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Exposure Draft

IFRS Accounting Standard

International Tax Reform—Pillar Two Model Rules

Proposed amendments to IAS 12

Comments to be received by 10 March 2023

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Exposure Draft ED/2023/1 *International Tax Reform—Pillar Two Model Rules* is published by the International Accounting Standards Board (IASB) for comment only. Comments need to be received by 10 March 2023 and should be submitted by email to commentletters@ifrs.org or online at <https://www.ifrs.org/projects/open-for-comment/>.

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CONTENTS

	<i>from page</i>
INTRODUCTION	4
INVITATION TO COMMENT	5
[DRAFT] AMENDMENTS TO IAS 12 <i>INCOME TAXES</i>	8
APPROVAL BY THE IASB OF EXPOSURE DRAFT <i>INTERNATIONAL TAX REFORM—PILLAR TWO MODEL RULES</i> PUBLISHED IN JANUARY 2023	10
BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT <i>INTERNATIONAL TAX REFORM—PILLAR TWO MODEL RULES</i>	11

Introduction

Why is the IASB publishing this Exposure Draft?

In December 2021, the Organisation for Economic Co-operation and Development (OECD) published its Pillar Two model rules. The rules are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy and were agreed by more than 135 countries and jurisdictions representing more than 90% of global GDP.

The Pillar Two model 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; and
- (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%.

Stakeholders informed the International Accounting Standards Board (IASB) of concerns about the potential implications for income tax accounting resulting from jurisdictions implementing the Pillar Two model rules. In particular, stakeholders were concerned about the uncertainty over the accounting for deferred taxes arising from the rules and said there was an urgent need for clarity in the light of the imminent enactment of tax law to implement the rules in some jurisdictions.

Proposals in this Exposure Draft

The proposals in this Exposure Draft would introduce:

- (a) a temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules; and
- (b) targeted disclosure requirements.

The IASB expects the proposed amendments to provide timely relief for affected entities and avoid inconsistent interpretations of IAS 12 *Income Taxes* developing in practice. The proposed amendments would also require an entity to provide specific information to users of financial statements before and after the Pillar Two model rules are in effect.

Next steps

The IASB will consider the comments it receives on the Exposure Draft and will decide whether to proceed with the proposed amendments. The IASB plans to complete any resulting amendments in the second 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 is requesting comments only on matters addressed in this Exposure Draft.

Questions for respondents

Question 1—Temporary exception to the accounting for deferred taxes (paragraphs 4A and 88A)
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<p>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.</p>
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<p>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.</p>
--

<p>The IASB also proposes that an entity disclose that it has applied the exception.</p>
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<p>Paragraphs BC13–BC17 of the Basis for Conclusions explain the IASB’s rationale for this proposal.</p>
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<p>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.</p>

Question 2—Disclosure (paragraphs 88B–88C)
<p>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:</p> <ul style="list-style-type: none"> (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: <ul style="list-style-type: none"> (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. <p>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.</p> <p>Paragraphs BC18–BC25 of the Basis for Conclusions explain the IASB’s rationale for this proposal.</p> <p>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.</p>

Question 3—Effective date and transition (paragraph 98M)
<p>The IASB proposes that an entity apply:</p> <ul style="list-style-type: none"> (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 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>; and (b) the disclosure requirements in paragraphs 88B–88C for annual reporting periods beginning on or after 1 January 2023. <p>Paragraphs BC27–BC28 of the Basis for Conclusions explain the IASB’s rationale for this proposal.</p> <p>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.</p>

Deadline

The IASB will consider all written comments received by 10 March 2023.

How to comment

Please submit your comments electronically:

Online <https://www.ifrs.org/projects/open-for-comment/>

By email commentletters@ifrs.org

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 IAS 12 *Income Taxes*

Paragraphs 4A, 88A–88C (and their related heading) and 98M are added.

Scope

...

- 4A This Standard 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, including tax law that implements qualified domestic minimum top-up taxes described in those rules.¹ 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 Standard, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

...

Disclosure

...

International tax reform—Pillar Two model rules

- 88A 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 4A).
- 88B An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.
- 88C In periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity shall 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) for the current period is below 15%. The entity shall also disclose the tax expense (income) and accounting profit 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:

¹ The Pillar Two model rules are available at <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm>.

INTERNATIONAL TAX REFORM—PILLAR TWO MODEL RULES

- (i) identified in applying paragraph 88C(b) but in relation to which the entity might not be exposed to paying Pillar Two income taxes; or
- (ii) not identified in applying paragraph 88C(b) but in relation to which the entity might be exposed to paying Pillar Two income taxes.

Effective date

...

98M *International Tax Reform—Pillar Two Model Rules*, issued in [Month] 2023, added paragraphs 4A and 88A–88C. An entity shall apply:

- (a) paragraphs 4A and 88A immediately upon issue of these amendments and retrospectively in accordance with IAS 8; and
- (b) paragraphs 88B–88C 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* published in January 2023**

The Exposure Draft *International Tax Reform—Pillar Two Model Rules*, which proposes amendments to IAS 12 *Income Taxes*, was approved for publication by all 12 members of the International Accounting Standards Board.

Andreas Barckow	Chair
Linda Mezon-Hutter	Vice-Chair
Nick Anderson	
Patrina Buchanan	
Tadeu Cendon	
Zach Gast	
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*

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

Background

The Pillar Two model rules

- BC1 In December 2021, the Organisation for Economic Co-operation and Development (OECD) published *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, hereafter referred to as the ‘Pillar Two model rules’. These rules:
- (a) are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy and were agreed by more than 135 countries and jurisdictions representing more than 90% of global GDP; and
 - (b) provide a template that jurisdictions can translate into domestic tax law and implement as part of an agreed common approach.¹

Objective and scope

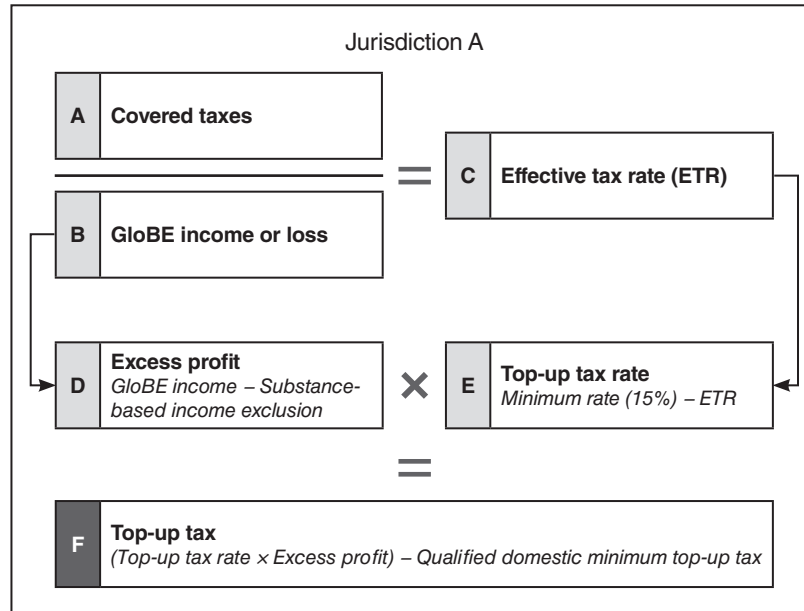
- BC2 The Pillar Two model rules:
- (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and
 - (c) typically require the ultimate parent entity of the group to pay top-up tax—in the jurisdiction in which it is domiciled—with respect to profits of its subsidiaries that are taxed below 15%.
- BC3 The rules generally 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.

¹ See further information at <https://www.oecd.org/tax/beps/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm>.

Computation of top-up tax

BC4 Figure 1 illustrates the computation of top-up tax in a given jurisdiction.

Figure 1—Computation of Top-up Tax in Jurisdiction A



BC5 In summary, the Pillar Two model rules specify that:

- covered taxes* comprise current tax expense in a jurisdiction after adjusting for tax credits and deferred taxes. These adjustments include adding deferred tax expenses capped at 15% (subject to further adjustments). The amount includes income taxes (or taxes in lieu of those) for the fiscal year.
- Global Anti-Base Erosion (GloBE) income or loss* is the profit or loss in a jurisdiction included in the consolidated financial statements of the ultimate parent entity, before eliminating intragroup items and after making other adjustments (for example, adjusting for some common differences between accounting requirements and tax rules).
- the *effective tax rate* is calculated by dividing covered taxes by the GloBE income or loss for a jurisdiction. The resulting rate is subtracted from 15% to calculate the *top-up tax rate* for the jurisdiction.
- excess profit* is the GloBE income or loss minus the substance-based income exclusion. The substance-based income exclusion is intended to exclude a fixed return for substantive activities in a jurisdiction. Payroll costs and the carrying amount of tangible assets are used as indicators of substantive activities.

- (e) *top-up tax* is the product of excess profit and the top-up tax rate in a jurisdiction. An entity then reduces that top-up tax by any applicable qualified domestic minimum top-up tax (see paragraph BC7).

Charging provisions

- BC6 A liability to pay top-up tax may arise under one of two rules, namely:
- (a) the *income inclusion rule* (IIR) whereby a parent is liable for top-up tax in proportion to its ownership interest in subsidiaries that were taxed below 15%. The ultimate parent entity is primarily liable for top-up tax under the rule but, in some circumstances, intermediate parent entities may be liable.
 - (b) the *UTPR*, which is a backstop mechanism for profits taxed below 15% that are not charged under the IIR.
- BC7 Jurisdictions may also introduce a *qualified domestic minimum top-up tax*. This top-up tax is computed on a basis similar to the Pillar Two model rules, but would be charged in the jurisdiction in which the profit arises rather than in the ultimate parent entity's jurisdiction.

Potential implications for income tax accounting

- BC8 Stakeholders informed the 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. Those concerns related to:
- (a) how to account for top-up tax (see paragraphs BC9–BC10);
 - (b) the usefulness of the information that could result from accounting for deferred taxes related to top-up tax (see paragraph BC11); and
 - (c) the urgent need for clarity in the light of the imminent enactment of tax law to implement the rules in some jurisdictions (see paragraph BC12).

How to apply IAS 12 to account for top-up tax

Scope of IAS 12

- BC9 Stakeholders generally agree that top-up tax is an income tax—in the scope of IAS 12 *Income Taxes*—in the consolidated financial statements of the ultimate parent entity of a group subject to the Pillar Two model rules. However, they said it was unclear whether top-up tax is an income tax in the financial statements of a group's subsidiaries—for example, if an entity is liable to pay such tax with respect to profits of entities that are not part of its reporting group (for example, with respect to a fellow subsidiary's profits).

Deferred tax accounting

- BC10 Stakeholders said it is unclear how an entity accounts for deferred taxes related to top-up tax. For example:

- (a) *whether the Pillar Two model rules create additional temporary differences*—is it possible to link directly the recovery or settlement of the carrying amount of assets and liabilities to future top-up tax payments (or the reduction of these payments)? Whether an entity will pay top-up tax will depend on many factors, including, for example, whether permanent differences arise in the entity’s calculation of income taxes under domestic tax regimes.
- (b) *whether to remeasure deferred taxes*—is an entity required to remeasure deferred taxes recognised under domestic tax regimes to reflect potential top-up tax payable under the Pillar Two model rules?
- (c) *which tax rate to use to measure deferred taxes*—which tax rate does an entity use to measure any deferred taxes related to top-up tax, considering that paragraph 47 of IAS 12 requires an entity to use the tax rates that are expected to apply when the asset is realised or the liability is settled? The tax rate that will apply to an entity’s excess profit in future periods depends on a number of factors that are difficult—if not impossible—to forecast reliably.

The usefulness of the deferred tax information

BC11 Some stakeholders questioned the usefulness of the information that would result from recognising deferred taxes related to top-up tax, particularly if an entity is required to estimate the tax rate to apply in measuring these deferred taxes. They said recognising deferred taxes related to top-up tax could be extremely complex and, therefore, the costs of doing so might outweigh the benefits.

Urgent need for clarity

BC12 IAS 12 requires an entity measuring deferred tax assets and liabilities to reflect tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. Because some jurisdictions are expected to enact tax law to implement the Pillar Two model rules in the first half of 2023, stakeholders said:

- (a) there is little time to resolve the uncertainties about how to apply IAS 12 in accounting for top-up tax; and
- (b) without further clarification, an entity might incur costs in developing and applying their own interpretations of the requirements in IAS 12, which could result in:
 - (i) diversity in the accounting applied by affected entities; and
 - (ii) information that is potentially not useful for users of financial statements.

Proposed amendments to IAS 12

- BC13 After considering stakeholders' concerns, the IASB agreed that entities need time to determine how to apply the principles and requirements in IAS 12 to account for deferred taxes related to top-up tax. The IASB also needs time to engage further with stakeholders and consider whether, for example, any action is needed to support the consistent application of IAS 12.
- BC14 Because the rules are expected to be implemented in some jurisdictions in the near term, the IASB concluded that it would not be feasible to complete the activities mentioned in paragraph BC13 before new tax laws are expected to be enacted and, consequently, before entities are required to reflect those laws in accounting for deferred taxes.

Temporary exception to the accounting for deferred tax

- BC15 The IASB proposes to introduce a temporary exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.² Introducing such a temporary exception would:
- (a) provide affected entities with relief from accounting for deferred tax assets and liabilities in relation to a complex new tax law to be enacted in multiple jurisdictions in a short period of time;
 - (b) avoid entities developing diverse interpretations of IAS 12, which could result in the Standard being applied inconsistently; and
 - (c) allow time for jurisdictions to enact new tax law, for stakeholders to assess how the rules have been implemented by those jurisdictions, for entities to assess how they are affected and for the IASB to consider whether it needs to undertake further work.

Mandatory application

- BC16 The IASB proposes that the temporary exception be mandatory, instead of optional. Making the exception mandatory would:
- (a) result in greater comparability between entities' financial statements, and thus result in more useful information for users of financial statements; and
 - (b) eliminate the risk that entities might inadvertently develop accounting policies that are inconsistent with the principles and requirements in IAS 12.

² This Basis for Conclusions refers to tax law enacted or substantively enacted to implement the Pillar Two model rules, including tax law that implements qualified domestic minimum top-up taxes, and the income taxes arising from it, as 'Pillar Two legislation' and 'Pillar Two income taxes'.

Duration of the exception

- BC17 Further work is needed to determine how entities apply the principles and requirements in IAS 12 to account for deferred taxes related to Pillar Two income taxes (see paragraph BC13), which in turn depends on how jurisdictions implement the Pillar Two model rules. The IASB concluded that it is not possible to determine—at present—how much time such work will require. Consequently, the IASB proposes not to specify how long the temporary exception would be in place.

Disclosures

- BC18 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 financial statements when Pillar Two legislation:
- (a) is enacted or substantively enacted, but not yet in effect (see paragraphs BC19–BC24); and
 - (b) is in effect (see paragraph BC25).

Periods before legislation is in effect

- BC19 In periods before Pillar Two legislation is in effect, users of financial statements need information to help them assess an entity's exposure to paying top-up tax. However, in these periods, entities are likely to be in the process of assessing their exposure and preparing to comply with the legislation. Therefore, requiring entities to provide detailed information reflecting the specific requirements of the Pillar Two legislation would either not be feasible or be likely to result in undue cost or effort.
- BC20 The IASB sought to identify what information would provide users of financial statements with insights into an entity's potential exposure to paying top-up tax but that would not involve undue cost or effort. Considering this balance of costs and benefits, the IASB proposes to require an entity to disclose, for the current period only:
- (a) information about Pillar Two legislation enacted or substantively enacted in jurisdictions in which the entity operates (paragraph 88C(a)); and
 - (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 be required to disclose the tax expense (income) and accounting profit³ for these jurisdictions in aggregate, as well as the resulting weighted average effective tax rate (paragraph 88C(b)).

³ Paragraph 5 of IAS 12 defines accounting profit as 'profit or loss for a period before deducting tax expense'.

- BC21 Requiring entities to disclose information for the current period prepared in accordance with IAS 12 would be less costly than requiring them to provide information based on the requirements of the Pillar Two legislation. Entities would have access to at least some of the information needed to comply with the proposed requirement in paragraph 88C(b) in applying requirements in IAS 12. For example, in preparing the reconciliation required by paragraph 81(c), an entity determines the accounting profit in jurisdictions with different tax rates to calculate the effects of these different rates (see paragraph 85).
- BC22 The Pillar Two model rules include specific requirements that differ from those in IAS 12 in relation to calculating an effective tax rate for each jurisdiction. For this reason, some IASB members were opposed to requiring entities to disclose information prepared in accordance with IAS 12. In their view, such information would not be useful to users of financial statements because it would not be based on the requirements in the Pillar Two model rules and would relate to periods in which the rules are not yet in effect. In their view, such information could also be misleading or commercially sensitive.
- BC23 However, a majority of IASB members were of the view that information prepared in accordance with IAS 12 would still be useful to users of financial statements in providing an indication of an entity's potential exposure to paying top-up tax and the jurisdictions in which that potential exposure might exist. Because of the significance of the Pillar Two model rules, those IASB members viewed it as important that users of financial statements were given some indication of an entity's potential exposure to paying top-up tax.
- BC24 The IASB also proposes to require an entity to disclose whether assessments the entity has made in preparing to comply with Pillar Two legislation indicate there are additional (or fewer) jurisdictions in which the entity might be exposed to paying Pillar Two income taxes compared to those with an average effective tax rate of less than 15% based on the requirements in IAS 12 (paragraph 88C(c)). This information would:
- (a) supplement the information an entity provides in applying paragraph 88C(b);
 - (b) indicate whether an entity operates in jurisdictions in which it expects it might be taxed below the minimum rate in accordance with the specific requirements of the Pillar Two legislation; and
 - (c) not involve undue cost or effort because it would be required only if an entity has made such assessments.

Periods when legislation is in effect

- BC25 The IASB proposes to require an entity to disclose separately the current tax expense related to Pillar Two income taxes. The IASB concluded that disclosing that information would:
- (a) help users of financial statements understand the magnitude of Pillar Two income taxes relative to an entity's overall tax expense; and

- (b) not be costly because an entity will be required to recognise current tax related to Pillar Two income taxes.

Effect analysis

- BC26 The IASB concluded that the benefits of the proposed amendments outweigh the costs because the proposed amendments would:
- (a) provide timely relief for affected entities and would avoid diverse interpretations of IAS 12 developing in practice;
 - (b) safeguard the usefulness of the information that results from entities applying IAS 12 until questions about how to apply the Standard have been resolved; and
 - (c) improve the information provided to users of financial statements before and after Pillar Two legislation is in effect.

Effective date and transition

- BC27 The IASB concluded that, for the temporary exception to be effective, it would need to be available to entities 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 because such application would result in:
- (a) entities applying the exception from the date Pillar Two legislation is enacted or substantively enacted, even if that date is before the date on which the IASB issues final amendments; and
 - (b) no additional costs.
- BC28 The IASB proposes to require an entity to apply the disclosure requirements in paragraphs 88B–88C for annual reporting periods beginning on or after 1 January 2023. The IASB concluded that entities would need time to prepare the required information.



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