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Liabilities for levies

Identifying the triggering event

May 2013, Issue 2013/09

IN THE HEADLINES

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> The interpretation clarifies that the wording of the relevant legislation drives the timing of the recognition. This will achieve greater comparability between entities operating in the same market.

– Phil Dowad
KPMG's global IFRS revenue recognition and provisions leader

Interpretation provides clarity

Levies have become more common in recent years, with governments in a number of jurisdictions introducing levies to raise additional income. The key accounting question for those who pay the levy is when to recognise a liability. Current practice is mixed, especially for levies with minimum thresholds or which arise unevenly during the year.

In response to this issue, on 20 May 2013 the IASB issued Interpretation 21 *Levies*. It provides guidance on accounting for levies in accordance with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The term 'levy' is defined

The interpretation defines a levy as an outflow from an entity imposed by a government in accordance with legislation.

The key word here is 'imposed': levies do not arise from executory contracts or other contractual arrangements. However, outflows within the scope of IAS 12 *Income taxes*, fines and penalties, and liabilities arising from emission trading schemes are explicitly excluded from the scope.

What triggers a liability?

The interpretation confirms that an entity recognises a liability for a levy when – and only when – the triggering event specified in the legislation occurs.

An entity does not recognise a liability at an earlier date, even if it has no realistic opportunity to avoid the triggering event.

How it works

An entity is liable to pay a levy if it generates revenues in a specific market on 1 January 2013.

Under the interpretation, it does not recognise a liability at 31 December 2012 – even if it is economically compelled to operate in 2013 and prepares financial statements on a going concern basis.

No trigger beneath minimum threshold

If a levy is only payable once a specified amount has been reached – e.g. a specified level of revenue or output – then no liability is recognised until this 'minimum threshold' is reached. How the levy is calculated once this threshold is reached makes no difference to this conclusion.

Same requirements for interim reporting

The same recognition principles apply in the interim financial statements as in the annual financial statements, even if this results in uneven charges over the course of the year.

How it works

An entity with an annual reporting period ending on 31 December is liable to pay a levy if it operates in a specific market on 31 December 2013, but is not liable if it ceases to operate before that date.

Under the interpretation, it does not recognise a liability for the levy – or any portion of the levy – in the interim financial statements for the six month period ending on 30 June 2013.

Greater comparability

The interpretation will achieve greater comparability between entities that operate in the same market within the same jurisdiction. The timing of the liability recognition will depend on the precise wording of the relevant legislation.

How it works

A levy of 2% of revenues earned in 2013 is payable if an entity is operating in a specific market on a specified date.

If that specific date is 31 December 2013, then the liability would be recognised in 2013 – but if that specific date is instead 1 January 2014, then the entity cannot recognise the liability until 1 January 2014. In short, the wording of the legislation determines when the liability is recognised.

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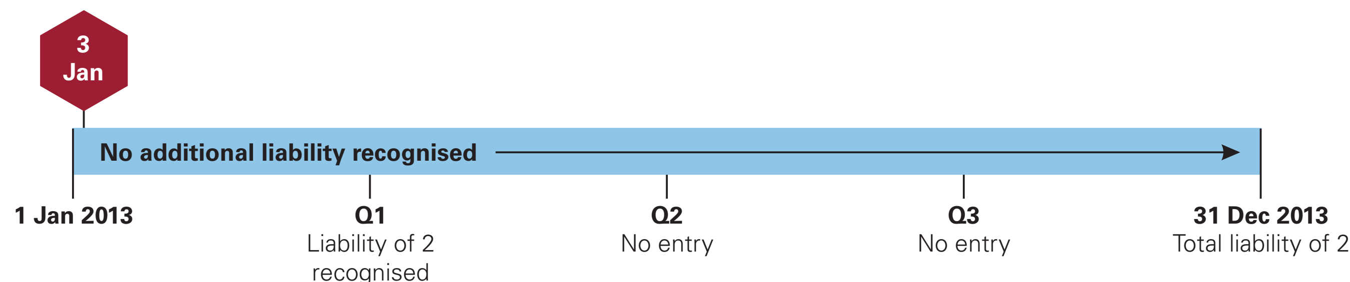
Illustrative examples

The following timelines indicate the points at which a liability is recognised for annual and interim reporting periods based on the circumstances described. The examples use an annual reporting period that ends on 31 December and assume the levy is payable on 1 January of the following year.

Example 1 – Levy triggered if the entity generates revenue in a specified period

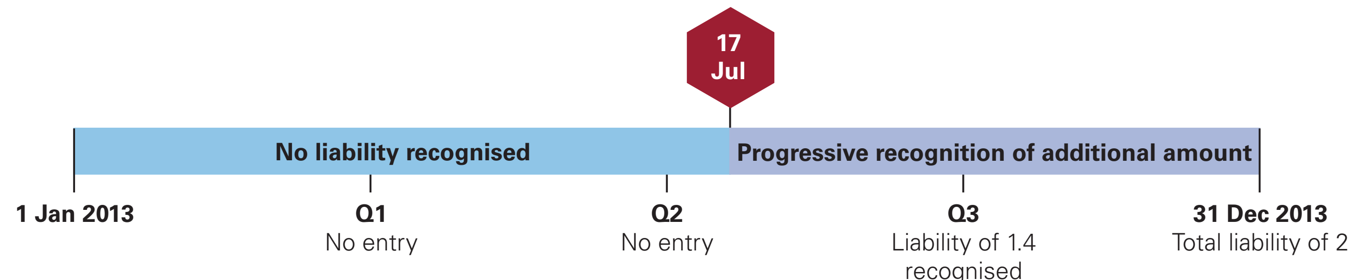
A levy is triggered in full as soon as the entity generates revenues in an annual period. The amount of the levy is calculated as 2% of total revenues for the preceding annual period. The entity generated revenue of 100 in the annual period ending 31 December 2012, and in 2013 starts to generate revenue on 3 January.



Q1 and full-year liability of 2 = (2% of prior year revenues of 100) recognised on 3 January.

Example 2 – Levy triggered if the entity generates revenues above a minimum amount of revenues

A levy is triggered if the entity generates revenues above 50 in an annual period. The amount of the levy is determined by reference to all revenues generated by the entity in the annual period – i.e. including the first 50. The levy is payable at a rate of 2%. In the annual period ending 31 December 2013, the entity reaches revenue of 50 on 17 July (Q3). The entity recognises a further 20 of revenue in Q3, and 100 in total for the year.



Q3 liability of 1.4 = (2% of 50) recognised on 17 July + (2% of 20) recognised in the remainder of Q3.

Full year liability of 2 = (2% of 50) recognised on 17 July + (2% of 50) recognised in the remainder of the year.

– Obligating event

Asset or expense?

The interpretation only provides guidance on when to recognise the liability. Other IFRSs should be applied to determine whether the debit side is an asset or expense.

How it works

In some jurisdictions, property taxes may be deemed to meet the definition of a levy.

Therefore, the interpretation would provide guidance on recognising the liability. An entity would need to separately determine whether under other IFRSs – e.g. IAS 2 *Inventories* – the payment could be capitalised. If not, then it would be expensed as incurred.

If a levy is prepaid before the triggering event arises, then an entity recognises an asset for the prepayment.

Factors to consider

In evaluating the effects of the interpretation, entities should consider the following questions.

- Does the entity have transactions with a government that meet the definition of a levy?
- Does the interpretation result in a change to the point in time or period in which a liability for a levy is recognised?
- When the liability is recognised, should the entity record an expense or an asset?

Entities that are affected by the interpretation may also need to determine if and how IT systems and processes should be updated to reflect the new recognition requirements.

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Find out more

For more information on the interpretation, please speak to your usual KPMG contact.

Effective date and transition

Interpretation 21 *Levies* is effective for annual periods commencing on or after 1 January 2014. The interpretation is applied on a retrospective basis.

Early adoption is permitted.

Timeline[1]

31 May 2012:
Draft interpretation published

20 May 2013:
Interpretation published

1 January 2014:
Latest date of adoption[2]

31 March 2014:
First interim reporting period

31 December 2014:
First annual statements

1 Assumes a 31 December year end with quarterly interim reporting.
2 Retrospective restatement of opening balances and comparatives required, if adoption of the interpretation results in a change in policy.

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