

IFRS news

January 2018

Must know

US Tax reform - accounting under IFRS

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At a glance

President Trump signed into law on 22 December 2017 extensive changes to the US tax system. These changes are substantively enacted for accounting purposes in 2017 and should be reflected in the financial statements at 31 December 2017.

The tax law changes summarised below could have a significant impact on the current and deferred taxes of entities with a US tax presence.

Tax law changes	IFRS tax accounting impact
<p>Tax rate The US federal corporate income tax rate is reduced from the existing rate of 35% to 21% with effect from 1 January 2018, regardless of the entity's tax year. Entities that do not have a 31 December reporting date will be subject initially to a pro-rated US federal corporate income tax rate that will apply to the first income tax year that ends after 31 December 2017. For example, a 30 June 2018 reporting date entity would apply a pro-rated US corporate tax rate of approximately 28%.</p>	<p>Deferred tax assets and deferred tax liabilities should be remeasured using the new tax rate, which will apply when the existing temporary differences reverse. Entities with non-calendar reporting dates may recognise the impact of the tax law changes in the interim period in which they were enacted. It is also acceptable to spread the effect over the remainder of the reporting period through the estimate of the annual effective tax rate for interim reporting periods. Entities with non-calendar reporting dates should also consider whether temporary differences reverse during a period when a pro-rated tax rate applies.</p>

Tax law changes	IFRS tax accounting impact
<p><i>Repeal of alternative minimum tax (AMT)</i> AMT is repealed. AMT carry-forwards at 1 January 2018 can now be offset against regular tax, and any remaining balances will be refundable over the next four years.</p>	<p>Unrecognised deferred tax assets should be reassessed now that the carry-forwards are generally expected to be fully refundable. Entities should decide whether to reclassify AMT carry-forwards as a receivable. An entity might classify AMT carry-forwards as deferred tax assets if they will be recovered against future tax obligations, or as a receivable if they will be repaid in cash. There is an accounting policy choice of whether to discount current tax balances. The FASB staff have concluded that AMT carry-forwards should not be discounted under US GAAP, regardless of the expected manner of recovery.</p>
<p><i>Changes in the way that net operating losses (NOLs) are recovered</i> NOLs generated after 2017 can be carried forward for an indefinite period, but generally cannot be carried back. Utilisation will be limited to 80% of taxable income in each year. There is no change to the rules applied to NOLs generated before the end of 2017.</p>	<p>These changes might alter the assessment of the recoverability of deferred tax assets arising from NOLs. The changes will largely affect the recoverability of NOLs arising after 1 January 2018, but there could also be an impact on existing temporary differences that are expected to reverse into NOLs after that date.</p>
<p><i>Interest expense limitation</i> The existing interest deduction limitations will be expanded. Interest deductions will be limited to 30% of adjusted taxable income. Interest not recovered in the year in which it is incurred can be carried forward indefinitely.</p>	<p>This will potentially create additional deferred tax assets that will need to be assessed for recoverability. Current-period interest will be deducted first, which might restrict an entity's ability to recognise deferred tax assets for interest deductions carried forward from previous periods in some cases.</p>
<p><i>Cost recovery (full expensing)</i> Certain capital expenditure placed in service after 27 September 2017 and before 1 January 2023 may be written off immediately for tax purposes. Companies can also elect not to immediately write off qualifying assets.</p>	<p>This election might affect the current tax charge in 2017. It might create new taxable temporary differences in 2017 and additional deferred tax assets for tax loss carry-forwards (if a taxable loss is determined) that should be assessed for recoverability. Deferred tax liabilities and assets would be measured at the new lower tax rate that will apply when they reverse.</p>
<p><i>Territorial tax regime</i> International tax provisions change the US approach to the taxation of foreign earnings, including the transition to a 'territorial regime' providing a 100% dividend received deduction (DRD) on certain qualifying dividends from foreign subsidiaries.</p>	<p>The new rules might cause entities to reassess whether an existing outside basis difference will reverse in the foreseeable future and could affect the measurement of any deferred tax liability arising on investments in subsidiaries. Future dividends paid by foreign subsidiaries will not be taxed, but there could be withholding and other tax consequences imposed by the foreign jurisdiction on such dividends.</p>

Tax law changes	IFRS tax accounting impact
<p><i>Repatriation – toll charge</i> There will be a deemed mandatory repatriation of previously undistributed earnings and profits (E&P) of foreign corporations owned by U.S. parents. The rate applied depends on the subsidiaries’ liquid and non-liquid assets. NOLs can be used to reduce the taxable income arising from the deemed repatriation and foreign tax credits (FTCs) can be used to settle the toll charge. The net charge can be paid in instalments over eight years.</p>	<p>There will be a current income tax liability in 2017 for the toll charge. There is an accounting policy choice of whether to discount current tax balances. The current tax liability might affect the recoverability of existing unrecognised deferred tax assets. The FASB staff have concluded that this liability should not be discounted under US GAAP.</p>
<p><i>Taxation of foreign earnings</i> Certain global intangible low-taxed income (GILTI) of subsidiaries of US parents will be taxable income for the parent each year, based on the excess of foreign income over a specified return (deemed return on tangible assets of foreign corporations). This will result in a US tax on foreign earnings where: (i) there is not a large aggregate foreign fixed asset base; and (ii) foreign earnings are taxed at a low rate.</p>	<p>It would be acceptable, under IFRS, to recognise the charge for GILTI in the year in which it is included on the tax return on the basis that it is triggered by the existence, on an aggregate basis, of ‘excess’ low-taxed foreign income in that year. It might also be acceptable to include the impact of the GILTI charge in the tax rate used to measure deferred taxes for temporary differences expected to reverse as GILTI. Judgement will be required to determine whether this is appropriate, and management should consider, for example, whether the entity is likely to be subject to the GILTI charge consistently, and whether it is possible to make a reliable estimate of its impact. Clear disclosure of the accounting model applied, the judgements made and the accounting impact should be given. The FASB staff have concluded that there is an accounting policy choice under US GAAP to either recognise GILTI as a period cost or include it in the measurement of deferred taxes.</p>
<p><i>Incentive for US production and selling abroad</i> An additional deduction for US companies that produce domestically and sell abroad has been introduced, referred to as Foreign Derived Intangible Income (FDII). The deduction is 37.5% (reduced to 21.875% for taxable years starting after 31 December 2025) for the portion of foreign-derived income in excess of a fixed return on qualifying business asset investment.</p>	<p>This type of deduction is not addressed specifically by IAS 12. Recognition in the year in which the deductions are included in the tax return would be an acceptable approach under IFRS, on the basis that it is foreign sales in each year that trigger the deduction. It might also be acceptable to include the impact in the tax rate used to measure deferred taxes on temporary differences that will be subject to FDII on reversal. Judgement is used to determine whether this is acceptable, and the decision will depend on an entity’s specific facts and circumstances. Clear disclosure of the accounting model applied, the judgements made and the accounting impact should be given. In our view, FDII should be accounted for as a special deduction under US GAAP and recognised in the year in which the deduction is claimed.</p>
<p><i>Foreign tax credits (FTCs)</i> There are significant modifications to the FTC provisions, and certain indirect FTCs are repealed.</p>	<p>This might affect the assessment of recoverability of deferred tax assets related to FTCs.</p>

Tax law changes	IFRS tax accounting impact
<p><i>Anti-base erosion – minimum tax on certain related party payments</i> A minimum tax, known as BEAT, will be paid when the tax calculation under BEAT exceeds the corporation’s regular tax liability (after the application of certain credits). BEAT is a modified taxable income after adding back base erosion payments, such as payments to related foreign persons (generally excluding payments for cost of goods sold).</p>	<p>The FASB staff have concluded that temporary differences should be measured at regular tax rates and the effects of BEAT should therefore be accounted for in the year in which it is incurred. This approach would be acceptable under IFRS.</p>

Recognition of the remeasurement of deferred taxes

IFRS requires the remeasurement of deferred taxes to be recorded outside profit or loss if the deferred tax relates to items previously recognised in other comprehensive income or equity, which is commonly referred to as ‘backwards tracing’. It might sometimes be difficult to determine how to allocate the remeasurement. For example, a change in tax rate might affect a deferred tax balance that was previously recognised partly outside profit or loss (for example, in connection with an employee benefit liability). A reasonable pro rata allocation, or other suitable method that achieves a more appropriate allocation, can be used to reflect an entity’s circumstances.

Judgements and estimates

The calculations and assessments required by the changes in US tax law are complex, and some entities might find it difficult to complete the analysis before the 2017 financial statements are issued.

Challenges will include the time needed to complete and collate the data for the calculations, the actual application of the new law and understanding some of the accounting implications.

Management should do its best to make a reliable estimate of the accounting impact of each aspect of the tax law changes, taking into account ‘reliable information that could reasonably be expected to have been obtained and taken into account’ (IAS 8 para 5), together with the entity’s existing approach to uncertain tax positions. Subsequent adjustments would typically be accounted for as a change in estimate. In almost all cases, management should be able to make a reliable estimate.

Entities should also present all of the required relevant disclosures, including those required by IAS 12 and also disclosures on judgements and estimation uncertainties required by paragraphs 125–133 of IAS 1.

Other accounting considerations

The tax law changes might have other accounting consequences. These might affect, for example, hedge accounting, impairment testing and liquidity disclosures. The extent of the impact and the areas affected will depend on a company’s particular circumstances.

Additional detailed information about the changes is included in the [US In depth publication - Accounting considerations of US tax reform](#).

IFRS IC decision on interest and penalties related to income taxes

Issue

The IFRS Interpretations Committee (IC) issued an agenda decision in September 2017 on interest and penalties related to income taxes.

IFRIC 23, 'Uncertainty over income tax treatments', applies to income taxes within the scope of IAS 12, 'Income taxes'. It does not address the accounting for interest and penalties related to income taxes. The IC considered whether it should develop guidance and concluded that the benefits of improvements in financial reporting from a project to consider interest and penalties would not outweigh the costs. It therefore decided that it should not develop guidance, and it issued an agenda decision.

The IC observed in the agenda decision that entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37, 'Provisions, contingent liabilities and contingent assets', to interest and penalties. If an entity considers that a particular amount payable or receivable for interest and penalties is an income tax, IAS 12 is applied to that amount. If an entity does not apply IAS 12 to an amount payable or receivable for interest and penalties, it applies IAS 37 to that amount.

The IC also observed that:

- an entity discloses its judgement in this respect applying paragraph 122 of IAS 1, 'Presentation of financial statements', if it has a significant effect on the amounts recognised in the financial statements; and
- regardless of whether an entity applies IAS 12 or IAS 37 when accounting for interest and penalties,

the entity discloses information about those items if material, because both IAS 12 and IAS 37 provide disclosure requirements.

Impact

Who might be affected?

Any entities that receive or pay interest or penalties related to income taxes might be affected by the agenda decision.

What is the impact?

In the absence of specific guidance in IAS 12, some entities might currently make an accounting policy choice to determine whether IAS 12 or IAS 37 is applied to interest and penalties related to income tax where there are uncertain tax positions. These entities will now need to consider the specific nature of the interest and penalties to determine which standard applies. This might lead to recognition, measurement and disclosure differences in some cases and to a change in income statement presentation.

When is the agenda decision effective? The agenda decision clarifies the existing guidance and is therefore effective immediately. Entities with a reporting date shortly after the agenda decision was issued should assess whether the agenda decision applies at that date. The views of any relevant securities regulator should be considered as part of that assessment. What should entities do? Affected entities should assess their approach to accounting for interest and penalties related to income taxes, and whether their accounting policies and presentation need to be changed. A change in accounting policy should be accounted for retrospectively in accordance with IAS 8, 'Accounting policies, changes in accounting estimates and errors'.

Insight

Entities need to decide whether a particular amount payable or

receivable for interest and penalties is an income tax. IC agenda decisions in [March 2006](#) and [May 2009](#) noted that IAS 12 defines income taxes as taxes that are based on taxable profits, and the term 'taxable profit' implies a notion of a net rather than a gross amount.

Judgement is required to determine which standard applies. Management should consider the substance and intent of the tax law and the settlement process with the tax authority to determine whether interest and penalties are separate components that are accounted for by applying IAS 37 or part of an overall settlement with the tax authority that is accounted for by applying IAS 12.

The relevant standard should be applied consistently to all aspects of the accounting.

- The guidance in IAS 12 (and IFRIC 23 with effect from 1 January 2019) should be applied to determine the unit of account, and to the recognition and measurement of amounts that are in the scope of that standard. This would include, for example, recognising current taxes outside of profit or loss if they relate to items recognised outside profit or loss and applying the entity's accounting policy to discounting current tax balances.
- Amounts determined to be in the scope of IAS 37 will be recognised and measured in accordance with that standard. Interest determined to be in the scope of IAS 37 will be recognised as finance cost, and penalties will be recorded as operating expenses.

Management should disclose clearly in accordance with IAS 1 the standard that has been applied to interest and penalties if the impact is material. Where can entities find more details?

See the [September 2017 IFRIC Update](#) for the full agenda decision.

Issues of the month

PwC IFRS Blog

Accounting for Cryptocurrency

What is cryptocurrency?

Before we get out our big sexy accounting books, a quick refresher on cryptocurrencies. A cryptocurrency is a medium of exchange such as the US dollar.

There are currently many different types of cryptocurrency in existence. The most popular, Bitcoin, was the first cryptocurrency to appear in January 2009. However, since then the marketing folks have gotten hold of this and we have even funkier names such as Ethereum, Ripple, Litecoin and many more (I'm just waiting for IFRSCoin and then I'm investing!)

Like the US dollar, cryptocurrency has no intrinsic value in that it is not redeemable for another commodity, such as gold. Unlike the US dollar, however, cryptocurrency has no physical form, is not legal tender, and is not currently backed by any government or legal entity. In addition, its supply is not determined by a central bank and all transactions are performed and validated by the users of the system without an intermediary (such as a bank) facilitating these functions. The term cryptocurrency is used because the technology is based on public-key cryptography (for those without a PhD in programming, this just means that the communication is secure from third parties).

If you're more interested in cryptocurrencies than the accounting thereof, take a look on this [link](#).

So what's the accounting issue?

The speed, ease and cost savings associated with this type of currency means it has the potential to become the popular choice for payments, with large brands such as eBay, Dell and PayPal accepting Bitcoin payment. Although the function of a cryptocurrency is to improve the ability of parties to transact digitally with each other, to date most investors in cryptocurrencies are investing in them with the hope of realising capital gains. For example, the value of Bitcoin increased approximately 700% between January 2017 and the beginning of November 2017 (now if only I was investing in these things rather than trying to work out the accounting, sigh).

Holdings of cryptocurrencies can be both large and their value can be volatile – so users of financial statements probably want to know about them. However, there is a significant shortcoming: today's accounting standards are not written with cool cryptocurrencies in mind!

What is wrong with today's accounting?

Most common sense accountants (yes, there are still some of us left) would agree that the best accounting for a cryptocurrency would be fair value. After all, that's the value at which investors will either realise their investment or be able to transact in exchange for other goods and services.

Unfortunately ye olde accounting rules haven't quite moved with the times it seems. In order to be able to measure cryptocurrencies at fair value (sheesh, typing out cryptocurrency is getting tiring, can I just say Bitcoin from now on please, you know what I mean?),

the Bitcoin needs to meet the accounting definition of a financial asset. And that's where the back wheels fall off, because Bitcoins are:

1. Not legal tender (i.e. cash as defined);
2. Not cash equivalents because their value is exposed to significant changes in market value; and
3. Not a contractual right to receive either cash or a cash equivalent.

So Bitcoins fail the definition of a financial asset. Okay, so where does that leave us (other than scratching our collective heads in consternation). Well, today's accounting rules would lead to accounting for Bitcoins either as an intangible asset or inventories.

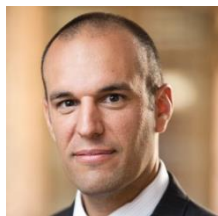
If the Bitcoins are recognised as inventory, then they would need to be measured at cost. I guess at a pinch the entity could disclose the fair value of the Bitcoins, but that's about as good a solution as eating baby food because you have no teeth.

If the Bitcoins are recognised as intangible assets, then the default position would also be to measure them at cost. There is the possibility that if the Bitcoins are accounted for as intangible assets, an entity might be able to justify that there is an active market for the Bitcoins, in which case the Bitcoins would be able to be measured at fair value. However, this is still only second prize, because movements in that fair value would be recognised through other comprehensive income and the gain would not be recycled through profit and loss when the Bitcoins are realised.

Issues of the month

Conclusion

Accounting for Bitcoins at fair value with movements reflected in profit or loss would provide the most useful information to investors. However, existing accounting requirements do not seem to permit this.



Accounting for cryptocurrency is not on the agenda of the International Accounting Standards Board. How long do you think it will take before cryptocurrency is a big enough deal that we need a bespoke solution?

This week's guest blogger is Gary Berchowitz, PwC Partner.

Connect with him on [LinkedIn](#).

Cannon street press

The January 2018 IASB *Update* has been published and the work plan updated.

The topics for discussion were:

- Primary Financial Statements
- Financial Instruments with Characteristics of Equity
- Conceptual Framework
- IFRS Implementation Issues
- Goodwill and Impairment
- Post-implementation Review of IFRS 13 Fair Value Measurement



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