Response to Exposure Draft on International Tax Reform – Pillar Two Model Rules

The Institute of Chartered Accountants of India

Comment Letter Regarding Exposure Draft for Proposed Amendments to IAS 12 International Tax Reform – Pillar Two Model Rules.

We welcome ICAI to initiate this discussion to have views from different professionals and institution on such an important piece of accounting since this would have implications on all business especially those on multi-national companies over a period of time and may also be a critical factor for the decision making.

My personal views are as follows:

Question – 1 : Temporary exception to the accounting for deferred taxes

Response: IAS 12 applies to Income Taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the OECD, including tax law that implements qualified domestic minimum top-up taxes described in those rules. The first option is to provide exception to any disclosure in this regard as substantiated in BC13 – BC17 of Basis for Conclusions.

Analysis of the following provisions of IAS:

a. Para 9 of IAS 1 indicates

Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's:
(a) assets;
(b) liabilities;
(c) equity;
(d) income and expenses, including gains and losses;
(e) contributions by and distributions to owners in their capacity as owners; and
(f) cash flows.

This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

Analysis of the above Para: By giving exemption to disclosure, in my view; would be contrary to the objective of financial statements and it may materially impact their economic decisions. Further, 'other information' in the Notes would also assist the users of financial statements in predicting the entity's future cash flows etc., Hence, without giving any disclosure on Two Pillar taxation; would be contrary to IAS 1.

b. Even as per Conceptual Framework to prepare financial statements Para 5.24 'Other Factors' mentions 'Faithful representation of a recognised asset, liability, equity, income or expenses involves not only recognition of that item, but also its measurement as well as presentation and disclosure of information about it. Further Para 5.25 mentions:

Hence, when assessing whether the recognition of an asset or liability can provide a faithful representation of the asset or liability, it is necessary to consider not merely its description and measurement in the statement of financial position, but also:

(a) the depiction of resulting income, expenses and changes in equity. For example, if an entity acquires an asset in exchange for consideration, not recognising the asset would result in recognising expenses and would reduce the entity's profit and equity. In some cases, for example, if the entity does not consume the asset immediately, that result could provide a misleading representation that the entity's financial position has deteriorated.

(b) whether related assets and liabilities are recognised. If they are not recognised, recognition may create a recognition inconsistency (accounting mismatch). That may not provide an understandable or faithful representation of the overall effect of the transaction or other event giving rise to the asset or liability, even if explanatory information is provided in the notes.

(c) presentation and disclosure of information about the asset or liability, and resulting income, expenses or changes in equity. A complete depiction includes all information necessary for a user of financial statements to understand the economic phenomenon depicted, including all necessary descriptions and explanations. Hence, presentation and disclosure of related information can enable a recognised amount to form part of a faithful representation of an asset, a liability, equity, income or expenses.

Analysis of above Para: Hence, not disclosing anything about Pillar Two Tax Model would only result in suppressing the information required by the primary users of the financial statements.

Per the Proposal of the Exposure Draft, Question1, there is also discussion on IAS 12 Para BC13 – BC17 of Basis of Conclusion, which are as follows:
Analysis of the above Paras: The above para from Basis of Conclusion deals only with the following circumstances:

a. Use of Fair Valuation Of Investment Vs. Revaluation of other than Investment property;

b. Presumption of recovery of value through Sale of PPE or Intangible Asset

c. Deferred Tax need not be discounted

d. Measurement of deferred taxes at the acquisition date should be consistent with the subsequent measurement of deferred tax.

e. Exception not to apply to underlying assets and liabilities using fair value.

Therefore, these paragraphs do not exclusively deal with providing exception for deferred tax asset or liability on possible changes in the value of an asset or liability if an entity had to adopt Pillar Two Model Rules.

Conclusion: Disagree with the view that there need not be any specific disclosure of information about deferred tax assets and liabilities related to Pillar Two income taxes.

Question – 2 : IASB proposes that, in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity disclose for the current period only:

a. information about such legislation enacted or substantively enacted in jurisdictions in which the entity operates;

b. the jurisdictions in which the entity's average effective tax rate (calculated as specified in para 86 of IAS 12) for the current period is below 15%. The entity would also disclose the accounting profit and tax expense (income) for these jurisdictions in aggregate, as well as the resulting weighted average effective tax rate.

c. whether assessments the entity has made in preparing to comply with Pillar Two legislation indicate that there are jurisdictions:

(i) identified in applying the proposed requirement in (b) but in relation to which the entity might not be exposed to paying Pillar Two income taxes; or

(ii) not identified in applying the proposed amendment requirement in (b) but in relation to which the entity might be exposed to paying Pillar Two income taxes.

Para BC18-BC25 of the Basis for Conclusion explains the IASB's rationale for this proposal.

BC18 The Board concluded that the amendments should apply to all temporary differences that arise relating to underlying assets within the scope of the exception, not just those separate temporary differences created by the remeasurement of the underlying asset. This is because the unit of account applied in determining the manner of recovery in the Standard is the underlying asset as a whole, not the individual temporary differences.

BC25 Some respondents to the exposure draft drew the mistaken conclusion that the exposure draft required presumption of *immediate* sale at the end of the reporting period when assessing the presumption of recovery through sale. **The Board observed that paragraph 47 of IAS 12 requires deferred tax assets and liabilities to be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled on the basis of tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.** This requirement applies even when the presumption of recovery through sale is used.

Analysis of the above Paras: Amendments shall apply to all types of temporary differences that arises on underlying assets. In case of Pillar Two income taxes also; where the income tax is levied on the income; it is natural that the deferred tax assets / liabilities needs to be calculated unless there is specific exemption given or a standard prescribes so or by not recognizing deferred tax the financial statements show a true and fair view with a suitable note in the financial statements.

Conclusion: Agree with the view that, in periods in which Pillar Two legislation is in effect, an entity discloses separately its current tax expense (income) related to Pillar Two Income taxes.

Question – 3 : The IASB proposes that an entity apply:

a. the exception – and the requirement to disclose that the entity has applied the exception – immediately upon issue of amendments and retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; and

b. the disclosure requirements in Para 88B – 88C for annual reporting periods beginning on or after 1 January 2023.

Para BC 27 – BC 28 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Conclusion: Where IASB has issued an exception, yes this may be used and when the amendments are made the Deferred Tax is accounted as per IAS 8.

Further, would request or consider, IASB to consider to give the following directions or advice:

a) Where an entity has taken a legal opinion or view on the possible impact on the financial statements on application of Pillar Two Income Taxes; companies may elaborate in the Notes to Accounts on:
    a. A brief of the legislation of Pillar Two Income Taxes;
    b. Why does the entity view that it is material or not material;
    c. What could be the implications on its earnings, to the extent quantifiable based on management's best estimate?
    d. Incremental tax that the entity may have to bear
b) Would it be wrong for an entity to account for deferred tax based on the temporary differences that are based on current filings and reporting under local laws (in other words, would it be incomplete or inaccurate accounting?).
c) Should an entity give possible impact (scenario analysis) of the impact of Pillar Two Income Taxes?

Sincerely,

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