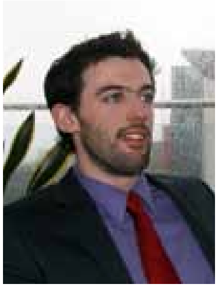

Tax Accounting under FRS 102

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Introduction

On 14 March 2013, the Financial Reporting Council issued FRS 102, "The Financial Reporting Standard Applicable in the UK and Republic of Ireland". This is the third standard in the complete overhaul of the existing Irish generally accepted accounting practice (GAAP), following the issuing of FRS 100, "Application of Financial Reporting Requirements", and FRS 101, "Reduced Disclosures Framework", in 2012. Adoption of these new standards is mandatory for accounting periods beginning on or after 1 January 2015, with early adoption available for periods ending on or after 31 December 2012.

FRS 102 is the most significant of the new standards, as it is likely to impact on most entities currently preparing their financial statements under Irish GAAP. This article focuses on the impact of FRS 102 on tax accounting, with a brief reference to the new financial reporting options included as an appendix.

What's the Same?

For entities that have always reported under the existing Irish GAAP, many of the tax accounting requirements of FRS 102 will be similar to those required under the existing Irish GAAP standards (FRS 16, "Current Tax", and FRS 19, "Deferred Tax").

Current tax

Current tax is still the tax estimated to be payable to the tax authorities.

Deferred tax

The “timing-differences” approach based on the mismatch between the period in which gains and losses are recognised in the financial statements and the period in which the tax effects are taxable/deductible has broadly been maintained.

Recognition of deferred tax assets

FRS 102 uses the word “probable” as a threshold for the recognition of deferred tax assets. “Probable”, however, is defined as “more likely than not”, so broadly there is no change in the recognition of deferred tax assets under FRS 102 compared with FRS 19.

The longer-term significance of changing GAAP will arise from its ongoing impact on tax calculations. Entities will need to consider areas where tax follows the accounting and where adjustments are required to move from the accounting treatment to the tax treatment.

The use of “substantively enacted” tax rates

FRS 102 contains the same language regarding the legislative process in Ireland – i.e. current and deferred tax assets and liabilities are computed by reference to the substantively enacted tax rate at the reporting date.

Uncertain tax positions

Similar to FRS 16, FRS 102 provides no explicit guidance on the recognition or measurement of “uncertain tax positions”.

Offsetting deferred tax assets and liabilities on the balance sheet

The broad criteria that permitted offsetting under FRS 19 (i.e. taxes levied by the same tax authority arising in the same taxable entity) are retained under FRS 102.

What’s New?

While FRS 102 eliminates much of the text contained in FRS 16 and FRS 19, it adds some new guidance, much of which has been borrowed from the International Financial Reporting Standard equivalent (IAS 12).

Glossary of defined terms

FRS 102 is much more reader-friendly. The relevant section covering tax (section 29) is just over four pages, with any relevant definitions included as a separate glossary at the back of the standard. The corresponding guidance under previous GAAP (FRS 16 and FRS 19) runs to over 40 pages.

Discounting

FRS 102, like IAS 12, prohibits the discounting of any deferred tax balances. Conversely, discounting of deferred tax balances was previously permitted under FRS 19.

Presentation of deferred tax on pensions

While there is no difference in the calculation of deferred tax, FRS 17, “Retirement Benefit Schemes”, required that the associated deferred tax be presented with the pension’s asset or liability. No similar requirement exists in FRS 102, and therefore it should be presented together with other deferred taxes.

Are There Any Significant Differences to Note?

The longer-term significance of changing GAAP will arise from its ongoing impact on tax calculations. Entities will need to consider areas where tax follows the accounting and where adjustments are required to move from the accounting treatment to the tax treatment. In many cases, the starting point for taxable income is profit or loss per the entity accounts. Where a change in accounting policy affects the recognition of income or expense, this could have a tax effect in terms of both cash tax payments and the effective tax rate of the entity.

The table below outlines some of the key differences between old Irish GAAP and FRS 102 and their potential impact on cash tax payments and on an entity’s effective tax rate and deferred tax balances.

Area	"Old" Irish GAAP (FRS 16/19)	"New" Irish GAAP (FRS 102)	Cash tax impact	Effective tax rate/deferred tax impact
Acquired goodwill and intangibles	Amortised over assumed maximum useful life of 20 years.	Amortised over 5 years where useful economic life cannot be reliably estimated.	A tax deduction is available only in respect of certain intangible assets (IP) and associated goodwill used for the purposes of a trade. Broadly, a tax deduction is available in line with the write-off in the accounts or over 15 years if the appropriate election is made in the period the expenditure is incurred. If a tax deduction is taken in line with the accounts, accelerated amortisation on transition to FRS 102 would decrease cash tax in the near future, with increased tax payments later. The option to spread the deduction over 15 years is available only when election made in the year that the expenditure is incurred. Therefore, subject to the statute of limitations, it is not possible retrospectively to elect for amortisation over 15 years, meaning automatic accelerated amortisation.	Accelerated amortisation of goodwill will give rise to a higher ETR if it is not tax-deductible. In respect of IP: > Where a tax deduction is taken in line with the amounts amortised to the accounts, there should be no impact on the ETR. > Where an election is made, there should be no impact on the ETR where deferred tax is provided on any difference between book and tax amortisation. > There should be no impact on the ETR where neither book nor tax amortisation is available. There will be no impact on the ETR if the accounting amortisation of goodwill is in line with the tax amortisation.
Financial instruments	Cost model with the option to use FRS 23/26/29 (equivalent to full IFRS). Derivatives are not usually held on balance sheet. No concept of embedded derivatives. Practice is to apply "synthetic" accounting for economic hedges. Guidance on hedging of foreign exchange allows use of contract forward rates.	"Basic" financial instruments (e.g. simple bank loans) are measured at cost or at amortised cost using the effective interest rate method. Equity instruments with a reliably measurable fair value (e.g. quoted prices in an active market) are measured at FVTPL. Complex financial instruments (e.g. derivatives) are measured at FVTPL. There are simplified restrictive hedging requirements, and no requirement to separate embedded derivatives. There is an option to apply IAS 39 or IFRS 9 (as adopted in the EU) for recognition and measurement (but retaining reduced disclosure).	Amounts taken to profit or loss will generally be taxable/deductible. Where FVTPL is used for the first time, it will be necessary to consider whether amounts (both profits and losses) have dropped out for taxation purposes in earlier periods. If a taxable restatement arises in the year of transition, the amount restated will be spread over the following 5 years for tax purposes. Where transitional rules apply, it will be necessary to consider "anti-avoidance" rules in relation to "bed-and-breakfast" transactions. The anti-avoidance provision will apply where there is a disposal of a financial asset or liability at a loss in the 6-month period before the "changeover day" and where, within an 8-week period around the disposal (i.e. 4 weeks before and 4 weeks after), the company acquires an asset that is substantially identical from an economic viewpoint. Where the conditions for hedge accounting are satisfied, the tax treatment will follow the accounting.	The ETR is more likely to be volatile if any resulting deferred tax assets are not recognised. Otherwise, the ETR will be "normalised" through deferred tax provisions.

Foreign currency	SSAP 20 permits the use of "local" currency, providing limited further guidance. Entities can adopt FRS 23, which is the same as IFRS.	Transactions are recorded in functional currency and presented in presentational currency.	There will be a potentially significant effect where entities have previously used the "local"-currency approach permitted by SSAP 20. Foreign-exchange movements taken to profit or loss as a result of the functional-currency approach will be taxable, causing more volatility in cash tax payable on an annual basis.	There will be no impact on the ETR where any deferred tax is fully provided. If deferred tax assets are not recognised, more volatility will result.
Investment property	Mandatory revaluation to open-market value with movements going through the Statement of Recognised Gains and Losses and accumulating in a revaluation reserve.	Use FVTPL unless fair-value measurement would present undue cost or effort, in which case cost is permitted.	There will be no effect because investment properties are taxed on a chargeable gains basis.	Deferred tax will be required on all temporary differences including revaluations (more deferred tax calculation is required than for Irish GAAP).
Multi-employer pension schemes	The exemption for multi-employer schemes allows treatment as a DC scheme in some entities (including group schemes).	The exemption for multi-employer schemes allows treatment as a DC scheme. There is no exemption for group schemes (entities under common control). Entities may need to recognise a liability where they have entered into an agreement to fund a deficit.	There will be no effect because tax deductions available for pensions are based on cash payments rather than amounts charged to profit or loss	There will be no ETR impact where any deferred tax is fully provided. If deferred tax assets are not recognised, more volatility will result.

DC = defined contribution ETR = effective tax rate FVTPL = fair value through profit or loss

Disclosures

The disclosure requirements are not significantly different from existing Irish GAAP, although there are some new points to be aware of:

- Rate reconciliation: FRS 19 required a reconciliation of pre-tax income multiplied by the statutory tax rate to the current tax expense, whereas FRS 102 requires a reconciliation to total tax expense from continuing operations. This is consistent with IAS 12.
- Disclosure of deferred tax: Similar to FRS 19, deferred tax liabilities are presented within provisions, and deferred tax assets within debtors.
- Additional disclosures now required include adjustments to deferred tax for changes in tax status, changes in accounting policies and material errors.
- To assist readers in understanding future cash flows, there is a new requirement to disclose an estimate of the amount of net reversals of deferred tax assets and liabilities expected to occur during the following year.

Transitioning to FRS 102

Date for adoption

The mandatory effective date for FRS 102 is for accounting periods beginning on or after 1 January 2015 (with an opening balance sheet as of 1 January 2014). Early adoption is permitted for periods ending on or after 31 December 2012.

Transition to FRS 102 is retrospective. In other words, the opening balance sheet and comparative periods presented should reflect balances as if FRS 102 had always been applied. However, section 35 of FRS 102, "Transition to This FRS", provides a general exemption from retrospective application when it would be impracticable, although disclosure would be required. What this means in practice will likely depend on the complexities of a particular entity and on the reasons why the entity believes that it is impracticable to apply FRS 102 retrospectively.

Taxing transitional adjustments

One of the most immediate issues to be considered on transition to FRS 102 is the taxation of any transitional adjustments. Schedule 17A was introduced to the Taxes Consolidation Act 1997 in 2005 to deal with any transitional adjustments that arise on conversion to IFRS from Irish GAAP. Broadly, where conversion from Irish GAAP to IFRS created one-off income or expense items, these amounts were spread over five years in computing any corporation tax liability. It is likely that these rules would have much wider application in respect of FRS 102, as the adoption of this new accounting framework will affect significantly more Irish entities than transitions to IFRS.

However, Schedule 17A does not currently seem to provide for a scenario where an entity converts from one local GAAP to another (i.e. existing Irish GAAP to FRS 102). It would seem reasonable to suggest that Revenue would broadly follow existing practice, with any transitional adjustments on conversion from existing Irish GAAP to FRS 102 being spread over five years (with similar rules applying to bad debts and financial instruments as currently in force under Schedule 17A). Given that opening balance sheets from 1 January 2014 need to be prepared under FRS 102, it would be hoped that any required changes to legislation in respect of these transitional arrangements would be considered in the upcoming Budget.

Other considerations on conversion

Converting to a new accounting regime is not just an accounting or tax issue. As well as identifying the tax differences discussed above, entities will need to consider the impact of moving to a new accounting regime on other areas of the business. Other areas that may require consideration include:

- systems and reporting,
- staff and training,
- banking covenants,
- remuneration incentive schemes,
- distributable profits,
- group structure,
- pensions,
- hedging instruments and
- transfer pricing.

Conclusion

The transition to accounting for income taxes under the "new" Irish GAAP may not be as daunting as it might seem at first glance. If an entity is going to adopt FRS 102, new or different information may need to be collected, requiring a well-thought-out plan to effect this change. This should include identifying which differences will impact on the entity and what new data need to be collected, as well as creating procedures to gather these data. This will likely require updating tax reporting templates to calculate any new deferred tax assets/liabilities and to generate updated disclosures.

Appendix – Summary of the New Accounting Standards

What are the new standards?

- FRS 100 sets out the overall framework for financial reporting, explaining:
  - which standards apply to which types of entity,
  - when an entity can apply the reduced disclosure framework and
  - when an entity should follow a Statement of Recommended Practice (SORP) for a specialised industry.
- FRS 101 sets out a reduced disclosure framework. Certain qualifying entities, which otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS, can elect to apply this reduced disclosure framework when preparing their individual financial statements.
- FRS 102 introduces a single standard based broadly on the IFRS for SMEs.[1]

What are my options?

Under the new regime, the reporting landscape will be very different, with financial reporting requirements depending on the nature and size of an entity. The greatest impact is likely to be for those entities formerly reporting under current Irish GAAP. The majority of these entities will in future apply FRS 102 when preparing their annual financial statements. More specifically, the new standard will apply to all entities that neither are required nor elect to apply EU-adopted IFRS, FRS 101's reduced disclosure framework or the Financial Reporting Standard for Small Entities (FRSSE). The reporting options that will be available are summarised below.

	FRSSE	FRS 102	EU-adopted IFRS
Entities eligible for "small" companies regime	○	○	○
Entities not "small" and not required to apply EU-adopted IFRS		○	○
Entities required to apply EU-adopted IFRS			○

1 Broadly, FRS 102 replaces all existing FRS and SSAP. The single exception is FRS 27, "Life Assurance", which is being retained until a new standard relating to insurance accounting (FRS 103) is introduced in the future.