Accounting for deferred tax under FRS 102

13 December 2017

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Accounting for deferred tax under FRS 102

13 December 2017

Introduction

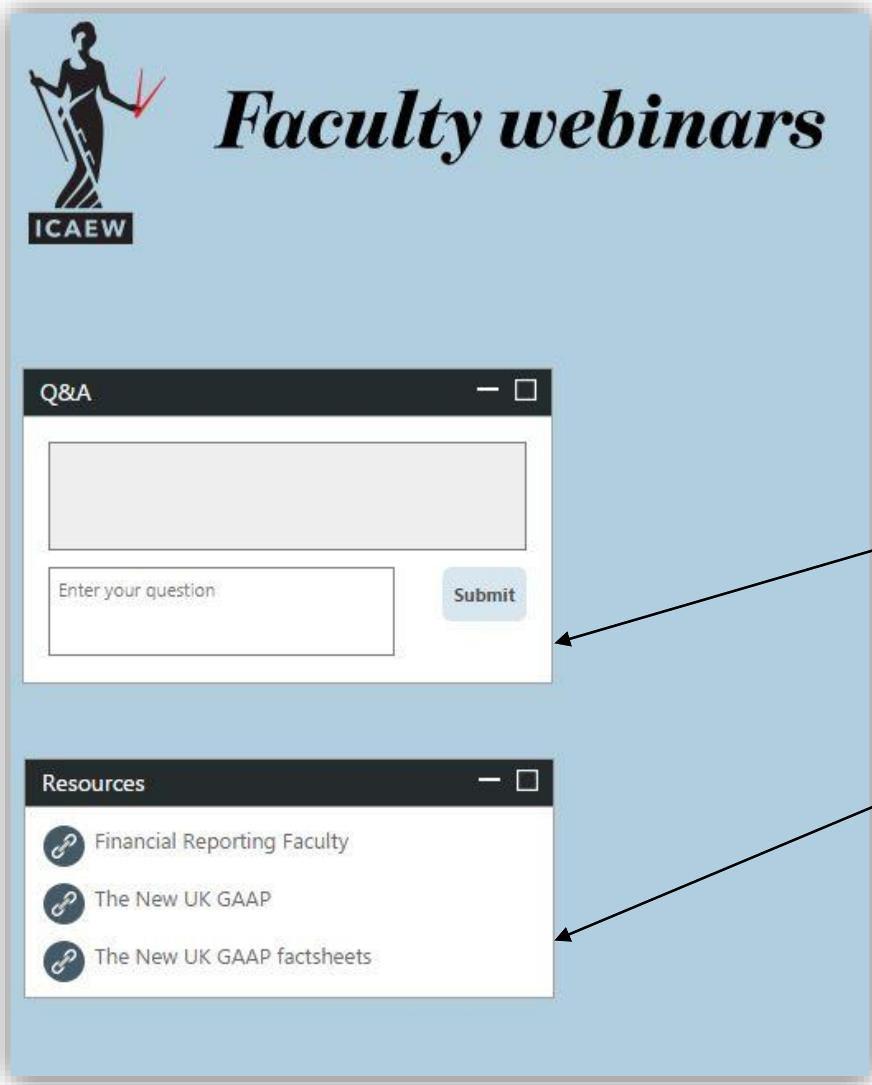
Marianne Mau
Technical Manager
ICAEW

Today's presenters

Matthew Howells
Director
Smith & Williamson

Paul Martin
Training manager
RSM

Ask a question



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Ask a question
Type your question into the question box then click submit.

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Poll – When it comes to accounting for deferred tax, which of the following areas do you find the most challenging?

Contents

Basic requirements

Definition

"Income tax payable (recoverable) in respect of the taxable profit (tax loss) for future reporting periods as a result of past transactions or events"

In other words, accounting effect and tax effect fall into different periods

So need to identify items that are treated differently for tax and accounting purposes

Two types of difference

- **Timing differences**
  - Generally do calculate DT
- **Permanent differences**
  - Generally don’t calculate DT

Timing differences

Differences between

- Taxable profit

and

- Total comprehensive income as stated in the accounts

Examples include

- Tax allowances v depreciation
- Unrelieved tax losses

Example 1 – tax allowances v depreciation

1 January 20X7: Entity A acquires a machine for £80,000

Eligible for 100% UK capital allowances in year of purchase

Estimated UEL: 4 years

Estimated RV: nil

Year end: 31 December

Example 1 (continued)

Year	Depreciation	Tax allowances	Timing difference	Cumulative timing difference
20X7	20,000	80,000	(60)	(60)
20X8	20,000	0	20	(40)
20X9	20,000	0	20	(20)
20Y0	20,000	0	20	0

To calculate DT liability, apply ***relevant tax rate*** to cumulative timing difference. Generally the rate:

- Enacted or substantively enacted at reporting date,

    and

- Expected to apply to reversal of timing difference

Example 2 – unrelieved tax losses

If such losses can be offset against future taxable profits, those taxable profits will be lower than accounting profits in those future periods

This gives rise to a DT asset

These can only be recognised to the extent that it is probable that they will be recovered against

- Future reversal of deferred tax liabilities, or
- Other future taxable profits

May be a ‘key source of estimation uncertainty’

Permanent differences

Definition

‘differences between an entity’s taxable profits and its total comprehensive income as stated in the accounts, other than timing differences’

- Certain types of income and expenses are non-taxable or disallowable (eg expenses for client entertaining)
- Certain tax charges or allowances are greater or smaller than the corresponding income or expense in the accounts

Revaluations

PROPERTY, PLANT AND EQUIPMENT

INVESTMENT PROPERTIES

Revaluations of PPE

Two types of timing difference

- Revaluation uplift (recognised in OCI, and subsequently depreciated through profit or loss over UEL)
- May be differences between tax allowances and depreciation (as seen before)

Both factors will give rise to deferred tax (liability)

Points to note

- DT is provided ***irrespective*** of whether taxable gain can be deferred or rolled over into a replacement asset
  - Eg UK holdover relief or rollover relief
- DT must always be recognised in same component of TCI as the transaction that gave rise to the DT

Example – allocation of DT

1 January: Entity B remeasures a machine, revaluation surplus £100,000

Recognised in revaluation reserve via OCI

DT on revaluation surplus (assume 20% tax rate): £20,000

- Expense within OCI

Estimated UEL: 40 years

- Change in DT liability on reversal of timing difference (as machine is depreciated) recognised within profit or loss (£500 pa)

Investment property

Timing difference

- Measured at FV with changes recognised in profit or loss each period
- Current tax consequences of changes in value on likely to arise on sale of property

Gives rise to deferred tax

Which tax rates to use

General principle: use rates expected to apply to reversal of timing difference

Must use rates applicable to ***sale*** of asset for

- Revalued non-depreciable assets (eg freehold land)
- Most investment properties

If indexation allowances are available, reduce DT

Share-based payments

Equity-settled share-based payments

Timing difference

- Usually recognise expense in profit or loss over vesting period
- Tax treatment usually very different
    - Eg may receive tax deduction on exercise of options, based on intrinsic value

Gives rise to deferred tax (asset)

Example

Start of year 1: grant share options with FV of £400,000

Vesting period: 4 years

Company expects to receive a tax deduction on exercise at end of year 5

Expected intrinsic value of options at exercise date is estimated at the end of:

Year 1: £420,000

Year 2: £340,000

Year 3: £290,000

Year 4: £320,000

Tax rate: 20%

Example (continued)

Year	Cumulative P&L charge	Expected intrinsic value at exercise (time-apportioned)	Cumulative deferred tax asset (movement during each period to P&L tax credit)
1	£100,000	£420,000 x 1/4 = £105,000	20% x £100,000 = £20,000
2	£200,000	£340,000 x 2/4 = £170,000	20% x £170,000 = £34,000*
3	£300,000	£290,000 x 3/4 = £217,500	20% x £217,500 = £43,500*
4	£400,000	£320,000 x 4/4 = £320,000	20% x £320,000 = £64,000*

- * DT asset capped at expected intrinsic value at exercise (ie the future tax deduction)
- DT asset written off if options not expected to be exercised at all

Groups

BUSINESS COMBINATIONS

UNREALISED PROFITS

Business combinations

No timing difference – but…

- In consolidated accounts, recognise DT on difference between:
  - Value at which acquired assets and liabilities are recognised in the consolidated balance sheet, and
  - Amount that will be deducted or assessed for tax

Not tax income or expense - adjusted against goodwill

Example

- Entity D acquires Entity C on 1 January 2018
- Assume tax rate of 20%

Asset in C	Book value in C	FV in D's consolidated accounts	Tax value	DT
Building (PPE)	£60,000	£70,000	Nil	£70,000 – 0 = £70,000 x 20%
Brand name	Not recognised	£40,000	Nil	£40,000 – 0 = £40,000 x 20%

- DR Goodwill, CR DT liability
- DT liability will reduce as assets are depreciated in subsequent periods

Undistributed profits

INCOME OR EXPENSES FROM A SUBSIDIARY, ASSOCIATE, BRANCH, OR INTEREST IN JOINT VENTURE

Undistributed profits

Timing difference

- In consolidated accounts, recognise income (or expenses) relating to a subsidiary, associate, branch, or interest in joint venture
- May only be assessed (or allowed) for tax in a future period (eg when investor receives dividends from investee)

Undistributed profits

Recognise deferred tax – unless…

- Probable that timing difference will not reverse in foreseeable future (ie dividend will not be paid), and
- Investor is able to control reversal of timing difference
  - ie is the investor able to control when the investee pays a dividend?
    - Subsidiary – likely
    - Associate – unlikely
    - JV – depends on terms of agreement

Disclosures

Two levels

Overarching requirement

‘information necessary for a user of the accounts to evaluate the nature and financial effect of… deferred tax consequences of recognised transactions and other events’

Specific requirements

- FRS 102.29.26 - 27

Make the right disclosures

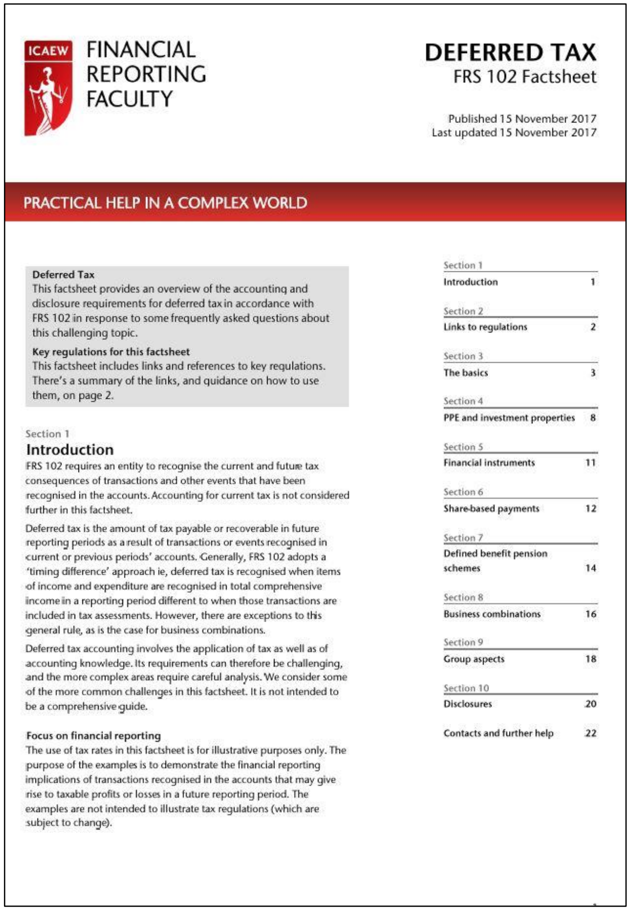
Some disclosures required by FRS 102 sometimes not fully understood or overlooked, eg

- Reconciliation to ***total*** tax expense (income)
- Amount of reversals expected in the next year
- Explanation of potential tax consequences of a distribution

Take care!

Questions

Factsheets



ICAEW FINANCIAL REPORTING FACULTY

DEFERRED TAX

FRS 102 Factsheet

Published 15 November 2017
Last updated 15 November 2017

PRACTICAL HELP IN A COMPLEX WORLD

Deferred Tax
This factsheet provides an overview of the accounting and disclosure requirements for deferred tax in accordance with FRS 102 in response to some frequently asked questions about this challenging topic.

Key regulations for this factsheet
This factsheet includes links and references to key regulations. There's a summary of the links, and guidance on how to use them, on page 2.

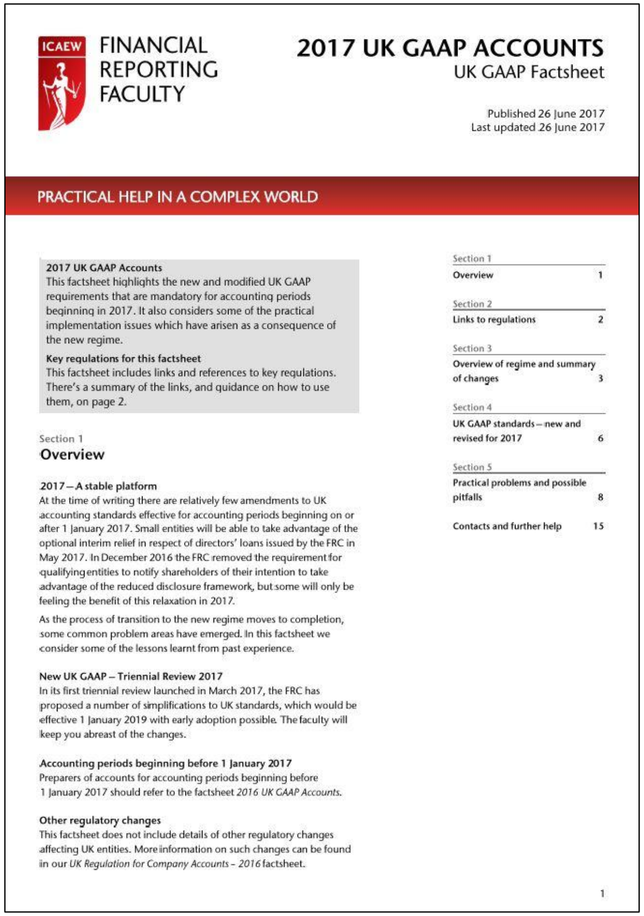
Section 1
Introduction

FRS 102 requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the accounts. Accounting for current tax is not considered further in this factsheet.

Deferred tax is the amount of tax payable or recoverable in future reporting periods as a result of transactions or events recognised in current or previous periods' accounts. Generally, FRS 102 adopts a 'timing difference' approach ie, deferred tax is recognised when items of income and expenditure are recognised in total comprehensive income in a reporting period different to when those transactions are included in tax assessments. However, there are exceptions to this general rule, as is the case for business combinations.

Deferred tax accounting involves the application of tax as well as of accounting knowledge. Its requirements can therefore be challenging, and the more complex areas require careful analysis. We consider some of the more common challenges in this factsheet. It is not intended to be a comprehensive guide.

Focus on financial reporting
The use of tax rates in this factsheet is for illustrative purposes only. The purpose of the examples is to demonstrate the financial reporting implications of transactions recognised in the accounts that may give rise to taxable profits or losses in a future reporting period. The examples are not intended to illustrate tax regulations (which are subject to change).



ICAEW FINANCIAL REPORTING FACULTY

2017 UK GAAP ACCOUNTS

UK GAAP Factsheet

Published 26 June 2017
Last updated 26 June 2017

PRACTICAL HELP IN A COMPLEX WORLD

2017 UK GAAP Accounts
This factsheet highlights the new and modified UK GAAP requirements that are mandatory for accounting periods beginning in 2017. It also considers some of the practical implementation issues which have arisen as a consequence of the new regime.

Key regulations for this factsheet
This factsheet includes links and references to key regulations. There's a summary of the links, and guidance on how to use them, on page 2.

Section 1
Overview

2017 – A stable platform
At the time of writing there are relatively few amendments to UK accounting standards effective for accounting periods beginning on or after 1 January 2017. Small entities will be able to take advantage of the optional interim relief in respect of directors' loans issued by the FRC in May 2017. In December 2016 the FRC removed the requirement for qualifying entities to notify shareholders of their intention to take advantage of the reduced disclosure framework, but some will only be feeling the benefit of this relaxation in 2017.

As the process of transition to the new regime moves to completion, some common problem areas have emerged. In this factsheet we consider some of the lessons learnt from past experience.

New UK GAAP – Triennial Review 2017
In its first triennial review launched in March 2017, the FRC has proposed a number of simplifications to UK standards, which would be effective 1 January 2019 with early adoption possible. The faculty will keep you abreast of the changes.

Accounting periods beginning before 1 January 2017
Preparers of accounts for accounting periods beginning before 1 January 2017 should refer to the factsheet *2016 UK GAAP Accounts*.

Other regulatory changes
This factsheet does not include details of other regulatory changes affecting UK entities. More information on such changes can be found in our *UK Regulation for Company Accounts – 2016* factsheet.

The new UK GAAP

A new financial reporting framework in the UK is effective for accounting periods beginning on or after 1 January 2015.

The UK's Financial Reporting Council (FRC) has published five standards which together form the basis of the new UK regime. The Financial Reporting Standard for Smaller Entities (FRSSE) has been withdrawn and small entities brought within the scope of FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland for accounting periods beginning on or after 1 January 2016. For more information on the changes to small company reporting visit **icaew.com/smallcompanyreporting**

UK Reporting framework

FRS 100 Application of Financial Reporting Requirements sets out the new reporting regime.

More info

Small entity reporting

A new financial framework for small and micro entities is effective from 1 January 2016.

More info

Reduced disclosures

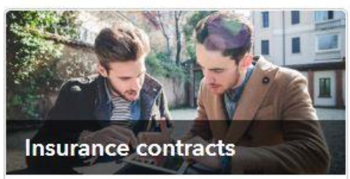
FRS 101 Reduced Disclosure Framework available to certain UK IFRS reporters.

More info

The reporting standard

FRS 102 The Financial reporting Standard applicable in the UK and Republic of Ireland.

More info



Insurance contracts

FRS 103 Insurance Contracts - requirements and guidance for insurance contracts.

More info

Interim Financial Reports

FRS 104 Interim Financial Reporting for entities that apply FRS 102.

More info

The micro-entities regime

FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime.

More info

Factsheets

Practical online guidance written exclusively for faculty members by experts.

More info

Questions

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to keep up-to-date with the latest financial reporting developments and breaking faculty news.

Future webinars and events

Webinars

- 23 Jan – Alternative Performance Measures
- 22 Feb - Integrated Reporting – the UK experience
- 22 Mar - UK GAAP Update

Visit icaew.com/frfwebinars for details of our upcoming webinars

Events 2018

The faculty will be holding Practitioners' Essential Spring 2018 roadshow, along with conferences and events throughout the year.

Visit icaew.com/frfevents for details of upcoming events

Thank you for attending

Contact the Financial Reporting Faculty

+44 (0)20 7920 8533

✉ frfac@icaew.com

icaew.com/frf

@ICAEW_FRF

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short survey

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