UKEB
UK Endorsement Board

Dr Andreas Barckow
Chairman
International Accounting Standards Board
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[7 March 2023]

Dear Dr Barckow

Exposure Draft ED/2023/1 International Tax Reform – Pillar Two Model Rules: Proposed amendments to IAS 12

1. The UK Endorsement Board (the UKEB) is responsible for endorsement and adoption of IFRS for use in the UK and therefore is the UK's National Standard Setter for IFRS. The UKEB also leads the UK's engagement with the IFRS Foundation on the development of new standards, amendments and interpretations. This letter is intended to contribute to the Foundation's due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended International Accounting Standards undertaken by the UKEB.

2. There are currently approximately 1,500 entities with equity listed on the London Stock Exchange that prepare their financial statements in accordance with IFRS Standards.[1] In addition, UK law allows unlisted companies the option to use IFRS and approximately 14,000 such companies currently take up this option.[2]

3. We welcome the opportunity to provide comment on the International Accounting Standards Board (IASB) Exposure Draft (ED) *International Tax Reform: Pillar Two Model Rules* (the Amendments). In developing this letter, we have consulted with a number of stakeholders, including preparers, accounting firms and institutes and users of accounts.

4. We support the IASB's objectives as well as the accelerated timetable for the development of the Amendments. In the light of the uncertainties surrounding the application of IAS 12 *Income Taxes* to Pillar Two income taxes, and in particular

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[1] UKEB calculation based on LSEG and Eikon data. This calculation includes companies listed on the Main market as well as on the Alternative Investment Market (AIM).
[2] UKEB estimate based on FAME, Companies Watch and other proprietary data.

the challenges in accounting for deferred tax arising from the Pillar Two model rules, we consider it important to provide clarity and minimise the risk of diversity in accounting practice as quickly as possible.

Accelerated timetable

5. We agree that the project needs to be treated as urgent. Pillar Two legislation is already in the process of being enacted in multiple jurisdictions. In the UK, legislation implementing Pillar Two model rules (enacting both the Income Inclusion Rule (IIR) and a Domestic Minimum Tax (DMT)) is expected to be laid in the next Finance Bill. While parliamentary timetables are inherently uncertain, this legislation is currently expected to be substantively enacted[3] before the House of Commons goes into its summer recess (provisionally scheduled for 20 July 2023). In the UK, both the IIR and DMT are expected to apply to financial accounting periods beginning on or after 31 December 2023.

6. Given this expected timetable for substantive enactment of the legislation in the UK, absent the Amendments, UK entities may need to reflect Pillar Two income taxes in their deferred tax accounting from mid-2023 onwards. This could affect the interim accounts of entities with December year ends and the annual accounts of entities with year ends from May 2023 onwards. Provisional data indicates there are at least ten listed and a number of unlisted IFRS reporters in the UK with May or June year ends that are likely to be within the scope of the Pillar Two model rules.

7. The UKEB would need to ensure that the Amendments are endorsed before those groups are able to use the proposed exception from deferred tax accounting. Consequently, the UKEB welcomes the IASB's accelerated timetable.

Mandatory temporary exception and 'sunset clause'

8. We agree with the introduction of a mandatory exception from accounting for deferred tax arising from the Pillar Two model rules and agree that the mandatory exception should be temporary. We also agree with the absence of a 'sunset clause'. This will allow the IASB to consider whether and, if so, how Pillar Two income taxes should be addressed within IAS 12 without undue pressure.

9. However, we consider that the IASB should commit to reviewing these Amendments, once stakeholders have developed experience of the tax requirements and have been able to consider the implications for deferred tax accounting.

[3] In the UK, 'substantive enactment' is generally taken to be when a Finance Bill has been passed by the House of Commons and is awaiting only passage through the House of Lords and Royal Assent.

DRAFT

Detailed comments on ED proposals

10. As stated above, the UKEB supports the objectives of the Amendments. We recognise that the IASB has sought to require disclosures that will provide insight into an entity's potential exposure to Pillar Two top-up taxes without resulting in undue cost or effort for preparers. We also appreciate that the disclosures required during the period when the tax is substantively enacted but not yet effective are likely to have a maximum lifespan of one or two years. However, based on our analysis and on our outreach to-date with UK stakeholders, we are concerned that the proposed disclosure requirements may be unhelpful and, potentially, misleading. Nevertheless, we strongly recommend the IASB does not delay the publication of the Amendment solely to perfect these disclosures.

11. We have answered the ED's specific questions in the Appendix to this letter. Our main recommendations are set out in the following paragraphs.

Disclosures in the period when the Pillar Two rules are enacted or substantively enacted, but not yet in effect

12. ED paragraph 88C(b) and (c) require:

"In periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity shall disclose for the current period only: [...]

(b) the jurisdictions in which the entity's average effective tax rate (calculated as specified in paragraph 86) for the current period is below 15%. The entity shall also disclose the tax expense (income) and accounting profit 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."

13. UK preparers and accounting firms expressed concerns that paragraph 88C (b) may result in qualitative and quantitative information that does not meet the objective expressed at BC19. They commented that the jurisdictional effective tax rate on an IAS 12 basis could be a poor proxy for the jurisdictional effective tax rate on a Pillar Two basis. We understand that the disclosures under paragraph 88C (c) are designed to indicate cases when an entity is aware that the information provided under paragraph 88C (b) may be insufficient in isolation.

DRAFT

However, stakeholders expressed concerns that 88C (c) does not provide a sufficient corrective, since it does not require any quantitative, or other detailed information.

General disclosure requirement

14. Given the challenges and concerns noted above, we recommend that the IASB considers replacing the detailed requirements in paragraph 88C with the disclosure objective, namely to help users of the accounts assess the entity's current and future exposure to paying top-up tax, based on assessments the entity has made in preparing to comply with Pillar Two legislation. This requirement could then be accompanied by some illustrative examples of how entities may meet that disclosure objective, possibly as educational guidance developed after the publication of the Amendments.

15. As different parts of the Pillar Two model rules are enacted and then become effective around the world, groups will have to report on many different economic and legal scenarios. The disclosures required during the period when the tax is substantively enacted but not yet effective are likely to have a short lifespan. A more flexible requirement, along the lines of our suggestion here, could facilitate the provision of relevant information tailored to an entity's need as their circumstances evolve over time. Additionally, it may be more appropriate than specific detailed requirements which may not meet the overall disclosure objective in all scenarios.

16. IAS 8 paragraphs 30 and 31 offer a precedent for entities to disclose known or reasonably estimable information relevant to assessing the possible impact of future events. They are applied in the context of the introduction of a new accounting standard. We consider that this context is similar, in that users need forward-looking information in respect of new regulatory requirements, albeit for taxation rather than accounting.

17. For example, a general disclosure requirement could include wording such as: "*An entity shall provide information, based on the assessments it has made to date in preparing to comply with Pillar Two legislation, to enable users to assess an entity's current and future exposure to paying Pillar Two top-up tax, the jurisdictions that are the primary cause of such exposure and, to the extent a reliable estimate can be made, the expected quantitative impact*".

18. We suggest that these general disclosure requirements should remain in place for the life of the temporary exception but should be reconsidered when the IASB reviews the Amendments, once most jurisdictions have implemented the Pillar Two model rules.

19. Should the IASB decide to retain 88C (a), (b) and (c) as drafted, we recommend that the IASB incorporates the objective of the disclosure requirement, i.e. "*to help users assess an entity's exposure to paying top-up tax*" (ED/2023/01 paragraph

DRAFT

BC19) in the disclosure requirement itself at paragraph 88C. In accordance with the findings of the IASB project *Disclosure Initiative–Principles of Disclosure,* including the objective of the disclosure would assist preparers and auditors in making judgements about what information users would find most relevant.

20. We further recommend that the IASB complements the general disclosure objective with educational guidance and examples of the kinds of disclosure it expects from preparers to ensure consistency and quality of disclosure. However, we would not wish the Board to delay publication of the Amendments to produce such guidance.

21. We support the IASB's proposals regarding disclosures in periods in which Pillar Two legislation is in effect and regarding the effective date and transition.

22. If you have any questions about this response, please contact the project team at UKEndorsementBoard@endorsement-board.uk.

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

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Appendix 1 Questions on ED *International Tax Reform: Pillar Two Model Rules*

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.

A1. For the reasons set out in the Basis for Conclusions, we support the proposed approach of requiring entities to neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

A2. We consider that this requirement will enhance the comparability of financial statements whilst providing entities with relief from the cost and complexities of deferred tax accounting in relation to Pillar Two income taxes.

A3. We agree with the introduction of a mandatory exception from accounting for deferred tax arising from the Pillar Two model rules and agree that the mandatory exception should be temporary. We also agree with the absence of a 'sunset clause'. This will allow the IASB to consider whether and, if so, how Pillar Two income taxes should be addressed within IAS 12 without undue pressure.

A4. However, we consider that the IASB should commit to reviewing these Amendments, once stakeholders have developed experience of the tax requirements and have been able to consider the implications for deferred tax accounting.

A5. Furthermore, we support the requirement for entities to state that they have applied the mandatory exception. We consider that this disclosure requirement

DRAFT

will provide clarity over the accounting approach taken and increase users' confidence in the comparability of the financial statements.

A6. IAS 12 applies to accounting for income taxes.[4] Paragraph BC9 of the ED observes: "*Stakeholders generally agree that top-up tax is an income tax – in the scope of IAS 12 Income Taxes – in the consolidated financial statements of the ultimate parent entity of a group subject to the Pillar Two model rules. However, they have said that it is unclear whether top-up tax is an income tax in the financial statements of a group's subsidiaries […]*". However, while the Amendments may be interpreted as implying that all taxes arising from Pillar Two are income taxes in the scope of IAS 12, the Amendments do not provide an explicit statement to that effect. This may risk increasing diversity in practice in the financial statements of a group's subsidiaries, thereby reducing the comparability of financial statements.

A7. In order to provide clarity in this area, the IASB could consider removing the word "*income*" from the first sentence in paragraph 4A, so that it reads "*This Standard applies to ~~income~~ taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules […]*".

A8. We also consider that paragraphs 88B and 88C could clarify that the Amendments require a reporting entity to disclose any exposure to top-up tax, even if that exposure arises in respect of a fellow subsidiary not within its control, for example.

DRAFT

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

[4] IAS 12 paragraph 2 states that "*For the purposes of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits.*"

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.

Disclosures in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect

A9. We support the introduction of requirements for entities to disclose their exposure to Pillar Two income taxes once legislation is enacted or substantively enacted but not yet in effect. We consider that this requirement will go some way to mitigating the absence of deferred tax accounting for Pillar Two income taxes. However, we do not recommend the IASB to delay the publication of the Amendments solely to perfect these disclosures.

A10. UK stakeholders agreed that the key objective of the disclosures should be to provide users of accounts with an indication of groups' exposure to paying additional (top-up) taxes. Based on paragraph BC19, this appears to be the overall objective of the disclosures in paragraph 88C. We understand that detailed quantitative information about an entity's exposure to Pillar Two income taxes will not initially be available because of the requirement to produce financial statements significantly ahead of the first Pillar Two return. Therefore, we agree that the IASB has sought to require disclosures that will provide insight without resulting in undue cost or effort.

A11. Preparers we spoke to raised no concerns over their practical ability to provide the proposed disclosures under paragraph 88C. However, stakeholders (particularly preparers) expressed concerns that, as drafted, those disclosures may not be sufficient to achieve the objective and, at worst, could be misleading (see paragraphs A14 to A16 below).

Paragraph 88C (a)

A12. UK stakeholders questioned the clarity of **paragraph 88C (a)** – for example, what does 'information about legislation' mean? They considered that the requirement in its current form would likely lead to disclosure of varying quality and potentially to lengthy disclosure of little informational value. Preparers were particularly concerned that the requirement does not appear to allow for the exercise of

DRAFT

materiality judgements in the provision of this information (for example, regarding an entity's operations in each relevant jurisdiction).

A13. For example, if a parent company's jurisdiction has enacted the Pillar Two Income Inclusion Rule, information about legislation enacted but not yet effective in subsidiary jurisdictions could be of minimal relevance from a group perspective. Nevertheless, such disclosure could appear to be required by 88C (a). We recognise, therefore, that entities and auditors will need to use judgement when meeting this requirement. We suggest incorporating a disclosure objective as explained below.

Paragraphs 88C (b) and (c)

A14. UK preparers and accounting firms expressed concerns that **paragraph 88C (b)** may provide qualitative and quantitative information that does not meet the objective expressed at BC19. They commented that the jurisdictional effective tax rate calculated on an IAS 12 basis could be a poor proxy for the jurisdictional effective tax rate calculated on a Pillar Two basis.[5]

A15. We understand that the disclosures under **paragraph 88C (c)** are designed to indicate cases when an entity is aware that the information provided under 88C (b) may be insufficient in isolation. UK preparers commented that the existence of 88C (c) highlights the inadequacy of the IAS 12 paragraph 86 effective tax rate as a proxy. Further, preparers expressed concerns that paragraph 88C (c) does not provide a sufficient corrective, since it does not require any quantitative, or other detailed information.

A16. First, if an entity has not completed its Pillar Two assessments, it might provide no information under 88C (c) at all. In addition, 88C (c) does not require any quantitative or other detailed information. Listing jurisdictions under paragraph 88C (c) would not give any indication as to the quantum of tax exposure in the relevant jurisdictions, so even with this additional information the disclosure under 88C (b) could be insufficient.

General disclosure requirement

A17. Given the challenges and concerns noted above, we recommend that the IASB considers replacing the detailed requirements in paragraph 88C with a more general requirement to provide information sufficient to meet the objective, namely to help users of the accounts assess the entity's current and future exposure to paying top-up tax, based on assessments the entity has made in preparing to comply with Pillar Two legislation. This requirement could then be

[5] For example, we have been told that a group could have an effective tax rate, calculated under IAS 12 paragraph 86, in a jurisdiction that is under 15% for specific reasons, such as a significant asset disposal which is exempt under a substantial shareholding rule or a participation exemption. Such a transaction would lower the jurisdictional effective tax rate under IAS 12 paragraph 86 but, we were informed, would not affect the group's jurisdictional effective tax rate for Pillar Two purposes.

DRAFT

accompanied by some illustrative examples of how entities may meet that disclosure objective, possibly as educational guidance developed after the publication of the Amendments.

A18. As different parts of the Pillar Two model rules are enacted and then become effective around the world, groups will have to report on many different economic and legal scenarios. The disclosures required during the period when the tax is substantively enacted but not yet effective are likely to have a maximum lifespan of one or two years. A more flexible requirement, along the lines of our suggestion here, could facilitate the provision of relevant information tailored to an entity's need as their circumstances evolve over time. Additionally, it may be more appropriate than specific detailed requirements which may not meet the overall disclosure objective in all scenarios.

A19. IAS 8 paragraphs 30 and 31 offer a precedent for entities to disclose known or reasonably estimable information relevant to assessing the possible impact of future events. They are applied in the context of the introduction of a new accounting standard. We consider that this context is similar, in that users need forward-looking information in respect of new regulatory requirements, albeit for taxation rather than accounting.

A20. For example, a general disclosure requirement could include wording such as: "*An entity shall provide information, based on the assessments it has made to date in preparing to comply with Pillar Two legislation, to enable users to assess an entity's current and future exposure to paying Pillar Two top-up tax, the jurisdictions that are the primary cause of such exposure and, to the extent a reliable estimate can be made, the expected quantitative impact*".

A21. We suggest that these general disclosure requirements should remain in place for the life of the temporary exception, but should be reconsidered when the IASB reviews the Amendments, once most jurisdictions have implemented the Pillar Two model rules.

A22. Should the IASB decide to retain 88C (a), (b) and (c) as drafted, we recommend that the IASB incorporates the objective of the disclosure requirement, i.e. "*to help users assess an entity's exposure to paying top-up tax*" (ED/2023/01 paragraph BC19) in the disclosure requirement itself at paragraph 88C. In accordance with the findings of the IASB project *Disclosure Initiative–Principles of Disclosure*, including the objective of the disclosure would assist preparers and auditors in making judgements about what information users would find most relevant.

A23. We further recommend that the IASB complements the general disclosure objective with educational guidance and examples of the kinds of disclosure it expects from preparers to ensure consistency and quality of disclosure. However, we would not wish the Board to delay publication of the Amendments to produce such guidance.

DRAFT

Disclosures in periods in which Pillar Two legislation is in effect

A24. We support the proposed requirement for entities to disclose their current tax expense in relation to Pillar Two income taxes separately, once Pillar Two is effective. We consider that separate disclosure will provide useful information on the impact of this new international tax, usefully compensating also for the temporary exception from deferred tax accounting for Pillar Two income taxes.

A25. However, IAS 12 has not previously required separate disclosure of a specific tax. We therefore recommend that the IASB includes the rationale for requiring this disclosure – which will be ongoing – within the Basis for Conclusions.

A26. UK preparers noted that paragraphs 88C (a), (b) and (c) require detail on the jurisdiction-by-jurisdiction impact of the Pillar Two model rules during the period between the Pillar Two model rules being enacted and coming into effect. This information exceeds the information required once Pillar Two legislation is in effect. UK preparers thought that the reason for requiring this additional detail for a short interim period only was unclear. They were concerned that the reduction in detail once Pillar Two was effective could be perceived as a lack of transparency.

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.

A27. We agree with the IASB's proposals regarding the effective date and transition.

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