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IFRS Developments

# Brexit and the implications for tax accounting

**What you need to know**

- On 29 March, the UK Government gave notice of its intention to withdraw from the EU
- There is no immediate effect on IFRS reporting requirements
- Entities need to consider the implications for tax accounting, which may need to be disclosed now

## Background

On 29 March 2017, the UK Government invoked Article 50 of the Treaty of Lisbon, thereby formally notifying the European Council of the UK's intention to withdraw from the European Union (EU) (Brexit). This begins the process of negotiating an exit deal for the UK with the European Council.

The negotiation period set by Article 50 is two years. Therefore, the UK will leave the EU by 29 March 2019, unless either a deal is reached at an earlier date, or the negotiation period is extended by unanimous consent of the European Council.

There will be no immediate change to UK financial and corporate reporting requirements, as the UK remains a member of the EU until the end of the negotiation period. However, entities need to consider the potential effects of Brexit when preparing their upcoming interim and annual reports. This will affect not only UK entities, but also entities in the EU and other countries that trade, or have other financial relationships with, UK entities. In particular, entities may need to make additional disclosures in the management commentary or in the notes to the financial statements to address the potential implications of Brexit.

One particular area of focus is taxation and tax accounting, which may be significantly impacted by Brexit.

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## Tax accounting implications

Tax legislation in EU member states and other countries, contains tax exemptions and tax reliefs (e.g., withholding tax and merger relief) that depend on whether or not the entities involved are EU domiciled. Once the UK leaves the EU, these exemptions and reliefs may no longer apply to transactions between UK entities and entities that remain within the EU. In those cases, additional tax liabilities may crystallise. It is uncertain which of these exemptions and reliefs will be renegotiated as part of the UK's exit.

IAS 12 *Income Taxes*, the income tax accounting standard, requires entities to measure current and deferred tax at the amount expected to be paid to the taxation authorities, using tax rates and tax laws that have been enacted, or substantively enacted, at the end of the reporting period. However, the triggering of Article 50 gives rise to uncertain tax positions (UTPs) as it raises significant uncertainty about how the existing tax legislation will apply after Brexit. It has also raised uncertainty about the future tax status of entities, which may lead to changes in the accounting treatment.

## What do entities need to consider?

Given the uncertainties around taxation, we expect entities to continue to apply their current accounting policies, until the position becomes clearer. However, the level of uncertainty may require additional disclosure in the financial statements.

IAS 1 *Presentation of Financial Statements* requires entities to disclose the significant accounting policies used in preparing the financial statements, including the judgments that management has made in applying those accounting policies that have the most significant effect on the amounts recognised in the financial statements. IAS 1 also requires entities to disclose information about the assumptions they make about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Therefore, entities will need to carefully consider the assumptions and estimates made about future tax positions and consider whether additional disclosure of the uncertainties arising from Brexit is needed.

As Brexit negotiations progress, the uncertainties about tax legislation and the application of IAS 12 may start to be resolved as each jurisdiction confirms the appropriate tax treatment. Therefore, entities will need to consider the current position at each reporting date and may need to make changes to the accounting treatment and disclosures that have previously been presented.

This is likely to be an area of significant focus for regulators as highlighted by the European Securities and Markets Authority (ESMA) in the European common enforcement priorities for 2016 financial statements. In this document, ESMA clarifies the expectation that entities that expect to be affected by Brexit should provide disclosures about the exposure to risks, the likely impact and how management intends to mitigate the risks. As negotiations proceed and the terms of the withdrawal deal become clearer, regulators are likely to expect entities to provide more detailed analysis of the risks and impact.

### Next steps

- Entities need to review their tax accounting and consider the need for additional disclosures regarding the risks and uncertainties.
- Entities need to closely monitor the Brexit negotiation process and developments around tax legislation in individual countries. As uncertainties are resolved, this may require changes to the tax accounting treatment.

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