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# **FISCAL UNIT CONSOLIDATION GUIDANCE**

These Guidance Notes are issued by the Malta Institute of Accountants (MIA) to assist Members in recognising and measuring current and deferred tax under the Consolidated Group (Income Tax) Rules (“the Rules”). The Rules were introduced through Legal Notice 110 of 2019 as subsidiary legislation to the Income Tax Act, Chapter 123 of the Laws of Malta. These Guidance Notes are not a substitute to any legislation, International Financial Reporting Standards (“IFRS”) and Interpretations thereof, or the Accountancy Profession (General Accounting Principles For Small and Medium-Sized Entities) Regulations (“GAPSME”), but are intended to assist members in complying with the Rules. This document has been the subject of a lengthy due process with the involvement of the MIA’s Financial Reporting, Audit and Assurance, and Direct Taxation Committees, and sets out what is deemed as best practice by the MIA.

It is the responsibility of every accountant and auditor to exercise professional judgement accordingly. The MIA shall not be held responsible for any loss sustained by any person who relies on this guidance.

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# Contents

2. Preface
3. Consolidation procedures and subsidiaries that are not members of the fiscal unit
  - 3.1 Consolidation procedures
  - 3.2 Subsidiaries that are not members of the fiscal unit
4. Recognition, measurement, presentation and disclosure of income tax expense (income)
  - 4.1 Underlying accounting principles
  - 4.2 Recognition, measurement and presentation of tax balances within the FUCFS
  - 4.3 Recognition and measurement of tax balances within the principal taxpayer's and the subsidiaries' financial statements
  - 4.4 Consequences of joining, or leaving, a fiscal unit
  - 4.5 Other disclosure considerations
5. Scope of the fiscal unit's consolidated financial statements
6. Contents of the auditor's report

## 2. Preface

Following the introduction of the Rules, entities that form part of a group and that satisfy the requirements set out within those Rules may elect to form a fiscal unit for corporate income tax purposes with effect from the year of assessment 2020. When such an election is made, the members of the fiscal unit are treated as a single taxpayer, and their tax return is based on the fiscal unit's consolidated financial statements ("FUCFS").

For this purpose it is important to bear in mind that the fiscal unit's members do not necessarily need to reflect the group of companies as would be defined under IFRS or GAPSME. In fact, members that would form part of the 'group' under either one of these two accounting frameworks may be omitted from the fiscal unit, with such omission either being voluntary or, if the conditions laid out in the Rules are not satisfied, mandatory. Thus, a fiscal unit may be smaller than the 'group' for accounting purposes.

Some key features of the Rules having accounting implications include the following:

- the fiscal unit must prepare consolidated financial information, based upon which the fiscal unit's tax liability will be calculated;
- the fiscal unit's parent company is, at law, the fiscal unit's principal taxpayer and assumes the rights, duties and obligations under the Income Tax Acts relative to that fiscal unit;
- in the event that the principal taxpayer defaults on payment of the fiscal unit's tax liability, the tax authorities have a right to claim the unpaid tax balances from any member of the fiscal unit which is a 100% subsidiary of the principal taxpayer and which is a transparent subsidiary, as each such fiscal unit member is jointly and severally liable for any tax balances due;
- upon joining a fiscal unit, any unabsorbed capital allowances or tax losses carried forward by a member of the fiscal unit (for which a deferred tax asset ("DTA") existed, even if this had not been recognised):
  - either become balances of the principal taxpayer; or
  - are held in abeyance by that fiscal unit member, and any such capital allowances or tax losses carried forward may not be deducted against the fiscal unit's taxable income, and neither the fiscal unit member's taxable income until and unless that fiscal unit member were to leave the fiscal unit;

broadly speaking, in those situations where a shareholder, including the principal taxpayer's shareholder, is registered for Maltese income tax refund purposes, the Rules allow the fiscal unit to compute its tax liability at a rate of income tax which reflects the effective tax rate that would have resulted from the declaration of a dividend and the subsequent refund due to the shareholder.

The MIA has deemed it opportune to issue these Guidance Notes, the scope of which is to illustrate what is deemed as best practice in the local circumstances. These Guidance Notes are being issued solely to assist members in applying the requirements of IFRS to a local situation and should not be construed as an Interpretation. Interpretations on IFRS remain those issued by the International Financial Reporting Interpretations Committee of the International Accounting Standards Board.

These Guidance Notes address the following matters:

- consolidation procedures (page 5);
- considerations relevant to the recognition, measurement, presentation and disclosure of income tax charges (income) and balances in the FUCFS, as well as in the parent company's and the other fiscal unit's members' statutory financial statements (page 7);
- the scope of the FUCFS, setting out what statements and other disclosure notes may be omitted from a fiscal unit's special purpose consolidated financial statements (page 57); and
- where special purpose consolidated financial statements are prepared, the contents of the auditor's report on those special purpose consolidated financial statements (page 58). In this regard, the MIA notes that if the members of a fiscal unit are consistent with the IFRS or GAPSME group for statutory purposes, and that group of companies already prepares a full consolidated set of financial statements that complies with IFRS or GAPSME and that is audited, the fiscal unit may use those consolidated financial statements for the purposes of satisfying the requirements of the Rules, and special purpose consolidated financial statements need not be prepared in such situations.

Throughout these Guidance Notes, references to 'balance sheet' shall also include other statements with a similar meaning, such as 'statement of financial position', and references to 'income statement' shall also include other statements with a similar meaning, such as 'statement of profit or loss' and 'profit and loss account'.

Wherever tax rates are mentioned in these Guidance Notes, the assumption is that prior to forming a fiscal unit, the entities were subject to a standard corporate tax rate of 35% on their taxable profits; special rates of tax – such as those that may result from industrial incentives, as well as adjustments to tax rates as a result of the application of double tax relief, notional interest deductions, etc – are not within scope of these Guidance Notes.

### **3. Consolidation procedures and subsidiaries that are not members of the fiscal unit**

#### **3.1 Consolidation procedures**

A fiscal unit is required to prepare consolidated financial information, based upon which its tax liability is computed; this financial information may comprise a fully-consolidated set of financial statements prepared in accordance with either IFRS or GAPSME. To the extent, therefore, that the fiscal unit members are identical to the group for which consolidated financial statements are already prepared in accordance with IFRS or GAPSME, those consolidated financial statements may be used as the basis for computing the fiscal unit's tax liability.

Situations will however arise either where the fiscal unit members differ from the members of the group for which statutory IFRS or GAPSME consolidated financial statements are already prepared, or alternatively where the principal taxpayer is exempted from preparing statutory consolidated financial statements under IFRS or GAPSME. In such situations, the fiscal unit is required to prepare consolidated financial information that will form the basis for the fiscal unit's tax liability. The consolidation procedures that the fiscal unit must follow in such cases are broadly consistent with the requirements of IFRS and GAPSME. Specifically:

- all fiscal unit members' financial information must be combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expense;
- the principal taxpayer's investment (together with that of any other intermediate parent company within the fiscal unit) in each subsidiary, together with the parent entity's portion of equity of each subsidiary, are eliminated;
- balances and transactions – including income, expenses and dividends – occurring between members of the fiscal unit are eliminated in full;
- in respect of the principal taxpayer's subsidiaries that are members of the fiscal unit, any ownership interests in those fiscal unit members that are held by non-controlling investors are presented as a separate component of consolidated equity, whereby such non-controlling interests are measured at:
  - the amount of those non-controlling interests at the date of the original acquisition of control over the subsidiary; and
  - the non-controlling interest's share of changes in equity since the date of the original acquisition of control.
- all members of the fiscal unit must have uniform accounting policies, and they must furthermore also have a financial period that ends on the same date.

Further guidance on consolidation procedures can be found in IFRS 10, or in Section 22 of GAPSME.

#### **3.2 Subsidiaries that are not members of the fiscal unit**

There will be situations in which the principal taxpayer's subsidiaries may not all be members of the fiscal unit, either because the Rules preclude those subsidiaries from forming part of the fiscal unit, or because the principal taxpayer and the subsidiary do not elect to have that subsidiary form part of the fiscal unit.

The eliminations referred to above (in respect of investments in subsidiaries and balances and transactions occurring between members of the fiscal unit) do not apply to those subsidiaries of the principal taxpayer which are not members of the fiscal unit.

The MIA considers it best practice to measure such subsidiaries within the FUCFS in accordance with the measurement rules applicable to an investor’s separate financial statements, as set out in IAS 27 or in Section 10 of GAPSME. In this regard, paragraph 4 of IAS 27 allows subsidiaries to be measured at cost, at fair value, or using the equity method of accounting. Meanwhile, paragraph 10.12 of GAPSME allows subsidiaries, associates and joint ventures to be measured at cost, or using the equity method of accounting.

In terms of presentation, the MIA considers it best practice for items related to subsidiaries that are not members of the fiscal unit to be presented within the FUCFS as set out in Table 1:

<b>Item</b>	<b>Presentation approach in the balance sheet and in related notes<sup>1</sup></b>
Investment in subsidiaries	Investments in subsidiaries may be presented as, ‘Investments in subsidiaries that are not members of the fiscal unit.’
Debts due from subsidiaries	Debts due from subsidiaries may be presented as, ‘Loans advanced to subsidiaries that are not members of the fiscal unit’, ‘Amounts due from subsidiaries that are not members of the fiscal unit’ and other similar descriptions.
Debts due to subsidiaries	Debts due to subsidiaries may be presented as, ‘Borrowings from subsidiaries that are not members of the fiscal unit’, ‘Amounts due to subsidiaries that are not members of the fiscal unit’ and other similar descriptions.

*Table 1: Reference to subsidiaries that are not part of the fiscal unit*

Similarly, income and expense items from subsidiaries that are not members of the fiscal unit, such as dividend income, impairment losses on investments in such subsidiaries and (as applicable) fair value movements or the results of the application of the equity method of accounting, should be described in a similar manner to the descriptions included in Table 1 above. The taxability/deductibility of any such income or expense is not however within scope of these Guidance Notes.

These Guidance Notes suggest avoiding making reference to ‘unconsolidated subsidiaries’ in order to avoid potential confusion with investments in special purpose entities (‘SPEs’ or ‘SPVs’).

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<sup>1</sup> Page 57 of these Guidance Notes contains a list of notes that may be omitted from the fiscal unit’s consolidated financial information.

## **4. Recognition, measurement, presentation and disclosure of income tax expense (income)**

These Guidance Notes address the recognition and measurement of tax and, where applicable, intra-group balances from the perspective of both the fiscal unit itself, as well as the parent entity and subsidiary members of the fiscal unit; this chapter is organised into the below sections.

### **4.1 Underlying accounting principles**

- 4.1.1 Tax expense
- 4.1.2 Income, expense and equity transactions
- 4.1.3 Selection of accounting policies

### **4.2 Recognition, measurement and presentation of tax balances within the FUCFS**

- 4.2.1 Applicable tax rate
  - 4.2.1.1 Current tax
  - 4.2.1.2 Deferred tax
- 4.2.2 Other considerations relevant to the recognition of deferred tax balances
- 4.2.3 Presentation in the FUCFS

### **4.3 Recognition and measurement of tax balances within the principal taxpayer's and the subsidiaries' financial statements**

- 4.3.1 Recognition and measurement of tax balances in the income statement
  - 4.3.1.1 Applicable tax rate
  - 4.3.1.2 Current tax expense
  - 4.3.1.3 Intra-group funding arrangements
  - 4.3.1.4 Deferred tax balances on losses carried forward and unabsorbed capital allowances
  - 4.3.1.5 Deferred tax balances on temporary differences

### **4.4 Consequences of joining, or leaving, a fiscal unit**

- 4.4.1 Consequences of joining a fiscal unit
  - 4.4.1.1 Changes in the applicable tax rate
  - 4.4.1.2 Changes to the amount of recognised DTA or DTL arising on temporary differences
  - 4.4.1.3 Losses carried forward and unabsorbed capital allowances
- 4.4.2 Consequences of leaving a fiscal unit
  - 4.4.2.1 Changes in the applicable tax rate
  - 4.4.2.2 Losses carried forward and unabsorbed capital allowances

### **4.5 Other disclosure considerations**

## 4.1 Underlying accounting principles

The following IFRS and GAPSME principles form the backdrop against which much of these Guidance Notes have been drawn up.

### 4.1.1 Tax expense

Under both IAS 12 and Section 16 of GAPSME, tax expense (income) comprises both the current and deferred tax expense (income) included within profit or loss for a period. The following definitions are key to these Guidance Notes:

	<b>IFRS (IAS 12)</b>	<b>GAPSME (Section 16)</b>
Current tax	"5 Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period."	"16.4 Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period."
Deferred tax	N/A <sup>2</sup> .	"16.4 Deferred tax expense (income) is the amount of tax expense (income) included in the determination of profit or loss for the period in respect of changes in deferred tax assets and deferred tax liabilities during the period."
Taxable profit	"5 Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)."	"16.2 Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)."

Table 2: Key definitions from IAS 12 and Section 16 of GAPSME

The key principle in both IAS 12 and in Section 16 of GAPSME is that current tax arises on an entity's taxable profit (tax loss), where taxable profit (tax loss) is that amount – determined in accordance with the applicable tax rules – based upon which tax is payable (recoverable).

<sup>2</sup> IAS 12 provides definitions for deferred tax assets and deferred tax liabilities, but not for "deferred tax".

#### 4.1.2 Income, expense and equity transactions

A fiscal unit's parent company is, in accordance with the Rules, the principal taxpayer. The principal taxpayer and its subsidiaries may enter into arrangements through which intra-group receivables and payables may be created as a result of the principal taxpayer's assumption of its subsidiaries' tax assets and liabilities (or its acquisition of their tax assets on losses carried forward and unabsorbed capital allowances).

Any such intra-group arrangements must be assessed in light of the definitions of 'income' and 'expense'. Specifically, increases (or decreases) in an entity's net assets should only be recognised as income (or expense) if they meet the respective definitions of income and expense within IFRS or GAPSME. These are defined as follows:

	<b>IFRS (Conceptual Framework for Financial Reporting)</b>	<b>GAPSME (Section 3)</b>
Income	"4.68 Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims."	"3.27 Income is increases in economic benefits during the financial reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants."
Expense	"4.69 Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims."	"3.29 Expenses are decreases in economic benefits during the financial reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants."

*Table 3: Definitions of income and expense under IFRS and GAPSME*

One of the key principles within the above definitions is that transactions with equity participants do not give rise to income or expense if those transactions are carried out with the equity participants in their capacity as equity participants (i.e. the transactions lack commercial substance).

Indeed, contributions in which a subsidiary receives net assets from equity participants, without exchanging items of similar value with the equity participants (such as issues of share capital, or receipts of gratuitous donations), are not income, and are instead recognised by a subsidiary as an equity transaction. Similarly, distributions to equity participants, in which a subsidiary transfers net assets to the equity participants without receiving items of similar value (such as dividend declarations) are not expenses, and are instead recognised by a subsidiary as an equity transaction.

### 4.1.3 Selection of accounting policies

IAS 8 and Section 5 of GAPSME both require preparers to develop and apply accounting policies that result in information that is relevant and reliable. Where reporting entities have an accounting policy choice to make, MIA members are reminded that once an accounting policy is adopted, it must be applied consistently across accounting periods; should a voluntary change in accounting policy be subsequently made, preparers must follow the requirements of IAS 8 or Section 5 of GAPSME.

## 4.2 Recognition, measurement and presentation of tax balances within the FUCFS

### 4.2.1 Applicable tax rate

#### 4.2.1.1 Current tax

Paragraph 46 of IAS 12 requires current tax balances to be measured using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period; GAPSME requirements contained in paragraph 16.23 are consistent with IAS 12 in this regard.

The Rules were enacted through Legal Notice 110 of 2019, and they are effective for entities with a financial year commencing 1 January 2019 and beyond. These Guidance Notes do not therefore provide guidance on the interpretation of 'enacted or substantively enacted', and their focus is solely to address what the 'tax rate' is.

As set out in the Preface to these Guidance Notes on page 3, in those situations where a shareholder is registered for Maltese income tax refund purposes, the Rules allow the fiscal unit to compute its tax liability at a rate of income tax which reflects the effective tax rate that would have resulted from the distribution of a dividend and the subsequent refund due to the shareholder. To achieve this objective, the Rules establish that a fiscal unit's taxable profit – which is based on the fiscal unit's accounting profit as determined in accordance with the consolidation procedures described earlier in these Guidance Notes, and subsequently adjusted for differences between accounting profit (loss) and taxable profit (loss) – shall be taxed at a blended tax rate.

The blended tax rate that is applicable to current tax for any given year can be set out in the following formula:

$$\text{Fiscal unit's blended tax rate} = 35\% - \frac{\text{tax refund claimable}}{\text{fiscal unit's chargeable income}}$$

In situations covered by these Guidance Notes where the entities were, prior to forming a fiscal unit, subject to a standard corporate tax rate of 35% on their taxable profits, the above formula can also be expressed as follows:

$$\text{Fiscal unit's blended tax rate} = \frac{\text{aggregate current tax charge from all sources of income}}{\text{aggregate taxable profit}}$$

From a purely mathematical point of view, the following table sets out what the blended tax rate applicable to a fiscal unit's taxable income would be in a non-exhaustive set of scenarios.

<b>Scenario prior to the enactment of the Rules</b>	<b>Blended tax rate</b>	<b>Comments</b>
All of the fiscal unit members' profits were taxed at 35%, and a refund of 6/7 of all of the tax paid by the fiscal unit members could be claimed by the shareholder upon the declaration of dividends by the fiscal unit members.	5%	In such a scenario, the fiscal unit will directly self-assess its current tax liability at the blended rate of 5%, without the need to declare dividends.
All of the fiscal unit members' profits were taxed at 35%, and no refund could be claimed by the shareholder.	35%	This scenario is expected to be rare.
All of the fiscal unit members' profits were taxed at 35%, and a refund of 6/7 of some of the tax paid by fiscal unit members could be claimed by the shareholder upon the declaration of dividends by the fiscal unit members.	Somewhere between 5% and 35%	The blended rate will change each year depending on the composition – and weighting – of the fiscal unit's sources of income.

*Table 4: Determination of a fiscal unit's blended tax rate*

In practice, the numerator in the earlier formulae ("tax refund claimable" or "aggregate current tax charge from all sources of income") can only be derived by analysing each source of a fiscal unit's profit (loss) and multiplying that figure of profit (loss) by the tax rate applicable to that source of income. The "aggregate tax charge from all sources of income" can therefore be expressed as follows:

$$(Profit_1 \times Tax\ rate_1) + (Profit_2 \times Tax\ rate_2) \dots + (Profit_n \times Tax\ rate_n)$$

where Profit is a source of income and Tax rate is the tax rate applicable to that source of income.

### Illustration 1: Calculation of a fiscal unit's blended tax rate

A fiscal unit has two sources of income in year 202X, Source 1 and Source 2. The following analysis sets out the fiscal unit's current tax charge, and its blended tax rate. For the purposes of this example, it is assumed that the fiscal unit's taxable income is equivalent to its accounting profit before tax.

	Source 1	Source 2	Total
	€	€	€
Accounting and taxable profit	1,000	9,000	10,000
Applicable tax rate	35%	5%	
<u>Current tax expense</u>	<u>350</u>	<u>450</u>	<u>800</u>

The fiscal unit's blended tax rate in year 202X is 8% (being €800 divided by €10,000).

As an entity's current tax is, from an accounting point of view, the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period; it therefore follows that the fiscal unit's current tax expense should be measured at the blended rate as set out in Illustration 1, which is itself derived from different tax rates applied to different sources of income. In Illustration 1, the fiscal unit's tax rate for year 202X applicable to current tax would therefore be 8%.

#### 4.2.1.2 Deferred tax

The MIA considers the above analysis of how a fiscal unit's blended rate for current tax is derived to be critical to the determination of which rate(s) of tax to apply to deferred tax balances. Consistently with current tax, paragraph 47 of IAS 12 also requires deferred tax balances to be measured using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period; GAPSME requirements contained in paragraph 16.24 are consistent with IAS 12 in this regard.

Additionally, the same paragraphs require entities to apply the tax rates that are expected to apply to the period when the asset is realised or the liability is settled. Thus, where a fiscal unit has different sources of taxable income to which different tax rates are expected to apply when the DTA is realised or the deferred tax liability ("DTL") is settled, the MIA considers it best practice to apply different rates of tax to the different types of deferred tax balances. Each deferred tax balance should accordingly be measured using the tax rate that is expected to apply when the reversal of the DTA or DTL takes place. In the MIA's view, deferred tax balances arising in any given year of assessment should not be measured at the fiscal unit's blended tax rate for that year, as that blended rate does not represent the rate of tax that is expected to apply when the DTA or DTL is reversed.

This is illustrated in Illustration 2 below.

## Illustration 2: Measurement of a fiscal unit's tax expense (income), and deferred tax balances on temporary differences

A fiscal unit has two sources of income in year 202X, Source 1 and Source 2. The following analysis sets out the fiscal unit's current tax charge, and its blended tax rate. Temporary differences arise in both sources of income.

### Current tax computation

	Source 1	Source 2	Total
	€	€	€
Accounting and taxable profit	1,100	13,000	14,100
Less temporary differences	(100)	(4,000)	(4,100)
<b>Taxable profit</b>	<b>1,000</b>	<b>9,000</b>	<b>10,000</b>
Applicable tax rate	35%	5%	
<b>Current tax expense</b>	<b>350</b>	<b>450</b>	<b>800</b>

### Deferred tax computation

	Source 1	Source 2	Total
	€	€	€
Movement in temporary difference	100	4,000	4,100
Applicable tax rate	35%	5%	
<b>Deferred tax expense</b>	<b>35</b>	<b>200</b>	<b>235</b>
<b>Total tax expense</b>	<b>385</b>	<b>650</b>	<b>1,035</b>

In subsequent years when the liability is settled, the reversal of the DTL will also be measured using the above rates.

It should be noted that whilst the blended rate of current tax is of 8% (as illustrated in Illustration 1), the effective tax rate in year 202X (i.e. total tax expense of €1,035 divided by the accounting profit of €14,100) is of 7.3%. The difference between the effective tax rate and the blended rate of 8% is attributable to the fact that the blended rate is calculated on the basis of taxable profit only, i.e. it ignores deferred tax.

**Illustration 3 below gives an example where, in addition to temporary differences, there are also non-temporary differences between a fiscal unit's accounting profit (loss) and its taxable profit (loss).**

Illustration 3: Measurement of a fiscal unit's tax expense (income), and deferred tax balances on temporary differences

A fiscal unit has two sources of income in year 202X, Source 1 and Source 2. The following analysis sets out the fiscal unit's current tax charge, and its blended tax rate. Temporary and non-temporary differences arise in both sources of income.

Current tax computation

	Source 1	Source 2	Total
	€	€	€
Accounting profit	1,000	12,800	13,800
Add non-deductable expenditure	100	200	300
Less temporary differences	(100)	(4,000)	(4,100)
	1,000	9,000	10,000
Applicable tax rate	35%	5%	
Current tax expense	350	450	800

Deferred tax computation

	Source 1	Source 2	Total
	€	€	€
Movement in temporary difference	100	4,000	4,100
Applicable tax rate	35%	5%	
Deferred tax expense	35	200	235
Total tax expense	385	650	1,035

In subsequent years when the liability is settled, the reversal of the DTL will also be measured using the above rates.

In this illustration, the blended current tax rate is 8%, whilst the total effective tax rate for year 202X is 7.5% (i.e. total tax expense of €1,035 divided by the accounting profit of €13,800).

The estimation required when there are DTA and DTL balances could involve significant judgement, particularly where there are loss-making entities within a fiscal unit. This is because those losses carried forward may eventually be offset against profits within the fiscal unit that may be taxable at different rates to those applicable to the revenue source which gave rise to the tax loss. Taking an example where:

- a fiscal unit comprises a parent and a subsidiary,
- the parent's profits are taxed at 35% whereas the subsidiary's profits are taxed at 5%, and
- the subsidiary incurs a tax loss that exceeds the parent's taxable profits,

the subsidiary's tax loss is carried forward and will be available to offset future taxable profits. Those tax losses may however be absorbed by profits of the parent or by profits of the subsidiary, depending on the timelines when the parent and the subsidiary next generate taxable profits. For example, that subsidiary's tax loss could be absorbed:

- by the parent's taxable profits if the subsidiary once again incurs a tax loss in the subsequent year, or
- by the subsidiary's taxable profits if the subsidiary generates sufficient taxable profits in the subsequent year.

Situations could also arise where the losses carried forward may be partially absorbed by profits that are taxed at one rate, and partially by profits that are taxed at a different rate; they could also be partially absorbed in one year, and partially carried forward once again to subsequent years.

In such situations, consideration needs to be given by preparers and auditors to whether detailed scheduling of future expected reversals of temporary differences and absorption of tax losses is required in order to properly measure the entities' DTA and, as applicable, DTL. For entities applying IFRS, consideration will also need to be given to whether additional disclosures will be required under paragraph 125 of IAS 1 to provide information about assumptions made about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

#### **4.2.2 Other considerations relevant to the recognition of deferred tax balances**

MIA members are reminded that both IAS 12 and Section 16 of GAPSME contain requirements that address those situations in which DTL and DTA must be recognised, as well as those situations in which DTL and DTA cannot be recognised (for instance, upon the recognition of goodwill). The formation of a fiscal unit does not override those requirements, and the recognition of deferred tax balances must be assessed within the context of those requirements.

#### **4.2.3 Presentation in the FUCFS**

In addition to presenting an entity's tax expense (income) in its income statement, and disclosing information – about deferred tax balances, and movements therein – within the notes to the financial statements, paragraph 81(c) of IAS 12 also requires disclosure of, "an explanation of the relationship between tax expense (income) and accounting

profit in either or both of the following forms:

- i. a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or
- ii. a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed.”

Paragraph 16.34 of GAPSME also requires medium-sized entities to disclose a reconciliation, adopting the format from paragraph 81(c)(i) of IAS 12.

The above requirements in IAS 12 and in Section 16 of GAPSME deliberately consider the possibility that more than one rate of tax may be applicable to an entity's income. The MIA considers preparers to have flexibility through an accounting policy choice on what tax rate to use for the purposes of disclosing the reconciliation. Specifically, the MIA considers that the following approaches could all comply with the requirements of IAS 12 or Section 16 of GAPSME:

1. apply the applicable tax rate to each source of income's accounting profit before tax; or
2. apply the Maltese domestic tax rate of 35% to the fiscal unit's accounting profit before tax; or
3. apply the predominant tax rate applicable to the fiscal unit's accounting profit before tax.

It is important to keep in mind that the choice should reflect what the preparers believe will provide the most meaningful information to users of the financial statements. Depending on the approach selected, if the nature of the income (and the rate) changes, the applicable tax rate will need to be reassessed.

The following illustrations show how the selection of the applicable tax rate affects the presentation of the numerical reconciliation.

#### Illustration 4: Presentation of a numerical reconciliation

Following on from Illustration 1, the three approaches to the presentation of a numerical reconciliation would result in the following disclosures:

	(1)	(2)	(3)
	€	€	€
Profit before tax	10,000	10,000	10,000
Tax at the applicable rates / rate of 35% / rate of 5%*	800	3,500	500
Tax effect of:			
- income subject to tax at different rates	-	(2,700)	300
Tax expense	800	800	800

\* The figures are obtained as follows:

(1)  $(€1,000 \times 35\%) + (€9,000 \times 5\%)$ ;

(2)  $€10,000 \times 35\%$ ;

(3)  $€10,000 \times 5\%$ .

Meanwhile, in respect of Illustration 2, the three approaches would result in the following reconciliations:

	(1)	(2)	(3)
	€	€	€
Profit before tax	14,100	14,100	14,100
Tax at the applicable rates / rate of 35% / rate of 5%*	1,035	4,935	705
Tax effect of:			
- income subject to tax at different rates	-	(3,900)	330
Tax expense	1,035	1,035	1,035

\* The figures are obtained as follows:

(1)  $(€1,100 \times 35\%) + (€13,000 \times 5\%)$ ;

(2)  $€14,100 \times 35\%$ ;

(3)  $€14,100 \times 5\%$ .

Finally, in respect of Illustration 3, the three approaches would result in the following reconciliations:

	(1)	(2)	(3)
	€	€	€
Profit before tax	13,800	13,800	13,800
Tax at the applicable rates / rate of 35% / rate of 5%*	990	4,830	690
Tax effect of:			
- income subject to tax at different rates	-	(3,900)	330
-non-deductible expenditure	45	105	15
Tax expense	1,035	1,035	1,035

\* The figures are obtained as follows:

(1)  $(€1,000 \times 35\%) + (€12,800 \times 5\%)$ ;

(2)  $€13,800 \times 35\%$ ;

(3)  $€13,800 \times 5\%$ .

### 4.3 Recognition and measurement of tax balances within the principal taxpayer's and the subsidiaries' financial statements

#### 4.3.1 Recognition and measurement of tax balances in the income statement

##### 4.3.1.1 Applicable tax rate

As discussed in section 4.2.1.1 of these Guidance Notes on page 10, a fiscal unit's blended tax rate is a figure that is derived from (a) a fiscal unit's different sources of income, (b) the amount of such taxable income, and (c) the rate of tax applicable to each source of taxable income. Such rates will typically range from 5% (for those sources of income which previously entitled the shareholder to a refund of 6/7 of all the taxes paid by the fiscal unit members) to 35% (for those sources of income on which no refund could previously be claimed)<sup>3</sup>.

In the absence of a fiscal unit, each entity is directly subjected to tax obligations arising from its taxable profit (tax loss); its tax computation in such a scenario forms the basis for the entity's tax return and, accordingly, its assessment of tax obligations.

However, members of a fiscal unit are not individually subject to tax, and any tax computation performed at the level of an individual member of a fiscal unit is a 'notional' tax computation to assess how much of the fiscal unit's tax obligations relate to that member<sup>4</sup>.

<sup>3</sup> These Guidance Notes consider scenarios where a standard corporate tax rate of 35% is applicable on an entity's taxable profits.

<sup>4</sup>The notional tax computation is also necessary to satisfy certain requirements related to the fiscal unit's tax computation.

As the actual tax obligations only arise at the level of the fiscal unit, the MIA considers it best practice for individual fiscal unit members to apply, both for current tax and for deferred tax purposes, the same rate or rates of tax as their sources of income are assessed at the level of the fiscal unit itself as these are the only tax rates to which their taxable profit (tax loss) will be subject.

Therefore, if a fiscal unit member's sources of income previously entitled the shareholder to a refund of 6/7 of the taxes paid, that fiscal unit member should apply a tax rate of 5% to those sources of income, being the only rate at which that income will be taxed once it forms part of the fiscal unit. Similarly:

- if a fiscal unit member's sources of income previously entitled the shareholder to a refund of 5/7 of the taxes paid, that fiscal unit member should apply a tax rate of 10% to those sources of income, and
- if a fiscal unit member's sources of income did not previously entitle the shareholder to a refund, that fiscal unit member should apply a tax rate of 35% to those sources of income.

#### 4.3.1.2 Current tax expense

As set out on page 7 of these Guidance Notes, paragraph 5 of IAS 12 defines current tax as, "the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period," and taxable profit (tax loss) as, "the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)." GAPSME's Section 16 has consistent definitions.

It is important to note that the definition of taxable profit (tax loss) makes reference to profit (or loss) based, "upon which income taxes are payable (recoverable)". The definition clearly focuses on profits (or losses) that give rise to tax implications; no weighting, or reference, is given in the definition to which entity is liable to settle any resulting tax obligations.

Within the context of a fiscal unit, 'taxable profit' is assessed at the level of the fiscal unit's consolidated income statement.

That being said, the MIA believes that the profit (or loss), "upon which income taxes are payable (recoverable)" arises in each fiscal unit member, including the parent entity. The MIA therefore believes it to be best practice that, despite the principal taxpayer having the primary obligation at law to remit tax payments to the tax authorities, each individual member of a fiscal unit notionally has a 'taxable profit' – being the taxable profit that the entity would have registered had it not formed part of the fiscal unit – and should accordingly recognise a current tax expense in relation to those taxable profits.

The following table sets out which entity the MIA believes should recognise current tax expense in the income statement:

<b>Entity having taxable income</b>	<b>Entity that should recognise a current tax expense</b>
Fiscal unit's parent (i.e. the principal taxpayer)	Fiscal unit's parent
Subsidiaries	Each individual subsidiary having a taxable profit

*Table 5: Recognition of current tax expense*

These Guidance Notes acknowledge that as a result of consolidation adjustments, a fiscal unit member's profit before tax on a stand-alone basis may differ from the profit before tax that it contributes to the group, for instance where intra-group sales are adjusted on consolidation. A question therefore arises regarding whether the fiscal unit's subsidiaries should consider 'taxable profit' to represent:

- the profit figure that would be determined at a stand-alone level, i.e. ignoring any consolidation adjustments referred to in section 2 of these Guidance Notes (a "Stand-Alone Approach"), or
- the profit figure that the subsidiary contributes to the fiscal unit's profit before tax, i.e. after having recognised consolidation adjustments (a "Fiscal Unit Approach").

The MIA considers both these approaches to be consistent with the IASB's Conceptual Framework for Financial Reporting and with Section 3 of GAPSME, and therefore considers preparers to have an accounting policy choice. Numerical examples of each of the approaches are included in Illustration 6, Illustration 7, Illustration 8, and Illustration 9 set out on page 26 onwards.

The accounting policy choice also has implications on the recognition and measurement of DTA on tax losses and unabsorbed capital allowances carried forward (as addressed on page 34).

#### 4.3.1.3 Intra-group funding arrangements

As set out above, each member of a fiscal unit should recognise a tax expense on its notional taxable profit. Nevertheless, the Rules set out that the fiscal unit's parent company is the principal taxpayer. Subsidiaries of a fiscal unit's parent entity will therefore only have obligations directly towards the tax authorities – by virtue of being jointly and severally liable – in the event that the principal taxpayer defaults on its obligations to remit tax payments to the tax authorities.

Accordingly, the MIA believes that when a subsidiary recognises a current tax expense and a current tax liability, it should immediately derecognise the current tax liability as it is not the subsidiary that has the primary obligation to the tax authorities; what is recognised in place of the current tax liability depends on what arrangement is in place between the principal taxpayer and its subsidiaries.

Conversely, a parent entity should recognise a current tax liability, with the arrangement in place between the principal taxpayer and the subsidiaries also determining what contra-entries a parent entity should record.

It should be borne in mind that it is not the purpose of these Guidance Notes to address what type of intra-group arrangement could potentially work better for which fiscal units, and the below comments solely address the accounting implications of different

types of arrangements.

Members are reminded that disclosure requirements arise under both IAS 24 and Section 20 of GAPSME in respect of related parties, together with balances and transactions with those related parties; preparers and auditors should give due consideration to the need to disclose information related to intra-group tax arrangements.

#### 4.3.1.3.1 No tax funding arrangement is in place

Where no tax funding arrangement is in place, a parent entity assumes its subsidiaries' obligations to remit tax payments to the tax authorities without requiring its subsidiaries to transfer assets or other economic benefits to it.

As set out in section 4.1.2 on page 9 of these Guidance Notes, one of the key principles within the definitions of 'income' and 'expense' is that transactions with equity participants do not give rise to income or expense if those transactions are carried out with the equity participants in their capacity of equity participants (i.e. the transactions lack commercial substance).

The MIA considers the assumption by a parent entity of its subsidiaries' tax obligations where no tax funding arrangement is in place to be a transaction that lacks commercial substance. In other words, such an arrangement is one in which a parent entity and its subsidiaries do not exchange items of equal or similar value, and the reason for this is purely attributable to the equity ownership that a parent entity has in its subsidiaries.

Accordingly, the assumption by a parent entity of its subsidiaries' tax obligations does not represent an expense to a parent entity, and neither does it represent income to a subsidiary. The MIA therefore considers it appropriate for:

- a parent entity to recognise an investment in its subsidiaries that is equivalent to their current tax liability, and
- the subsidiaries to recognise a contribution from the parent entity directly within their equity reserves.

#### 4.3.1.3.2 A tax funding arrangement is in place

Where a tax funding arrangement is in place, a parent entity assumes its subsidiaries' obligations to remit tax payments to the tax authorities and requires its subsidiaries to transfer assets or other economic benefits to it. Such arrangements will give rise to the subsidiaries recognising a payable to the parent entity, and the parent entity conversely recognising a receivable from the subsidiaries.

That being said, the required accounting entries will also depend on how much a subsidiary is required to remit to its parent entity under the arrangement in place between them. Different arrangements may be in place between a principal taxpayer and its subsidiaries, for instance the intra-group obligation may be based on:

- a subsidiary's accounting profit or its taxable profit (multiplied by a tax rate); or
- a subsidiary's IFRS or GAPSME profit before tax or its IFRS or GAPSME profit before tax as adjusted for intra-group profits or expenses (multiplied by a tax rate); or
- a tax rate that reflects the rate incurred by the fiscal unit or a tax rate that reflects the rate that would have been incurred by the subsidiary had it not formed part of

the fiscal unit (multiplied by a subsidiary's profit).

The arrangement between a principal taxpayer and its subsidiaries is a private agreement between the entities themselves, and the above permutations are non-exhaustive. In accounting for such arrangements, the amount of the intra-group receivable/payable must reflect the arrangement actually in place between a parent entity and its subsidiaries; the following table sets out the accounting implications if the amount of the intra-group receivable/payable is different to a subsidiary's current tax expense:

<b>Amount required by the arrangement to be remitted by a subsidiary to the parent entity</b>	<b>Accounting implications on the subsidiary's derecognition of the current tax liability</b>
A subsidiary is required to remit an amount that is less than its current tax expense.	The difference between the derecognised current tax liability and the payable to the parent should be recognised as a contribution from the parent entity directly within a subsidiary's equity reserves; the parent entity should recognise an investment in the subsidiary for an equivalent amount.
A subsidiary is required to remit an amount that is more than its current tax expense.	<p>The difference between the derecognised current tax liability and the payable to the parent entity represents a deemed distribution of a subsidiary's assets to the parent entity, and should be recognised as a distribution to the parent entity directly within a subsidiary's equity reserves; the parent entity should recognise dividend income for an equivalent amount.</p> <p>In such a scenario, preparers will also need to be consider the requirements of the Companies Act, under which a company – in this case a subsidiary of the fiscal unit – may only make distributions to its shareholders from profits that are available for distribution.</p>

*Table 6: Accounting implications of having a tax funding arrangement where the intra-group balance does not equal a subsidiary's current tax expense*

These Guidance Notes bring to the MIA members' attention that the complete absence of an agreement between the principal taxpayer and its subsidiaries would pose a difficulty for preparers as they would be required to interpret, at law, what rights and obligations exist between the principal taxpayer and its subsidiaries; these Guidance Notes do not provide any advice in this regard, and it is recommended that a formal arrangement is entered into between all members of a fiscal unit, thus avoiding such interpretative challenges.

The above accounting considerations are illustrated in Illustration 5 below.

### Illustration 5: Recognition of current tax balances

A fiscal unit comprises two entities in year 202X, the parent entity ("Parent") and one subsidiary ("Subsidiary"). Each company's profit before tax, and tax rate applicable to those profits, is set out below. For both entities, their accounting profit and taxable profit are equal to each other.

	Parent €	Subsidiary €	Fiscal unit €
Accounting and taxable profit	1,000	9,000	10,000
Applicable tax rate	35%	5%	
Current tax expense	350	450	800

The fiscal unit's blended tax rate in year 202X is 8% (being €800 divided by €10,000).

The following accounting entries are recognised by Subsidiary and by Parent in respect of current tax:

<i>Subsidiary</i>	€	€
Dr Tax expense	450	
Cr Current tax liability		450
 <i>Parent</i>		
Dr Tax expense	350	
Cr Current tax liability		350

Additionally, Subsidiary must derecognise its current tax liability as this is assumed by Parent. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) to (d) below.

#### a) Where no tax funding arrangement is in place

<i>Subsidiary</i>	€	€
Dr Current tax liability	450	
Cr Capital reserves		450
 <i>Parent</i>		
Dr Investment in Subsidiary	450	
Cr Current tax liability		450

b) Where a tax funding arrangement is in place, and Subsidiary is required to remit €450 to Parent

<i>Subsidiary</i>	€	€
Dr Current tax liability	450	
Cr Payable to Parent		450
 <i>Parent</i>		
Dr Receivable from Subsidiary	450	
Cr Current tax liability		450

c) Where a tax funding arrangement is in place, and Subsidiary is required to remit €250 to Parent (i.e. less than the current tax liability)

<i>Subsidiary</i>	€	€
Dr Current tax liability	450	
Cr Payable to Parent		250
Cr Capital reserves		200
 <i>Parent</i>		
Dr Receivable from Subsidiary	250	
Dr Investment in Subsidiary	200	
Cr Current tax liability		450

d) Where a tax funding arrangement is in place, and Subsidiary is required to remit €500 to Parent (i.e. more than the current tax liability)

<i>Subsidiary</i>	€	€
Dr Current tax liability	450	
Dr Distribution to Parent <sup>5</sup>	50	
Cr Payable to Parent		500

<sup>5</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

*Parent*

Dr Receivable from Subsidiary	500	
Cr Dividend income from Subsidiary		50
Cr Current tax liability		450

Under each of scenarios (a) to (d), a current tax expense of €800 and a current tax liability of €800 are recognised within the FUCFS; as applicable, Parent’s receivable from Subsidiary, investment in Subsidiary and dividend income from Subsidiary, together with Subsidiary’s payable to Parent, capital reserve (or other similar description) and distribution to Parent are eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes.

Illustration 6, Illustration 7, Illustration 8, and Illustration 9 illustrate the accounting entries that the MIA considers to be best practice when there are intra-group transactions under each of the “Stand-Alone Approach” and the “Fiscal Unit Approach”. The following table sets out the scenarios addressed in each illustration:

<b>Illustration</b>	<b>Key facts</b>	<b>Approach</b>
Illustration 6	There are no unrealised profits at the reporting date	“Stand-Alone Approach”
Illustration 7	There are no unrealised profits at the reporting date	“Fiscal Unit Approach”
Illustration 8	Unrealised profits at the reporting date are adjusted upon consolidation	“Stand-Alone Approach”
Illustration 9	Unrealised profits at the reporting date are adjusted upon consolidation	“Fiscal Unit Approach”

*Table 7: Overview of illustrations*

It is important to bear in mind that within the context of a fiscal unit, intra-group transfers of assets from one fiscal unit member to another do not change the tax base of the transferred asset, as the intra-group transfer is reversed in the FUCFS through the consolidation procedures. From the perspective of the fiscal unit member that purchases assets from another fiscal unit member, the asset’s tax base at initial recognition is likely to be different to its accounting carrying amount at initial recognition. Under paragraphs 15 and 24 of IAS 12, and likewise under paragraphs 16.9 and 16.10 of GAPSME, the fiscal unit member that purchased the asset does not recognise a DTA or DTL if the transaction is not a business combination and at the time of the transaction, it affects neither accounting profit nor taxable profit (tax loss).

**Illustration 6: Recognition of current tax balances when there are intra-group sales and the “Stand-Alone Approach” is adopted; no tax funding arrangement is in place**

A fiscal unit comprises three entities in year 202X, the parent entity (“Parent”) and two subsidiaries (“Subsidiary A” and “Subsidiary B”). Each company’s profit before tax, and tax rate applicable to those profits, is set out below. There are no temporary differences. Subsidiary A’s profit before tax arises entirely from the sale of inventories to Subsidiary B, and Subsidiary B’s profit before tax arises from selling all those inventories to third parties outside of the fiscal unit.

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Accounting and taxable profit	-	10,000	5,000	15,000
Consolidation adjustments	-	(10,000)	10,000	-
Consolidated accounting and taxable profit	-	-	15,000	15,000
Applicable tax rate	5%	5%	5%	
Current tax expense	-	500	250	750

The following accounting entries are recognised by the fiscal unit members in respect of current tax:

<i>Subsidiary A</i>	€	€
Dr Tax expense	500	
Cr Current tax liability		500

<i>Subsidiary B</i>	€	€
Dr Tax expense	250	
Cr Current tax liability		250

Additionally, Subsidiary A and Subsidiary B must derecognise their current tax liabilities as these are assumed by the Parent.

<i>Subsidiary A</i>	€	€
Dr Current tax liability	500	
Cr Capital reserves		500

<i>Subsidiary B</i>	€	€
Dr Current tax liability	250	
Cr Capital reserves		250

<i>Parent</i>	€	€
Dr Investment in Subsidiary A	500	
Dr Investment in Subsidiary B	250	
Cr Current tax liability		750

A current tax expense of €750 and a current tax liability of €750 are recognised within the FUCFS; Parent's investment in Subsidiary A and in Subsidiary B, together with Subsidiary A's and Subsidiary B's capital reserves (or other similar description) are eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes.

Had there been a tax funding arrangement in place, Parent, Subsidiary A and Subsidiary B would have applied the guidance in Illustration 5 when derecognising the current tax liability.

**Illustration 7: Recognition of current tax balances when there are intra-group sales and the “Fiscal Unit Approach” is adopted; no tax funding arrangement is in place**

This illustration assumes an identical fact pattern to Illustration 6, in which Subsidiary A's profits are entirely derived from sales of inventory to Subsidiary B, however the subsidiaries adopt the “Fiscal Unit Approach”. Each company's profit before tax, and tax rate applicable to those profits, is set out below.

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Accounting profit	-	10,000	5,000	15,000
“Fiscal Unit Approach” adjustment	-	(10,000)	10,000	-
<b>Taxable profit</b>	<b>-</b>	<b>-</b>	<b>15,000</b>	<b>15,000</b>
Applicable tax rate	5%	5%	5%	
<b>Current tax expense</b>	<b>-</b>	<b>-</b>	<b>750</b>	<b>750</b>

Under the “Fiscal Unit Approach”, Subsidiary A's accounting profit before tax is adjusted to eliminate the intra-group profit, which is accordingly recognised as taxable income of Subsidiary B.

The following accounting entries are recognised by the fiscal unit members in respect of current tax:

<i>Subsidiary B</i>	€	€
Dr Tax expense	750	
Cr Current tax liability		750

Additionally, Subsidiary B must derecognise its current tax liability as this is assumed by the Parent.

<i>Subsidiary B</i>	€	€
Dr Current tax liability	750	
Cr Capital reserves		750
<i>Parent</i>	€	€
Dr Investment in Subsidiary B	750	
Cr Current tax liability		750

The numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate is presented as follows:

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Profit before tax	-	10,000	5,000	15,000
Tax at the rate of 5%	-	500	250	750
Tax effect of:				
- adjustment for profits within the fiscal unit	-	(500)	500	-
Tax expense	-	-	750	750

A current tax expense of €750 and a current tax liability of €750 are recognised within the FUCFS; Parent's investment in Subsidiary B, together with Subsidiary B's capital reserves (or other similar description) are eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes.

Had there been a tax funding arrangement in place, Parent and Subsidiary B would have applied the guidance in Illustration 5 when derecognising the current tax liability.

The substance of the "Fiscal Unit Approach" is that Subsidiary B computes its taxable income by taking a consistent view of:

- its accounting profit on the inventories bought from Subsidiary A as being the fiscal unit's accounting profit on those inventories; and
- the inventories' tax base being that of the fiscal unit.

Additional considerations are necessary where there are unrealised intra-group profits as at the reporting date, such as those arising upon the intra-group sale of inventories where the inventories are still held within the fiscal unit at the reporting date. Of particular relevance is the fact that the inventory's tax base does not change when an intra-group sale takes place; indeed, the tax base is determined at the level of the fiscal unit itself, as this is the taxable entity.

Taking an example where Subsidiary A and Subsidiary B are both members of the same fiscal unit, and Subsidiary A purchases inventory for €85,000 and sells it to Subsidiary B for €95,000:

- the fiscal unit does not recognise a profit until Subsidiary B sells the inventory to third parties;
- when Subsidiary B sells the inventory to third parties (for instance, at a sales value of €100,000), the tax base continues to remain €85,000; and
- the fiscal unit's taxable profit is of €15,000 when Subsidiary B sells the inventory to third parties.

The MIA considers that it is appropriate – particularly in respect of the fiscal unit member that purchases assets from a fellow fiscal unit member – to make different arguments under the “Stand-Alone Approach” and the “Fiscal Unit Approach”; these arguments, using an intra-group sale of inventory as an illustration, are set out in Table 8<sup>6</sup>:

Approach	Selling entity within the fiscal unit	Purchasing entity within the fiscal unit
“Stand-Alone Approach”	Whether the selling entity is, or is not, a member of the fiscal unit has no bearing on the inventory's cost for tax purposes.	<p>The underlying principle of the “Stand-Alone Approach” is that each entity calculates its taxable profit (tax loss) in a consistent manner with the way it would have done so had it not formed part of a fiscal unit.</p> <p>The MIA therefore considers it appropriate to assume that the inventory notionally has a tax cost that is equivalent to the theoretical amount it would have had, had the purchasing entity not formed part of a fiscal unit.</p> <p>Accordingly, the purchasing entity's notional taxable profit is represented by the difference between its sales price and the theoretical tax cost the inventory would have had, had the purchasing entity not formed part of the fiscal unit.</p>
“Fiscal Unit Approach”	The selling entity does not make a taxable profit on the intra-group sale of inventories, and no further considerations are required.	<p>The underlying principle of the “Fiscal Unit Approach” is that each entity calculates its taxable profit (tax loss) in a manner that reflects the taxable profit (tax loss) it contributes to the fiscal unit.</p> <p>The MIA considers it appropriate to assume that the inventory's tax cost is equivalent to fiscal unit's tax cost, and accordingly the purchasing entity's taxable profit from the sale of inventory to third parties is equivalent to the fiscal unit's taxable profit thereon.</p>

*Table 8: Considerations relevant to intra-group sales of assets, using inventory as an example*

<sup>6</sup> For the purpose of the discussion in Table 8, it is assumed that the same asset is only transferred once within the fiscal unit before being transferred to a party outside of the fiscal unit.

In summary, the MIA considers it best practice for a purchasing entity to calculate its taxable profit (tax loss) using a different notional tax cost for assets purchased intra-group, depending on whether it applies the “Stand-Alone Approach”, the “Fiscal Unit Approach” or another acceptable method.

Additional considerations must be made by the parent if there is a tax funding arrangement in place, the terms of which are such that:

- it creates an obligation in the selling subsidiary to pay the parent, and
- that obligation is created when the intra-group sale is made, irrespective of whether or not the fiscal unit will eventually register a taxable profit on a future sale to third parties.

Where such an arrangement is in place, the selling entity and the parent should respectively recognise an intra-group payable and receivable when the obligation arises under the terms of the arrangement, i.e. in the year in which the selling entity recognises a profit from an intra-group sale. From the parent’s perspective, the MIA considers it best practice for the parent to recognise a provision under IAS 37 or Section 17 of GAPSME if it is probable that the fiscal unit will eventually realise a profit from a sale to a third party (in which case the parent, as principal taxpayer, will have an obligation to remit income tax payments to the tax authorities).

The recognition of a provision arises because whilst the MIA considers the parent not to have a legal obligation:

- towards the tax authorities until and unless the fiscal unit effects a future transfer of the asset (at a profit) to a third party, or
- to refund the payment to the subsidiary if the fiscal unit does not transfer the asset (at a profit) to a third party,

the parent does have a constructive obligation to the subsidiary. That constructive obligation arises because by establishing the right to payment from the subsidiary, it has created a valid expectation in the subsidiary that it will discharge the fiscal unit’s obligation to settle tax payments when (and if) they crystallise, without the parent having any right to additional payment from the subsidiary. Other than in the case of utilisation of the provision upon crystallising tax liabilities, subsequent remeasurements of the provision would be recognised in the parent’s profit or loss in accordance with IAS 37 or Section 17 of GAPSME.

To the extent that the parent does not consider it probable that the fiscal unit will make a future taxable profit from a sale of the asset to a third party, then the parent should not recognise a provision under IAS 37 or Section 17 of GAPSME upon initial recognition of the receivable from the subsidiary as the recognition criteria for a provision would not be satisfied. In this case, the MIA considers it best practice for the parent to recognise a credit in profit or loss as the transaction does not give rise to a liability, and neither does the increase in its net assets arise from transactions with its shareholders. Preparers would need to give consideration to whether disclosures of contingent liabilities would be necessary in order to comply with IAS 37 or Section 17 of GAPSME.

The above considerations are illustrated in Illustration 8 and Illustration 9.

**Illustration 8: Recognition of current tax balances when there are unrealised profits on intra-group sales and the “Stand-Alone Approach” is adopted; no tax funding arrangement is in place**

This illustration assumes an identical fact pattern to Illustration 6, however all the inventories sold by Subsidiary A to Subsidiary B are still held by Subsidiary B at the end of Year 1. These inventories are subsequently sold to third parties by Subsidiary B during Year 2.

Each company's profit before tax, and tax rate applicable to those profits, is set out below.

*Year 1*

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Accounting and taxable profit	-	10,000	-	10,000
<u>Consolidation adjustments</u>	-	(10,000)	-	(10,000)
Consolidated accounting and taxable profit	-	-	-	-
Applicable tax rate	5%	5%	5%	-
Current tax expense	-	500		

*Year 2*

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Accounting and taxable profit	-	-	5,000	5,000
<u>Consolidation adjustments</u>	-	-	10,000	10,000
Consolidated accounting and taxable profit	-	-	15,000	15,000
Applicable tax rate	5%	5%	5%	
Current tax expense	-	-	250	750

The following accounting entries are recognised by the fiscal unit members in respect of current tax:

*Year 1*

	Subsidiary A	Parent	Fiscal Unit
	€	€	€
Dr Tax expense		500	
Cr Current tax liability			500

Additionally, Subsidiary A must derecognise its current tax liability; Parent does not however recognise a current tax liability as Subsidiary A's profit is reversed through the consolidation procedures and the fiscal unit has no liability, as at that date, towards the tax authorities.

<i>Subsidiary A</i>	€	€
Dr Current tax liability	500	
Cr Capital reserves		500
<i>Year 2</i>		
<i>Subsidiary B</i>		
Dr Tax expense	250	
Cr Current tax liability		250
Dr Current tax liability	250	
Cr Capital reserves		250
<i>Parent</i>		
Dr Investment in Subsidiary A	500	
Dr Investment in Subsidiary B	250	
Cr Current tax liability		750
<p>A current tax expense of €750 and a current tax liability of €750 are recognised within the FUCFS; Parent's investment in Subsidiary A and in Subsidiary B, together with Subsidiary A's and Subsidiary B's capital reserves (or other similar description) are eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes.</p> <p>Had there been a tax funding arrangement in place, Parent, Subsidiary A and Subsidiary B would have applied the guidance in Illustration 5 when derecognising the current tax liability. Additionally, Parent would have recognised a provision of €500 in Year 1 if it determined that a future crystallisation of a tax liability was probable. Upon crystallisation of the liability in Year 2, the recognition of a tax liability of €750 by Parent would not have an impact on its profit or loss, as its recognition would be offset by a release of €500 from the Year 1 provision, and by the recognition of a receivable of €250 from Subsidiary B in Year 2.</p>		

**Illustration 9: Recognition of current tax balances when there are unrealised profits on intra-group sales and the “Fiscal Unit Approach” is adopted; no tax funding arrangement is in place**

This illustration assumes an identical fact pattern to Illustration 8, however the subsidiaries adopt the “Fiscal Unit Approach”. Each company’s profit before tax, and tax rate applicable to those profits, is set out below.

*Year 1*

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Accounting profit	-	10,000	-	<sup>7</sup>
“Fiscal Unit Approach” adjustment	-	(10,000)	-	-
<b>Taxable profit</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Applicable tax rate	5%	5%	5%	-
Current tax expense	-	-	-	-

*Year 2*

	Parent	Subsidiary A	Subsidiary B	Fiscal Unit
	€	€	€	€
Accounting profit	-	-	5,000	15,000
“Fiscal Unit Approach” adjustment	-	-	10,000	-
<b>Taxable profit</b>	<b>-</b>	<b>-</b>	<b>15,000</b>	<b>15,000</b>
Applicable tax rate	5%	5%	5%	-
Current tax expense	-	-	750	750

The following accounting entries are recognised by the fiscal unit members in respect of current tax:

*Year 1*

No accounting entries are recognised as neither entity has a taxable profit or a current tax liability.

*Year 2*

*Subsidiary B*

Dr Current tax liability	750	
Cr Capital reserves		750

<sup>7</sup> The fiscal unit’s profit is nil in Year 1, as Subsidiary A’s profit is eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes. Likewise, following the consolidation adjustments in Year 2, the fiscal unit’s profit is €15,000.

*Parent*

Dr Investment in Subsidiary B	750	
Cr Current tax liability		750

A current tax expense of €750 and a current tax liability of €750 are recognised within the FUCFS; Parent's investment in Subsidiary B, together with Subsidiary B's capital reserves (or other similar description) are eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes.

Had there been a tax funding arrangement in place, Parent, Subsidiary A and Subsidiary B would have applied the guidance in Illustration 5 and in Illustration 8 when derecognising the current tax liability.

#### 4.3.1.4 Deferred tax balances on losses carried forward and unabsorbed capital allowances

##### 4.3.1.4.1 Subsidiaries' tax losses carried forward and unabsorbed capital allowances

###### 4.3.1.4.1.1 Recognition and measurement in the year in which the tax losses and unabsorbed capital allowances arise

Under paragraph 34 of IAS 12 and paragraph 16.11 of Section 16 of GAPSME, DTA on losses carried forward and on unused credits (such as unabsorbed capital allowances) can only be recognised, "to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised."

When an entity is a member of a fiscal unit and it notionally incurs a tax loss, that loss is immediately assumed by the fiscal unit itself, and is immediately available for the fiscal unit to either offset against its taxable income, or – if it has insufficient taxable profits from other members of the fiscal unit – to carry forward to future years. This is also true for unabsorbed capital allowances.

It is therefore possible for a situation to arise where:

- a subsidiary would be unable to recognise a DTA under IAS 12 or Section 16 of GAPSME if it had not been a member of a fiscal unit; and
- the fiscal unit itself is able to either offset that subsidiary's tax loss against its taxable income from other sources, or is alternatively able to recognise a DTA because it, "is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised."

The question that therefore arises is whether the fiscal unit's subsidiaries should perform the assessment of probability of future taxable profit by considering its own

<sup>7</sup> The fiscal unit's profit is nil in Year 1, as Subsidiary A's profit is eliminated through the consolidation procedures discussed in section 3 of these Guidance Notes. Likewise, following the consolidation adjustments in Year 2, the fiscal unit's profit is €15,000.

future taxable profits at a stand-alone level (the “Stand-Alone Approach”), or whether the assessment should be carried out with reference to the current and future taxable profits of the fiscal unit as a whole (the “Fiscal Unit Approach”). The MIA considers both these approaches to be consistent with the IASB’s Conceptual Framework for Financial Reporting and with Section 3 of GAPSME, and preparers therefore have an accounting policy choice. In summary, the MIA considers it best practice for an entity to recognise a deferred tax asset using either the “Stand-Alone Approach”, the “Fiscal Unit Approach” or another acceptable method.

Preparers should however note that the same approach should be applied consistently to the measurement of current tax balances (as discussed in section 4.3.1.2 on page 19 of these Guidance Notes), as well as deferred tax balances.

Table 9 and Table 10 set out the implications on a subsidiary’s recognition of DTA under the different approaches in a variety of scenarios.

<b>Scenario: Result of the probability assessment under a “Stand-Alone Approach”</b>	<b>Implications on the subsidiary’s recognition of DTA</b>
It is probable that the subsidiary’s future taxable profits would allow absorption of all the tax losses and unabsorbed credits carried forward.	Recognise the DTA in full.
It is probable that the subsidiary’s future taxable profits would allow absorption of some, but not all, the tax losses and unabsorbed credits carried forward.	Recognise a DTA only to the extent that it can be justified by the subsidiary’s own future taxable profits.
It is not probable that the subsidiary’s future taxable profits would allow absorption of tax losses and unabsorbed credits carried forward.	Do not recognise a DTA.

*Table 9: Recognition of DTA under the “Stand-Alone Approach”*

It is important to note that under the “Stand-Alone Approach”, no consideration is given to the fiscal unit’s present or future taxable profits. Thus, even if a fiscal unit’s profits from other members of the fiscal unit are sufficient to immediately offset (through consolidation) the subsidiary’s tax loss, the subsidiary just the same does not recognise a DTA. This contrasts with the “Fiscal Unit Approach”, as set out in Table 10.

<b>Scenario: Result of the probability assessment under a “Fiscal Unit Approach”</b>	<b>Implications on the subsidiary’s recognition of DTA</b>
It is probable that – to the extent that the subsidiary’s tax loss and credits are not immediately offset against the fiscal unit’s other taxable income – the fiscal unit’s future taxable profits will allow it to absorb all the remaining tax losses and unabsorbed credits carried forward.	Recognise the DTA in full.
The subsidiary’s tax loss and credits are not all immediately offset against the fiscal unit’s other taxable income, and it is probable that the fiscal unit’s future taxable profits would only allow it to absorb some of the tax losses and unabsorbed credits carried forward.	Recognise a DTA only to the extent that the fiscal unit either immediately offsets the tax loss against other taxable profits, or it is probable that the fiscal unit will have sufficient future taxable profits.
None of the subsidiary’s tax loss and credits are immediately offset against the fiscal unit’s other taxable income, and it is not probable that the fiscal unit’s future taxable profits would allow it to absorb the tax losses and unabsorbed credits carried forward.	Do not recognise a DTA.

*Table 10: Recognition of DTA under the “Fiscal Unit Approach”*

In accordance with the Rules, any deferred tax balances arising on a subsidiary’s losses carried forward and unabsorbed capital allowances are immediately transferred to the principal taxpayer (which is the recipient of the losses). Therefore, similar to current tax (and irrespective of whether it applies the “Stand-Alone Approach” or the “Fiscal Unit Approach”), a subsidiary must immediately derecognise any DTA it has recognised.

The below table sets out the accounting implications that the MIA considers to be best practice based on whether a subsidiary applies a “Stand-Alone Approach” or a “Fiscal Unit Approach”, as well as based on whether or not there is a tax funding arrangement in place.

Consistently with the earlier discussions on the transfer of economic benefits by an entity to its shareholders, the transfer of losses carried forward and unabsorbed capital allowances will represent a distribution to shareholders if it is not compensated by the transfer from the shareholders to the entity of assets of a similar value. Any such distributions will however need to be assessed within the context of the requirements of the Companies Act in terms of distributions only being allowed out of profits available for distribution.

Approach	Tax funding arrangement	Accounting implications of the subsidiary's derecognition of DTA
Stand-Alone	None	<p>The subsidiary recognises a distribution directly within its equity reserves, equivalent to the deferred tax that is derecognised; the parent entity recognises dividend income at an equivalent amount.</p> <p>To the extent that the fiscal unit is able to recognise a higher amount of DTA than the subsidiary was able to recognise, the parent entity also recognises an additional DTA, and an equivalent amount of tax income within its income statement.</p>
Stand-Alone	The arrangement entitles the subsidiary to a receivable from the parent entity that is equivalent to the amount of derecognised deferred tax.	The subsidiary recognises a receivable equivalent to the amount of derecognised deferred tax; the parent entity similarly recognises a payable.
Stand-Alone	The arrangement entitles the subsidiary to a receivable from the parent entity that is equivalent to the amount of deferred tax that the fiscal unit is able to recognise.	<p>The subsidiary recognises a receivable in accordance with the arrangement. To the extent that the receivable exceeds the amount of derecognised DTA, the subsidiary also recognises a contribution from shareholders directly within equity reserves.</p> <p>The parent entity recognises a payable in accordance with the arrangement, and recognises a DTA for an equivalent amount. Additionally, to the extent that the total DTA exceeds the amount of DTA derecognised by the subsidiary, the parent entity also recognises an investment in the subsidiary and tax income within its income statement.</p>
Fiscal Unit	None	The subsidiary recognises a distribution directly within its equity reserves, equivalent to the deferred tax that is derecognised; the parent entity recognises dividend income at an equivalent amount.
Fiscal Unit	The arrangement entitles the subsidiary to a receivable from the parent entity that is equivalent to the amount of deferred tax that the fiscal unit is able to recognise.	The subsidiary recognises a receivable equivalent to the amount of derecognised deferred tax; the parent entity similarly recognises a payable.

*Table 11: Accounting implications of a subsidiary transferring unabsorbed capital allowances and losses carried forward to the fiscal unit's parent*

The following illustrations are reflective of the above recognition and measurement principles.

**Illustration 10: Recognition and measurement of current and deferred tax balances on tax losses carried forward under the “Stand-Alone Approach”, where it is probable that both the subsidiary’s and the fiscal unit’s future taxable profits would allow absorption of all the tax losses carried forward**

A fiscal unit comprises two entities in year 202X, the parent entity (“Parent”) and one subsidiary (“Subsidiary”). Each company’s profit or loss before tax is set out below. Both entities’ applicable tax rate is 5%, and their accounting profit is equal to their taxable profit. It is probable that both Subsidiary’s and the fiscal unit’s future taxable profits would allow absorption of all the tax losses carried forward.

	Parent	Subsidiary	Fiscal Unit
	€	€	€
Accounting and taxable profit/ tax loss	1,000	(9,000)	(8,000)
Applicable tax rate	5%	5%	5%
Current tax expense	50	-	-

The following accounting entries represent each of Parent’s and Subsidiary’s recognition and measurement of current and deferred tax balances on their taxable profit/tax loss.

	€	€
<i>Subsidiary</i>		
Dr DTA	450	
Cr Tax income		450
<i>Parent</i>		
Dr Tax expense	50	
Cr Current tax liability		50

Additionally, Subsidiary must derecognise its DTA as this is transferred to the fiscal unit. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) and (b) below.

a) Where no tax funding arrangement is in place

	€	€
<i>Subsidiary</i>		
Dr Distribution to Parent <sup>8</sup>	450	
Cr DTA		450

<sup>8</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

*Parent*

Dr DTA	450	
Cr Divident Income from Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

b) Where a tax funding arrangement is in place, and Parent is required to remit €450 to Subsidiary

<i>Subsidiary</i>	€	€
Dr Receivable from Parent	450	
Cr DTA		450

*Parent*

Dr DTA	450	
Cr Payable to Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

Within the FUCFS, a DTA of €400 (being 5% of the fiscal unit's tax loss of €8,000) is recognised; under both scenarios in (a) and (b), the intra-group balances are eliminated upon consolidation as discussed in section 3 of these Guidance Notes.

As Parent immediately benefits from a reduction of €50 in its current tax payment obligations, the current tax liability is derecognised against an equivalent amount of DTA.

**Illustration 11: Recognition and measurement of current and deferred tax balances on tax losses carried forward under the "Fiscal Unit Approach", where it is probable that both the subsidiary's and the fiscal unit's future taxable profits would allow absorption of all of the tax losses carried forward**

This illustration assumes the same fact pattern as illustrated in Illustration 10, however Subsidiary adopts the "Fiscal Unit Approach".

The following accounting entries represent each of Parent's and Subsidiary's recognition and measurement of current and deferred tax balances on their taxable profit/tax loss.

<i>Subsidiary</i>	€	€
Dr DTA	450	

Cr Tax income		450
<i>Parent</i>		
Dr Tax expense	50	
Cr Current tax liability		50
<p>Additionally, Subsidiary must derecognise its DTA as this is transferred to the fiscal unit. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) and (b) below.</p>		
<u>a) Where no tax funding arrangement is in place</u>		
	€	€
<i>Subsidiary</i>		
Dr Distribution to Parent <sup>9</sup>	450	
Cr DTA		450
<i>Parent</i>		
Dr DTA	450	
Cr Dividend income from Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50
<u>b) Where a tax funding arrangement is in place, and Parent is required to remit €450 to Subsidiary</u>		
	€	€
<i>Subsidiary</i>		
Dr Receivable from Parent	450	
Cr DTA		450
<i>Parent</i>		
Dr DTA	450	
Cr Payable to Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

<sup>9</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

Within the FUCFS, a DTA of €400 (being 5% of the fiscal unit's tax loss of €8,000) is recognised; under both scenarios in (a) and (b), the intra-group balances are eliminated upon consolidation as discussed in section 3 of these Guidance Notes.

As Parent immediately benefits from a reduction of €50 in its current tax payment obligations, the current tax liability is derecognised against an equivalent amount of DTA.

**Illustration 12: Recognition and measurement of current and deferred tax balances on tax losses carried forward under the “Stand-Alone Approach”, where it is probable that the subsidiary’s future taxable profits would only allow absorption of some of the tax losses; it is however probable that the fiscal unit’s future taxable profits would allow absorption of all of the tax losses**

This illustration assumes the same fact pattern as illustrated in Illustration 10. In this illustration, however, although Subsidiary’s future taxable profits would only justify the recognition of a DTA of €200 (whereas the fiscal unit’s future taxable profits would allow absorption of all of the tax losses).

The following accounting entries represent each of Parent’s and Subsidiary’s recognition and measurement of current and deferred tax balances on their taxable profit/tax loss.

	€	€
<i>Subsidiary</i>		
Dr DTA	200	
Cr Tax income		200
<i>Parent</i>		
Dr Tax expense	50	
Cr Current tax liability		50

Additionally, Subsidiary must derecognise its DTA as this is transferred to the fiscal unit. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) to (c) below.

a) Where no tax funding arrangement is in place

<i>Subsidiary</i>		
Dr Distribution to Parent <sup>10</sup>	200	
Cr DTA		200
<i>Parent</i>		

Dr DTA	450	
Cr Dividend income from Subsidiary		200
Cr Tax income		250
Dr Current tax liability	50	
Cr DTA		50
<u>b) Where a tax funding arrangement is in place, and Parent is required to remit €200 to Subsidiary</u>		
<i>Subsidiary</i>	€	€
Dr Receivable from Parent	450	
Cr DTA		200
<i>Parent</i>		
Dr DTA	450	
Cr Payable to Subsidiary		200
Cr Tax income		250
Dr Current tax liability	50	
Cr DTA		50
<u>c) Where a tax funding arrangement is in place, and Parent is required to remit €450 to Subsidiary</u>		
<i>Subsidiary</i>	€	€
Dr Receivable from Parent	450	
Cr DTA		200
Cr Capital reserves		250
<i>Parent</i>		
Dr Investment in Subsidiary	250	
Dr DTA	450	
Cr Tax income		250
Cr Payable to Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

<sup>10</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

Within the FUCFS, a DTA of €400 (being 5% of the fiscal unit's tax loss of €8,000) is recognised; under each of scenarios (a) to (c), the intra-group balances are eliminated upon consolidation as discussed in section 3 of these Guidance Notes.

As Parent immediately benefits from a reduction of €50 in its current tax payment obligations, the current tax liability is derecognised against an equivalent amount of DTA.

**Illustration 13: Recognition and measurement of current and deferred tax balances on tax losses carried forward under the “Fiscal Unit Approach”, where it is probable that the subsidiary’s future taxable profits would only allow absorption of some of the tax losses; it is however probable that the fiscal unit’s future taxable profits would allow absorption of all of the tax losses**

This illustration assumes the same fact pattern as illustrated in Illustration 10. In this illustration, however, although Subsidiary's future taxable profits would only justify the recognition of a DTA of €200, the fiscal unit's future taxable profits justify the recognition of a DTA on all tax losses carried forward.

The following accounting entries represent each of the Parent's and the Subsidiary's recognition and measurement of current and deferred tax balances on their taxable profit/tax loss.

<i>Subsidiary</i>	€	€
Dr DTA	450	
Cr Tax income		450
 <i>Parent</i>		
Dr Tax expense	50	
Cr Current tax liability		50

Additionally, Subsidiary must derecognise its DTA as this is transferred to the fiscal unit. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) and (b) below.

a) Where no tax funding arrangement is in place

<i>Subsidiary</i>		
Dr Distribution to Parent <sup>11</sup>	450	
Cr DTA		450

<sup>11</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

*Parent*

Dr DTA	450	
Cr Dividend income from Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

b) Where a tax funding arrangement is in place, and Parent is required to remit €450 to Subsidiary

<i>Subsidiary</i>	€	€
Dr Receivable from Parent	450	
Cr DTA		450

*Parent*

Dr DTA	450	
Cr Payable to Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

Within the FUCFS, a DTA of €400 (being 5% of the fiscal unit's tax loss of €8,000) is recognised; under each of scenarios (a) to (b), the intra-group balances are eliminated upon consolidation as discussed in section 3 of these Guidance Notes.

As Parent immediately benefits from a reduction of €50 in its current tax payment obligations, the current tax liability is derecognised against an equivalent amount of DTA.

**Illustration 14: Recognition and measurement of current and deferred tax balances on tax losses carried forward under the "Stand-Alone Approach", where it is not probable that the subsidiary's future taxable profits would allow absorption of any of the tax losses; it is however probable that the fiscal unit's future taxable profits would allow absorption of all of the tax losses**

This illustration assumes the same fact pattern as illustrated in Illustration 10. In this illustration, however, Subsidiary's future taxable profits do not justify the recognition of a DTA (whereas the fiscal unit's future taxable profits would allow absorption of all of the tax losses).

The following accounting entries represent each of the Parent's and the Subsidiary's recognition and measurement of current and deferred tax balances on their taxable profit/tax loss.

<i>Subsidiary</i>	€	€
N/A		
<i>Parent</i>		
Dr Tax expense	50	
Cr Current tax liability		50

Additionally, Parent must recognise the DTA as this is transferred to the fiscal unit. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) and (b) below.

a) Where no tax funding arrangement is in place

<i>Subsidiary</i>	€	€
N/A		
<i>Parent</i>		
Dr DTA	450	
Cr Tax income		450
Dr Current tax liability	50	
Cr DTA		50

b) Where a tax funding arrangement is in place, and Parent is required to remit €450 to Subsidiary

<i>Subsidiary</i>	€	€
Dr Receivable from Parent	450	
Cr Capital reserves		450
<i>Parent</i>		
Dr Investment in Subsidiary	450	
Dr DTA	450	
Cr Tax income		450
Cr Payable to Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

Within the FUCFS, a DTA of €400 (being 5% of the fiscal unit's tax loss of €8,000) is recognised; under both scenarios (a) and (b), the intra-group balances are eliminated upon consolidation as discussed in section 3 of these Guidance Notes.

As Parent immediately benefits from a reduction of €50 in its current tax payment obligations, the current tax liability is derecognised against an equivalent amount of DTA.

**Illustration 15: Recognition and measurement of current and deferred tax balances on tax losses carried forward under the “Fiscal Unit Approach”, where it is not probable that the subsidiary’s future taxable profits would allow absorption of any of the tax losses; it is however probable that the fiscal unit’s future taxable profits would allow absorption of all of the tax losses**

This illustration assumes the same fact pattern as illustrated in Illustration 10. In this illustration, however, although Subsidiary’s future taxable profits do not justify the recognition of a DTA, the fiscal unit’s future taxable profits justify the recognition of a DTA on all tax losses carried forward.

The following accounting entries represent each of the Parent’s and the Subsidiary’s recognition and measurement of current and deferred tax balances on their taxable profit/tax loss.

	€	€
<i>Subsidiary</i>		
Dr DTA	450	
Cr Tax income		450
<i>Parent</i>		
Dr Tax expense	50	
Cr Current tax liability		50

Additionally, Subsidiary must derecognise its DTA as this is transferred to the fiscal unit. The accounting entries are dependent on the extent of any intra-group funding arrangement; these are considered in the variants (a) and (b) below.

a) Where no tax funding arrangement is in place

	€	€
<i>Subsidiary</i>		
Dr Distribution to Parent <sup>12</sup>	450	
Cr DTA		450
<i>Parent</i>		
Dr DTA	450	
Cr Dividend income from Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

<sup>12</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

b) Where a tax funding arrangement is in place, and Parent is required to remit €450 to Subsidiary

	€	€
<i>Subsidiary</i>		
Dr Receivable from Parent	450	
Cr DTA		450
<i>Parent</i>		
Dr DTA	450	
Cr Payable to Subsidiary		450
Dr Current tax liability	50	
Cr DTA		50

Within the FUCFS, a DTA of €400 (being 5% of the fiscal unit's tax loss of €8,000) is recognised; under each of scenarios (a) to (b), the intra-group balances are eliminated upon consolidation as discussed in section 3 of these Guidance Notes.

As Parent immediately benefits from a reduction of €50 in its current tax payment obligations, the current tax liability is derecognised against an equivalent amount of DTA.

#### 4.3.1.4.1.2 Recognition and measurement in subsequent years

As discussed in section 4.3.1.4.1.1 of these Guidance Notes, a subsidiary is notionally required to perform an assessment of the probability of future taxable profits against which the tax losses carried forward and unabsorbed capital allowances can be utilised; the subsidiary recognises a deferred tax asset – which is then immediately derecognised – based on this assessment.

Given that the tax losses carried forward and unabsorbed capital allowances are immediately assumed by the fiscal unit itself, the MIA believes that in subsequent years, a subsidiary should not – with respect to tax losses of previous years – reassess the probability of future taxable profits at each reporting date. Therefore:

- any distributions recognised in previous years are not reversed by a subsidiary if the fiscal unit is no longer able to recognise a deferred tax asset; and
- no distributions (and no additional deferred tax assets) should be recognised by a subsidiary in a subsequent year if the fiscal unit was initially unable to recognise a deferred tax asset, and in a subsequent year recognises a deferred tax asset on those tax losses carried forward and unabsorbed capital allowances.

Meanwhile, if a tax funding arrangement is in place, the accounting treatment depends on when the contractual rights and obligations to intra-group receivables and payables arise:

- if the intra-group receivables and payables are established in the year in which the tax losses and unabsorbed capital allowances arise, the accounting treatment as was discussed in section 4.3.1.4.1.1 of these Guidance Notes would have been adopted in the year in which those tax losses and unabsorbed capital allowances had arisen; and
- if the intra-group receivables and payables are only established in a subsequent reporting period (for instance when the fiscal unit is able to utilise the tax losses carried forward and unabsorbed capital allowances or recognise a deferred tax asset thereon), the subsidiary should record the intra-group receivable against a capital reserve, and the parent entity should record the intra-group payable against an investment in the subsidiary.

#### 4.3.1.4.2 Parent entity's losses carried forward and unabsorbed capital allowances

The MIA considers it best practice for a parent entity's losses carried forward and unabsorbed capital allowances to be assessed under paragraph 34 of IAS 12 and paragraph 16.11 of Section 16 of GAPSME by reference to whether it is probable that the fiscal unit will have available future taxable profit, "against which the unused tax losses and unused tax credits can be utilised."

#### 4.3.1.5 Deferred tax balances on temporary differences

DTA and DTL should – subject to the recognition exceptions referred to in section 4.2.2 on page 15 of these Guidance Notes – be recognised by entities for all temporary differences.

Taxable or deductible temporary differences arise whenever there is a difference between an asset's or liability's carrying amount and its tax base. Unlike tax losses carried forward and unabsorbed capital allowances, DTA and DTL arising on temporary differences and not transferred to, or assumed by, the fiscal unit. Indeed, whereas if a subsidiary leaves a fiscal unit, any tax losses carried forward and unabsorbed capital allowances will continue to remain within the fiscal unit, the reversal of any temporary differences would impact the subsidiary's own tax obligations in periods after having left the fiscal unit.

As a result, the MIA considers it appropriate for each fiscal unit member to recognise DTA and DTL arising on temporary differences relating to its own assets and liabilities. The recognition of DTA remains subject to the recognition criteria set out earlier in these Guidance Notes.

### 4.4 Consequences of joining or leaving a fiscal unit

Joining, or leaving, a fiscal unit requires consideration of:

- changes in the applicable tax rate(s); and
- unabsorbed capital allowances or tax losses carried forward.

#### 4.4.1 Consequences of joining a fiscal unit

##### 4.4.1.1 Changes in the applicable tax rate

As previously set out in section 4.3.1.1 on page 18 of these Guidance Notes, the MIA considers it best practice for individual fiscal unit members to apply, both for current tax and for deferred tax purposes, the same rates of tax as their sources of income are assessed at the level of the fiscal unit itself. This will often give rise to a change in an entity's applicable tax rate(s) upon joining a fiscal unit.

For instance, an entity which previously applied a corporate tax rate of 35% may determine that as a result of joining a fiscal unit, its applicable tax rate is reduced to 5%.

The Rules were issued in May 2019 with a financial year of 1 January to 31 December 2019 being the first basis year for which a fiscal unit could be registered. The timelines established by the Rules for the registration of a fiscal unit are such that situations may have arisen where a decision to form a fiscal unit was only taken after an entity's financial statements – which may be impacted by the Rules – were authorised for issue.

For instance, a fiscal unit whose financial year was 1 January to 31 December 2019 was given until 31 August 2020 to register as a fiscal unit for the basis year from 1 January to 31 December 2019.

Where a decision to form a fiscal unit is made after the end of the reporting period that will be the first basis year for the fiscal unit, but before those financial statements are authorised for issue, the MIA considers it appropriate to reflect the effects of forming

a fiscal unit within those financial statements. This is the case even if the necessary forms to register as a fiscal unit have not yet been submitted to the tax authorities, but the formal decision has been made to submit the said forms within the established deadlines.

Judgement needs to be applied in those instances where financial statements are authorised for issue before a formal decision to form a fiscal unit has been made. The MIA considers that it would generally not be appropriate to reflect within those financial statements the effects of forming a fiscal unit if the internal discussions to form a fiscal unit were tentative and a decision was not close to being made. On the other hand, if internal discussions were advanced, and a decision to register as a fiscal unit with effect from that basis year was merely a formality, then the MIA considers that it may be appropriate to reflect the effects of forming a fiscal unit within those financial statements. These Guidance Notes do not make that judgement, and preparers and auditors are required to consider the specific facts and circumstances existing in each scenario.

Similarly, under paragraph 5 of IAS 8, as well as paragraph 5.3 of GAPSME, prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

These Guidance Notes do not make judgement on whether prior year financial statements that were authorised for issue before a formal decision to form a fiscal unit had been made should, or should not, have given rise to adjustments to the applicable tax rate(s) within those financial statements. Preparers and auditors are also required to apply professional judgement based on the specific facts and circumstances existing in each scenario to determine whether the Rules "could reasonably be expected to have been...taken into account in the preparation and presentation of those financial statements."

#### **4.4.1.2 Changes to the amount of recognised DTA or DTL arising on temporary differences**

Paragraph 60 of IAS 12 requires changes in deferred tax balances as a result of changes in tax rates or laws to be, "recognised in profit or loss, except to the extent that it relates to items previously recognised outside profit or loss." GAPSME is silent in this regard, and the MIA considers it best practice to adopt the same approach as required by IAS 12.

For instance, if an entity had previously recognised a DTA or DTL on a temporary difference on revaluation of assets or liabilities, and the movement in the deferred tax balance had been recognised within other comprehensive income, any adjustment to the DTA or DTL arising from a change in the applicable tax rate should also be recognised within other comprehensive income. Conversely, for all temporary differences on which the related DTA or DTL had been recognised in profit or loss, any adjustment to the DTA or DTL arising from a change in the applicable tax rate should be recognised in profit or loss.

#### 4.4.1.3 Losses carried forward and unabsorbed capital allowances

As set out in the preface to these Guidance Notes on page 3, upon joining a fiscal unit, any unabsorbed capital allowances or tax losses carried forward by a member of the fiscal unit (for which a DTA existed, even if this had not been recognised):

- either become balances of the principal taxpayer; or
- are held in abeyance by that fiscal unit member, and any such capital allowances or losses carried forward may not be deducted against the fiscal unit's taxable income, and neither the fiscal unit member's taxable income until and unless that fiscal unit member were to leave the fiscal unit.

Meanwhile, under both IAS 12 and Section 16 of GAPSME, DTA on losses carried forward and on unused credits (such as unabsorbed capital allowances) can only be recognised to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. The probability assessment must be re-assessed at each reporting date in order to determine whether a previously-recognised DTA continues to satisfy the conditions for recognition, or whether a previously-unrecognised DTA now satisfies the conditions for recognition.

##### 4.4.1.3.1 Losses carried forward and unabsorbed capital allowances that are assumed by the fiscal unit

A number of permutations could exist in respect of DTA on losses carried forward and unabsorbed capital allowances that are assumed by the fiscal unit, and the MIA believes that the appropriate recognition and measurement principles are dependent upon the facts and circumstances relevant to each individual scenario.

It is important to bear in mind that following the formation of a fiscal unit, the assessment of probability of future taxable profits in the FUCFS – which would have been performed at the level of each individual entity prior to forming the fiscal unit – must be performed at the fiscal unit's level for losses carried forward and unabsorbed capital allowances that are assumed by the fiscal unit upon its formation. On the other hand, within a subsidiary's financial statements, that assessment depends on whether the subsidiary applies the "Stand-Alone Approach" or the "Fiscal Unit Approach".

Table 12 sets out what the MIA considers to be best practice in this regard. For the purposes of the table, the first column (recognition by the subsidiary) refers to whether a subsidiary recognised a DTA prior to joining a fiscal unit, and the second column (recognition by the fiscal unit) refers to whether the fiscal unit recognises a DTA on the same losses carried forward and unabsorbed capital allowances upon its formation.

Recognition by		Tax funding arrangement	Accounting Implications
Subsidiary	Fiscal Unit		
Yes	Yes	Yes	<p>The subsidiary derecognises the DTA, and recognises in its stead a receivable from the parent entity; the parent entity recognises a DTA and a payable to the subsidiary.</p> <p>Where the fiscal unit did not previously prepare consolidated financial statements, it will immediately recognise the above amounts (as adjusted for the elimination of intra-group balances). Where it previously prepared consolidated financial statements, measurement within those financial statements is not impacted on a consolidated basis, however there may be instances in which consideration will need to be given to whether, as an adjustment to opening balances without restating comparatives, certain tax assets and liabilities should be offset upon forming the fiscal unit.</p>
Yes	Yes	No	<p>The subsidiary derecognises the DTA, and recognises in its stead a distribution to the parent entity<sup>13</sup>; the parent entity recognises a DTA and dividend income from the subsidiary.</p> <p>Where the fiscal unit did not previously prepare consolidated financial statements, it will immediately recognise the above amounts (as adjusted for the elimination of intra-group balances). Where it previously prepared consolidated financial statements, measurement within those financial statements is not impacted on a consolidated basis, however there may be instances in which consideration will need to be given to whether, as an adjustment to opening balances without restating comparatives, certain tax assets and liabilities should be offset upon forming the fiscal unit.</p>
Yes	No	Yes	<p>If the subsidiary applies:</p> <ul style="list-style-type: none"> <li>the “Stand-Alone Approach”, it derecognises the DTA, and recognises in its stead a receivable from the parent entity; or</li> </ul>

<sup>13</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

			<ul style="list-style-type: none"> <li>the “Fiscal Unit Approach”, it derecognises the DTA as the recognition criteria is no longer satisfied, charging profit or loss with a deferred tax charge. If a receivable from the parent arises nonetheless, it recognises a receivable and an equity contribution directly within its capital reserves.</li> </ul> <p>The parent entity recognises an investment in the subsidiary (which may need to be tested for impairment) and a payable to the subsidiary.</p> <p>Where the fiscal unit did not previously prepare consolidated financial statements, it will not be impacted; where it previously prepared consolidated financial statements, the deferred tax asset will need to be derecognised through profit or loss.</p>
Yes	No	No	<p>It the subsidiary applies:</p> <ul style="list-style-type: none"> <li>the “Stand-Alone Approach”, it derecognises the DTA, recognises in its stead a distribution to the parent entity<sup>14</sup>; or</li> <li>the “Fiscal Unit Approach”, it derecognises the DTA as the recognition criteria is no longer satisfied, charging profit or loss with a deferred tax charge.</li> </ul> <p>The parent entity is not impacted.</p> <p>Where the fiscal unit did not previously prepare consolidated financial statements, it will not be impacted; where it previously prepared consolidated financial statements, the deferred tax asset will need to be derecognised through profit or loss.</p>
No	Yes	Yes	<p>If the subsidiary applies the “Stand-Alone Approach”, it recognises a receivable from the parent entity, and an equity contribution directly within its capital reserves; the parent entity recognises a DTA and a payable to the subsidiary, together with an investment in the subsidiary and a deferred tax credit in profit or loss.</p>

<sup>14</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

			<p>If the subsidiary applies the “Fiscal Unit Approach”, it recognises a DTA and a deferred tax credit in profit or loss, and immediately derecognises the DTA and recognises a receivable from the parent entity in its stead; the parent entity recognises a DTA and a payable to the subsidiary.</p> <p>Where the fiscal unit did not previously prepare consolidated financial statements, it will immediately recognise the above amounts (as adjusted for the elimination of intra-group balances); where it previously prepared consolidated financial statements, it recognises a DTA and a deferred tax credit in profit or loss.</p>
No	Yes	No	<p>If the subsidiary applies the “Stand-Alone Approach”, it does not record any entries; the parent entity recognises a DTA and a deferred tax credit in profit or loss.</p> <p>If the subsidiary applies the “Fiscal Unit Approach”, it recognises a DTA and a deferred tax credit in profit or loss, and immediately derecognises the DTA and recognises in its stead a distribution to the parent entity<sup>15</sup>; the parent entity recognises a DTA and dividend income from the subsidiary.</p> <p>Where the fiscal unit did not previously prepare consolidated financial statements, it will immediately recognise the above amounts (as adjusted for the elimination of intra-group balances); where it previously prepared consolidated financial statements, it recognises a DTA and a deferred tax credit in profit or loss.</p>

*Table 12: Accounting implications on DTA on losses carried forward and unabsorbed capital allowances that are assumed by the fiscal unit*

Additional considerations are required where the derecognition or recognition of DTA in Table 12 is also impacted by a change in the applicable tax rate, for instance where a subsidiary measured a DTA at 35% of its losses carried forward and unabsorbed capital allowances prior to joining a fiscal unit, and its DTA is measured at 5% following the formation of a fiscal unit. Where this situation arises, the MIA considers it best practice for the subsidiary to:

- first adjust the DTA in accordance with the guidance set out in section 4.4.1.2 of these Guidance Notes on page 50; and
- then recognise the adjustments set out in Table 12 above.

<sup>15</sup> Preparers will also need to consider the requirements of the Companies Act, under which Subsidiary may only make distributions to Parent from profits that are available for distribution.

To the extent that a tax funding arrangement is in place for the assumption of pre-existing DTA on losses carried forward and unabsorbed capital allowances, *and* the amount owed by the parent entity to a subsidiary is more than the DTA resulting *after* the above adjustment in accordance with section 4.4.1.2 of these Guidance Notes, any difference should be treated as a capital contribution, or a distribution, in accordance with the guidance set out in section 4.3.1.3.2 on page 21 and section 4.3.1.4.1 on page 34.

#### 4.4.1.3.2 Losses carried forward and unabsorbed capital allowances that are held in abeyance by the subsidiary

Careful consideration needs to be given to the probability of having available future taxable profits against which the unused tax losses and unused tax credits can be utilised where losses carried forward and unabsorbed capital allowances are held in abeyance. The below table sets out what the MIA considers to be best practice in respect of losses carried forward and unabsorbed capital allowances that are held in abeyance by a subsidiary of a fiscal unit.

<b>Treatment of DTA prior to joining a fiscal unit</b>	<b>Relevant considerations upon joining a fiscal unit</b>
Recognised	<p>Where a DTA was previously recognised (implying that it was probable that future taxable profit would be available against which the unused tax losses and unused tax credits could be utilised), a reassessment will immediately be required to determine whether the entity continues to satisfy the conditions for the continued recognition of a DTA.</p> <p>In making that judgement, preparers and auditors should bear in mind that with the losses carried forward and unabsorbed capital allowances held in abeyance, they are not available for use until and unless the subsidiary leaves the fiscal unit.</p>
Not recognised	<p>Where a DTA was not previously recognised, it is implied that it was not probable that future taxable profit would be available against which the unused tax losses and unused tax credits could be utilised. With the losses carried forward and unabsorbed capital allowances now held in abeyance, the MIA considers that it very unlikely that a situation could arise where recognition of a DTA could be justified.</p>

*Table 13: Recognition of DTA on losses carried forward and unabsorbed capital allowances that are held in abeyance*

## 4.4.2 Consequences of leaving a fiscal unit

### 4.4.2.1 Changes in the applicable tax rate

Changes in the applicable tax rate upon joining a fiscal unit have been addressed in section 4.4.1.1 on page 38 of these Guidance Notes. The MIA considers it appropriate to apply the same guidance to changes in the applicable tax rate as a result of leaving a fiscal unit.

### 4.4.2.2 Losses carried forward and unabsorbed capital allowances

Upon leaving a fiscal unit, any losses carried forward and unabsorbed capital allowances are retained by the principal taxpayer (unless these were held by the subsidiary in abeyance upon joining the fiscal unit), even if they would have originated from a subsidiary that no longer remains a member of the fiscal unit. Accordingly, a subsidiary leaving a fiscal unit would not have an impact on what amount of losses carried forward and unabsorbed capital allowances pertain to the fiscal unit itself, the parent entity or the relevant subsidiary. However:

- from the subsidiary's perspective, leaving a fiscal unit will need to be considered when reassessing the recognition criteria for DTA on losses carried forward and unabsorbed capital allowances that the subsidiary had kept in abeyance upon joining the fiscal unit; and
- from the perspective of the fiscal unit, a profit-making subsidiary leaving the fiscal unit could also have implications on the fiscal unit's ability to continue to recognise DTA on losses carried forward and unabsorbed capital allowances (whilst a loss-making subsidiary leaving the fiscal unit could conversely give rise to a situation where the fiscal unit might be able to start recognising a DTA, or increase the amount recognised).

## 4.5 Other disclosure considerations

### 4.5.1 Contingent liabilities

As set out in the preface to these Guidance Notes on page 3, wholly-owned subsidiaries of the principal taxpayer which are transparent subsidiaries are jointly and severally liable with the principal taxpayer for tax payment obligations towards the tax authorities. Preparers and auditors are therefore required to give consideration to IAS 37 and to Section 17 of GAPSME to determine whether, and if applicable to what extent, it is probable or possible that the principal taxpayer will default on its payment obligations towards the tax authorities.

If the likelihood of a default by the principal taxpayer is remote, preparers and auditors are reminded that the other fiscal unit members should not disclose the arrangement as a contingent liability, since disclosure as such would imply that a default by the principal taxpayer is more likely than remote.

## 5 Scope of the fiscal unit's consolidated financial statements

As set out earlier in these Guidance Notes, preparers must adopt the recognition and measurement rules, as well as the consolidations procedures, set out in IFRS or in GAPSME. Subject to the below exceptions, the preparation and presentation of the FUCFS must likewise follow the requirement of IAS 1, or Section 4 of GAPSME.

Rule 11 - Consolidated audited accounts of the Guidelines in relation to the Consolidated Group (Income Tax) Rules requires the preparation of FUCFS. Where the FUCFS are prepared solely for the purposes of complying with the said Rule, the principal taxpayer may avail itself of the following exclusions from the presentation requirements in IAS 1, or in Section 4 of GAPSME:

- (a) presentation of a statement of cash flows;
- (b) disclosure of comparative information – however this exclusion may only be applied in for the first year of fiscal unity;
- (c) disclosure of the items listed in Annex 1 as part of the notes to the FUCFS.

Annex 1: Items that may be excluded from the notes to the FUCFS.

1. Critical accounting estimates and judgements
2. Segment reporting
3. Earnings per share
4. Financial assets at fair value through profit or loss
5. Financial assets at fair value through other comprehensive income
6. Other financial assets at amortised cost
7. Inventories
8. Trade and other receivables
9. Cash and cash equivalents
10. Non-current assets or disposal groups classified as held for sale
11. Share capital
12. Revaluation reserve
13. Other reserves
14. Trade and other payables
15. Cash flow information
16. Share based payments
17. Fair value measurement
18. Commitments
19. Business combinations

20. Related parties

21. Risk management policies

Article 176 (1) of the Companies Act requires that, "...the balance sheet shall be dated and signed on behalf of the board by two directors of the company". It is therefore important for the directors' authorisation for issue of the FUCFS to be evidenced on the face of the balance sheet.

## 6 Contents of the auditor's report

The consolidated financial statements to be issued for the purposes of complying with the Consolidated Group (Income Tax) Rules (L.N. 110 of 2019) may be the same as those prepared for statutory purposes in accordance with the Companies Act. There will be instances, however, when the Group may have been exempt from preparing consolidated accounts for statutory purposes and/or where the entities forming part of the fiscal unit are different to those forming part of a 'group' as per Companies Act and IFRSs/GAPSME. In those instances, an additional set of financial statements may therefore be required in order to comply with the financial reporting requirements of the Consolidated Group (Income Tax) Rules (L.N. 110 of 2019).

When the FUCFS are different from the statutory consolidated financial statements (if they are required), these are expected to be prepared in accordance with a basis of accounting which follows the measurement and recognition principles of either IFRS or GAPSME and audited in accordance with International Standards on Auditing, but amended with the requirements of the Fiscal consolidation rules. As a result, in some instances, the FUCFS will be departing from the requirements of IFRS/GAPSME. Examples include instances where the entities forming part of the fiscal unit are different to those captured under IFRS/GAPSME consolidation rules or reduced disclosures that are allowed as per Rule 11 - Consolidated audited accounts of the Guidelines in relation to the Consolidated Group (Income Tax) Rules. In these cases, given that the financial statements are being prepared under a modified IFRS/GAPSME framework, the FUCFS will need to be prepared under a compliance framework rather than a fair presentation framework (that would apply if full IFRS/GAPSME standards were being followed) as per ISA 700. Therefore, an ISA 800 report would need to be issued with the same considerations as per ISA 600, which therefore implies obtained sufficient and appropriate audit evidence on all the units forming part of the fiscal consolidation.

The audit report on the FUCFS prepared under a compliance framework will therefore need to include:

- Reference to the basis of preparation (the audit report should not refer to compliance with IFRSs/GAPSME but should refer to the basis of preparation that will explain the modified framework being applied). Proposed wording for inclusion in the basis of preparation is also being given in the template below;
- An emphasis of matter paragraph to explain the basis of preparation and also refer to the restricted use for this report (given that it is being prepared in accordance with special purpose framework);
- In circumstances where an audit report would have already been issued on a separate set of financial statements prepared for statutory purposes, an "Other matter" paragraph making reference to the previously issued audit report is to be included;
- Modified wording in relation to some auditor's responsibilities to reflect the reduced

disclosures allowed as per Rule 11 - Consolidated audited accounts of the Guidelines in relation to the Consolidated Group (Income Tax) Rules.

- Any other information section will need to be presented with the wording of ISA720.

The above are not exhaustive and reference is to be made to ISA 800.

An illustrative template is disclosed below.

#### **Extract from Note 1 - Basis of preparation**

These consolidated financial statements have been prepared by the Directors of ABC Limited as the principal taxpayer of the Fiscal Unit registered with the Tax Authorities as set out in Note XX to the financial statements to comply with the financial reporting requirements of the Consolidated Group (Income Tax) Rules (L.N. 110 of 2019).

The financial statements comply with the recognition and measurement criteria set out in International Financial Reporting Standards (IFRSs) as adopted by the EU [or Accountancy Profession (General Accounting Principles for Small and Medium-sized Entities) Regulations, 2015 and the Schedule accompanying and forming an integral part of those Regulations (GAPSME)], with the exception that only the subsidiaries forming part of the 'fiscal unit' as set out in Note XX have been consolidated. The interests in subsidiaries that are not consolidated are treated as investments measured in line with measurement rules applicable to an investor's separate financial statements, as set out in IAS 27 [or in Section 10 of GAPSME]. The presentation and disclosures are in line with the Guidelines in relation to L.N. 110 of 2019 as issued by the Commissioner for Revenue.

These accounting policies, which are highlighted in detail below, are deemed to be an acceptable special purpose framework in the circumstances and constitute a compliance framework.

## Independent auditor's report

To the Directors of ABC Limited

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### 6.1.1.1 Our opinion

In our opinion, the consolidated financial statements of the Fiscal Unit of which ABC Limited is the principal taxpayer ("the Fiscal Unit") are prepared, in all material respects, in accordance with the L.N. 110 of 2019 and the Guidelines in relation to the Consolidated Group (Income Tax) Rules as described in Note 1 to these financial statements.

### What we have audited

The consolidated financial statements comprising<sup>16</sup>:

- the consolidated statement of financial position (Balance Sheet) as at 31 December 20X1;
  - the consolidated statement of comprehensive income (Income Statement) for the year then ended;
  - the consolidated statement of changes in equity for the year then ended; and
  - the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.
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### 6.1.1.2 Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Independence

We are independent of the Fiscal Unit in accordance with the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Cap. 281) that are relevant to our audit of the financial statements in Malta. We have fulfilled our other ethical responsibilities in accordance with these Codes.

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<sup>16</sup> If the exemption of the presentation of cashflow is not availed of, this paragraph should also include reference to the cashflow statement.

## Emphasis of Matter - Basis of accounting and restriction on distribution

We draw attention to Note X to the consolidated financial statements, which describes the basis of accounting. The accounting policies used and disclosures made are not intended to, and do not, comply with all the requirements of International Financial Reporting Standards as adopted by the EU [or Accountancy Profession (General Accounting Principles for Small and Medium-sized Entities) Regulations, 2015 and the Schedule accompanying and forming an integral part of those Regulations (GAPSME)]. The consolidated financial statements are prepared for the fiscal unit as defined in Note XX for the purposes of the Income Tax Act to comply with the financial reporting requirements of L.N. 110 of 2019 and the Guidelines in relation to the Consolidated Group (Income Tax) Rules. As a result, the financial statements may not be suitable for another purpose<sup>17</sup>.

Our report is intended solely for the directors of ABC Limited and for the purposes described above, and should not be distributed to parties other than those for whom the financial reporting framework is designed and any other previously agreed recipients. Our opinion is not modified in respect to this matter.

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## Other matter

ABC Limited has prepared separate financial statements for the year ended 31 December 20X1 for statutory purposes in accordance with the provisions of the Maltese Companies Act (Cap.386), on which we issued an auditor's report to the shareholders of ABC Limited dated XXXX.

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## Responsibilities of the directors [and those charged with governance for the financial statements]

The directors are responsible for the preparation of these financial statements in accordance with the Consolidated Group (Income Tax) Rules, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Fiscal Unit's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Fiscal Unit or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Fiscal Unit's financial reporting process.

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<sup>17</sup> 'Other information' section to be included if other information accompanying the financial statements is presented.

## Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fiscal Unit's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fiscal Unit's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fiscal Unit to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that complies with the Guidelines in relation to L.N. 110 of 2019.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Fiscal Unit to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

## Other matters on which we are required to report by exception

We also have responsibilities under the Maltese Companies Act (Cap. 386) to report to you if, in our opinion:

- Adequate accounting records have not been kept, or that returns adequate for our audit have not been received from branches not visited by us.
- The financial statements are not in agreement with the accounting records and returns.
- We have not received all the information and explanations we require for our audit.

We have nothing to report to you in respect of these responsibilities.

[Signature in the name of the audit firm]

[Auditor Address]

[Date]