
In brief

A look at current financial reporting issues

28 March 2017

'Brexit' and implications for income tax

Issue

The UK Government is about to give formal notice of its intention to leave the EU. This notice will trigger the process of negotiating the UK's exit, which is likely to last at least two years.

There are various tax reliefs and exemptions that apply to transactions between UK entities and entities in other EU member states, under existing tax laws, that might cease to apply when the UK's exit finally occurs. The tax legislation, if any, that will replace those reliefs and exemptions is unknown at this stage. This document addresses the potential implications for income tax accounting.

Impact

IAS 12 does not explicitly address income tax uncertainties. It requires entities to measure income tax, including uncertainties, at the amount expected to be paid, using the tax laws that have been enacted or substantively enacted by the end of the reporting period.

The standard appears to envisage a process in which national parliaments consider and enact tax laws. However, Brexit is different because the UK's withdrawal notice will occur before it is known what revised arrangements might be enacted in the future. The notice of withdrawal is the commencement and not the culmination of a legal process. There is substantial uncertainty about what will happen to UK and European tax laws over the next two years.

Entities might therefore conclude that the UK giving notice of its intention to withdraw substantively enacts the UK's withdrawal from the EU. However, the effects of the withdrawal on tax legislation will depend on the 'withdrawal agreement' (if any), which might contain tax reliefs similar to or different from those currently available. This is, in itself, a tax uncertainty.

Entities should assess the potential tax consequences of the withdrawal agreement. It is likely that, during the negotiation process, entities might become aware of potential exposures, but the outcome will be insufficiently clear to determine whether additional tax liabilities are expected to arise or to make a meaningful estimate of the amounts involved. Good quality disclosure of the uncertainty and the potential exposures should be given in these circumstances.

Management should re-assess, at each reporting date, the potential tax impact of the withdrawal agreement and the amount, if any, that is expected to be paid. If management expects that there will be an additional tax liability as a result of the development of the negotiations, that liability should be estimated on the basis of the amount expected to be paid.

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Alternatively, entities might conclude that any reliefs available while the UK is a member of the EU will fall away in two years and reflect the consequences of this conclusion in their income tax accounting, even though those reliefs might be replaced by legislation yet to be enacted. This approach is likely to cause increased volatility in income tax accounting that could make the financial statements more difficult to understand.

Insight

Some have argued that the UK's notice of intention to leave the EU could be revoked, but this has not been tested in court. Entities should therefore assume that withdrawal will happen. The UK's withdrawal from the EU is likely to have tax consequences for businesses in the UK and in the EU, and for other entities that have operations or corporate structures in the UK and in other EU member states. These consequences are uncertain. Management should consider the potential tax uncertainties and make the disclosures necessary to explain the uncertainty and the potential exposures.

Entities with period ends before the date of notice of withdrawal should disclose the potential implications for income tax accounting in accordance with IAS 10.

Management should also consider any potential changes to tax laws as a result of the withdrawal and the negotiation between the UK and other EU members when they consider the tax implications of any future transactions.

Other financial reporting issues

In depth, 'Brexit: Accounting implications of UK's Brexit decision', addresses other potential financial reporting issues. These include valuation and impairment, hedging and provisions for restructuring. Many of these issues might still be relevant for entities in the process of preparing annual or interim financial reports.



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