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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting: **March 2009, London**

Project: **Classification of Tonnage Tax as Income Tax in accordance with IAS 12 (Agenda Paper 5B)**

INTRODUCTION

1. In November 2008, the IFRIC received a request to consider whether tonnage tax should be considered as income tax and be presented accordingly in the financial statements (see Appendix A for the full text of the submission).

2. In some European countries, shipping companies elect to be taxed either under a specific tonnage tax regime or on the standard corporate income tax regulations.

DIFFERING INTERPRETATIONS

3. The submission presents two differing views as to whether tonnage tax is or is not income tax.

View 1: proponents of view 1 are in favour of presenting tonnage tax as income tax on the grounds that such a tax is an alternative way of calculating shipping companies' taxable profits.

View 2: tonnage tax is not income tax and cannot be accounted for in accordance with IAS 12. The reason for such an assessment is that tonnage tax is not based on income.

STAFF ANALYSIS

4. Tonnage tax is an alternative method of calculating corporation tax by reference to the net tonnage of the ship operated. **Other profits of a tonnage tax company are taxable in the normal way**.

5. The staff understands that the tonnage tax regime is optional and applies only to the shipping activities of a company. Should a company be diversified, it would have two corporation tax bases.

6. The tonnage tax regime is set to be an incentive to enable European companies to operate direct-owned fleets and to stop the decline in this activity. The advantage of such a regime for shipping companies is that their taxable profits from shipping activities are determined at fixed rates by reference to the tonnage of their ships, rather than by reference to variable business results.

7. The staff believes that tonnage capacity or tonnage transported does not meet the definition of taxable profit as set out in paragraph 5 of IAS 12. Profit is clearly defined in the Glossary to IFRSs as “The residual amount that remains after expenses […] have been deducted from income. […]”.

8. The staff therefore believes that tonnage tax cannot be considered an income tax.

STAFF RECOMMENDATION

9. The staff has assessed the issue raised in the submission against the IFRIC agenda criteria as follows:

    a) The constituents assert that the issue has practical and widespread relevance.

    b) The submission sets out two differing views. Diversity of interpretation would lead to differences in the presentation and measurement of income tax and would impair comparability.

c) The issue is sufficiently narrow in scope that the IFRIC could resolve it efficiently.

d) Current discussions held by the Board on the IAS 12 replacement project do not address the issue of the definition of taxable profit. Therefore, the staff does not expect the Board to deal with this specific issue as part of its current project.

10. The staff analysis is that IAS 12 is sufficiently clear that we do not expect diversity in practice to arise.

11. The staff has set out proposed wording for the tentative agenda decision in Appendix B.

QUESTIONS FOR THE IFRIC

12. Does the IFRIC agree with the staff recommendation?

13. Does the IFRIC have any comments on the drafting of the tentative agenda decision?

APPENDIX A: Submission

1. The issue:

The issue relates to whether tonnage tax is considered income tax in accordance with IAS 12, particularly regarding its income statement classification.

Description of the case

Shipping companies are permitted to be taxed based on shipping tonnage (tonnage tax). The tonnage tax is based on either

- tonnage transported or
- tonnage capacity

A shipping company can choose to be taxed based either on the tonnage tax regulations or the standard corporate income tax regulations in his tax jurisdiction. This choice is irrevocable.

Tonnage tax is found in several European countries. The following discussion is based on the application of tonnage tax in one specific European country.

2. Current practice:

Applicability of IAS 12

Two different views exist as to whether tonnage tax should be classified as income tax in the income statement.

Factors supporting presenting the tonnage tax as income tax in the income statement:

In the specific European country, tonnage tax is part of the income tax legislation as a substitute for income-based taxation.

Proponents of this view state that income taxes are based on taxable profits (IAS 12 paragraph 2). The definition of taxable profit in IAS 12 paragraph 5 describes taxable profit as the amount determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable. Tonnage tax is established by the tax authorities as a method for calculating taxable profits. Therefore, proponents of this view believe tonnage tax meets the definition of income tax and should be reflected as such in the income statement.

Factors against presenting the tonnage tax as income tax in the income statement:

Tonnage tax is not based on income, which is critical to the definition of income tax in IAS 12 (see IAS 12 paragraph 1). It is based instead on tonnage transported or tonnage capacity.

The Issuer's taxable profits (or losses) have no impact on the tonnage tax calculation; for example, tonnage tax is payable at a constant amount regardless to whether there is profit or loss in the current year.

Because the calculation of tonnage tax does not incorporate taxable profits, proponents of this view believe that it does not qualify as income tax. It is irrelevant whether the option to use the tonnage tax is actually incorporated within the income tax legislation. Its substance is similar to other operating costs and thus, proponents of this view believe that tonnage tax should be included in the calculation of operating results; not as a separate line item below operating results.

3. Reasons for the IFRIC to address the issue:

a) Is the issue widespread and practical?

Tonnage tax regulations exist in several countries. Thus, this issue applies to many shipping companies in those countries.

b) Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?

As discussed above, certain companies view the tonnage tax as an income tax while others do not.

c) Would financial reporting be improved through elimination of the diversity?

Financial reporting will be improved by eliminating diversity in practice within the shipping industry.

d) Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and *Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process?

We are of the opinion that the issue is sufficiently narrow to be addressed by an interpretation of the IFRIC.

e) If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process).

N.A.

[Appendix B is omitted from Observer note]