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INFORMATION NOTE

CORPORATE INCOME TAX REPORTING BY IRISH ISSUERS

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THE IRISH AUDITING AND ACCOUNTING SUPERVISORY AUTHORITY (IAASA)

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

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1. Context for and purpose of this Information Note

Corporate income tax has become an important topic in the financial statements of many issuers that are subject to income tax in a number of jurisdictions and/or where significant judgement and a high degree of estimation is required to determine the world-wide provision for taxes. Macro-economic factors and other events impacting issuers' tax exposure may include:

(a) Brexit;

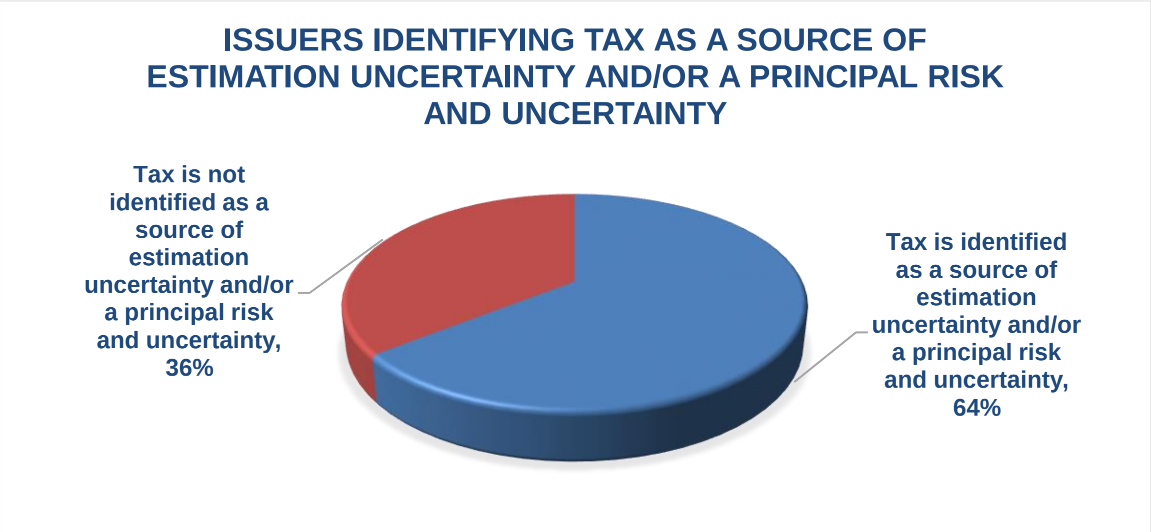
(b) tax reform in the US (Tax Cuts and Jobs Act 2017); and

(c) international tax developments and OECD initiatives related to base erosion and profit shifting (BEPS).

The findings in this Information Note are based on a desktop review of aspects of corporate income tax reporting by equity issuers falling under IAASA's financial reporting examination remit (mainly entities admitted to trading on the Main Market of Euronext Dublin (Irish Stock Exchange)). Our findings have also been informed by cases discussed at the European accounting enforcers forum[1].

For the purpose of this Information Note, we have not corresponded with the issuers concerned.

A majority of issuers examined (18/28[2]) identified taxation as a source of estimation uncertainty and/or a principal risk and uncertainty.



The purpose of this Information Note is to assist issuers' management and those charged with governance in the preparation of high quality financial reports by offering observations regarding the disclosure of:

(a) the effective tax rate (ETR);

(b) the tax reconciliation disclosed in the notes to the financial statements; and

(c) uncertain tax positions (UTPs).

It is expected that this Information Note will result in issuers providing more transparency in their corporate income tax disclosures in accordance with the requirements of IAS 12 *Income Taxes* and

[1] i.e. at the European Securities Markets Authority (ESMA)-sponsored European Enforcers Co-Ordination Sessions (EECS)

[2] The remaining three issuers have REIT tax status under the Finance Act 2013 and have, therefore, been excluded from the results of this desktop survey

IAS 1 *Presentation of Financial Statements*. Issuers may wish to note that the topics set out in this Information Note, together with the application of IFRIC 23 *Uncertainty over Income Tax Treatments*[3], will be monitored by IAASA in future examinations.

2. IAS 12 *Income Taxes*

IAS 12.79 requires that the major components of tax expense (income) shall be disclosed separately.

IAS 12.81(c) states that issuers shall disclose separately an explanation of the relationship between tax expense (income) and accounting profit in either or both of:

(a) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s); or

(b) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed.

IAS 12.84 states that:

> '*The disclosures required by paragraph 81(c) enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future …*'

The disclosure requirements of paragraphs 17 and 122 to 129 of IAS 1 *Presentation of Financial Statements* may also be relevant in preparing the corporate income tax disclosures. The specific facts and circumstances of each issuer will also impact the nature and extent of disclosures.

3. Messages to issuers in preparing corporate income tax disclosures

It is IAASA's expectation that, in preparing corporate income tax disclosures, management, Directors and Audit Committees will, to the extent considered appropriate, consider the following topics.

3.1. Effective tax rates

The interest of users of financial statements in understanding movements in the current and future effective tax rates[4] has increased in recent years due to a combination of entity specific factors together with the effect of international events such as the tax consequences of Brexit, US tax reform and OECD initiatives related to BEPS.

The key findings from our examination of issuers' disclosure of the effective tax rates are as follows:

(a) eighteen issuers (64%) identified tax as a source of estimation uncertainty and/or a principal risk and uncertainty; in contrast, only 10 (36%) of Auditors' Reports identified tax as a key audit matter;

(b) seventeen issuers (61%) disclosed the effective rate of tax or, conversely, 39% did not refer to the ETR. Of these 17 issuers, seven (41%) disclosed a modified ETR;

(c) modified ETRs excluded varying combinations of the following items from its calculation – exceptional items, amortisation of acquired intangibles, transaction costs, share of profits of joint ventures and associates, equity accounted investments, non-trading items. Modified ETR was in some instances described as being based upon adjusted earnings or underlying earnings; and

(d) eighteen issuers (64%) disclosed the reasons for the movement in the ETR; however, ten issuers (36%) did not disclose the reasons for movements in the ETR.

[3] IFRS IC 23 is effective for accounting periods beginning on or after 1 January 2019

[4] The average effective tax rate is the tax rate expense (income) divided by the accounting profit (IAS 12.86 refers)

Examples of disclosures providing entity specific reasons for the movements in the ETR included the following:

‘*current tax increase in Europe is offset by a decrease in the Americas*’;

‘*change in UK legislation restricting the use of tax losses*’;

‘*the exceptional impact of US tax reform in the current year*’; and

‘*changes in jurisdiction in which the group operates*’ and ‘*changes in the geographic mix of profits.*’

Key messages for management, Directors and Audit Committees
Disclosures regarding ETRs and movements in the future ETRs should be improved in order to ensure compliance, in full, with the disclosure requirements IAS 12.81, IAS 12.84 and IAS 1.17(c). In the current climate of economic uncertainty, users of financial statements need to be able to understand the significant factors that could affect the relationship between the tax expense (income) and the accounting profit in the future.

Disclosures are most informative to users when they display the following characteristics:

(a) they are entity-specific and explain the key factors influencing the entity’s ETR;

(b) the disclosures link the movement in the ETRs to specific factors, events or circumstances e.g. changes in the geographic mix of profits, change in overseas tax rates, foreign tax reform legislation;

(c) the ETR is transparent and easily understood e.g. not unduly complicated or modified by a large number of adjustments which might diminish its understandibility and comparability;

(d) avoid the use of boilerplate disclosures; and

(e) disclosures explain the sustainability or otherwise of future ETRs.

3.2. Tax reconciliations

The tax reconciliation required by IAS 12.81(c) is designed to enable users of financial statements to understand whether the relationship between tax expense/(income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future [IAS 12.84].

The qualitative tax disclosures in the notes to the financial statements should supplement the quantitative data and should explain the significant tax reconciliation items, particularly where items are material and/or unusual.

The key findings from our examination of issuers’ tax reconciliations and related notes are as follows:

(a) all issuers disclosed a tax reconciliation;

(b) the items that most frequently materially impacted the effective tax rate were:

(i) differences in foreign taxes (68% of issuers);

(ii) expenses/(income) not tax deductible (taxable) for tax purposes (61%);

(iii) deferred tax assets not recognised/reversal of amounts (39%); and

(iv) adjustments in respect of prior years (32%).

However, we noted some practices which may negatively impact users' understanding:

(a) seventeen issuers (61%) demonstrated unclear labelling in one or more material tax reconciliation items;

(b) nineteen issuers (68%) indicated netting of items within the reconciliation thereby rendering the significance of some reconciling items unclear;

(c) eighteen issuers (64%) did not disclose a qualitative explanation of at least one or more material tax reconciliation items sufficient to enable users to gain an understanding of unusual items and/or the significant factors that could affect the tax in the current/future periods; and

(d) nineteen issuers (68%) had significant earnings in multiple tax jurisdictions; however, twenty-six issuers (93%) prepared a tax reconciliation using the domestic/ Irish standard rate of corporation tax as compared to the average effective tax rate of the group. IAS 12.81(c) permits the latter approach; however, reconciling tax to an average group ETR where profits are earned in many jurisdictions may be more informative to users.

Key messages for management, Directors and Audit Committees

The transparency of tax reconciliations needs be improved to enable users to understand, in full, unusual tax reconciliation items and the significant factors that could affect the effective tax rate in the future in accordance with the disclosure requirements of IAS 12.81 and IAS 12.84. This can be achieved where the following measures are adopted:

(a) use clear labels in describing material and or unusual tax reconciliation items. Avoid, as far as possible, the use of generic labels such as 'other items', 'prior period adjustments' and 'other differences' that add no informational value to users;

(b) describe the nature of material tax reconciliation items, the circumstances giving rise to same and whether or not material items are unusual and or recurring;

(c) avoid unnecessary netting of items in the tax reconciliation. The disaggregation of material tax reconciliation items provides more meaningful information to users; and

(d) preparers of financial reports should carefully deliberate as to which tax reconciliation presentation option provides the more user useful information – a reconciliation using the domestic/ Irish standard rate of corporation tax or an average effective tax rate across the group.

3.3. Uncertain tax positions

IFRS does not define UTPs. However, UTPs are commonly regarded as transactions and calculations for which the ultimate outcome is uncertain and where the complexity of the tax treatment may be such that the outcome by the relevant tax authority may take several years to be determined.

The key findings from issuers' disclosures of UTPs are as follows:

<u>Accounting policy – measurement of UTPs</u>

(a) twenty issuers (71%) referred to UTPs in the notes to the financial statements;

(b) however, a majority of these issuers described their accounting policy for UTPs in very general terms such as:

> '*Estimates are required in determining the provision for taxes at the reporting date*';
>
> '*Provisions for tax liabilities require management to make judgements and estimates in relation to tax issues and exposures*'; and
>
> '*The amounts provided/ recognised for tax are based on management's estimate having taken appropriate professional advice*'.

(c) general and boilerplate disclosure of UTP accounting policies limits the ability of users of the financial statements to understand the criteria applied in the recognition and measurement of UTPs;

(d) six issuers (21%) referred to a UTP measurement policy based on a probability weighted expected value approach, a most likely single outcome approach or a combination of those two approaches; and

(e) no issuer quantified the aggregate amount of UTPs separately. This contrasts with the fact that eighteen issuers (64%) identified tax as a source of estimation uncertainty and/or a principal risk and uncertainty.

Key messages for management, Directors and Audit Committees
Users understanding of issuers' accounting policy for the recognition, measurement and disclosure of uncertain tax positions needs to be improved in full compliance with the disclosure requirements of IAS 1.117 to IAS 1.129. This can be achieved were issuers to apply the following recommendations in preparing financial statements:

(a) provide a clear disclosure of the criteria applied for the recognition, measurement, disclosure and classification of UTPs (e.g. UTPs are measured using most likely single outcome approach or a probability weighted expected value approach);

(b) avoid the excessive use of generic or boilerplate language in the disclosure of UTPs accounting policy;

(c) if a UTP provision is recognised, specify the measurement methodology applied and set out the factors considered in determining the amount of UTPs recognised; and

(d) consider whether or not separate disclosure of UTPs is required on the basis that UTPs are individually or collectively material and/or in accordance with the disclosure requirements of IAS 1.17, IAS 1.122 and IAS 1.125.

In considering the extent of UTP disclosures in financial statements, issuers should also have regard to the requirements of IFRS IC 23 *Uncertainty over Income Tax Treatments.*

4. Issuers included in this Information Note

Issuers included in this desktop survey comprised all 31 equity issuers falling within IAASA's financial statement examination remit at 31 December 2017.

These issuers were:

AIB Group plc
Aminex plc
Aryzta AG
Bank of Cyprus Holdings plc
Bank of Ireland Group plc
CRH plc
C&C Group plc
Cairn Homes plc
Dalata Hotel Group plc
Datalex plc
DCC plc
FBD Holdings plc
Glanbia plc
Glenveagh Properties plc
Grafton Group plc
Green REIT plc
Greencore Group plc
Hibernia REIT plc
IFG Group plc
Independent News & Media plc
Irish Continental Group plc
Irish Residential Properties REIT plc
Kenmare Resources plc
Kerry Group plc
Kingspan Group plc
Mainstay Medical International plc
Paddy Power Betfair plc
Permanent TSB Group Holdings plc
Ryanair Holdings plc
Smurfit Kappa Group plc
UDG Healthcare plc