

# IFRS 16 AND TAX

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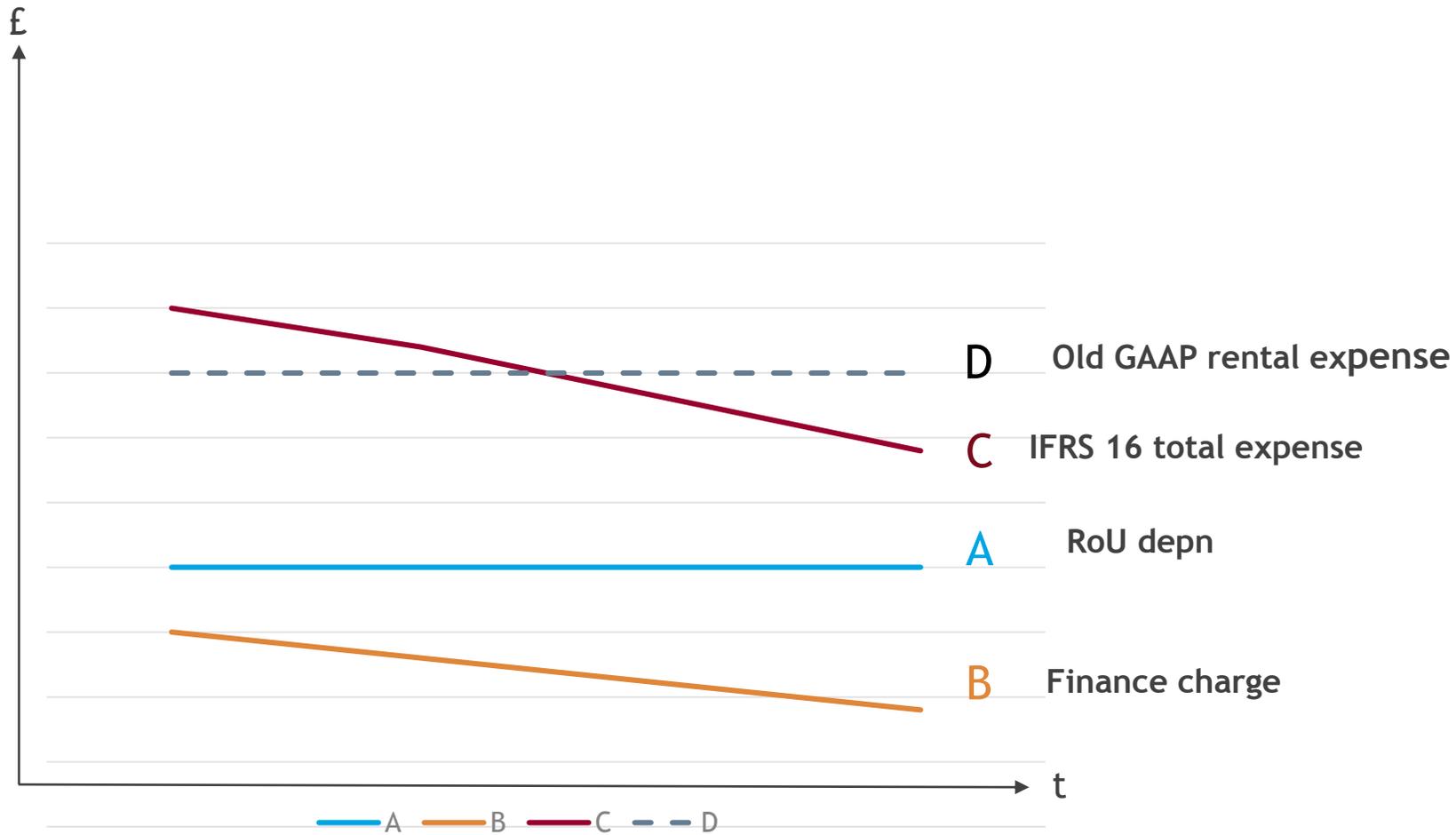
# IFRS 16 OVERVIEW

- Periods of account starting on or after 1.1.19
- Lessees, not lessors
- Recognise RoU asset and lease liability (on balance sheet)
- No distinction between operating and finance lease
- Off b/s
  - low value assets (<\$5k)
  - very short leases (<12m)
- Applies equally to property and chattels
- UK GAAP: not until mid-2020s

# OVERVIEW OF TAX CHANGES (FA 2019)

1. Frozen GAAP rule abolished from 2019  $\implies$  tax can follow accounts (don't need 2 sets of books)
2. Going forward, tax relief for:
  - a) finance charge; and
  - b1) RoU depn charge, using SP 3/91 principles; or
  - b2) capital allowances, for long funding lease
3. Transitional adjustment to be spread for tax purposes over remainder of lease
4. Larger groups who make CIR calculations will need to distinguish operating and finance leases using hypothetical GAAP
5. Existing capital allowance treatment for LFLs is largely preserved

# ACCELERATING TAX RELIEF



# TRANSITIONAL ADJUSTMENT

FR / MR1	RoU asset computed as if IFRS 16 had always applied	Usually a debit (subject to onerous lease provisions)	PBT higher? DT asset
MR2	RoU asset equalised with lease liability	No adjustment	Simplicity

*Notes:*

- 1. MR ('Practical expedients') offer some lease-by-lease choices eg, adjust asset value by onerous lease provision instead of impairment review*
- 2. Existing finance leases - no change in opening RoU asset and lease liability*



# TRANSITIONAL SPREADING

- Spread for tax over weighted mean remaining lease term
- Per portfolio or per lease
- Deferred tax impact
- Asset sale/lease termination
- Interco transfer
- Cessation of trade
- Tracking leased assets



## EARLY ADOPTERS

APs starting before 1.1.19

- Frozen GAAP rule still applies
- Replace RoU depn and finance charge with old GAAP deduction
- Tax v accounts mismatch

First AP starting on or after 1.1.19

- Transitional adjustment to be computed as if accounting change had been made in 2019 (para 14 Sch 14 FA2019)

# OPERATING V FINANCE LEASE DISTINCTION

- Hypothetical GAAP may still be reqd
- Corporate Interest Restriction (s494 TIOPA 2010)

Finance lease: tested interest expense, exclude from EBITDA

Operating lease: exclude from interest expense, include in EBITDA

- Capital allowance entitlement for HP contracts (s67 CAA 2001)
- Some anti-avoidance rules

# CAPITAL ALLOWANCES - CHATTELS

- Continue to be available to lessee under long funding lease ('LFL') rules
- LFL - lease term > 7 years; and (i) PVMLP  $\geq$  80% of asset's FV; or (ii) lease term > 65% of remaining UEL
- Transitional: existing LFLs are grandfathered ie, no deemed disposal and reacqn
- New LFLs will always be treated as LFFLs (finance leases). This means CAs available on PVMLP (rather than MV of the asset cf, UK GAAP operating leases)
- Rental dedns on LFFLs are limited to the finance charge (s377)
- Lease subject to remeasurement (eg, rentals linked to outturn performance): tax relief can be adjusted via s377A if not available via CAs.

## SOME PRACTICAL CONSIDERATIONS

- Onerous lease provisions
  - either released in transitional adjustment or rebadged as RoU asset impairment
  - pre-conversion tax benefit unwinds over remainder of lease, either via transitional spreading or via a lower RoU depn charge
- Lease incentives - may be d/w by adjusting opening RoU asset for any prepaid or accrued lease payments
- Identification of a lease - unclear boundary between service and operating lease eg, bareboat charter, fibre-optic cable capacity
- Pressure to unbundle services?
- Shorter property leases?