

Financial Reporting Bulletin

Changes to corporation tax rates following the 2007 Budget announcement

Effective date

Immediate.

Background

The headline rate of Corporation Tax in the UK has been set at 30 per cent for a number of years. However, following the Budget announcement on 21 March 2007 the headline corporation tax rate in the UK is to be lowered from 30 per cent to 28 per cent from April 2008.

The 2007 Finance Bill has now been passed by the House of Commons and was awaiting only passage through the House of Lords and Royal Assent at 29 June 2007.

Uncertainty may therefore arise in the near future as to what tax rates should be applied in the calculation of current taxation and deferred taxation both in terms of accounting under UK GAAP and IFRS.

Requirements

The paragraphs below consider the requirements in respect of current and deferred tax under:

- UK GAAP (FRS 16 'Current Tax' and FRS 19 'Deferred Tax')
- IFRS (IAS 12 'Income Tax').

1) Overview of the current guidance under UK GAAP in respect of tax rates

i) Current tax

Current tax should be measured at the amounts expected to be paid (or recovered) using the tax rates and laws that have been **enacted or substantively enacted by the balance sheet date**.

ii) Deferred tax

Deferred tax should be measured at the **average tax rates** that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been **enacted or substantively enacted by the balance sheet date**.

iii) Determination of tax rates in respect of current and deferred tax

Paragraph 15 of FRS 16 and paragraph 40 of FRS 19 both state that a UK tax rate can be regarded as having been substantively enacted if it is included in either:

- (a) a Bill that has been passed by the House of Commons **and is awaiting only passage through the House of Lords and Royal Assent**; or
- (b) a resolution having statutory effect that has been passed under the Provisional Collection of Taxes Act 1968*.

*Such a resolution could be used to collect taxes at a new rate before that rate has been enacted. In practice, corporation tax rates are now set a year ahead to avoid having to invoke the Provisional Collection of Taxes Act for the quarterly payment system.

iv) Events after the balance sheet date

Paragraph 22(h) of FRS 21 'Events after the balance sheet date' states that changes in tax rates or tax laws **enacted or announced after the balance sheet date** that have a significant effect on current or deferred tax assets or liabilities are a non-adjusting event after the balance sheet date.



2) Overview of the current guidance under IFRS in respect of tax rates

i) Current Tax

IAS 12 paragraph 46 states that current tax liabilities (assets) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been **enacted or substantively enacted by the balance sheet date**.

ii) Deferred Tax

IAS 12 paragraph 47 states that deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have **been enacted or substantively enacted by the balance sheet date**.

iii) Determination of tax rates in respect of current and deferred tax

IAS 12 paragraph 48 further goes on to state that current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been **enacted**. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the **substantive effect of actual enactment**, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the **announced tax rate** (and tax laws).

iv) Events after the balance sheet date

Paragraph 22(h) of IAS 10 'Events after the balance sheet date' states that changes in tax rates or tax laws **enacted or announced after the balance sheet date** that have a significant effect on current or deferred tax assets or liabilities are a non-adjusting event after the balance sheet date.

3) Application under UK GAAP and IFRS in terms of the UK tax system

Both FRS 16 and FRS 19 under UK GAAP and IAS 12 in IFRS make it clear that current and deferred tax assets and liabilities will be measured by reference to the tax rates and tax laws that have been enacted **or substantively enacted** at the balance sheet date.

In the UK, changes in tax laws and rates are normally announced in a Finance Bill on Budget day, but **unless the Finance Bill has been passed by the House of Commons and is awaiting only passage to the House of Lords or awaiting Royal Assent**, the process of enactment cannot be regarded as substantively complete. The 2007 Finance Bill reached this stage on 29 June 2007, and therefore the revised UK tax rates should be applied in calculating the deferred tax provisions for all companies with a 29 June 2007 or later balance sheet date.

Financial Reporting Bulletin Issue 16/2007

Action required

Current and deferred tax under both UK GAAP and IFRS should be calculated based on the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

The changes in the 2007 Finance Bill reached this stage on 29 June 2007, and therefore the revised UK tax rates should be applied in calculating the deferred tax provisions for all companies with a 29 June 2007 or later balance sheet date.

Companies with a balance sheet date prior to 29 June 2007 will have to disclose the effect, if significant, on current or deferred tax assets or liabilities as a non-adjusting event.

It should be noted that not all changes proposed in the Budget have been included in the 2007 Finance Bill. The Bill will abolish balancing allowances and balancing charges in relation to Industrial Buildings Allowances (IBAs) (except in very limited circumstances) but the phasing out of claiming IBAs will be included in the Finance Bill 2008. Accordingly, the phasing out of IBAs **is not substantively enacted**.

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