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**External Reporting Board
Te Kawai Arahi Purongongo Mowaho
Submission Via Portal**

Dear Sir/Madam,

International Tax Reform – Pillar Two Model Rules

The IASB proposes:

- a temporary but mandatory prohibition on the application of deferred tax for the Pillar 2 reforms; and
- disclosures of the effect of Pillar 2 legislation.

Deferred tax

In short, Pillar 2 tax legislation is expected to be complex and initially uncertain. It raises questions on whether a temporary difference exists at all for assets and liabilities and, if so, what is the future tax rate that should be applied to that temporary difference?

Due to complexity, the potential for divergent applications of IAS 12 and the lack of time to provide either guidance or specific rules, the IASB proposes that deferred tax should not be accounted for Pillar 2 taxes.

This is sensible and I agree with the proposal (question 1).

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I understand that future work will occur on accounting for deferred tax for Pillar 2 taxes. I provide some observations on the impact of Pillar 2 rules in case they are useful.

When a Pillar 2 tax potentially applies, there will be existing deferred tax recognized at the current legislated tax rate at both the entity and consolidated level. Temporary differences and therefore deferred tax is generally established on an asset/liability basis (i.e. is there a difference between the accounting carrying value and the tax base for the specific asset or liability.). However, deferred tax assets are subject to a recognition requirement which considers the probable future taxable income of the relevant entity.

The first question is what difference, if any, does a Pillar 2 rule make to the relevant tax rate? There will be a different tax rate only if there is Excess Profit (GloBe income – substance based income exclusion) and the Effective Tax Rate is less than the Minimum Rate. Both of these depend on future activity and the effect of existing tax legislation. This means the likelihood of a Pillar 2 tax applying in the future is uncertain.

An entity may have projections for future accounting and taxable income (if it has existing deferred tax assets) and for future accounting income (from impairment testing). Both sources of information may allow a projection of the possible future effect of a Pillar 2 tax.

However, the future effect of a Pillar 2 tax may not be attributable to a particular asset or liability. This suggests that either there is no temporary difference or that the Pillar 2 tax itself creates a deferred tax asset or liability (for example, similar to a tax loss which is not itself a temporary difference for a particular asset or liability.)

If the IASB concludes that there is no temporary difference then its work should still consider how the future effect of Pillar 2 rules should be disclosed. The IASB should consider whether disclosure of the assumptions made which determine whether the entity considers Pillar 2 tax is/is not payable in the future.

Disclosures

The IASB proposes for periods when Pillar 2 rules are substantively enacted but before effective date:

- a disclosure of the fact of the legislation having been enacted;
- for jurisdictions (“low” tax jurisdictions) where the effective tax rate (per paragraph 86 of IAS 12) is less than the minimum, disclosures of tax expense, accounting profit and weighted average effective tax rate;
- where assessments made by the entity indicate possible Pillar 2 results, disclosures of:
 - entities in the “low” tax jurisdictions which may not be subject to Pillar 2 tax; and
 - entities outside the “low” tax jurisdictions which may be subject to Pillar 2 tax.

For post effective date Pillar 2 tax, current tax must be disclosed.

Pre-effective date

The effective tax rate calculation in paragraph 86 of IAS 12 is not the same as the effective tax rate calculation under Pillar 2. (However, I understand that paragraph 86 is meant to be a proxy for the possible application of the rules.) This means that notwithstanding proposed 88C(c), the information required by 88C (b) may be misleading.

Assume that Country A is the location of a holding company for subsidiaries. Dividend income of the company will likely not be taxable. Its effective tax rate under paragraph 86 is 0%. However, under the GloBE rules, it will have no GloBE income and no top up tax arises for Country A.

88C (b) would require disclosure of its tax expense (\$0), accounting income (equal to dividends assuming no impairment and investments are recognized at cost), and the weighted average tax rate (0%). Assuming some assessment has been made, 88C (c) would likely apply so the entity would disclose that no Pillar 2 tax is likely.

Although this may be presented in a table form (i.e. country A information plus the “no likely tax” disclosure in a table), it is doubtful that this provides any useful information for a user.

The IASB should note that:

- Pillar 2 taxes would apply to the holding company’s subsidiaries so that a “no effect” of Pillar 2 for the holding company is not controversial;
- The Holding Company’s income, as an entity, will not be income of the group at a consolidated level. The Holding Company’s dividend income is replaced with income of the subsidiaries.

A disclosure of Holding Company income that is not subject to Pillar 2 does not appear meaningful.

Question 2 in relation to pre effective date

I suggest that the IASB consider the following:

- whether any assessment has been made of the effect of Pillar 2 rules.
- If no assessment has been made, disclose per current sub-paragraph (b).
- If an assessment has been made, disclose, per current sub-paragraph (b) for jurisdictions where Pillar 2 Top Up tax may apply. (This includes jurisdictions above and below the minimum tax rate calculated under paragraph 86. The paragraph can therefore be ignored.)

This suggestion is made as the primary information, prior to the effective date, a user should know is whether the entity has made an assessment of the possible impact of the Pillar 2 rules. The income and tax information is secondary as the actual Pillar 2 tax will depend on future activity in future periods.

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Post effective date

The practical issue that needs to be considered is timing and availability of information.

Typically, for financial statements, the tax calculated is an estimate (to materiality). Detailed reviews and calculations for tax return purposes follow after the financial statements are audited and finalised. Changes to the estimate are recognized as prior period current tax expense. The systems and processes and knowledge of current tax rules can be expected to be well established so that the estimate of current tax is reasonably reliable (albeit subject to some uncertainty).

Each entity's position is likely to be different and specific but estimates of Pillar 2 taxes prepared for a current period financial statements may range from \$0 to significant amounts.

Although groups can be expected over time to build compliance systems which produce better estimates of Pillar 2 Top Up tax, it is unlikely that those systems will be fully complete or robust particularly in the first years of Pillar 2 applying. This is especially the case because of the complexity of the GloBE rules and the interaction of the various possible taxes that might apply. The estimates of Pillar 2 Top Up tax are therefore likely to be less reliable than current income tax estimates. Adjustments for prior period taxes are more likely in future years.

The IASB should consider whether paragraph 88B provides an unwarranted implication of certainty of the amount of Pillar 2 tax disclosed - does paragraph 88B imply a level of certainty of the amount of Pillar Two taxes that is not reflective of the reality? I suggest that it is not.

I note and understand that other financial statement and assurance standards may provide the answer to address this uncertainty.

Question 2 for post-effective date

However, I consider it would be useful if paragraph 88B acknowledged the uncertainty and how that might be dealt with. A specific addition to paragraph 88B could be to require disclosure/confirmation that the entity has appropriate systems and processes to confirm Pillar 2 Top Up Tax and that future (post-balance date) actions may alter the amount. I expect that many entities will state the amount is subject to change as their processes are completed for the relevant tax returns.

Personal details

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I have provided a short biography in Appendix 1 should that be helpful in understanding my relevant experience and perspective. My contact details are below should that be helpful.

Yours sincerely


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Cc International Accounting Standards Board,
By email: commentletters@ifrs.org

Deputy Commissioner, Inland Revenue, Policy and Regulatory Stewardship
By email

Appendix 1 – short biography

Professional employment and positions

Inland Revenue – July 1983 to March 1986, in the Christchurch District Office

KPMG – March 1986 to 31 December 2021, in the Christchurch, Melbourne and Wellington offices and firms, positions as a tax manager, director and partner

Cantin Consulting – 1 January 2022 to present

The KPMG and Cantin Consulting roles included client services (including as a specialist on audit engagements) as well as, especially tax policy work. KPMG New Zealand publishes its tax policy public submissions on the KPMG website (under tax submissions) and Cantin Consulting submissions are published in my LinkedIn.

Public commentary (as KPMG taxmail and Cantin Consulting Musings) is also available on the KPMG website and in LinkedIn posts.

Professional Activities

Chartered Accountants Australia and New Zealand and its predecessors – Christchurch Branch Tax Committee, National Tax Committee and Tax Advisory Group member including a number of years as chair of that group. Regulation and tax policy work in these roles is based on a public interest view rather than a member view. Submissions to Departments and Ministries and to parliamentary select committees are available on its website.

Member of Institute of Directors

Qualifications and Awards

Master of Arts (Hons) – History, University of Canterbury

Bachelor of Commerce – Accounting major, University of Canterbury

Fellow Chartered Accountant, Chartered Accountants Australia and New Zealand

Meritorious Service Award, Chartered Accountants Australia and New Zealand.

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