



January 2026

## FRS 102 factsheet – Periodic Review 2024

### Tax implications of the amendments

The Periodic Review 2024 Amendments to FRS 102 are applicable for accounting periods beginning on or after 1 January 2026. Early application is permitted, provided that all amendments are applied at the same time. Note that amendments in respect of supplier finance arrangements published at the same time are applicable from 1 January 2025.

### Summary

The revisions to FRS 102 introduce significant changes to how UK GAAP entities account for leases and revenue. These will have direct consequences for corporate tax calculations because UK tax rules generally start from accounting profit. Understanding these implications is critical for planning cash flow, compliance, and stakeholder communication.

### Core tax principles

UK tax rules require companies to prepare financial statements for tax purposes under Generally Accepted Accounting Practice (GAAP). This principle means that the starting point for calculating corporation tax is the accounting profit reported in those financial statements. In most cases, tax treatment follows the accounting treatment unless specific legislation requires an adjustment. As a result, any change in accounting policy, such as those introduced by the 2024 amendments to FRS 102 can have a direct and significant impact on tax outcomes. The effect of these changes is felt in two critical areas:

- The calculation of corporation tax liabilities for the current year, because the timing and pattern of income and expense recognition under the new standards may differ from previous practice, and
- The measurement of deferred tax assets and liabilities, as temporary differences arise between accounting and tax recognition when transitional adjustments or spreading rules apply.

These changes don't only alter the reported profit; they also affect the timing of tax payments, potentially accelerating or deferring cash outflows.

### Revenue recognition

The revised Section 23 introduces a five-step model for revenue recognition, moving from a risk-and-reward approach to a control-based model. This change can significantly alter the timing of revenue recognition, especially for entities with long-term contracts, bundled goods and services, or variable consideration.

### What happens on transition?

Under tax rules, when there is a change from one valid basis to another, adjustments ensure receipts and deductions are taxed once only. Transitional adjustments arising from the change in accounting policy are treated like prior period adjustments but without reopening earlier returns. These adjustments, whether positive (increasing profit) or negative (creating a loss) are taken into the tax computation for the year of change. For example, a company with a 31 December 2026 year-end will include the impact of the transitional adjustment in that year's tax return.

Crucially, there is no spreading relief for revenue adjustments. The full cumulative adjustment is taxed or relieved in the first year, which can create significant one-off tax charges or credits. This impacts the timing of tax payments and may push companies into the quarterly instalment regime.

Deferred tax will also be affected, because the timing difference between accounting and tax recognition will often result in a deferred tax asset or liability. Because accounting recognises a catch up immediately and tax also recognises it in the year of adoption, deferred tax generally arises from ongoing timing differences in the future revenue profile. Entities should thus reassess deferred tax assets/liabilities at transition, consider recoverability (especially for deferred tax assets) and ensure disclosure of the nature and amounts of deferred tax arising from the change in accounting policy.

For example, if an entity has a three year services contract for £900,000 which runs from 2024 to 2026. Under the old revenue policy, the entity recognised revenue on a straight line basis: £300,000 per year.

Thus, revenue up to 2025 under the old model was £600,000 (£300,000 for two years) On 1 January 2026, the entity adopts the revised FRS 102 Section 23 five step model and determines that revenue should be recognised over time using an input method. Based on actual effort incurred, management concludes that by 31 December 2025 the contract is 80% complete. Thus, the revenue under the new model is £720,000 (80% of £900,000).

Using the modified retrospective approach, the £120,000 (£720,000 less £600,000) catch up is recorded directly in opening equity (retained earnings) at 1 January 2026 rather than in the 2026 profit or loss.

The entire £120,000 catch up is included in taxable profits for 2026. It doesn't get spread over future years. This can increase the corporation tax charge and may affect quarterly instalment payments and cash flow planning for 2026.

Because the accounting effect sits in opening equity while tax takes the full amount in 2026, you also need to reassess deferred tax at the date of initial application and then track the unwinding across 2026–2027. If the new model brings forward revenue into 2024–25, there will typically be less revenue left to recognise in 2026–27 than under the old policy. That changed timing creates temporary differences which deferred tax will capture. In practice, you'll often recognise a deferred tax liability or adjust existing deferred tax at transition and see it reverse in subsequent periods as the new revenue profile plays out.

## Post-transition considerations

After adopting the revised Section 23 revenue model, the tax effects don't end with the initial catch-up adjustment.

Since the new model can accelerate or defer revenue versus the old risks and rewards approach, taxable income will follow these revised timing profiles. Practically, this means post transition years can see higher or lower taxable profits than previously forecast, affecting quarterly instalments and increasing the risk of interest on underpayments if forecasts are not updated promptly.

The deferred tax created at the date of initial application will also begin to unwind as the new revenue profile plays out. If, before adoption, more revenue was effectively “pulled forward” under the new model, there is generally less left to recognise in later years; in that case, a deferred tax liability recognised at transition will reverse as post transition accounting revenue is lower than it would have been under the old policy.

Conversely, if on adoption revenue was deferred, a deferred tax asset recognised at transition will reverse when revenue catches up in later periods. For example, suppose a cumulative positive catch up of £120,000 was recognised for tax in the adoption year (no spreading applies to revenue) and a 25% deferred tax liability of £30,000 was posted at transition to reflect the fact that future accounting revenue would now be lower. If the new model results in £100,000 less accounting revenue in the first post transition year than under the old approach, £25,000 of that deferred tax liability would reverse in that year, with the balance reversing as the timing differences continue to unwind.

This pattern, current tax taking the full catch up in the adoption year and deferred tax reversing thereafter is a central feature of the amended standard's interaction with tax.

Another impact is that contract assets and contract liabilities become ongoing drivers of temporary differences after adoption. When revenue is recognised ahead of billing, an unbilled contract asset arises and the accounting profit can outpace what is recognised for tax where taxable income is more closely aligned to invoicing or cash. For example, if at a year-end, you have recognised £300,000 of revenue under the new model but only £240,000 has been invoiced, the £60,000 difference typically gives rise to a deferred tax liability of £15,000 at a 25% rate, which will reverse when that £60,000 is invoiced and taxed in the next period.

The reverse situation occurs with advance consideration: a contract liability in accounting defers revenue, potentially creating a deferred tax asset that reverses as performance obligations are satisfied. Maintaining contract level schedules so that these temporary differences are measured and reversed accurately is essential for compliant tax reporting.

Judgements about variable consideration (such as bonuses, rebates, performance fees) and significant financing components (such as big prepayments or delayed receipts) can also produce persistent timing differences after transition. If a performance bonus is probable and constrained at set amount, accounting may recognise that amount this year while tax may only bring it into charge when the bonus crystallises next year.

In that situation, a deferred tax liability arises this year and reverses when tax catches up in the following period. Similarly, where there is a significant financing component such as a substantial prepayment, accounting splits the transaction price into service revenue and interest accretion over time. If tax is closer to cash, temporary differences appear both on the deferred revenue and the interest element, with associated deferred tax balances unwinding as the financing effect runs off.

Finally, the shift in taxable profit patterns after transition can impact how brought forward losses are used and how instalments are calculated. If the new model pushes a significant portion of revenue into the year following adoption, that year could experience a sharp increase in taxable profits. At the group level, this interacts with the £5 million deductions allowance and the 50% cap on profits above that threshold. For example, if deferred revenue results in £6 million of taxable profits, the group can fully offset £5 million, but only half of the remaining £1 million, leaving £500,000 taxable. So, a tax liability may arise where none was expected based on the normal level of profitability of the business prior to the amendments.

## Lease accounting

Under the new model, lessees must recognise right-of-use (ROU) assets and lease liabilities on the balance sheet, replacing the previous operating lease treatment. The ROU asset is measured at present value and depreciated over the lease term, while the liability is amortised using the effective interest method. In the income statement, companies will record depreciation and interest instead of a straight-line rental expense.

### What happens on transition?

When a company adopts the amended FRS 102 lease accounting, it may choose to carry forward figures from IFRS 16 (if previously applied) or apply the new model retrospectively. This can create one-off adjustments in the opening balance sheet, such as recognising ROU assets and lease liabilities for leases that were previously off-balance sheet.

These adjustments can significantly affect taxable profits in the first year of adoption, particularly for companies with extensive property portfolios, vehicle fleets, or long/high value leases. To avoid a sudden spike or dip in taxable income, UK tax law allows companies to spread the impact of these transitional adjustments over the weighted average remaining lease term. This is similar to the approach taken when IFRS 16 was introduced for IFRS reporters.

Groups with significant operating lease commitments face additional challenges. Calculating transitional tax adjustments across numerous leases can be complex, especially when lease terms, payment schedules, and discount rates vary. Thus, accurate data and robust systems are essential to ensure compliance.

Because accounting recognises the transition effect upfront and tax relief is spread, a deductible temporary difference frequently arises, leading to a deferred tax asset at the adoption date. Recognition should consider recoverability and expected profitability; subsequent unwinding mirrors the annual tax spreading.

### Post-transition considerations

For tax purposes, both depreciation on the ROU asset and interest on the lease liability are allowable deductions. The aggregate deduction over the lease term remains the same, but the timing changes. Since the finance cost will be calculated using the effective interest rate in relation to the outstanding lease liability, this will generally result in a higher interest expense in the earlier years when the lease liability is higher, and a lower expense as the lease liability decreases. This can accelerate tax relief initially but reduce it later, affecting cash flow and instalment planning.

For example, if a business has a three-year lease with a 5% discount rate, these are the impacts on the tax deductions:

	Year 1 £	Year 2 £	Year 3 £
Cash payments	24,000	24,000	24,000
Income statement			
Finance cost (ie interest)	3,250	2,413	1,333
ROU depreciation charge	21,668	21,668	21,668
Total lease expense in income statement	24,918	24,081	23,001
Expenses charged under the old rules	24,000	24,000	24,000
Difference in allowable tax deductions	918	81	(999)

Another element which would be impacted is Corporate Interest Restriction (CIR) rules. These rules are designed to limit the amount of tax relief available for interest and other financing costs incurred by UK companies. These rules apply at the group level and generally cap deductions where net interest expense exceeds £2 million per year.

The calculation is based on tax-adjusted earnings, which means that any changes to accounting treatment can have a significant impact.

Under the new lease model, the finance charges are treated as interest for CIR purposes. At the same time, transitional adjustments and the shift in expense recognition can reduce tax-adjusted EBITDA, which is the key metric used to determine the group's interest capacity. This combination of higher finance costs and lower EBITDA can tighten the CIR restriction and lead to disallowed interest deductions, creating additional complexity for groups with large lease portfolios.

To mitigate this impact, CIR legislation provides for certain elections, such as the group ratio election, which can increase the allowable interest deduction in some circumstances. However, these elections are irrevocable and can have knock-on consequences for future periods, including how other entities within the group calculate their interest capacity. For this reason, any decision to make an election should be preceded by detailed modelling and scenario analysis to understand both the immediate and long-term effects. Careful planning is essential to avoid unexpected restrictions and ensure that the group's tax position remains efficient under the new lease accounting regime.

There are also further tax implications in the special scenarios below:

1. Cessation of trade - When a business ceases trading, any remaining transitional amount related to leases (from the spreading adjustment) is brought into account immediately in the cessation period for tax purposes. This ensures that all tax relief or charges are recognised before the trade ends, preventing amounts from “leaking” into future periods where the trade no longer exists. Companies need to calculate the unrelieved balance and include it in the final tax computation for the cessation year. This can create a significant one-off adjustment.
2. Early termination of a lease (without cessation) - Where a lease ends early but the trade continues, the transitional spread typically continues on the original schedule; early termination doesn't of itself accelerate the transitional amounts. Businesses must continue applying the scheduled transitional adjustments in tax computations and manage deferred tax unwinding carefully. This requires robust tracking systems.
3. Transfers to connected parties - When a lease (or portfolio) is transferred to a connected party within a group, the transferor stops making transitional adjustments, while the transferee continues the spreading. Thus, the obligation to spread follows the lease, not the original holder. This needs to be reflected in group tax packs and intercompany reconciliations to ensure the correct entity claims or accounts for the remaining adjustments. Misalignment can lead to errors in group tax reporting and deferred tax balances.

### Other tax implications

The amendments to FRS 102 will bring operating leases onto the balance sheet, creating significant changes to both the income statement and the balance sheet. These changes aren't just an accounting exercise, they can have far-reaching implications for regulatory and tax compliance. Metrics such as turnover and gross assets often determine whether a company falls within the scope of various regimes, including the Senior Accounting Officer (SAO) requirements, country-by-country reporting, Pillar Two compliance, and payment practice reporting. Each of these frameworks imposes additional obligations, and failure to comply can result in severe consequences, ranging from financial penalties to, in some cases, criminal liability for directors.

For smaller businesses, this could also affect eligibility for investment incentives such as the Enterprise Investment Scheme (EIS), which requires gross assets to be no more than £15 million, and the Seed Enterprise Investment Scheme (SEIS), which has a limit of £200,000. Losing access to these reliefs could significantly impact funding strategies and investor attractiveness.

For larger businesses, the increase in gross assets could push groups beyond thresholds for exemptions from mandatory transfer pricing documentation for SMEs and trigger obligations under the SAO regime.

These changes mean that companies must not only prepare for the accounting transition but also reassess their compliance landscape. Early modelling and impact analysis are essential to avoid unexpected breaches and ensure that governance, reporting, and tax planning remain robust under the new framework.

### Step-by-step checklist for considering tax implications of FRS 102 amendments

Step	Action Item	Considerations	Done (✓)
1	Confirm entity is within scope of revised FRS 102 (not FRS 105).		
2	Identify first reporting period affected (eg year ending 31 Dec 2026).		
3	Calculate transition tax adjustment for revenue - Full cumulative adjustment taxed in year of change (no spreading relief); can create significant one-off tax charges or credits.		
4	Calculate transition tax adjustment for leases - Transitional adjustments spread over weighted average remaining lease term; complex for large lease portfolios.		
5	Reassess deferred tax assets and liabilities due to timing differences arising from the new revenue and lease profiles.	Consider recoverability of deferred tax assets.	
6	Model cash flow impacts of tax changes and assess whether company is pushed into quarterly instalment regime.		
7	Update quarterly instalment forecasts to avoid interests on underpayments.		
8	Review CIR (Corporate Interest Restriction) implications.	Lease finance costs treated as interest; combined with lower EBITDA can tighten CIR limits and disallow deductions.	
9	Assess impact on group relief and £5 million deductions allowance, if applicable.		
10	Update deferred tax disclosures (nature and amount of transitional adjustments; track reversal of timing differences post-transition).		
11	Maintain contract-level schedules for temporary differences for accurate deferred tax measurement and reversal (contract assets/liabilities, variable consideration).		
12	Assess impact on regulatory and tax compliance (SAO, CbCR, Pillar Two, and investment relief eligibility (EIS/SEIS)).		
13	Model impact on key metrics (EBITDA, covenants, remuneration targets).	Document judgements and assumptions for audit readiness.	
14	Communicate with governance, lenders, and stakeholders ahead of year-end.		

This factsheet is based on regulations and law as of 16 January 2026 and professional advice should always be taken.

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