

Proposed amendments to FRS 102 (Lecture B1358 – 18.52 minutes)

The FRC has announced proposed changes to FRS 102 – the first in many years. The starting point for computing taxable trading profits is the profit computed in accordance with GAAP (UK GAAP or UK IAS), so some of the changes will change the way that some items are accounted for and this will affect their corporation tax treatment.

There is a proposed change to the section on income taxes which tax practitioners will need to provide input for.

When finalised, the changes will be mandatory for accounting periods beginning from 1 January 2025. Earlier adoption is permitted but if so, all of the amendments must be adopted.

Leases – Section 20

Tax law allows all expenses recognised in respect of leases for tax purposes if the accounts are prepared in accordance with GAAP, i.e. no adjustments would be needed to the accounting figures, but need to ensure that GAAP has been followed, apart from the 15% disallowance for cars with CO₂ emissions above the allowed maximum (currently 50g/km).

Broadly, lessees will recognise a 'right-of-use' asset and lease liability. The right-of-use asset will be depreciated (broadly over the lease term). The lease liability will attract interest expense (reducing over the lease term as rentals paid reduce the liability). This is similar to finance lease accounting under existing FRS 102.

Preparers can choose to expense the following leases like current operating leases:

1. Short term leases – i.e. the lease term is less than 12 months;
2. Leases where the underlying asset is of low value (c. £5,000 - £10,000).

Examples of low value items include tablet computers, PCs, home printers and photocopiers, mobile phones and desk phones, televisions, small items of furniture and portable power tools.

These can continue to be accounted for as presently.

Examples of non-low value items include vehicles, heavy plant (e.g. bulldozers), farm machinery (e.g. tractors, harvesters), vessels, aircraft and land and buildings.

These leases will need to be capitalised as right-of-use assets and lease liabilities.

If a lease contract contains separate lease components, the lessee must account for each separately, but can choose to treat it as a single lease if at least 50% of the consideration relates to a single lease component.

Non-lease components payable to the lessor (e.g. maintenance costs, crew, insurance, fuel, servicing) should be accounted for separately to the lease, but there is a practical expedient where the lessee can choose to include these non-lease components as part of the lease. This would change the way they are recognised in the P&L as the costs would form part of the depreciation of the right-of-use asset and interest expense on the lease liability.

This will be acceptable for tax purposes as it is in accordance with GAAP.

The lease liability must be remeasured in certain circumstances, but unlike IFRS, if the payments vary because of inflation or market rent review, the entity can choose:

1. To recognise the change in the payments from the original amounts in P&L each period; or
2. Remeasure the lease liability, using the revised cash flows but discounted at the original discount rate when the lease commenced.

Each of these will affect the timing of expense recognition for the lease and therefore its tax treatment.

On adoption of the revised lease section, there is no prior period adjustment to make. For leases still existing at the start of the first mandatory adoption period, the lease liabilities are measured at the present value of the future lease payments.

The opening right-of use asset will equal the lease liability, adjusted for any prepayment or accrual that was recognised at the previous year-end.

The tax law provides that any prior-period adjustment on adoption of a new leases standard must be spread over the weighted average lease term remaining at the start of the period of adoption, but on adoption of the FRS 102 changes there should be no transitional tax rules to be concerned about.

Revenue – Section 23

The FRC is proposing to adopt the IFRS model for revenue recognition:

1. Identify the contract with the customer;
2. Identify the promises in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the promises in the contract;
5. Recognise allocated revenue when the entity satisfies a promise.

For simple businesses, the change is unlikely to affect the way revenue is recognized. For more complex transactions, and long-term service providers such as bespoke software, the changes are likely to result in deferral of revenue over a longer period

Any changes to revenue recognition would need to be made retrospectively for contracts not completed by the start of the comparative period. The effect on prior-year profits would be recognised in the year the changes are adopted for tax purposes.

Income taxes – Section 29

The amendments introduce the concept of 'uncertain tax treatments', i.e. uncertainty over whether HMRC will accept the treatment adopted in the return (or proposed to be adopted)

If it is more than 50% likely, the treatment will not be accepted, the entity must book a liability for the expected additional tax payable in the accounts, using either the most likely outcome (in a binary decision) or expected value if there are multiple possible outcomes (e.g. a transfer pricing or asset valuation scenario).

This covers all material liabilities, unlike the tax law requirement for an uncertain tax position return where the difference is more than £5 million.

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