
IASB[®] meeting

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Project	Pillar Two Model Rules—Amendments to the <i>IFRS for SMEs</i>[®] Accounting Standard
Topic	Temporary exception to deferred tax accounting
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Introduction and purpose

1. This paper:
 - (a) summarises feedback on Question 1 of the Invitation to Comment in the [Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed Amendments to the IFRS for SMEs Standard*](#) (Exposure Draft), which asks about the proposals:
 - (i) to introduce a temporary exception to the requirements to recognise deferred tax assets and liabilities related to Pillar Two income taxes; and to disclose information that would otherwise be required by paragraphs 29.39–29.41 of the *IFRS for SMEs* Accounting Standard (the Standard) about deferred tax assets and liabilities related to Pillar Two income taxes; and
 - (ii) to require an SME to disclose that it has applied the exception; and
 - (b) provides our analysis of that feedback and recommendations.

Structure of this paper

2. This paper includes:
 - (a) summary of staff recommendations (paragraphs 3–4);
 - (b) staff analysis of feedback on the proposals to introduce:
 - (i) the temporary exception to deferred tax accounting (paragraphs 5–16);
and
 - (ii) the temporary exception—proposed disclosure requirement (paragraphs 17–26); and
 - (c) staff recommendations and questions to the IASB (paragraphs 27–28).

Summary of staff recommendations

3. We recommend the IASB finalise its proposals in the Exposure Draft:
 - (a) to introduce a temporary exception to the requirements to recognise deferred tax assets and liabilities related to Pillar Two income taxes; and to disclose information that would otherwise be required by paragraphs 29.39–29.41 of the *IFRS for SMEs* Standard about deferred tax assets and liabilities related to Pillar Two income taxes;
 - (b) to make the temporary exception mandatory;
 - (c) not to specify how long the temporary exception will be in place; and
 - (d) to require an SME within the scope of Pillar Two legislation to disclose that it has applied the temporary exception (considering our suggested improvements to clarity of drafting in paragraph 25 of this agenda paper).
4. We also recommend the IASB make no changes to the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes.

Temporary exception to deferred tax accounting

Proposals in the Exposure Draft

5. The IASB proposes to add paragraph 29.3A to the *IFRS for SMEs* Standard, which would state:

29.3A This section 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 section, an entity shall neither recognise deferred tax assets and liabilities related to Pillar Two income taxes nor disclose information that would otherwise be required by paragraphs 29.39–29.41 about deferred tax assets and liabilities related to Pillar Two income taxes.

6. Paragraph BC12 of the Exposure Draft explains the reasons for this proposal:

BC12 [...] Introducing this exception would:

- (a) provide affected SMEs with relief from accounting for deferred tax assets and liabilities in relation to complex new tax legislation to be enacted by multiple jurisdictions in a short period;
 - (b) avoid the development of diverse interpretations of Section 29 of the *IFRS for SMEs* Standard and the resulting inconsistent application of the Standard;
- and

- (c) allow time for stakeholders to assess how the Pillar Two model rules have been implemented in different jurisdictions, for SMEs to assess how they are affected and for the IASB to consider whether to do further work.

7. In addition:

- (a) paragraph BC15 of the Exposure Draft explains the reasons for the IASB's proposal that the temporary exception be mandatory:

BC15 The IASB proposes to make the application of the temporary exception mandatory because doing so would:

- (a) result in greater comparability between SMEs' financial statements and, therefore, provide more useful information for users of financial statements; and
- (b) eliminate the risk of SMEs inadvertently developing accounting policies that are inconsistent with the principles and requirements in Section 29 of the *IFRS for SMEs* Standard.

- (b) paragraph BC16 of the Exposure Draft discusses the duration of the exception:

BC16 The IASB concluded that it was not possible to determine how much time the activities described in paragraph BC11 would require because they would depend on how and when jurisdictions implement the Pillar Two model rules. Therefore, the IASB proposes not to specify how long the temporary exception will be in place. The IASB will monitor developments related to the implementation of the Pillar Two model rules to determine when to do further work. Any further work does not necessarily need to coincide with the next periodic review of the *IFRS for SMEs* Standard.

Summary of feedback

8. All respondents agreed with the proposed mandatory temporary exception. Respondents said the proposed amendments would provide:
- (a) a timely relief for affected SMEs and avoid diverse application of the requirements in the *IFRS for SMEs* Accounting Standard.
 - (b) much needed clarity. Uncertainties exist relating to an entity's ability to assess future tax consequences and in turn account for deferred taxes—that is, whether there will be temporary differences, amount and the tax rate to be applied. These uncertainties exist because, 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 the cost of obtaining the information outweighing the benefit.
 - (c) sufficient time for SMEs to understand how individual jurisdictions have adopted Pillar Two model rules and how to apply the principles and requirements in the *IFRS for SMEs* Accounting Standard to these rules.
9. Some respondents commented on the urgency of the proposed amendments. They appreciated the IASB's efforts to publish the Exposure Draft as soon as possible and said timely finalisation of the proposed amendments is essential because some jurisdictions are expected to enact or substantively enact Pillar Two model rules during 2023.
10. Some respondents commented on the duration of the temporary exception. Of those respondents:
- (a) most suggested the IASB reconsider the need for the exception when there is sufficient clarity about how jurisdictions implemented the rules and when the IASB has decided to revisit the temporary exception in IAS 12 *Income Taxes*; and

- (b) two national standard-setters from Latin America recommended the IASB set the estimated expiration date of the exception.
11. An accounting firm and a national standard-setter suggested the IASB add the terms ‘Pillar Two legislation’ and ‘Pillar Two income taxes’ (as defined in the new proposed paragraph 29.3A) to the Glossary of terms in Appendix B to the *IFRS for SMEs* Standard. In these respondents’ view, this would be consistent with the IASB’s usual approach to defined terms, which is to include them in the Glossary.
12. A national standard-setter suggested the IASB clarify that in applying the exception in the proposed new paragraph 29.3A, an entity should *not* remeasure deferred taxes recognised under domestic tax regimes to reflect Pillar Two income taxes it expects to pay when recovering or settling a related asset or liability.¹ The respondent noted that the IASB considered but decided against expanding the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes for the reasons set out in paragraph BC104 of the Basis for Conclusions on Amendments to IAS 12 *International Tax Reform—Pillar Two Model Rules*. However, in the respondent’s view, SMEs may be less likely to have the expertise necessary to understand how top-up taxes are charged or to interpret how they would be accounted for. Therefore, SMEs would likely find such clarification helpful.

Staff analysis

13. Feedback from respondents unanimously confirms the need for the mandatory exception for the reasons set out in the Exposure Draft.
14. Furthermore, most respondents who commented agreed with the proposal not to specify how long the temporary exception will be in place. For the reasons set out in the Exposure Draft, we continue to think it would not be possible to estimate the duration of the exception at this stage. We think the IASB will be able to reconsider

¹ The respondent suggested adding new paragraph 29.27A to state, for example: As an exception to the requirements in this section, an entity shall not take into account the effects of Pillar Two legislation when measuring deferred tax assets and deferred tax liabilities.

the need for the exception in the *IFRS for SMEs* Accounting Standard when it undertakes further work for IAS 12 *Income Taxes* to determine whether to remove the temporary exception or to make it permanent.

15. We do not think it is necessary to add the terms ‘Pillar Two legislation’ and ‘Pillar Two income taxes’ to the Glossary of terms in Appendix B to the *IFRS for SMEs* Standard because they are already explained in the proposed new paragraph 29.3A and they are not used elsewhere in the Standard.
16. We think it is unnecessary to clarify in Section 29 of the *IFRS for SMEs* Accounting Standard that an entity should *not* consider the effects of Pillar Two legislation when measuring (or remeasuring) deferred taxes recognised under domestic tax regimes. For example, if an entity were to remeasure its existing deferred tax liability to reflect additional Pillar Two income taxes it expects to pay when recovering (or settling) the related asset or liability, it would in effect be recognising a deferred tax liability related to Pillar Two income tax, which is not the IASB’s intention. We recognise that some affected SMEs may have limited capacity within a short period to fully understand all the implications of Pillar Two legislation on income tax balances recognised in their financial statements. Therefore, we think it would be helpful to explain in the Basis for Conclusions on the final amendments to the *IFRS for SMEs* Accounting Standard why it is unnecessary to expand the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes (see paragraph BC104 of the Basis for Conclusions on the Amendments to IAS 12 *International Tax Reform—Pillar Two Model Rules*).

Temporary exception—proposed disclosure requirement

Proposals in the Exposure Draft

17. The IASB proposes to add paragraph 29.42 to the *IFRS for SMEs* Standard, which would state:

29.42 An entity shall disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes (see paragraph 29.3A).

18. Paragraph BC13 of the Exposure Draft explains the reasons for this proposal:

BC13 The IASB also proposes to require an SME to disclose that it has applied the temporary exception. The IASB concluded that this requirement would:

- (a) provide entity-specific information because some SMEs are unaffected by Pillar Two legislation and, therefore, would not apply the exception; and
- (b) make the exception's application transparent to users of financial statements during the periods in which it is applied.

Summary of feedback

19. Almost all respondents agreed, or did not disagree, with the proposed disclosure requirement. A few respondents suggested the IASB clarify in paragraph 29.42 that the disclosure is not applicable to SMEs that are unaffected by Pillar Two model rules. In these respondents' view, even though this clarification is included in paragraph BC13 of the Basis for Conclusions on the Exposure Draft, it would be more helpful if it were included in the Standard.
20. A national standard-setter disagreed with the proposal and suggested the IASB consider replacing it with the requirement to disclose whether, based on known or reasonably estimable information, an entity is, or expects to be, within the scope of Pillar Two legislation. In this respondent's view:
- (a) it could be complicated for an SME to determine whether the exception has been applied because SMEs may be less likely to have the expertise necessary

to understand how top-up taxes are charged or to interpret how they would be accounted for.

- (b) most SMEs will not be within the scope of Pillar Two legislation. Therefore, it would be more useful to users of financial statements if those that expect to be within the scope made that fact clear, rather than only those whose deferred tax balances would, in the absence of the exception, have been affected (that is, a subset of those within the scope).

Staff analysis

21. Feedback from respondents confirms that entities within the scope of Pillar Two legislation (and *only* such entities) should disclose that they have applied the mandatory exception in the proposed new paragraph 29.3A.
22. We disagree with the suggestion in paragraph 20 of this agenda paper because in our view there is no compelling reason why the requirements for SMEs should differ from the requirements in IAS 12.
23. Disclosing that an entity has applied the exception would provide entity-specific information, which would make application of the exception clear and transparent. In other words, by disclosing this information, an entity would inform users of financial statements that it is in the scope of the Pillar Two model rules and it has not recognised deferred taxes related to Pillar Two income taxes, despite potentially being exposed to paying top-up taxes. Users of financial statements would likely find this information useful, because without detailed knowledge of the requirements in, and amendments to, the *IFRS for SMEs* Accounting Standard they would know when the temporary exception is mandatory and when it is not (because it has been removed from the Standard). In which case, the benefits for users would exceed the costs for preparers.

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24. In addition, we think that affected SMEs will have access to expertise and resources available from within the group to determine that they have applied the exception because the Pillar Two model rules apply to large multinational groups.
25. Based on our analysis, we think the new paragraph 29.42 should more clearly articulate that the exception applies only to entities that are within the scope of Pillar Two legislation. For example, the revised new paragraph 29.42 could read (new text is underlined):
- 29.42 An entity within the scope of Pillar Two legislation shall disclose that it has applied the exception [...].
26. Therefore, we recommend the IASB finalise its proposals in the Exposure Draft (considering our suggested improvements to clarity of drafting) to require an SME within the scope of Pillar Two legislation to disclose that it has applied the temporary exception.

Staff recommendations

27. We recommend the IASB finalise its proposals in the Exposure Draft:
- (a) to introduce a temporary exception to the requirements to recognise deferred tax assets and liabilities related to Pillar Two income taxes; and to disclose information that would otherwise be required by paragraphs 29.39–29.41 of the *IFRS for SMEs* Standard about deferred tax assets and liabilities related to Pillar Two income taxes;
 - (b) to make the temporary exception mandatory;
 - (c) not to specify how long the temporary exception will be in place; and
 - (d) to require an SME within the scope of Pillar Two legislation to disclose that it has applied the temporary exception (considering our suggested improvements to clarity of drafting in paragraph 25 of this agenda paper).

28. We also recommend the IASB make no changes to the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes.

Questions for the IASB

Proposals to finalise

1. Does the IASB agree with the staff recommendation to finalise the proposals in the Exposure Draft:
 - (a) to introduce a temporary exception to the requirements to recognise deferred tax assets and liabilities related to Pillar Two income taxes; and to disclose information that would otherwise be required by paragraphs 29.39–29.41 of the *IFRS for SMEs* Standard about deferred tax assets and liabilities related to Pillar Two income taxes;
 - (b) to make the temporary exception mandatory;
 - (c) not to specify how long the temporary exception will be in place; and
 - (d) to require an SME within the scope of Pillar Two legislation to disclose that it has applied the temporary exception (considering our suggested improvements to clarity of drafting in paragraph 25 of this agenda paper)?

Staff recommendations in response to feedback

2. Does the IASB agree with the staff recommendation to make no changes to the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes?