

# IAS 12 Income Taxes

## — Basis for Conclusions (Abridged)

*This Basis for Conclusions accompanies, but is not part of, IAS 12.*

*Following are the paragraphs from the IASB's Basis for Conclusions on IAS 12 necessary to understand the 2023 amendments.*

### **International Tax Reform—Pillar Two Model Rules (2023 amendments)**

BC96 In May 2023, the IASB issued *International Tax Reform—Pillar Two Model Rules*. The amendments introduced:

- (a) a temporary exception to the requirements to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes; and
- (b) targeted disclosure requirements for affected entities.

### **Background**

#### **Pillar Two model rules**

BC97 In October 2021, more than 135 jurisdictions agreed to the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting's *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. Since then, the OECD has published model rules and other documents related to the second pillar of this solution (the Pillar Two model rules).

BC98 The Pillar Two model rules provide a template that jurisdictions can translate into domestic tax law and implement as part of an agreed common approach. The 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 a group to pay top-up tax—in the jurisdiction in which it is domiciled—on profits of its subsidiaries that are taxed below 15%.

### **Potential implications for income tax accounting**

BC99 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) *the scope of IAS 12*—stakeholders were generally of the view that top-up tax is an income tax—and therefore within the scope of IAS 12—in the consolidated financial statements of the ultimate parent entity of a group subject to the rules. However, stakeholders 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 (such as with respect to a fellow subsidiary's profits).
- (b) *the accounting for deferred taxes*—stakeholders said it was unclear how an entity would account for deferred taxes related to top-up tax. For example, they asked:
  - (i) do the rules create additional temporary differences? In particular, 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 to the reduction of these payments)?
  - (ii) should an entity remeasure deferred taxes recognised under domestic tax regimes to reflect potential top-up tax payable under the Pillar Two model rules?
  - (iii) which tax rate should an entity use to measure deferred taxes related to top-up tax, considering that paragraph 47 of IAS 12 requires an entity to use the tax rates expected to apply in future periods? The tax rates that will apply in these periods depend on several factors that are difficult—if not impossible—to forecast reliably.
- (c) *the usefulness of deferred tax information*—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.
- (d) *the urgent need for clarity*—stakeholders said there was little time to resolve the uncertainties about how to apply IAS 12 in accounting for top-up tax given the imminent implementation of the rules in some jurisdictions. This

lack of clarity would result in diversity in the accounting applied by affected entities and information that is potentially not useful.

### **Temporary exception to deferred tax accounting**

BC100 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 to consider whether any action is needed to support the consistent application of IAS 12. The IASB concluded that it was not feasible to complete these activities before jurisdictions enact new tax laws and thus before entities are required to reflect those laws in accounting for deferred taxes.

BC101 The IASB therefore decided 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. The IASB concluded that doing so would:

- (a) provide affected entities with relief from accounting for deferred tax assets and liabilities in relation to complex new tax legislation to be enacted by multiple jurisdictions in a short period of time;
- (b) avoid the development of diverse interpretations of IAS 12 and the resulting inconsistent application of the Standard; and
- (c) allow time for stakeholders to assess how the Pillar Two model rules have been implemented in different jurisdictions, for entities to assess how they are affected and for the IASB to consider whether to do further work.

BC102 The IASB also decided to require an entity to disclose that it has applied the temporary exception. The IASB concluded that this requirement would:

- (a) provide entity-specific information because some entities are unaffected by Pillar Two legislation and, therefore, would not apply the exception; and
- (b) make the exception's application transparent to users of financial statements during the periods in which it is applied.

### **Scope**

BC103 The IASB decided not to provide further clarifications or guidance on the circumstances in which top-up tax is an income tax (see paragraph BC99(a)). The IASB concluded that it would not be possible to do so without delaying the finalisation of amendments that were urgently needed. The IASB also decided not to require entities to deem top-up tax to be an income tax in all circumstances because that could have resulted in unintended consequences. Therefore, an entity determines whether, in its circumstances, top-up tax is an income tax before applying the requirements in IAS 12.

BC104 The IASB decided it was unnecessary to expand the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes. The IASB concluded that an entity would not remeasure such deferred taxes to reflect Pillar Two income taxes it expects to pay when recovering or settling a related asset or liability because the temporary exception applies to deferred tax assets and liabilities related to such income taxes.

### **Mandatory application**

BC105 The IASB decided to make the application of the temporary exception mandatory because doing so would:

- (a) result in greater comparability between entities' financial statements and, therefore, more useful information for users of financial statements; and
- (b) eliminate the risk of entities inadvertently developing accounting policies that are inconsistent with the principles and requirements in IAS 12.

### **Duration**

BC106 The IASB concluded that it was not possible to determine how much time would be required for the activities described in paragraph BC100 because they would depend on how and when jurisdictions implement the Pillar Two model rules. Therefore, the IASB decided not to specify how long the temporary exception will be in place. The IASB also decided to monitor developments related to the implementation of the Pillar Two model rules to determine when to do further work.

### **Disclosures**

#### **Periods before legislation is in effect**

##### *Disclosure objective*

BC107 In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, users of financial statements need information that helps them understand an entity's exposure to Pillar Two income taxes arising from that legislation. In these periods, the enacted legislation could create exposures that are not yet reflected in the entity's income tax expense for the period, and users might be unable to understand such exposures from other information an entity discloses in its financial statements. Accordingly, the IASB decided to set a disclosure objective based on this information need.

##### *Information that meets the disclosure objective*

BC108 The IASB considered that an entity was likely to be in the process of assessing its exposure and preparing to comply with Pillar Two legislation in periods in which the legislation is enacted or substantively enacted but not yet in effect. Requiring an entity to disclose information reflecting all the specific requirements of the legislation would either not be feasible or be likely to result in undue cost or effort. Consequently, when it exposed draft amendments for comment, the IASB proposed requiring an entity to disclose specific items of information based on the requirements in IAS 12. However, feedback suggested the benefits of disclosing such information might not outweigh the costs of preparing it, particularly because:

- (a) information based on the requirements in IAS 12 differs from that based on the requirements of the Pillar Two model rules. Respondents expressed mixed views about the usefulness of information based on the requirements in IAS 12 for the purpose of informing users of financial statements about an entity's exposure to Pillar Two income taxes. Some respondents said the information could be misleading, and that entities might be able and prefer to disclose information available from assessments about their exposure.
- (b) the disclosure requirements are expected to apply to only a few reporting periods. Respondents said the benefits of providing information based on IAS 12 requirements for only a few reporting periods might not outweigh the costs an entity would incur to prepare that information (for example, the costs of setting up new processes).

BC109 In considering this feedback, the IASB observed that legislation in some jurisdictions was expected to be effective as early as 1 January 2024. Therefore, the IASB expected many entities to have some information about their exposure available to them by the time the disclosure requirements are applicable. For example, some entities might have already made significant progress in assessing their exposure and might be preparing to account for Pillar Two income taxes in their current tax accounting.

BC110 To balance the factors discussed in paragraphs BC108–BC109, the IASB decided:

- (a) to require an entity to disclose information that meets the disclosure objective, but not to specify the items of information an entity is required to disclose or the basis on which the entity prepares that information. This approach would allow an entity to disclose information that is available from its assessments and that reflects its circumstances, which will vary from entity to entity.
- (b) to require an entity to disclose known or reasonably estimable information. The IASB concluded that this approach is similar to the requirements in paragraphs 30–31 of IAS 8, which apply in a comparable situation. To the extent information is not known or reasonably estimable, the IASB decided to require an entity to disclose instead a statement to that effect and to disclose information about the entity's progress in assessing its exposure. The IASB concluded that this information would help users of financial statements understand why the entity is unable to disclose further information.

BC111 Some IASB members were concerned that requiring an entity to disclose only known or reasonably estimable information could result in some entities disclosing no quantitative information to meet the disclosure objective. Nonetheless, having considered the feedback, some IASB members expected that, by the time the disclosure requirements are applicable, many entities are likely to have available to them some known or reasonably estimable information. After considering those views, a majority of IASB members concluded that such a requirement appropriately balances meeting users' information needs with the cost of reporting such information.

BC112 The IASB also decided to require that, to meet the disclosure objective, an entity shall disclose:

- (a) information that is both qualitative and quantitative in nature. The IASB considered feedback from users of financial statements that indicated that they need both qualitative and quantitative information to understand an entity's exposure to Pillar Two income taxes. The IASB included examples of qualitative and quantitative information to help an entity understand the type of information it can provide to meet the disclosure objective.
- (b) information based on an entity's circumstances at the end of the reporting period. The IASB concluded that an entity would not have to disclose information about possible future transactions and other possible future events (forward-looking information) to meet this requirement. For example, an entity would not be required to forecast future profits, reflect mitigation actions it expects to take in future periods, or consider possible future changes in tax legislation.

BC113 Furthermore, the IASB clarified that the information an entity is required to disclose to meet the disclosure objective does not have to reflect all the specific requirements of the Pillar Two legislation and can be provided in the form of an indicative range. The IASB concluded that the information an entity discloses to meet the disclosure objective would be useful even if:

- (a) it is prepared on a simplified basis that does not reflect all the specific requirements of the legislation; and
- (b) it lacks a high level of precision.

#### **Periods when legislation is in effect**

BC114 The IASB decided to require an entity to disclose separately the current tax expense related to Pillar Two income taxes. The IASB concluded that this information:

- (a) would help users of financial statements understand the magnitude of Pillar Two income taxes relative to an entity's overall tax expense; and

- (b) would not be costly to prepare because an entity would already be required to recognise current tax related to Pillar Two income taxes.

### **Effects analysis**

BC115 The IASB concluded that the benefits of the amendments outweigh the costs because the amendments:

- (a) provide timely relief for affected entities and avoid diverse interpretations of IAS 12 developing in practice;
- (b) safeguard the usefulness of information prepared applying IAS 12 requirements until questions about how to apply the Standard have been resolved; and
- (c) improve the information provided to users of financial statements before and after Pillar Two legislation is in effect.

### **Transition**

BC116 The IASB concluded that:

- (a) for the temporary exception to be effective, it needs to be available to entities immediately upon the issue of the amendments; and
- (b) requiring an entity to apply the disclosure requirements in paragraphs 88B–88D for annual reporting periods beginning on or after 1 January 2023—but not for interim periods ending on or before 31 December 2023—provides an entity with enough time to prepare the required information.

BC117 The IASB decided to require an entity to apply the temporary exception retrospectively. This requirement would result in an entity applying the exception from the date Pillar Two legislation is enacted or substantively enacted—even if that date is before the date of issuing the amendments—and would not result in additional costs.

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