
IASB meeting

Date	April 2023
Project	International Tax Reform—Pillar Two Model Rules
Topic	Cover paper
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Introduction and purpose

1. In January 2023, the International Accounting Standards Board (IASB) published the [Exposure Draft](#) *International Tax Reform—Pillar Two Model Rules*, which proposed amendments to IAS 12 *Income Taxes*. The comment period ended on 10 March 2023.
2. The purpose of this meeting is to:
 - (a) provide the IASB with:
 - (i) a summary of feedback on the Exposure Draft; and
 - (ii) our analysis and recommendations on how to proceed.
 - (b) ask the IASB whether it agrees with our recommendations.

Structure of agenda papers for this meeting

3. This cover paper includes:
 - (a) background (paragraphs 6–22); and
 - (b) feedback overview (paragraphs 23–27).

4. In addition to this paper, there are four agenda papers for this meeting:

Agenda papers	Description
Agenda Paper 12A <i>Temporary exception to deferred tax accounting</i>	This paper discusses feedback on the proposal to introduce a temporary exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.
Agenda Paper 12B <i>Disclosures</i>	This paper discusses feedback on the proposals to require an entity to disclose specific information to users of financial statements (investors) before and after the Pillar Two model rules are in effect.
Agenda Paper 12C <i>Transition and effective date</i>	This paper discusses feedback on the proposals for transition and effective date of the proposed amendments.
Agenda Paper 12D <i>Due process</i>	This paper sets out due process steps and requests permission to ballot amendments to IAS 12 (subject to the IASB's decisions at this meeting).

5. The papers for this meeting use the following terms to describe the extent of feedback:

Term	Extent of response among respondents
Almost all	all except a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

Background

The Pillar Two Model Rules

6. In December 2021, the Organisation for Economic Co-operation and Development (OECD) published *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, hereafter referred to as the ‘Pillar Two model rules’.¹ These rules:
- (a) are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy and were agreed by more than 135 countries and jurisdictions representing more than 90% of global GDP; and
 - (b) provide a template that jurisdictions can translate into domestic tax law and implement as part of an agreed common approach.

Objective and scope

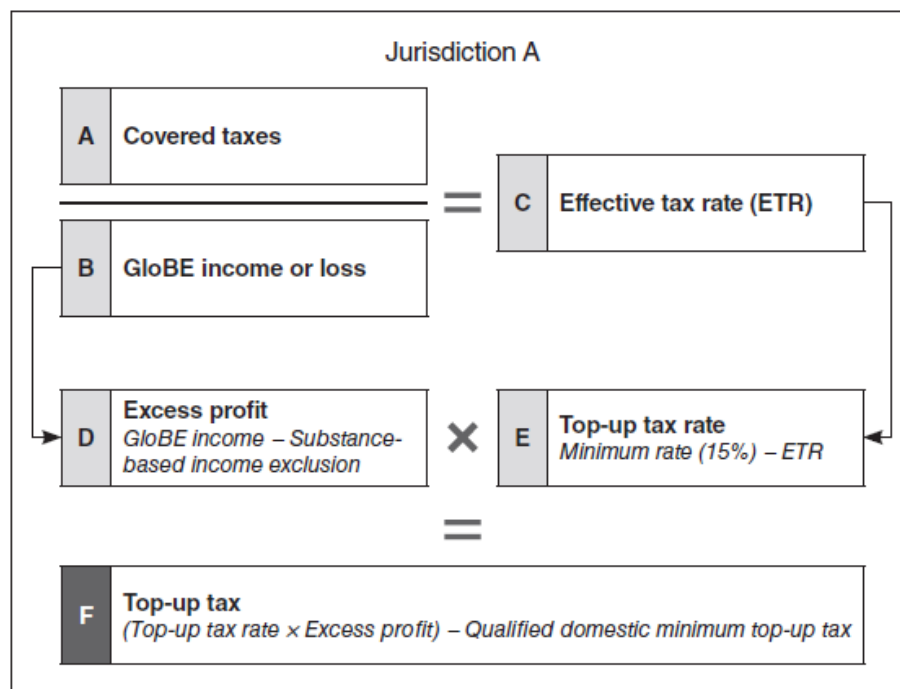
7. The Pillar Two model rules:
- (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and
 - (c) typically require the ultimate parent entity of the group to pay top-up tax—in the jurisdiction in which it is domiciled—with respect to profits of its subsidiaries that are taxed below 15%.
8. The rules generally apply to multinational groups with revenue in their consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal

¹ See further information [here](#).

years. The rules specify inclusion thresholds for some jurisdictions and exclude some types of entities from their scope.

Computation of top-up tax

9. The following figure illustrates the computation of top-up tax in a given jurisdiction:



10. In summary, the Pillar Two model rules specify that:

- (a) *covered taxes* comprise current tax expense in a jurisdiction after adjusting for tax credits and deferred taxes. These adjustments include adding deferred tax expenses capped at 15% (subject to further adjustments). The amount includes income taxes (or taxes in lieu of those) for the fiscal year.
- (b) *Global Anti-Base Erosion (GloBE) income or loss* is the profit or loss in a jurisdiction included in the consolidated financial statement of the ultimate parent entity, before eliminating intragroup items and after making other adjustments (for example, adjusting for some common differences between accounting requirements and tax rules).

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- (c) the *effective tax rate* is calculated by dividing covered taxes by the GloBE income or loss for a jurisdiction. The resulting rate is subtracted from 15% to calculate the *top-up tax rate* for the jurisdiction.
 - (d) *excess profit* is the GloBE income or loss minus the substance-based income exclusion. The substance-based income exclusion is intended to exclude a fixed return for substantive activities in a jurisdiction. Payroll costs and the carrying amount of tangible assets are used as indicators of substantive activities.
 - (e) *top-up tax* is the product of excess profit and the top-up tax rate in a jurisdiction. An entity then reduces that top-up tax by any applicable qualified domestic minimum top-up tax (see paragraph 12).

Charging provisions

- 11. A liability to pay top-up tax may arise under one of two rules, namely:
 - (a) the *income inclusion rule* (IIR) whereby a parent is liable for top-up tax in proportion to its ownership interest in subsidiaries that were taxed below 15%. The ultimate parent entity is primarily liable for top-up tax under the rule but, in some circumstances, intermediate parent entities may be liable.
 - (b) the *UTPR*, which is a backstop mechanism for profits taxed below 15% that are not charged under the IIR.
- 12. Jurisdictions may also introduce a *qualified domestic minimum top-up tax*. This top-up tax is computed on a basis similar to the Pillar Two model rules, but would be charged in the jurisdiction in which the profit arises rather than in the ultimate parent entity's jurisdiction.

Potential implications for income tax accounting

13. Stakeholders informed the IASB of concerns about the implications for income tax accounting resulting from jurisdictions implementing the Pillar Two model rules within a short period of time. Those concerns related to:
- (a) how to account for top-up tax (see paragraphs 14–15);
 - (b) the usefulness of the information that could result from accounting for deferred taxes related to top-up tax (see paragraph 16); and
 - (c) the urgent need for clarity in the light of the imminent enactment of tax law to implement the rules in some jurisdictions (see paragraph 17).

How to apply IAS 12 to account for top-up tax***Scope of IAS 12***

14. Stakeholders generally agree that top-up tax is an income tax—in the scope of IAS 12—in the consolidated financial statements of the ultimate parent entity of a group subject to the Pillar Two model rules. However, they said it was unclear whether top-up tax is an income tax in the financial statements of a group’s subsidiaries—for example, if an entity is liable to pay such tax with respect to profits of entities that are not part of its reporting group (for example, with respect to a fellow subsidiary's profits).

Deferred tax accounting

15. Stakeholders said it is unclear how an entity accounts for deferred taxes related to top-up tax. For example:
- (a) *whether the Pillar Two model rules create additional temporary differences—* is it possible to link directly the recovery or settlement of the carrying amount of assets and liabilities to future top-up tax payments (or the reduction of these payments)? Whether an entity will pay top-up tax will depend on many

factors, including, for example, whether permanent differences arise in the entity's calculation of income taxes under domestic tax regimes.

- (b) *whether to remeasure deferred taxes*—is an entity required to remeasure deferred taxes recognised under domestic tax regimes to reflect potential top-up tax payable under the Pillar Two model rules?
- (c) *which tax rate to use to measure deferred taxes*—which tax rate does an entity use to measure any deferred taxes related to top-up tax, considering that paragraph 47 of IAS 12 requires an entity to use the tax rates that are expected to apply when the asset is realised or the liability is settled? The tax rate that will apply to an entity's excess profit in future periods depends on a number of factors that are difficult—if not impossible—to forecast reliably.

The usefulness of the deferred tax information

16. Some stakeholders questioned the usefulness of the information that would result from recognising deferred taxes related to top-up tax, particularly if an entity is required to estimate the tax rate to apply in measuring these deferred taxes. They said recognising deferred taxes related to top-up tax could be extremely complex and, therefore, the costs of doing so might outweigh the benefits.

Urgent need for clarity

17. IAS 12 requires an entity measuring deferred tax assets and liabilities to reflect tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. Because some jurisdictions are expected to enact tax law to implement the Pillar Two model rules in the first half of 2023, stakeholders said:
- (a) there is little time to resolve the uncertainties about how to apply IAS 12 in accounting for top-up tax; and
 - (b) without further clarification, an entity might incur costs in developing and applying their own interpretations of the requirements in IAS 12, which could result in:

- (i) diversity in the accounting applied by affected entities; and
- (ii) information that is potentially not useful for investors.

Summary of the proposals in the Exposure Draft

18. After considering stakeholders' concerns, the IASB agreed that entities need time to determine how to apply the principles and requirements in IAS 12 to account for deferred taxes related to top-up tax. The IASB also needs time to engage further with stakeholders and consider whether, for example, any action is needed to support the consistent application of IAS 12.
19. Because the rules are expected to be implemented in some jurisdictions in the near term, the IASB concluded that it would not be feasible to complete the activities mentioned in paragraph 18 before new tax laws are expected to be enacted and, consequently, before entities are required to reflect those laws in accounting for deferred taxes.
20. The IASB therefore decided to propose amendments to IAS 12. The proposed amendments would introduce:
 - (a) *a temporary exception to the accounting for deferred taxes* arising from the implementation of the Pillar Two model rules; and
 - (b) *targeted disclosure requirements* including specific information about an entity's potential exposures (before legislation is effective) and current tax expense related to Pillar Two income taxes (after legislation is effective).
21. The IASB concluded that the benefits of the proposed amendments outweigh the costs because the proposed amendments would:
 - (a) provide timely relief for affected entities and would avoid diverse interpretations of IAS 12 developing in practice;

- (b) safeguard the usefulness of the information that results from entities applying IAS 12 until questions about how to apply the Standard have been resolved; and
- (c) improve the information provided to investors before and after Pillar Two legislation is in effect.

22. Agenda papers 12A–12C for this meeting provide further information about the proposals.

Feedback overview

Overview of respondents

23. The IASB received 94 comment letters by the comment letter deadline.² Responses were received from national standard-setters, accountancy bodies, preparers, accounting firms, regulators, individuals (including academics) and investors. The charts below group the responses by type of respondent and geographical region:

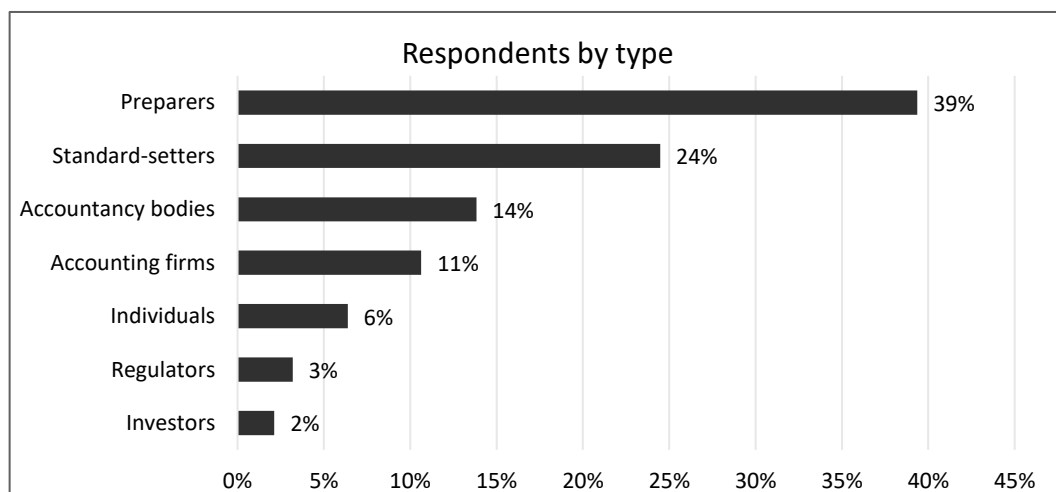


Chart 1— Respondents by type of respondent

² At the date of posting this paper, there were three late comment letters.

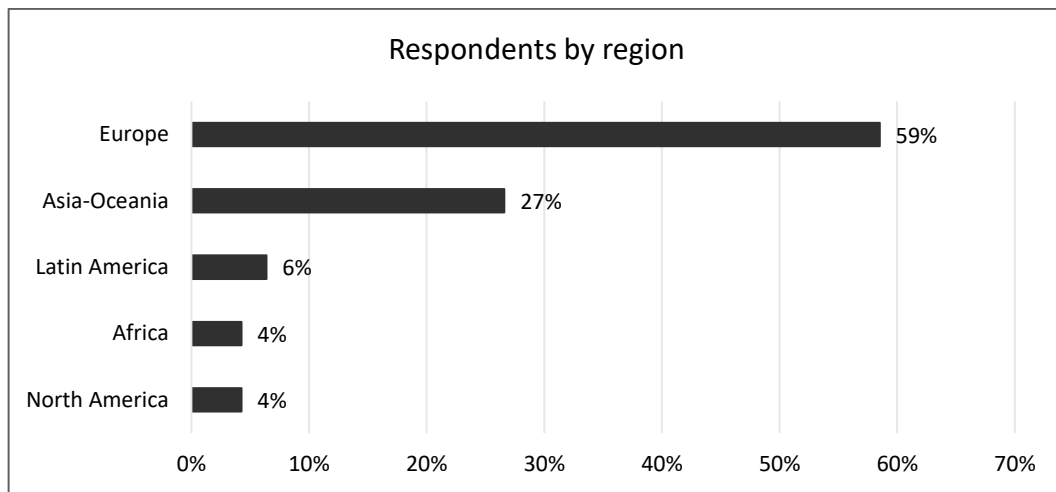


Chart 2— Respondents by geographical region

Summary of feedback

24. The following is a high-level summary of feedback:
- (a) *temporary exception to the accounting for deferred taxes*—almost all respondents agree with the proposed temporary exception. Most of these respondents agree for the reasons set out in the Exposure Draft. However, respondents comments on aspects of the proposal, such as the scope of the temporary exception and the proposal to require an entity to disclose that it has applied the exception.
 - (b) *targeted disclosure requirements*—most respondents agree with the disclosure proposals for periods after legislation is effective. However, respondents expressed mixed views on the disclosure proposals for periods before legislation is effective. In particular:
 - (i) many respondents disagree. In general, these respondents say the proposed disclosures would not result in useful information and would require entities to incur significant costs.
 - (ii) many respondents agree. These respondents either do not raise concerns or generally agree that the proposals achieve the IASB’s objective of requiring entities to disclose information that could

provide insights into an entity's potential exposures to paying Pillar Two income taxes without resulting in undue cost or effort.

- (iii) some respondents neither agree nor disagree but raise similar concerns to those raised by respondents that disagree.

- 25. Agenda Papers 12A–12C provide further information about the feedback.

Feedback from outreach activities

- 26. In addition to feedback in comment letters, we obtained feedback from members of the Global Preparers Forum (GPF) and the Capital Markets Advisory Committee (CMAC) at their meetings in March 2023.
- 27. Agenda Papers 12A–12C include a summary of relevant feedback from these meetings.