PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS (Q&As)

<u>Q&A No. 2020-07</u>

PAS 12 – Accounting for the Proposed Changes in Income Tax Rates under the Corporate Recovery and Tax Incentives for Enterprises Act (CREATE) Bill

Issues

1. Is the CREATE Bill considered substantively enacted as of December 31, 2020?

2. Is the subsequent enactment of the CREATE Bill considered an adjusting event?

3. What is the impact on the calendar year (CY) 2020 and CY2021 financial statements (FS) of companies covered by the reduced income tax rates, in case the CREATE bill (with retroactive effect in 2020 as described below) will be passed into law **after** the reporting period of a company:

    a. But before its audited FS issue date and before the actual filing of the CY2020 annual income tax return (ITR)?; **Or**
    b. After its audited FS issue date but before the actual filing of the CY2020 annual ITR?

Fact Pattern

On November 26, 2020, the Senate approved on 3rd and final reading Senate Bill No. 1357, otherwise known as the "Corporate Recovery and Tax Incentives for Enterprises Act" or "CREATE", which seeks to reduce the corporate income tax rates and to rationalize the current fiscal incentives by making it time-bound, targeted, and performance-based.

Initially, the House of the Representatives, which already passed their counterpart measure in September 2019, informed the Senate that the latter's version would be adopted by the Lower House. However, on December 15, 2020, the Senate received an official letter from the Lower House indicating that in fact, they have designated members for the bicameral conference, with the intention of holding a bicameral conference to reconcile disagreeing provisions on the Lower House and the Senate versions of the bill.

The proposed law will be transmitted to the President of the Philippines for his approval into law only after the reconciled version of the measure is ratified by both houses of Congress in plenary.

As of December 31, 2020, the CREATE bill is pending ratification by both Houses.

The proposed changes to the Corporate Income Tax (CIT) rates under the Senate version (i.e., the CREATE Bill) are, as follows:

1. Reduction in CIT rate effective July 1, 2020 as follows:

   Domestic corporations shall be subject to the following reduced CIT rates depending on their assets and taxable income:
   a. Those with assets amounting to P100,000,000 and below, and with taxable income equivalent to P5,000,000 and below will be subjected to a 20% tax rate;
   b. Those with assets above P100,000,000 or those with taxable income amounting to more than P5,000,000 will be subjected to a 25% tax rate.

   (Note: Computation of total assets is exclusive of the value of the land where the property, plant, and equipment are situated.)

   Foreign Corporations (resident and nonresident foreign corporations) will have a fixed reduced tax rate of 25%.

2. Proprietary educational institutions and hospitals which are nonprofit previously subject to a tax of 10% on their taxable income, shall be imposed a tax rate of 1% beginning July 1, 2020 until June 30, 2023.

3. Regional Operating Headquarters (ROHQs) of multinational companies previously subject to a tax of 10% on their taxable income shall be subject to the regular corporate income tax effective December 31, 2020.

4. Effective July 1, 2020 until June 30, 2023, the MCIT rate shall be one percent (1%).

Since the CREATE Bill will still have to go through the Bicameral Committee Hearing and has to be submitted to the President for approval, the same may not be passed into law until the first quarter of 2021, at the earliest.

Unless the Bicameral Committee changes the rates or the retroactive effectivity to July 1, 2020 as provided in the current version or the President reject such provisions using his veto power, the reduced CIT rate of 20% or 25% (as the case may be) and the 1% CIT on proprietary hospitals / educational institutions may retroact to July 1, 2020 as intended. Accordingly, the annual income tax return for CY2020 to be filed on or before April 15, 2021 may already have to use the prorated CIT rate for CY2020.

Consensus

1. The CREATE Bill is not considered substantively enacted as of reporting date, 31 December 2020, given the following circumstances as of said date:

    a. Congress as the legislative body and the President representing the executive body of the Government are separate and independent from each other;

    b. The bill is still pending with the bicameral committee of Congress, and consequently not yet submitted to the President of the Philippines;

    c. Upon submission to the President of the Philippines, he may either approve it or exercise his veto power to stop the enactment of the subject bill;

    d. In case the bill is vetoed by the President, Congress may not be able to garner the required two-thirds vote to overturn the presidential veto.

2. Under PAS 10.22h, if the bill is passed into law **after** the balance sheet date but **before** the issuance of the audited financial statements, it is treated as a non-adjusting event. Disclosure of the nature of changes and impact to the financial statements is required if the impact is expected to be significant.

3. On the other hand, if the bill is passed into law **after** the issue date of the CY2020 audited FS but prior to the actual filing of the CY2020 annual ITR, there is no subsequent event that requires related FS disclosure. However, companies may consider disclosing the general key features of the proposed bill and expected financial impact.

4. Based on the foregoing consensus, below are the impact to the CY 2020 financial statements and CY 2021 financial statements:

    CY 2020 FS

    - Current and deferred taxes for FS reporting purposes will still be measured using the applicable income tax rates as of December 31, 2020 since the CREATE bill was not yet enacted / substantively enacted as of such date (there will be difference between the provision for current income tax per CY2020 FS and the amount of income tax due per CY2020 ITR).
    - If the CREATE bill is enacted prior to CY2020 audited FS issue date and before the actual filing of the CY2020 ITR, this is a non-adjusting event but significant effects of changes in tax rates on current and deferred tax assets and liabilities should be disclosed (Companies in this case will have to compute for current and deferred taxes based on adjusted tax rates to determine the impact of the change in the tax rate).
    - If the CREATE bill is enacted after the CY2020 audited FS issue date but before the actual filing of the CY2020 ITR, this is no longer a subsequent event, but companies may consider disclosing the general key features of the proposed bill and the expected impact in its audited FS.

CY2021 FS

- PAS 12 provides that components of tax expense (income) may include “any adjustments recognized in the period for current tax of prior periods” and “the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes”, among others *(PAS 12.80.b and PAS 12.80.d)*
- An explanation of changes in the applicable tax rate(s) compared to the previous accounting period is also required to be disclosed. *(PAS 12.81.d)*
- Hence, the provision for current income tax for CY2021 will include the difference between income tax per CY2020 FS and CY2020 ITR (since the latter will not be taken up in the CY2020 FS and thus be taken up in the CY2021 FS)
- Deferred tax assets and liabilities as of December 31, 2021 will be remeasured using the new tax rates. The impact of remeasurement is recognized in profit or loss (i.e., provision for/benefit from deferred income tax), unless it can be recognized in other comprehensive income or another equity account as provided for in *PAS 12.61A*
- Any movement in deferred taxes arising from the change in tax rates that will form part of the provision for/benefit from deferred taxes will be included as well in the effective tax rate reconciliation.

Basis for Consensus

Issue 1

- PAS 12, *Income Taxes*, requires current and deferred taxes to be measured with reference to the tax rates and laws, as enacted or substantively enacted by the end of the reporting period. *(PAS 12.46 and PAS 12.47)*

- In some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws). *(PAS 12.48)*

- PAS 12 gives no guidance as to how this requirement is to be interpreted in different jurisdictions. In most jurisdictions, however, a consensus has emerged as to the meaning of ‘substantive enactment’ for that jurisdiction. Nevertheless, in practice apparently similar legislative processes in different jurisdictions may give rise to different treatments under PAS 12. For example, in most jurisdictions, a tax legislation can only be deliberated and promulgated by a separate legislative body after which, requires the formal approval of the executive head of state in order to become a law. However, in some jurisdictions the head of state has the sole power to announce, promulgate and issue tax laws through presidential decrees, whereas in others, the head of state has a more ceremonial role (and cannot practically fail to approve the legislation).

- The general principle tends to be that, in those jurisdictions where the head of state has executive power that is independent and separate from the legislative body, a legislation is not substantively enacted until actually approved by the head of state. Where, however, the head of state’s powers are more ceremonial, substantive enactment is generally regarded as occurring at the stage of the legislative process where no further amendment is possible.

- The Philippines is a republic with a presidential form of government wherein the power is equally divided among its three branches: executive, legislative, and judicial. One basic corollary in a presidential form of government is the principle of separation of powers wherein legislation belongs to Congress, execution to the Executive, and settlement of legal controversies to the Judiciary. Under the Philippine legislation process, bills are laws in the making. They pass into law when they are approved by both Houses (i.e., the House of Representatives and the Senate) and the President of the Philippines. Under Article VI, Section 21 of the Constitution, the President has the power to veto a legislative bill and stop its enactment. The House of Representatives may overturn a presidential veto by garnering a two-thirds vote. If the President does not act on a proposed law submitted by Congress, it will lapse into law after 30 days of receipt. *(https://www.officialgazette.gov.ph/about/gov/the-legislative-branch/)*

Issue 2
PAS 10, *Events after the Reporting Period*, identifies the enactment or announcement of a change in tax rates and laws after the end of the reporting period as an example of a non-adjusting event *[PAS 10.22(h)]*. For example, an entity with a reporting period ending on 31 December issuing its financial statements on 20 April the following year would measure its tax assets and liabilities by reference to tax rates and laws enacted or substantively enacted as at 31 December even if these had changed significantly before 20 April and even if those changes had retrospective effect. However, in these circumstances the entity would have to disclose the nature of those changes and provide an estimate of the financial effect of those changes if the impact is expected to be significant. *[PAS 10.21]*

Issue 3
Refer to Basis for Conclusion of Issues 1 and 2

Transition and Effective Date
The consensus in this Q&A is effective from the date of approval of the FRSC.

Date approved by PIC: January 27, 2021

PIC Members

Wilson P. Tan, Chairman

Emmanuel Y. Artiza	**Ma. Gracia F. Casals-Diaz**
Christian Francis S. Felismino	**Zaldy D. Aguirre**
Joeffrey Mark P. Ferrer	**Ferdinand George A. Florendo**
Gerry I. Piator	**Eduardo M. Olbes**
Rosario S. Bernaldo	**Lyn I. Javier**
Ma. Isabel E. Comedia	**Arnel Onesimo O. Uy**
Jerome Antonio B. Constantino	**Lovely M. Del Amen-Aquino**

Date approved by FRSC: January 29, 2021

REFERENCES

PAS 12.46

Current tax assets or liabilities are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

PAS 12.47

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

PAS 10.3

Events after the reporting period are those events, favorable and unfavorable, that occur between the end of the reporting period and the date when the financial statements are authorized for issue. Two types of events can be identified:
(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

PAS 10.21

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:
(a)the nature of the event; and
(b)an estimate of its financial effect, or a statement that such an estimate cannot be made.

PAS 10.22(h)

Changes in in law enacted or announced after the reporting period is an example of non-adjusting events, that if material, warrant disclosure in financial statements. PAS 10 mentions tax law only, but this rule is applicable to changes in law in general.

PAS 12.80

Components of tax expense (income) may include:
(a) current tax expense (income);
(b) any adjustments recognized in the period for current tax of prior periods;
(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;
(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
(e) the amount of the benefit arising from a previously unrecognized tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
(f) the amount of the benefit from a previously unrecognized tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;
(g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56; and

(h) the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with IAS 8, because they cannot be accounted for retrospectively.

PAS 12.61A

Current tax and deferred tax shall be recognized outside profit or loss if the tax relates to items that are recognized, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognized, in the same or a different period:

(a) in other comprehensive income, shall be recognized in other comprehensive income (see paragraph 62).

(b) directly in equity, shall be recognized directly in equity (see paragraph 62A).