



Need to know

IASB amends IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from OECD Pillar Two model rules

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This *Need to know* outlines the amendments to IAS 12 *Income Taxes* titled *International Tax Reform—Pillar Two Model Rules*, published by the International Accounting Standards Board (IASB) in May 2023.

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- The IASB published amendments to IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from the implementation of the OECD Pillar Two model rules, together with targeted disclosure requirements for affected entities.
- Applying the exception, an entity does not recognise deferred tax assets and liabilities related to the OECD Pillar Two income taxes. It also does not disclose any information about these deferred tax assets and liabilities.
- In periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity is required to disclose known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.
- The amendments require that an entity applies the exception—and the requirement to disclose that it has applied the exception—immediately upon issuance of the amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The remaining disclosure requirements are required for annual reporting periods beginning on or after 1 January 2023. The amendments are subject to endorsement for use in the UK, please refer to the observation related to effective date and transition below.

Background

In March 2022, the Organisation for Economic Co-operation and Development (OECD) released **technical guidance** on its 15% global minimum tax agreed as the second 'pillar' of a project to address the tax challenges arising from digitalisation of the economy. This guidance elaborates on the application and operation of the Global Anti-Base Erosion (GloBE) Rules **agreed and released in December 2021** which lay out a co-ordinated system to ensure that multinational enterprises with revenues above €750 million pay tax of at least 15% on the income arising in each of the jurisdictions in which they operate.

For more information please see the following websites:

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The IASB decided to respond to stakeholders' concerns about the potential implications of the imminent jurisdictional implementation of these 'Pillar Two' rules on the accounting for income taxes applying IAS 12.

The amendments

The IASB amends the scope of IAS 12 to clarify that the 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 amendments introduce a temporary exception to the accounting requirements for deferred taxes in IAS 12, so that an entity would neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

Observation

The IASB acknowledges that entities need time to determine how to apply the principles and requirements in IAS 12 to account for deferred taxes related to Pillar Two income taxes. 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.

The IASB therefore concluded that it would not be feasible to complete these activities before jurisdictions enact new tax laws and, consequently, before entities are required to reflect those laws in accounting for deferred taxes.

Applying the amendments, an entity is required to disclose that it has applied the exception. An entity also discloses separately its current tax expense (income) related to Pillar Two income taxes.

In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, an entity is required to disclose known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.

To meet this disclosure objective, an entity is required to disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the reporting period. That information does not need to reflect all the specific requirements of the legislation and could be provided in the form of an indicative range. To the extent information is not known or reasonably estimable, an entity should instead disclose a statement to that effect and information about its progress in assessing its exposure.

Examples of information an entity could disclose to meet these disclosure requirements include:

- qualitative information such as information about how an entity is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist; and
- quantitative information such as:
 - an indication of the proportion of an entity's profits that might be subject to Pillar Two income taxes and the average effective tax rate applicable to those profits; or
 - an indication of how the entity's average effective tax rate would have changed if Pillar Two legislation had been in effect.

Observation

The IASB has decided that the Pillar Two model rules (and the amendments to IAS 12) are also relevant to entities applying the *IFRS for SMEs* Accounting Standard. The IASB has therefore added to its work plan a narrow-scope standard-setting project to amend Section 29 *Income Tax* of the *IFRS for SMEs*. An exposure draft is expected in June 2023.

In the UK, the Financial Reporting Council (FRC) published Financial Reporting Exposure Draft (FRED) 83 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and FRS 101 Reduced Disclosure Framework—International tax reform—Pillar Two model rules* (FRED 83) which proposes to introduce a temporary exception to the accounting for deferred taxes arising from the implementation of the OECD's Pillar Two model rules, alongside targeted disclosure requirements. Once finalised, the exception proposed in FRED 83 is expected to take effect immediately on issue of the amendments to FRS 102.

Effective date and transition

The amendments require that an entity applies the exception—and the requirement to disclose that it has applied the exception—immediately upon issuance of the amendments and retrospectively in accordance with IAS 8.

The remaining disclosure requirements are effective for annual reporting periods beginning on or after 1 January 2023. An entity is not required to disclose the information warranted by these requirements for any interim period ending on or before 31 December 2023.

Observation

Various jurisdictions have started the process of enacting tax legislation to implement the Pillar Two model rules. Entities that may be subject to them will need to monitor the legislation process in the jurisdictions in which they operate and assess whether the Pillar Two legislation has been enacted (or substantively enacted) in any such jurisdictions. Once the Pillar Two legislation has been enacted or substantively enacted, an entity will need to consider the IAS 12 impact of legislation on its financial statements.

In jurisdictions with endorsement and adoption processes for IFRS Accounting Standards, such as the UK, the amendments may not be available for immediate use. The Secretariat of the UK Endorsement Board (UKEB) is currently preparing its Draft Endorsement Criteria Assessment with the aim to endorse the amendments as soon as possible.

In such cases, before the amendments are available for use, an entity may, after considering the following factors, conclude that the deferred tax requirements in IAS 12 do not apply to income taxes arising from the Pillar Two model rules:

- The Basis for Conclusions to the amendments notes uncertainties as to whether the Pillar Two model rules create additional temporary differences, whether there is a need to remeasure deferred taxes and if so which tax rate to use to measure deferred taxes, which in turn may result in diversity in the accounting applied by affected entities.
- The staff paper prepared for the IASB meeting on 11 April 2023 (Agenda Paper 12A, Appendix A, item 4) notes (in response to the request for clarification on whether Pillar Two legislation gives rise to temporary differences) that “one of the main reasons for introducing the temporary exception is to ‘avoid entities developing diverse interpretations of IAS 12’”.
- The February 2023 US FASB staff announcement that, under ASC 740 (the US GAAP standard addressing the accounting for income taxes, based on a framework similar to IAS 12), deferred taxes should not be recognised or adjusted for the effect of the Pillar Two legislation.
- The limited informational value, in terms of relevance and reliability, that would be provided if the entity were to apply deferred tax accounting to Pillar Two income taxes including because:
 - of the perceived complexities and uncertainties of the calculations required by the Pillar Two model rules (e.g. the tax rate that will apply to an entity’s excess profit in future periods) which depend on a number of factors that are difficult, if not impossible, to forecast reliably; and
 - deferred tax assets and liabilities would only be recognised for a short period, until the amendments are available for use and require their derecognition.

In line with the requirements of IAS 1, an entity should consider the nature and extent of the disclosures to be made in its financial statements, including those on material accounting policy information and judgements management has made in the process of applying the entity’s accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Further information

If you have any questions about the amendments to IAS 12, please speak to your usual Deloitte contact.

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