IFRS Accounting

Staff paper

Agenda reference: 12A

IASB® meeting

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

Introduction and purpose

1. In October 2021, more than 135 countries and jurisdictions—representing more than 90% of global GDP—agreed to a major international tax reform that introduces a global minimum tax for large multinational enterprises (MNEs). These countries and jurisdictions joined the OECD/G20 *Inclusive Framework on Base Erosion and Profit Shifting* statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The two-pillar solution comprises:

   (a) *Pillar One*—which aims to ensure a fairer distribution of profits and taxing rights among countries for the largest MNEs; and

   (b) *Pillar Two*—which aims to put a floor on tax competition by introducing a global minimum corporate tax rate set at 15% for large MNEs.

2. In December 2021, the OECD released the Pillar Two model rules, also referred to as the 'Global Anti-Base Erosion' or 'GloBE' rules. These rules aim to ensure large MNEs pay a minimum amount of tax on income arising in each jurisdiction in which they operate. The rules provide a template that jurisdictions can translate into domestic tax law.

3. The Pillar Two model rules are intended to be implemented as part of an agreed-upon common approach, and introduced via domestic tax law by 2023. We have been informed that some jurisdictions are expected to enact the rules as early as the first half of 2023, although this is still uncertain.

4. The purpose of this paper is to:

   (a) provide an overview of the Pillar Two model rules;

   (b) discuss the potential implications of the rules on the accounting for income taxes applying IAS 12 *Income Taxes;*

   (c) provide our analysis of whether standard-setting is needed in response to the imminent implementation of the rules; and

(d) ask the International Accounting Standards Board (IASB) whether it agrees with our recommendation to undertake narrow-scope standard-setting.

Summary of staff recommendations

5. We recommend that the IASB amend IAS 12 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) whether it is in the scope of the Pillar Two model rules and whether it operates in low-tax jurisdictions;

      (ii) the fact that it has applied the exception; and

      (iii) its current tax expense related to Pillar Two top-up tax.

   (c) require entities to apply the amendments to IAS 12:

      (i) immediately upon their issuance; and

      (ii) retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Overview of the Pillar Two model rules

The objective of the rules

6. The Pillar Two model rules apply a system of top-up taxes that results in the total amount of taxes payable on an MNE's excess profit in a jurisdiction representing at least the minimum rate of 15%. It is expected that, typically:

   (a) the ultimate parent entity of the MNE group would be liable for top-up tax in respect of low-taxed subsidiaries; and

   (b) top-up tax would be payable to the parent entity's local tax authority.

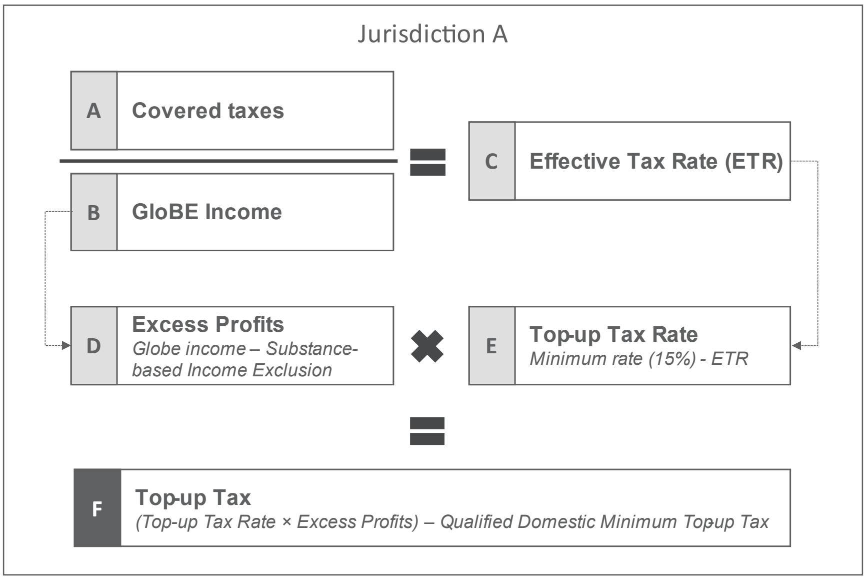
Scope

7. The rules apply to MNE Groups with revenue in their consolidated financial statements exceeding EUR 750 million in at least two of the four preceding fiscal years. Jurisdictions in which revenue is less than EUR 10 million and profits less than EUR 1 million are excluded.

8. Entities with no foreign presence or consolidated revenue of less than EUR 750 million are outside the scope of the rules, as are government entities, international organisations, non-profit organisations and entities that meet the definition of a pension fund, investment fund or real estate fund.

Computation process

9. The jurisdictional top-up tax computation process is illustrated in Picture 1 and explained further in paragraphs 12–29.



Picture 1— Computation of Top-up Tax in Jurisdiction A

10. Appendix A to this paper includes a simple example to illustrate the computation process.

11. Further information about the Pillar Two model rules can be found in the following OECD documents:

(a) Pillar Two model rules in a nutshell;

(b) fact sheets;

(c) Pillar Two model rules; and

(d) commentary on the Pillar Two model rules.

(A) Covered taxes

12. The starting point for the computation of covered taxes is an entity's current tax expense. The amount includes the entity's income taxes for the fiscal year (or taxes in lieu of those) and excludes non-income-based taxes (such as indirect taxes, payroll taxes and property taxes).

13. An entity then adjusts that current tax expense for:

    (a) *tax credit adjustments*—an entity treats tax credits refundable after four years as a reduction in covered taxes in the year such credits are granted. But an entity adds qualified refundable tax credits—payable within four years—to its covered taxes when it uses such credits to reduce current tax expense.

    (b) *deferred tax adjustments*—an entity takes account of temporary differences and prior year losses by including its deferred tax expense (subject to some adjustments). To prevent any excess tax from sheltering unrelated income, the deferred tax included is capped at the minimum rate (15%). The Pillar Two model rules also include a recapture mechanism that adjusts for some deferred tax liabilities arising from temporary differences that have not been reversed within five years.

(B) GloBE income or loss

14. The GloBE income or loss for the fiscal year is an entity's profit or loss included in the consolidated financial statements of the ultimate parent entity, before eliminating intragroup items and making some purchase accounting adjustments.

15. An entity then adjusts that amount to eliminate some common differences between accounting and tax rules (book-to-tax differences). These adjustments include:

    (a) *excluded dividends and excluded equity gain or loss*—avoids double counting of previously-taxed income and aligns with participation exemptions and similar reliefs common in many jurisdictions;

    (b) *policy disallowed expenses*—disallows deductions for illegal payments;

    (c) *accrued pension expenses*—disallows deductions of pension expenses until an entity pays contributions to the pension fund;

    (d) *stock-based compensation*—prevents top-up tax arising in respect of book-to-tax differences associated with stock-based compensation plans;

    (e) *asymmetric foreign currency gains and losses*—avoids distortions arising when the functional currencies used for accounting and tax are different; and

    (f) exclusion of international shipping income.

(C)/(E) Effective tax rate and top-up tax rate

16. An entity divides the amount of covered taxes by the GloBE income—calculated at a jurisdictional level—to determine the jurisdiction's effective tax rate (ETR). When the ETR is below the minimum

rate (15%), the entity calculates the jurisdiction's top-up tax rate. The entity does so by subtracting the ETR from the minimum rate—for example, if the ETR is 10%, the top-up tax rate is 5% (15% - 10%).

(D) Excess profit

17. The excess profit for the jurisdiction is equal to the GloBE income less the substance-based income exclusion. The substance-based income exclusion is intended to exclude from the top-up tax rules a fixed return for substantive activities within a jurisdiction. Payroll costs and tangible asset carrying values are used as indicators of substantive activities.

18. The substance-based income exclusion for a jurisdiction is the sum of the payroll and tangible asset carve-outs for each entity in that jurisdiction, calculated as follows:

    (a) the payroll carve-out is 10% (reducing to 5% over a number of years) of an entity's eligible payroll costs of eligible employees that perform activities for the MNE Group in the jurisdiction, with some adjustments.

    (b) the tangible asset carve-out is 8% (reducing to 5% over a number of years) of the carrying value of eligible tangible assets in the jurisdiction. Eligible tangible assets include property, plant, and equipment (PP&E), natural resources and the right of use of tangible assets in the jurisdiction.

(F) Top-up tax

19. An entity calculates top-up tax by multiplying the entity's excess profit by its top-up tax rate in the jurisdiction. The entity then reduces that top-up tax by any applicable qualified domestic minimum top-up tax (see paragraphs 28–29).

20. An entity calculates the effective tax rate and any top-up tax for each jurisdiction (blended for all entities in that jurisdiction). The entity then allocates top-up tax to individual entities based on their relative GloBE income. This allocation takes no account of the effective tax rate of individual entities, which means that top-up tax can be allocated to high-taxed entities in a jurisdiction.

Charging provisions

21. A liability to pay top-up tax may arise under two types of provision:

    (a) the income inclusion rule (IIR); and

    (b) the under-taxed profits rule (UTPR).[1]

[1] The model rules refer to this charging provision simply as 'UTPR'.

Income Inclusion Rule

22. The IIR is the main rule. Under the IIR, top-up tax is payable at the level of a parent entity in proportion to its ownership interest in entities located in low-tax jurisdictions. The IIR applies a top-down approach—the ultimate parent entity is primarily liable for top-up tax but, if it is not required to apply the IIR, top-up tax is imposed on the next intermediate parent entity in the ownership chain subject to the IIR.

23. Top-up tax is attributed to parent entities in proportion to their share of profits of low-taxed entities. The rules also include an offsetting mechanism that applies when more than one parent entity is liable for top-up tax under the IIR for the same low-taxed entity.

24. There are specific rules for parent entities with a significant minority interest (partially-owned parent entities). These rules impose top-up tax on partially-owned parent entities—as an exception to the top-down approach described in paragraph 22—to avoid potential tax leakages and ensure an appropriate allocation of the tax burden to minority-interest owners.

Under-Taxed Profits Rule

25. The UTPR is a backstop mechanism designed to ensure that minimum tax is paid when an entity with low-taxed income is held through a chain of ownership that results in no IIR charge on the low-taxed income. For example, this might occur if the ultimate or intermediary parent's jurisdiction has not yet implemented the Pillar Two model rules.

26. IIR and UTPR use the same calculation methodology and ruleset, but the UTPR allows the tax authorities in a jurisdiction other than that of a parent to recover top-up tax. This is expected to work by requiring an adjustment (such as by disallowing a deduction) to compensate for the low-taxed income. The adjustment is an amount sufficient to result in the group being taxed at an effective minimum tax rate of 15% in all jurisdictions in which it operates. The allocation of UTPR top-up tax between jurisdictions is made in proportion to the relative share of assets and employees in each jurisdiction.

27. The operation of the UTPR may result in top-up tax for a particular low-taxed entity being imposed on multiple group entities in other jurisdictions, including entities with no direct equity relationship with the low-taxed entity.

Qualified domestic minimum top-up tax

28. An entity generally pays top-up tax in the jurisdiction of the ultimate parent entity of the group rather than in the low-tax jurisdiction in which it operates that triggers the additional payment. Therefore, the rules allow jurisdictions to introduce their own domestic minimum top-up tax based on the Pillar Two mechanics to avoid potential tax leakages. For example, a jurisdiction may implement a qualified

domestic minimum top-up tax such that, if the effective tax rate domestically is lower than 15%, top-up tax would be payable in that jurisdiction (instead of the ultimate parent entity's jurisdiction).

29. As a consequence, some countries may change their domestic tax policy in anticipation of the Pillar Two model rules becoming effective. Nonetheless, additional top-up tax under Pillar Two may still be payable depending on whether the domestic effective tax rate calculation is consistent with the rules.

Overview of the requirements in IAS 12

30. The following paragraphs provide a brief overview of the requirements in IAS 12 that are relevant to understanding the accounting implications of the Pillar Two model rules, specifically:

    (a) scope (paragraphs 31–32);

    (b) temporary differences and deferred taxes (paragraphs 33–35);

    (c) measurement of deferred taxes (paragraphs 36–37); and

    (d) the effect of tax rates and laws being enacted (or substantively enacted) (paragraphs 38–39).

Scope

31. Paragraph 1 of IAS 12 states that the Standard 'shall be applied in accounting for incomes taxes.' IAS 12 does not define 'income taxes' but paragraph 2 states:

> For the purposes of this Standard, *income taxes include all domestic and foreign taxes which are based on taxable profits…* [Emphasis added]

32. Paragraph 5 of IAS 12 defines taxable profit (tax loss) as:

> …the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Temporary differences and deferred taxes

33. Paragraph 5 of IAS 12 defines temporary differences as follows:

> *Temporary differences* are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.

34. Paragraph 5 of IAS 12 goes on to state that:

> Temporary differences may be either:

(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

35. Paragraphs 15 and 24 of IAS 12 require an entity to recognise—with some exceptions—deferred tax assets and liabilities for all temporary differences. This is because the existence of a temporary difference means that the recovery or settlement of the carrying amount of the related asset or liability will have tax consequences—it will make future tax payments larger (or smaller) than they would otherwise be.[2]

Measurement of deferred taxes

36. Paragraph 47 of IAS 12 states:

Deferred tax assets and liabilities shall be measured at the *tax rates that are expected to apply to the period when the asset is realised or the liability is settled*… [emphasis added]

37. Applying paragraph 47 of IAS 12, an entity is therefore required to determine the tax rates expected to apply in future periods when the related asset is realised or the related liability is settled (when temporary differences reverse). This is different from the measurement requirements for current taxes, which require an entity to use tax rates at the end of the reporting period.

Tax rates and laws enacted (or substantively enacted)

38. Paragraph 47 of IAS 12 also requires an entity to measure deferred taxes based on 'tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.'[3] Paragraph 48 of IAS 12 goes on to state that:

Current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. However, in

[2] For further reference, paragraph 16 of IAS 12 explains how tax consequences arise when an entity recovers the carrying amount of an asset and that carrying amount exceeds the asset's tax base.

[3] As explained in paragraph 36, paragraph 47 of IAS 12 requires an entity to measure deferred tax 'at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled'. In doing so, the entity reflects tax rates that have been enacted (or

some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).

39. The exact point at which tax rates and tax laws are deemed to be substantively enacted depends on a jurisdiction's legislative processes. Notably, however, IAS 12 requires an entity to reflect enacted (or substantively enacted) tax rates and tax laws in the measurement of deferred taxes, even if they are not yet effective.

Potential implications on the accounting for income taxes

40. Stakeholders have informed us of concerns about the implications of the imminent implementation of the Pillar Two model rules on the accounting for income taxes. Stakeholders' concerns relate to:

(a) how an entity would apply IAS 12 to account for top-up tax (see paragraphs 41–54);

(b) the usefulness of the information that could result from accounting for deferred taxes with respect to top-up tax (see paragraphs 55–56); and

(c) the urgency of clarity given the imminent implementation of the Pillar Two model rules by some countries and jurisdictions (see paragraphs 57–58).

How to apply IAS 12 to account for top-up tax

41. Stakeholders raise several questions about how an entity would account for top-up tax arising from the implementation of the Pillar Two model rules. They say top-up tax differs from income taxes that arise under traditional tax regimes: traditional income taxes are generally based directly on an entity's taxable profit; top-up tax, on the other hand, arises only if an entity pays an insufficient amount of income taxes at a jurisdictional level.

42. IAS 12 was not designed to be applied to such taxes. Therefore, stakeholders say it is unclear how an entity would apply the requirements in IAS 12 to account for top-up tax. In particular, stakeholders question whether top-up tax is in the scope of IAS 12 and, if so, how an entity accounts for deferred taxes with respect to top-up tax.

43. Regarding deferred taxes, stakeholders ask:

(a) whether the Pillar Two model rules create additional temporary differences;

substantively enacted) by the end of the reporting period. For example, a new tax rate enacted by the end of the reporting period may be effective only one year after the end of the reporting period. In this case, the entity uses the new tax rate only in measuring deferred tax related to assets expected to be realised, and liabilities expected to be settled, after one year.

(b) whether an entity is required to remeasure deferred taxes recognised for existing temporary differences under domestic tax regimes; and

(c) which tax rate an entity uses to measure any deferred taxes with respect to top-up tax.

44. We explain stakeholders’ questions further in the following paragraphs.

Is top-up tax in the scope of IAS 12?

45. Stakeholders ask whether top-up tax is an income tax, and therefore whether it is in the scope of IAS 12.

46. Stakeholders generally agree that top-up tax is an income tax in the consolidated financial statements of the ultimate parent entity of a group subject to the Pillar Two model rules. In these financial statements, most stakeholders agree that top-up tax is ‘based on taxable profits’ of the entity. However, stakeholders say it is unclear whether:

(a) top-up tax is an income tax in the consolidated or separate financial statements of intermediate parent entities and subsidiaries—in these cases, an entity might, for example, be liable to pay top-up tax with respect to low-taxed profits of an entity that is not part of the reporting entity or group (for example, the low-taxed profit might relate to a sister entity). Some question whether such top-up tax would be an income tax if it is not based on the taxable profit of the reporting entity or group.

(b) top-up tax imposed under the UTPR mechanism is an income tax—similar to the situation described above, top-up tax due under the UTPR may refer to low-taxed profit of entities that are not part of the group or reporting entity (for example, it may refer to low-taxed profit of an entity’s parent).

47. Questions also arise as to which entity in a group would recognise an income tax expense resulting from the recognition of a top-up tax liability: the entity liable to pay top-up tax under the Pillar Two rules (generally, a parent entity), the entity to which top-up tax is allocated (see paragraph 20) or the entity whose low-taxed profits triggered the payment of top-up tax in a given jurisdiction.

Do the Pillar Two model rules create additional temporary differences?

48. Stakeholders say it is unclear whether the Pillar Two model rules create temporary differences in addition to those that exist under an entity’s domestic tax regime. They ask whether the recovery or settlement of assets and liabilities can be deemed to have direct tax consequences under the rules.

49. Whether an entity will pay top-up tax ultimately depends on many factors, including, for example, whether permanent differences exist in the entity's calculation of income taxes for domestic purposes.[4] Consider the following example:

> An entity receives tax incentives through additional deductions for research and development expenses. Such additional deductions are permanent differences that reduce an entity's taxable profit in the period. This would, in turn, result in lower taxes paid in the jurisdiction and, consequently, a lower ETR for Pillar Two purposes. Permanent differences therefore:
>
> (a) affect the calculation of the ETR and how much top-up tax an entity pays in a future period; and
>
> (b) could result in an ETR lower than 15%, even if the tax rate in a jurisdiction is higher than 15%.

50. Therefore, stakeholders ask whether it is possible to:

    (a) directly link the recovery or settlement of the carrying amount of specific assets and liabilities to the payment of future top-up tax (or the reduction of these payments); and

    (b) conclude with sufficient certainty that the recovery of an asset or settlement of a liability will make future tax payments larger or smaller.

51. Some stakeholders also ask whether:

    (a) the Pillar Two model rules give rise to temporary differences similar to those that arise with respect to investments in subsidiaries, branches and associates and interests in joint arrangements (see paragraphs 38–45 of IAS 12), often referred to as 'outside basis' temporary differences; and

    (b) the substance-based income exclusion (see paragraph 18) would affect the tax base of related fixed assets, and therefore whether it would give rise to temporary differences.

[4] In this paper, we use the term 'permanent differences' to refer to expenses that are never deductible, or income that is never taxable, under domestic tax law—for example, tax law generally does not allow deductions for fines and penalties. The term could also refer to additional deductions given as tax incentives. The term is often used as a contrast to 'timing differences', which refer to expenses that are not deductible, or income that is not taxable, in a specified reporting period, but that will be so in a different period. These terms should not be confused with the term 'temporary difference', which has a different meaning (see definition in paragraphs 33–34 of this paper).

Would an entity remeasure deferred taxes recognised for existing temporary differences?

52. Stakeholders ask whether an entity would remeasure deferred taxes recognised for existing temporary differences (arising under domestic tax regimes) to reflect potential additional top-up tax that could arise under the Pillar Two model rules (for example, if an entity operates in a jurisdiction in which it expects that its Pillar Two ETR will be lower than the minimum tax rate of 15%). These stakeholders say it is unclear whether the reversal of these temporary differences result in top-up tax and, therefore, whether the related deferred tax measurement should reflect any additional tax that will result from the recovery or settlement of assets and liabilities.

How to determine the rate used to measure deferred taxes?

53. If an entity concludes that it would recognise deferred taxes for additional temporary differences arising under the Pillar Two model rules—or remeasure deferred taxes related to existing temporary differences—questions than arise as to which rate the entity would use to measure those deferred taxes. In particular, whether paragraph 47 of IAS 12 (see paragraph 36) requires an entity to estimate the top-up tax rate that will apply when the related temporary differences are expected to reverse.

54. Stakeholders say:

    (a) the top-up tax rate that will apply to an entity's excess profit in future periods depends on multiple factors that are extremely difficult—if not impossible—to forecast reliably; and

    (b) an entity cannot simply assume that the tax rate should be equal to the difference between the domestic tax rate and the minimum tax rate (15%).

The usefulness of the information

55. Some stakeholders question the usefulness of the information that would result from recognising deferred taxes with respect to top-up tax, particularly if an entity is required—for the purposes of measuring deferred taxes—to estimate the top-up tax rate that will apply when temporary differences reverse. These stakeholders say:

    (a) estimating that top-up tax rate would be costly and might not result in reliable measurement (see paragraph 54).

    (b) an entity might have to frequently remeasure deferred taxes to reflect changes in estimated future top-up tax rates. Such remeasurements might not provide useful information to users of financial statements (investors); they could instead reduce the usefulness of the information resulting from deferred tax accounting with respect to domestic tax regimes.

56. Some stakeholders say, given the complexity of the Pillar Two model rules, recognising deferred taxes with respect to top-up tax would be extremely complex. Therefore, the costs of doing so might outweigh the benefits.

Urgent need for clarity

57. Stakeholders say, although it is still uncertain when jurisdictions will implement the Pillar Two model rules, they expect many will do so during 2023, and possibly as early as the first half of 2023. This would be consistent with some jurisdictions' intention to make the Pillar Two model rules effective for accounting periods beginning after 31 December 2023.

58. As explained in paragraph 38, IAS 12 requires entities to reflect—in the measurement of deferred tax assets and liabilities—tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. Therefore, some stakeholders say there is little time to resolve the uncertainties about how the Pillar Two model rules would affect the accounting for deferred taxes applying IAS 12. Without further clarification, entities might incur significant costs in determining and applying their own interpretations of the requirements in IAS 12, which could result in diversity in the accounting entities apply and potentially result in information that is not useful for investors (see paragraph 55 above).

Staff analysis

59. We agree with stakeholders that it is not immediately apparent how an entity would apply the principles and requirements in IAS 12 in accounting for top-up tax arising from the Pillar Two model rules.

60. IAS 12 was not designed to apply to income tax law such as that enacted to implement the rules. Although income tax regimes vary significantly around the world—and entities have been able to apply IAS 12 in these circumstances—in our view, the rules are sufficiently different from traditional tax regimes and will be applicable to a sufficiently large number of entities to require specific consideration by the IASB.

61. Further work would be needed to determine how an entity applies the principles and requirements in IAS 12 to Pillar Two top-up tax. Such work would involve:

    (a) determining the circumstances in which top-up tax is an income tax in the scope of IAS 12 (and therefore when to apply deferred tax requirements);

    (b) analysing how an entity applies the principles and requirements in IAS 12 on the recognition and measurement of deferred taxes in the context of the Pillar Two model rules; and

    (c) engaging with stakeholders and considering any further action needed to support the consistent application of IAS 12.

62. Having determined how to apply IAS 12 to Pillar Two top-up tax, that further work might also involve assessing the usefulness of the information for investors—and that the benefits of such information outweigh the costs of preparing it—or whether standard-setting is needed.

63. Undertaking such work could require some considerable time. Given the pace at which the rules are expected to be implemented in different jurisdictions, in our view it would not be feasible to complete the activities described in paragraph 61 before new tax laws are expected to be enacted (or substantively enacted) and, consequently, before entities are required to reflect the new laws in accounting for income taxes. Further, although it is too early to say, the IASB might decide to undertake standard-setting after completing these activities, at which point it might not be possible to amend the requirements in IAS 12 before entities have to apply them.

64. The Pillar Two model rules are part of what some consider to be a historic international tax reform. More than 135 countries and jurisdictions agreed to the rules, which are estimated to generate around USD 150 billion in additional global tax revenues annually. Therefore, we expect the implementation of the Pillar Two model rules to have a material effect on many larger listed entities around the world.

A temporary exception from deferred tax accounting

65. Based on our analysis in paragraphs 59–64, we recommend that the IASB introduce a temporary exception from accounting for deferred taxes with respect to Pillar Two top-up tax. Introducing such a temporary exception would:

    (a) provide relief for affected entities from determining how to apply the deferred tax accounting requirements in IAS 12 to a complex new tax regime in a short period of time;

    (b) avoid different interpretations of IAS 12 developing in practice that might result in inconsistent application of the Standard; and

    (c) allow time for jurisdictions to enact new tax laws and for stakeholders to assess how the rules have been implemented by those jurisdictions.

66. Such a temporary exception would also allow time for the IASB to assess how the rules have been implemented around the world and consider whether it needs to undertake further work.

67. Introducing a temporary exception would result in a potential loss of the information that would otherwise be provided by recognising deferred taxes. However, in our view the possible inconsistent application of the requirements in IAS 12 would result in less useful information than consistent application of the temporary exception.

Features of a temporary exception

What would be the scope of the temporary exception?

68. In our view, the temporary exception should apply only to income taxes arising from laws enacted to implement the OECD's Pillar Two model rules, including any qualified domestic minimum top-up tax. Scoping the temporary exception in this way would ensure that the exception is not applied to other income taxes.

Should the exception be mandatory or optional?

69. In our view, the temporary exception should be mandatory. This would result in IFRS reporters applying the same accounting treatment for Pillar Two top-up tax—entities would not recognise deferred taxes with respect to that tax. Making the exception mandatory would:

    (a) result in greater comparability between entities, and thus in our view result in more useful information for investors; and

    (b) make it easier for investors to understand how entities have accounted for Pillar Two top-up tax, avoiding the need to identify an entity's accounting policy and the related effects in its financial statements.

70. Further, making the exception mandatory would eliminate the risk that entities might inadvertently develop accounting policies inconsistent with the principles and requirements in IAS 12.

How long should the exception be in place?

71. As explained in paragraph 61, further work is needed to determine how an entity applies the principles and requirements in IAS 12 to Pillar Two top-up tax, which in turn depends on how jurisdictions implement the Pillar Two model rules. It is not possible to determine with precision how much time such work will require. It is also still uncertain when jurisdictions will implement the rules. Consequently, in our view the IASB should not at this stage specify how long any exception from accounting for deferred taxes will be in place.

Disclosures

Objective of new disclosure requirements

72. We considered whether the IASB should introduce new disclosure requirements in addition to introducing the temporary exception discussed in paragraphs 65–71. In making this assessment, we considered whether entities should be required to disclose information to compensate for the potential loss of information that would result from the temporary exception.

73. We have not considered potential wider investor information needs about income taxes, such as those raised by stakeholders during the IASB's Third Agenda Consultation.[5] Attempting to address any such wider information needs would be beyond the scope of the proposed narrow-scope amendments.

74. Further, given the urgency with which the IASB would have to finalise any narrow-scope amendments (see paragraph 84), in our view any new disclosure requirements should be simple, narrow in scope and specifically related to the fact that the IASB is proposing to introduce the temporary exception.

Proposed disclosure requirements

75. As explained in paragraph 35, deferred tax assets and liabilities provide information about the tax consequences of recovering or settling the carrying amount of assets and liabilities. These tax consequences result from the existence of temporary differences. Because it is not immediately apparent how an entity would identify temporary differences—and measure the related deferred taxes—with respect to top-up tax, we think an entity is unlikely to be able to disclose meaningful information about the tax consequences of recovering or settling the carrying amount of assets and liabilities under the Pillar Two model rules.

76. However, in our view the IASB should require an entity to disclose:

(a) whether it is in the scope of the Pillar Two model rules and whether it operates in low-tax jurisdictions[6]; and

(b) the fact that the entity has applied the temporary exception.

77. The information above would allow investors to identify that the entity is exposed to paying Pillar Two top-up tax and that it has not recognised deferred taxes with respect to this tax regime.

78. We also recommend that the IASB require an entity to disclose separately the current tax expense related to Pillar Two top-up tax. That information would allow investors to understand the magnitude of top-up tax relative to an entity's overall tax expense. Disclosing that information would in our view not be costly for entities. If top-up tax is an income tax in the scope of IAS 12, entities would be required to account for the respective current tax; entities would therefore be required to calculate that amount in preparing its financial statements in any event.

79. We also considered whether the IASB should require an entity to disclose—in reporting periods ending after jurisdictions have substantively enacted the Pillar Two model rules but before the rules are effective (when top-up tax is not yet payable)—information that gives investors an indication of the

[5] Some stakeholders said the IASB should 'enhance disclosures to help investors better understand a company's income tax charge and potential effects on future cash flows' and 'develop more effective disclosures about a company's tax optimisation structures to help investors understand the nature of such tax structures, which countries may be involved, what risks exist and the sustainability of such tax structures'.

[6] Low-tax jurisdictions are jurisdictions in which the entity reasonably expects the effective tax rate to be lower than the minimum rate of 15%. This could include jurisdictions in which (a) tax rates are lower than the minimum rate or (b) tax incentives, tax exemptions or additional tax deductions an entity receives might result in an effective tax rate lower than the minimum rate.

amount of top-up tax the entity will pay in future periods. For example, the IASB could require an entity to disclose:

(a) its assessment of the amount of top-up tax it expects to pay in future periods; or

(b) information about the amount (or proportion) of an entity's profits that were taxed in low-tax jurisdictions in current or previous periods.

80. Although we think such information could be useful for investors, we recommend that the IASB does not propose to require disclosure of it specifically with respect to Pillar Two model rules. In our view:

(a) requiring an entity to disclose such information would aim to help investors assess the effects of the legislation on the current tax an entity will pay in future periods, rather than provide information about deferred taxes an entity would otherwise have recognised absent the temporary exception. Deferred taxes reflect the tax consequences of recovering and settling the carrying amount of assets and liabilities; they do not provide information about current tax an entity will pay on future profits.

(b) such a requirement, if introduced, could have much broader applicability than just the Pillar Two model rules. For example, a particular jurisdiction may announce that tax rates will increase in the future. Information about the expected increase in current tax an entity will pay in the future in that particular jurisdiction might be useful for investors. Currently, IAS 12 requires the disclosure of no such information.[7] Similarly, we think there could be other situations in which information about the expected effects of announced (but not yet effective) laws and regulations on an entity's future operations might be useful for investors.

(c) as discussed in paragraph 76, we recommend that entities disclose whether they are in the scope of the Pillar Two model rules and whether they operate in low-tax jurisdictions. Entities would disclose this information in periods before the rules becomes effective. This information would identify entities exposed to the payment of future top-up tax.

(d) given the significance of the international tax reform, we expect that entities might already disclose such information absent specific requirements (for example, we expect entities to already disclose some information in their 2022 year-end reporting).

[7] IAS 12 only requires an entity to reflect the announced rates in the measurement of recognised current and deferred tax assets and liabilities.

Transition and effective date

81. In our view, for the temporary exception to be effective (as discussed in paragraph 65), it would need to be:

    (a) available to entities immediately upon the issue of the amendments, such that it can be applied to any financial statements not yet authorised for issue; and

    (b) applied retrospectively, particularly if the amendments were finalised after legislation to implement the Pillar Two model rules have been enacted (or substantively enacted).

82. We also expect that retrospective application would result in no additional costs for entities because the Pillar Two model rules have not yet been enacted.

83. Therefore, we recommend that the IASB require entities to apply the temporary exception:

    (a) immediately upon the issue of any final amendments; and

    (b) retrospectively in accordance with IAS 8.

Possible timing if the IASB decides to undertake standard-setting

84. In addition to the factors discussed in paragraphs 81–83, for the temporary exception to be effective, it would need to be introduced as soon as possible and preferably before jurisdictions implement the Pillar Two model rules. As mentioned in paragraph 3, it is expected that some jurisdictions will enact new tax legislation to implement the rules as early as the first half of 2023. Therefore, any standard-setting would have to be completed urgently.

Comment period

85. Paragraph 6.7 of the IFRS Foundation *Due Process Handbook* states that:

> The [IASB] normally allows a minimum period of 120 days for comment on an exposure draft. If the matter is narrow in scope and urgent the [IASB] may set a comment period of less than 120 days but no less than 30 days after consulting and obtaining approval from the DPOC.

86. If the IASB agrees with our recommendation to undertake standard-setting, given that the amendments would be narrow in scope and urgent, we plan to request approval from the Due Process Oversight Committee (DPOC) for a comment period of 60 days.

Proposed timetable for balloting and publication

87. If the IASB agrees with our recommendations, we think it would be possible to publish an Exposure Draft in January 2023 and, subject to the comments received, issue final amendments to IAS 12 during the second quarter of 2023.

88. In order to achieve that timetable, we also ask:

    (a) for permission to ballot an exposure draft of the proposed amendments—Appendix B sets out a summary of the due process steps taken so far; and

    (b) whether any IASB member would intend to dissent from the publication of the Exposure Draft (in accordance with paragraph 6.9 of the *Due Process Handbook).*

Conclusion

89. In summary, we are of the view that introducing a temporary exception from accounting for deferred taxes would:

    (a) provide timely relief for affected entities and avoid different interpretations of IAS 12 developing in practice. We think this would safeguard the usefulness of the information that results from applying IAS 12 until questions about how to apply IAS 12 have been resolved.

    (b) allow some time for stakeholders and the IASB to assess how jurisdictions have enacted tax laws implementing the rules, and for the IASB to consider whether it needs to undertake further work.

90. If the IASB agrees with the staff recommendations in this paper, the staff will begin the balloting process for proposed amendments to IAS 12.

Questions for the IASB

1. Does the IASB agree with the staff recommendations to amend IAS 12 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) whether it is in the scope of the Pillar Two model rules and whether it operates in low-tax jurisdictions;

        (ii) the fact that is has applied the temporary exception; and

(iii) its current tax expense related to Pillar Two top-up taxes.

(c) require entities to apply the proposed amendments to IAS 12:

(i) immediately upon their issuance; and

(ii) retrospectively in accordance with IAS 8.

2. Does the IASB agree with the staff recommendation to ask the DPOC to approve a 60-day comment period for the Exposure Draft of proposed amendments to IAS 12?

3. Is the IASB satisfied that it has complied with the applicable due process steps and that it should begin the balloting process for the Exposure Draft?

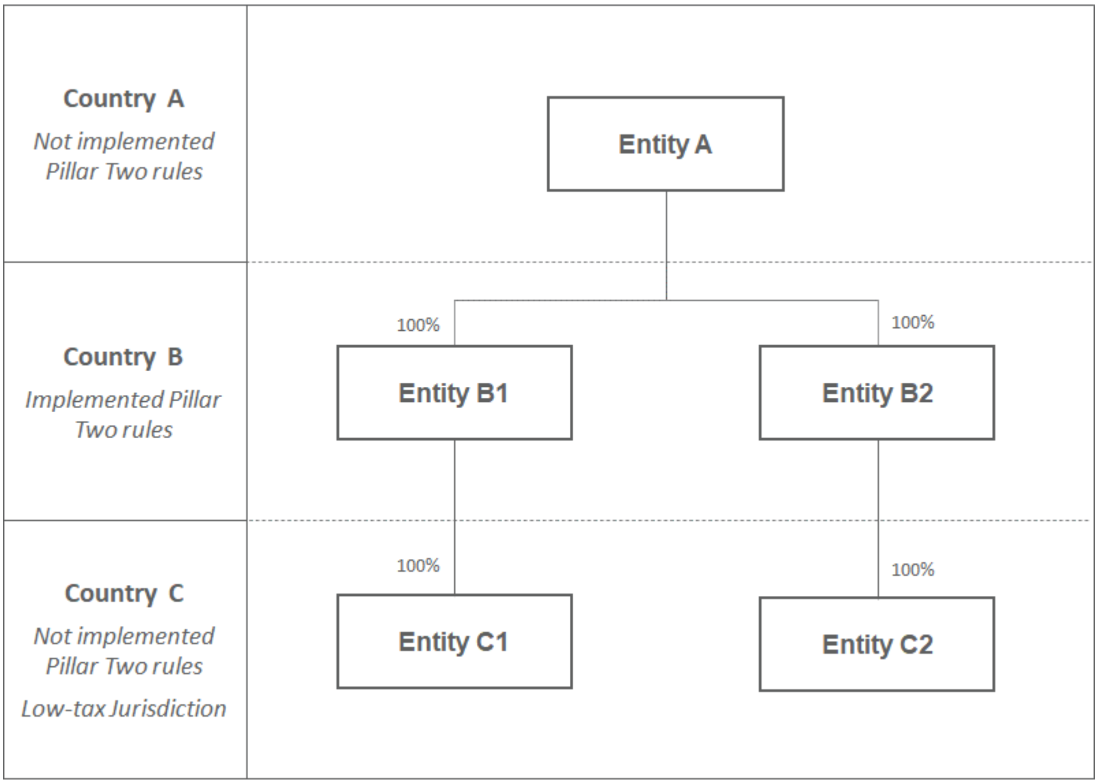
4. Does any IASB member intend to dissent from the proposals in the Exposure Draft?

Appendix A—Numeric example

A1. The following is a simple numeric example illustrating our understanding of how an entity would calculate top-up tax in accordance with the Pillar Two model rules.

Group structure

A2. Consider the following group structure:



Picture 2—Group structure for numeric example

A3. In the example above, entities A, B1 and B2 have a Pillar Two effective tax rate (ETR) above the minimum rate of 15%, but Entities C1 and C2 are located in a low-tax jurisdiction with an ETR below 15%. Only Country B has enacted tax law that implements the Pillar Two model rules.

A4. The Group is determined to be a multi-national enterprise (MNE) in the scope of the rules. Because Country A has not implemented the rules, any top-up tax would be due and payable by entities in Country B.

Computation of Pillar Two top-up tax

A5. The table below shows the covered taxes, GloBE income and substance-based income exclusion for entities C1 and C2:

Entity	Covered taxes	GloBE income	Substance-based income exclusion
Entity C1	120	1,100	100
Entity C2	200	2,100	100
Total	**320**	**3,200**	**200**

A6. The effective tax rate (ETR) and top-up tax due in Country B are calculated as follows:

Country B		Computation
Effective Tax Rate	10%	320 ÷ 3,200
Top-up Tax Rate	5%	15% - 10%
Excess profits	3,000	3,200 - 200
Top-up tax	**150**	**3,000 × 5%**

A7. The top-up tax is allocated between the individual entities in Country C based on their relative Globe income, as follows:

Low-taxed entities	Top-up tax allocated	Computation
Entity C1	52	150 **×** (1,100 ÷ 3,200)
Entity C2	98	150 **×** (2,200 ÷ 3,200)
Total	**150**	52 + 98

Applying the charging provisions

A8. In this example, because the ultimate parent entity (Entity A) is located in a jurisdiction that has not implemented the Pillar Two model rules, the top-up tax is imposed in the next intermediate parent entities that are subject to the Income Inclusion Rule (IIR)—in this example, entities B1 and B2.

A9. Applying the IIR, top-up tax is attributed to the parent entities in proportion to their share of profits of the low-taxed entities, as follows:

(a) Entity B1 has a 100% interest in entity C1, so it is liable for 100% of the top-up tax allocated to entity C1 (CU 52); and

(b) Entity B2 has a 100% interest in entity C2, so it is liable for 100% of the top-up tax allocated to entity C2 (CU 98).

A10. The example above illustrates the application of only the IIR charging provision. It does not illustrate the potential applicability of the UTPR charging provision nor Qualified Domestic Minimum Top-up tax.

Appendix B—Due process steps

B1. The following table summarises the required due process steps taken in developing the proposed amendments. The table does not list all the optional steps.

Step	Actions
IASB meetings are held in public, with papers available for observers. All decisions are made in public sessions	• The IASB is discussing this matter in public at its November 2022 meeting.
Consultation with the Trustees and the Advisory Council	• The Trustees and Advisory Council will be updated on the project as part of their discussions of the Board's technical activities.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs	• The proposed amendments would provide timely relief to affected entities and avoid different interpretations of IAS 12 developing in practice. We think this would safeguard the usefulness of the information that results from applying IAS 12 until questions have been resolved. • We expect the amendments to reduce the costs that entities would incur in applying the requirements in IAS 12 in the context of the Pillar Two model rules. • Because the amendments are narrow in scope, we see no need to have a separate effects analysis.
Finalisation	
Due process steps reviewed by the IASB	• This paper asks the IASB to review the due process steps for the project.
The Exposure Draft has an appropriate comment period	• This paper recommends seeking approval from the Due Process Oversight Committee (DPOC) for a comment period of 60 days. The proposed comment period is less than the minimum period specified in paragraph 6.7 of the *Due Process Handbook* but more than 30 days. Therefore, approval from the DPOC is required.
Drafting	
Drafting quality assurance steps are adequate	• The translations, editorial and taxonomy teams will review drafts during the balloting process.
Publication	
Exposure Draft published	• The Exposure Draft will be made available on the project website when published.

Press release to announce publication of the Exposure Draft	• A press release will be published on our website with the Exposure Draft.