

IFRS in Focus

UK exit from the European Union

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Income tax reporting following triggering of 'Article 50'

On 29 March 2017, the United Kingdom's ambassador to the European Union delivered a letter to the President of the European Council giving formal notice under Article 50 of the Lisbon Treaty of Britain's withdrawal from the European Union.

EU law includes several directives, transposed into the law of each member state, providing relief or deferral of (direct) income tax on various transactions, typically between members of a group incorporated in different member states. For both UK entities and groups with British operations, triggering Article 50 raises the question of whether there are any immediate financial reporting effects of the possible withdrawal of those reliefs.

At the commencement of this unprecedented process, significant uncertainty exists over the precise steps (both at a European Union and individual member state level) to be followed before withdrawal of the UK from the EU takes effect. In addition, the legislation enacted at a member state level may not be uniform across the EU, may in some cases be supplemented by bilateral agreements and is unlikely to address explicitly the effect of withdrawal of a member state. As a result, prior to negotiation between the UK, the European Council and potentially individual member states, the form that any change in tax law might take is uncertain.

Given these layers of complexity, it is difficult to conclude that a change in tax law has been 'substantively enacted' as that term is applied in IAS 12 *Income Taxes* on triggering of Article 50, or what effect any such change would have on current and deferred tax balances. So overall there is a significant level of uncertainty about the future tax obligations of groups currently taking advantage of reliefs based on the application of EU law to UK companies.

For more information please see the following websites:

www.iasplus.com

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Which transactions might be affected?

Notwithstanding the discussion above, it is worth considering the tax consequences of withdrawal from the EU. The following directives have been identified as providing reliefs which may not be available following the conclusion of the 'Brexit' process.

- i. **Parent – Subsidiary Directive:** concerns the elimination of withholding taxes on dividends paid to the "parent companies";
- ii. **Interest and Royalties Directive:** concerns the elimination of certain withholding taxes on interest and royalties;
- iii. **Merger Directive:** concerns the deferral of tax on gains for certain cross-border transactions, transfers of assets and exchange of shares within the EU (the applicable national law may provide for deferral only until the assets are transferred outside of the EU).

Any potential changes to the applicable withholding tax rates/laws on distributions, interest or royalties would apply to such transactions made after the date of withdrawal from the EU. By comparison, withdrawal may trigger the immediate payment of tax previously relieved or deferred on tax gains arising from transactions in the scope of the Merger Directive.

Beyond these specifics, changes to or withdrawal of other aspects of EU law – for example, the EU Arbitration Convention, used as a means of settling tax disputes between member states – could have an effect on companies' tax affairs.

We do not expect the triggering of Article 50 to result in changes to recognised tax balances, but would expect an entity to provide disclosures on significant risks and uncertainties around future tax rates and payments. These might be included in any or all of:

- Narrative disclosure of risks and uncertainties as required by many local laws and regulations, for example SEC Regulation S-K, the EU Transparency Directive as implemented in each member state and the strategic report requirements of the UK Companies Act.
- Discussion in the tax note on possible future changes in the entity's effective tax rate.
- A discussion of sources of estimation uncertainty as required by IAS 1 *Presentation of Financial Statements*, which might often include discussion of tax risks.

The nature and extent of disclosure will be a function of the individual entity's exposure to any change in those reliefs and could include, depending on those circumstances:

- The existence of undistributed profits which may be subject to a different tax treatment should dividends be paid post 'Brexit'.
- The entity's use of transactions subject to the Interest and Royalties Directive and whether any change in practice is anticipated following withdrawal of the UK from the EU.
- The extent to which the entity has previously transferred business and assets between the UK and another EU member state with tax deferred under the Merger Directive.

Disclosure might also be appropriate of any existing current or deferred tax balances that might be affected by changes resulting from withdrawal and, in circumstances where a reasonable estimate can be made, the likely quantum of that effect.

Discussion of tax uncertainties might also form part of any broader discussion of the likely effects of 'Brexit' on an entity's future financial position or performance.

The Deloitte IFRS in Focus '[UK referendum on membership of the European Union: Financial reporting implications](#)' provides guidance on the broader issues arising from the 'Brexit' process.



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