Association of Financial Mutuals
Direct tax and accounting update

June 2024

Agenda

- Capital expenditure – full expensing
- R&D schemes merger / changes
- Multinational and domestic top-up taxes (OECD Pillar 2)
- FRS 102 amendments – leases and revenue recognition

Capital expenditure – full expensing

Full expensing has been made permanent in Finance Act 2024 which received Royal Assent on 22 February 2024.

Recap of full expensing

- Full expensing is a first-year allowance ("FYA") that provides companies incurring capital expenditure on plant and machinery from 1 April 2023 with:
  - 100% FYA for expenditure on assets qualifying as main rate pool assets
  - 50% FYA for expenditure on assets qualifying as special rate pool assets
- This comes with the caveat that the qualifying plant and machinery acquired were new and unused.
- Full expensing was due to end on 1 April 2026 however this has now been made permanent.

What we expect

- At present, broadly, full expensing is not available for leased plant or machinery (s46 CAA 2001).
- As part of the Spring Budget 2024, the Government announced it is considering extending permanent full expensing to leased asset, however only "when fiscal conditions allow".
- Will need to be considered alongside the changes to lessor and lessee accounting from 1 January 2026 (see later).

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R&D schemes merger / changes

The merged RDEC scheme and ERIS have replaced the old RDEC and SME schemes from 1 April 2024.

Same rules – different calculations.

Merged RDEC scheme

You can choose to claim under the merged RDEC scheme instead even if you are eligible for Enhanced R&D Intensive Support ("ERIS"), but you cannot claim under both schemes for the same expenditure.

The calculation and the payment steps of the merged RDEC scheme are broadly the same as the old RDEC scheme, however:

- A lower rate of notional tax restriction at Step 2 of the payment steps is available to small profit-makers and loss-makers; small profits rate (19%) applies to companies with total profits chargeable to corporation tax of less than £50,000, excluding the RDEC claimed.
- A more generous PAYE cap applies at Step 3: the amount of the PAYE cap for claims under both the merged RDEC scheme and ERIS is £20,000 plus 300% of the company's relevant PAYE and National Insurance contribution liabilities.

A summary of the RDEC steps is as follows:

Step 1: Offset RDEC against corporate tax liability → Step 2: Apply national tax rate to RDEC → Step 3: Restrict RDEC by reference to R&D PAYE cap & NIC → Step 4: Offset RDEC against any outstanding Corporation Tax liabilities for any accounting periods → Step 5: Offset RDEC against group companies' corporate tax liability → Step 6: Offset RDEC against other tax liabilities (i.e. VAT, PAYE or liabilities under a contract settlement) → Step 7: RDEC balance due to the company

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Enhanced R&D Intensive Support

Enhanced Research & Development Intensive Support allows loss-making ‘R&D intensive’ SMEs to:

- Deduct an extra 86% of their qualifying costs (additional deduction) in calculating their adjusted trading loss, as well as the 100% deduction which already appears in the accounts (or as a result of s1308 CTA 2009 conditions being satisfied – allowable as a deduction in computing the profit if that option is taken) to make a total deduction of 186%.
- Claim a payable tax credit, which is not liable to tax and which is worth up to 14.5% of the tax loss.
- For accounting periods beginning on or after 1 April 2024, a company is considered ‘R&D intensive’ if its qualifying R&D expenditure is 30% or more of its total expenditure (previously 40% prior to 1 April 2024).
- Profit-making SMEs and non R&D intensive loss-makers will, for accounting periods beginning on or after 1 April 2024, be entitled to the new merged RDEC scheme.

Multinational and domestic top-up taxes (OECD Pillar 2)

Pillar 2 – GloBE is the OECD led 15% global minimum tax regime. Applicable to large groups, it impacts accounts disclosures, tax provisioning and tax compliance at a global and local level.

Key Pillar 2 – GloBE terms you need to know

A. Income Inclusion Rule (“IIR”) – ‘**eat your children's lunch**’

B. Under Taxed Profits Rule (“UTPR”) – ‘**eat the whole family's lunch**’

C. Qualified Domestic Minimum Top-up Tax (“QDMTT”) – ‘**eat your own lunch**’

Timing – A and C for 2024 or 2025 for most countries, B scheduled for 1 year after

‘Easy’ reporting and QDMTT – what clients are worried about

- Heads of Tax do not trust their current CbCR returns or data
- Deferred tax (“DT”) and current tax (“CT”) data does not line up to CbCR revenue return data by country
- Even where local jurisdictions have QDMTT provisions enacted (including safe harbours), local filings will be required

Opportunities and work required

- **Step 1**: CbCR data review
- **Step 2**: Collect data
- **Step 3**: Transitional ‘easy’ calculation by jurisdiction using either Excel or a bespoke Pillar 2 tool
- **Step 4**: Develop a plan for how to deal with ‘hard’ and complex calculations on a best endeavours basis (see below)
- Build capability and controls for IFRS / UK GAAP reporting
- Build capability for QDMTT tax filings by jurisdiction

Who is affected and how?

- Any group liable for Country-by-Country reporting (“CbCR”)
- Hurdle test is >€750m of consolidated global accounting revenue (2 of last 4 years)
- Only one country where a group operates needs to have an IIR in place for the IIR to apply
- **GloBE return – deadline for the 1st period is 18 months after the year-end (30 June 2026 earliest), after then 15 months after year-end**
- **Local jurisdictions likely to need QDMTT return at the same time as GloBE return but that will be on a jurisdiction-by-jurisdiction basis**
- **IFRS and UK GAAP reporters have made tax disclosures in 2023 year-end accounts in respect of the expected qualitative and quantitative impact**

‘Hard’ reporting and ‘hard’ QDMTT

- Systems do not exist to capture all the data
- Potential for large IT transformation projects over next three years
- Local calculations and filings to be required for QDMTT – in many cases these may at least initially be more straight-forward due to the potential for safe harbour tests to apply

Opportunities/work required

- Complex subsidiary country QDMTT calculations and review as part of wider CIT compliance
- Identification of whether QDMTT safe harbours apply
- Improvement of complex calculations (move away from Excel to a more detailed modelling tool)
- Large IT transformation and automation of Pillar 2 – GloBE

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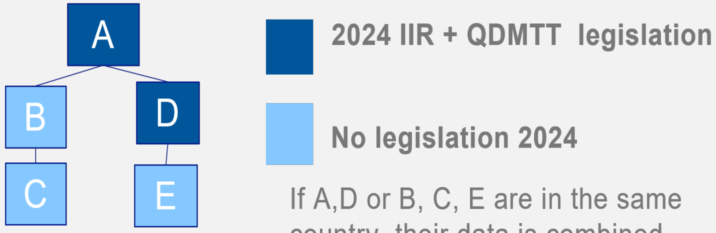
Example A: IIR

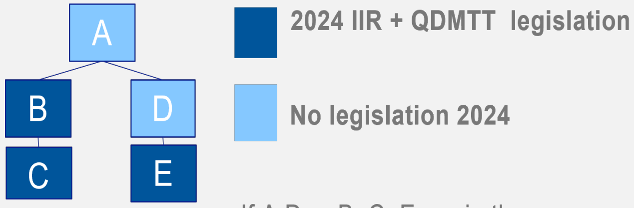
- A reports in accounts (2023 y/e) and for tax (by 30 June 2026)
- Tax reports in respect of B, D, C and E can be:
  a) **'Easy'** if (CT + DT) / CbCR Revenue > 15% in 2024 for a jurisdiction
  b) **'Horrendous'** if either (a) fails or B, C, D or E are JV and/or investment entities
- If B, C, D or E fail both the transitional test and the more complex calculation, A collects tax equal to the difference between the effective tax rate ("ETR") as calculated by the full Pillar 2 – GloBE rules and 15% for each jurisdiction



If A,D or B, C, E are in the same country, their data is combined

Example B: IIR to UTPR

- For IRR, B reports for B, C and E or B and E report separately
- If C implements UTPR, then A and D are also brought into the calculation even if they have no Pillar 2 legislation in their jurisdiction
- Country C (UTPR country) collects any shortfall to 15% in the other countries (i.e. eats the family's lunch)
- A and D can eat their own lunch by implementing QDMTT (peer reviewed)



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FRS 102 amendments – leases and revenue recognition

Introducing a five-step model for revenue recognition and on-balance sheet recognition for most leases by lessees under FRS 102 and 105

The principal amendments expected to have an impact on financial statements are:

a) New accounting requirements for revenue in FRS 102 and FRS 105 'The Financial Reporting Standard applicable to the Micro-entities Regime' based on the **five-step model for revenue recognition** from IFRS 15 Revenue from Contracts with Customers with appropriate simplifications.

b) New lease accounting requirements in FRS 102, based on the **on-balance sheet model** from IFRS 16 Leases with appropriate simplifications.

The principal effective date for these amendments is accounting periods **beginning on or after 1 January 2026**, with early application permitted provided all amendments are applied at the same time.

Five-step model for revenue recognition

As part of the FRC's 2024 Periodic Review, a new Section 23 of FRS 102 has been aligned with 'Revenue from Contracts with Customers' within IFRS 15, providing a new five-step revenue recognition model.

- Step 1 – Identification of contract
- Step 2 – Identification of the separate performance obligations in the contract
- Step 3 – Determine the transaction price
- Step 4 – Allocation of the transaction price to the separate performance obligations
- Step 5 – Revenue to be recognised as each performance obligation is satisfied

For FRS 105 'The Financial Reporting Standard applicable to the Micro-entities Regime', a revised Section 18 'Revenue from Contracts with Customers' was introduced (a simplified version of Section 23 of FRS 102).

On-balance sheet model for leases

IAS 17 treatment of leases under UK GAAP will be entirely replaced with a new Section 20 of FRS 102, with an on-balance sheet lease accounting model based on that in IFRS 16 Leases.

For lessee accounting, IFRS 16 removed the classification of leases as either operating or finance leases. Leases are presented on the balance sheet in the form of a right-of-use asset and a lease liability.

Lessor accounting was not changed significantly.

There may be deferred tax implications if there is an accounting transitional adjustment which needs to be spread and brought into tax.

	IAS 17	IFRS 16 / FRS 102 Section 20
Finance lease	Recognition of leased assets and liabilities Recognition of depreciation and lease interest	Asset: ➢ Right-of-Use asset Liability: ➢ Lease liability Exemptions: • Short lease (lease term of 12 months or less) • Low value lease (c.$5k or less when they are new)
Operating lease	Recognition of lease interest	

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