IAS 33 ***Earnings per Share*** (June 2017)

Tax arising from payments on participating equity instruments
The Committee received a request to clarify how an entity determines profit attributable to ordinary shareholders when calculating basic earnings per share (EPS). In the fact pattern described in the submission:

a. the entity has two classes of equity instruments—ordinary shares and participating equity instruments. Participating equity holders participate in dividends together with ordinary shareholders according to a predetermined formula.
b. applying IAS 32 *Financial Instruments: Presentation*, the entity classifies the participating equity instruments as equity. Dividends are paid to participating equity holders only when they are paid to ordinary shareholders.
c. the dividends on participating equity instruments are deductible for tax purposes. Accordingly, such payments reduce taxable income and thus reduce income taxes payable to the taxation authorities ('tax benefit').

The submitter asked whether, in determining profit attributable to ordinary shareholders (ie the numerator) in the basic EPS calculation, the entity reflects the tax benefit that would arise from the hypothetical distribution of profit to participating equity holders.

Paragraph A14 of IAS 33 requires an entity to allocate profit or loss to the different classes of shares and participating equity instruments in accordance with their dividend rights and other rights to participate in undistributed earnings. Paragraph A14 of IAS 33 also requires an entity to allocate profit or loss (after adjusting for cumulative dividends and dividends declared in the period) to ordinary shares and participating equity instruments to the extent that each instrument shares in earnings as if all of the profit or loss for the period had been distributed (ie the hypothetical distribution).

The Committee concluded that, when calculating basic EPS in the fact pattern described in the submission, the entity adjusts profit or loss attributable to ordinary shareholders for the portion of any tax benefit attributable to those ordinary shareholders. This is because the tax benefit is a direct consequence of the hypothetical distribution of profit to the participating equity holders required by paragraph A14 of IAS 33. The entity applies this accounting treatment regardless of whether it recognises the tax benefit in equity or in profit or loss.

The Committee observed that this treatment is also consistent with the objective of basic EPS outlined in paragraph 11 of IAS 33—namely, to provide a measure of the interests of each ordinary share in the performance of the entity over the reporting period.

The Committee concluded that the principles and requirements in IAS 33 provide an adequate basis for an entity to calculate basic EPS in the fact pattern described in the submission. Consequently, the Committee decided not to add this matter to its standard-setting agenda.