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Comments on the Exposure Draft（ED/2023/1）

International Tax Reform—Pillar Two Model Rules

1. The Accounting Standards Board of Japan (the “ASBJ” or “we”) welcome the opportunity to provide our comments on the International Accounting Standards Board (“IASB”)’s Exposure Draft (ED/2023/1) *International Tax Reform—Pillar Two Model Rules* (hereinafter referred to as the “Exposure Draft”).

2. We agree with the IASB’s proposal to introduce a temporary exception to the accounting for deferred taxes arising from tax laws enacted or substantively enacted to implement the Pillar Two model rules published by the OECD.

3. At the same time, we have significant concerns with the timing of the issuance of the final standard for the amendments to IAS 12 *Income Taxes*. Depending on the timing of the issuance of the final standard, many entities applying IFRS accounting standards in our jurisdiction would not be able to apply the temporary exception proposed in the Exposure Draft. In our jurisdiction:

   (1) The revised corporate income tax law which introduces the Income Inclusion Rules (hereinafter referred to as the “IIR”) included in the OECD’s Pillar Two model rules is expected to be enacted or substantively enacted by the end of March 2023; and

   (2) Many entities have fiscal years ending in March.

4. Accordingly, we strongly urge the IASB to issue the final amendment to introduce the temporary exception as soon as possible so that entities with fiscal years ending

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in March can benefit from the temporary exception that would be provided in the amendment to IAS 12.

5. Since the Pillar Two model rules were published in December 2021, jurisdictions that joined the agreement are in the process of implementing the agreement in their respective domestic tax laws. While the status of implementation may differ among jurisdictions, we strongly believe that the temporary exception should apply to all entities that are affected by this change. However, as proposed, entities operating in jurisdictions in which the agreement have been or will be implemented earlier than others may not benefit from the temporary exception this year, simply due to the timing of the issuance of the final standard by the IASB.

6. Moreover, the Exposure Draft proposes that the temporary exception be made mandatory, rather than optional (paragraphs 4A and BC16 of the Exposure Draft). We agree with making the temporary exception mandatory, but we also believe that whether the temporary exception applies to the entity should not depend on when the financial statements are authorised for issuance. That is, if the financial statements are authorised for issuance before the issuance of the final standard by the IASB, entities would not be able to apply the temporary exception merely as a result of the timing of the finalisation of the amendment, whereas if the financial statements are issued authorised for issuance after the issuance of the final standard by the IASB, entities would be required to apply the temporary exception.

7. We believe the most critical and urgent aspect of the Exposure Draft is to provide the temporary exception. In order to expedite the process of issuing the final amendments, we strongly recommend that the IASB first focus on introducing the temporary exception and the effective date for the exception (that is, only paragraphs 4A and 98M(a) of the Exposure Draft).

8. We note that the objective of introducing the temporary exception and the objective of providing additional disclosures proposed in paragraphs 88B-88C of the Exposure Draft are separate objectives. That is, the objective of providing the temporary exception is to allow time for the IASB and others to respond to the newly enacted tax laws and to determine the appropriate and consistent accounting treatment, whereas, the objective of the additional disclosure requirements is to require the disclosure of information that would satisfy the needs of users of financial statements relating to the entities' exposure to paying the top-up taxes. Accordingly, we believe

that the IASB does not necessarily need to finalise the two separate proposals at the same time.

9. We also note that the IASB proposes different effective dates for the temporary exception and the additional disclosure requirements in paragraphs 88B-88C of the Exposure Draft. Considering that the Exposure Draft proposes that the additional disclosure requirements be effective for annual reporting periods beginning on or after 1 January 2023, the urgency and the possible effects on the timing of the issuance of the final standard by the IASB would be significantly different between the temporary exception and the additional disclosure requirements.

10. We believe that the IASB should not pursue the finalisation of both proposals at the same time but should prioritise the finalisation of the temporary exception. Some may argue that separating the proposals and issuing two standards may be cumbersome because it would require going through procedures (such as endorsement or translation) twice, within a short period of time. However, we believe it is of upmost importance to finalise the standard that would provide the temporary exception as soon as possible, so that the number of entities that could benefit from the temporary exception would be maximised.

Conclusion

11. For our comments on the specific questions, please refer to the Appendix. When preparing our comments, we assumed that the proposal to introduce the temporary exception would be finalised first and the other proposals will be considered later.

12. We hope our comments are helpful for the IASB's consideration. If you have any questions, please feel free to contact us.

Yours sincerely,

Yasunobu Kawanishi
Chair
Accounting Standards Board of Japan

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.

(Our view on the introduction of temporary exceptions)

1. We agree with the IASB's proposal to introduce a temporary exception for the following reasons:

   (1) We think that it will take some time to determine the appropriate accounting for deferred tax assets and deferred tax liabilities under IAS 12 reflecting the changes in the tax laws related to the introduction of Pillar Two model rules, because, for example, the model rules are complex.

   (2) Because the Pillar Two model rules are to be introduced as an international framework by the OECD, we think that the accounting treatment for such rules should be internationally consistent.

   (3) Given the limited time before the enactment of the tax laws to implement the model rules, we think that introduction of the temporary exception to the accounting for deferred taxes is an acceptable solution.

(Timing of finalising the amendment to introduce a temporary exception)

2. We have significant concerns with the timing of the issuance of the final standard for the amendments to IAS 12. Depending on the timing of the issuance of the final

standard, many entities applying IFRS accounting standards in our jurisdiction would not be able to apply the temporary exception proposed in the Exposure Draft. In our jurisdiction:

(1) The revised corporate income tax law which introduces the IIR included in the OECD's Pillar Two model rules is expected to be enacted or substantively enacted by the end of March 2023; and

(2) Many entities have fiscal years ending in March.

3. Accordingly, we strongly urge the IASB to issue the final amendment to introduce the temporary exception as soon as possible so that entities with fiscal years ending in March can benefit from the temporary exception that would be provided in the amendment to IAS 12.

4. Entities with December year ends have similar concerns when they prepare their interim financial statements for the first-quarter ending March 2023. This is because the timing of the issuance of the final standard to introduce the temporary exception would affect the estimate of the weighted average annual income tax rate that is calculated in accordance with IAS 34 *Interim Financial Reporting* paragraph 30(c).

5. Furthermore, we think that concerns are not unique to our jurisdiction. The Pillar Two model rules adopt a Top-down approach. Under this approach, if a jurisdiction in which the ultimate parent entity operates has not implemented the model rules pertaining to the IIR, its subsidiaries that are intermediate parent entities operating in jurisdictions which have implemented the model rules pertaining to the IIR become liable for the top-up tax. Therefore, the status of implementation of the model rules in one jurisdiction may affect entities located in other jurisdictions when they prepare their consolidated financial statements.

6. Since the Pillar Two model rules were published in December 2021, jurisdictions that joined the agreement are in the process of implementing the agreement in their respective domestic tax laws. While the status of implementation may differ among jurisdictions, we strongly believe that the temporary exception should apply to all entities that are affected by this change. However, as proposed, entities operating in jurisdictions in which the rules have been or will be implemented earlier than others may not benefit from the temporary exception this year, simply due to the timing of the issuance of the final standard by the IASB.

7. Moreover, the Exposure Draft proposes that the temporary exception be made mandatory, rather than optional (paragraphs 4A and BC16 of the Exposure Draft). We agree with making the temporary exception mandatory, but we also believe that whether the temporary exception applies to the entity should not depend on when the financial statements are authorised for issuance. That is, if the financial statements are authorised for issuance before the issuance of the final standard by the IASB, entities would not be able to apply the temporary exception merely as a result of the timing of the finalisation of the amendment, whereas if the financial statements are issued authorised for issuance after the issuance of the final standard by the IASB, entities would be required to apply the temporary exception.

(Proposal to accelerate finalisation of the amendment to implement the temporary exception)

8. We believe the most critical and urgent aspect of the Exposure Draft is to provide the temporary exception. In order to expedite the process of issuing the final amendments, we strongly recommend that the IASB first focus on introducing the temporary exception and the effective date for the exception (that is, only paragraphs 4A and 98M(a) of the Exposure Draft).

9. We note that the objective of introducing the temporary exception and the objective of providing additional disclosures proposed in paragraphs 88B-88C of the Exposure Draft are separate objectives. That is, the objective of providing the temporary exception is to allow time for the IASB and others to respond to the newly enacted tax laws and to determine the appropriate and consistent accounting treatment, whereas, the objective of the additional disclosure requirements is to require the disclosure of information that would satisfy the needs of users of financial statements relating to the entities' exposure to paying the top-up taxes. Accordingly, we believe that the IASB does not necessarily need to finalise the two separate proposals at the same time.

10. We also note that the IASB proposes different effective dates for the temporary exception and the additional disclosure requirements in paragraphs 88B-88C of the Exposure Draft. Considering that the Exposure Draft proposes that the additional disclosure requirements be effective for annual reporting periods beginning on or after 1 January 2023, the urgency and the possible effects on the timing of the issuance of the final standard by the IASB would be significantly different between the temporary exception and the additional disclosure requirements.

11. We believe that the IASB should not pursue the finalisation of both proposals at the same time but should prioritise the finalisation of the temporary exception. Some may argue that separating the proposals and issuing two standards may be cumbersome because it would require going through procedures (such as endorsement or translation) twice, within a short period of time. However, we believe it is of upmost importance to finalise the standard that would provide the temporary exception as soon as possible, so that the number of entities that could benefit from the temporary exception would be maximised.

12. We also believe that the disclosure about the application of the temporary exception proposed in paragraph 88A of the Exposure Draft is of lower priority because the temporary exception is mandatory rather than optional.

(Comments on future projects)

13. Considering that the Pillar Two model rules were published as an international framework by the OECD, we believe that the accounting treatment for the impact of such rules should be consistent internationally. Therefore, once the IASB issues the final standard to introduce the temporary exception, we recommend that the IASB provide clarification on the appropriate accounting treatment of other aspects pertaining to the implementation of the model rules.

14. In our jurisdiction, the revised corporate income tax law which introduces the IIR is expected to become effective on 1 April 2024. Clarifications or modifications that would contribute to the consistent accounting treatment regarding the impact of the introduction of the model rules need to be provided by the time entities in our jurisdiction prepare their financial statements, including their interim financial statements, for the first time after the effective date of the revised tax law.

15. The following are examples that we recommend that the IASB provide clarifications on or modifications to IFRS accounting standards.

(Scope of income taxes)

16. We do not think that whether the top-up tax meets the definition of an income tax as defined in paragraph 2 of IAS 12 is sufficiently clear to determine the appropriate and consistent accounting treatment. We would not object if the IASB concludes that the top-up tax paid by the parent entity and/or the intermediate parent entities should be treated as an income tax in the consolidated financial statements of the

group. At the same time, we think the issue becomes more complicated in the separate financial statements because the entity paying the top-up tax (that is, the parent entity) is different from the entities operating in the low tax jurisdictions and generate profits that are subject to the top-up tax (that is, subsidiaries of the group). Although the Pillar Two model rules are to be implemented in each jurisdiction, we believe that the conclusion regarding whether the top-up tax would meet the definition of an income tax should be consistent internationally for both consolidated and separate financial statements.

(Recognition and measurement of current taxes)

17. It is anticipated that entities would calculate the top-up tax using a complex mechanism specific to the Pillar Two model rules, including calculation of the effective tax rate on a jurisdictional-blending basis, reduction of certain 'carve-out' amounts from profit under the substance-based income exclusion rule, and other adjustments made to calculate profit, including the exclusion of certain amounts to avoid double taxation. We also note that entities are required to file their returns no later than 15 months after the end of the annual reporting period (18 months for the first transitional year), taking into account the complexity of the calculations.

18. If the top-up tax is determined to be an income tax as defined by IAS 12, we assume that the current tax expense related to the top-up tax should be recognised in the consolidated financial statements of the group when subsidiaries operating in low-tax jurisdictions report net income or loss on which the top-up tax is calculated, despite the complex nature of calculating the top-up tax and later due date of filing return. We expect the IASB to clarify the appropriate timing of the recognition of the current taxes through the amendments to IAS 12, together with the issues on the scope of income taxes noted in the paragraph 16.

19. In addition, we note that there are practical concerns associated with the estimate of the current tax expenses related to the top-up tax when subsidiaries operating in low-tax jurisdictions report net income or loss and are required to recognise them in their consolidated financial statements. Considering the later due date of filing return as a period of relief for the complex calculation of the top-up tax, we believe that certain relief for financial reporting purposes, such as inclusion of a simplified approach for estimating current tax expense should be provided, so that accounting requirements would not diminish the benefits of providing the period of relief.

20. We also note that entities are required to estimate the top-up tax when they calculate the estimated weighted average annual income tax rate in accordance with paragraph 30(c) of IAS 34. Without a relief that would permit the use of a simplified approach, a reasonable estimate of top-up taxes would be required for interim financial statements, which is likely to be even more difficult than making a reasonable estimate for annual financial statements.

(Consideration of a permanent solution)

21. Paragraph 47 of IAS 12 requires the measurement of deferred tax assets and liabilities at "tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period." We note that there may be cases other than the introduction of the Pillar Two model rules, where entities encounter difficulties in developing appropriate and consistent accounting policies for deferred taxes, when there is limited time between the revision of tax laws and the authorisation of financial statements for issuance. Accordingly, we think that the IASB should consider adopting a general relief regarding the accounting for deferred taxes when there is limited time between the revision of tax laws and the authorisation of financial statements for issuance, possibly with a set of criteria for applying such general relief.

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:

Question 2—Disclosure (paragraphs 88B–88C)
(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.

(Timing of the discussion on disclosure requirements)

22. As noted in our response to Question 1, we believe the most critical and urgent aspect of the Exposure Draft is to provide the temporary exception.

23. We note that the objective of introducing the temporary exception and the objective of providing additional disclosures proposed in paragraphs 88B-88C of the Exposure Draft are separate objectives. Moreover, considering that the Exposure Draft proposes that the additional disclosure requirements be effective for annual reporting periods beginning on or after 1 January 2023, the urgency and the possible effects on the timing of the issuance of the final standard by the IASB would be significantly different between the temporary exception and the additional disclosure requirements.

24. We believe that the IASB should not pursue the finalisation of both proposals at the same time but to prioritise the finalisation of the temporary exception. That is, whether and if so how to proceed the proposals for additional disclosures will be considered later.

25. Furthermore, we do not support the proposed additional disclosure requirements because of the concerns described in the following paragraphs.

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

26. The IASB notes in paragraph BC19 of the Exposure Draft that the purpose of proposing the disclosure requirements of paragraph 88C is to help users of financial statements assess an entity's exposure to paying the top-up tax.

27. Although we understand the needs of users of financial statements for information relating to the implementation of the model rules, we think that the proposed disclosures would not necessarily result in providing information that is useful for the users of the financial statements. Our concerns on the proposals are more specifically described in the following paragraphs.

Information about such legislation enacted or substantively enacted in the jurisdiction in which the entity operates (paragraph 88C(a))

28. Each jurisdiction will implement the Pillar Two model rules in their respective domestic tax laws, and the timing of such implementation will differ by jurisdiction. For a multinational entity that operates in multiple jurisdictions, the amount of the top-up tax to be paid by the entity will be affected by the status of implementation in each jurisdiction, which would change over time. Accordingly, we do not believe that information about the legislation status for a period before the model rules are not yet in effect will be useful for assessing an entity's exposure to paying top-up tax unless all jurisdictions have implemented the Pillar Two model rules.

29. In addition, we do not think that proposals in paragraph 88C(a) of the Exposure Draft is sufficiently clear to identify the jurisdictions the IASB intends to require disclosure. We recommend that the IASB reconsider the objective of the disclosure requirements so that only useful information will be disclosed and that ensures comparability across entities. The following are cases where we think further clarification is needed before the finalisation of the disclosure requirements:

    (1) Whether information about Pillar Two legislation enacted or substantively enacted in jurisdictions in which subsidiaries of the group operate would be required when the relevant tax legislation has been enacted or substantively enacted in the jurisdiction in which the parent entity operates.

    (2) Whether information about Pillar Two legislation enacted or substantively enacted but not in effect in jurisdictions in which subsidiaries of the group operate would be required when the relevant tax legislation has been in effect in the jurisdiction in which the parent entity operates.

(3) Whether information about all the jurisdictions in which subsidiaries of the group operate and the Pillar Two legislations are enacted or substantively enacted would be required when the relevant tax legislation has not been enacted or substantively enacted in which the parent entity operates.

Information about the entity's average effective tax rate (paragraphs 88C (b) and (c))

30. Paragraph 88C(b) of the Exposure Draft proposes disclosure of information prepared in accordance with IAS 12, such as the entity's average effective tax rate for the current period (calculated in accordance with paragraph 86 of IAS 12). We are not convinced that the proposed disclosures would result in providing useful information for assessing an entity's exposure to the payment of top-up tax for the following reasons:

    (1) Although financial accounting profit and tax expense (income) are used as elements for the calculation of the top-up tax, various adjustments specified in the Pillar Two model rules, such as the calculation of the effective tax rate on a jurisdictional-blending basis, reduction of certain 'carve-out' amounts from profit under the substance-based income exclusion rule, and other adjustments made to calculate profit, make the calculation of the top-up tax more complicated. Accordingly, we do not believe that information regarding the entity's average effective tax rate calculated as specified in paragraph 86 of IAS 12 is helpful in assessing the future payment of the top-up tax.

    (2) By the time the Pillar Two model rules are in effect, entities may shift their existing tax strategies by, for example, reconsidering the location of their businesses, taking into account the total tax burden including the top-up taxes. In addition, the increase in tax rates or changes to tax legislations may be expected in some jurisdictions that currently have low tax rates. Accordingly, we do not believe that information relating to certain periods before the Pillar Two model rules become in effect is helpful in the assessment of the future payment of the top-up tax.

31. We also think the costs imposed on preparers of the financial statements for providing the proposed additional disclosures need to be considered. Because IAS 12 does not currently require jurisdiction-by-jurisdiction information, entities may need to update their processes for collecting information about their subsidiaries. For example, preparers in our jurisdiction indicated that there are entities that currently

obtain information about some of their subsidiaries only through their intermediate parent entity's consolidated financial statements. Such entities may need to change their processes so that they can obtain information about each subsidiary included in the intermediate parent entity's consolidated financial statements. Entities will then be required to blend information of each subsidiary on a jurisdiction-by-jurisdiction basis.

32. We note that entities will need to collect and blend information for tax purposes (that is, in order to calculate top-up taxes in accordance with the Pillar Two model rules). At the same time, we note that the model rules allow time to calculate the top-up tax (with additional time for the initial application), considering the practical burdens on entities to do the complex calculation of the top-up tax. We think that the disclosure requirements in periods before the model rules are not in effect should not effectively diminish the benefits provided by the model rules.

(Proposed disclosure for the period when Pillar Two legislation is in effect)

33. We have concerns about the proposed disclosure requirement in paragraph 88B of the Exposure Draft for separate disclosure of current tax expense (income) related to Pillar Two income taxes in the following respects:

    (1) The IASB should determine whether the top-up tax meets the definition of income tax as defined in IAS 12 before requiring the disclosure proposed in paragraph 88B.

    (2) The IASB should clarify the objective of the proposed disclosure as to why current tax expense related to the top-up tax is required to be disclosed separately from other tax items when the top-up tax is considered to meet the definition of an income tax.

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

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

(Transitional for the introduction of temporary exceptions)

34. As noted in our response to Question 1, we strongly urge the IASB to issue the final amendment to introduce the temporary exception as soon as possible so that entities with fiscal years ending in March can benefit from the temporary exception that would be provided in the amendment to IAS 12.

35. We agree with the IASB in that the temporary exception should be made applicable to financial statements that have not yet been authorised for issuance at the time of publication of the final standard. However, we are concerned that the IASB describes the proposed treatment to "mandate that amendments to the standard issued after the closing date be applied to financial statements not yet authorised for issue at that date" only in the Basis for Conclusions (paragraph BC27). We request the IASB to include this statement within the main body of IAS 12 as an explicit transitional requirement in order to ensure consistent application in practice.