

PLAIN-ENGLISH ACCOUNTING

Practical Accounting and Auditing Implementation Guidance

EITF ISSUE 06-3 – SOME IMPLEMENTATION GUIDANCE

In June 2006, the Emerging Issues Task Force [EITF] issued EITF Issue 06-3, entitled *How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement [That Is, Gross versus Net Presentation]*, where the guidance in this Issue became effective for financial reports for interim and annual reporting in periods beginning after December 15, 2006 [calendar-year 2007], where the guidance could have been implemented earlier.

Practice Note: While the EITF guidance is not new, now that reporting entities, and practitioners associated with those entities, are “preparing and reporting” on 2007 financial statements, they are beginning to “notice” a new item on disclosure checklists related to the requirement for a policy note that is new for 2007, so “questions are being asked” about “how to do” the things that are required in EITF Issue 06-3.

Some Background Information. Taxes are assessed by various governmental authorities on many types of transactions, where the taxes range from sales taxes that are applied to broad classes of transactions involving a wide-range of goods and services to excise taxes that are applied to only specific types of transactions or items. Given the “variety” of these type taxes, and given the “various” approaches that have been used by reporting entities in reflecting these type taxes in the financial statements [in particular, the income statement], the EITF decided to address [and provide guidance on] two different issues:

- Whether the scope of the guidance in this Issue [06-3] should include all nondiscretionary amounts assessed by governmental authorities, all nondiscretionary amounts assessed by those authorities in connection with transactions with customers, only sales, use, and valued-added taxes, or any tax assessed by a governmental authority that is incurred as a result of a revenue transaction.
- How taxes assessed by a governmental authority within the scope of this Issue [06-3] should be presented in the income statement.

Practice Note: On the latter point, some reporting entities have been reflecting these amounts [the taxes] “gross” within the income statement

while most reporting entities have been reflecting these taxes on a “net” basis. As such, the “display policy” [gross versus net] could have a significant impact on revenue and cost amounts that are reflected within the body of the income statement.

EITF Consensus #1 = The EITF reached a consensus on each of the issues [noted above] that were addressed. Related to the scope of the document, the guidance in EITF Issue 06-3 encompasses any tax that is assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer. Examples of circumstances that “fall within the scope” of the guidance include [but are not limited to] sales taxes, use taxes, value-added taxes, and some excise taxes. But, the guidance does not include [i.e., it excludes] tax schemes that are based on gross receipts and taxes that are imposed during inventory procurement processes.

EITF Consensus #2 = Related to the second issue, the EITF reached a consensus that the presentation of taxes within the scope of this guidance [see the previous paragraph] either on a gross basis [included in revenues and costs] or on a net basis [excluded from revenues] is an accounting policy decision that needs to be addressed in the policy notes to the financial statements using the guidance in APB Opinion No. 22, entitled *Disclosure of Accounting Policies*. Importantly, reporting entities are not required to reevaluate their existing policies related to taxes assessed by governmental authorities in order to comply with the technical literature requirements in Issue 06-3. In addition, for any taxes that are reported on a gross basis, reporting entities should disclose the amounts of those taxes in both interim and annual statements for each period in which an income statement is presented [assuming the amounts are significant]. The disclosure of the amount of taxes can be made on an aggregate basis.

Implementation Point #1 = As noted above, reporting entities are not required to reevaluate existing policies related to the display of taxes within the scope of EITF Issue 06-3. However, it would not be unexpected for reporting entities to “change their minds” related to using a particular policy [particularly, if they are using the “gross” display method], and, if a policy change is implemented, it would be important to implement the change using the guidance in SFAS No. 154, entitled *Accounting Changes and Error Corrections*, in that there would be a “voluntary” change in accounting principles that would need to be reflected in the financial statements utilizing the SFAS No. 154 guidance.

Implementation Point #2 = As noted above, in making the transition to including disclosures that are required using the guidance in EITF Issue 06-3, reporting entities are required to implement the guidance retrospectively, so that there would be a need to include appropriate

disclosures for comparative financial statements that are presented with current-year statements. This issue would be something to “consider” only when the “gross” display methodology is being utilized in that, if the “net” methodology is utilized, the policy note does not need to “disclose the numbers” associated with taxes collected and remitted.

Example Policy Note = Given that there is a new policy note disclosure requirement, and given the paucity of literature that is available as to how the note should/could be written, reporting entities might consider just “popping-in” a policy note that is something like the following:

Presentation of Certain Taxes

The Company collects various taxes from customers and remits these amounts to applicable taxing authorities. The Company’s accounting policy is to exclude these taxes from revenues and cost of sales.

END NOTE: Adding the policy note related to the EITF 06-3 issue is not something that should be “troubling” to reporting entities and/or practitioners associated with those entities in that all that is necessary is to just “add the note” [see example above], where the purpose of providing this information is just to try to help so that we do not “miss the note” in our efforts to do things right while we are trying to do the right things!

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