
IASB[®] meeting

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Project	International Tax Reform—Pillar Two Model Rules
Topic	Potential amendment to the <i>IFRS for SMEs</i>[®] Accounting Standard
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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. They are intended to be implemented as part of an agreed-upon common approach and introduced via domestic tax law by 2023.¹

3. At its November 2022 meeting, the International Accounting Standards Board (IASB) discussed the potential effects of the OECD's Pillar Two model rules on the accounting for income taxes by an entity applying IAS 12 *Income Taxes*. The IASB published the Exposure Draft *International Tax Reform—Pillar Two Model Rules* in January 2023. The Exposure Draft was open for comment until 10 March 2023. At its supplementary meeting in April 2023, the IASB discussed the feedback on the Exposure Draft and decided to finalise amendments to IAS 12². The amendments will introduce:
 - (a) a temporary exception to the accounting for deferred taxes arising from the jurisdictional implementation of the global tax rules; and
 - (b) targeted disclosure requirements for affected companies to help users of the financial statements better understand a company's exposure to Pillar Two income taxes arising from that legislation, particularly before the effective date of that legislation.
4. Our outreach provides evidence that Pillar Two model rules could also have material effects on financial statements of some entities applying the *IFRS for SMEs* Accounting Standard.
5. The purpose of this paper is to:
 - (a) provide our analysis of the relevance of the proposed amendments to IAS 12 to entities applying the *IFRS for SMEs* Accounting Standard; and
 - (b) ask the IASB whether it agrees with our recommendation to undertake a narrow-scope standard-setting project to amend the *IFRS for SMEs* Accounting Standard outside the periodic review of the Accounting Standard

¹ For the overview of the Pillar Two model rules, see paragraphs 6–29 of [Agenda Paper 12A](#) for the November 2022 IASB meeting.

² The final amendments to IAS 12 *Income Taxes* are expected to be issued by the end of May 2023.

(that is, outside the Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard).

6. This paper includes:
- (a) requirements in Section 29 Income Tax of the *IFRS for SMEs* Accounting Standard (paragraphs 7–8);
 - (b) staff analysis (paragraphs 9–22);
 - (c) possible project timing if the IASB decides to undertake standard-setting (paragraphs 23–26);
 - (d) staff recommendations and questions for the IASB (paragraphs 27–28); and
 - (e) Appendix A—excerpts from Section 29 of the *IFRS for SMEs* Accounting Standard.

Requirements in Section 29 *Income Tax* of the *IFRS for SMEs* Accounting Standard

7. Section 29 includes the requirements that are relevant to understanding the potential implications of Pillar Two model rules on the accounting for income taxes applying the *IFRS for SMEs* Accounting Standard (see Appendix A to this paper).
8. We note that the requirements for accounting for income taxes in Section 29 of the *IFRS for SMEs* Accounting Standard are based on those in IAS 12. Therefore, in our view, the concerns raised by stakeholders and discussed in paragraphs 40–58 of [Agenda Paper 12A](#) for the November 2022 IASB meeting are relevant to a subset of non-publicly accountable entities (SMEs) applying the *IFRS for SMEs* Accounting Standard. We analyse the relevance in the next section.

Staff analysis

Background

9. Paragraph P9 of the Preface to the *IFRS for SMEs* Accounting Standard states that this Accounting Standard is based on IFRS Accounting Standards (full IFRS Accounting Standards) with modifications to reflect the needs of users of small and medium-sized entities' (SMEs') financial statements and cost-benefit considerations. SMEs, as defined in paragraph 1.1 of the Accounting Standard, are entities that do not have public accountability and publish general purpose financial statements for external users.
10. Pillar Two model rules generally apply to multinational groups with revenue in their consolidated financial statements exceeding EUR 750 million in at least two of the four preceding fiscal years. The rules specify inclusion thresholds for some jurisdictions and exclude some types of entities from their scope.
11. We expect the implementation of the Pillar Two model rules to have a material effect on many larger listed, as well as some non-listed, entities around the world.

Relevance to SMEs

12. In considering whether to amend the *IFRS for SMEs* Accounting Standard, the IASB first examines whether a new or amended IFRS Accounting Standard is relevant to the financial statements of an SME. Where an amendment fails that test, it will be rejected and not considered further. Simplicity and faithful representation are the other two alignment principles the IASB applies in the Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard when considering each new or amended Accounting Standard for alignment with the *IFRS for SMEs* Accounting Standard³.

³ See paragraph BC29 of the Basis for Conclusions on the Exposure Draft *Third edition of the IFRS for SMEs Accounting Standard*.

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13. The staff monitors the progress of the projects on the IASB's work plan and where necessary seeks advice from the members of the SME Implementation Group (SMEIG) whether any actions should be taken for the amendments to full IFRS Accounting Standards.
 14. Our preliminary outreach with the members of the SMEIG in January 2023 on forthcoming amendments to the IFRS Accounting Standards did not provide evidence that the proposed amendments to IAS 12 would be relevant to SMEs and require an urgent amendment to the *IFRS for SMEs* Accounting Standard. Nor was this identified as an issue for the *IFRS for SMEs* Accounting Standard in the comment letters the IASB received on the Exposure Draft *International Tax Reform—Pillar Two Model Rules* and the Exposure Draft *Third edition of the IFRS for SMEs Accounting Standard*, both of which comment periods ended in March 2023.
 15. However, some jurisdictions have more clarity about how their domestic tax policy may change for the Pillar Two model rules becoming effective and our ongoing outreach activities have indicated that the rules might have a material effect on some SMEs' financial statements.
 16. To obtain evidence about the relevance of the Pillar Two model rules (and the proposed amendments to IAS 12) to SMEs, in March 2023 we undertook further outreach with SMEIG members. We have also reached out to large accounting firms.
 17. Most SMEIG members that responded were not aware of entities applying the *IFRS for SMEs* Accounting Standard being captured (or potentially captured) by the Pillar Two model rules. However, a few SMEIG members (including two from national standard-setters) said that some of these entities may be captured, including subsidiaries of large multinational groups. We also received three responses from the large accounting firms. Comments from respondents included:
 - (a) subsidiaries (of the multinational enterprises) applying the *IFRS for SMEs* Accounting Standard might be in the scope of the Pillar Two model rules—for example, a subsidiary (in South Africa applying the *IFRS for SME* Accounting

Standard) whose parent prepares consolidated financial statements applying US GAAP. If this is the case, such entities might face significant complexities in recognising the deferred tax assets and deferred tax liabilities arising from the rules.

- (b) there might be entities applying the *IFRS for SMEs* Accounting Standard that are parent entities that will be in the scope of the Pillar Two model rules.
 - (c) there is potential for entities that both apply the *IFRS for SMEs* Accounting Standard and reside in jurisdictions with tax rates below 15% to be affected.
 - (d) some entities applying national GAAP that is based on the *IFRS for SMEs* Accounting Standard can be affected by the Pillar Two model rules.
 - (e) it is unclear how domestic tax policies in various jurisdictions may change as a consequence of the Pillar Two model rules becoming effective, so it is difficult to assess potential implications of Pillar Two model rules on the accounting for deferred tax applying the *IFRS for SMEs* Accounting Standard. By the time the Third Edition of the *IFRS for SMEs* Accounting Standard is published, the domestic tax policies will be known, but it may still be unclear how to account for deferred tax arising from the rules. So, there may still be a need for some form of exemption.
18. Based on the feedback received in the outreach, we think that some entities applying the *IFRS for SMEs* Accounting Standard could be affected by the Pillar Two model rules, even if this is a limited subset of SMEs. However, for these entities the effect of the proposed amendment to IAS 12 (namely a temporary exception to the accounting for deferred taxes arising from the jurisdictional implementation of the global tax rules) would provide significant relief. Therefore, we think the IASB should consider whether SMEs affected by the Pillar Two model rules should be given similar relief.

Urgency

19. Determining when to align the *IFRS for SMEs* Accounting Standard with a new or amended IFRS Accounting Standard is an essential step in the periodic reviews of the Accounting Standard.
20. Paragraph BC190 of the Basis for Conclusions on the 2015 *IFRS for SMEs* Accounting Standard states:
- The IASB decided that new and revised full IFRS Standards should not be considered until they have been issued. This is because, until a final full IFRS Standard is issued, the IASB's views are always tentative and subject to change.
21. Paragraph P16 of the Preface to the *IFRS for SMEs* Accounting Standard states that, in rare cases, some matters may need to be considered outside the periodic reviews of the Accounting Standard:
- On occasion, the IASB may identify an urgent matter for which amendment of the *IFRS for SMEs* may need to be considered outside the periodic review process. However, such occasions are expected to be rare.
22. The Third Edition of the *IFRS for SMEs* Accounting Standard, from the second comprehensive review, will not be issued until late 2024 at the earliest. Paragraphs 9–18 of this paper explain why we consider the Pillar Two model rules to be relevant to a subset of SMEs. Consequently, considering the nature of the potential amendments, we think the IASB should treat the matter as urgent and undertake a narrow-scope standard-setting outside the Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard, even though the amendments to IAS 12 have not been issued yet. Otherwise, SMEs might be penalised compared to entities applying full IFRS Accounting Standards.

Possible project timing if the IASB decides to undertake standard-setting

23. Paragraph 6.7 of the Due Process Handbook states:

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

24. We note that the IASB published the Exposure Draft *International Tax Reform—Pillar Two Model Rules* with a 60-day comment period. We recognise that SMEs may have limited time and resources available to respond to the IASB’s consultation. However, we consider the Pillar Two model rules to be relevant to only a subset of SMEs, which are either subsidiaries of large multinational groups or relatively large SMEs generating revenues exceeding the thresholds specified in the Pillar Two model rules. Therefore, on balance, we think that a 75-day comment period would strike the right balance between the urgency of the matter and stakeholders’ capacity to respond to the proposed amendments.
25. If the IASB agrees with our recommendations in this paper, at a future meeting, we will present our recommendations on the proposed amendments to Section 29 of the *IFRS for SMEs* Accounting Standard considering the IASB’s decisions on the final amendments to IAS 12 and applying the IASB’s other two alignment principles—that is, simplicity and faithful representation.
26. If the IASB agrees with our recommendations at that future meeting, we think it would be possible to publish an exposure draft of the proposed amendments to Section 29 of the *IFRS for SMEs* Accounting Standard in June 2023 and, subject to the comments received, issue final amendments in the fourth quarter of 2023.

Staff recommendations

27. Based on the outreach, we think that the proposed amendments to IAS 12 are relevant to some entities applying the *IFRS for SMEs* Accounting Standards. In addition, we think this is an urgent matter that should be considered outside the periodic review process.
28. If the IASB agrees with our recommendation in this paper to undertake standard-setting project to amend Section 29 of the *IFRS for SMEs* Accounting Standard, 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 75-day comment period.

Questions for the IASB

1. Does the IASB agree with the staff recommendation to undertake a narrow-scope standard-setting project to amend Section 29 *Income Tax* of the *IFRS for SMEs* Accounting Standard?
2. Does the IASB agree with the staff recommendation to ask the DPOC to approve a 75-day comment period for the exposure draft of proposed amendments to Section 29 of the *IFRS for SMEs* Accounting Standard?

Appendix A—excerpts from Section 29 of the *IFRS for SMEs* Accounting Standard

A1. Paragraph 29.1 states:

For the purpose of this Standard, income tax includes all domestic and foreign taxes that are based on taxable profit. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

A2. Appendix B to the Accounting Standard defines taxable profit (tax loss) as:

The profit (loss) for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the taxation authorities. Taxable profit equals taxable income less amounts deductible from taxable income.

A3. Paragraphs 29.7–29.8 state the general principle for recognition of deferred tax:

29.7 It is inherent in the recognition of an asset or a liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this section requires an entity to recognise a deferred tax liability (deferred tax asset) with certain limited exceptions. If the entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability without affecting taxable profit, no deferred tax arises in respect of the asset or liability.

29.8 An entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the

differences between the carrying amounts of the entity's assets and liabilities in the statement of financial position and the amounts attributed to those assets and liabilities by the tax authorities (such differences are called 'temporary differences'), and the carryforward of currently unused tax losses and tax credits.

A4. Paragraph 29.27 require an entity to measure a deferred tax liability (asset) using the tax rates and tax laws that have been enacted or *substantively enacted* by the reporting date. It goes on to state that an entity shall regard tax rates and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so.

A5. Paragraph 29.28 states:

When different tax rates apply to different levels of taxable profit, an entity shall measure deferred tax liabilities (assets) using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the deferred tax liability to be settled (deferred tax asset to be realised).