International Tax Reform—Pillar Two

Model Rules

Proposed amendments to IAS 12

Comments to be received by 10 March 2023

Question 1—Temporary exception to the accounting for deferred taxes (paragraphs 4A and 88A)
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 IASB proposes that, as an exception to the requirements in IAS 12, an entity neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.
The IASB also proposes that an entity disclose that it has applied the exception.
Paragraphs BC13–BC17 of the Basis for Conclusions explain the IASB's rationale for this proposal.
Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you would suggest instead and why.

Comments:

1.1 SIRC of ICAI agree with the proposals in larger perspective, since the tax challenges stemming from the digitalization of the economy is a global issue requiring a global solution. 'Pillar Two Model Rules' seeks to put a floor on competition over corporate income tax, through the introduction of a global minimum corporate tax rate that countries can use to protect their tax bases. The Rules aim at additional benefits that will also arise from the stabilisation of the international tax system and the increased tax certainty for taxpayers and tax administrations.

1.2 However, SIRC of ICAI concerned that the introduction of a minimum tax regime will impose additional taxation on companies, increase the administrative burden and raise the cost of investment and impede tax sovereignty of states. The introduction of a minimum tax constitutes could be a blow to the principle of tax sovereignty, which is not in the interest of a small export-oriented economies. In almost all countries parliaments ask for the preservation of the right to structure their tax systems without undue interference from other governments. The introduction of a global minimum tax undermines the possibility of a country to design its tax system in accordance with its economic policies and priorities.

1.3 SIRC favours fair transparent tax competition. Such competition increases pressure on governments to implement efficient and competitive tax legislation which in turn facilitates investments, growth, and new jobs. An overall increase in the corporate income tax burden on the other hand, will have a negative impact. The fact is to be accepted that taxation will be based on accounting rules and not tax rules decided by parliaments.

Do you support the IASB's proposal to introduce a temporary mandatory exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, including the qualified domestic minimum top-up tax?

Do you support the IASB's proposal to extend a temporary mandatory exception also to the disclosures about potential deferred taxes arising from the implementation of the Pillar Two model rules?

Do you think it is necessary to encourage the IASB to clarify whether and how paragraph 4A of the ED is applicable in situations outside the context of consolidated financial statements of the ultimate parent entity (e.g., subsidiary's separate financial statements level or sub-group consolidated financial statements level)?

Comments:

1.4 SIRC of ICAI welcomes that the exception is mandatory. Making this exception mandatory enhances comparability and avoids the risk of accounting inconsistencies. In addition, disclosing that the entity has to apply the exception provides transparency about the fact that the entity might be impacted by top-up tax.

1.5 However, SIRC of ICAI notes that extending such a mandatory exception to the disclosure about deferred tax assets and liabilities related to Pillar Two income taxes could lead, in future periods, to a potential loss of some relevant information. The currently proposed mandatory exception can be understood that even in future periods when companies are able to provide this information, it will not be allowed to provide it in the notes to the financial statements.

1.6 Furthermore, SIRC of ICAI supports the Board's approach not to include a sunset clause for the application of the 'exception'. It would grant additional time to impacted entities and tax specialists to assess the effects of the new tax law and, consequently, to provide more useful and accurate financial information. In addition, taking into account that the OECD Pillar Two rules might be implemented at a different point in time in the various jurisdictions, a uniform timeline would not be appropriate. In addition, it gives time to the Board to engage with stakeholders and to carefully consider any need for standard-setting.

1.7 Nevertheless, SIRC of ICAI encourages the Board to monitor the forthcoming enactment process, to coordinate with other standard setters, to already define a specific work plan and envisage a timeline to analyse the impacts of the Pillar Two rules and to assess whether an additional standard-setting activity is required.

1.8 SIRC of ICAI also highlights that the timing at which the amendments will be published by the Board is critical. Indeed, given the timing at which some jurisdictions are expected to enact or substantively enact the Pillar Two model rules, it could impact interim reporting and annual reporting periods ending before 31 March 2023.

1.9 SIRC of ICAI acknowledges that IAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules. However, it is unclear whether Pillar Two income taxes are in the scope of IAS 12 in situations outside the context of consolidated financial statements. Therefore, we suggest that the Board clarify which standard would apply in such situations, providing that the issuance of these urgent amendments is not delayed.

1.10 SIRC agrees with the Board's proposal to provide a mandatory temporary exception to the requirements in IAS 12 under which an entity should neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

1.11 SIRC of ICAI welcomes the Board's proposal to apply the exception to the accounting for deferred taxes to qualified domestic top-up tax. Such domestic top-up tax is subject to the same concerns as potential deferred tax that arises from the other Pillar Two rules. This temporary exception would be:

(a) Relief to entities from applying the complex calculation as required by the new tax law, including that related to the qualified domestic top-up tax, as they do not have to consider future tax effects;

(b) Avoid diversity in practice in applying IAS 12 requirements without affecting comparability between entities' financial statements, both before and after the top-up tax applies;

(c) To provide more time for entities to better understand the implications of new local tax laws leading to more reliable and useful financial information; and

(d) allow to better understand users' information needs related to top-up tax.

Question 2

The 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 paragraph 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 requirement in (b) but in relation to which the entity might be exposed to paying Pillar Two income taxes.
The IASB also proposes that, in periods in which Pillar Two legislation is in effect, an entity disclose separately its current tax expense (income) related to Pillar Two income taxes.
Paragraphs BC18–BC25 of the Basis for Conclusions explain the IASB's rationale for this proposal.
Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you would suggest instead and why?

2.1 SIRC of ICAI supports the efforts of the Board to define an approach that would provide information to the users to assess an entity's exposure to paying top-up tax that would not involve undue costs or effort.

2.2 SIRC of ICAI is of the view that it is unclear what the ED means by the accounting profit of a jurisdiction: Is it the sub-consolidated accounting profit, as defined by IAS 12, of all entities existing in a given jurisdiction; or is it the aggregated accounting profit of all entities existing in a given jurisdiction?

2.3 Further we observe that under Pillar Two rules, an entity might be exposed to paying Pillar Two income tax even if the law is in force in jurisdictions other than that of the ultimate parent entity of the group. This point is to be emphasised in the ED to avoid any confusion.

2.4 We indicate that under Pillar Two rules, there might be a difference between the entity liable to pay the top-up tax and the entity that triggers the top-up tax. In case that the Board clarifies that Pillar Two income taxes are in the scope of IAS 12 in situations outside the context of consolidated financial statements of the ultimate parent, it gives room for doubt that whether the disclosure requirements proposed in paragraph 88C (b) in the ED are fit for purpose for separate financial statements.

2.5 Another consequence of this ED is to subject to Top-up Tax any permanent benefit that arises in a jurisdiction in a year in which there is a tax loss. This will occur, regardless of the materiality of that benefit relative to the profit or income in the jurisdiction, and regardless of whether that permanentdifference will in fact have the effect of resulting in an 'effective tax rate' in the jurisdictionbelow the minimum tax rate.

2.6 The principle that requires the taxpayer to correct the previous fiscal year if there is a tax decrease, but it does not allow correction in case of anincrease. This means that additional top-up tax can be levied, but a top-uptax paid can never be repaid. A tax system generally requires that income and expenses are allocated to the fiscal year to which they relate. The reassessment system allows/requires a taxpayer to correct a previous fiscalyear six years after the year expired; regardless of if it is an upward or downward adjustment. The Directive seems to indicate that an adjustment is recorded in the financial accounts for a previous fiscal year. An adjustment to the taxes in a previous fiscal year does not, however, change the financial statements of that year. Instead, it is reflected as a prior year adjustment in the financial statements of the year the adjustment is made.

2.7 Additional guidance is also needed on how to determine whether a Deferred Tax Liability has reversed within 5 years. The Deferred Tax Liability-movement of a category between year 'Zero' and year '5' by simply comparing the closing balance amounts on a Deferred Tax Liability general ledger account level, will not appropriately indicate whether a Deferred Tax Liability recorded in year 'Zero' has actually reversed within the relevant time frame.

2.8 From a tax perspective, tangible assets are commonly understood broadly to include physical assets with a finite monetary value that are not intangible assets. Hence, from a tax perspective, tangible assets include both current and non-current physical assets.

2.9 The ED ought to recognize that movements in the underlying pool ofassets/liabilities within a category should be considered when calculating the Deferred Tax Liability subject to recapture. A potential approach could be to allow the taxpayer to prove, by movements in sub ledgers or in other ways, that a Deferred Tax Liability related to an individual asset/liability or to a pool has reversed (even if thegross balance has increased). It appears obvious that the term "tangible assets" should be interpreted to include both current and noncurrent assets. A definition whereby only certain categories of tangible/physical assets would qualify would distort the applicability of the recapture accrual exception depending on the mix of physical assets used between different industries and business models. Hence, it is to be clarified by way of a definition in the ED which explicitly states that both current and non-current assets are covered. Also, for insurance companies it is important that contingency reserves get the same treatment as other insurance reserves and that should be made clear in the ED. Due to the insurance business model, insurance companies must make assumptions of the future. Contingency reserves are a legitimate way for insurance companies to cater for factors that are random or otherwise difficult to assess.

2.10 The ED is not appropriately considering the nature of a company's business activities. In many industries, leasing and rental to third parties is a significant part of the business model.

2.11 It is highlighted that in many industries like automotive industry, where the produced goods have a substantial value, the business include a customer finance activity which leases or rents out the products to customers as a way to finance the "acquisition". Therefore, the ED should be amended to ensure that the exception of property held for sale, lease or investment should not apply, where it is done for the benefit of the commercial activities of another constituent entity in the same jurisdiction. Likewise, the ED should make clear that the exception does not apply where leasing or rent etc., is the core commercial activity of the constituent entity.

Question to Constituents Do you consider that the disclosure requirements included in paragraph 88C (b) ofthe ED will result in providing users of financial statements with insights into anentity's potential exposure to paying top-up tax? Do you consider that the benefit ofproviding this disclosure requirement would outweigh the cost of preparing thisinformation? Is there any other indication that could provide users with betterinsights into an entity's potential exposure to paying top-up tax but that would notinvolve undue cost or effort?

Comments:

2.12 We are in favour of a requirement to provide users with information that tries to provide insights about an entity´s potential exposure to paying top-up-tax, but there are some doubts whether the information included the ED is useful for users of financial statements. For instance, to identify those jurisdictions that might be exposed to paying top-up tax and for which aggregate figures would then be given, the income tax rate could be used instead of the entity’s average effective tax rate.

2.13 The ED also proposes to require an entity to disclose, if existing, that the entity has made assessments in preparing to comply with Pillar Two legislation and an indication of whether there are additional (or fewer) jurisdictions in which the entity might be exposed to paying Pillar Two income taxes compared to those disclosed under relevant paragraph of the ED.

2.14 SIRC of ICAI agrees with the disclosure of an entity´s current tax expense (income) related to Pillar Two income taxes as it would enable users of financial statements to understand the magnitude relative to an entity's overall tax expense and it will not be costly. The reason is that entity needs to recognise the current tax in their financial statements anyway.

Question 3 The IASB proposes that an entity apply: (a) the exception-and the requirement to disclose that the entity has appliedthe exception-immediately upon issue of the amendments andretrospectively in accordance with IAS 8 Accounting Policies, Changes inAccounting Estimates and Errors; and (b) the disclosure requirements in paragraphs 88B–88C for annual reportingperiods beginning on or after 1 January 2023. Paragraphs BC27–BC28 of the Basis for Conclusions explain the IASB’s rationale forthis proposal. Do you agree with this proposal? Why or why not? If you disagree with the proposal,please explain what you would suggest instead and why.

Comments:

3.1 SIRC of ICAI agrees with the Board’s proposal that entities should apply:

(a) The exception and the requirement to disclose that the entity has applied the exception immediately upon issue of the amendments and retrospectively in accordance with IAS 8; and

(b) The disclosure requirements in paragraphs 88B–88C of the ED for annual reporting periods beginning on or after 1 January 2023.

3.2 Such an approach would not lead to significant additional costs for preparers and would allow entities to apply the mentioned exception retrospectively starting from the date Pillar Two legislation is enacted.

3.3 However, it is unclear as to how an entity would account for the deferred tax in relation to top-up tax. It is not clear, if the Pillar Two rules would create additional temporary differences to be dealt with under deferred tax or if the deferred tax calculated under national tax rules would need to be remeasured to reflect the potential top-up tax payable. There was also a need for clarification on the tax rate to be used to measure deferred taxes related to top-up tax. Under IAS 12 the tax rate to be used would be the rate that is expected to apply when the asset is realised or the liability is settled; however, the rate that would apply to excess profit (under Pillar Two) in future periods would depend on a number of factors that are difficult to reliably forecast.

3.4 The costs of calculating the deferred tax relating to top-up tax could therefore outweigh the benefits. Given the complexity of the calculation and the uncertainty surrounding the tax rate to be used, there was a view that the information produced in relation to deferred tax would not be useful enough to users of the accounts.