

International Association of Tax Judges

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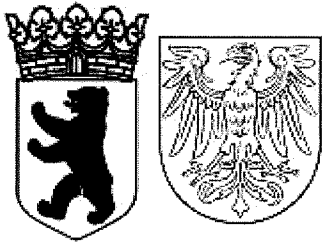
Commercial and Tax Accounting

Panel

- Chair : Philippe Martin (France)
- Steven D'Arcy (Canada)
- Joao Bianco (Brazil)
- Pramod Kumar (India)
- Susanne Tiedchen (Germany)
- Yoon Junseok (South Korea)

Outline

- Part I : Tax / Accounting relationship
- Part II : Choices made by tax courts
- Part III : Selected issues



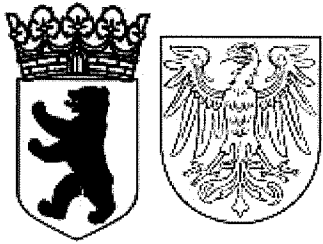
Dr. Susanne Tiedchen
Finanzgericht Berlin-Brandenburg

Commercial and Tax Accounting in Germany

Part I

Commercial and tax accounting are linked together very closely by the principle of dependence („Maßgeblichkeitsprinzip“).

- > The annual financial statement is the basis for the tax balance sheet
- > Generally accepted accounting standards are applicable for tax accounting



Dr. Susanne Tiedchen
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Commercial and Tax Accounting in Germany

Part I

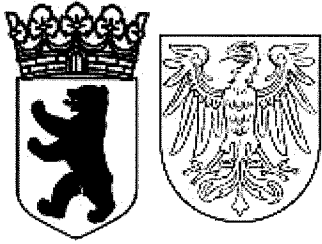
Generally accepted accounting principles

≠ US-GAAP

≠ IAS/IFRS

Generally accepted accounting principles were developed over a long time and are today part of the German Commercial Act.

There is no standard setting Committee (like the IASB or FASB).



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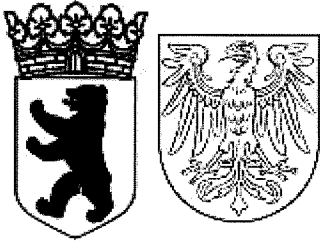
Commercial and Tax Accounting in Germany

Part I

Generally accepted accounting principles are (examples)

- Completeness („Vollständigkeitsprinzip“)
- Prohibition of offset („Saldierungsverbot“)
- Going concern („Going concern“, „Fortführungsprinzip“)
- Prudence („Vorsichtsprinzip“)
- Individual valuation („Einzelbewertungsprinzip“)

Not an accounting principle is true and fair view



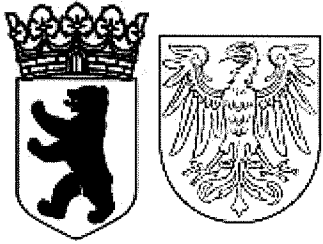
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Commercial and Tax Accounting in Germany

Part I

Problems implied by the principle of dependence („Maßgeblichkeitsprinzip“):

- Changes in the Commercial Act have an impact on tax accounting
- The accounting principle „Prudence“ collides with the purpose of tax accounting to state the taxpayer's (real) ability to pay
- The development of a Common Consolidated Corporate Tax Base (CCCTB) in Europe would put an end to the principle of dependence

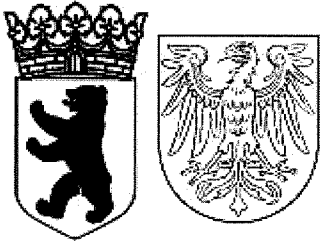


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Commercial and Tax Accounting in Germany

Part I

Sec. 5 para 1 Income Tax Act: Traders who are obliged, on the basis of statutory provisions, to keep books and to prepare financial statements in regular intervals, or who do so without any such obligation, have to apply the business assets for the end of the fiscal year that have to be shown **pursuant to generally accepted accounting principles of commercial law**, unless another carrying value is or was chosen in the frame of exercise of a tax option right.



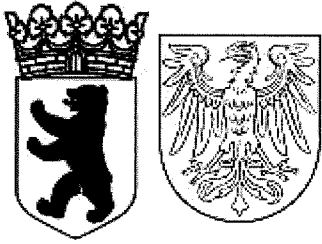
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Commercial and Tax Accounting in Germany

Part I

Sec. 5 para 6 Income Tax Act: Provisions on withdrawals and contributions, on admissibility of changes in the balance sheet, on operating expenses, on valuation and on depreciation for wear and tear or asset depletion have to be complied with.

-> Special provisions in the Income Tax Act or Corporate Tax Act prevail over the generally accepted accounting principles.



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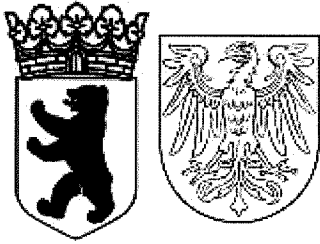
Commercial and Tax Accounting in Germany

Part I

-> Generally Accepted Accounting Principles have to be applied for tax accounting purposes

Most of these principles are today in the Commercial Code, but not all of them (e.g. materiality),

and sometimes (rarely) the Commercial Code states rules which contradict the generally accepted accounting principles



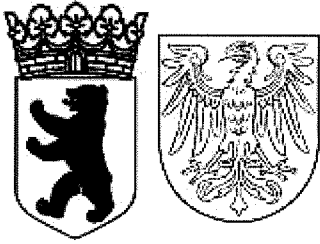
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Commercial and Tax Accounting in Germany

Part I

Examples for special tax regulations which contradict generally accepted accounting principles and/or regulations in the Commercial Code:

- Various regulations concerning both recognition and valuation of provisions (to be dealt with in Part III)
- Regulations on depreciation for wear and tear, Sec. 7 para 1 Income Tax Act
- Regulations on costs of production of buildings, Sec. 6 para 1 No. 1.a Income Tax Act



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Commercial and Tax Accounting in Germany

Part I

Sec. 6 para 1 No. 1.a Income Tax Act:

Costs of production of a building also include expenditures for repair and modernization measures that are carried out within three calendar years after acquisition of the building in case that the expenditures excluding value added tax exceed 15 per cent of the acquisition costs of the building (production costs related to acquisition). ...

France

- Strong connection between tax and accounting
- Thin legal basis for connection
 - Income tax: art. 38 quater Annex III General Tax Code:
« Businesses must abide by the definitions set in the General Accounting Plan, unless they are incompatible with the rules governing the tax base »
 - Local Business Tax: uses value-added as tax base: no explicit reference to accounting rules but concepts borrowed from accounting
- Case law: connection unless tax law differs

France

- Commercial code not very detailed for accounting
- General Accounting Plan approved by Economy Minister
- Authority for Accounting Rules (2009): prepares accounting regulations, approved by Minister
- AAR also issues opinions
- Opinions by professional associations representing accountants

Brazil

PART I

1) How is the tax/accounting relationship set up in tax law?

- Relationship is explicit and regulated by law
- Commercial law determines that financial statements will be based on GAAP
- Specific activities (banking, insurance) must adopt separate books

Brazil

History

Phase 1 – until 2007

- “Pure GAAP” was not completely adopted
- Tax law determined accounting procedures for tax purposes
- Davos – “Brazilian GAAP” was challenged by international investors

Brazil

Phase 2 – from 2007 to 2014

- Pure GAAP for accounting purposes

- Br GAAP for tax purposes

- 2 financial statements

- Problems

- Example: dividends are tax exempt. How do you calculate dividends? According to pure GAAP or to BR GAAP?

Brazil

Phase 3 – from 2014 to today

- Pure GAAP fully adopted for accounting purposes
- Tax law determines a list of adjustments :
earnings not taxed and expenses non deductible

Brazil

- **Example of adjustment: depreciation**

- Tax accounting
 - 100% of the amount of the asset is depreciated according to a fixed period of time determined by tax authorities (cars within 5 years, real estate within 25 years etc)

- Commercial accounting
 - The company estimates how many years the asset will be used and the price of resale. Only the difference will be subject to depreciation.

Brazil

Case law:

Deductibility of provision for bad debt for banks :

- Central Bank determines conservative rules (increased provisions)
- Tax law determines non conservative rules (decreased provisions)
- Banks challenged the tax law and wanted to apply Central Bank regulation for tax purposes
- Courts decided against Banks

Brazil

2) What does tax accounting mean for tax purposes?

- Commercial law determines that financial statements will be based on GAAP
- Accounting Rules Committee issues rules (based on international standards)
- Private association with 12 members appointed by private associations
- Rules may be or may not be approved by regulators. If approved they are mandatory

- Example:
 - Rules approved by the Central Bank are mandatory for banks
 - Rules approved by SEC are mandatory for listed companies
 - Rules approved by the Accountants Association are mandatory for accountants



Tax Court of Canada

Use of Commercial Accounting under the Income Tax Act

The Honourable Justice Steven D'Arcy

Canada

Determination of Income

- Generally speaking, under section 3 of the *Act*, income of a taxpayer for a taxation year is income (or loss) from a source, including taxpayer's income from each of
 - an office,
 - employment,
 - a business and
 - property.

Canada

Income from a Business or Property

- Section 9 of *Act* – Taxpayers income for a taxation year from a business or property is the taxpayer's *profit* for that business or property.
- Section 9 is subject to various statutory adjustments contained in the *Act*.

Canada

Income from a Business or Property

- Profit not defined in the *Act*.
- One of the most litigated provisions of the *Act*.
- Leading case: decision of the Supreme Court of Canada (the “SCC”) in *Canderel Ltd. v. R.* [1998] 1 SCR 147.

Canada

SCC's Six Principles

- The determination of profit is a question of law.
- The profit of a business for a taxation year is to be determined by setting against the revenues from the business for that year, the expenses incurred in earning said income.
- In seeking to ascertain profit, the goal is to obtain an accurate picture of the taxpayer's profit for the given year.

Canada

SCC's Six Principles

- In ascertaining profit, the taxpayer is free to adopt any method which is not inconsistent with
 - the provisions of the *Act*;
 - established case law principles or “rules of law”; and
 - well-accepted *business principles*

Canada

SCC's Six Principles

- Well-accepted business principles, **which include but are not limited to the formal codification found in GAAP**, are not rules of law but interpretive aids.
- To the extent that they may influence the calculation of income, they will do so only on a case-by-case basis, depending on the facts of the taxpayer's financial situation.

Canada

SCC's Six Principles

- On reassessment, once the taxpayer has shown that he has provided an accurate picture of income for the year, which is consistent with the *Act*, the case law, and well-accepted business principles, the onus shifts to the Minister to show
 - either that the figure provided does not represent an accurate picture, or
 - that another method of computation would provide a more accurate picture.

Canada

Well Accepted Business Principles

- Well accepted principles of business (or accounting) practice, also referred to as ordinary commercial principles or well accepted principles of commercial trading
- Codified in *generally accepted accounting principles (GAAP)*
- Non-legal tools; external to the legal determination of profit.

Canada

Well Accepted Business Principles

- GAAP will generally form the foundation of well accepted business principles.
- However, Courts must not delegate the criteria for the legal test of profit to the accounting profession.
- There may be occasions where GAAP and well-accepted business principles recognized by law differ.

Canada

Well Accepted Business Principles

- SCC – “To the extent that they may be applicable to particular circumstances, *well-accepted business principles* are to be assessed and applied only on a case-by-case basis, and only for the purpose of achieving an accurate picture of profit for the year in question for income tax purposes.”

Financial and Tax Accounting

Judge Yoon, Junseok

yon.junseok7@gmail.com

Part 1

Relationship Between Financial and Tax Accounting

Corporation Tax Act (1949) v. Financial Accounting (1959)

Corporation Tax Act Article 43

- The Corporation Tax Act clarifies the relationship.
- Tax Accounting (T/A) > Financial Accounting (F/A)

Why do two systems of T/A and F/A exist?

- Tax law does not have all provisions for taxable income (T.I.).
- Different objectives between T/A and F/A
 - To Prevent tax avoidance v. To Provide accurate information

Part 1

Relationship Between Financial and Tax Accounting

Financial Accounting Standards

- Korean-International Financial Reporting Standards (**K-IFRS**)
- Korean-Generally Accepted Accounting Principles (**K-GAAP**)
- Accounting standards classified by types of business approved by the Securities and Futures Committee
- Accounting standards enacted under other Acts approved by the Minister of Strategy and Finance.

Part 1

Relationship Between Financial and Tax Accounting

Korea Accounting Standards Board (KASB)

- Private organization composed of accounting professionals
- Authorized by the Financial Services Commission (FSC)
- KASB has adopted the IFRS as K-IFRS approved K-GAPP

- K-IFRS for listed corporations.
- Unlisted Corporations may elect to adopt K-IFRS or K-GAPP.
- K-IFRS and K-GAPP are mandatory.

Part 1

Relationship Between Financial and Tax Accounting

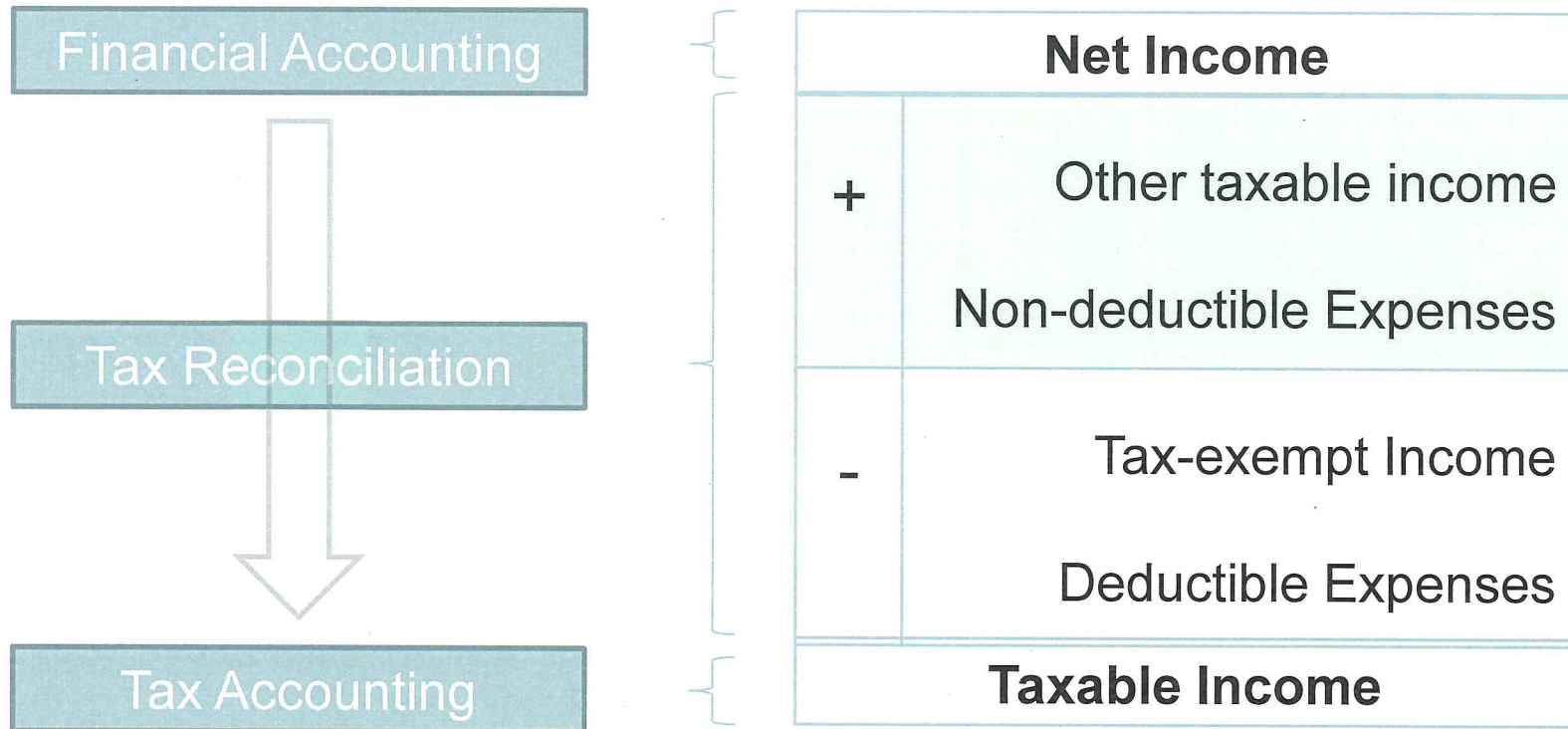
Examples of tax legislation which are different from F/A

		Accounting Standards	Tax Legislation
Recognition	Bad Debt	Fully Deducted	Limited
	Donations		Limited
	Tax, Fine		No
Timing	Accrued Interest	Accrual Basis	Between Accrual and Cash Basis

Rebate, Depreciation expense (in Part 3)

Part 1

Relationship Between Financial and Tax Accounting



Part 1

Relationship Between Financial and Tax Accounting

Tax Reconciliation for Income

- All the sources of income that are not accounted for in F/A may be included as T.I.

Tax Reconciliation for Expense

- Only those listed by tax law
- Two different ways exist for tax reconciliation.

Part 1

Relationship Between Financial and Tax Accounting

Accounts Receivable
(A/R)

\$100



Irrecoverable loss

Case 1. A debtor's bankruptcy

If the A/R would be deducted in F/A (reflected in F/S),

Thus resulting in a deduction from T.I.

If the A/R has not already been reflected in F/S,

It may not be deducted form T.I.

Part 1

Relationship Between Financial and Tax Accounting

Case 2. An expiration of 5-year extinctive prescription period

The A/R may be deducted from T.I., even if it is not recognized in F/S

Introductory slides

**Commercial Accounting Vs Tax Accounting -
the changing paradigm in India**

Pramod Kumar, India

IATJ Annual Assembly @ Helsinki* October 6, 2017

Background

•Section 145 of the Income Tax Act, 1961, as it then stood, provided that “income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee”. Where no method of accounting was employed, where accounts were incomplete or incorrect, the income could not be properly deduced from the method of accounting regularly employed by the taxpayer, the computation of income was to be done on the basis of best judgment of the Assessing Officer.

•As to what should be the correct method of accounting, the statutory provision had nothing to say. It was in this backdrop that the courts and tribunals frequently had to deal with as to what is the right accounting approach. There are a number of decisions which deal with this aspect, and these decisions held, time and again, that the taxable income must be determined on the basis of correct accounting principles. Whether as to what constitutes ‘actual cost of an asset’, how the income from borrowed funds, during the period of business being set up, is to be treated, what are the principles on the basis of which closing stock is to be valued, the Courts have consistently referred to Indian GAAP and guidance notes of the professional bodies.

Background

- Of course, wherever the Income Tax Act had specific provisions dealing with certain situations, such as deductions for unpaid government duties, deduction for provisions, or deductions for expenditure incurred, without making appropriate tax withholdings, or taxation on presumptive basis, these provisions held the field irrespective of the accounting method employed by the assessee.
- A small step was taken for introduction of accounting standards in 1996 and making it mandatory for the assessee to follow the same, only two accounting standards were notified in Section 145(2). The formulation of tax accounting standards started in 2002 and the first set of tax accounting standards, which are known as ICDS and which replace earlier two accounting standards as well, were notified in 2015- later amended in 2016. Where the taxpayer does not follow these mandatory standards, the Assessing Officer has the liberty to make a best judgment assessment.

The game changers- ICDS and IndAS

Introduction of Indian Accounting Standards (Ind AS), prescribing the manner in which accounts are to be maintained, and making them mandatory for specified companies— notified by Ministry of Corporate Affairs, Govt of India, in February 2015

Effective from the financial year ending March 2017, IndAS is made mandatory for all the companies with a net worth of INR 500 crores (€ 65 million approx). In the next year, it will be mandatory for all the listed companies and any unlisted company, irrespective of their net worth, and all other companies with a net worth of INR 250 crores (€ 32.5 million approx)

Introduction of the new Income Computation and Disclosure Standards (ICDS), prescribing the manner in which taxable commercial profits etc are to be computed for the purpose of taxation under the Income Tax Act (ITA), and making them applicable on almost all such taxpayers, was notified by the Central Board of Direct Taxes, Govt of India, in September 2016

In case of conflict between provisions of the ITA and the new ICDS, the ITA provisions prevail. The provisions of presumptive taxation of income, artificial disallowances under the statute, MAT and restrictions on deductibility of provisions etc thus ordinarily remain intact, except, say, computing threshold application limit on the basis of ICDS revenue recognition principle.

ICDS and IndAS – Broad approach

- There is a clear demarcation of principles on the basis of which tax accounting and commercial accounting is to be done.
- While commercial accounting provides for the basis of accounting, the tax accounting provides for the basis on which the taxable commercial profit is computed.
- The thrust of IndAS is convergence with the global reporting standards in an integrated global market, and that is the direction in which commercial accounting is moving.
- The thrust of ICDS, on the other hand, to minimize the alternatives, reduce the litigation and provide taxpayer certainty, and that is the direction in which tax accounting is moving in India.
- IndAS apply on specified relatively large and medium sized companies, while Accounting Standards (Indian GAAP) hold field for the remaining companies.

Applicability of ICDS

- All taxpayers, whether resident or non-resident, are required to compute taxable income in respect of commercial profits on the basis of ICDS. No threshold limit for application of ICDS.
- In respect of all commercial profits- whether under the head 'profits and gains from business and profession' or under the head 'income from other sources'. There are three other heads of income, which can be taxed under the Indian Income Tax Act, i.e. income from salaries, income from house property and capital gains, but then none of these heads deal with the commercial profits.
- ICDS issued so far in respect of **(i) Accounting Policies; (ii) Inventories; (iii) Construction Contracts; (iv) Revenue Recognition; (v) Tangible Fixed Assets; (vi) Effect of Changes in Foreign Exchange Rates; (vii) Government**

Application of IndAS and Indian GAAP

- IndAS applicable, as on now, applies mandatorily only on the listed companies, whether listed in a stock exchange in India or abroad, and on companies with a net worth of more than INR 250 crores (€ 32.5 millions)
- All other companies are required to follow Accounting Standards specified in Annexure to Companies (Accounting Standards) Rules, 2006 i.e. Ind GAAP, unless such companies voluntarily adopt IndAS.
- ICDS prevails over IndAS and I-GAAP but the specific provisions of the Income Tax Act prevail over ICDS as well

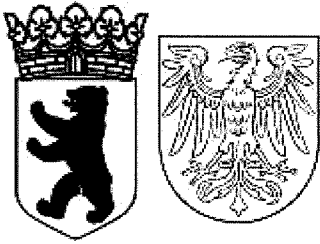
Is ICDS questioning basic accounting principles?

- Is accounting principle of conservatism valid any longer, with particular reference to preponement of revenue recognition and booking incomes before the income actually accrues or arises- merely based on possibilities? Are the Courts likely to approve such departure from the first principles of accounting?
- Are the commercial realities not being ignored? Does it, for example, not make any difference, so far as foreign currency translations are concerned, whether the foreign operations are integrated operations or non-integrated, i.e. standalone, operations? How would courts view such an approach?
- If all the judicial precedents on the interpretation of courts on accounting principles are to be ignored, does it not amount of wholesale burial of the well settled law on correct accounting principles? Will such an approach meet the tests of judicial scrutiny?

Part II

Choices made by tax courts

Question 1: Do courts have to deal with a « grey area » where legislation does not fully define the relationship between commercial and tax accounting ?



Dr. Susanne Tiedchen
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Commercial and Tax Accounting in Germany

Part II

Question 1:

The relationship is set up clearly in Sec. 5 para 1 Income Tax Act, but there is a discussion about the range of the reference „that have to be shown pursuant to generally accepted accounting principles of commercial law“.

France

- Income tax: specific accounting treatment may be neither a « definition » nor clearly contradicted by tax law
- Business tax: General Tax Code lists items used for calculation of value-added, obviously accounting items but no reference to any specific accounting regulation

Brazil

PART II

- Grey area: yes because tax law cannot list ALL the possible adjustments
- GAAP is subjective and criteria change
- National Tax Code: income tax is due if the right to receive the income is completely vested and the amount completely determined.
- In case of conflict, tax law prevails

Part 2

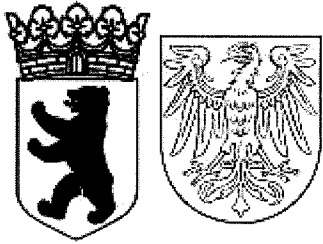
Q1. Grey Area

Technically there should be no grey area between F/A and T/A; as the tax law holds priority and those not specified by the tax law may be accounted for according to F/A.

The grey area exists mostly in interpreting the tax law itself.

Part II

Question 2: Is there a court philosophy about connection or disconnection?



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Part II

Question 2:

No, as the principle of dependence has to be followed

France

- Conseil d'Etat has almost elevated the tax/accounting connection to the rank of general principle of tax law
- Reasons given: simplicity, legal certainty
- In borderline cases, accounting treatment prevails if no clearly diverging tax rule (e.g. CE 27 June 1994 121748 Villeroy et Boch, about fixed costs in case of under-production)

Part 2

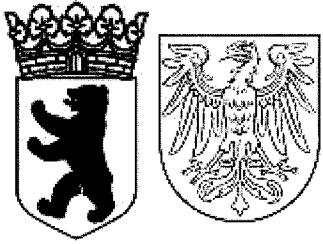
Q2. Court Philosophy

No, as prescribed by tax law.

And it's a matter of interpretation of tax law.

Part II

Question 3: Do tax courts define and apply principles of tax law that may prevent the full application of commercial accounting solutions?



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Commercial and Tax Accounting in Germany

Part II

Question 3:

Tax courts interpret the accounting principles, and sometimes they do so (without openly saying so) in the light of the purpose of tax accounting (state the taxpayer's ability to pay)

France

- No « tax principles » used against accounting if accounting treatment is not contradicted by the wording of tax law

Part 2

Q3. Applying Principles of Tax Law

Tax courts have set aside F/A standards by prioritizing tax legislation, instead of the sole principles of tax.

Corporate Tax Act Article 19

Deductible expenses.....shall be losses or expenses.....directly related to the business.....normal practices of the industry and correlate directly to the derivation revenue.

In each case, tax courts may consider various factors such as legal certainty, objective of T/A to interpret and apply the tax law.

Part 2

Q3. Applying Principles of Tax Law

Corporation Tax Act Article 52 [**Denial of certain transactions**]

For tax purposes, tax authorities may deny certain transactions which are reduced unjustly tax burden.....still valid for financial purposes.

Certain income that has not been recognized under F/A may be included as taxable income or certain expense that has recognized under F/A may not be deducted from T.I.

Part 2

Q3. Applying Principles of Tax Law

Specifically the Substance over Form Principle is applied in tax law.

This prevents those who with special influence from manipulating T.I. through transaction with related parties.

Examples would be;

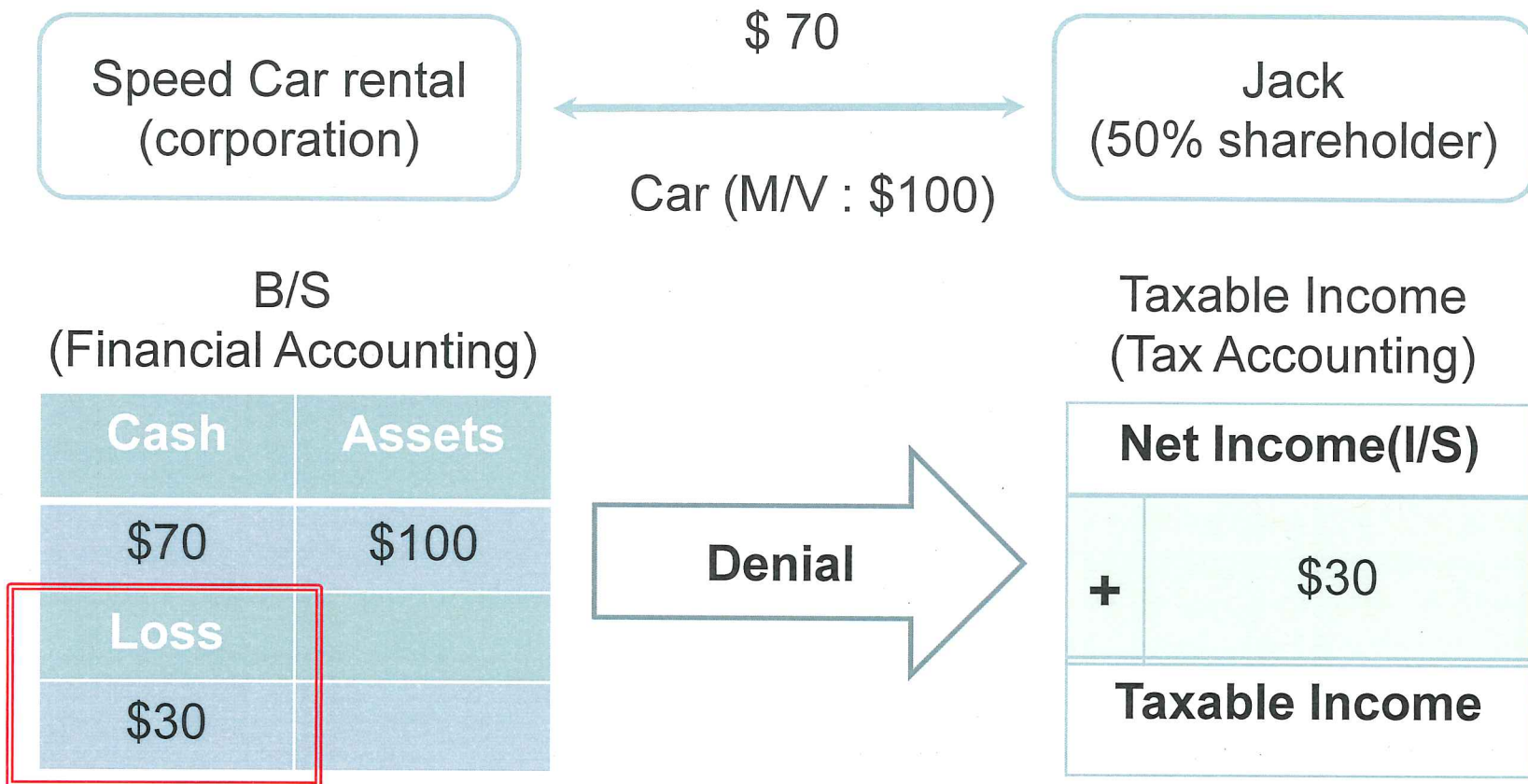
Purchasing assets from a related party at significantly higher price

Selling assets to a related party at significantly lower price

12 transaction types are specified in the tax law.

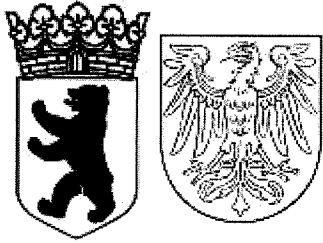
Part 2

Q3. Applying Principles of Tax Law



Part II

Question 4: Do tax courts make distinctions between accounting rules, professional accounting guidelines and accounting doctrine?



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Commercial and Tax Accounting in Germany

Part II

Question 4:

Tax courts apply the generally accepted accounting principles only,

but professional accounting guidelines are taken into account as part of the discussion in the same way other decisions, commentaries and articles in law journals are taken into account.

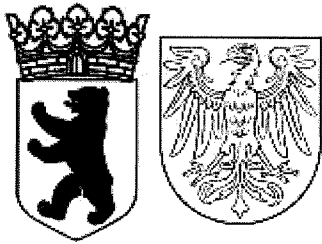
Tax courts do not apply or even look at foreign standards like IAS/IFRS or US-GAAP

France

- Tax courts apply accounting regulations
- Strong case law following accounting opinions given by Authority for Accounting Rules (or predecessor). Even willingness to reconsider a court solution after contrary accounting opinion (CE 2 June 2006, 269998, Unilever: provisions for discount coupons issued by companies)
- Otherwise opinions by accountants are looked at but there is a margin for court interpretation

Part II

Question 5: Do tax courts interpret commercial accounting rules? How do accountants feel about this?



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Commercial and Tax Accounting in Germany

Part II

Question 5:

Yes, the tax courts are the courts who predominantly interpret commercial accounting rules.

France

- Tax courts are major source of judicial interpretation of accounting rules
- But development of accounting opinions by Authority for Accounting Rules

Part 2

Q4 & Q5. Interpretation of Accounting Standards

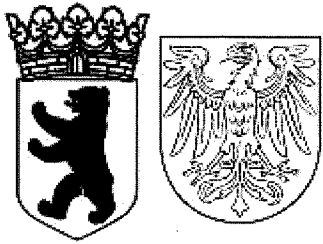
Interpretation of F/A standards and priority of application among F/A standards rarely become material issues in cases pending at the courts.

Not otherwise provided by tax legislation, tax courts may follow K-IFRS and K-GAPP in the light of professional accounting guidelines.

Part III

Selected issues

Issue 1: Characterization of contracts
(Legal analysis, accounting analysis,
economic analysis?)



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Commercial and Tax Accounting in Germany

Part III

Issue 1: Characterization of contracts

- Courts are not bound by the legal labeling the parties use
- Economic approach as a method of interpretation

Brazil

PART III

- **Issue 1** – repurchase agreement
(grey area)
- **Facts:**
 - Company has a building (book value of 100).
 - It is going to be sold to independent third party for 120.
 - The building will be repurchased by the Company after 3 years for 150
 - During the 3 year period the building will be rented by the Company.

Brazil

- **Tax law:**
- Whenever an asset is sold, capital gain must be taxed
- Therefore the Company should pay income tax on 20

- **Accounting Rule:**
- Considering that the building will be used by the Company during the 3 year period
- Considering that the building will be repurchased
- There is no “sale” and there is no “gain”
- The operation is a loan and 50 must be posted as financial expense
- Substance over form

Brazil

- **Proposed solution**
- Accounting rules may not change the juridical nature of the contract
- A sale is a sale. Capital gain is capital gain. A loan is a loan.
- Tax law prevails

Brazil

- **Issue 1** - exchange of assets
(grey area)
- **Tax Law:** assets exchanged are booked at cost value and are not subject to capital gain.
- **Accounting rule:** if assets exchanged are of different nature, they must be booked at fair value and capital gain is recognized.

Brazil

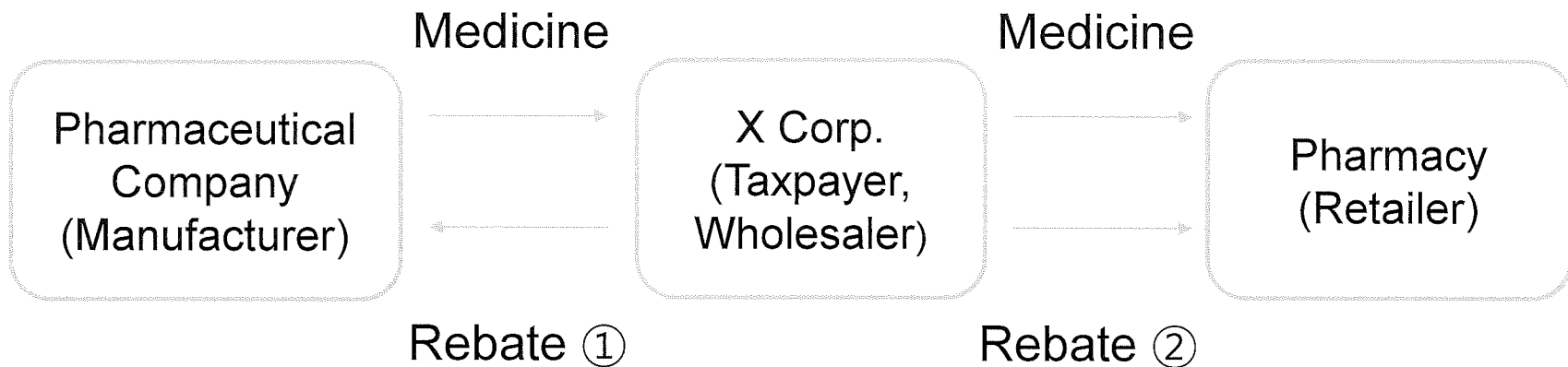
- **Proposed Solution**
- National Tax Code:
 - income tax is due if the right to receive the income is completely vested and the amount completely determined.
- Exchange of assets
 - There is no vested right to income
 - There is no determined amount of income (fair value!!)
- Tax Law prevails

Part 3

Issue 1. Characterization of contracts

Supreme Court Decision 2012Du7608 Decided in Jan. 15, 2015

Facts



All rebates recognized as sales promotion expense in F/S

Part 3

Issue1. Characterization of contracts

Judgment

Rebate ① (to manufacturer) → Ordinary expense

As inventory control is a key component as is the recognition of unequal balance between manufacturer and wholesaler.

This rebate is widely recognized as normal business practices.

Part 3

Issue1. Characterization of contracts

Judgment

Rebate ② (to retailer) → Not Ordinary expense

This rebate may cause the increase of unnecessary medicine sales and abuse of medicine, which may endanger public health, even if it was not prohibited by related regulations at the time of issuance.

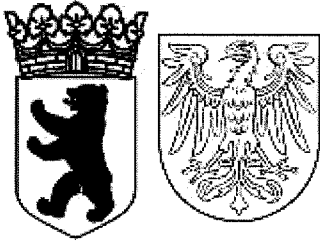
Part III

Issue 2: Provisions

Tax rules different from accounting rules?

Tax deductibility only if taxpayer creates accounting provision?

Can taxpayer create accounting provision but not deduct it fiscally?



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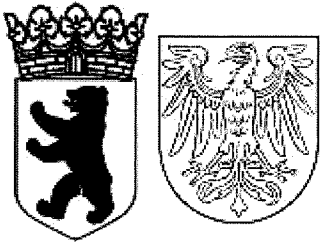
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Part III

Issue 2: Provisions

Sec. 5 para 3 Income Tax Act: Provisions for the infringement of third party patent rights, copyrights or similar property rights may only be established in the event that

1. claims were asserted by the right holder for infringement of the right or
2. there is a serious risk of assertion of claims based on the infringement of the right



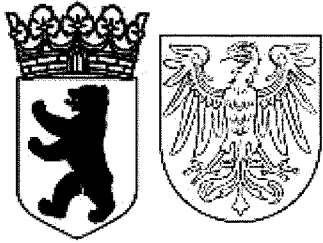
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Part III

Issue 2: Provisions

Sec. 5 para 4 Income Tax Act: Provisions for an obligation to make a grant on the occasion of an anniversary of service may only be established in case that the employment relationship exists for at least ten calendar years, the anniversary of service requires the existence of an employment relationship of at least 15 calendar years, the commitment was made in writing and to the extent that the beneficiary if the grant acquires his expectancy after 31 December 1992.



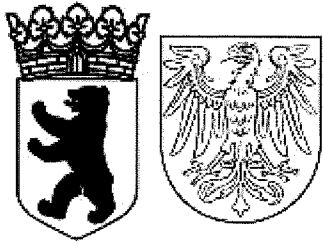
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Part III

Issue 2: Provisions

Sec. 5 para 4a Income Tax Act: Provisions for imminent losses from pending transactions may not be established. ...



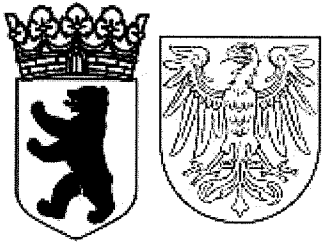
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Part III

Issue 2: Provisions

Sec. 5 para 4b Income Tax Act: ... Provisions for an obligation to safe recovery of radioactive residues and demounted or dismantled radioactive components of plants may not be established, to the extent that expenditures are related to treatment or processing of nuclear fuel that was recuperated from processing of irradiated nuclear fuel and does not qualify as radioactive waste.



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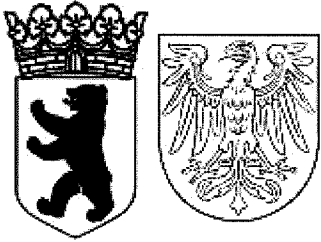
Part III

Issue 2: Provisions

Sec. 6 para 3a Income Tax Act: A maximum recognition of provisions has to be based on the consideration of the following principles, in particular:

...

c) future advantages that will presumably be connected with the performance of the obligation have to be taken into account, to the extent that they do not need to be capitalised as receivables, in impairment terms in their valuation; ...



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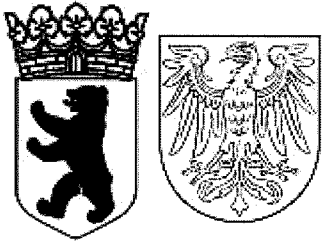
Part III

Issue 2: Provisions

Sec. 6 para 3a Income Tax Act: A maximum recognition of provisions has to be based on the consideration of the following principles, in particular:

...

d) provisions for obligations the arising of which in economic terms was caused by the going concern have to be accumulated on a pro rata temporis basis in equal installments. ...



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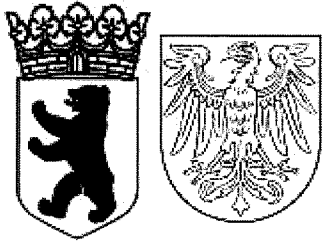
Part III

Issue 2: Provisions

Sec. 6 para 3a Income Tax Act: A maximum recognition of provisions has to be based on the consideration of the following principles, in particular:

...

e) provisions for obligations have to be discounted with an interest rate of 5,5 per cent; ...



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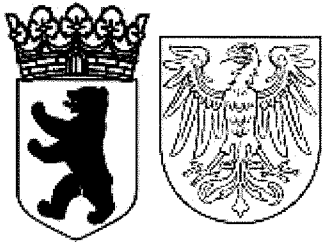
Part III

Issue 2: Provisions

Sec. 6 para 3a Income Tax Act: A maximum recognition of provisions has to be based on the consideration of the following principles, in particular:

...

f) For valuation, the conditions applicable as of the balance sheet record date is relevant; future increases of prices and costs may not be taken into account.



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Part III

Issue 2: Provisions

As of 2010, the deductibility of a provision for tax purposes does not require that said provisions was deducted in the annual financial statement.

Provisions in the annual financial statement are usually deducted in the tax balance sheet as well, unless Sec. 5 or 6 Income Tax Act state otherwise.

France

- Accounting provisions are tax-deductible unless tax law says otherwise
- Under tax law, some provisions are not deductible (retirement, termination of employment)
- Tax law uses concept of event in tax year that makes the expense or loss likely

France

- Tax law requires that provisions be created in accounting in order to be tax-deductible
- Case law: provision created in accounting must be deducted for tax purposes. No option to have provision in accounting but not in tax (CE 23 December 2013, 346018, Foncière du Rond-Point)

Brazil

- **Issue 2** – provisions
(black and white area)
- Deductible provisions are only those listed by tax law
- All the others are non deductible

Part 3

Issue2. Provisions

There are 3 requirements for deductible expense.

Certain expenses are required to be listed in F/S

- Example of A/R (Bankruptcy case)

Part 3

Issue2. Provisions

It's not common to exclude recognizable expense for tax purpose

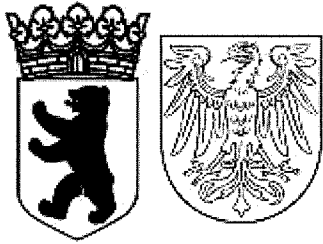
- If the line item created is a recognizable expense, a taxpayer must deduct it for tax purpose.
- If the item is not an unrecognized expense (such as legal reserve), a taxpayer may elect to deduct or not for tax purposes as prescribed by tax law.

Part III

Issue 3: Accounting options

Can taxpayers choose an accounting standard for tax purposes?

If accounting rules allow an option, do tax courts follow taxpayer's choice?



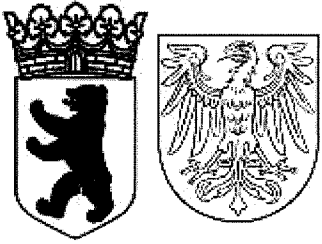
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Part III

Issue 3: Accounting options

None as far as choosing accounting standards



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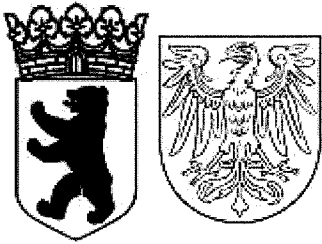
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Part III

Issue 3: Accounting options

No tax option rights („Wahlrechte“) as far as tax accounting is concerned.

Tax accounting leads to tax paying, and taxpayers must be treated equally in a way that they must be taxed according to their ability to pay.



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Part III

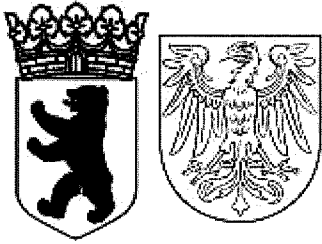
Issue 3: Accounting options

No tax option rights („Wahlrechte“) as far as tax accounting is concerned.

Example: depreciation for wear and tear

Commercial accounting: any method that does not contradict the generally accounting principles is allowed

Tax accounting: only one method allowed (mostly depreciation in equal annual instalments)



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Part III

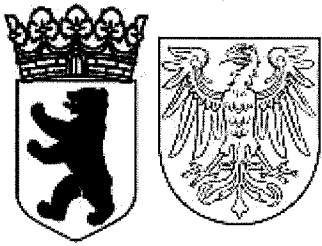
Issue 3: Accounting options

No tax option rights („Wahlrechte“) as far as tax accounting is concerned.

Example: procedures for simplifying valuation for similar inventory assets

Commercial accounting: It may be assumed that either the first or the last assets acquired or produced were consumed or sold first. (Sec. 256 Commercial Code)

Tax accounting: It may be assumed that the last assets acquired or produced were consumed or sold first. (Sec. 6 para 1 no. 2 a Income Tax Act)



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Part III

Issue 3: Accounting options

No tax option rights („Wahlrechte“) as far as tax accounting is concerned.

Generally: If there is an option right in the generally accepted accounting principles to recognize an asset in the balance sheet, the asset must be recognized in the tax balance sheet. If there is an option to recognize a debt or provision in the balance sheet, said debt or provision must not be recognized in the tax balance sheet.

BFH (Federal Tax Court) GrS 2/68, Feb 3rd 1969, BStBl. II 1969, 291, 293

France

- Tax courts accept the tax consequences of accounting options if accounting law really offers a choice and if it is not incompatible with tax rules
- Accounting choice works both ways: tax administration must accept taxpayer's choice but taxpayer is bound by his decision (CE 20 June 2016, 361832, Gecina)

Brazil

- **Issue 3** – accounting options
(black and white area)
- Taxpayers are free to choose the accounting option and enjoy/suffer the consequences
- Example:
 - Interest charged in the purchase of real estate may be either booked as financial expense or as cost of acquisition of the asset.
 - The accountant may choose. Tax law accepts both alternatives.

Part 3

Issue3. Accounting Options

Taxpayers hold the discretion to choose an accounting method unless a particular method is designated under the tax law.

Best tax solution already exists?

If F/A places sole priority on reducing taxes, it would not serve its original function to present transparent accounting information.

Part 3

Issue3. Accounting Options

Depreciation Expense

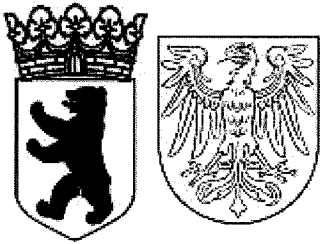
- Expenses only reported in F/S are allowed to be deducted.
- Taxpayers have choices on the period of durable, methods by following the accounting and tax rules.
- Book depreciation : estimated useful life of assets, salvage value
Tax depreciation : fixed method and period provided by tax law
- In actuality, most taxpayers select to adopt the method for tax purposes.

Part III

Issue 4: Accounting mistakes

Can taxpayer argue before tax court that his tax burden should be reduced because he made an accounting mistake?

What if the accounting mistake is fraudulent or deliberate?



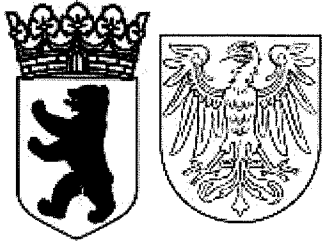
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Part III

Issue 4: Accounting mistakes

Sec. 4 para 2 Income Tax Act: A person subject to taxation may amend the statement of assets (balance sheet) even after its submission to the tax office to the extent that it does not comply with generally accepted accounting principles in compliance with the provisions of this Act; this change is inadmissible in case that a statement of assets (balance sheet) is based on a tax assessment that may neither be set aside nor amended any more. ...



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Part III

Issue 4: Accounting mistakes

Sec. 4 para 2 Income Tax Act (cont.): ... Furthermore, an amendment of a statement of assets (balance sheet) shall only be admissible in the event that it has a close temporal and factual connection with an amendment pursuant to sentence 1 and to the extent that the profit is impacted by the amendment pursuant to sentence 1.

France

- Accounting mistakes (when taxpayer has no choice in accounting law) can be corrected by tax administration or taxpayer (given applicable time limits)
- But taxpayer cannot correct « deliberate tax mistakes », when taxpayer has deliberately violated accounting rules, for tax reasons but mostly for non-tax reasons (artificial improvement of company accounts in order to fool lenders or creditors)

Brazil

- **Issue 4** – accounting mistakes
(black and white area)
- Mistakes may not cause payment of tax
- Mistakes may be corrected any time during the 5 year period
– statute of limitation
- Accounting options may not be changed
- A fraudulent mistake is a mistake.
- May be corrected if against the taxpayer and should be corrected if benefits the tax payer.

Part 3

Issue4. Accounting Mistakes

Tax credits on correction of wrongful accounting

- Corporate Tax Act Article 58-3
- Accounting errors, intentional or not, may be corrected during the 5-year period.
- The overpaid tax is not refunded; but is received as tax credits for the following the 5-business year.
- Only maximum of 20% of the credits may be used each year.

Part 3

Issue4. Accounting Mistakes

Accounting fraud

- The Supreme Court rules that credit for overpaid tax may be deducted according to the tax rule notwithstanding the accounting fraud.
- It's because of the Substance over Form Principle on tax imposition.