

1 FRED 68

(LECTURE A605 – 9.21 MINUTES)

On 20 September 2017, the FRC issued FRED 68 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Payments by subsidiaries to their charitable parents that qualify for gift aid*. FRED 68 was only open for comment until 20 October 2017 as the FRC are planning to finalise the issues raised in FRED 68 along with the changes announced in FRED 67 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland Triennial review 2017 – Incremental improvements and clarifications*.

FRED 68 was issued as the FRC became aware of significant differences in the accounting treatment for gift aid payments made by a subsidiary to its charitable parent. Gift aid payments are made during the nine months following the relevant balance sheet date and are regarded as a distribution to owners for accounting purposes, but a donation for tax purposes. Currently, it is common for such payments to be accrued at the balance sheet date and for the subsidiary to be treated as effectively tax exempt. The adoption of FRS 102 has caused some charitable groups to revisit this treatment.

1.1 Accounting issues

FRS 102 (September 2015) currently does not specifically deal with all the accounting treatments for gift aid payments and where FRS 102 does not deal with a transaction, event or condition, paragraphs 10.4 and 10.5 require judgement to be applied in developing an accounting policy which is relevant and reliable while having regard to other requirements which deal with similar and related issues. Paragraph 22.17 of FRS 102 requires distributions to owners to be recognised in equity.

The most common type of distribution are dividends to the shareholders and FRS 102 contains a number of requirements which apply to dividends, which should be regarded as applicable to other distributions to owners and this would include gift aid payments. Paragraph 32.8 of FRS 102 specifically prohibits dividends from being accrued at the balance sheet date if they have not been declared by the end of the balance sheet date and this rule also applies to gift aid payments. This is because if distributions are not declared by the balance sheet date, no obligation exists. The upshot of this treatment where a subsidiary is concerned is that it will have taxable profits and hence there will be a need to recognise a tax expense as paragraph 29.14 of FRS 102 prevents the tax effects of dividends being recognised before the dividend has been recognised.

The FRC did consider whether to provide an exemption from paragraph 32.8 of FRS 102. However, some charities put a deed of covenant in place, hence a liability would be recognised in these situations so it was concluded that an exception would not be appropriate for this type of distribution.

1.2 *Proposed treatment for gift aid and associated tax*

FRED 68 proposes to amend FRS 102 so that when it is probable (ie more likely than not) that a gift aid payment will be made in the nine months following the balance sheet date, the tax effects are to be taken into account at the reporting date. This reflects the fact that, in the majority of cases, subsidiaries will minimise their liability to corporation tax as a result of making the gift aid payments.

Special rules exist in tax legislation which allow a gift aid payment made *after* the balance sheet date to be granted tax relief in the earlier period hence the FRC propose making an exception to paragraph 29.14 of FRS 102 to allow the tax effects of the expected gift aid payment to be recognised at the balance sheet date provided certain conditions are met. Proposed paragraph 29.14A will outline these conditions as follows:

29.14A As an exception, when:

- (a) an entity is wholly-owned by a charitable **parent**;
- (b) it is probable that a gift aid payment will be made to the charitable parent within nine months of the reporting date; and
- (c) that payment will qualify to be set against profits for tax purposes.

the income tax effects of that gift aid payment shall be recognised at the reporting date. The income tax effects shall be measured consistently with the tax treatment planned to be used in the entity's income tax filings. A deferred tax liability should not be recognised in relation to such a gift aid payment.

[*footnote] In this context charitable refers to an entity that has been recognised by HMRC as being eligible for certain tax reliefs because of its charitable purposes.

FRED 68 will also clarify the following points:

- the gift aid payment, as a distribution to owners, shall not be accrued at the balance sheet date (unless a deed of covenant is in place) and shall be recognised within equity; and
- the tax effects of the gift aid payment are to be recognised in profit or loss.

Paragraph 29.22A will be inserted into FRS 102 as follows:

29.22A As an exception to paragraph 29.22, an entity shall present the tax loss. expense (income) effects of distributions to **owners** in profit or

Should the amendments go through as exposed in FRED 68, divergent practices will be reduced which will improve consistency among reporting entities.

1.3 *Effective date*

The amendments proposed in FRED 68 are effective for periods starting on or after 1 January 2019 and earlier application will be permitted provided that all of the amendments (including those in FRED 67) are applied at the same time.