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What you need to know

• IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs.

• The scope of this interpretation is very broad and captures various obligations, which are imposed by governments in accordance with legislation and sometimes not always described as ‘levies.’ Therefore, entities need to consider the nature of the payment carefully when determining if the payment is in the scope of IFRIC 21.

• A levy liability can only be accrued progressively if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation.

• For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability is recognised before the specified minimum threshold is reached.

• The interpretation does not address the accounting for the debit side of the transaction that arises from recognising a liability to pay a levy. Entities must look to other relevant standards to determine whether the recognition of a liability to pay a levy would give rise to an asset or an expense.

• The interpretation is effective for annual periods beginning on or after 1 January 2014 and retrospectively applied for all prior periods presented.
1. Introduction

When governments or other public authorities impose levies on entities’ business activities, as opposed to income taxes and fines or other penalties, it is not always clear when the liability to pay a levy arises and should be recognised. In May 2013, the IFRS Interpretations Committee (IFRS IC or the Committee) issued IFRIC 21 Levies to address this issue. IFRIC 21 provides interpretative guidance on the accounting for levies based on the recognition criteria in IAS 37 Provisions, Contingent Liabilities and Contingent Assets. The interpretation also indicates how these recognition criteria should be applied in an interim financial report prepared in accordance with IAS 34 Interim Financial Reporting.

IFRIC 21 is effective for annual periods commencing on or after 1 January 2014 and is applied retrospectively, with early application permitted.

In this publication, we address some of the frequently asked questions that arise as entities begin to apply IFRIC 21. The examples discussed herein assume that the effect of the time value of money is immaterial. This publication is not intended to provide a comprehensive list of IFRIC 21 issues and entities must consider all specific facts and circumstances when analysing any potential impacts.

This publication is based on the International Accounting Standards Board’s (IASB) official pronouncements up to 30 April 2014; entities will need to consider any guidance published thereafter.

2. Scope of IFRIC 21

IFRIC 21 was developed to address concerns over the timing of recognition for government-imposed levies in which the obligation to pay a government levy depended on participation in a particular market on a specified date. However, the definition of levy in IFRIC 21 has resulted in the scope of the interpretation being broader than entities might have expected.

The term ‘levy’ may not be widely used across jurisdictions, and may be referred to as a charge, duty, tax, etc. However, it is not the terminology, but the nature of the payment that should be considered when determining if it is in the scope of IFRIC 21. Entities need to be cautious about deciding to apply IFRIC 21 to an arrangement before conducting a thorough assessment of the specific facts and circumstances.

Extract from IFRIC 21

2 This Interpretation addresses the accounting for a liability to pay a levy if that liability is within the scope of IAS 37. It also addresses the accounting for a liability to pay a levy whose timing and amount is certain.

3 This Interpretation does not address the accounting for the costs that arise from recognising a liability to pay a levy. Entities should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

4 For the purposes of this Interpretation, a levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (i.e. laws and/or regulations), other than:

(a) those outflows of resources that are within the scope of other Standards (such as income taxes that are within the scope of IAS 12 Income Taxes); and
Extract from IFRIC 21

(b) fines or other penalties that are imposed for breaches of the legislation.

'Government' refers to government, government agencies and similar bodies whether local, national or international.

5 A payment made by an entity for the acquisition of an asset, or for the rendering of services under a contractual agreement with a government, does not meet the definition of a levy.

6 An entity is not required to apply this Interpretation to liabilities that arise from emissions trading schemes.

Entities should consider all payments imposed by governments pursuant to legislation (i.e., laws and/or regulations), to determine whether they are within the scope of IFRIC 21. The interpretation provides a broad definition of government including, municipal, provincial, state, federal or international governments or government agencies or organisations controlled or administered by government.

Sometimes, the legislation is not always clear about the nature of the payment and the activity that gives rise to the obligation. Therefore, legal opinions, past court rulings, and current practices may have to be examined to determine the appropriate accounting treatment that can require significant judgements, not only about whether the payment falls within the scope of IFRIC 21, but also (if in scope), when a liability should be recognised (see section 3 below).

Payments for income taxes, fines and other penalties that are imposed for breaches of legislation, as well as costs relating to the acquisition of assets and contractual arrangements for services with a government are specifically excluded from the scope of IFRIC 21. Additionally, application is not required for liabilities that arise from emission trading schemes.

Different jurisdictions use different mechanisms to impose payments to governments. Consequently, each type of payment imposed by government needs to be evaluated on its own merits and according to the requirements of the local law.

Questions which entities should consider in their assessment include:

- Is the payment within the scope of other IFRS standards¹?
- Is the payment a fine or penalty imposed for breaches of the legislation?
- Is the payment for the acquisition of an asset, or for the rendering of services under a contractual agreement with a government²?

If the answer is ‘No’ to all three questions above, then the payment is likely to be a levy within the scope of IFRIC 21.

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¹ See questions 2.1, 2.3 and 3.1 of this publication
² See question 2.5 of this publication
Below are some frequently asked questions when applying the scoping paragraphs of IFRIC 21:

**Question 2.1 - Does IFRIC include only liabilities under IAS 37?**

No. IFRIC 21.2 clarifies that both levies that give rise to a liability under IAS 37, and levies whose timing and amounts are certain are within scope of the interpretation. Therefore, the scope of IFRIC 21 is broader than IAS 37 and includes both obligations under IAS 37, where the liability is of uncertain timing or amount and other non-contractual liabilities imposed by government that are not under IAS 37, because the legislation establishes a certain timing and amount for the levy. For example, a non-refundable fixed fee imposed by government payable at a specific date may be a levy within the scope of IFRIC 21.

However, IFRIC 21.4(a) is clear that it does not apply to liabilities that are within the scope of other standards, including those addressed by IAS 19 *Employee Benefits*[^3] and contractual obligations of certain timing and amount that are financial liabilities within scope of IAS 39 *Financial Instruments: Recognition and Measurement*. In addition, the Interpretations Committee concluded in 2006 that any taxes not within the scope of other standards (such as IAS 12) are within the scope of IAS 37 (see IFRIC 21.BC4) and therefore such taxes may be within the scope of IFRIC 21.

**Question 2.2 - What does ‘imposed by governments’ mean?**

On one hand, it has been argued that the term ‘imposed by governments’ in IFRIC 21.4 implies that the recipient must also be a governmental body or entity. On the other hand, it is considered irrelevant whether the payments pass through one or more non-governmental bodies or entities before being received by the government, or whether the payment is ultimately retained by the supplier of goods or services. In our view, IFRIC 21 does not distinguish between recipients of the payment; the key factor is whether the payment is required by law.

In some cases, the legislation requires the entity collecting the payment to act as an agent of a government body and to remit the payments collected in full to the government. There may also be instances where the payments under the legislation are retained by the collecting entity, which is not the government. For example, consider a purchaser of renewable energy. Under the legislation, a fee is payable for each unit of renewable energy consumed and this fee is collected and retained by the suppliers of the renewable energy. In such cases, the entity that purchases the renewable energy will pay an amount in excess of the market price to its suppliers, all of which is retained by the suppliers (because, in this case, the objective of the legislation is to subsidise the higher cost of generating energy from renewable sources). In our view, such a fee is ‘imposed by government’.

Therefore, under IFRIC 21.4, as long as the payments are required by law, they are generally considered to be imposed by the government. In some cases, such assessments may be complex and require the exercise of judgement.

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[^3]: IAS 19.8 defines employee benefits as ‘all forms of consideration given by an entity in exchange for service rendered’ by employees or for the termination of employment.”
Question 2.3 - What are some examples of payments within the scope of other Standards?

IFRIC 21.4(a) states that income taxes are within the scope of IAS 12 Income Taxes\(^4\). Another example of a payment that is within the scope of other standards is contractual payments made to government in a service concession arrangement. Entities need to consider whether there are other payments made, under the legislation, by entities that are in the scope of other standards, such as IAS 19. This determination may involve the exercise of judgement.

Payroll taxes that are payable by the employer are a common example of payments that are in scope of other standards. Although payment of such taxes is usually required by legislation, they are likely to be viewed as an employee benefit in respect of the services rendered by employees. Employee benefits are not limited to payments made directly to the employee, but also include costs due in respect of employment services rendered under IAS 19.6-7. Therefore, payments in respect of payroll taxes would typically be within the scope of IAS 19, rather than levies under IFRIC 21. Entities should assess the specific facts and circumstances in determining if it falls within scope of IAS 19.

There may be other types of payments where this assessment becomes more judgemental, such as hybrid taxes. These are income taxes that are assessed as a percentage of taxable profits, but the legislation also requires a floor amount of tax to be paid based on another measure, such as a percentage of equity or capital. The question is whether the minimum floor amount and the amount taxed based on taxable profits should be considered in their entirety or as separate components and consequently to what extent the hybrid tax (or any element of it) falls within scope of IAS 12 or (to the extent that it is not an income tax) IFRIC 21. In answering this question, entities need to examine the specific facts and circumstances.

Question 2.4 - What are some other examples of payments that may be in scope of IFRIC 21?

Some of the legislation can be quite complex, so entities need to carefully analyse the specific facts and circumstances in accordance with the definition of ‘levy’ in IFRIC 21. However, where entities are making payments for any of the following items, it may be necessary to assess for any potential IFRIC 21 impacts:

- Taxes other than income taxes, e.g., property tax\(^5\), land tax, capital-based tax, etc.
- Certain fees, concessions, contributions or royalties fees imposed on industries which are regulated by the government\(^6\), e.g., telecommunications, mining, airline, banking, insurance, dairy produce, energy and natural resources, etc.
- Transaction taxes based on activity in a specified market e.g., banking, insurance, etc.

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\(^4\) IAS 12.2 indicates that income taxes include all domestic and foreign taxes that are based on taxable profits. Income taxes also include taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity.

\(^5\) Also see question 2.5 and section 5 of this publication.

\(^6\) Also see question 2.5 of this publication.
Question 2.5 - What does the scope exclusion in paragraph 5 of IFRIC 21 mean?

IFRIC 21 also states that a payment made by an entity for the acquisition of an asset, or for the rendering of services under a contractual agreement with a government, does not meet the definition of a levy.

IFRIC 21.5 and IFRIC 21.BC7 clarify that any acquisition of assets or exchange transactions under a contractual agreement with the government, including payments arising from service concession arrangements or provision of services would not be in the scope of IFRIC 21. Levies for which the activity triggering the payment is the acquisition of assets, or provision of services, with a third party (and not the government) would not meet the scope exclusion within IFRIC 21.5, i.e., they will be in the scope of IFRIC 21.

There are instances when this assessment may be more straightforward. A common example would be property taxes paid to the government, which are generally not expected to meet the scope exclusion in paragraph 5. We do not usually view such payments to be reciprocal transactions, because the entity paying the levy does not receive a specific asset or service in exchange for the payment. While a variety of public services are provided by government, in most cases, eligibility to receive those services is not conditional upon payment of a specific tax. For example, parties other than those paying the property tax are often provided the same public services as those paying the property tax.

In other cases, this assessment may require more judgement, such as taxes payable under a licence agreement. Consider the case where a television (TV) station acquired a broadcasting licence from the government or a third party. Under the legislation, regardless of whether the licence is acquired directly from the government or a third party, entities holding such licences are required to make social contributions based on 10% of the purchase price, in addition to fees based on a percentage of the revenue earned. There is an argument that, because the social contributions and the revenue-based fees are payments to the government under the legislation in return for the continued use of an asset, i.e., a licence, these payments are consideration in relation to the asset acquired. Therefore, these payments may meet the scope exclusion under IFRIC 21.5.

Entities should carefully consider specific facts and circumstances in making such assessments.

How we see it

We believe the interpretation will reduce previous diversity in practice. However, given the broad scope of IFRIC 21, entities should carefully consider all payments imposed by governments in accordance with legislation and assess for any impact on their financial statements.
3. Recognition and measurement

Once a levy is assessed to be within the scope of IFRIC 21, the appropriate point of recognition must be determined.

3.1 Identification of the obligating event

For levies within the scope of IFRIC 21, the activity that creates the obligation to pay the levy (as specified in the legislation) is the event that determines the point of recognition. In some cases, this activity is related to the entity's participation in a relevant market at a specific date(s). IFRIC 21 clarifies that neither a constructive nor a present obligation arises as a result of being economically compelled to continue operating; or from any implication of an intention and ability to continue operations in the future.

Extract from IFRIC 21

8 The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. The generation of revenue in the previous period is necessary, but not sufficient, to create a present obligation.

9 An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period.

10 The preparation of financial statements under the going concern assumption does not imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.

11 The liability to pay a levy is recognised progressively if the obligating event occurs over a period of time (i.e., if the activity that triggers the payment of the levy, as identified by the legislation, occurs over a period of time). For example, if the obligating event is the generation of revenue over a period of time, the corresponding liability is recognised as the entity generates that revenue.

12 If an obligation to pay a levy is triggered when a minimum threshold is reached, the accounting for the liability that arises from that obligation shall be consistent with the principles established in paragraphs 8–14 of this Interpretation (in particular, paragraphs 8 and 11). For example, if the obligating event is the reaching of a minimum activity threshold (such as a minimum amount of revenue or sales generated or outputs produced), the corresponding liability is recognised when that minimum activity threshold is reached.
Question 3.1 - Should constructive obligations to pay a levy be recognised?

Yes. IFRIC 21.2 does not distinguish between legal or constructive obligations for liabilities under IAS 37. In other words, so long as there is a legal or constructive obligation under IAS 37 to pay a levy, IFRIC 21 applies. Moreover, IFRIC 21.9 does not preclude the recognition of constructive obligations to pay a levy. Rather, it merely clarifies that the economic compulsion to operate in the future (or some other form of economic compulsion) does not create the type of constructive obligation that would allow or require recognition of a liability to pay the levy. For example, the future participation in a market does not create an obligation even if the entity is economically compelled to continue participating in the market. Therefore, the actual event under the legislation that triggers the obligation to pay a levy would still need to occur before a liability can be recognised.

However, there may be cases in which particular facts and circumstances make the occurrence of the event giving rise to payment unavoidable. Therefore, they give rise to a legal or constructive obligation to pay the levy. Consider the case where, according to tax regulation, debit and credit movements on bank accounts (e.g., payments to suppliers and collections from customers) are subject to a transaction tax at 0.1% upon settlement. If legislation prohibits any alternative means of settlement (e.g., payment through offsetting arrangements or any other forms of consideration), the obligation to pay the transaction tax becomes unavoidable as soon as the entity has a contractual right to receive payment from a customer or has a contractual obligation to pay its supplier. In such cases, the obligation to pay the levy is recognised at the same time as the legal obligation to pay the supplier or right to collect from the debtor arises (i.e., at the point of purchase or sale).
### 3.2 Timing and measurement of liability recognition

The table below summarises the illustrative examples that accompany IFRIC 21, which provide guidelines on how to account for the timing of the recognition for the various types of levies:

<table>
<thead>
<tr>
<th>Illustrative examples</th>
<th>Obligating event</th>
<th>Recognition of liability⁷</th>
</tr>
</thead>
<tbody>
<tr>
<td>Levy triggered progressively as revenue is generated in specified period</td>
<td>Generation of revenue in the specified period</td>
<td>Recognise progressively</td>
</tr>
<tr>
<td></td>
<td></td>
<td>A liability must be recognised progressively because, at any point in time during the specified period, the entity has a present obligation to pay a levy on revenues generated to date.</td>
</tr>
<tr>
<td>Levy triggered in full as soon as revenue is generated in one period, based on revenues from a previous period</td>
<td>First generation of revenue in subsequent period</td>
<td>Full recognition at that point of time</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Where an entity generates revenue in one period, which serves as the basis for measuring the amount of the levy, the entity does not become liable for the levy, and therefore cannot recognise a liability, until it first starts generating revenue in the subsequent period.</td>
</tr>
<tr>
<td>Levy triggered in full if entity operates as a bank at the end of the annual reporting period</td>
<td>Operating as a bank at the end of the reporting period</td>
<td>Full recognition at the end of the annual reporting period</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Before the end of the annual reporting period, the entity has no present obligation to pay a levy, even if it is economically compelled to continue operating as a bank in the future. The liability is recognised only at the end of the annual reporting period.</td>
</tr>
<tr>
<td>Levy triggered if revenues are above a minimum specified threshold (e.g., when a certain level of revenue has been achieved)</td>
<td>Reaching the specified minimum threshold</td>
<td>Recognise an amount consistent with the obligation at that point of time</td>
</tr>
<tr>
<td></td>
<td></td>
<td>A liability is recognised only at the point that the specified minimum threshold is reached. For example, a levy is triggered when an entity generates revenues above specified thresholds: 0% for the first CU50 million and 2% above CU50 million. In this example, no liability is accrued until the entity’s revenues reach the revenue threshold of CU50 million.</td>
</tr>
</tbody>
</table>

⁷ Please also see section 5 on the potential impact on interim financial reports.
When a levy is payable progressively, for example as the entity generates revenues, the entity recognises a liability over a period of time on that basis. This is because the obligating event is the activity that generates revenues. Some examples of progressive-type levies are provided in the tables below:

### Examples of features for progressive-type levy

<table>
<thead>
<tr>
<th>Application examples of recognition of liability</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Minimums</strong> - If the legislation prescribes that no levy is triggered until revenues reach a certain threshold (such as 0% tax rate on revenues until they reach CU50 million, and then the payment is 2% of revenues in excess of that amount).</td>
</tr>
<tr>
<td>For an entity that earns CU49 million as at 30 June 20x1, CU51 million as at 31 July 20x1 and CU100 million as at 31 December 20x1, the liability that should be recognised as at:</td>
</tr>
<tr>
<td>30 June 20x1 - No provision is recognised</td>
</tr>
<tr>
<td>31 July 20x1 - CU20,000 is recognised (2% x CU1 million)</td>
</tr>
<tr>
<td>31 December 20x1 - CU1 million is recognised (2% x CU50 million)</td>
</tr>
</tbody>
</table>

| **Progressive tax rates** - If the legislation prescribes that the tax rate is escalating (such as 2% on the first CU50 million in revenues, 3% for revenues in excess of CU50 million). |
| For an entity that earns CU49 million as at 30 June 20x1, CU51 million as at 31 July 20x1 and CU100 million as at 31 December 20x1, the liability that should be recognised as at: |
| 30 June 20x1 - CU980,000 is recognised (2% x CU49 million) |
| 31 July 20x1 - CU1,030,000 is recognised ((2% x CU50 million) + (3% x CU1 million)) |
| 31 December 20x1 - CU2.5 million is recognised ((2% x CU50 million) + (3% x CU50 million)) |

| **Specified formula** - If the legislation prescribes that the levy is calculated based on a specified formula that does not match the actual activity for the period. |
| Take for example, where a calendar year-end entity has to pay a monthly levy based on 0.1% of a 12-month rolling average of a specified performance measure e.g., gross profit. |
| Under the legislation, the 12-month period which the rolling average of the gross profit would be based on relates to the preceding 12 months, for example: |
| 30 June 20x1 - 1 July 20x0 to 30 June 20x1 |
| 31 July 20x1 - 1 August 20x0 to 31 July 20x1 |
| 31 December 20x1 - 1 January 20x1 to 31 December 20x1 |

<table>
<thead>
<tr>
<th>Period</th>
<th>12 month rolling average (CU)</th>
<th>Liability to be recognised (CU)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 20x0 - 30 June 20x1</td>
<td>50 million</td>
<td>50,000</td>
</tr>
<tr>
<td>1 August 20x0 - 31 July 20x1</td>
<td>60 million</td>
<td>60,000</td>
</tr>
<tr>
<td>1 January 20x1 - 31 December 20x1</td>
<td>40 million</td>
<td>40,000</td>
</tr>
</tbody>
</table>

The examples above are not exhaustive. Entities should look out for any similar features and assess them accordingly. In particular, where there are complex formulae or features unique to the recognition and measurement of the levy liability, entities will need to ensure that adequate accounting records are maintained to support the calculations of these levies.
It is also important to keep in mind that the legislation may impose the levy at a specified point in time (e.g., 31 December 20x1) for convenience, but the levy is, in fact, payable by law in relation to a specific period of time (e.g., from 1 January to 31 December) regardless of the frequency of payments. This may be common in some jurisdictions’ property tax mechanisms, and whether the levy is ‘point-in-time’ or ‘time-period’ based may not be explicit from the relevant legislation. For example, the taxpayer may have a legal right to refund from the government if the property is not held by the taxpayer throughout the 12-month period. In such cases, entities should assess whether the obligating event is progressive, i.e., that the obligating event is the entity holding the property over a specified period. Property tax arrangements are further explored in section 5 below.

4. Recognition of an asset or expense

IFRIC 21 only provides guidance on when to recognise a liability, which is the credit side of a journal entry. The interpretation specifically states that it does not address whether the debit side is an asset or an expense, except for the case of prepaid levies. Therefore, it is worthwhile highlighting that the introduction of IFRIC 21 is not expected to change the existing IFRS treatment of whether the levies are expensed or capitalised as an asset.

Extract from IFRIC 21

3 This Interpretation does not address the accounting for the costs that arise from recognising a liability to pay a levy. Entities should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

14 An entity shall recognise an asset if it has prepaid a levy but does not yet have a present obligation to pay that levy.

Prepayments may be fairly common in arrangements in which the legislation requires entities to pay levies in advance and where the obligating events for these levies are progressive. For example, property taxes that are paid in advance at a specified date (e.g., 1 January) for an obligating event that relates to future periods (e.g., 1 January to 31 December). In such instances, IFRIC 21.14 clarifies that an entity would recognise the prepaid levy as an asset. In this scenario, the prepaid levy would then be amortised over the period.

Aside from prepaid levies, there are also instances when the assessment of expensing the liability or recognising a corresponding asset requires the application of other standards, such as IAS 2 Inventories, IAS 11 Construction Contracts, IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets. Given that levies are imposed by government and arise from non-exchange transactions, there would not typically be a clear linkage to future economic benefits. Consequently, if the incurrence of the liability does not give rise to an identifiable future economic benefit to the entity, the recognition of an asset would be inappropriate as the definition of an asset would not be met. In such cases, the debit side would therefore be to an expense account.

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8 Transactions in which the entity paying the levy does not receive any specific asset or services in exchange for the payment.

9 IAS 38.8 where asset is defined as a resource: (a) controlled by an entity as a result of past events; and (b) from which future economic benefits are expected to flow to the entity.
In the case where asset recognition is appropriate under other IFRS standards, levies are generally not expected to give rise to a stand-alone asset in its own right, given that the payments for acquisition of goods are scoped out under IFRIC 21.5. However, a levy may form part of the acquisition costs of some other asset, provided it meets the asset recognition criteria in other IFRS standards. Take for example, an entity that is required to pay an import duty to the government under the legislation for any large cargo trucks purchased from overseas. The entity uses these large cargo trucks as part of their operations to transport their goods to customers locally and therefore the entity capitalises these trucks as part of their property, plant and equipment under IAS 16.6-7. The import duty that is payable under the legislation may give rise to an IFRIC 21 levy, which would generally also be capitalised as part of the cost of the asset under IAS 16.16(a).

In addition, the point of recognition of an asset (if appropriate under other IFRS standards) may not always coincide with the point at which the levy liability is recognised. For example, where the levy is expensed at a point in time under IFRIC 21 requirements, but there may be a separate asset to be recognised over time under other IFRSs. In such cases, it creates an accounting mismatch in the pattern and timing of the recognition of asset and liability, which impacts the financial results of entities. We explore some scenarios in the following examples:

**Question 4.1 - How should recharges of levies to lessees be treated where the investment property is accounted for under the fair value model?**

In some cases, the levies may be recharged to customers. Take, for example, the case where a company (landlord) has an investment property which is leased to tenants and the landlord recharges the paid property tax to tenants. This is provided within the clauses in the lease agreements where the lessor has the right to recharge property tax based on either:

a) Actual paid property tax
   Or
b) Budgeted property maintenance expenses (including property tax), in which case, the lessor and lessee agreed on the yearly amount of rechargeable expenses. The difference between actual and budgeted expenses will be incurred by the landlord

The lease agreement provides that the recharging of the property tax will be a component of the monthly rental billed to the tenant. The tenant will be liable to pay the recharged property tax so long as the tenant continues renting the property during the period after 1 January.

The entity is liable for the payment of the property tax as at 1 January every year, as long as it is the registered owner of the property and the levy is non-refundable from the government even if the entity sells the property after 1 January. The amount payable is calculated based on 0.1% of the appraised value estimated by the tax authorities as at 1 January each year. As at 1 January 20x1, the appraised value of the property is CU50 million.

The entity accounts for the investment property under IAS 40 *Investment Property* using the fair value model.
**Question 4.1 - How should recharges of levies to lessees be treated where the investment property is accounted for under the fair value model?**

**Answer:**

Given that the levy payable on 1 January 20x1 is non-refundable even if the entity sells the property during the year, the obligating event under IFRIC 21 is at a point in time on 1 January 20x1. The full liability is recognised as at 1 January 20x1.

Since the investment property is accounted for using the fair value model, future recoveries of previously accrued and expensed levies from the lessees would be included in the expected cash flows in determining the fair value of the investment property in accordance with IAS 40.50. Any gain or loss arising from a change in the fair value of investment property must be recognised in profit or loss for the period in which it arises.

The expensing of the levy liability and the fair value adjustment on the investment property affects different line items in the statement of profit or loss and other comprehensive income. However, their affects may have a largely offsetting net impact on the overall financial results, depending on the specific facts and circumstances.

**Variation:**

If the investment property were accounted for under the cost model and not the fair value model, the issue of an accounting mismatch between the timing of expensing the liability and the recognition of any recharges also arises. If the landlord has a contractual right to recharge the levies, the recognition of any asset (receivable) with respect to the right to recharge lessees for previously accrued and expensed levies would depend on the specific terms and conditions in the lease agreement with the tenant and would need to be accounted for under the relevant IFRS standards.

5. **Interim reporting**

IFRIC 21 clarifies that the same recognition principles should be applied in the interim 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. This means that the entity does not accrue a proportion of the annual amount that it expects to be liable for over the year, or otherwise allocate it to the interim periods. Similarly, a liability (or part of a liability) should not be deferred if a present obligation to pay the levy exists at the end of the interim period.

**Extract from IFRIC 21**

13 An entity shall apply the same recognition principles in the interim financial report that it applies in the annual financial statements. As a result, in the interim financial report, a liability to pay a levy:

(a) shall not be recognised if there is no present obligation to pay the levy at the end of the interim reporting period; and

(b) shall be recognised if a present obligation to pay the levy exists at the end of the interim reporting period.
This is relatively simple when a levy is triggered on a specific day or when a specific event occurs. When a levy is triggered progressively, for example, as the entity generates revenues, the levy is accrued over time. At any time in the year, the entity would have a present obligation to pay a portion of the levy that would be based on revenues generated to that date and it recognises a liability on that basis.

If a levy is triggered in full as soon as the entity commences generating revenues, the liability is recognised in full on the first day that the entity commences generating revenue. In this case, the entity does not defer the liability recognition over the year or otherwise allocate it to subsequent interim periods.

When the legislation provides that a levy is triggered by an entity operating in a market only at the end of the annual reporting period, no liability is recognised until the last day of the annual reporting period. No amount is recognised before that date in anticipation of the entity still operating in the market. Therefore, in the interim financial reports, no liability for the levy would be recognised. Only if the entity reports for the last quarter of that year would the liability appear in an interim report.

Following from the illustrative examples in the table within section 2, the impact on interim reports for the various types of levies is summarised below:

<table>
<thead>
<tr>
<th>Illustrative examples</th>
<th>Obligating event</th>
<th>Recognition of liability in interim reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Levy triggered progressively as revenue is generated in specified period</td>
<td>Generation of revenue in the specified period</td>
<td>Recognise progressively based on revenue generated</td>
</tr>
<tr>
<td>Levy triggered in full as soon as revenue is generated in one period, based on revenues from a previous period</td>
<td>First generation of revenue in subsequent period</td>
<td>Recognise only if first revenue generated in interim period</td>
</tr>
<tr>
<td>Levy triggered in full if entity operates as a bank at the end of the annual reporting period</td>
<td>Operating as a bank at the end of the reporting period</td>
<td>Recognise only if interim period includes the last day of the annual reporting period specified in the legislation. Otherwise, a provision would not be permitted to be recognised in interim reports</td>
</tr>
<tr>
<td>Levy triggered if revenues are above a minimum specified threshold (e.g., when a certain level of revenue has been achieved)</td>
<td>Reaching the specified minimum threshold</td>
<td>Recognise only where the minimum threshold has been met or exceeded during the interim period. Otherwise, a provision would not be permitted to be recognised in interim reports</td>
</tr>
</tbody>
</table>
In the following examples, specific scenarios are provided to illustrate the above principles. Given the different levy mechanisms used across jurisdictions, it is important for entities to analyse their specific facts and circumstances in line with the relevant legislation, in determining the accounting treatment in their interim reports.

**Question 5.1 - How do you account for a levy that is triggered in full as soon as the entity generates revenue and when is the liability recognised?**

An entity has a calendar year end. In accordance with legislation, a levy is triggered in full as soon as the entity generates revenue in 20x2. The amount of the levy is determined by reference to revenue generated by the entity in 20x1. The entity generated revenue in 20x1 and starts to generate revenue in 20x2 on 3 January 20x2.

**Answer:**

In this example, the liability is recognised in full on 3 January 20x2 because the obligating event, as identified by the legislation, is the first generation of revenue in 20x2. The generation of revenue in 20x1 is necessary, but not sufficient, to create a present obligation to pay a levy. Before 3 January 20x2, the entity has no obligation. In other words, the activity that triggers the payment of the levy as identified by the legislation is the first generation of revenue at a point in time in 20x2.

The generation of revenues in 20x1 is not the activity that triggers the payment of the levy. The amount of revenue generated in 20x1 only affects the measurement of the liability and the obligating event is still the generation of revenue in 20X2.

In the interim financial report, because the liability arises in full on 3 January 20x2, the liability is recognised in full in the first interim period of 20x2.

**Question 5.2 - For a levy that is triggered in full as soon as the entity generates revenue from a certain activity above an annual threshold, what is the impact on the quarterly interim reports if this threshold is then reduced pro rata when the entity ceases participation in that activity during the year?**

A bank has a calendar year-end. In accordance with legislation, a bank levy is triggered only if the bank generated revenue above the annual threshold of CU10 million. The amount of the levy payable is calculated based on 0.1% of revenue with an annual threshold of CU10 million and is assessed as at 31 December every year. However, if the bank ceases operations during the year, the annual threshold of CU10 million will then be reduced pro rata, based on the number of days the bank was in operation during the year and the levy payable will then be based on 0.1% of the pro-rated annual threshold.

The owners of the bank ceased operation with effect from 1 July 20x1. As at 31 March 20x1 and 30 June 20x1, the revenue generated amounted to CU4 million and CU8 million, respectively.
Question 5.2 - For a levy that is triggered in full as soon as the entity generates revenue from a certain activity above an annual threshold, what is the impact on the quarterly interim reports if this threshold is then reduced pro rata when the entity ceases participation in that activity during the year?

Answer:

In the interim reports, the provision recognised in the statement of financial position would be:

<table>
<thead>
<tr>
<th>Date</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 20x1:</td>
<td>Nil</td>
</tr>
<tr>
<td>30 June 20x1:</td>
<td>Nil</td>
</tr>
<tr>
<td>30 September 20x1:</td>
<td>CU5,000 (CU10 million x (6/12 months) x 0.1%)</td>
</tr>
<tr>
<td>31 December 20x1:</td>
<td>CU5,000 (CU10 million x (6/12 months) x 0.1%)</td>
</tr>
</tbody>
</table>

Based on discussions by the IFRS IC during their March 2014 meeting, the threshold for determining the entity’s liability would only be reduced (or pro-rated) if, and only if, the entity stops the relevant activity before the end of the annual assessment period. This means that the pro-rated annual threshold would only apply from the date the entity stops the relevant activity in the market.

At 31 March 20x1 and 30 June 20x1, the bank has not ceased operations and the annual threshold remains at CU10 million. Since the revenue generated as at 31 March 20x1 and 30 June 20x1 did not meet the annual threshold, no liability is recognised under IFRIC 21 on both dates.

In contrast, the bank ceased operation from 1 July 20x1. Hence, the annual threshold would have been pro-rated and reduced to CU5 million at that date. For the quarters as at 30 September and 31 December 20x1, a liability of CU5,000 should thus be recognised accordingly.

In many countries, property taxes are levied by municipalities or other local government bodies on the owner of a property. Such taxes may be material to entities in certain sectors (e.g., real estate). Even within a single jurisdiction, there could be several different property tax mechanisms. Generally, each property tax arrangement must be assessed on its own merits. To facilitate such assessments, we have explored some illustrative fact patterns of property tax mechanisms in the following questions.
**Question 5.3 - How do you account for a levy that is triggered in full as soon as the entity holds a property at a specified date and what is the impact on the quarterly interim reports?**

In accordance with the legislation, property tax is imposed on the registered owner of the property as at 1 April each year. The amount payable is calculated based on 0.1% of the appraised value estimated by the tax authorities as at 1 April each year. Payments are to be made in arrears in instalments on June, September, December and March month-end dates and any unpaid instalments remain as the liability of the registered owner of the property as at 1 April.

The law also states that if the property is sold during the year, there will be no refund made from the government to the seller. The new property owner will only be liable to pay the property tax arising on 1 April of the coming year, subsequent to the date of purchase.

An entity has a calendar year-end and prepares quarterly interim reports. It holds a property as at 1 April 20x1, which has an appraised value of CU50 million. On 30 June 20x1, it sold the property to another entity.

**Answer:**

In the interim report as at 31 March 20x1, no liability is recognised since the obligating event is not until 1 April, assuming all previous year instalments have been paid on time. Upon 1 April, the liability of CU50,000 (CU50 million x 0.1%) is recognised in full.

For the subsequent interim period reports as at 30 June, 30 September and 31 December, the liability recognised in the statement of financial position would be CU50,000 less the instalment payments made during the year.

If in a variation to the above fact pattern, the seller is able to obtain a refund of a proportionate share of the paid property tax (i.e., CU 37,500) from the buyer of the property and this refund will form part of the sales price of the property based on the sales contract between the buyer and seller, this would not change the above accounting under IFRIC 21.
Question 5.4 - How do you account for a levy that is triggered progressively as the entity holds the property through a specified period of time?

In accordance with legislation, property tax is payable by the registered owner of the property as at 1 April each year. The amount payable is calculated based on 0.1% of the appraised value estimated by the tax authorities at 1 April each year. Payments are to be made in instalments at every March, June, September and December month end.

The law does not explicitly state that the property taxes relate to a period of time. However, the law states that if the property is sold during the year, the amount of property tax paid will be pro-rated for the period from 1 April to the date of sale, and any excess paid will be refunded to the entity by the government. The new property owner will be liable to pay property tax to the government for the period from the date of purchase to 31 March.

An entity has a calendar year-end and prepares quarterly interim reports.

It holds a property during the period 1 April 20x1 to 31 March 20x2, which has an appraised value of CU50 million as at 1 April 20x1. Prior to 1 April 20x1, the entity did not hold any property.

Answer:

In this fact pattern, although the law does not explicitly state that the property tax relates to the entity holding the property over a period of time, it is evident that the obligating event occurs rateably over the 12-month period from 1 April to 31 March. This is because the law allows for a pro-rated refund to be given to the entity for the portion of the period when the entity no longer holds the property. This implies that it is a time-based progressive levy.

As such, the levy is triggered over a 12-month period and the liability is recognised rateably over the 12-month period. In contrast with question 5.3, it is not the ownership of the property at a specified date that is the obligating event. Rather, it is the continued holding of the property throughout the period that gives rise to the obligating event.

As such, in the interim reports, the provision recognised in the statement of financial position would be:

<table>
<thead>
<tr>
<th>Date</th>
<th>Provision Recognised</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 20x1:</td>
<td>Nil</td>
</tr>
<tr>
<td>30 June 20x1:</td>
<td>CU12,500 (CU50,000 divide by 4), less any instalment payments made</td>
</tr>
<tr>
<td>30 September 20x1:</td>
<td>CU25,000 (cumulative portion of the prior quarter and current quarter), less any instalment payments made</td>
</tr>
<tr>
<td>31 December 20x1:</td>
<td>CU37,500 (cumulative portion of the prior two quarters and current quarter), less any instalment payments made</td>
</tr>
<tr>
<td>31 March 20x2:</td>
<td>CU50,000 (cumulative portion of the prior three quarters and current quarter), less any instalment payments made</td>
</tr>
</tbody>
</table>
6. Effective date and transition

This interpretation is effective for interim and annual periods commencing on or after 1 January 2014 and is applied retrospectively in line with IAS 8.19. Therefore, the same recognition principles should be applied to all periods presented in both interim reports and annual financial statements issued for interim or annual periods commencing on or after 1 January 2014. Early adoption is permitted and should be disclosed.

Extract from IFRIC 21

Effective date and transition

This appendix is an integral part of the Interpretation and has the same authority as the other parts of the Interpretation.

A1 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies this Interpretation for an earlier period, it shall disclose that fact.

A2 Changes in accounting policies resulting from the initial application of this Interpretation shall be accounted for retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

If an entity changes the way in which it recognises the levy liability on initial application of IFRIC 21, it must consider whether the previous accounting was appropriate under IAS 37. IFRIC 21 was issued as a result of the IASB acknowledging that there was diversity in practice due to IAS 37 being interpreted differently across industries, jurisdictions and entities. As such, it is not expected that a change in policy on initial application of IFRIC 21 represents a correction of error. Therefore, the effect of initial application of the interpretation will generally be accounted for as a change in accounting policy in accordance with IFRIC 21 Appendix A.A2 and IAS 8.14.

An example of the disclosures required upon adoption of IFRIC 21 is contained in our publication, Good Group (International) Limited - Illustrative Interim Condensed Consolidated Financial Statements for the period ended 30 June 2014\(^\text{10}\).

\(^{10}\text{Available at ey.com/ifrs}\)
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