Anthony Wong Lun Wai

Subject: FW: CONSULTATIONS ON PILLAR 2-RELATED ISSUES
Attachments: Copy of IAS 12 Exposure Draft - feedback.xlsx; IASB ED re amendments to IAS 12 for P2 Taxes - comments.docx

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From: Peter Tisman
Sent: Monday, 13 February 2023 11:09 am
To: Anthony Wong Lun Wai <anthonylwwong@hkicpa.org.hk>
Cc: Selraniy Chow Pui Yin <selraniychow@hkicpa.org.hk>; Cecilia Kwei <ceciliakwei@hkicpa.org.hk>; Eky Liu <eky@hkicpa.org.hk>
Subject: RE: CONSULTATIONS ON PILLAR 2-RELATED ISSUES

Hi Anthony,

The comments received from Ed Lean are below and in the attachments. He works with financial services sector clients, so the comments are from that sector.

Regards,
Peter

From: *Ed*ward Lean <edward@leansolutions.com.hk>
Sent: Monday, February 13, 2023 10:56 AM
To: Peter Tisman <peter@hkicpa.org.hk>
Cc: Selraniy Chow Pui Yin <selraniychow@hkicpa.org.hk>
Subject: RE: CONSULTATIONS ON PILLAR 2-RELATED ISSUES

Hi Peter,

Please see below and attached comments from three different financial services groups. Thanks and please let me know if there are any questions.

88A	No comments
88B	Top-up tax is paid by one nominated entity for the group and may not necessarily represent tax of that paying entity. Technically speaking, if the tax does not belong to the “paying entity”, it should not be disclosed under IAS 12? This exposure draft needs to provide more guidance and authority of which entity should be disclosing the Pillar 2 income taxes in its current tax expense line.
88C(a)	No comments
88C(b)	• 88B(b) asks for jurisdictions in which the entity’s average ETR for the current period is below 15%, where such information should already be available. Therefore, if this condition needs to stay, it should not add too much additional burden to us, although we are not sure how relevant this disclosure is for GloBE, since having an accounts-based ETR below 15% does not necessarily mean that the GloBE ETR is under 15%.
88C(c)	• What are the details and assessments are required to satisfy this particular disclosure?

	• For an insurance company, its ETR could fluctuate quite materially resulting from investment movements. Even though if some GloBE modelling has been done in 2023 to forecast the outlook to 2024 for both insurance and investment revenue, how accurate can that be in order to perform an "assessment" that satisfies this condition. There is risk that we will be forced into relative detailed P2 calculations to meet this requirement. If we use CY data, is this CY data reflective of the group's GloBE assessment for 2024? We would have thought para 88C (b) gives enough of an indication as to where there might be a risk of additional tax. Therefore, the proposal is to remove this condition. • If this condition needs to be kept, the exposure draft should be more clear and explicit that maybe it's only descriptions of work done for GloBE is required, rather than extensive disclosures of quantitative impact. If quantitative impact is required, the exposure draft needs to be clear as to what details and extent is needed especially in FY23 disclosures before the actual implementation of GloBE and filing of GloBE return. Also there should be mention of whether this disclosure should be lessen for jurisdictions that has their own QDMTT? • Investors will be most interested in impact on Group ETR (which once computed will have to be validated by auditor), what is being proposed is adding more detail where again it is not clear what the benefit will be.
Overall	Although it is a positive point that this exposure draft allows for temporary exception of calculating deferred tax for GloBE, it however mentioned that further work is needed to determine how entities apply the principles and requirements in IAS 12 to account for deferred tax related to Pillar 2 income taxes. Pillar 2 income taxes is a tax that aggregates different calculations of numerous entities in many jurisdictions. There is currently no simple balance sheet numbers we can use to calculate Pillar 2 income taxes and thus it will not be easy to find a meaningful way to estimate deferred tax for Pillar 2 income taxes. Maybe we should keep this in mind to brainstorm on some meaningful way to estimate this deferred tax in due course.

Kind regards,
Ed

Edward Lean
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Exposure Draft - IFRS Accounting Standard (Jan 2023) [Due by 10 March 2023]
International Tax Reform—Pillar Two Model Rules
Feedback on Proposed amendments to IAS 12

S/N	Question	Feedback
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.	Who is "entity"? consol a/c by UPE or accounts of sub-group? Agree with the exception and disclosure on application of exception Reason: Unlikely for MNEs to be ready to compute DTA/DTL due to complexities of BEPS rules that have annual & 5-year elections coupled with data collation and co-ordination of entities in each jurisdiction
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.	Periods before legislation is in effect Av ETR of jurisiction may not be reflective of BEPS ETR. Even if ETR is below 15%, the jurisdiction could be excluded from top-up if safe harbour test is met which is based on NPBT and revenue or substance-based exclusion or simplified ETR If useful for shareholders to know potential exposure of top-up taxes, to consider disclosure of key jurisdictions that are potentially subject to top-up taxes based on preliminary assessment on FY 2023? Periods when legislation is in effect 1) For scenarios where the UPE (or intermediate entity, e.g. designated filing entity) is liable for Pillar Two income taxes in the relevant jurisdiction but chooses to pass on to its Constituent Entities in a Low-Tax Jurisdiction their allocated share of the Pillar Two income taxes, it is unclear from Para 88B whether the Pillar Two income tax allocated to these Low-Taxed Constituent Entities should be reported as those Low-Taxed Constituent Entities' current tax expense (or income) or whether the entity primarily liable for the Pillar Two income taxes should recognise the full amount in it's current tax expense (or income). 2) if allocated tax expense is to be reflected in the Constituent Entities, it is not clear if it should be based on allocation provided under BEPS rules or actual allocation/recovery by UPE or designated local entity

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.

In general, we support the proposals to prohibit deferred tax accounting in respect of P2 Taxes as the position of these taxes is still unclear. However, there are drafting issues with the proposals.

The proposals seem to imply that P2 Taxes are income taxes under IAS 12 (at least in the group consolidated financial statements). This is not clearly so, as the amount of P2 taxes is not based on taxable profits. Rather it is based on sum of the top-up tax for each jurisdiction which is calculated as the difference between the minimum rate of 15% and the ETR of the jurisdiction calculated under the GloBE rules multiplied by the excess profit of the jurisdiction. As the covered taxes under the GloBE rules may include taxes other than income taxes, the P2 Taxes cannot be said to be based on taxable profits.

Furthermore, the P2 Taxes suffered by a group may not reflect the entities in that group. For example, 50/50 joint ventures.

4A applies to an entity but it is not clear that P2 Taxes will be income taxes of an entity. Ignoring the concerns above, it should be clarified that the amendments only relate to consolidated financial statements and not standalone financial statements.

As noted in the basis for conclusions, it is unclear whether P2 Taxes give rise to deferred tax and how this would be measured. As such, it is inappropriate to frame the proposals regarding deferred tax as an exception to IAS 12. This implies that they may give rise to deferred tax and an exception to the requirements is being applied. Furthermore, the requirement to disclose the application of this 'exception' implies that entities must determine if there is deferred tax and then disclose if they have applied the exception from measuring and disclosing it, which is not possible until it has been concluded whether P2 Taxes give rise to deferred tax. Instead, the proposals should amend IAS 12 to prohibit measurement, recognition and disclosure of any deferred taxes arising in respect of P2 Taxes and not require the disclosure of this (as it provides no meaningful information to users of financial statements if it is mandatory).

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.

The disclosures do not provide any useful information for users of financial statements as they do not reflect the actual calculation of P2 Taxes and therefore the likely amount of P2 Taxes that an entity will suffer. Furthermore, any impact assessment an entity has made is inherently unreliable as it is based on forecasts of the future detailed components of the performance and position of the entity (which are unknowable) and the final P2 Tax legislation, which is still evolving.

The disclosures may in fact be misleading to users of financial statements and will put the entity is a difficult position. It may need to be conservative in its disclosures of jurisdictions that may suffer P2 Taxes in order to avoid claims of securities fraud if it has not disclosed (through no fault of its own) jurisdictions that it ultimately suffers P2 Taxes in.

The opening wording of 88B, that requires the disclosures to be made for the current period only, is misleading. If an entity has assessed the impact of P2 Taxes, it will not have made that assessment in respect of the current period (i.e. the period before the P2 Taxes are in effect) and so no additional jurisdictions will be disclosed under 88C(c)(i) and all jurisdictions identified under 88C(b) will also need to be identified under 88C(c)(ii).

Alternatively, if it is supposed to mean assessments the entity has made of the impact for years when the tax is in effect, the disclosure requires comparison of the accounting ETR of entities in one year (when the P2 Taxes are not in effect) with the P2 Taxes impact assessments done by the entity for other future years (when the P2 Taxes are in effect) and is a meaningless comparison and not useful for users of financial statements.

The meaning of 'jurisdictions' and 'jurisdictions in which the entity operates' in 88C is unclear. The GloBE rules specifically define where entities and permanent establishments are located for determining the top-up tax of a jurisdiction and also re-allocate income and tax between jurisdictions in certain cases. Therefore, these disclosures are meaningless.

Regarding 88B, if the undertaxed payment rule is applied by denial of deductions (rather than as a new tax charge), effectively increasing the domestic corporate income tax charge, is that a P2 Tax that must be disclosed separately from its current tax expense (income)?

It is unclear why the disclosure of accounting profit and tax expense for the jurisdictions identified in 88C(b) in aggregate provides any useful information to users of financial statements? Is this requirement supposed to be to disclose the accounting profit and tax expense for EACH jurisdiction identified in 88C(b)?

The disclosures required by 88C(c) are driven by an entity's impact assessments undertaken. This will result in severe lack of comparability between entities as the basis of these assessments, their rigor, their timing, the assumptions that were used and even whether they are made at all will vary between entities. In fact, an entity that has made no impact assessment (which can be justified due to the uncertainty in forecasting the financial and non-financial data required to calculate the P2 Taxes and the fluidity in the development of the actual rules) needs to make no disclosures.

There are many difficulties with accurately forecasting the impact of P2 Taxes including:

- ***difficulty in forecasting the financial and non-financial data required for the GloBE calculations in the future years when the P2 Taxes come into effect. This is particularly problematic in certain industries where there is volatility in profits before tax and the components of those profits (e.g. the insurance industry where investment returns are driven by market performance and are unknowable in advance);***
- ***the GloBE Rules may have been enacted in a period (say 2023) but are unlikely to affect most entities until later periods (2024 or 2025). However, while the rules may have been enacted (and have been already in Korea) they are still subject to significant change. For example, the OECD released Agreed Additional Guidance on the rules, which substantially affect their application, after Korea enacted its laws. Furthermore, the OECD are still consulting on significant parts of the implementation of the rules, which must be applied by enacting jurisdictions. That is in addition to the fact that most jurisdictions will need to enact the rules domestically and may implement QDMTTs, which will result in differing application of the final P2 Taxes; and***
- ***the impact of corporate transactions (e.g. M&A) and planning between the period of disclosure and the P2 Taxes coming into effect should not be underestimated.***

All of these factors contribute to the disclosures in 88C providing no useful information to users of financial statements and may in fact be very misleading to them.

It is also unclear how an entity should apply these disclosure requirements in its standalone financial statements? Presumably it should not but, again, confirmation should be provided that the proposals only apply to consolidated financial statements.

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

The IASB proposes that an entity apply:

(d) 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

(e) 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.

As identified above, all of the disclosure requirements provide no useful information to users of financial statements and may in fact be very misleading to them. As such, disclosures should only be required once the P2 Taxes are in effect.