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IFS *Newsalert*

International Financial Services (IFS) - Ireland

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PwC Ireland Financial Services Tax Group

PwC is a leading provider of tax services to business in Ireland's IFS sector. This group provides advice and news on Irish and international tax issues - and tax-related business issues - affecting IFS businesses in Ireland. Specialisms within the group include banking, treasury, asset finance, securitization, insurance, and investment management.

For issues relating to this new alert please contact your usual PwC contact or the specialists listed at the end of this article.

IFRS and tax

International Financial Reporting Standards are almost upon us and will be in force in less than three months. Much work has already been done by financial services groups in assessing the differences between current accounting and disclosure practices and those required under IFRS. But little has been done to date in assessing the impact on corporate tax liabilities. The process has not been helped by the large degree of uncertainty regarding the tax implications of IFRS.

Who will be affected by IFRS?

With effect from 1 January 2005 listed companies throughout the EU (including Irish listed companies) must apply IFRS in their consolidated accounts. EU member states have the option to widen the application of IFRS to other companies. The Department of Enterprise, Trade and Employment (DETE) recently made its intentions public in this regard by publishing a consultation draft Statutory Instrument.

The draft Statutory Instrument gives Irish companies the option to prepare individual company accounts under Irish GAAP or IFRS. However, if the option to use IFRS is taken then it must, with limited exceptions, be followed for all subsequent accounting periods. Also, there is a group consistency requirement, so that, with certain limited exceptions, the same financial reporting framework (i.e. either IFRS or Irish GAAP) must be applied in the individual accounts of an Irish parent and all of its Irish subsidiaries "unless there are good reasons for not doing so". There is no guidance on what "good reasons" might be except to say that all companies in a group may not be equipped to move to IFRS at the same time. From a tax viewpoint, is the absence of clarity on how IFRS will affect the tax position of companies a good reason for not switching certain subsidiaries to IFRS? In addition, if the adoption of IFRS by certain subsidiaries could give rise to significant acceleration or volatility of tax payments, is this a good reason for those subsidiaries not to adopt IFRS? The answer to these questions remains unclear.

Where will IFRS impact on tax?

As accounting profits are the starting point for computing a company's taxable profits then it goes without saying that the adoption of a complete new set of accounting standards creates fundamental tax issues in many areas. On 2 June 2004 we outlined what we considered to be the more significant of these issues in a letter to the Revenue Commissioners. The text of this letter is reproduced as an Appendix to this News Alert.

IAS 39, which deals with accounting for financial instruments, is the key accounting standard for financial services groups. An amended version of IAS 39 was endorsed by EU Accounting Regulatory Committee on 1 October 2004 (the so called EU Commission "carve-out"). Whether “full” IAS 39 or the amended version is applied in Ireland there is no doubt that it will give rise to very significant tax issues for financial services groups.

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The table below lists a number of key areas where differences between current accounting standards and IFRS will have a tax impact. The list is not exhaustive and does not deal with issues in specific sectors such as insurance.

When will the tax implications of IFRS become clear?

At the time of going to print Revenue are continuing to consider how the tax code, in terms of law or practice or both, may need to be adapted in response to IFRS developments. They are engaging in a process of consultation with industry representative bodies (e.g. Irish Bankers Federation, Financial Services Industry Association, Institute of Chartered Accountants) in an attempt to work out positions on the issues taking account of compliance costs, competitiveness, certainty and yield. Until those positions are developed it is impossible to tell how they will be implemented - by amending legislation, a Statement of Practice or a combination of both. It would appear a Statement of Practice outlining the proposed Revenue approach would go a long way to clarifying issues and help companies to formulate their approach and reach a decision as to whether to adopt IFRS. Adoption will have deferred tax implications in any event but many companies will be interested in the cash flow implications caused by the impact on corporation tax. With the introduction of IFRS imminent it is hoped that Revenue will soon publish proposals for dealing with IFRS which can be the subject of detailed consultation.

Table: Tax impact of IFRS changes

	Current accounting	IFRS	Possible tax impact
Investments	Amortised cost	Fair value	Unrealised gains/losses in tax net?
Derivatives	Off balance sheet	Fair value	Hedging possible on an after-tax basis?
Income recognition	Upfront/spread	Spread	Lower taxable profits?
Loan loss provisions	General allowed	Specific allowed	All loan loss provisions allowed?
Debt v Equity	Form	Substance	Impact on tax structures?
Share options	Cost	Fair value	Deductible?

If you have any comments on the content of this publication, or have any other issues you would like to raise, please contact your usual tax contact within PricewaterhouseCoopers, or one of the following:

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