



Financial Reporting Council

Dr Andreas Barckow

IASB Chair
International Accounting Standards Board
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD

11 July 2023

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

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to the above Exposure Draft.

This response draws on the FRC's experience in developing financial reporting standards applicable in the UK and Republic of Ireland. The FRC's overriding objective in developing financial reporting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. In achieving its overriding objective, the FRC aims to provide succinct financial reporting standards that, amongst other things, have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective.

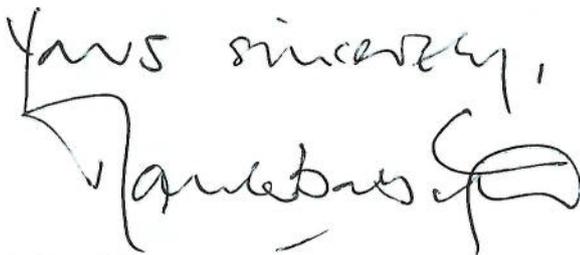
The FRC's accounting standards include FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The requirements in FRS 102 are based on the *IFRS for SMEs Accounting Standard*, modified in terms of the scope of entities eligible to apply it, the accounting treatments provided, and the required disclosures.¹ In some instances, those modifications include incorporating requirements that are consistent with IFRS Accounting Standards.

¹ For details, refer to the *Significant differences between FRS 102 and the IFRS for SMEs Standard* available at: <https://www.frc.org.uk/accountants/accounting-and-reporting-policy/uk-accounting-standards/significant-differences-between-frs-102-and-the-if>

The FRC has recently issued amendments to FRS 102 that introduce a temporary exception to the accounting for deferred tax arising from the implementation of the Pillar Two model rules, alongside targeted disclosure requirements.² Those amendments are based on the amendments made to IAS 12 *Income Taxes in International Tax Reform—Pillar Two Model Rules (Amendments to IAS 12)*, and we also responded to the IASB's Exposure Draft ED/2023/1 *International Tax Reform—Pillar Two Model Rules – Proposed amendments to IAS 12*.³

We agree there is an urgent need to amend the *IFRS for SMEs* Standard for this issue and we support the IASB making these amendments as a separate standard-setting project outside a comprehensive review. In general, we support the idea that the *IFRS for SMEs* Accounting Standard may need amendment for urgent narrow-scope matters between comprehensive reviews. This is something we have done a number of times in relation to FRS 102, and it can be a cost-efficient measure for preparers. When the IASB revisits this topic for IAS 12 it should also consider the implications for the *IFRS for SMEs* Accounting Standard.

The FRC's comments in response to your questions are included in the Appendix. If you have any queries or would like to discuss our comments in more detail, please do not hesitate to contact Stephen Maloney (Senior Project Director) or Adrian Wallis (Project Director) at ukfrs@frc.org.uk.



Mark Babington

Executive Director, Regulatory Standards

Direct telephone line: 020 7492 2323

Email: M.Babington@frc.org.uk

² <https://www.frc.org.uk/news/july-2023/frc-issues-amendments-to-frs%C2%A0102-and-frs%C2%A0101>

³ https://www.frc.org.uk/getattachment/2cee14a4-f0bd-41ef-ada1-765fca956111/Exposure-Draft-ED_2023_01-FRC-Comment-Letter.pdf

Appendix: Responses to the questions for respondents

Question 1—Temporary exception to the 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.

Temporary exception to the accounting for deferred tax (proposed new paragraph 29.3A)

- A1. We agree with the proposal to introduce a temporary exception to the requirements to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.
- A2. In our response to ED/2023/1 we commented that we thought the IASB should consider including a further exception within the ‘Measurement’ section of IAS 12 because it may be unclear if the fact that the reversal of deferred tax balances recognised under domestic tax regimes may give rise to a top-up tax charge, or eliminate one that would otherwise have been due, means the tax rate used to measure those balances should reflect Pillar Two legislation. We appreciate that paragraph BC104 of the Basis for Conclusions to *International Tax Reform—Pillar Two Model Rules (Amendments to IAS 12)* concludes that, in respect of the amendments to IAS 12, this would be unnecessary because if an entity were to remeasure an existing deferred tax liability to reflect additional Pillar Two income taxes it expects to pay it would, in effect, be recognising a deferred tax liability related to Pillar Two income taxes. However, we think that our suggestion is pertinent for SMEs because they may be less likely to have the expertise necessary to understand how top-up taxes are

charged or to interpret how they would be accounted for. The FRC included a corresponding temporary exception to measurement in our amendments to FRS 102, with unanimous support from respondents to our consultation. We suggest the IASB also consider including a corresponding exception within the 'Measurement of deferred tax' section of Section 29, for example as follows:

29.27A As an exception to the requirements in this section, an entity shall not take into account the effects of Pillar Two legislation when measuring deferred tax assets and deferred tax liabilities.

Disclosure that the temporary exception has been applied (proposed new paragraph 29.42)

- A3. We disagree with the proposal to require an SME to disclose that it has applied the exception.
- A4. Paragraph BC13 of the Exposure Draft concludes that an entity would only make the disclosure required by proposed new paragraph 29.42 if it has applied the exception (ie if it would have recognised or disclosed information about deferred tax assets or liabilities related to Pillar Two income taxes in the absence of the exception introduced by proposed new paragraph 29.3A).
- A5. In our response to ED/2023/1 we commented that we thought the IASB should consider requiring an entity that expects to be within the scope of Pillar Two legislation to disclose that fact, rather than requiring an entity to disclose that it has applied the temporary exception. We appreciate that the IASB did not make that change to its amendments to IAS 12; however, we think our suggestion is pertinent for SMEs because:
- a. it could be complicated to determine whether the exception has been applied and SMEs may be less likely to have the expertise necessary to understand how top-up taxes are charged or to interpret how they would be accounted for; and
 - b. the majority of SMEs will not be within the scope of Pillar Two legislation and therefore it would be useful to users of financial statements if those that do expect to be within scope made that fact clear, rather than disclosure being made only by that subset of

in-scope entities whose deferred tax balances would (in the absence of the exception) have been affected.

The FRC took this approach in our amendments to FRS 102, with majority support from respondents to our consultation. Accordingly, we suggest that the IASB also considers replacing proposed new paragraph 29.42, for example as follows:

29.42 If, based on known or reasonably estimable information, an entity is, or expects to be, within the scope of Pillar Two legislation it shall disclose that fact.

Defined terms

A6. We do not consider the approach that has been taken is unclear, but note that proposed new paragraph 29.3A takes an inconsistent approach to defined terms compared with that which is typically used in the *IFRS for SMEs* Accounting Standard, which would be to include the defined terms in the Glossary.

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.

Clarification of 'other events' (amended paragraph 29.38)

A7. We do not agree with the proposal to clarify that 'other events' in the disclosure objective in paragraph 29.38 includes enacted or substantively enacted Pillar Two legislation because we do not think the amendment would have the intended effect (set out in

paragraph BC19(a) of the Exposure Draft) of resulting in disclosure of information about the nature and financial effect of income tax consequences of Pillar Two legislation in periods before that legislation is in effect. There are no current tax consequences before the legislation is in effect, and there are no deferred tax consequences because proposed new paragraph 29.3A would provide an exception to recognising deferred tax assets or liabilities related to Pillar Two income taxes.

A8. We also make the following observations:

- a. The requirement for Pillar Two legislation to be 'enacted or substantively enacted' is duplicated in both proposed new paragraph 29.3A and amended paragraph 29.38. In our amendments to FRS 102 we did not include those words in our definition of 'Pillar Two legislation' and we suggest the IASB considers the same change.
- b. The drafting suggests that it is the Pillar Two legislation itself which is an 'other event', but we think the relevant event is the enactment or substantive enactment of such legislation.
- c. Amended paragraph 29.38 would refer specifically to Pillar Two legislation, but we think the clarification could apply to any tax legislation, for example the substantive enactment of a new tax rate. It may be helpful if the clarification were more generic.

New disclosure requirements in periods before Pillar Two legislation is in effect

A9. We agree with the conclusion in paragraph BC19(a) of the Exposure Draft that the objective of paragraph 29.38 (which applies to all income tax consequences) is not the same as the objective developed as part of the IAS 12 amendments (which specifically deals with an entity's exposure to the Pillar Two income taxes). We think that the concept of 'exposure' does not exist in the current disclosure requirements of Section 29 and if the IASB would like to introduce a requirement that is similar to paragraphs 88C and 88D of IAS 12 in to the *IFRS for SMEs* Accounting Standard it would need to incorporate that language directly.

A10. The FRC took this approach in our amendments to FRS 102 (although we also make an exemption from the disclosure requirement available for 'qualifying entities'⁴) with majority support from respondents to our consultation. However, we consider that our approach in

⁴ Broadly, a member of a group where the parent of that group prepares publicly available consolidated financial statements.

FRS 102 may not necessarily be appropriate for the *IFRS for SMEs* Accounting Standard, for example because:

- a. the *IFRS for SMEs* Accounting Standard does not provide a reduced disclosure framework for 'qualifying entities' and it may not be proportionate to apply the requirement to all entities that are affected by Pillar Two legislation; and
- b. we agree with the conclusion in paragraph BC19(b) of the Exposure Draft that any potential amendments to introduce new disclosure requirements or to amend existing disclosure requirements for entities for periods before Pillar Two legislation is in effect would be applied for only a relatively short period.

Overall, we think that feedback from users of SME financial statements will be crucial in assessing whether disclosure would provide useful information.

Current tax expense (proposed new paragraph 29.43)

A11. We agree with the proposal for an entity to disclose separately its current tax expense (income) related to Pillar Two income taxes. This would allow users of financial statements to understand the scale of an entity's exposure to Pillar Two income taxes in the current period.

A12. However, we consider that the requirement should, like other disclosures about tax expense (income), apply when Pillar Two income taxes are a major component of tax expense (income). The FRC took this approach in our amendments to FRS 102, with majority support from respondents to our consultation. We think that the IASB should also consider merging proposed new paragraph 29.43 into existing paragraph 29.39, for example as follows:

29.39 An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:

...

(i) current tax expense (income) related to Pillar Two income taxes.

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.

A13. We agree with the proposals. The FRC took a similar approach in our amendments to FRS 102, with unanimous support from respondents to our consultation.

A14. FRC stakeholders have told us that for a temporary exception in FRS 102 to be effective it would need to be available to entities for reporting periods in which Pillar Two legislation is enacted or substantively enacted. By extension, the FRC therefore agrees that the exception proposed for the *IFRS for SMEs* Accounting Standard should apply immediately and retrospectively upon issue of the amendments.

A15. We think it is reasonable that the proposed disclosure requirements should only be effective for annual reporting periods beginning on or after 1 January 2023, to provide reporting entities with sufficient time to prepare.