that recommendation that could balance the concerns raised by IASB members at the 22 November meeting.

¹ In agenda paper 12A and in this paper we use—for simplicity—the term 'low-tax jurisdiction' to refer to jurisdictions in which the entity is taxed at an effective rate below 15%. The term does not imply that being 'low-tax' is a characteristic of specific jurisdictions.

Staff analysis

3. We have grouped IASB members' concerns into:
 - (a) concerns about a proposed requirement to disclose whether an entity operates in low-tax jurisdictions; and
 - (b) concerns about whether that proposed requirement is sufficient to meet the information needs of users of financial statements (investors) in accounting periods before the Pillar Two model rules become effective (pre-effective date periods).

Disclosure of whether an entity operates in low-tax jurisdictions

Summary of IASB member feedback

4. Some IASB members expressed concerns about:
 - (a) a lack of clarity as to how an entity would determine whether it operates in low-tax jurisdictions in pre-effective date periods. In particular, it was unclear whether entities would make this determination based on:
 - (i) the specific requirements of the Pillar Two model rules or, instead, on whether an entity's effective tax rate (calculated based on IAS 12 requirements) is below 15% in a jurisdiction; and
 - (ii) information for the current period or for future periods (for example, whether entities would consider the effective tax rate in jurisdictions in the current period, or whether they would be required to estimate expected effective tax rates in future periods).
 - (b) requiring an entity to disclose its expectations about whether it will be operating in low-tax jurisdictions in future periods before it has completed its assessment of new legislation enacted. Some IASB members said entities would be unable to state whether they will operate in low-tax jurisdictions according to the Pillar Two rules because this would be known only in the future. Entities would therefore be able to disclose only a 'guess', which could expose them to litigation risk. However, entities would be able to disclose factual information about legislation enacted to implement the Pillar Two model rules, as well as information about work already undertaken by management in preparing to comply with such legislation.

Staff analysis

5. To respond to these concerns, the IASB could require an entity to disclose either:
 - (a) whether it reasonably expects to be operating in low-tax jurisdictions based on the specific requirements of the Pillar Two model rules; or, alternatively

- (b) whether it operates in jurisdictions in which its effective tax rate calculated based on IAS 12 requirements² is below 15% for the current period.
6. We expect that, by the time entities would be required to disclose the information above, at least some of those entities will have progressed in their work to assess the effects of the Pillar Two model rules such that they will be able to disclose whether they are operating in jurisdictions in which they expect to be taxed below 15% according to the rules.
7. However, entities that have not made sufficient progress to be able to disclose that information would still have the option to disclose information based on IAS 12 requirements. Calculating whether a jurisdiction's effective tax rate is below 15% applying the requirements in IAS 12 would allow an entity to use information used in preparing its financial statements, including information used to prepare the reconciliation required by paragraph 81(c) of IAS 12 (hereafter referred to as the 'effective tax rate reconciliation'). Therefore, an entity would *not* be required to take into account the specific requirements in the Pillar Two model rules in advance of having considered and assessed those rules and their effects.
8. Although such information could give only an *indication* of an entity's potential exposure to the rules, in our view this information would still be useful to investors in periods before the rules become effective. It would allow investors to understand that the entity is potentially exposed to paying Pillar Two top-up tax and that the entity has not recognised deferred taxes with respect to the rules.
9. As noted in paragraphs 4(b), some IASB members also said entities would be able to disclose factual information about legislation enacted to implement the Pillar Two model rules in jurisdictions in which it operates. In our view, such information would be helpful to investors in understanding legislation enacted that is expected to affect the entity.
10. In summary, incorporating the recommendations above to what we had recommended in Agenda Paper 12A, if an entity expects to be in the scope of the rules, it would be required to disclose:
- (a) information about legislation enacted—or substantively enacted—to implement the Pillar Two model rules in jurisdictions in which the entity operates; and
- (b) whether the entity:
- (i) operates in jurisdictions it reasonably expects to be low-tax jurisdictions based on the specific requirements of the Pillar Two model rules; or, alternatively
- (ii) operates in jurisdictions in which its effective tax rate (calculated based on IAS 12 requirements) is below 15% for the current period.
11. The information described above would constitute the 'base' requirements the IASB could propose together with its proposal to introduce a temporary exception. Paragraphs 12–17 discuss further

² Paragraph 86 of IAS 12 states that the 'the average effective tax rate is the tax expense (income) divided by the accounting profit.'

requirements the IASB could propose in addition to these ‘base’ requirements to respond further to investor information needs about an entity exposure to paying top-up tax.

Additional information

Summary of IASB member feedback

- 12. Some IASB members expressed concerns that, in pre-effective date periods, the proposed requirements recommended in Agenda Paper 12A would fail to provide investors with sufficient information for them to be able to assess an entity’s exposure to paying top-up tax. These IASB members suggested that entities be required to disclose further information, such as the low-tax jurisdictions in which an entity operates or an entity’s pre-tax profits and effective tax rates in these jurisdictions. However, some IASB members expressed concerns about the potential sensitivity of disclosing tax information on a country-by-country basis.

Staff analysis

- 13. Should the IASB decide to propose that entities provide further information, the IASB’s discussion on 22 November identified a number of different ways that additional disclosure requirements could be developed.
- 14. In our view, the IASB could decide to require the base information set out in paragraph 10 and, in addition, require *one* of the following three alternatives. In each of these alternatives, an entity would identify low-tax jurisdictions on the basis of IAS 12 requirements and provide the information only in pre-effective date periods (and only for the current period, not comparative periods):

Alternative A	Disclose the low-tax jurisdictions in which an entity operates.
Alternative B	Disclose the accounting profit before tax, the income tax expense and the resulting weighted-average effective tax rate for all low-tax jurisdictions in aggregate. In other words, an entity would be required to disaggregate information—already disclosed in the effective tax rate reconciliation—for (i) all low-tax jurisdictions in aggregate, and (ii) all non-low-tax jurisdictions in aggregate.
Alternative C	Disclose the accounting profit before tax, the income tax expense and the resulting effective tax rate for <i>each</i> low-tax jurisdiction. In other words, an entity would be required to disaggregate information—already disclosed in the effective tax rate reconciliation—for (i) <i>each</i> low-tax jurisdiction, and (ii) all non-low-tax jurisdictions in aggregate.

-
15. We would recommend that, if the IASB decides to propose one of the alternatives, the proposed requirements specify that an entity prepare that information on the same basis as it prepares the information it provides in its effective tax rate reconciliation. Therefore, an entity would:
- (a) disaggregate the accounting profit and tax expense³ included in the reconciliation for each jurisdiction in which the entity operates;
 - (b) determine the jurisdictions in which the effective tax rate (tax expense divided by the accounting profit) is below 15%; and
 - (c) in Alternative B or Alternative C, disclose the accounting profit and tax expense (in aggregate for Alternative B) for all low-tax jurisdictions, as well as the resulting (weighted-average) effective tax rate.
16. In preparing its effective tax rate reconciliation applying IAS 12, an entity would already need to know the accounting profit and domestic tax rate by jurisdiction to, for example, explain the effect of higher or lower tax rates as a reconciling item. In addition, as explained in paragraph 85 of IAS 12 (and the illustrative example included after that paragraph), an entity might prepare its effective tax reconciliation by aggregating separate reconciliations prepared using the domestic rate in each individual jurisdiction; it would do so if that would provide the most meaningful information to investors. In that case, an entity would already have the disaggregated information needed to meet the information required by the alternatives.
17. In considering whether to propose one of the alternatives in addition to the information recommended in paragraph 10, we note the following:
- (a) the additional information would be based on current period information prepared applying IAS 12; entities would not be asked to disclose its expectations about the future. Although this basis of preparation is different from that of the Pillar Two model rules (and thus would not give investors an exact picture of the entity's potential exposure), we are of the view that it would still provide indicative information to investors and would avoid any possible litigation risk.
 - (b) because it is based on current period information prepared applying IAS 12, the costs of providing the information would be lower than if entities were asked to prepare the information on another basis. With that said, entities would be required to provide the information as from the first time they report after the amendments are issued—the amendments would have immediate effect. The time available to implement the requirements would therefore be short.

³ Paragraph 5 of IAS 12 defines accounting profit as 'profit or loss for a period before deducting tax expense' and tax expense (tax income) as 'the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax'.

- (c) Alternative B would address concerns about asking entities to provide country-by-country information because the information would be required for all low-tax jurisdictions in aggregate.
18. In addition to the above, the IASB could:
- (a) require an entity to disclose if the work it has already done in preparing to comply with the Pillar Two model rules indicates that there could be jurisdictions in which it could be exposed to paying top-up tax in addition to those identified as having an effective tax rate below 15% applying IAS 12 requirements; and
 - (b) exempt an entity from disclosing any of the information discussed in this paper if it has disclosed more useful information—based on the Pillar Two model rules—about its exposure to paying top-up tax either in the financial statements or elsewhere, in a statement such as management commentary, that is available to investors on the same terms as the financial statements and at the same time.

Question for the IASB

1. Does the IASB agree with the staff recommendation to amend IAS 12 to require an entity to disclose, in pre-effective date periods:
 - (a) information about legislation enacted—or substantively enacted—to implement the Pillar Two model rules in jurisdictions in which the entity operates; and
 - (b) whether the entity:
 - (i) operates in jurisdictions it reasonably expects to be low-tax jurisdictions based on the specific requirements of the Pillar Two model rules; or, alternatively
 - (ii) operates in jurisdictions in which its effective tax rate (calculated based on IAS 12 requirements) is below 15% for the current period.
2. Does the IASB wish to amend IAS 12 to require entities to disclose additional information—described as alternatives A, B or C in paragraph 14—in pre-effective date periods? If 'yes', does the IASB also wish to require the disclosure in paragraph 18(a) or provide the exemption in paragraph 18(b)?