Draft interpretation on levies

What you need to know

- The draft interpretation on levies provides clarification on the recognition and measurement of the liability for levies charged by public authorities on entities operating in a specified market.
- The draft interpretation has a wide scope and will affect many entities that are subject to different levies, taxes and tolls.
- The draft interpretation clarifies that the obligating event that gives rise to a liability is the activity that triggers the payment of the levy as identified by legislation.
- No liability would be recognised before the triggering event even if the entity expects to be liable.
- The draft interpretation is open for public comment until 5 September 2012.

Highlights

On 31 May 2012, the IFRS Interpretations Committee (the Committee) issued for public comment, Draft Interpretation DI/2012/1 Levies Charged by Public Authorities on Entities that Operate in a Specific Market (DI). The DI clarifies that an entity recognises a liability for a levy only when the activity that triggers payment, as identified by the relevant legislation, occurs. The DI further clarifies that anticipation of continuing operations in the future and the going concern assumption do not lead to an entity recognising a liability at a reporting date for levies that will only arise from operating in a future period.

The DI proposes that the same recognition principles would be applied in the interim financial statements as applied in the annual financial statements. Therefore, a liability should not be anticipated if there is no present obligation to pay the levy at the end of the interim reporting period.

There is no effective date proposed in the DI but early adoption would be allowed. The final interpretation would be applied retrospectively.

Background

Levies have become more common in recent years as governments try to generate income. As a result, the Committee received requests for clarification on the accounting for levies in the annual and interim financial statements of an entity subject to such levies. In particular, the question raised was when the liability to pay a levy should be recognised. That is, the definition of a present obligation in IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Scope

This DI is applicable to all levies that public authorities impose on entities that operate in a specific market, a specific country, a specific region or a specific industry in a specific country. Levies are not defined by the DI. However, the DI details characteristics that should exist in respect of levies within scope of the DI. Levies must:

- Require a transfer of resources to a public authority (or designated third party) in accordance with legislation
- Represent non-exchange transactions to the entity
- Be triggered when a specific activity occurs
- Be calculated based on data for the current or previous reporting period
Levies that are specifically excluded from the scope of this DI include: income taxes accounted for under IAS 12 Income Taxes; levies due only if a minimum revenue threshold is achieved; fines/penalties imposed for breaches of legislation; and contracts between a public authority and a private entity.

Levies that are payments to a public authority that give rise to a licence or intangible right would be considered to be an exchange transaction and, hence, would not be within the scope of the DI. An example is the payment to a public authority to operate in a market, such as a banking licence. Judgement may be necessary to determine whether the levy provides an intangible right to the entity or not.

Examples of levies that are non-exchange contracts and may be scoped into the DI include: carbon taxes; stamp duties arising from asset acquisitions; and production levies (e.g., dairy production and wine grape levies). Whether a levy is an exchange contract will depend on the jurisdictional legislation or regulation.

A common feature of levies is that they may not become payable unless a specified threshold is met. The event that triggers the payment of the levy could be considered as either: (i) passing the threshold; or (ii) progress towards the threshold when it is considered probable that the threshold will be met by the entity. The Committee did not reach a consensus on this issue. Hence, the DI does not address the accounting for levies that are due only if a minimum revenue threshold is achieved.

The DI provides three examples to illustrate the application of the principles:

- The first example demonstrates a levy that is accrued over time. The levy is recognised progressively as the entity generates revenues in a specific market. At any date in the year, the entity has a present obligation to pay a levy based on revenues generated to date.
- In the second example, a levy is triggered in full as soon as the entity commences generating revenues in a specific market. In this example, the liability is recognised in full on the first day that the entity generates revenue. Furthermore, the entity does not defer and amortise this amount over the year.
- The third example illustrates when a levy is triggered by an entity being in operation at the end of the annual reporting period. In this example, a liability is not recognised until the last day of the reporting period. The levy expense in this circumstance is recognised in the last interim period for that year and not accrued in earlier interim periods.

Under the DI, measurement of the levy is not restricted to financial metrics, and could be calculated based on non-financial information (e.g., number of workers). Furthermore, the measurement of levies may relate to metrics from a previous reporting period. Nevertheless, the measurement of levies does not affect when they should be recognised.

The DI requires that when an entity recognises the levy liability, the entity must also recognise an expense, and only an expense. Due to the non-exchange nature of the levy, recognition of an asset would not be permitted.

### How we see it

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We believe that the DI could eliminate the diversity currently observed in practice. However, we are concerned that a wide range of levies could be within the scope of this interpretation. This may have a consequential impact on other standards.

### When is a liability recognised?

A liability is recognised for a levy when the activity that triggers payment of the levy under the specified legislation occurs. This event may be at a point in time, such as on a specified date or when a transaction occurs. Alternatively, it may occur over time, such as a levy on revenue generating activities occurring during the current year.

Next steps

This DI is open for public comment until 5 September 2012. We encourage entities to submit comments to the Committee.