IFRS Accounting

Staff paper

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IASB® meeting

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Project	**Pillar Two Model Rules—Amendments to the *IFRS for SMEs*® Accounting Standard**
Topic	**Disclosure requirements**
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Introduction and purpose

1. This paper:

   (a) summarises feedback on Question 2 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 clarify that 'other events' in the disclosure objective in paragraph 29.38 of the Standard include enacted or substantively enacted Pillar Two legislation;

   (ii) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect; and

   (iii) to require an SME to disclose separately its current tax expense (income) related to Pillar Two income taxes in periods when Pillar Two legislation is in effect; and

   (b) provides our analysis of that feedback and recommendations.

Structure of this paper

2. This paper includes:

   (a) summary of staff recommendations (paragraph 3);

   (b) staff analysis of feedback on the proposed disclosure requirements in periods:

      (i) before Pillar Two legislation is in effect (paragraphs 4–22); and

      (ii) when Pillar Two legislation is in effect (paragraphs 23–28);

   (c) staff recommendations and questions to the IASB (paragraph 29); and

   (d) Appendix A—recommended changes to the IASB's proposals in the Exposure Draft.

Summary of staff recommendations

3. We recommend the IASB finalise its proposals in the Exposure Draft:

   (a) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect;

   (b) to clarify that 'other events' in the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard (the Standard) include enactment or substantive enactment of tax rates and tax laws, such as Pillar Two legislation (see Appendix A to this paper); and

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

Periods before Pillar Two legislation is in effect

Proposals in the Exposure Draft

4. The IASB proposes:

(a) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect; and

(b) to clarify that 'other events' in the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard include enacted or substantively enacted Pillar Two legislation (proposed new text is underlined):

> 29.38 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events (such as enacted or substantively enacted Pillar Two legislation).

5. Paragraphs BC18–BC20 of the Exposure Draft explain the IASB's reasons for the proposals:

> BC18 When amending IAS 12 in May 2023 the IASB added a disclosure objective. An entity is required to disclose—in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect—information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.
>
> BC19 The disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard requires an SME to disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events. The IASB observed that:
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> (a) paragraph 29.38 (which applies to all income tax consequences) is not the same as the objective developed as part of the IAS 12 amendments (which specifically deals with an entity's exposure to the Pillar

Two income taxes). Nonetheless, the IASB concluded that the objective in paragraph 29.38 would be expected to result in SMEs affected by Pillar Two legislation providing some information about the nature and financial effect of income tax consequences of such enacted (or substantively enacted) legislation in periods before the legislation is in effect (for example, information available from an SME's assessment of its exposure to Pillar Two income taxes). This is because, in the IASB's view, 'other events' in paragraph 29.38 include enacted (or substantively enacted) Pillar Two legislation.

(b) although it is still uncertain when jurisdictions will implement the Pillar Two model rules, feedback on the Exposure Draft *International Tax Reform—Pillar Two Model Rules [Proposed amendments to IAS 12]* confirmed that many jurisdictions are expected to enact in 2023 Pillar Two legislation that has effect from 1 January 2024. Consequently, any potential amendments to introduce new disclosure requirements or to amend existing disclosure requirements for SMEs for periods before such legislation is in effect would be applied for only a relatively short period.

c) information needs of users of SMEs' financial statements can differ from those of users of financial statements of entities applying full IFRS Accounting Standards.[footnote omitted] Indeed, the absence of any new specific disclosure requirements would allow an SME to retain flexibility in deciding what information to disclose to meet the disclosure objective in paragraph 29.38.

BC20 Therefore, the IASB concluded that it should not propose amendments to the disclosure objective in paragraph 29.38 or any new disclosure requirements that would apply in periods before Pillar Two legislation is in effect. Nonetheless, for the avoidance of doubt, the IASB proposes to clarify in paragraph 29.38 of the Standard that 'other events' include the enacted or substantively enacted Pillar Two legislation.

Summary of feedback

New disclosure requirements

6. Almost all respondents agreed, or did not disagree, with the IASB's proposal *not* to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted, but not yet in effect. Of those who commented, most agreed for the reasons set out in the Basis for Conclusions on the Exposure Draft, a few others said the approach is comprehensive and provides appropriate simplification for SMEs, given the timing of the enactment of Pillar Two legislation.

7. An accountancy body suggested adding the same disclosure requirements as in new paragraphs 88C–88D of IAS 12 because these requirements would provide useful information to users of financial statements prepared applying the *IFRS for SMEs* Standard.

'Other events'

8. For the reasons explained in the Basis for Conclusions on the Exposure Draft, most respondents agreed with the proposed clarification that 'other events' in the disclosure objective in paragraph 29.38 of the Standard include enactment or substantive

enactment of Pillar Two legislation. A few respondents suggested the IASB provide illustrative examples or guidance on the types and extent of information that would help SMEs meet the disclosure objective. A few respondents suggested using more generic terms in paragraph 29.38 instead of referring specifically to Pillar Two legislation.

9. An accounting firm said clarification is not needed because ‘it is already understood that the “transactions and other events” referred to [in paragraph 29.38 of the *IFRS for SMEs* Standard] include enactment or substantive enactment of tax rates and laws’. In this respondent’s view, were the IASB to clarify the meaning of ‘other events’, instead of referring specifically to ‘enacted or substantively enacted Pillar Two legislation’, it should use more generic terms, such as ‘enacted or substantively enacted tax rates and laws’. Another accounting firm said the proposed clarification in paragraph 29.38 of the Standard might imply that a different approach is required for disclosures about enactment (or substantive enactment) of Pillar Two legislation and about enactment (or substantive enactment) of other tax rates and tax laws and suggested deleting the proposed clarification.

10. Two accounting firms and a national standard-setter disagreed with the IASB’s proposals because, in these respondents’ view, the proposed clarification in paragraph 29.38 of the *IFRS for SMEs* Standard would not meet its objective or would be more onerous than the requirements in paragraphs 88C–88D of IAS 12. In these respondents’ view, paragraph 29.38 of the Standard requires disclosure of information that enables users of its financial statements to evaluate the nature and financial effect of the *current and deferred tax* consequences of other events. But in periods before Pillar Two legislation is in effect, there will be no current tax consequences to be disclosed or deferred tax consequences, because of the exception in the proposed paragraph 29.3A of the Standard.

Staff analysis

New disclosure requirements

11. Feedback confirms there is no need to develop new requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect — almost all respondents agreed with this proposal. Therefore, for the reasons explained in the Exposure Draft, we recommend finalising the proposal without any changes.

12. We disagree with the suggestion (in paragraph 7 of this paper) to require SMEs to disclose the same information as required by paragraphs 88C and 88D of IAS 12. This would be inconsistent with the IASB's proposal not to introduce new disclosure requirements in periods before Pillar Two legislation is in effect, which almost all respondents agreed with.

13. We note that in deciding what information to disclose to meet the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard, applying paragraphs 10.4–10.6 of the Standard, an SME could look to the disclosure requirements in the amendments to IAS 12 and paragraph P17 of the Preface to the *IFRS for SMEs* Accounting Standard, which states:

> SMEs shall not anticipate or apply changes made in full IFRS before those changes are incorporated into the *IFRS for SMEs* unless, in the absence of specific guidance in the *IFRS for SMEs*, an SME chooses to apply guidance in full IFRS and those principles do not conflict with requirements in the hierarchy in paragraphs 10.4–10.5.

14. We believe, such an approach could be followed by a subsidiary of a group that applies the amendments to IAS 12 in the group's consolidated financial statements.

'Other events'

15. Feedback from respondents confirms that it would be helpful to clarify the meaning of 'other events' in paragraph 29.38 of the *IFRS for SMEs* Standard. We agree with the drafting suggestion to use the form that would fit better in the sentence and replace 'enacted or substantively enacted' with 'enactment or substantive enactment'. We also agree with respondents who suggested using more generic language because the amendments would be more meaningful and 'future-proof'. Using generic language would also avoid misperception that 'other events' might include *only* enactment of Pillar Two legislation instead of enactment or substantive enactment of other tax rates and tax laws. See Appendix A to this paper for our recommended wording changes to the IASB's proposals.

16. We do not agree with suggestions to provide examples illustrating information that an entity could disclose to enable users of its financial statements to evaluate the nature and financial effect of enactment of Pillar Two legislation because:

    (a) the examples would be relevant for only a short period. Indeed, many jurisdictions are expected to enact Pillar Two legislation in 2023, with effect from 1 January 2024.

    (b) the Pillar Two model rules provide a template that jurisdictions can translate into domestic tax law. Therefore, enactment and implementation of Pillar Two legislation will differ between various jurisdictions. It would be impracticable to develop examples to cater for the many possible scenarios and individual circumstances of affected entities. On the contrary, examples illustrating only a few specific scenarios would have limited utility.

    (c) in deciding what information to disclose to meet the disclosure objective in paragraph 29.38, affected SMEs (particularly subsidiaries of large multinational groups applying full IFRS) could look to the disclosure requirements in the amendments to IAS 12 and use the information disclosed by their parent entities (or build on the information disclosed by other entities applying IAS 12 in their jurisdiction or within their consolidated group).

(d) entities might follow the illustrative examples without considering their specific circumstances or information needs of users of their financial statements. Such approach would not fully realise the benefits of the flexibility the entities have in deciding what information to disclose and might impair the quality of disclosures. In paragraph BC19(c) of the Basis for Conclusions on the Exposure Draft the IASB observed that 'the absence of any new specific disclosure requirements would allow an SME to retain flexibility in deciding what information to disclose to meet the disclosure objective in paragraph 29.38'.

17. We think that some of the concerns summarised in paragraph 10 may have arisen because of the respondents' alternative reading of the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard. We note that applying this paragraph an entity discloses information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax *consequences* of:

(a) recognised transactions.

(b) other events. The paragraph does not state that 'other events' are *recognised* in the financial statements or does not limit the required information to *recognised* current or deferred tax consequences only. Therefore, the IASB concluded in paragraph BC19(a) of the Basis for Conclusions on the Exposure Draft that 'the objective in paragraph 29.38 would be expected to result in SMEs affected by Pillar Two legislation providing some information about the nature and financial effect of income tax consequences of such enacted (or substantively enacted) legislation in periods before the legislation is in effect (for example, information available from an SME's assessment of its exposure to Pillar Two income taxes)'.

18. In addition, as explained on page 86 of Module 29 of the Supporting Material for the *IFRS for SMEs* Standard 'in addition to the requirement in paragraph 29.38, paragraph 3.2 requires additional disclosures when compliance with the specific requirements in

the *IFRS for SMEs* Standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance. Consequently, in addition to the disclosures specified in paragraphs 29.39 to 29.41, an entity should provide further information about its circumstances in the note disclosures if such information would be helpful to users of the financial statements'.

19. Because paragraph 29.38 of the Standard relates to recognised and unrecognised income tax consequences of other events (even if such other events are not recognised yet), SMEs need to consider their specific circumstances in deciding what information to disclose to meet the disclosure objective in paragraph 29.38 of the Standard. For example, some jurisdictions might implement Pillar Two legislation in such way that an entity might not be exposed to top-up income tax, because it is payable by the entity's ultimate parent.[1] But even in such scenario, an entity would be required to disclose information that enables users of its financial statements to evaluate the nature and financial effect of unrecognised tax consequences. For example, such information might include, but would not be limited, to disclosing the following:

> X operates in a jurisdiction that has enacted Pillar Two legislation in such way that it requires X's ultimate parent Y to pay Pillar Two income taxes arising on X's profits. At the end of the reporting period, 31 December 20X3, X assessed that the legislation enacted in its jurisdiction would not have a financial effect in X's financial statements because any Pillar Two income taxes that might arise with respect to X's profits would be payable by its ultimate parent Y.
>
> Y might charge X for the Pillar Two income taxes payable on X's profits, which might give rise to an intragroup liability. At the end of the reporting period there was no agreement between X and Y

[1] We think such scenarios will be rare and likely exist in jurisdictions which have not implemented QDMTT. This is because, for example, only 3 of 36 jurisdictions analysed here will not implement QDMTT within the next 3 years.

> that would require X to be charged for any Pillar Two income taxes paid by Y with respect to X's profits.

20. In some other cases, disclosures required by paragraph 29.38 of the Standard might necessitate quantitative information, for example:

> X Group operates in jurisdictions that have enacted Pillar Two legislation. The legislation in these jurisdictions is effective from 1 January 20X4. At the end of the reporting period, 31 December 20X3, X assessed whether it is affected by the legislation and concluded that its profits in jurisdiction A (around 20%–25% of its total profit) might be subject to Pillar Two income taxes, because the Group expects the average effective tax rate applicable to those profits to be around 10%.

21. Therefore, we recommend finalising the proposals:

    (a) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect; and

    (b) to clarify that 'other events' in the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard include enactment or substantive enactment of Pillar Two legislation.

22. In addition, in response to the feedback, we also recommend including generic language in paragraph 29.38 of the Standard to avoid misperception that 'other events' include only enactment or substantive enactment of Pillar Two legislation (see Appendix A to this paper).

Periods when Pillar Two legislation is in effect

Proposals in the Exposure Draft

23. The IASB proposes to add paragraph 29.43 to the *IFRS for SMEs* Standard, which would state:

> An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.

24. Paragraph BC21 of the Exposure Draft explains the reasons for this proposal:

> The IASB proposes to require an SME to disclose separately its current tax expense (income) related to Pillar Two income taxes because doing so would:
>
> (a) help users of financial statements understand the magnitude of Pillar Two income taxes relative to an SME's overall tax expense—disaggregation of amounts presented in an SME's financial statements helps users understand those statements; and
>
> (b) not be costly to prepare because an SME would already be required to recognise current tax related to Pillar Two income taxes.

Summary of feedback

25. All respondents agreed, or did not disagree, with the IASB's proposal for an entity to disclose separately its current tax expense (income) related to Pillar Two income taxes. Those who commented agreed for the reasons explained in the Basis for Conclusions on the Exposure Draft. An accounting firm also said the requirement would 'facilitate comparability between entity's financial statements, providing useful and relevant information to enable users to understand the impact of Pillar Two income taxes relative to the total tax expense'. A national standard-setter suggested

merging the proposed paragraph 29.43 into paragraph 29.39 of the Standard, because in this respondent's view, the requirement should apply when Pillar Two income taxes are a major component of tax expense (income).

Staff analysis

26. We continue to agree with the proposal for the reasons explained in paragraph BC21 of the Exposure Draft. In our view, understanding the magnitude of Pillar Two income taxes relative to an entity's overall tax expense is necessary because the entity would not be recognising deferred tax assets and liabilities related to Pillar Two income taxes. The greater the magnitude of such taxes, the higher the potential effect of the missing deferred tax information.

27. We do not agree with the suggestion to merge the proposed new paragraph 29.43 into the existing paragraph 29.39 because:

    (a) this might raise concerns about the interaction with the proposed paragraph 29.3A, which provides the exception to the requirements to 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; and

    (b) in our view, the proposed structure (that is, to include the proposed new paragraphs 29.42–29.43 under a new heading) enhances understandability and accessibility of the new requirements.

28. Therefore, we recommend finalising the proposal to require an entity to disclose separately its current tax expense (income) related to Pillar Two income taxes.

Staff recommendations

29. We recommend the IASB finalise its proposals in the Exposure Draft:

    (a) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect;

(b) to clarify that 'other events' in the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard include enactment or substantive enactment of tax rates and tax laws, such as Pillar Two legislation (see Appendix A to this paper); and

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

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) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect;

    (b) to clarify that 'other events' in the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard include enactment or substantive enactment of tax rates and tax laws, such as Pillar Two legislation (see Appendix A to this paper); and

    (c) to require an entity to disclose separately its current tax expense (income) related to Pillar Two income taxes?

Appendix A—recommended changes to the IASB’s proposals in the Exposure Draft

A1. Our recommended changes to the IASB’s proposals in the Exposure Draft would:

(a) use generic language in the disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard; and

(b) include drafting suggestion to replace ‘enacted or substantively enacted’ with ‘enactment or substantive enactment’.

A2. New text is underlined and deleted text is struck through.

29.38	An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events (<u>including enactment or substantive enactment of tax rates and tax laws, such as Pillar Two legislation</u>). ~~enacted or substantively enacted Pillar Two legislation).~~