DI/2012/1

Levies Charged by Public Authorities on Entities that Operate in a Specific Market

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Public Discussion

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Contents

1. Background

IFRSIC – 31 Mai 2011

- Release of DI/2012/1
- End of Comment Period: 5 September 2012

Background per DI

- a public authority
- may impose a levy
- on entities,
- that operate in a specific market.

→ **Question**: how to account for the levy in the financial statements of the entity paying the levy?

1. Background

Examples (taken from the Staff Papers of the IFRSIC)

– **UK bank levy**: is charged, if the entity <u>at the end of its financial year</u> is active as a bank. The levy will be determined by reference to the balance sheet numbers for equity and liabilities as per this date.

→ is the levy (proportionally) to be accrued for per first quarter of the financial year?

– **France – railway levy**: is charged, if the entity <u>on the first day of its financial year</u> does have a licence to be active in this market. The levy is determined by reference to the sales volume of the previous financial year.

→ is the levy to be accrued for by the end of the previous financial year?

2. Scope

3 only **levies**, that are recognised as liabilities in accordance with IAS 37

4 **DI does not address:**

a) income taxes within the scope of IAS 12

b) levies that are due only if a minimum revenue threshold is achieved

c) fines or other penalties imposed for breaches of the legislation

d) contracts between a public authority and private entity

2. Scope

5 **levies within the scope of the DI** have the following characteristics:

a) they require a transfer of resources to a public authority in accordance with legislation

b) they are paid by entities that operate in a specific market as identified by the legislation

c) they are non-exchange transactions

d) they are triggered when a specific activity identified by the legislation occurs

e) the calculation basis of the levy uses data for the current period or a previous reporting period

2. Scope

Comments of the IFRS-Committee:

- not specific enough
  (e.g. mandatory rebates in the healthcare industry: Levy? Public authority?)
- no appropriate reasoning for the scope-out of *non-exchange transactions* (DI.BC5 – is it true, that the majority of levies is covered?)
- possible '*scope-creep*' with respect to rate-regulated activities

3. Issues and preliminary consensus of IFRSIC

Question 1/5: What is the **obligating event** that gives rise to a liability to pay a levy?

7 … is the activity that triggers the payment of the levy as identified by the legislation.

Question 2/5: Does the **economic compulsion** to continue to operate in a future period create a constructive obligation to pay a levy that will arise from operating in that future period?

8 **No**.

Question 3/5: Does the **going concern principle** imply that an entity has a present obligation to pay a levy that will arise from operating in a future period?

9 **No**.

3. Issues and preliminary consensus of IFRSIC

Question 4/5: Does the recognition of a liability to pay a levy arise

a) at a **point in time** or

b) **progressively over time**?

10 a) **generally** at a point in time;

b) **however**, if the obligating event occurs over a period of time, it is recognised progressively.

11 The liability to pay a levy that is within the scope of this draft Interpretation gives rise to an **expense**.

3. Issues and preliminary consensus of IFRSIC

Question 5/5: Can the levy expense be anticipated or deferred in the interim financial statements?

12 The same recognition principles shall be applied in the interim financial statements as are applied in the annual financial statements. As a result, in the interim financial statements, the levy expense should not be:

a) **anticipated** if there is no present obligation to pay the levy at the end of the interim reporting period; or

b) **deferred** if a present obligation to pay the levy exists at the end of the interim period.

3. Issues and preliminary consensus of IFRSIC

Comments of the IFRS-Committee:

- the conclusions reached by the IFRSIC are considered to be properly derived from the underlying IFRS
- however, the conclusions are partly not considered to be 'satisfactory' since for interim financial statements – based on economic substance – information needs to be reported which is not in line with what is considered a 'realistic picture' of the entity's expense situation:
  - if the obligating event occurs in Q4 –
  - then there is no expense for Q1 – Q3.

  That in such instances no expenses are to be anticipated for Q1-Q3 is in line though with underlying IFRS, neither the **Conceptual Framework** nor **IAS 37** allow such an approach (no strict *matching-principle*).

3. Issues and preliminary consensus of IFRSIC

Comments of the IFRS-Committee:

– therefore proposal: an approach as established in **IAS 34.B7** for ‘contingent lease payments‘ should be made possible

Contingent lease payments can be an example of a legal or constructive obligation that is recognised as a liability. If a lease provides for contingent payments based on the lessee achieving a certain level of annual sales, an obligation can arise in the interim periods of the financial year before the required annual level of sales has been achieved, if that required level of sales is expected to be achieved and the entity, therefore, has no realistic alternative but to make the future lease payment.

– DI.BC7: not addressed is the issue of accounting for levies that are due only if a minimum revenue threshold is achieved in the current period – that the Committee did not reach a consensus does not satisfy as an argument

4. Effective date and transition

Appendix A to the DI:

A1 Effective date: still open;

optional earlier application: allowed, if appropriate disclosure is made.

A2 Transition: ‘retrospectively‘ according to IAS 8.

Comments of the IFRS-Committee to Appendix A:

– Agreement

Other comments of the IFRS-Committee:

– Consolidation of IFRIC 6 (=> waste electrical and electronic equipment) and the DI to become <u>one</u> single pronouncement

Appendix: Application of DI/2012/1 on German bank levy

Staff view – also all following pages

Scope

- bank levy according to RStruktFV falls into the scope of the DI (since neither IAS 12 nor IAS 32 / 39 are applicable)

Preliminary consensus of IFRSIC:

- **obligating event (DI.7)**: according to § 1para 5 sentence 1 RStruktFV the bank levy is to be paid

  „[1]As an annual charge … of all banks subject to § 2 of the Restrukturierungs-fondsgesetz ..., which as per 1 January of the year for which the levy will be charged do have a licence in accordance with the Kreditwesengesetz."

  Thus, the liability to pay the bank levy will generally be incurred in full amount as per the beginning of the year for which the levy will be charged – and not per 30 September, when the levy is due to be paid (§ 1 para 1 RStruktFV – due date).

Appendix: Application of DI/2012/1 on German bank levy

Preliminary consensus of IFRSIC:

– however, questionable is whether something different is true due to § 1 para 5 sentences 2-3 RStruktFV:

„[2]The annual levy is reduced for banks whose licence will be cancelled or returned between 1 January and 31 March by 75 per cent, and for banks whose licence will be cancelled or returned between 1. April and 30 June by 50 per cent. [3]The duty to pay the levy ends upon completion of the calendar year, in which the licence will be cancelled or returned."

according to § 1 para 5 sentence 2 RStruktFV, the liability is to be recognised for the interim periods **Q1 & Q2 only proportionally** (since the banks could avoid paying the levy by returning their licence – see analogous: IAS 37 App. C - Example 6 (*Legal requirements to fit smoke filters*)).

Appendix: Application of DI/2012/1 on German bank levy

Preliminary consensus of IFRSIC:

– as per 1 July of a financial year (for **Q3 and Q4**) an entity must,

if the licence in accordance with the Kreditwesengesetz has not been returned by 30 June,

recognise the levy in its full amount for the financial year** as a liability since the bank will not be in position anymore to avoid its payment

** subject to the payment which needs to be made as per 30 September.

Appendix: Application of DI/2012/1 on German bank levy

Preliminary consensus of IFRSIC:

- further in question is the approach of recognition expense in the interim period of the financial year:

  DI.10 – *recognised progressively*

  DI.12 – *interim financial statements – no deferral if present obligation*

- **Q1** – in analogy to the liability recognised (3/12 of the annual levy) ✓
- **Q2** – in analogy to the liability recognised (3/12 of the annual levy) ✓

- **Q3** – in analogy to the liability recognised (**6/12** of the annual levy)

  or

- **Q3** – according to DI.10 *progressively over time* (**3/12** of the annual levy)

Appendix: Application of DI/2012/1 on German bank levy

Preliminary consensus of IFRSIC:

– the answer to the accounting for **Q3** finally will depend on whether the bank levy is viewed as an **expense pertaining to a period of time** (annual levy) – if that view is supported, the bank levy during the financial year will need to be recognised ***progressively over time***

– **expense pertaining to a period of time – Q3** to be charged with **3/12** of the annual bank levy:

(1) in the RStruktFV it is clearly stated that the levy is an ‘annual levy’;

(2) for interim period the same accounting policies shall be applied as in the annual statements (IAS 34.28 ff.) – would a payment of the bank levy be required on a bi-annual basis, the portion pertaining to the second year would be deferred / anticipated in the annual financial statements.

Appendix: Application of DI/2012/1 on German bank levy

Preliminary consensus of IFRSIC:

– **expense not pertaining to a period of time – Q3** to be charged with **6/12** of the annual expense:

(1) in case of expenses pertaining to a period of time (rent, leases, interest, insurances etc.) the entity in return receives a service over time – this is not the case for the bank levy.

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