PKF FRANCISCLARK
Chartered accountants & business advisers

# FRS 102 - The tax impact

## Background

FRS 102 represents a major change to the UK financial reporting landscape. Understanding how the changes will impact on your company's tax position will help you plan for the new regime, make informed decisions and ensure you have the information available. The new regime will apply to any company that is not eligible to use the small companies' regime and is not required, or does not choose, to apply EU-adopted IFRS.

It is important to consider both the tax impact on transition as well as on-going implications. There may be far higher volatility in profits which need managing in terms of tax cashflow, as well as on the ability to pay dividends or restructure.

Planning ahead ensures you have time to fully consider the tax implications, allow time to do something differently, or make any beneficial tax elections.

## Restatement on transition

In adopting the new accounting standards, there will be a need to re-state the previous year's figures. Any prior year accounts adjustment could require an adjustment to the current year's corporation tax computation.

The underlying nature of the prior year adjustment will determine whether or not it is taxable or relievable. For example, additional goodwill amortisation may be allowable, but an additional pension provision would not achieve further tax relief.

## Tax implications in summary

The main accounting changes that will impact on the tax position are summarised below:

| Area | Tax implications under | | Commentary |
|---|---|---|---|
| | Current rules | FRS 102 | |
| Goodwill & intangible assets (post 2002 regime) | Amortised over useful economic life, with a rebuttable presumption that this will not exceed 20 years.<br><br>Can elect for 4% relief. | If a reliable estimate of the useful economic life cannot be made the life should not exceed 5 years.<br><br>If already elected then existing 4% rule remains. | Shorter amortisation periods may result under FRS 102, leading to faster tax relief.<br><br>No change under FRS 102. |
| Investment property | In accounts normally shown at open market value. Revaluation adjustments go through the statement of total recognised gains and losses.<br><br>Generally not taxed until sold. | In accounts normally **shown at fair value**. Changes in value will go through other comprehensive income unless the change is to below cost in which case the part of the change to below cost will go through the profit and loss.<br><br>Generally not taxed until sold. | No change – still subject to corporation tax on capital gain when sold. |
| Lease incentives | Spread over the period to the first rent review. | Spread over the expected lease term. | Good news for lessees – tax relief could be slightly accelerated. Bad news for lessors – tax relief is deferred. |



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|---|---|---|---|
| | Current rules | FRS 102 | |
| Financial instruments (e.g. interest rate swaps, hedging) | Many fall within the loan relationship rules, but the current rules are complex.<br>There is a proposal to overhaul the regime for corporate debt & derivative contracts.<br>Certain derivative contracts are not held at fair value on the balance sheet unless an election is made. They are currently only disclosed in the notes to the accounts. | Default rule is that tax follows the accounts treatment, meaning that the fair value movements recognised in the profit & loss will be relevant for tax.<br>If the instrument has been entered into for hedging reasons, the fair value movements are disregarded for tax purposes (until the instrument is settled) unless an election is made to follow the accounts. | The impact of transitional adjustments will need to be considered, along with options for spreading (over 10 years). |
| Deferred Tax | FRS 19 does not require deferred tax on revalued assets if no binding contract for sale. | Deferred tax is always recognised on revalued assets but where the deferred tax charge or credit is posted to will follow the treatment of the revaluation itself. | Increased deferred tax charge may reduce distributable profits.<br>Consider the impact of any rollover claims. |
| Pensions – defined benefit | Pension contributions are only allowed when paid. | The requirement to recognise any deficit on the balance sheet in relation to multi-employer schemes may reduce realised profits.<br>No change to timing of tax relief – pension contributions are still only allowed when paid. | May substantially reduce realised profits which may impact on scope for dividends or incentive plans.<br>No tax relief on additional pension provision. |
| Employee benefits | No specific requirement in UK GAAP to accrue for holiday pay. | Must make accruals for holiday pay entitlement. | Provided the amounts are paid within 9 months, this will accelerate tax relief. Likely to be a tax advantage on transition. |

## What are the other implications?

As well as considering the impact on the corporation tax and deferred tax charge, there are also other important factors to take into account when assessing the impact of FRS 102:

- **Timing of tax payments** – some companies may find that they fall in or out of the quarterly installment payment regime, so the timing of their corporation tax may change. Given that taxable profits may also be subject to greater volatility, this could put a strain on cashflow.
- **Banking covenants** – increased profit volatility as well as changes to balance sheet valuations may all have an impact on the requirements of bank covenants. We recommend discussing the potential impact with your bank at an early stage to manage expectations.
- **Employee benefits, earnouts & key performance indicators** – where these are linked to company results, the impact on existing plans and future proposals needs to be addressed.
- **Distributable reserves** – substantial changes (for example in relation to pensions) may wipe out distributable profits. Consider the impact on future dividend policy or re-structuring plans.

**If you would like more information on the tax impact of FRS 102 on your company, please speak to your usual Francis Clark contact.**



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