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IFRS in Focus
New IFRIC Interpretation on Levies

Contents

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This edition of IFRS in Focus outlines the requirements of the IFRIC Interpretation IFRIC 21 Levies ("the Interpretation") issued recently.

The Bottom Line

- A levy is a payment to a government for which an entity receives no specific goods or services.
- The obligating event is the activity that binds the entity to pay the levy which is typically specified in legislation enacting the levy.
- A liability to pay a levy to a government should only be recognised when an obligating event has occurred. While levies may be calculated based on past performance (such as generating revenue) that itself is a necessary, but not sufficient, condition to recognise a liability.
- The Interpretation is effective from 1 January 2014.

Why has this Interpretation been issued?

The Interpretation was developed to address concerns about how to account for levies that are based on financial data of a period that is different from that in which the activity that gives rise to the payment of the levy occurs. That is, when should an entity accrue a liability for a levy which becomes payable in a subsequent period? Views were divided about what is the obligating event that triggers the recognition of a liability, and in particular, whether economic compulsion should be considered. Questions were also raised about the obligating event when a levy is incurred, progressively or in full, when a minimum threshold is met or when it is subject to the entity operating on a specified date. If levies are incurred progressively, a further question was raised as how to accrue for that obligation in the interim reports issued during that period.

What is a 'levy'?

The Interpretation defines a levy as "an outflow of resources embodying future economic benefits that is imposed by governments on entities in accordance with legislation". Taxes within the scope of IAS 12 *Income Taxes* are excluded as are fines and penalties. Payments to governments for services or the acquisition of an asset under a contractual arrangement are also outside the scope. That is, the levy must be a non-reciprocal transfer to a government where the entity paying the levy does not receive specific goods and services in exchange. For the purposes of the Interpretation, a 'government' is defined in accordance with IAS 20 *Accounting for Government Grants and Disclosures of Government Assistance*. When an entity acts as an agent for a government to collect a levy, the agency cash flows collected are outside the scope of the Interpretation.

It is worth noting that the Interpretation not only deals with levies that give rise to provisions under IAS 37 but also those for which the timing and amount are certain.

Observation

The distinction between a 'tax' within the scope of IAS 12 and a levy that is addressed by IFRIC 21 is not necessarily clear cut. IAS 12 does not define an 'income tax' though the IFRS IC in the Basis for Conclusions to IFRIC 21 draws on previous notions it has considered that an income tax is one based on a net amount (typically taxable profit), so by implication levies cover other non-reciprocal payments to government.

Entities are not required to apply the Interpretation to emission trading schemes, however, they may elect to apply it to such schemes as an accounting policy choice.

How does the Interpretation impact the accounting for levies?

Consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, a liability is recognised when the obligating event occurs. The obligating event is the activity that triggers payment of the levy. This is typically specified in the legislation that imposes the levy. For example, if an entity pays a levy on the previous period's (20X0) revenue but the levy is only payable if the entity is operating at 1 January (20X1), the obligating event is being in operation on 1 January and the levy should not be accrued until that date. The logic is that generating revenue in the previous year is a *necessary* but not a *sufficient* condition to trigger the recognition of a liability.

Observation

The Interpretation does not address what to do with the corresponding debit from the recognition of a liability. In many cases, the corresponding entry will be to recognise an expense for the period unless an entity can demonstrate that there is an element of prepayment which can be carried forward as an asset.

The Interpretation also considers a range of different levy arrangements. The table below summarises different types of levy arrangements dealt with by the Interpretation.

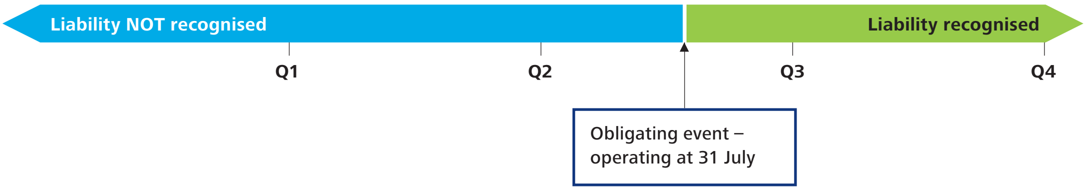
Levy Arrangement	When would a liability be recognised?
Levy is triggered progressively as the entity generates revenue.	The obligating event is the generation of revenue as specified in legislation. An entity accrues a liability to pay the levy as it generates revenue.
Levy triggered in full as soon as the entity generates revenue in a given year.	The obligating event is initial revenue generated by entity. In these arrangements a levy is typically payable based on the revenue of a previous period. Accordingly, earning revenue in the previous period is a necessary but not a sufficient condition to recognise a liability for the payment of the levy.
Levy is triggered in full if the entity is operating on a specified date.	The obligating event is being in operation on a specified date and until that date, the entity can avoid paying the levy. In this case, even though the amount of levy is calculated based on balances in a previous period, no obligation is accrued until the specified date has been reached.
Levy is triggered if the entity generates revenue above a specified minimum amount of revenue.	The obligating event is generating revenue above the trigger level. No liability is accrued until the trigger level is reached, irrespective of the likelihood of that even occuring. Accordingly, even if that minimum is always reached each period and it is reasonably certain that the threshold will be met in the current period, the liability is not booked until the obligating event has been reached.

Observation

Examples of levies that would be within the scope of the Interpretations include: (a) the United Kingdom Banking levy, assessed on entities acting as banks at the end of the reporting period and is based on the carrying amount of equity and liabilities at the end of the reporting period; and (b) the French C3S tax which is calculated as a percentage of revenues in the preceding annual period triggered when an entity participates in its market on the first day of the annual reporting period.

When should an obligation to pay a levy be recognised in interim financial statements?

The Interpretation makes it clear that a liability to pay a levy should only be recognised in interim reports once the obligating event has occured. The diagram below illustrates the effect on interim statements for a calendar year end entity.



> Observation
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> The Basis for Conclusions to IFRIC 21 notes that in accordance with paragraph 16A of IAS 34 *Interim Financial Reporting* it may be necessary for an entity to provide disclosures about levies recognised in current, or to be recognised in future, interim financial reports.

When does the Interpretation apply?

The Interpretation applies to annual reporting periods beginning on after 1 January 2014. In accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the Interpretation is to be applied retrospectively.

> Observation
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> Entities will need to review all the levies they currently pay to assess whether their existing accounting policy is consistent with the requirements of IFRIC 21.

Key contacts

IFRS global office
Global IFRS Leader
Veronica Poole
ifrsglobalofficeuk@deloitte.co.uk

Global IFRS Communications Director
Mario Abela
ifrsglobalofficeuk@deloitte.co.uk

IFRS centres of excellence

Americas		
Canada	Karen Higgins	iasplus@deloitte.ca
LATCO	Fermin del Valle	iasplus-LATCO@deloitte.com
United States	Robert Uhl	iasplusamericas@deloitte.com
Asia-Pacific		
Australia	Anna Crawford	iasplus@deloitte.com.au
China	Stephen Taylor	iasplus@deloitte.com.hk
Japan	Shinya Iwasaki	iasplus-tokyo@tohmatsu.co.jp
Singapore	Shariq Barmaky	iasplus-sg@deloitte.com
Europe-Africa		
Belgium	Thomas Carlier	BEIFRSBelgium@deloitte.com
Denmark	Jan Peter Larsen	dk_iasplus@deloitte.dk
France	Laurence Rivat	iasplus@deloitte.fr
Germany	Andreas Barckow	iasplus@deloitte.de
Italy	Franco Riccomagno	friccomagno@deloitte.it
Luxembourg	Eddy Termaten	luiasplus@deloitte.lu
Netherlands	Ralph ter Hoeven	iasplus@deloitte.nl
Russia	Michael Raikhman	iasplus@deloitte.ru
South Africa	Graeme Berry	iasplus@deloitte.co.za
Spain	Cleber Custodio	iasplus@deloitte.es
United Kingdom	Elizabeth Chrispin	iasplus@deloitte.co.uk

Designed and produced by The Creative Studio at Deloitte, London. 27226A