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Dr Andreas Barckow
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Our ref RD/288

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Dear Dr Barckow

Comment letter on Exposure Draft ED/2023/3 *International Tax Reform – Pillar Two Model Rules – Proposed amendments to the IFRS for SMEs Standard*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft ED/2023/3 *International Tax Reform – Pillar Two Model Rules – Proposed amendments to the IFRS for SMEs Standard*. We have consulted with, and this letter represents the views of, the KPMG network.

We commend the IASB on promptly undertaking this project in response to significant concerns about the potential challenges for some small and medium-sized entities (SMEs) of accounting for the deferred tax impacts of Pillar Two legislation. We strongly support the proposal to amend the *IFRS for SMEs®* Accounting Standard (SMEs Standard) to introduce a temporary mandatory exception from deferred tax accounting for Pillar Two legislation, which will provide a welcome relief for affected SMEs.

We do, however, suggest an alternative approach to the disclosure requirements to better achieve the IASB's objective of compensating for the potential loss of information resulting from the temporary exception. We include our suggestions in the response to the specific questions raised by the Exposure Draft (see Appendix).

Finally, we note that it is critical to finalise the proposed amendments to the SMEs Standard as quickly as possible, as jurisdictions are actively moving to enact or substantively enact their Pillar Two legislation.

Please contact Reinhard Dotzlaw at reinhard.dotzlaw@kpmgifrg.com or Úna Curtis at una.curtis@kpmg.ie if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix: Responses to specific questions

Question 1—Temporary exception to accounting for deferred taxes (proposed new paragraphs 29.3A and 29.42)
Section 29 Income Tax of the IFRS for SMEs Standard 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 a temporary exception to the requirements in Section 29, an SME neither recognise deferred tax assets and liabilities related to Pillar Two income taxes nor disclose information that would otherwise be required by paragraphs 29.39–29.41 about deferred tax assets and liabilities related to Pillar Two income taxes. The IASB also proposes to require an SME to disclose that it has applied the exception. Paragraphs BC11–BC16 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with these proposals, please explain what you would suggest instead and why.

We support the IASB's proposal to amend the SMEs Standard to provide a temporary exception to the requirements in Section 29, so that an SME neither recognises deferred tax assets and liabilities related to Pillar Two legislation nor discloses information that would otherwise be required by paragraphs 29.39–29.41 about deferred tax assets and liabilities related to Pillar Two legislation. We do, however, recommend including a definition of Pillar Two legislation in the final amendment to promote consistency in the interpretation and application of the exception.

We also support the IASB's proposal to require an SME to disclose that it has applied the exception.

As discussed in our covering letter, we believe these amendments are urgently needed and encourage the IASB to take them forward as quickly as possible.

Question 2—Disclosures (amended paragraph 29.38 and proposed new paragraph 29.43)
This Exposure Draft proposes: (a) to clarify that 'other events' in the disclosure objective in paragraph 29.38 of the Standard include enacted or substantively enacted Pillar Two legislation; and (b) not to introduce new disclosure requirements in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect. Paragraphs BC18–BC20 of the Basis for Conclusions explain the IASB's rationale for these proposals. In periods when Pillar Two legislation is in effect, the IASB proposes to require an SME to disclose separately its current tax expense (income) related to Pillar Two income taxes. Paragraph BC21 of the Basis for Conclusions explains the IASB's rationale for this proposal. Do you agree with these proposals? Why or why not? If you disagree with these proposals, please explain what you would suggest instead and why.

We support the IASB's intended objective of ensuring that the users of the financial statements of SMEs affected by Pillar Two legislation are compensated for the potential loss of information resulting from the temporary exception by having information available to them about the income tax exposures of such enacted (or substantively enacted) legislation in periods before the legislation is in effect. However, we do not believe that the proposed amendment to paragraph 29.38 of the Standard to clarify that 'other events' include enacted or substantively enacted Pillar Two legislation achieves this objective. We are also concerned that the proposed changes may cause confusion.

The IASB's proposed clarification is included in a sentence that discusses current or deferred tax consequences of recognised transactions and other events. In the periods before the new Pillar Two legislation is in effect, there will be no current nor deferred tax consequences arising from it. Furthermore, because paragraph 29.38 specifically refers to disclosing information about deferred tax consequences, it directly contradicts the exemption proposed in 29.3A. Rather than risk confusion, we recommend deleting the words in brackets that the Exposure Draft proposes to add to 29.38 and instead creating an additional paragraph (to be numbered 29.38A) as follows:

> *29.38 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events ~~(such as enacted or substantively enacted Pillar Two legislation)~~.*

<u>*29.38A In complying with 29.38, an entity shall disclose information that enables users of its financial statements to evaluate its income tax exposure as a result of enacted or substantively enacted Pillar Two legislation before it becomes effective*</u>.

Question 3—Effective date and transition (proposed new paragraph A4)
The IASB proposes that an SME apply: (a) the exception (proposed new paragraph 29.3A)—and disclose it has applied the exception (proposed new paragraph 29.42)—immediately upon the issue of these amendments and retrospectively in accordance with Section 10 Accounting Policies, Estimates and Errors of the IFRS for SMEs Standard; (b) the amended paragraph 35.10(h) immediately upon the issue of these amendments; and (c) the disclosure requirement in proposed new paragraph 29.43 for annual reporting periods beginning on or after 1 January 2023. Paragraphs BC23–BC25 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with these proposals, please explain what you would suggest instead and why.

We agree with the IASB's proposals relating to the effective date and transition of the proposed amendments.