An Overview of the Tax Impact of IFRS 15 (Revenue Recognition) and IFRS 16 (Leases)

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Agenda

- Introduction
- Overview of IFRS 15
- Tax impact of IFRS 15
- Overview of 1FRS 16
- Tax Impact of IFRS 16
- Q&A

Overview of IFRS 15

Overview of IFRS 15

- Accounting for revenue is guided by IFRS 15 “Revenue from Contracts with Customers”
- Replaced IAS 18 on Revenue and IAS 11 on Construction contracts for accounting periods commencing after 1 January 2018
- IAS 18 based revenue recognition on the passing of risks and rewards
- IFRS 15 has widened the criteria for revenue recognition to include the transfer of control
- IFRS 15 provides that revenue should be booked to reflect the transfer of services or goods to customers with contracts effective 1 January 2018
- The revenue recognition under IFRS 15 is premised on the receipt of the sale consideration based on the contract terms

Overview of IFRS 15 (Five Step Model)

Identify the contract with a customer

Key element
Signing the contract(s) with a customer

Identify the performance obligation

Key element
This defines the obligations of the buyer and the seller under the contract

Determine the transaction price

Key element
Transaction price as consideration for the contractual obligations

Allocating the transaction price to the performance obligations

Key element
Transaction price should be allocated to the performance obligations

Recognise revenue

Key element
Recognise revenue when (or as) the entity satisfies the performance obligation

Tax Impact of IFRS 15

Value Added Tax (VAT)

- Section 5(3) of the VAT Acts - defines tax point for VAT

- VAT shall be due at the time of supply

- Section 12(1) of the VAT Act defines the time of supply as the earlier of the date when:
  a) the goods are delivered;
  b) services are provided;
  c) invoice is issued;
  d) a completion certificate is issued; or
  e) payment for the goods and services is received either in whole or in part

Tax Impact of IFRS 15

- IFRS 15 considers the transfer of control in revenue recognition - results in deferred income where payment has been received (transfer of risk and rewards)

- **Income Tax** - revenue will be deferred to the following year as the transfer of control has not been fulfilled; and

- **Value Added Tax** - Output VAT will be declared in the current year as the time of supply conditions have been met

Consequently, the sales declared in the VAT returns will be higher than the sales declared in the trial balance/P&L which may be queried by KRA

Tax Impact of IFRS 15

- Thoughts around deemed income?
- Expenses incurred in generating taxable income - should expenses relating to deferred income be deferred?
- Deferred tax liability for deferred income?
- After sales services and warranties - already priced in or separately priced and charged?

Tax Impact of IFRS 15

Excise duty

- Section 6(1) of the Excise Duty Act - defines tax point for excise duty
- Excise duty shall be due at the time of supply of excisable services or removal of excisable goods from the manufacturer's factory
- Section 4(1) of the Excise Duty Act defines the time of supply as the earlier of:
  a) The date on which the services are performed
  b) Date of invoice for the supply of the services is issued
  c) The date on which payment for the supply is received in whole or part
- Account for excise duty where control has not transferred to buyer?

Overview of IFRS 16

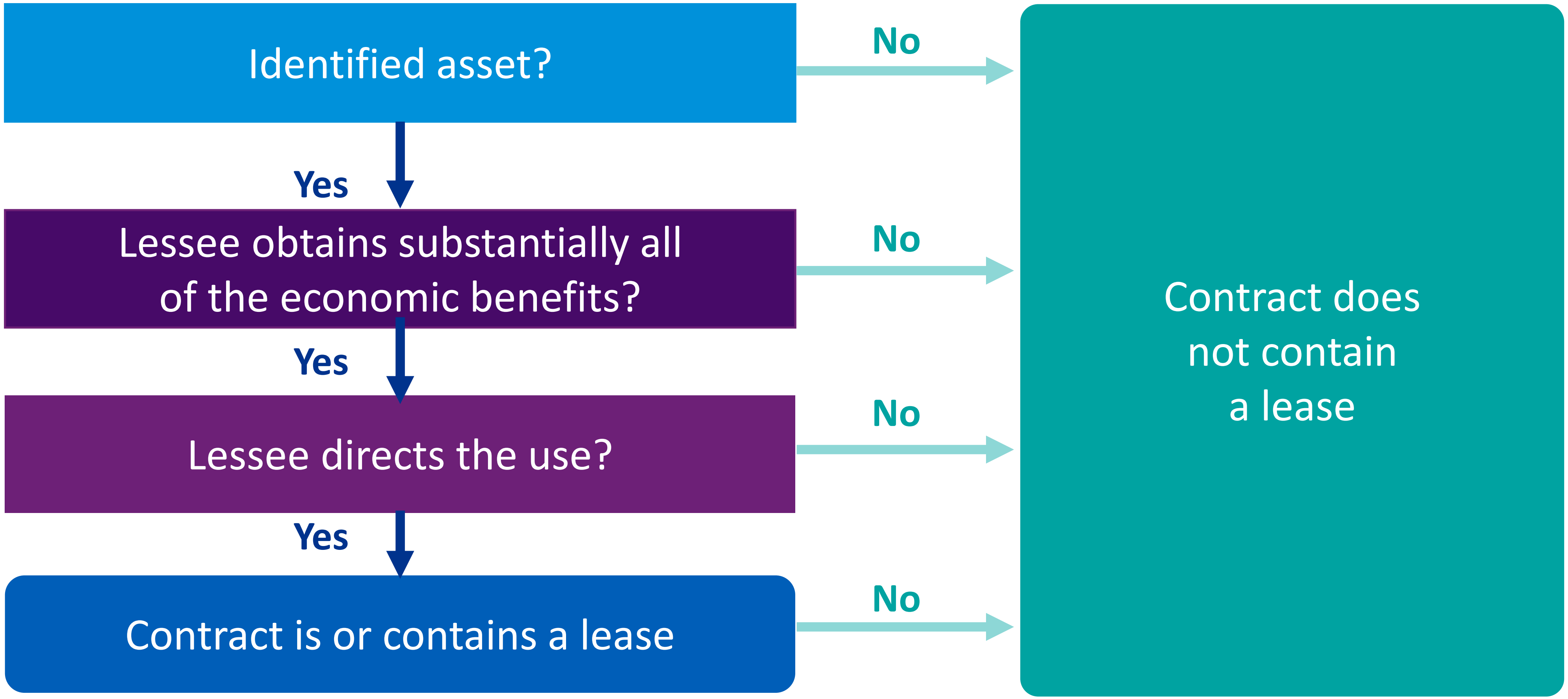
Tax Impact of IFRS 16

Effective 1 January 2019, IFRS 16 brought the following changes on the accounting of leases for leases:

Particular	Prior Treatment	Treatment under IFRS 16
Value of the Lease	Not included in the books of the lessee	The value of the lease is included as an asset in the Lessee's balance sheet (Right of Use) An equivalent amount is recognised as a lease liability at the beginning of the period
Depreciation	No depreciation recognised on leases	Depreciation is charged on the lease asset and debited in the P&L Accumulated depreciation reduces the lease asset
Payments on lease	Debited as Rent in the P&L	Posted in the balance sheet to reduce the lease liability
Interest on lease	No interest charged on leases	Interest derived from the lease liability Debited in the P&L as an expense and Credited in the balance sheet as part of the lease liability

Tax Impact of IFRS 16: Lease definition

A lease is a contract that conveys the right to use an asset for a period of time in exchange for consideration. Definition focuses on control over the use of an identified asset



Tax Impact of IFRS 16 on taxation of leases

Current tax computation

- **Depreciation charge on the Right of Use**

The depreciation recognised on the lease asset and debited in the P&L is disallowed under section 16(1)(a) of the Income Tax Act (ITA)

This is an add-back on the tax computation (akin to the normal depreciation add back)

- **Interest expense**

The interest charged on the lease liability is a notional interest

The interest is added back to the tax computation based on section 15(1) of the ITA

Tax Impact of IFRS 16 on taxation of leases

Current tax computation

- **Lease Payments**

Actual rent payments on the lease have been replaced in the P&L by the interest and depreciation expenses charged on the lease liability and asset respectively

By adding back the depreciation and interest in the tax computation, the actual rent expense is not claimed by the taxpayer

As such, an adjustment for the actual rent paid should be made in the tax computation based on section 15 (1) of the ITA

Tax Impact of IFRS 15 on taxation of leases

Deferred tax computation

- The lease asset and liability will decrease at varying rates from the inception to the end of the lease period in the agreement
- Actual rent allowed in the tax computation remains the same over the lease period, but the depreciation and interest added back varies, giving rise to a temporary difference over the lease period
- As a result, the difference between opening and closing values of the value of the lease asset and liability will give rise to a temporary difference
- A deferred tax at the applicable current tax rate will be applied on the temporary difference

Interactive Session