BY
Gary O'Mahony

Finance Act 2014 and FRS 102: the impact of the transitional provisions of Schedule 17A TCA 1997

Gary O'Mahony outlines how Schedule 17A applies to the changeover to new accounting standard FRS 102.

Gary trained in Arthur Andersen, qualifying as a Chartered Accountant in 1994 and as a tax professional in 1995. Previously a tax director with Ernst & Young, he joined Kieran Ryan & Co in 2004 as a tax partner and now heads up the tax department, dealing daily with many tax and commercial issues across a varied client portfolio.

How's that for a catchy title to grab your attention? If the prospect of more analysis on FRS 102 makes your eyelids get heavy, please read on and you'll be asleep in no time! If, however (and hopefully), this topic is of some interest to you, please also read on and (again hopefully!) a little enlightenment herein lies.

How did we get here?

To put it in context, a brief history follows on the interaction between profits chargeable to tax and accounting principles.

Prior to Finance Act 2005, tax legislation itself offered little guidance on whether accounting principles should be looked at in determining profits for the purposes of Schedule D Case I or II[1]. There are many specific provisions on what is taxable or deductible (or not) but nothing about where, for tax purposes, you actually start the profit calculation. In short, there was no statutory requirement to follow generally accepted accounting practice (GAAP) in computing trading profits of a trade.

That said, profit before tax is the obvious starting point and has been used for decades but, even if there was no uncertainty about the accounting treatment of any item, this accounts figure then required further adjustment for tax purposes where a legislative rule meant a different tax treatment to the accounting treatment[2]. Case law over time established

▶ Continued on Page 28

BY
Gary O'Mahony

▶ Continued from Page 27

precedents to assist and, typically, reliance was often placed on judicial interpretation[3]. However, for a wide variety of reasons (only one of which was uncertainty on the tax analysis), the position in the last years of the twentieth century was becoming complex, with attempts to standardise accounting frameworks ongoing internationally.

Returning to the specific Irish context, Section 48 Finance Act 2005 introduced a definition of GAAP into tax legislation for the first time, with the introduction of International Financial Reporting Standards (IFRS) being the driving force behind this. Even then, this major change only has relevance for companies with Schedule D Case I or II income, which means case law occasionally still has to be relied on for areas of doubt regarding other sources of profit or gain.

Section 48 does a few things, the most important of which is to essentially legislate[4] for what had emerged as a guiding principle – i.e. GAAP to be followed in computing profits chargeable to Schedule D Case I or II, subject to an adjustment required or authorised by law. Other changes were introduced[5] but the one of most relevance here is Schedule 17A TCA.

Schedule 17A begins with a definition of "relevant accounting standards" ("RAS") to comprise international accounting standards, and Irish GAAP which would produce results which are substantially the same as those produced by the application of IFRS. It then outlines transitional measures on certain aspects of transitioning from Irish GAAP to financial statements prepared in accordance with RAS. In broad terms, a company doing so should adjust its opening balance sheet as if the new standards had previously applied. If old and new RAS contain any different rules for recognising income and expenditure, income previously taxed or expenses previously deducted could feature again. Schedule 17A is the mechanism to "correct" this over a five-year period.

What just happened?

And so, more or less, things continued until FRS 102 appeared.

Each of the last two editions of this magazine has had an article[6] bringing the position up to date prior to the 1 January implementation day for FRS 102. While Robert Kirk's article is a succinct and timely overview of key headline issues, Aine Brennan focuses on the tax issues and "outlines Revenue's perspective on the key corporate tax considerations when a company transitions from Irish GAAP to FRS 102"[7]. At that time, Finance Act 2014 was not yet enacted so Revenue were then "currently reviewing the legislation governing transitional arrangements (i.e. Schedule 17A) to consider whether any legislative changes are required to facilitate the move from Irish GAAP to FRS 102".

Section 42 Finance 2014 followed. It amends the definition of RAS in Schedule 17A to include "Irish generally accepted accounting practice based on published standards to the extent that practice is based on the provisions of those published standards that are stated to embody international accounting standards." As updated, Schedule 17A therefore applies to the FRS 102 changeover.

Though clarifying what to do if old and new RAS contain different rules for recognising income and expenditure, the wording is unclear in some respects. It assumes a "published standard" will always state whether it does "embody international accounting standards". What if it embodies them but doesn't state that? It also seems to assume a standard like FRS 102 will be clear whether or not a treatment embodies IFRS rules. Will that always be the case? That said, in most cases it should hopefully be clear what the correct treatment is and how the transitional provisions apply[8].

And what does it mean now?

Schedule 17A lists the three areas likely to require an adjustment – amounts receivable and deductible, bad debts and gains/losses in financial instruments.

Paragraph 2 deals with "taxable amounts" and "deductible amounts"[9], with the best way of illustrating the impact by a straightforward example[10]. Bear in mind, the main purpose of the transitional rules is to seek to ensure against double counting or amounts falling out. Assume a fee of, say €300, received in respect of a three-year contract; it is received, accounted for under Irish GAAP and taxed up front. If, under RAS, it should be spread over the contract term (i.e. €100 per year), and assuming that the company moves to FRS 102 at the end of the first year, the position might be as follows:

	Year 1	Year 2	Year 3
Irish GAAP Treatment	300		
FRS 102 Treatment	100	100	100

Assuming the tax treatment follows the accounting treatment, €300 would be taxed in year 1, €100 in year 2 and €100 in year 3. Without a transitional measure, tax would be charged on €500, so the transitional measure requires the double counted amount (i.e. €200) to be identified. This is then allowed as a deductible amount over a period of five years[11] and allows the accounting treatment to be followed for tax purposes.

Transitional measures relating to gains and losses on financial assets and liabilities are provided for in Paragraph 4. Prior to Section 76B TCA[12], gains and losses on financial assets and liabilities were generally computed for tax purposes on a realised basis. Assume a financial instrument was purchased for €100 and sold for €140; the gain of €40 was included in taxable income when sold. Under RAS, gains and losses on such instruments are typically accounted for based on their "fair value" movement; under Section 76B, that basis also applies for tax purposes. If the FRS 102 transition gives a similar result to that set out above in Paragraph 2, the same "fix" is applied – i.e. adjust over a period of five years.

Transitional rules for bad debts provisions are set out in Paragraph 3. These are quite detailed but, essentially, provide that no adjustment to taxable profits is made for the doubtful debts provision restatement when transitioning to RAS. However, if at any time thereafter the provision level falls below that transition date level, an adjustment to taxable profits is then made to ensure no loss of deductibility for actual bad debts incurred.

Conclusion

Transitioning to FRS 102 means many changes/challenges. Though it seems tax is probably not one of the main ones, this article has hopefully helped illustrate the steps to take to address any tax "funnies" that might arise.

1. Section 18 TCA 1997 simply states "Tax under this Schedule (i.e. D) shall be charged in respect of the annual profits or gains arising or accruing..."
2. The treatment of book depreciation and capital allowances is probably the most common example of this.
3. For example, Gallagher v. Jones (66 TC 77) and Johnston v. Britannia Airways (67 TC 99) are two UK cases from the mid-1990s on the impact of accountancy principles in determining taxable profits.
4. Section 76A TCA 1997
5. For example, Section 76B deals with fair value accounting and unrealised gains and losses in certain instances.
6. Aine Brennan, Accountancy Plus Issue 3 2014; Robert Kirk, Accountancy Plus Issue 4 2014.
7. She also makes the point that "many of the FRS 102 changes should not impact on tax."
8. ..and that common sense can apply in areas of doubt.
9. Essentially, "deductible amounts" are income amounts that would be double counted and expenses that would not be counted; "taxable amounts" are income amounts otherwise not counted and expenses that would be double counted.
10. Taken from Revenue guidance notes and adapted slightly
11. Note: not five accounting periods.
12. See footnote 5.