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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/2023/1 *International Tax Reform – Pillar Two Model Rules – Proposed amendments to IAS 12 Income Taxes*

We appreciate the opportunity to comment on the International Accounting Standards Board's ('IASB') Exposure Draft ED/2023/1 *International Tax Reform – Pillar Two Model Rules – Proposed amendments to IAS 12* ('the ED'). 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 potential challenges of accounting for deferred tax impacts of the Pillar Two taxes. We strongly support the proposal to amend IAS 12 to introduce a temporary mandatory exception from deferred tax accounting for Pillar Two taxes, which will provide a welcome relief. We also support the proposed new disclosure requirements to compensate for the potential loss of information resulting from the temporary exception.

We note that comments have been raised about the clarity of some of the proposals, particularly in relation to their application in the separate financial statements or the consolidated financial statements of a sub-group. Therefore, we have included some suggestions for clarifications in the Appendix to this letter that can be made without potentially delaying the finalisation of this project.

We note that it is critical to finalise the proposed amendments to IAS 12 as quickly as possible, because some jurisdictions may enact or substantively enact their Pillar Two tax laws before 31 March 2023 and a number of jurisdictions are expected to do so before 30 June 2023.

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Please contact Reinhard Dotzlaw at reinhard.dotzlaw@kpmgifrg.com or Fred Versteeg at Versteeg.Fred@kpmg.nl 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 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.

We strongly support the proposal to amend IAS 12 to introduce a temporary mandatory exception from deferred tax accounting for Pillar Two taxes, which will provide a welcome relief.

We also agree with specifying that *all* Pillar Two taxes are in the scope of IAS 12. We note that there are four mechanisms that tax authorities can adopt under Pillar Two – Income Inclusion Rule (IIR), Undertaxed Payment Rule (UTPR), Qualifying Domestic Minimum Top-up Tax (QDMTT) and Subject to Tax Rule (STTR – under development) – and believe that all four mechanisms would pose challenges in relation to deferred tax accounting under IAS 12. Therefore, it is important to ensure that all four are covered by the proposed relief.

We understand, based on our reading of the proposed paragraph 4A accompanied by paragraph BC9 in the Basis for Conclusions, that the proposed amendments would apply to Pillar Two taxes that meet the definition on an income tax. However, the proposals are not intended to address a question of whether all Pillar Two taxes would be income taxes in the scope of IAS 12 in *all* financial statements prepared under IFRS Accounting Standards, including the separate financial statements and the consolidated financial statements of a sub-group. We appreciate that the scope of the project was intended to be sufficiently narrow to allow the IASB to progress it quickly. However, we strongly recommend specifying that all Pillar Two taxes would be income taxes in the scope of IAS 12 in all financial statements prepared under IFRS Accounting Standards. This would result in greater comparability between entities' financial statements and more useful information for the users. This can be done simply by removing the word 'income' from the first sentence in paragraph 4A – i.e. this paragraph applies to ~~income~~ taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules etc.

Question 2—Disclosure (paragraphs 88B–88C)

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.

We support the proposed new disclosure requirements to compensate for the potential loss of information resulting from the temporary mandatory exception. We note that some of the information may already be prepared by entities to comply with the existing requirements in IAS 12.

Questions have been raised about whether and how the proposed disclosure requirements should be applied in the separate financial statements or the consolidated financial statements of a sub-group – i.e. whether each entity in the group that may be potentially subject to the top-up tax is required to provide the proposed disclosures even if it is not expected to be legally liable for the top-up tax nor triggers it. Similar questions have been raised about the extent of the disclosure to be provided under paragraph 88C(a) – i.e. whether an entity is required to provide the *full* list of jurisdictions in which it operates with information about the status of Pillar Two legislation.

In addition, questions have been raised about the application of the proposed disclosure requirements during the transition period, because different countries may implement the new Pillar Two tax laws at different dates and the liability for the top-up tax may move up or down the group structure. For example, there may be scenarios in which an intermediate entity is liable for the top-up tax at the interim reporting date, but the ultimate parent entity is liable for it at the annual reporting date.

We recommend clarifying – e.g. in the Basis for Conclusions – the underlying principle to use in determining which group entities need to provide the proposed disclosures in their separate financial statements, the consolidated financial statements of a sub-group and during the transition period, and the extent of such disclosures. The underlying principle may be based on paragraph 31 of IAS 1 *Presentation of Financial Statements* which specifies that an entity does not need to provide a specific disclosure required by an IFRS standard if the information resulting from that disclosure is not material. Applying this principle, an entity would need to consider what information is relevant to the users of these specific sets of financial statements in understanding the potential exposure of that entity as a result of the Pillar Two tax legislation. For example, information provided by entities who expect to be liable for top-up tax (either during the transition period or when the new rules are 'business as usual' around the world) or expect to trigger top-up tax may be relevant to the users of their separate financial statements. Conversely, if a group entity does not expect to be liable for top-up tax nor expects to trigger it, then information about other entities in the group may obscure the relevant information in its separate financial statements.

Question 3—Effective date and transition (paragraph 98M)

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 the amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and

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

Paragraphs BC27–BC28 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.

We support the proposals related to the effective date and transition and do not have any comments.