Changes in financial reporting

Taxation Issues

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Important changes are being made to UK GAAP by Financial Reporting Standard 102 (FRS 102) which becomes effective for non-small entities in the UK (and ROI) for periods commencing on or after 1 January 2015. Small entities are also being brought within the scope of FRS 102 recognition and measurement requirements for periods commencing on or after 1 January 2016. Earlier adoption is permitted in both cases. **In Changes to financial reporting: The time to act is now**, we provided an overview of the considerations that you need to think about now. In this commentary we look at the impact of new UK GAAP on the calculation of current and deferred tax and the key changes to disclosure requirements.

Tax impact of FRS 102

FRS 102 will have an effect on taxation in the following ways:

- the calculation of current tax;
- the calculation of deferred tax; and
- disclosure requirements, in particular the reconciliation to tax note.

HMRC has already prepared an **overview paper** to assist companies applying the new standards which provides a summary of the key accounting changes and tax considerations that arise on transition to the new standards. The overview paper has been updated as standards and legislation have developed in recent months.

Broadly, in many areas tax follows the accounting treatment, unless, of course, there is specific tax legislation in place to the contrary. A different accounting treatment may, therefore, have an impact on tax payable.

Current tax

GAAP for current tax purposes

Tax law requires that the profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes. There are similar provisions in relation to corporation tax.

When an entity adopts new accounting policies tax law has provisions designed to ensure that all income is taxed once, and once only, and that all allowable expenditure is allowed, and allowed once only. The move from old UK GAAP to new UK GAAP is from one valid basis to another and are therefore taxable (or allowable) under the provisions outlined in **BIM34070**.

Adjustments required or authorised by law for tax purposes

Adjustments may arise under specific tax rules, or the general principles (although increasingly the general principles are being included within specific statutory requirements e.g. prohibition of tax relief for capital).

This principle applies both in income tax and corporation tax, although the tax law may be different e.g. the tax treatment of goodwill and intangibles.

Provided that the accounts have been prepared in accordance with generally accepted accounting practice they will be acceptable for tax purposes unless there is a specific tax law which overrides GAAP - whether from legislation or case law.

Current tax impact

Examples of changes likely to have a current tax charge implication on adoption of new UK GAAP include:

- Recognition of identifiable and measurable intangible assets separate from goodwill will result in the need to identify different useful lives and may interact with changes to tax reliefs available in this area
- Accruals for holiday pay and similar employment costs may result in additional allowable expenses, provided that the payment is made within nine months of the end of the year.
- Certain financing transactions at off-market rates
- Spreading of lease incentives over the lease term could increase the period over which the incentive is recognised and affect taxable profit.
- The inclusion of financial instruments on a fair value basis in certain circumstances can also affect taxable profits.

Deferred tax

Calculation of deferred tax

Deferred tax is future tax payable as a result of transactions in current or previous periods and is recognised for virtually all timing differences, with certain specified exceptions. Deferred tax is not recognised on permanent differences.

Though the calculation of deferred tax under FRS 102 is still based upon a timing differences approach, discounting is not permitted and the list of exemptions is different, making the calculation of deferred tax more complex and leading to deferred tax in more instances.

Deferred tax impact

Areas where FRS 102 requires that deferred tax is recognised, where there was no recognition under FRS 19 Deferred Tax are:

- On revaluations of non-monetary assets, such as fixed assets or investment properties, for which there is no binding agreement to sell and the gain or loss on sale has not been recognised.
- On unremitted earnings of subsidiaries, associates and joint ventures - where the income has not been accrued or there is no binding agreement in place to distribute the earnings.
- On rolled-over gains (arising on revaluations or disposals) prior to the assets into which the gains have been rolled over being sold.
- In relation to fair value adjustments in a business combination not recognised by the acquired entity in its own financial statements (e.g. on the write down of inventories).

Disclosure requirements

Probably the main disclosure difference concerns the reconciliation to tax. FRS 19 required a reconciliation of the current tax charge or credit reported in the profit and loss account to profit before tax multiplied by the applicable tax rate. However, FRS 102 requires a reconciliation of the total tax expense or income for the period (as included in profit or loss). Small entities continue to be exempt from taxation disclosures under FRS 102.

Disclosure impact

There are a number of other disclosure differences between FRS 102 and current GAAP:

- FRS 102 requires an analysis of the major components of the aggregate tax charge/credit recognised in the financial statements to be given whereas FRS 16 and FRS 19 required this analysis to be given separately for tax recognised in profit or loss and other comprehensive income.
- FRS 102 does not require disclosure of movements in deferred tax balances in the period or of unrecognised deferred tax amounts which were required by FRS 19.
- FRS 102 requires disclosure of the net reversal of deferred tax expected to occur in the period following the reporting period. This was not required under FRS 19.
- FRS 102 requires disclosure of the tax expense relating to discontinued operations but FRS 16 did not.
- There are no disclosure requirements in respect of current tax for small entities applying FRS 102. However, the financial statements of small entities may include the disclosures above if they are deemed necessary to achieve a true and fair view.

Assessing the impact

The potential tax consequences of transition to the new UK GAAP will need to be assessed early so that you can appropriately communicate the effect of any changes and help your clients prepare for the impact of implementing new UK GAAP or, in some circumstances, identify where early adoption may be an attractive option.

Recognition of deferred tax in a wider range of situations could significantly impact the balance sheet position of affected businesses.

How can Mercia help?

We can help you with the transition to New UK GAAP in the following ways:

- courses
- webinars
- client letters
- newswire
- blogs
- e-learning library

You can rest assured that we will continue to keep you up to date using all of these channels in the months ahead. You will find details of everything that we do on our website at www.mercia-group.co.uk and a subscription to our free monthly newswire is a great way of keeping yourself up to date with these.

Find out more about the range of services we can provide to help you and your clients with the transition to new UK GAAP

www.mercia-group.co.uk/newukgaap

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