Tax accounting implications of U.K. Budget 2011 changes

The U.K. Budget 2011 announced on 23 March 2011 introduces changes to the main rate of corporation tax which, when enacted, will affect companies with operations in the U.K. and will have an impact on both current and deferred tax calculations:

- A reduction in the rate of corporation tax from 28% to 26% as from 1 April 2011 (rather than to 27% as previously planned), with further annual reductions of 1% until the main rate reaches 23% on 1 April 2014.; and
- An increase in the rate of the supplementary charge for ring fence trades (affecting North Sea oil and gas) from 20% to 32%.

The reductions in the tax rate to 26% and 25% are expected to be included in Finance Bill 2011, which is expected to pass in July 2011. The move to 26%, however, has effect as from 1 April 2011 in accordance with the Provisional Collection of Taxes Act 1968 (PCTA 1968), as discussed below. The further rate changes discussed in the Budget (to 24% and 23%) are expected to be included in future Finance Bills.

Due to the methods being used to implement these changes, the impact on the deferred tax calculations of companies are expected to differ depending on whether a company reports under International Financial Reporting Standards (IFRS), US Generally Accepted Accounting Principles (US GAAP) or UK Generally Accepted Accounting Principles (UK GAAP). In summary:

- For reporting under IFRS or UK GAAP, tax rate changes are taken into account during the period in which the law is substantively enacted or enacted. The reduction in the rate of corporation tax to 26%, effective from 1 April 2011, was substantively enacted on 29 March 2011, following the last day of Budget debate. The further reduction to 25% will be substantively enacted when the Finance Bill 2011 passes the House of Commons. For the supplementary charge, this took place on Budget Day (23 March 2011).
- For reporting under US GAAP, tax rate changes are taken into account during the period that includes enactment. The current rate changes will not be considered enacted until Finance Bill 2011 has received Royal Assent.

U.K. law process

For a bill in the U.K. to become a law, it must pass through the House of Commons, the House of Lords and receive Royal Assent (Royal Assent is the Monarch’s agreement to make a bill into an Act of Parliament). A bill is enacted at the time Royal Assent has been received.

UK GAAP explains that a tax rate can be regarded as having been “substantively enacted” if it is included in either:

- 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
- A resolution having statutory effect that has been passed under the PCTA 1968. Such a resolution can be used to collect taxes at a new rate before the rate has been enacted.

Note that, although the House of Lords can pass a bill back to the House of Commons, it has no power to amend a bill that deals with public taxation. Therefore, once a bill has passed through the House of Commons, it should be substantively enacted for purposes of UK GAAP, and it is Deloitte’s position that it also should be substantively enacted for IFRS reporting purposes.

PCTA 1968 enables certain changes (such as the change in the corporation tax rate) to have statutory effect for a limited period. Under PCTA, if the House of Commons approves a Budget Resolution that contains certain specified wording, the resolution has statutory effect until the following 5 August (by which time the Finance Bill generally will have become law). Such a resolution, “Budget Resolution 5,” proposing to reduce the corporation tax rate to 26% from 1 April 2011 was passed on 29 March 2011 and, therefore, has statutory effect as from that date. This is the date the rate change is considered “substantively enacted” for UK GAAP and IFRS reporting purposes.
The further rate reduction to 25% as from 1 April 2012 is expected to be included in Finance Bill 2011 but, since it was not included in Budget Resolution 5, it will not be considered substantively enacted until Finance Bill 2011 passes the House of Commons.

IFRS analysis

- Current and deferred tax assets and liabilities are measured at tax rates (or tax rules) that are enacted or substantively enacted at the balance sheet date (IAS 12 para 46-49).
- Budget Resolution 5 reduces the main rate of corporation tax to 26% from 1 April 2011. The Resolution contains a declaration that it is expedient in the public interest that the resolution should have statutory effect under the provisions of PCTA 1968. Therefore, as noted above, this provision is considered to be substantively enacted on 29 March 2011.
- The reduction in the main rate of corporation tax to 25% will not be taken into account until Finance Bill 2011 has been passed by the House of Commons, which is expected to take place in July 2011.
- **Year-end reporting** – For entities with a year ending after 31 March, a portion of the current year earnings will be taxed at 26%. For entities with a year ending after 29 March, closing deferred tax balances should be calculated at 26%, with the impact being reflected in profit or loss, except to the extent the tax arises from a transaction or event that is recognized, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity (IAS 12.60).

**Interim accounting** –

- **Interim reporting date before the date of substantive enactment** – An entity that has an interim reporting date that falls before 29 March calculates its tax charge based on the expected forecast average annual effective tax rate, without taking into account the impact of the rate change on that forecast rate. The company should not anticipate the change in tax rates in calculating its expected forecast average annual effective tax rate. Deferred taxes are not adjusted.
- **Interim reporting date after the date of substantive enactment** – The company should reflect the change in tax rate in calculating its forecast average annual effective tax rate. The “catch-up” effect of the rate change on the opening deferred tax balances should be treated as a discrete item in the interim period.

UK GAAP analysis

- Deferred tax assets and liabilities are measured at tax rates enacted or substantively enacted at the balance sheet date (FRS 19 para 37).
- Budget Resolution 5 reduces the main rate of corporation tax to 26% as from 1 April 2011. The Resolution contains a declaration that it is expedient in the public interest that the resolution should have statutory effect under the provisions of PCTA 1968. Thus, as noted above, this provision is substantively enacted on 29 March 2011.
- The reduction in the main rate of corporation tax to 25% will not be taken into account until Finance Bill 2011 has been passed by the House of Commons, which is expected to take place in July 2011.
- The “substantively enacted” provisions relate to the measurement of current and deferred tax liabilities and assets.

US GAAP analysis

- Current and deferred tax assets and liabilities are measured at tax rates that are fully enacted (rather than substantively enacted) as of the balance sheet date (ASC 740-10-25-47).
- Both reductions in the main rate of corporation tax rate to 26% and 25% will, therefore, not be taken into account until Finance Bill 2011 is enacted (i.e. when the Bill receives Royal Assent).
- Since Finance Bill 2011 is not expected to be enacted until July 2011, there should be no impact of these tax rate changes reflected in the interim or year-end balance sheets prior to the date of enactment. Where their impact will be significant, however, disclosures may be required in reports issued prior to enactment.
Conclusion

As a result of differences between the accounting standards regarding when rate changes are taken into account, the U.K. rate change will impact current and deferred taxes in different periods, depending on whether the filer is reporting under IFRS, UK GAAP or US GAAP. It also will be important to monitor the disclosure requirements under all standards.

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