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Exposure Draft

IFRS for SMEs[®] Accounting Standard

International Tax Reform—Pillar Two Model Rules Proposed amendments to the *IFRS for SMEs* Standard

Comments to be received by 17 July 2023

Exposure Draft

International Tax Reform – Pillar Two Model Rules

Proposed amendments to the *IFRS for SMEs* Standard

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INTERNATIONAL TAX REFORM—PILLAR TWO MODEL RULES—PROPOSED AMENDMENTS TO THE IFRS
FOR SMEs STANDARD

CONTENTS

	<i>from page</i>
INTRODUCTION	4
INVITATION TO COMMENT	6
[DRAFT] AMENDMENTS TO THE <i>IFRS FOR SMEs</i> STANDARD	9
APPROVAL BY THE IASB OF EXPOSURE DRAFT <i>INTERNATIONAL TAX REFORM—PILLAR TWO MODEL RULES—PROPOSED AMENDMENTS TO THE IFRS FOR SMEs STANDARD</i> PUBLISHED IN JUNE 2023	12
BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT <i>INTERNATIONAL TAX REFORM—PILLAR TWO MODEL RULES—PROPOSED AMENDMENTS TO THE IFRS FOR SMEs STANDARD</i>	13

Introduction

Why is the IASB publishing this Exposure Draft?

- IN1 In October 2021 more than 135 jurisdictions agreed to the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting's *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. Since then, the OECD has published model rules and other documents related to the second pillar of this solution (the Pillar Two model rules).
- IN2 The Pillar Two model rules provide a template that jurisdictions can translate into domestic tax law and implement as part of an agreed common approach. The rules:
- (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and
 - (c) typically require the ultimate parent entity of a group to pay top-up tax—in the jurisdiction in which it is domiciled—on profits of its subsidiaries that are taxed below 15%.
- IN3 Stakeholders informed the International Accounting Standards Board (IASB) of concerns about the implications for income tax accounting resulting from jurisdictions implementing the Pillar Two model rules within a short period of time. In particular, stakeholders said it was unclear how to apply IAS 12 *Income Taxes* when accounting for deferred taxes related to the rules; and they also said that there was an urgent need for clarity because of the imminent implementation of the rules in some jurisdictions.
- IN4 After considering these concerns and feedback on proposed amendments to IAS 12, in May 2023 the IASB issued amendments to IAS 12.

Is there a similar need to amend Section 29 *Income Tax of the IFRS for SMEs Standard*?

- IN5 In considering whether and how to amend the *IFRS for SMEs Standard* for a new or amended full IFRS Accounting Standard, the IASB applies its alignment approach.¹ Having done so in relation to the amendments to IAS 12, the IASB assessed the Pillar Two model rules to be relevant to some small and medium-sized entities (SMEs).² Moreover, and because of the urgent need for clarification, the IASB decided to propose amendments to Section 29 *Income Tax* of the Standard as a separate standard-setting project outside the Second

¹ The alignment approach applies three principles: relevance to SMEs, simplicity and faithful representation.

² In this Exposure Draft, the term 'SMEs' refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs Standard* (that is, SMEs are entities that do not have public accountability and that publish general purpose financial statements for external users).

Comprehensive Review of the *IFRS for SMEs* Accounting Standard (the IASB's current periodic review of the Standard).

Proposals in this Exposure Draft

- IN6 The proposals in this Exposure Draft would:
- (a) introduce a temporary exception to the requirements to recognise deferred tax assets and liabilities related to Pillar Two income taxes; and to disclose information that would otherwise be required by paragraphs 29.39–29.41 of the *IFRS for SMEs* Standard about deferred tax assets and liabilities related to Pillar Two income taxes;
 - (b) introduce targeted disclosure requirements for affected SMEs in periods when Pillar Two legislation is in effect; and
 - (c) clarify that 'other events' in the disclosure objective in paragraph 29.38 of the Standard include enacted or substantively enacted Pillar Two legislation.
- IN7 The IASB expects the proposed amendments to provide timely relief for affected SMEs and avoid diverse interpretations of Section 29 of the *IFRS for SMEs* Standard developing in practice.

Next steps

- IN8 The IASB will consider the comments it receives on the proposals in this Exposure Draft and will decide whether to proceed with the proposed amendments to the *IFRS for SMEs* Standard. The IASB plans to issue any resulting amendments in the third quarter of 2023.

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) respond to the questions as stated;
- (b) specify the paragraph(s) to which they relate;
- (c) contain a clear rationale;
- (d) identify any wording in the proposals that is difficult to translate; and
- (e) include any alternative the IASB should consider, if applicable.

The IASB requests that comments should be confined to the matters addressed in this Exposure Draft.

However, respondents need not answer all the questions in this invitation to comment.

Questions for respondents

Question 1—Temporary exception to accounting for deferred taxes (proposed new paragraphs 29.3A and 29.42)
--

Section 29 <i>Income Tax</i> of the <i>IFRS for SMEs</i> 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.

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.

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.

Deadline

The IASB will consider all written comments received by 17 July 2023.

How to comment

Please submit your comments electronically:

Online	https://www.ifrs.org/projects/open-for-comment/
By email	commentletters@ifrs.org
Survey	https://ifrs.qualtrics.com/jfe/form/SV_9mEuI2EOjIUSxo

Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We normally grant such requests only if they are supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data. If you would like to request confidentiality, please contact us at commentletters@ifrs.org before submitting your letter.

[Draft] Amendments to the IFRS for SMEs Standard

Section 29
Income Tax

Paragraphs 29.3A and 29.42–29.43 (including their related heading) are added. Paragraph 29.38 is amended. New text is underlined.

Scope of this section

...

29.3A This section applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes described in those rules. Such tax law, and the income taxes arising from it, are hereafter referred to as ‘Pillar Two legislation’ and ‘Pillar Two income taxes’. As an exception to the requirements in this section, an entity shall 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.

...

Disclosures

29.38 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events (such as enacted or substantively enacted Pillar Two legislation).

...

International tax reform—Pillar Two model rules

29.42 An entity shall disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes (see paragraph 29.3A).

29.43 An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.

Section 35
Transition to the IFRS for SMEs

Paragraph 35.10(h) is amended. New text is underlined.

...

Procedures for preparing financial statements at the date of transition

...

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

...

- (h) deferred income tax. A first-time adopter may apply Section 29 *Income Tax* prospectively from the date of transition to the *IFRS for SMEs*.
A first-time adopter shall nonetheless apply the exception in paragraph 29.3A retrospectively.

Appendix A Effective date and transition

Paragraph A4 is added. For ease of reading, this paragraph has not been underlined.

...

A4 *International Tax Reform—Pillar Two Model Rules*, issued in [Month] 2023, added paragraphs 29.3A and 29.42–29.43, and amended paragraphs 29.38 and 35.10(h). An entity shall apply:

- (a) paragraphs 29.3A, 29.38, 29.42 and 35.10(h) immediately upon the issue of these amendments. Paragraphs 29.3A, 29.38 and 29.42 shall be applied retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors*.
- (b) paragraph 29.43 for annual reporting periods beginning on or after 1 January 2023.

Approval by the IASB of Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed Amendments to the IFRS for SMEs Standard* published in June 2023

The Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed Amendments to the IFRS for SMEs Standard* was approved for publication by all 14 members of the International Accounting Standards Board.

Andreas Barckow	Chair
Linda Mezon-Hutter	Vice-Chair
Nick Anderson	
Patrina Buchanan	
Tadeu Cendon	
Florian Esterer	
Zach Gast	
Hagit Keren	
Jianqiao Lu	
Bruce Mackenzie	
Bertrand Perrin	
Rika Suzuki	
Ann Tarca	
Robert Uhl	

Basis for Conclusions on Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed Amendments to the IFRS for SMEs Standard*

This Basis for Conclusions accompanies, but is not part of, the Exposure Draft International Tax Reform—Pillar Two Model Rules—Proposed Amendments to the IFRS for SMEs Standard. It summarises the considerations of the International Accounting Standards Board (IASB) in developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.

Background

Pillar Two model rules

- BC1 In October 2021 more than 135 jurisdictions agreed to the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting’s *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. Since then, the OECD has published model rules and other documents related to the second pillar of this solution (the Pillar Two model rules).
- BC2 The Pillar Two model rules provide a template that jurisdictions can translate into domestic tax law and implement as part of an agreed common approach. The rules:
- (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and
 - (c) typically require the ultimate parent entity of a group to pay top-up tax—in the jurisdiction in which it is domiciled—on profits of its subsidiaries that are taxed below 15%.
- BC3 The rules apply to multinational groups with revenue in their consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal years. The rules specify inclusion thresholds for some jurisdictions and exclude some types of entities from their scope.

Potential implications for income tax accounting

- BC4 Stakeholders informed the IASB of concerns about the implications for income tax accounting—and specifically deferred tax accounting—resulting from jurisdictions implementing the Pillar Two model rules within a short period of time. Those concerns related to entities affected by Pillar Two legislation and applying IAS 12 *Income Taxes*.
- BC5 Because the requirements for accounting for income taxes in Section 29 of the *IFRS for SMEs Standard* are based on those in IAS 12, the IASB considered whether to amend Section 29.

Relevance to SMEs

- BC6 In considering whether to amend the *IFRS for SMEs* Standard, the IASB first determines whether a new or amended full IFRS Accounting Standard is relevant to small and medium-sized entities (SMEs). The IASB determines relevance to SMEs by assessing whether the problem addressed by a new requirement in full IFRS Accounting Standards would make a difference in the decisions of users of financial statements prepared applying the *IFRS for SMEs* Standard.
- BC7 The staff consulted the SME Implementation Group and the large accounting firms to obtain evidence about the relevance of the Pillar Two model rules (and the amendments to IAS 12 proposed in the Exposure Draft *International Tax Reform—Pillar Two Model Rules*) to SMEs. The feedback provided evidence that the Pillar Two model rules could have a material effect on the financial statements of a subset of SMEs, particularly some subsidiaries of large multinational groups.

Urgency

- BC8 The IASB undertakes periodic reviews of the *IFRS for SMEs* Standard during which the IASB considers whether and, if so, how to align the Standard with any new and amended full IFRS Accounting Standards. In undertaking its reviews, the IASB decided that it should not consider any new and amended full IFRS Accounting Standards until they have been issued because its views remain tentative and subject to change until that time.³
- BC9 Furthermore, paragraph P16 of the Preface to the *IFRS for SMEs* Standard states that urgent matters may need to be considered outside the periodic reviews of the Standard. That said, such occasions are expected to be rare.
- BC10 The third edition of the *IFRS for SMEs* Accounting Standard—the product of the ongoing Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard—is not expected to be issued until late 2024 at the earliest. Given this timing, and considering stakeholders' concerns, the IASB has decided to propose urgent amendments to the *IFRS for SMEs* Standard to align the Standard with the amendments to IAS 12 for the Pillar Two model rules outside its periodic review.

Temporary exception to deferred tax accounting

- BC11 The IASB agreed that SMEs affected by the Pillar Two legislation need time to determine how to apply the principles and requirements in the *IFRS for SMEs* Standard to account for deferred taxes related to top-up tax. The IASB also needs time to engage further with its stakeholders and to consider whether any action is needed to support the consistent application of the Standard. The IASB concluded that it was not feasible to complete these activities before jurisdictions enact new tax laws and, thus, before SMEs are required to reflect those laws in accounting for deferred taxes.

³ Paragraph BC190 of the Basis for Conclusions on the *IFRS for SMEs* Standard (issued in 2015).

- BC12 The IASB therefore proposes to introduce a temporary exception to the requirements in Section 29 of the *IFRS for SMEs* Standard to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes. Introducing this exception would:
- (a) provide affected SMEs with relief from accounting for deferred tax assets and liabilities in relation to complex new tax legislation to be enacted by multiple jurisdictions in a short period;
 - (b) avoid the development of diverse interpretations of Section 29 of the *IFRS for SMEs* Standard and the resulting inconsistent application of the Standard; and
 - (c) allow time for stakeholders to assess how the Pillar Two model rules have been implemented in different jurisdictions, for SMEs to assess how they are affected and for the IASB to consider whether to do further work.
- BC13 The IASB also proposes to require an SME to disclose that it has applied the temporary exception. The IASB concluded that this requirement would:
- (a) provide entity-specific information because some SMEs are unaffected by Pillar Two legislation and, therefore, would not apply the exception; and
 - (b) make the exception's application transparent to users of financial statements during the periods in which it is applied.
- BC14 The IASB proposes to make a consequential amendment to paragraph 35.10(h) of the Standard to clarify that a first-time adopter is required to apply the exception in paragraph 29.3A also retrospectively. In the absence of this clarification, a first-time adopter would incur additional costs compared to SMEs already applying the *IFRS for SMEs* Standard.

Mandatory application

- BC15 The IASB proposes to make the application of the temporary exception mandatory because doing so would:
- (a) result in greater comparability between SMEs' financial statements and, therefore, provide more useful information for users of financial statements; and
 - (b) eliminate the risk of SMEs inadvertently developing accounting policies that are inconsistent with the principles and requirements in Section 29 of the *IFRS for SMEs* Standard.

Duration

- BC16 The IASB concluded that it was not possible to determine how much time the activities described in paragraph BC11 would require because they would depend on how and when jurisdictions implement the Pillar Two model rules. Therefore, the IASB proposes not to specify how long the temporary exception will be in place. The IASB will monitor developments related to the

implementation of the Pillar Two model rules to determine when to do further work. Any further work does not necessarily need to coincide with the next periodic review of the *IFRS for SMEs* Standard.

Disclosures

BC17 The IASB considered whether to introduce new disclosure requirements in addition to introducing the temporary exception. In doing so, the IASB considered the needs of users of SMEs' financial statements when Pillar Two legislation:

- (a) is enacted or substantively enacted, but not yet in effect (see paragraphs BC18–BC20); and
- (b) is in effect (see paragraph BC21).

Periods before legislation is in effect

BC18 When amending IAS 12 in May 2023 the IASB added a disclosure objective. An entity is required to disclose—in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect—information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.

BC19 The disclosure objective in paragraph 29.38 of the *IFRS for SMEs* Standard requires an SME to disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events. The IASB observed that:

- (a) 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). Nonetheless, the IASB concluded that the objective in paragraph 29.38 would be expected to result in SMEs affected by Pillar Two legislation providing some information about the nature and financial effect of income tax consequences of such enacted (or substantively enacted) legislation in periods before the legislation is in effect (for example, information available from an SME's assessment of its exposure to Pillar Two income taxes). This is because, in the IASB's view, 'other events' in paragraph 29.38 include enacted (or substantively enacted) Pillar Two legislation.
- (b) although it is still uncertain when jurisdictions will implement the Pillar Two model rules, feedback on the Exposure Draft *International Tax Reform – Pillar Two Model Rules* confirmed that many jurisdictions are expected to enact in 2023 Pillar Two legislation that has effect from 1 January 2024. Consequently, any potential amendments to introduce new disclosure requirements or to amend existing disclosure requirements for SMEs for periods before such legislation is in effect would be applied for only a relatively short period.

- (c) information needs of users of SMEs' financial statements can differ from those of users of financial statements of entities applying full IFRS Accounting Standards.⁴ Indeed, the absence of any new specific disclosure requirements would allow an SME to retain flexibility in deciding what information to disclose to meet the disclosure objective in paragraph 29.38.

BC20 Therefore, the IASB concluded that it should not propose amendments to the disclosure objective in paragraph 29.38 or any new disclosure requirements that would apply in periods before Pillar Two legislation is in effect. Nonetheless, for the avoidance of doubt, the IASB proposes to clarify in paragraph 29.38 of the Standard that 'other events' include the enacted or substantively enacted Pillar Two legislation.

Periods when legislation is in effect

BC21 The IASB proposes to require an SME to disclose separately its current tax expense (income) related to Pillar Two income taxes because doing so would:

- (a) help users of financial statements understand the magnitude of Pillar Two income taxes relative to an SME's overall tax expense—disaggregation of amounts presented in an SME's financial statements helps users understand those statements; and
- (b) not be costly to prepare because an SME would already be required to recognise current tax related to Pillar Two income taxes.

Effect analysis

BC22 The IASB concluded that the benefits of the proposed amendments outweigh the costs because the proposed amendments would:

- (a) provide timely relief for affected SMEs;
- (b) avoid diverse interpretations of Section 29 of the Standard developing in practice;
- (c) safeguard the usefulness of the information disclosed by an SME applying the *IFRS for SMEs* Standard until questions about how to apply Section 29 of the Standard to Pillar Two income taxes have been resolved; and
- (d) improve the information provided to users of SMEs' financial statements before and after Pillar Two legislation is in effect.

⁴ Paragraphs BC76 and BC157 of the Basis for Conclusions on the *IFRS for SMEs* Standard (issued in 2015).

Effective date and transition

- BC23 The IASB concluded that, for the temporary exception to be effective, it would need to be available to SMEs immediately upon the issue of the amendments and applicable to any financial statements not yet authorised for issue at that date. The IASB decided to propose retrospective application of the temporary exception in paragraph 29.3A because such application would:
- (a) allow an SME to apply the exception from the date the Pillar Two legislation is enacted or substantively enacted, even if that date is before the issue date of the amendments; and
 - (b) not result in additional costs.
- BC24 The IASB also decided that the consequential amendments to paragraph 35.10(h) would need to be applied immediately upon the issue of the proposed amendments to Section 29 of the *IFRS for SMEs* Standard to ensure that the Standard is no more onerous to apply by a first-time adopter than by SMEs already applying the Standard.
- BC25 The IASB proposes to require an SME to apply the disclosure requirements in proposed new paragraph 29.43 for annual reporting periods beginning on or after 1 January 2023. The IASB concluded that this effective date would provide an SME with enough time to prepare the required information. The IASB also expects that the disclosure requirements in paragraph 29.43 will only be applicable from 1 January 2024 when Pillar Two legislation is expected to be in effect in many jurisdictions.



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