

International Accounting Standards and Tax Law

Professor Rick Krever

Taxation Law and Policy Research Institute

Monash University

rick.krever@buseco.monash.edu.au

- 1 The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB) or its Board of Directors or the governments they represent. ADB makes no representation concerning and does not guarantee the source originality, accuracy, completeness, or reliability of any statement, information, data, finding, advice, opinion, or views presented.

IAS, IFRS, GAAP

- until recently, most countries applied national GAAPs
- GAAPs in many former colonies were based on former colonial powers' GAAPs
- serious problems in socialist countries which had no GAAPs
- Europe and much of the world moving to IFRS, leaving the U.S. GAAP and some national gaps for small business

IFRS and Tax

- some countries explicitly use IFRS to measure taxable business income (e.g., Slovakia)
- others implicitly use IFRS by taxing business “profits”
- in anglo countries, “profits” are coloured by judicial income and capital doctrines

Different objectives of accounting and tax

- accounting: measure performance for creditors and investors
- tax: measure economic gains in terms of ability to pay
- accounting: looking forward to future profitability
- tax: looking back to past gains

Divergences between accounting and tax

Tax law often contains (11 differences):

- “simpler” rules such as pooling for depreciation
- tax expenditures (concessions) intended to correct market failure, support positive externalities
- tax disincentives intended to discourage unwanted behaviour (e.g, fines, bribes)

- anti-avoidance rules to combat
 - income splitting
 - transfer pricing
- quarantine rules (capital gains, foreign income)
- debt-equity recharacterisation rules (e.g., thin capitalisation)
- surrogate benefit taxation (e.g., fringe benefits)
- certainty rules (e.g., warranties)

Further divergences

Three areas in which there are further and significant differences:

- tax law needs to attribute income and expenses to particular years (e.g., correcting mistakes)
- tax law does not recognise impediments (e.g., accrued leave entitlement)
- tax laws based on income and deduction rules cannot provide offsetting assets or liabilities

Flows Alone vs Flows and Assets

- accounting principles use liabilities and assets to offset receipts and outgoings
- for example, a pre-payment received for future services is offset by a liability so the net result is a deduction for this year's services only
- similarly, an expense for future benefits is offset by an asset

- But tax law often records income and expenses only; there is no record of assets or liabilities
- On the income side, statutory or judicial doctrines are needed to recognise receipts for pre-payments over the life of the obligation
- On the outgoing side, rules are needed first to deny the initial deduction and then to amortise the expense over time
- If recognition rules are not comprehensive, there is a risk of “nothings” or “black hole expenses”

- Examples:
 - Incur an expense to prevent a competitor from obtaining a licence to operate in your area
 - Incur an expense to acquire exclusive distribution rights for 10 years

How to use IFRS accounts for tax

- in all jurisdictions, whether explicitly use IFRS or not, tax starts with financial accounts
- then runs through a checklist of differences (add backs such as fines or fringe benefits) and additional deductions such as accelerated depreciation

- Important: changes must follow through to all future years
- example: 10 year effective life asset is depreciated in 4 years for tax purposes
- in initial years, there is an additional deduction to accounting profits
- in later years, there is an increase in accounting profits to add back depreciation