HM TREASURY

Financial Reporting Advisory Board Paper

IAS 12: *Income Taxes*

Issue:	Applying IAS 12 *Income Taxes* in the context of resource and other accounts covered by the Government Financial Reporting Manual.
Impact on guidance:	The proposed text in Annex A relates to the shadow FReM.
IAS/IFRS adaptation?	No
IPSAS compliant?	N/A
Interpretation for the public sector context?	No – full compliance for those entities subject to the tax regime.
Impact on budgetary regime?	No
Alignment with National Accounts?	N/A
Impact on Estimates?	No
Recommendation:	That the Board agree that IAS 12 applies in full to those entities subject to the tax regime.
Timing:	Not yet known: depends on decision to move to EU-adopted IFRS.

DETAIL

Background

1. IAS 12 *Income Taxes* prescribes the accounting treatment for income taxes and is applicable for periods beginning on or after 1 January 1998. The Standing Interpretation Committee (SIC) of the International Accounting Standards Board (IASB) has issued two Interpretations relating to IAS 12, SIC-21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* and SIC 25 *Income Taxes – Changes in the tax status of an entity or its shareholders.* Both are effective from 15 July 2000. Income taxes are also the subject of a short-term project currently under way by the IASB and the US

Financial Accounting Standards Board (FASB), aimed at reducing the differences between IFRS and US Statements of Financial Accounting Standards (SFAS). IAS 12 achieves significant convergence with the requirements of SFAS 144; however, differences arise because both Standards have numerous exceptions to the basic principle. The IASB's approach to convergence is not to reconsider the underlying approach, but rather to eliminate exceptions to the basic principle. A joint exposure draft was expected in early 2006, but a presentation to the ASB on 20 April 2006 confirmed that the timetable has slipped and a draft is unlikely to appear until later this year.

2. Current UK GAAP is enshrined in Financial Reporting Standard (FRS) 16 *Current Tax,* effective for accounting periods ending on or after 23 March 2000 and FRS 19 *Deferred Tax,* effective for accounting periods ending on or after 23 January 2002.

The main features of IAS 12

3. IAS 12 prescribes the accounting treatment for income taxes, that is, taxes that are based on taxable profit. Income taxes include all domestic and foreign income taxes including foreign withholding taxes payable by a subsidiary, associate or joint venture on distributions to the reporting entity. Therefore, the standard applies to UK corporation tax that is assessed on an entity's profits. IAS 12 deals with:

a) Current tax consequences of transactions and other events that give rise to current tax assets and liabilities, and

b) Future tax consequences of transactions and other events that give rise to deferred tax assets and liabilities.

4. Current tax for the current and prior periods should, to the extent unpaid, be recognised as a liability. It should be recognised as an asset to the extent that the amounts already paid exceed the amount due. The benefit of a tax loss, which can be carried back to recover current tax of a prior period, should be recognised as an asset. Current tax assets and liabilities for the present and prior periods should be measured at the amount expected to be paid to, or recovered from, the taxation authorities, at the tax rates applying at the balance sheet date.

5. Deferred tax liabilities should be recognised in full for all taxable temporary differences, except for liabilities arising from:

a) The initial recognition of goodwill;

b) A transaction which

    i. is not a business combination, and

    ii. at the time of the transaction, affects neither accounting profit nor taxable profit;

c) Temporary differences arising on investments in subsidiaries, branches and joint ventures if the entity is able to control the timing of the reversal of the difference, and it is probable that the temporary difference will not reverse in the future.

6. A deferred tax asset is recognised only to the extent that it is probable that a tax benefit will be realised in the future. If it is probable that a tax benefit will be realised, a deferred tax asset is recognised on unused tax losses and unused tax credits.

The main features of SIC 21 – Recovery of Revalued Non-Depreciable Assets

7. IAS 12.20 notes that the revaluation of an asset does not always affect taxable profit in the period of the revaluation and that the tax base of an asset may not be adjusted as a result of the revaluation. If the future recovery of the carrying amount is taxable, any difference between the carrying amount of the revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. SIC 21 addresses the issue of how the term "recovery" is interpreted in relation to an asset that is not depreciated and is revalued in accordance with IAS 16 *Property, Plant and Equipment.* SIC 21 also applies to investment properties that are revalued under IAS 40 *Investment Property* but would be considered non-depreciable if IAS 16 were applied (e.g. land).

8. The consensus is that as the asset is not depreciated, recovery of the carrying amount will be through sale rather than through use.

The main features of SIC 25 – Changes in the Tax Status of an Entity or its Shareholders

9. SIC 25 addresses the issue of how an entity accounts for the tax consequences of a change in its tax status or that of its shareholders. The consensus is that a change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised directly in equity and the current and deferred tax consequences of a change in tax status are included in profit or loss for the period.

Comparison with requirements under UK GAAP

10. IAS 12 deals with both current and deferred taxes. The rules in respect of current taxes are similar to those of FRS 16, although there are presentational differences. IAS 12 requires current tax to be presented on the face of the balance sheet (there is no such requirement in FRS 16) Other presentational differences include:

a) IAS 12 requires current tax to be charged directly to equity if it relates to items that are also charged or credited directly to equity;

b) FRS 16 requires all current tax to be included in the statements of performance (that is, profit and loss account or STRGL).

11. In respect of deferred tax, IAS 12 is conceptually different from FRS 19. Instead of accounting for timing differences (the basis used in FRS 19), it uses a balance sheet concept of temporary differences – differences between the carrying amount of assets, liabilities, income and expenditure and their tax base (the amount attributed to them for tax purposes). Temporary differences include not only timing differences, but other differences between the accounting and tax bases of assets, liabilities, income and expenditure that are not timing differences, for example, revaluation of assets for which no equivalent adjustment is made for tax purposes. Other differences include:

a) IAS 12 prohibits the discounting of deferred tax. FRS 19 permits, but does not require, discounting deferred tax;

b) IAS 12 requires a reconciliation of the total (current and deferred) tax charge to the tax charge that would result from applying the standard rate of tax to the profit on ordinary activities before tax. FRS 19 requires the reconciliation to be carried out for the current tax charge only.

12. The current IFRS/US convergence project on IAS 12 is likely to also include a review of SIC 21 and SIC 25. Depending on the results of this work, proposals for a UK standard to replace FRS 16 and FRS 19 will be issued by the ASB concurrently with the issue of proposals from the IASB.

Impact of IAS 12 on public sector accounts

13. Entities covered by the requirements of the FReM are usually exempt from the tax regime and therefore unlikely to apply IAS 12 in practice. However, where, exceptionally, an entity does have to account for income tax IAS 12 should apply in full to entities covered by the shadow FReM. RABIG members have been consulted and concur with this view.

14. The presentation and disclosure requirements of IAS 12 will be taken into account in developing the format of resource and other accounts in the light of the move to EU-adopted IFRS and other initiatives.

IAS/IFRS compliance

15. The proposals are compliant with IAS 12.

IPSAS compliance

16. IPSASB has yet to issue an IPSAS or an exposure draft of a future IPSAS to interpret IAS 12 for the public sector, and the proposals in Annex A to this paper have not, therefore, been benchmarked against international public sector interpretations.

Proposed text for the shadow Government Financial Reporting Manual

17. See Annex A for the proposed amendments to the shadow FReM.

Impact on the budgetary regime

18. The current consolidated budgeting guidance notes that Public Corporations and some NDPBs, exceptionally, have to account for Corporation Tax. However, such payments are non-budget because payments within central government of taxes on income are consolidated out. The implementation of IAS 12 will, therefore, have no impact on the budgetary regime.

Alignment with National Accounts

19. As with the budgetary regime, tax payments and receipts are netted to zero in National Accounts, therefore the implementation of IAS 12 will have no impact on National Accounts.

Impact on Estimates

20. Government departments are generally outside the tax regime therefore the implementation of IAS 12 will have no impact on Estimates.

Summary and recommendation

21. IAS 12 deals with both current and deferred taxes. In practice, the implementation of IAS 12 will have little or no effect on entities covered by the requirements of the FReM as these entities are generally outside the tax regime. Where, exceptionally, entities are subject to the tax regime, IAS 12 should apply in full. RABIG members also concur with this view.

22. The Board is invited to approve the proposed text for the shadow FReM at Annex A.

Financial Reporting Policy Team
21 September 2006

ANNEX A

PROPOSED TEXT FOR THE SHADOW GOVERNMENT FINANCIAL REPORTING MANUAL

IAS 12 Income taxes

Applicability

IAS 12 applies in full to those entities subject to the tax regime.

Objectives of IAS 12

The objectives of IAS 12 are to specify the accounting treatment for:

a) Current tax, i.e. the amount of income taxes payable (recoverable) in respect of taxable profit (tax loss) for the period. Income taxes payable for current and prior periods are recognised as a liability. Income tax recoverable or overpaid is recognised as an asset; and

b) Deferred tax. This recognises future tax consequences of temporary differences between amounts included in financial statements (for income and expenditure and assets and liabilities) and those included in the tax assessment.