

NewsAlert

Tax Accounting Services

Tax Management and Accounting Services

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Key tax accounting considerations of the United Kingdom's main corporate tax rate reduction

In summary

- The UK made two reductions to the main corporate tax rate:
 - Reduction from 27% to 26% effective April 1, 2011 to March 31, 2012
 - Reduction from 26% to 25% effective April 1, 2012
- Date of formal Enactment (required threshold for accounting under US GAAP):
 - July 19, 2011
- Date of Substantive Enactment (required threshold for accounting under UK GAAP & IFRS):
 - March 29, 2011 for the rate reduction from 27% to 26%
 - July 5, 2011 for the rate reduction from 26% to 25%
- Additional tax law changes are expected to be enacted in succeeding years, which will further lower the main corporate tax rate to 23% by 2014.
- Multinationals companies with UK entities are encouraged to assess the tax accounting implications of the tax law change.

Background

The Finance (No. 3) Act 2011, which reduced the main UK corporation tax rate to 26% effective April 1, 2011, received Royal Assent on July 19, 2011. This marks the end of the legislative procedures in relation to the Act and means that, for US GAAP purposes, the rate change is now considered enacted. The additional 1% rate reduction to 25%, effective April 1, 2012, was also legislated in Finance Act 2011 and received Royal Assent on July 19, 2011. Therefore, for US GAAP purposes, this additional reduction is also now considered enacted.

For UK GAAP and IFRS purposes, the 1% reduction of the main rate of UK corporation tax to 26%, was considered substantively enacted under the Provisional Collection of Taxes Act 1968 (PCTA) as a result of the budget resolutions passed by the UK House of Commons on March 29, 2011. Separate legislation to further reduce the main rate of UK corporation tax to 25% was passed and considered substantively enacted as part of the third reading in the House of Commons on July 5, 2011. Both rate reductions were included in the Finance (No. 3) Bill 2010-11 which received Royal Assent as Finance Act 2011 on July 19th.



The UK government has proposed additional corporate tax rate reductions to 23% by 2014. We expect incremental 1% annual reductions from 25% to 24%, effective April 1, 2013, and from 24% to 23%, effective April 1, 2014.

General rule on accounting for tax law changes

Under US GAAP, Accounting Standards Codification (ASC) 740 requires companies to use the tax law in effect at the balance sheet date. Companies should incorporate the benefit of the reduced tax rate within the annual effective tax rate in the interim period in which the legislation is enacted. Companies also must consider the reduced tax rate's effect on the deferred tax balances existing at the enactment date and record the impact as a discrete item in the interim period that includes the date of enactment. The effect of the reduced tax rates may require a detailed analysis to determine when the temporary differences existing at the enactment date are expected to reverse. (For a more in depth discussion on scheduling and estimating deferred tax balances during an interim period, refer to Section 7 of PwC's Guide to Accounting for Income Taxes). The effects, both current and deferred, are reported as part of the tax provision attributable to continuing operations, regardless of the category of income in which the underlying pre-tax income/expense or deferred tax asset/liability was or will be reported, such as discontinued operations or other comprehensive income.

Similar to US GAAP, companies reporting under IFRS are required to use the tax law in effect at the balance sheet date. Under IFRS, companies should incorporate the benefit of the reduced tax rate within the annual effective tax rate in the interim period in which the tax legislation is substantively enacted. Unlike US GAAP, under IFRS, companies should backwards trace the effects of a law change upon existing deferred tax balances in order to determine the portion of the adjustment that is recognized as part of the tax provision attributable to continuing operations or otherwise recognized as part of the tax provision that is allocable to other comprehensive income or equity. (For example, the adjustment of a deferred tax asset related to accrued pension costs that was previously recorded in other comprehensive income should likewise be recorded in other comprehensive income).

Financial statement disclosures

Companies should consider disclosure in their financial statements of the impact of the enacted changes in tax law. The current year's reconciliation of the effective tax rate should include a reconciling item for the effect of this enacted law change if the effect is considered "significant." Significant is defined by Rule 4-08(h) of SEC Regulation S-X as an individual item that is more than 5 percent of the amount computed by multiplying pre-tax income by the statutory tax rate. In addition, when changes in tax laws are enacted subsequent to the balance sheet date but before the financial statements are released, the effect on existing deferred tax assets or liabilities may need to be disclosed.

Companies should also consider whether enhanced disclosures over and above the required minimums should be made to assist users of accounts in understanding the implications of the changes.

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