



Technical Advisory Group Issue Paper

AGENDA ITEM: TAGFG03 – 11
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Section 25 Borrowing Costs/ Section 29 Income Tax – Response to ED2

Summary	This paper provides a summary and high level analysis of the consultation responses to the Specific Matters for Comment (SMCs) relating to Section 25 <i>Borrowing Costs</i> and Section 29 <i>Income Tax</i> . It proposes final guidance for TAG consideration.
Purpose/objective of the paper	The purpose of this paper is to provide a detailed analysis of the responses to the SMCs on ED2 of Sections 25 and 29. It seeks the views of TAG members on suggested approaches to the final guidance based on respondents' views and feedback on specific proposals.
Other supporting items	TAGFG03-Annex
Prepared by	Sarah Sheen
Actions for this meeting	Advise on: <ul style="list-style-type: none">i. whether Section 25 should include the capitalisation of borrowing costsii. whether Section 29 should include specifications on gift aid reliefiii. whether more guidance is included on the tax implications of grants and donations.

Technical Advisory Group

Section 25 Borrowing Costs/ Section 29 Income Tax – Response to ED2

1. Introduction

- 1.1 This paper:
- provides a summary and high level analysis of the consultation responses to the Specific Matters for Comment (SMCs) relating to Section 25 *Borrowing Costs* and Section 29 *Income Tax* – see also Appendix A.
 - sets out the responses from the Secretariat.
 - seeks TAG members' advice on the issues raised in the feedback to finalise the drafting of these sections.
- 1.2 This paper is split into two parts, Part A relates to Borrowing Costs and Part B relates to Income Tax.
- 1.3 The amended sections 25 and 29 including the Basis for Conclusions are provided for TAG in TAGFG03-Annex.

Part A Borrowing Costs

2. Background – Section 25 Borrowing Costs

- 2.1 Section 25 defines borrowing costs and sets out their recognition and disclosure requirements. It requires that an NPO recognises all borrowing costs (including those used to finance non-current assets) as an expense in surplus or deficit in the period in which they are incurred.
- 2.2 Section 25 was not a prioritised topic for review for the first edition of INPAG. Only minor changes to terminology were proposed for borrowing costs in Exposure Draft 2.

3. Approach to Section 25 (Alignment with IFRS for SMEs Accounting Standard)

- 3.1 Ninety-seven percent (thirty-two respondents), agreed with SMC 6a) that no significant alignment changes should be required for Section 25, other than the terminology changes. Three percent, (one respondent), disagreed. Fourteen respondents provided no response to this SMC.
- 3.2 A respondent that agreed with the approach to section 25 noted that this was an appropriate means of reducing complexity in this area. A second respondent commented that this was consistent with the *IFRS for SMEs Accounting Standard* and

that as such this was appropriate for the size of the entities anticipated to apply INPAG.

- 3.3 A respondent that agreed commented that guidance in some jurisdictions is to the effect that borrowing costs be capitalised where they are incurred for purposes of setting up a qualifying asset but that they were of the view that the approach in INPAG Section 25 is more valid for NPOs. A respondent that disagreed considered recognising the cost of borrowing immediately as an expense does not give a faithful representation of the cost of the asset. This is because borrowing costs are directly attributable to the acquisition, construction or production of a qualifying asset and are part of the cost of that asset.
- 3.4 The Secretariat agrees that capitalisation of borrowing costs is a better representation of the cost of construction of a qualifying asset and would note that that this is the accounting treatment in IAS 23 *Borrowing Costs*. The Secretariat would highlight that other GAAP based on *IFRS for SMEs* Accounting Standard permits this as an accounting policy choice.
- 3.5 The simplification in the *IFRS for SMEs* Accounting Standard is intended to reduce complexity. It is also arguably better suited to the size of NPOs anticipated to apply INPAG. It may be useful, however, to consider whether a policy choice might be introduced in future editions of INPAG permitting NPOs to consider whether capitalisation might better reflect the cost of assets they acquire or construct.
- 3.6 One of the respondents that agreed also commented that non-capitalisation of borrowing costs is useful from a “tax appreciation perspective” by expensing the costs. In this way NPOs can recover their cost deduction earlier rather than spreading them over a longer cycle. The Secretariat notes this comment.
- 3.7 The Secretariat does not recommend any further changes to Section 25. Extracts on the outcomes of the consultation on ED2 are provided in Appendix B.

Question 1: Do TAG members agree to retain the alignment with the *IFRS for SMEs* Accounting Standard and not permit the capitalisation of borrowing costs?

Part B Section 29 – Income Tax

4. Background – Section 29 Income Tax

- 4.1 Section 29 covers the recognition, measurement, presentation and disclosure requirements of income tax.
- 4.2 Section 29 requires an NPO to recognise the current and future tax consequences of transactions and other events that have been recognised in the financial statements. These tax amounts comprise current tax and deferred tax.

- 4.3 Current tax is income tax payable in respect of the taxable profit (tax loss) for the current period or past periods. Deferred tax is income tax payable or recoverable in future periods, generally because of the NPO recovering or settling its assets and liabilities for their current carrying amount, and the tax effect of the carry forward of currently unused tax losses and tax credits.
- 4.4 Section 29 requires an NPO to recognise a deferred tax liability or asset if the recovery of the carrying amount of an asset or the settlement of a liability will result in higher or lower tax payments in the future than would be the case if that recovery or settlement were to have no tax consequences.
- 4.5 Section 29 *Income Tax* was not a prioritised topic and largely follows the requirements in the equivalent Section in IFRS for SMEs (but see also comments in paragraph 5.10 below). Other than terminology changes, Section 29 requires that the tax expense is recognised in the same component as the transaction or other event that resulted in the tax expense rather than being recognised in total comprehensive income.

5. Agreement that all the elements of Section 29 should be included in INPAG

- 5.1 Eighty-six percent (twenty-four) respondents to this SMC agreed with SMC 9 a) that all the elements of Section 29 should be included in INPAG. Fourteen percent (four respondents) disagreed and were of the view that some or all the elements should be excluded. Fifteen respondents did not answer this question.
- 5.2 A respondent commented that that the guidance provides a comprehensive framework to ensure that NPOs properly account for income taxes, reflecting the potential tax consequences of their transactions and events. Respondents that agreed were of the view that the application of Section 29 will depend on the jurisdiction on which the NPO is based, so all the elements are necessary. Another respondent that agreed commented that an NPO would only need to apply the requirements that are relevant to its own transactions and balances. This respondent noted that requirements could also be relevant when an NPO group has a trading subsidiary and is preparing consolidated financial statements.
- 5.3 A respondent commented that accounting for income tax interacts with specific jurisdictional requirements and therefore it may be necessary for INPAG Guidance to highlight this.
- 5.4 A respondent noted that a national GAAP requires an entity to recognise the income tax effects of a future payment that qualifies for gift aid made by companies to NPOs at the reporting date, rather than in the future when the payment is made. The effect is that the gift aid tax relief for companies is recognised at the same time as any related tax charge and is therefore offset in profit or loss. A second respondent raised the issue of gift aid and was of the view that cross reference should be made to Section 23, but they also noted that in some jurisdictions NPOs will be subject to income tax on their investment income.

5.5 The Secretariat agrees that there are instances of different tax reliefs for gift aid for companies and recognises that there may be instances where jurisdictions have specific tax treatments (including tax credits) on investment income. However, the Secretariat is of the opinion that it would be very difficult to include specific examples in section 29 as these examples may not be fully representative of similar transactions internationally. The Secretariat is of the view that for this edition of INPAG no specific examples are included. Examples may be useful to consider for future editions, following research to identify the approach to any gift aid tax treatments.

5.6 The Secretariat considers, however, that it may be useful in the scope section to highlight that Section 29 will interact with the taxation requirements for an NPO's jurisdiction. Relevant commentaries have been included in the Basis for Conclusions in Appendix C. The amended paragraph G29.1 which includes the additional commentary on the taxation requirements of different jurisdictions is included below.

*G29.1 For the purpose of this Guidance, **income tax** includes all domestic and foreign taxes that are based on **taxable profit**. Income tax also includes taxes such as withholding taxes that are payable by a **controlled entity, associate or joint arrangement** on distributions to the **reporting NPO**. NPOs will need to comply with the domestic and foreign tax income tax reporting requirements applicable to them.*

5.7 A respondent that agreed raised concerns that the concepts of deferred tax assets and deferred tax liabilities are complicated and NPOs may need to have extra training to understand and apply the requirements. The Secretariat concurs that these are complex transactions for NPOs and where an NPO encounters such transactions training might be useful. The Secretariat would note that the IASB has issued educational material¹ on Section 29 of the IFRS for SMEs Accounting Standard which covers deferred tax, and this might be used by NPOs.

5.8 A respondent that disagreed considered that all or almost all of section 29 should be omitted. Their view was that an NPO does not seek to make profits and in most jurisdictions, they are not therefore subject to tax if they make a surplus (provided it is operating within its objects). They considered that INPAG should omit para G29.35 on capital distributions. This paragraph is extracted below for ease of reference:

*"When an NPO makes a capital distribution, it may be required to pay a portion of the distribution to taxation authorities on behalf of holders of **equity claims**. Such an amount paid or payable to taxation authorities is charged to **equity** as a part of the capital distribution.*

¹ IFRS Foundation Supporting Material for the IFRS for SMEs Standard on Section 29
<https://www.ifrs.org/content/dam/ifrs/supporting-implementation/smes/module-29.pdf>

- 5.9 One of the respondents that disagreed noted that the whole section was not applicable to its country as the legal framework does not allow distribution of profits to founder members and donors, as well as persons with management and representative powers of a NPOs, even when such profit is made within supporting entrepreneurial activity.
- 5.10 The Secretariat understands such sentiments, however, some NPOs are registered companies and may be subject to income tax as described by Section 29. The Secretariat is also of the view that INPAG has recognised that equity claims exist (although not a prevalent or material transaction) and as such may be subject to taxation. It would suggest that paragraph G29.35 is not removed. The Secretariat would therefore not suggest substantial change to Section 29.
- 5.11 The Basis for Conclusions confirms that paragraph 29.3 of IFRS for SMEs has been removed from Section 29. The purpose of paragraph 29.3 is to scope out Section 24 of IFRS for SMEs and to specifically address timing differences. The Basis for Conclusions suggested that additional guidance on timing differences arising from revenue from grants and donations may be appropriate. Paragraph 29.3 of the *IFRS for SMEs Accounting Standard* is included below:
- This section does not deal with the methods of accounting for government grants (see Section 24 Government Grants). However, this section does deal with the accounting for temporary differences that may arise from such grants.*
- 5.12 The Secretariat considers that even though Section 24 has been removed it has been replaced with Section 23 Part 1 *Revenue from Grants and Donations* and in jurisdictions where there are taxation consequences for revenue from grants and donations that temporary differences are likely still exist. Therefore, it might be beneficial to reinstate paragraph 29.3, referring instead to Section 23 Part I *Revenue from Grants and Donations* rather than section 24, to be clear that there may be circumstances where revenue from grants and donations is taxable and that any timing differences that may arise from such grants should be accounted for in accordance with Section 29.
- 5.13 It may also be appropriate to include additional examples for timing differences on revenue in accordance with Section 23 Part 1, though no specific issues have been identified so they have not been included in Section 29 at this juncture. Paragraph G29.3 has been reinstated with appropriate description in the Basis for Conclusions. Both paragraph G29.3 and the commentary in the Basis for Conclusions are included in Appendix D.

Question 2: Do TAG members agree that all the elements of Section 29 should be retained?

Question 3: What are TAG member's views on whether any specifications should be included on gift aid tax reliefs? Do TAG members agree that these should not be included in Section 29?



Question 4: Do TAG members agree that any income tax specifications on distributions should be retained?

Question 5: Do TAG members agree that paragraph 29.3 from IFRS for SMEs should be included in INPAG?

Question 6: Are TAG members of whether any illustrations should be included on any temporary differences relating to revenue from grants or donations which might be subject to tax?

6. Other Amendments

- 6.1 The Secretariat has made other minor amendments to Section 29 for consistency with other sections of INPAG, for example, the term equity has been either removed or replaced with net assets (see paragraph G29.41 and the heading) and “shareholders” has been replaced with “holders of equity claims” in paragraph G29.47.
- 6.2 Subject to TAG feedback on the issues raised, the Secretariat plans to make no further amendments to this Section. The draft text will be updated to reflect any changes to the Third edition of the *IFRS for SMEs* standard which is currently being finalised. The full draft text can be found in TAGFG03-Annex.
- 6.3 If these updates are not substantial in nature and do not raise issues that have previously considered by TAG members, the resulting updated version will be considered the draft final. Even if there are no substantial issues, TAG members will have another opportunity to comment on the drafts of these sections when all sections of INPAG have been updated.

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Appendix A Summary of Feedback Responses to SMCs for Borrowing costs and Income Taxes

SMC 6 a) Do you agree that there are no significant alignment changes required to Section 25, other than the terminology changes that have been made? If not, set out the alignment changes you believe are required.	Response	Number	% of those who responded
	Agree	32	97%
	Disagree	1	3%
	Neither agree nor disagree	0	-
	No Response	14	-
		47	100%

SMC 9 a) Are there any elements of Section 29 Income taxes that are not required by NPOs? If so, explain which elements are not needed and why?	Response	Number	% of those who responded
	Agree – All elements should be included	24	86%
	Disagree – Some or all elements should be excluded	4	14%
	No Response	19	-
		47	100%



Appendix B – Extracts from Section 25 – Borrowing Costs – Outcomes of the Consultation

BC25.2 Respondents to Exposure Draft 2 generally agreed with the proposals. A respondent that disagreed considered recognising the cost of borrowing immediately as an expense does not give a faithful representation of the cost of the asset. This is because borrowing costs are directly attributable to the acquisition, construction or production of a qualifying asset and are part of the cost of that asset.

BC25.3 The Secretariat agrees that capitalisation of borrowing costs is a better representation of the cost of construction of a qualifying asset. The simplification in the *IFRS for SMEs* Accounting Standard is intended to reduce complexity. It is also arguably better suited to the size of NPOs anticipated to apply INPAG. It may be useful, however, to consider whether a policy choice might be introduced in future editions of INPAG permitting NPOs to consider whether capitalisation might better reflect the cost of assets they acquire or construct.

Appendix C – Additions to the Basis for Conclusions relating to the Comments on Gift Aid

- BC29.6 The responses to Exposure Draft 2 supported the approach in Section 29. Two respondents raised the issue of gift-aid made by companies, with one commenting that a national GAAP requires an entity to recognise the income tax effects of a future payment that qualifies for gift-aid made by companies to NPOs at the reporting date, rather than in the future when the payment is made. The effect is that the gift aid tax relief for companies is recognised at the same time as any related tax charge and is therefore offset in profit or loss.
- BC29.7 The Secretariat agrees that there are instances of different tax reliefs for gift aid for companies. However, the Secretariat is of the opinion that it would be very difficult to include specific examples in section 29 as these examples may not be fully representative of similar transactions internationally. The Secretariat is of the view that for this edition of INPAG no specific examples are included.

Appendix D – Extracts from Section 29 Income Tax and the Basis for Conclusions on the Scope Paragraph

Reinstated Paragraph G29.3

G29.3 This section does not deal with the methods of accounting for revenue from grants and donations (see Section 23 Part 1 Revenue from grants and donations). However, this section does deal with the accounting for the tax implications of the temporary differences that may arise from such grants and donations.

Extracts from the Basis for Conclusions

BC29.3 Paragraph 29.3 of the *IFRS for SMEs* Accounting Standard scopes out Section 24 *Government Grants*. As Section 24 is removed and accounting for government grants is dealt with as part of a comprehensive section on revenue, this reference was initially removed from Section 29 but has been replaced by references to Section 23 Part 1 *Revenue from grants and donations*.

BC29.4 The purpose of paragraph 29.3 is to specifically address timing differences. Consideration was given to whether any additional guidance on timing differences arising from revenue was necessary, as well as additional guidance on gifts in-kind and services in-kind. It is therefore proposed that, as needed, additional text is developed (either core guidance or implementation guidance) as a consequential change as the drafting of the guidance on revenue is developed. No specific issues relating to government grants and income tax have as yet been identified for the first edition of INPAG. However, the original paragraph referring to the timing differences has been reinstated to recognise that timing differences might occur where there are any taxation consequences to revenue from grants and donations.