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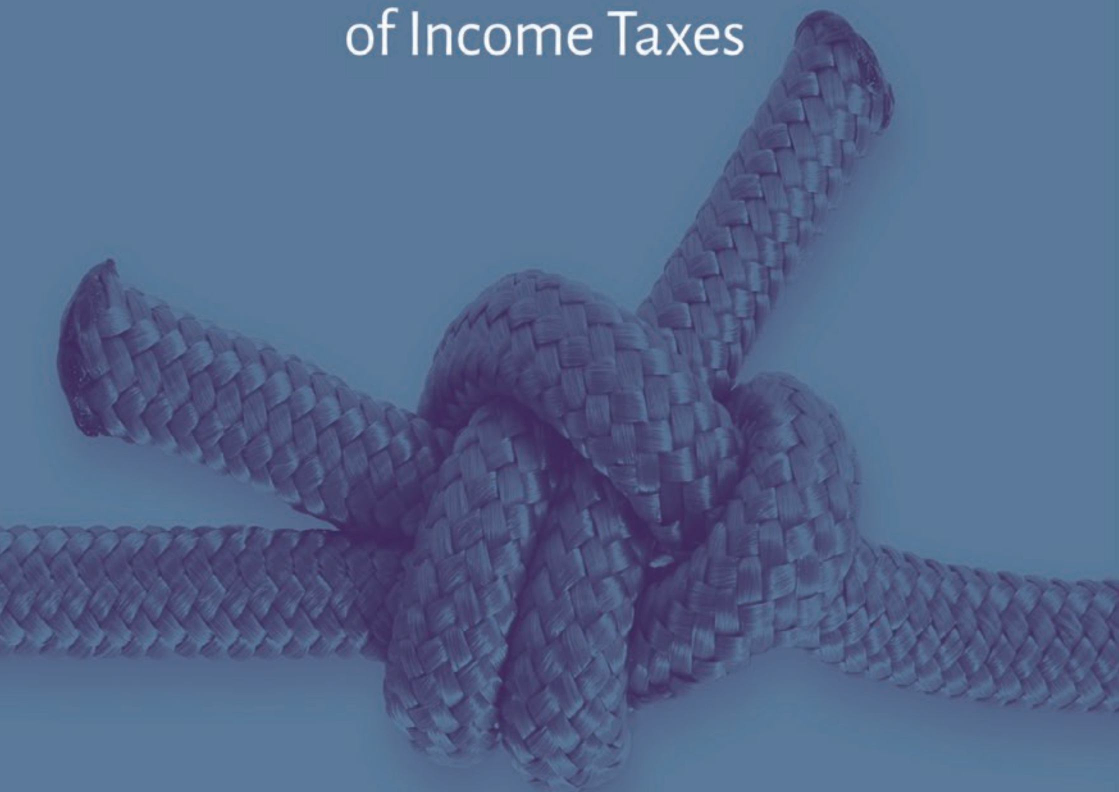
Tax Accounting

Unravelling the Mystery of Income Taxes



IBFD

Tax Accounting: Unravelling the Mystery of Income Taxes (Second Revised Edition)

Why this book?

Since the publication of the first edition of the book in 2015, numerous changes have taken place in the world of tax accounting. In addition to compressed close cycles and new reporting considerations and standards, companies are facing challenges due to increased regulatory scrutiny over income tax disclosures and account balances. At the same time, today's complex business and tax environment has resulted in ever-increasing demands for transparency and tax reporting standards at all levels. Public deficits due to COVID-19 support packages will only trigger more public attention to tax affairs. Moreover, guidance has been issued on good tax governance and/or tax risk management, and tax reporting and compliance by the UN Principles for Responsible Investment and the newly developed GRI 207: Tax 2019, which is the first public global standard for comprehensive tax disclosures.As with the previous edition, the basis of the book remains a ten-step methodology for accounting for income taxes, which can be applied in jurisdictions across the globe. The methodology presented is primarily based on the global accounting standard, namely the International Financial Reporting Standards (IFRS), with specific attention to US GAAP and some local standards. This methodology is comprehensive and complete. This updated edition covers the latest IFRS and IFRIC guidance for income taxes. Essentially, all chapters have been rewritten to cover new developments such as (i) digital services taxes; (ii) IFRIC 23 Uncertainty over Income Tax Treatments; (iii) tax accounting and tax risk management checklists; (iv) the impact of technology and new transparency initiatives; and (v) the impact of COVID-19 on companies.

The impact of COVID-19 on the results of companies' operations is discussed, consideration being given to the challenges the current market volatility may present for companies closing their financial statements. Other issues addressed include deferred tax assets recognition, impairment, increased need of cash by a group and distribution of dividends, and government grants and reliefs. Finally, a case study gives the reader a better understanding on how to arrive at the correct tax figures and disclosure notes, and in doing so truly unravels the mystery of how the reported income taxes can be explained.

Benefitting from the extensive insight and experience of the authors, the book will serve as a valuable reference tool to assist tax accountants, (tax) auditors, tax authorities, legislators, tax practitioners, and tax managers and directors in their daily practice, as well as a guideline for newcomers to the tax accounting environment.

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Foreword

When we published the first edition of this book in 2015, we presented a ten-step methodology for accounting for income taxes that can be applied in every jurisdiction around the globe. The methodology presented is primarily based on the global accounting standard, namely the International Financial Reporting Standards (IFRS), with specific attention to US GAAP and some local standards. This methodology is comprehensive and complete. At that point in time, the general public was also increasingly interested in the fiscal position of companies. Back then, we mentioned as an example the OECD BEPS developments, for instance in relation to country-by-country reporting and the disclosure of payments of income taxes by companies to the respective local authorities that might become an element of financial statements in the near future.

It has been only five years, but so many changes have taken place since then. On top of compressed close cycles, as well as new reporting considerations and standards, companies are facing challenges due to increased regulatory scrutiny over income tax disclosures and account balances. In today's increasingly complex business and tax environment, the demands for transparency have never been stronger. An ever-wider variety of stakeholders show an interest in how tax affairs are being managed and how much companies pay. Public deficits due to COVID-19 support packages will only trigger more public attention to tax affairs. Further, the guidance with respect to tax reporting increased at EU, OECD and jurisdictional level. In addition, guidance has been issued on good tax governance, tax risk management, and tax reporting and compliance by the UN Principles for Responsible Investment (PRI). Most recently, increased attention by the Global Reporting Initiative for taxes resulted in the newly developed GRI 207: Tax 2019 – the first public global standard for comprehensive tax disclosures.

The basis of this book is still the ten-step methodology for accounting for income taxes that can be applied in every jurisdiction around the globe. The chapters of the book, written by experts in the field, aim to apply and explain these ten steps.

This updated publication covers the latest IFRS and IFRIC guidance for income taxes.

Essentially, all chapters have been rewritten to cover new developments, such as: (i) digital services taxes; (ii) IFRIC 23 *Uncertainty over Income*

Tax Treatments; (iii) tax accounting and tax risk management checklists; (iv) the impact of technology and new transparency initiatives; and (v) the impact of COVID-19 on companies.

It is no surprise that the coronavirus (COVID-19) has impacted and will continue to impact the results of companies' operations. Given the volatility of market conditions, closing financial statements may be particularly challenging for many companies. Authors provide guidance on how companies can deal with COVID-19 from a tax accounting and reporting perspective. Items such as deferred tax assets recognition, impairment, increased need for cash by the group and the distribution of dividends, government grants and reliefs are addressed in this publication.

We hope this publication will be useful to all tax professionals, (tax) accountants, (tax) auditors and interested finance professionals working in the academic, consultancy or business environment.

Anuschka Bakker, Manager VAT, Transfer Pricing and Specialist Knowledge Group, IBFD
Tjeerd van den Berg, Partner, Netherlands TRS Practice & EMEA Tax Accounting Services Leader, PwC

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Chapter 1

Introduction to Tax Accounting

Tjeerd van den Berg*

This chapter is based on information available up to 1 July 2020.

1.1. Introduction

For those seeking to embark on a journey to unravel the mystery of income taxes, the necessary guide has arrived. This publication on accounting for income taxes under the International Financial Reporting Standards (IFRS), will serve such travellers well on this journey. This publication integrates an explanation of the essence of tax accounting, touching on primary tax accounting terminology, regulators, as well as other factors such as the influence of media on income tax reporting, calls for transparency and the International Accounting Standards Board (IASB), which publishes the International Financial Reporting Standard. A 10-step methodology is presented to correctly compute, determine and disclose the consequences in the financial statement of a company.

Following this 10-step methodology, both newcomers and trained specialists will appreciate a framework presented for the calculation of the correct income tax expense and preparation of the required disclosures. In addition, all readers will be served well by the discussion of the theoretical background underlying significant income tax related questions and discussion points.

To ensure that the theory discussed in the 10-step methodology directly connects with actual practice, examples are offered that come directly from the practical experience of the various authors. The first and foremost objective is to explain clearly to the reader a methodology regarding how to structure the accounting for income[1] taxes and to acquaint the reader with the theory and background of the various dogmas in the income tax standard.

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1. This is irrespective of whether one is a preparer or an auditor of (the income tax paragraph in) financial statements.

In addition, the place that accounting for income taxes and the respective standard has in the current environment is depicted and explained. The world has changed rapidly, and financial accounting – especially tax accounting – attracts the attention of a variety of stakeholders compared to the late 1990s. At the end of 2014, when the first edition of this publication was published, tax transparency became a serious topic. It is fair to say that the call for transparency is now louder than ever. An ever-wider variety of stakeholders show an interest in how tax affairs are being managed and how much companies pay. Public deficits due to COVID-19 support packages will only trigger more public attention in tax affairs.

Finally, a publication that focuses on accounting for income taxes under IFRS would not be complete without an explanation of the position that these standards have in the world of financial accounting. Furthermore, the topics considered here require an explanation of the organizational structure and procedures applied by the standard setter – the IASB – to arrive at a new reporting standard or interpretation thereof.

This chapter explains the importance of accounting for income taxes. Key definitions will be presented, followed by an explanation of the 10-step plan and thus the core structure of the publication. Next, various initiatives are outlined that promote increased transparency and fairness in the payment of income taxes. Finally, the discussion shifts to the IASB as an organization, as well as the place that the International Financial Reporting Standards have in the world of financial accounting and how the Standards came to be in this position.

1.2. Importance of accounting for income taxes

Many people will ask what is the relevance or importance of accounting for income taxes. The quick answer is that income taxes generally are one of the largest line items on a company's income statement. The more elaborate answer is that there are differences between the rules[2] that govern financial accounting and the rules that govern tax. Thus, the question concerns whether those differences are permanent or temporary in nature and whether these are reflected correctly in the financial statements. This is generally seen as a complex exercise that needs to be performed by tax accounting professionals.

2. For instance, IFRS.

The complexity increases and, thus, the importance, if one looks at accounting for income taxes in the context of multinational companies. The main reason is that tax law is applicable on a jurisdictional basis and differs from one jurisdiction to the next around the world, while the rules that govern financial accounting provide for a single set of reporting standards that are globally applicable. This combined with the fact that income and other taxes impact multiple areas of business, and are embedded through many line items in financial statements, makes taxes and – therefore the accounting for income taxes – a key risk area for many companies.

Tax accountants know and understand tax complexities such as transfer pricing, cross-border issues, hybrid loans and transparent entities. Furthermore, they know and understand the respective differences – either permanent or temporary in nature – that can arise between the principles used for financial reporting and those established by tax law. As can be seen in financial statements – even in single-entity financial statements – the reported tax expense seldom reflects the profit before tax multiplied by the statutory tax rate. Tax accountants focus on those differences. Basically, tax accounting is the fine art of connecting and reflecting the two worlds of financial accounting and tax in the financial statements.

1.3. Primary tax accounting terminology

Before embarking on the tax provision process, it is helpful to understand the objective of the accounting for income taxes standard. The International Financial Reporting Standards[3] explicitly state that their purpose is to prescribe the accounting treatment for income taxes. Specifically, the question concerns how to account for the current and future tax consequences of:

- the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognized in an entity's statement of financial position; and
- transactions and other events of the current period that are recognized in an entity's financial statements.

It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount[4] of that asset or liability.

3. The standard that governs income taxes is IAS 12.
4. Also, the book value reported in the financial statements.

A firm grasp of the most relevant (tax) accounting terms[5] is also essential to understanding the tax provision process. These terms are considered below, following the structure of the financial statements. According to IAS 1,[6] a complete set of financial statements consists of the following elements:

– *A statement of financial position as at the end of the period*. When looking at the statement of financial position (balance sheet) from a tax accounting perspective, the emphasis is on current and deferred tax assets and liabilities.[7] Current tax assets and liabilities represent amounts payable to, or receivable from, taxing authorities at the reporting date. These amounts are based on the taxable profit (or loss) for the past and current period.

  Deferred tax assets and deferred tax liabilities reflect the future tax consequences of temporary differences between the carrying values (or book basis) of assets and liabilities recognized on the balance sheet and their respective tax basis.[8] A deferred tax asset represents the amount of taxes expected to be received or recovered in the future as a result of (i) deductible temporary differences and (ii) the carry-forward of unused tax losses and/or tax credits. A deferred tax liability reflects the amount of income tax expected to be paid/incurred in the future as a result of the reversal of taxable temporary differences. All deferred tax balances are classified as non-current.

– *A statement of comprehensive income for the period*. When looking at the statement of comprehensive income (income statement) from a tax accounting perspective, the emphasis is on current and deferred tax expense.[9] Tax expense/(income) is the aggregate amount included in the determination of profit and loss for the period in respect of current and deferred tax. Current tax expense/(income) is the amount an entity expects to pay/(receive) based on taxable profits/(losses) arising in the reporting period. Deferred tax expense represents the amount expected to be received and/or paid in the future as a result of temporary differences originating and reversing in the reporting period.

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5. IFRS do not contain a single list of definitions. Rather, all individual standards contain their own relevant definitions. Those listed here are predominantly found in IAS 1 and IAS 12.
6. IAS 1, para. 10.
7. IAS 12, para. 5.
8. The tax basis of an asset or liability is the amount attributed to that asset or liability for tax purposes.
9. IAS 12, para. 5.

- *A statement of changes in equity for the period.* When looking at the statement of changes in equity for the period, the emphasis is on the current or deferred tax expense or receivable that is recorded directly in equity or in other comprehensive income (OCI), and thus not in the statement of comprehensive income. This is because, under IFRS, current and deferred tax is to be recognized outside profit or loss if the tax relates to items that are recognized, in the same or different period, outside profit or loss.[10]

- *A statement of cash flows for the period.* The statement of cash flows provides information about the changes in cash and cash equivalents during the reporting period, and requires that cash flows during the period be classified as pertaining to (i) operating, (ii) investing or (iii) financing activities. Income taxes are generally classified as pertaining to operating activities. Additionally, cash outflows for income tax payments made to tax authorities during the reporting period must be separately disclosed in the statement of cash flows or in the notes to the financial statements. In principle, cash flows arising from taxes on income are to be classified as cash flows from operating activities.[11]

- *Notes, consisting of a summary of significant accounting policies and other explanatory information.* From a tax accounting perspective, a key aspect is the required disclosure notes on income taxes.[12] For a complete overview and discussion of the respective disclosures, *see* chapter 8.

- *Comparative information in respect of the preceding period as specified in paragraphs 38 and 38A.*

- *A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.* This element does not have specific[13] tax accounting relevance.

10. IAS 12, para. 61A.
11. IAS 7, paras. 35-36.
12. IAS 12, para. 79 et seq.
13. In addition to what is stated in sec. 1.3., under *A statement of financial position as at the end of the period.*

1.4. How are income taxes accounted for?

Because there is no checklist provided in IAS 12, this publication will introduce a 10-step methodology to correctly compute, determine and disclose income tax consequences in the financial statements of a company. Throughout the publication, detailed explanations and clear examples are provided on all the individual steps that are to be taken to prepare correct financial statements. The 10-step methodology is generally applicable to all (international) financial reporting standards, and although this publication is based upon the IFRS and the respective standard on income taxes (i.e. IAS 12), this publication is useful for both IFRS, US Generally Accepted Accounting Principles (GAAP) and local GAAP filers. Also, it does not matter whether one applies the 10-step methodology as part of the preparation of financial statements or the auditing thereof. Lastly, once the financial statements of a company are prepared in accordance with IFRS,[14] the 10-step methodology is generically applicable. Essentially, the methodology is blind with regard to the number of entities and/or jurisdiction in which a company is active. Indeed, the methodology is as applicable to a single entity as it is to 500.

The 10 steps are presented in chronological order in the chapters of this publication. Some chapters contain more than one step, but most deal with a single step. The following steps can be distinguished:

- identify book-to-tax differences;
- calculate the current tax expense for the period;
- calculate any adjustments to prior years' tax expense;
- calculate the deferred tax asset or liability as at the close of the reporting period;
- assess any deferred tax assets for recognition;
- identify, recognize and measure any uncertain tax positions;
- reconcile the income tax accounts;
- calculate the total tax expense/(income) and allocate to (i) the statement of profit or loss, (ii) other comprehensive income or (iii) equity as appropriate;
- prepare the effective tax rate reconciliation; and
- prepare the relevant disclosures.

These steps are explained below.

14. Or US GAAP.

Step 1: Identify the book-to-tax differences (chapter 3)

The starting point for all tax (accounting) calculations is the "commercial" profit before tax. Therefore, the first step is to identify whether tax law demands or creates a difference in tax treatment as compared to how a certain transaction was treated and recorded under the applied accounting standard. Such differences are either permanent or temporary in nature.

Regarding the difference between permanent and temporary differences:[15]
– permanent differences will not reverse;
– temporary differences will reverse, in a future period;
– permanent differences are generally found on the income statement; and
– temporary differences are generally found on the balance sheet.[16]

There are multiple ways to identify permanent and temporary differences, for example:
– understand the connection between the financial reporting carrying value of items in the statement of financial position and the corresponding tax basis;
– discuss transactions that occurred during the year (e.g. acquisitions, divestitures); and
– review prior years' tax returns and provisions for continuing differences (in Dutch corporate income tax returns, one can check for differences between the tax balance sheet and the book balance sheet).

Step 2: Calculate the current tax expense (chapter 4)

The second step consists of computing an estimation of the tax expense, beginning with profit before tax as reported under the applicable reporting standard[17] and identifying both permanent and temporary differences. If the corporate income tax return is not based on IFRS/US GAAP,[18] but on another local GAAP, it may be easiest to break this step into two parts: identifying the permanent and temporary differences to estimate profit before tax under the applicable local GAAP,[19] and then identifying permanent and temporary differences between local GAAP and taxable profits for the period.

15. For a detailed outline and discussion of this first step, *see* ch. 3.
16. This means that a proper understanding of how and where items are reported for GAAP and IFRS purposes will aid in the effective application of IFRS and/or US GAAP.
17. Generally, IFRS or US GAAP.
18. Which is hardly the case.
19. Differences between local GAAP and IFRS/US GAAP are generally "temporary" in nature.

The calculation can be broken down as follows:

Profit before tax (IFRS/US GAAP)
+/− *Permanent differences*
+/− *Temporary differences*
= Profit before tax (local GAAP)
+/− *Permanent differences*
+/− *Temporary differences*
= Taxable Income
× *Substantively enacted tax rate*[20]
= Current tax expense[21]

Calculating the current tax expense is thus equivalent to preparing the current year tax return. There is no guidance provided by IAS 12 for this process. It basically comes down to applying (local) tax law to the current year results. Examples of other items that impact the overall tax expense include credits; offsetting losses; and different jurisdictions and their different rates.

Step 3: Calculation of adjustments to prior years' tax expense: Return-to-accrual adjustments and true-ups (chapter 4)

There may be a need to correct the calculated current tax expense as determined in previous periods. These adjustments could occur due to improved and/or additional knowledge gained in relation to the tax position taken in the published financial statements. Although not often seen in practice, the author would like to introduce a different use of the terms "return-to-accrual adjustments" and "true-ups".

Return-to-accrual adjustments. A return-to-accrual adjustment is an adjustment to a prior year's tax expense before and/or upon filing the tax return. There are estimates inherent in the tax provision process which may subsequently change due to subsequent rulings,[22] a change in tax law or a court ruling or – as is most often the case – because a more accurate calculation is possible compared to the preliminary estimate that was used to calculate the income tax expense at year-end. Ultimately, when the income tax return is filed, the current and deferred tax balances recognized in the financial statements must be updated to reflect the filing position. This may result

20. Under US GAAP, the enacted tax rate is to be used.
21. IAS 12, para. 5.
22. Meaning a specific agreement with the tax authorities, mostly as regards an item that is subject to multiple interpretations.

in adjustments to both current and deferred taxes payable/(receivable). Adjustments made up to the ultimate moment of filing the corporate income tax return are referred to here as return-to-accrual adjustments.

True-up adjustment. The author introduces an unofficial distinction between an adjustment before and/or upon filing the return and an adjustment after filing the corporate income tax return. This can arise, for instance, due to a deviating income tax assessment, a tax audit or a closed compromise with the tax authorities. All adjustments after filing the corporate income tax return are referred to here as true-up adjustments.[23]

Step 4: Calculate the deferred taxes at the reporting date (chapter 5)

The recognition of deferred tax is based on the principle that the tax effects of transactions recognized in the financial statements should be recognized in the same period as the transactions themselves, even if recognition in the income tax return is in a subsequent period. In this situation, when transactions are recognized for financial reporting purposes in different periods than the tax return, temporary differences are generally created.

It is inherent in the recognition of an asset or liability that the entity expects to recover or settle the carrying amount of that asset or liability. If the recovery or settlement of that carrying amount will make future tax payments larger (or smaller), deferred taxes must be recognized.

An entity analyses each of its assets and liabilities by comparing the carrying value with its tax basis. The carrying amount is the amount for which an asset or liability is recognized on the balance sheet.[24] The tax basis is the amount attributed to an asset or liability for tax purposes. Generally, this is the value attributed to an asset or liability in the tax return in determining whether cash flows resulting from the recovery/(settlement) of the entity's assets and liabilities will be taxable/(deductible).

23. US GAAP uses true-up adjustments for all adjustments up to filing the corporate income tax return, and uses prior-year adjustments for adjustments after the moment of filing the corporate income tax return.

24. There is a difference between IFRS and GAAP, in that the IFRS carrying amount is equal to the amount recognized on the IFRS balance sheet, while the local GAAP carrying amount is equal to the amount recognized on the local GAAP balance sheet.

	Deferred tax asset	Deferred tax liability
Asset (e.g. building, plant and equipment)	Carrying amount < tax basis	Carrying amount > tax basis
Liability (e.g. pension liability)	Carrying amount > tax basis	Carrying amount < tax basis

In this fourth step, the temporary differences that were analysed in Step 1 are multiplied by the appropriate tax rate to calculate deferred assets and liabilities. The tax effects of unused tax losses and unused tax credits are also identified and considered.[25] Generally speaking, the change in an entity's deferred tax position on the opening and closing balance sheet dates (generally resulting from the origination and reversal of temporary differences in the current period) is the deferred tax expense/(income) for the period. For exceptions to this rule, *see* chapter 5.

Step 5: Measurement of the deferred tax asset (chapter 6)

Deferred tax liabilities are recognized for all taxable temporary differences, subject to limited exceptions discussed in chapter 9.[26] Deferred tax assets, however, are recognized in the financial statements to the extent that it is probable that sufficient taxable profits will be available against which the deductible temporary difference (or tax loss or credit) can be utilized.[27] For this reason, an entity with deferred tax assets must evaluate its sources of future taxable profit as part of its income tax provision process in order to determine whether they must be recognized.

IAS 12 provides several criteria in assessing the probability that taxable profit will be available in the future,[28] namely:
- taxable temporary differences;
- taxable profits;
- losses that are identifiable and unlikely to recur; and
- tax planning opportunities.

25. IAS 12, para.13 (the benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognized as an asset). IAS 12, para. 34 (a deferred tax asset shall be recognized for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilized).
26. Ch. 9, para. 1, the initial recognition exemption.
27. IAS 12, paras. 34-36.
28. IAS 12, para. 36.

Step 6: Analyse the uncertain tax positions (chapter 7)

Tax law is complex, and positions taken in the tax return can often be interpreted in various ways, leading to disputes with the tax authorities and, sometimes, an assessment of additional tax being due. Common examples of uncertain tax positions include dividends and/or the application of participation exemptions, transfer pricing principles, interest deduction restrictions and the applicability of tax rulings.[29]

While an entity may have a technical basis for the position taken in the filed corporate tax return, these tax positions may still be “uncertain” if there is more than one way to interpret the applicable tax law as applied to the entity’s facts or if there is uncertainty whether a taxation authority will accept an uncertain tax treatment. If so, an entity needs to consider whether it is necessary to recognize a tax liability[30] for the respective uncertain tax position.

Step 7: Reconcile the tax accounts (chapter 8)

Here, the tax accounts recognized in the balance sheet position are adjusted to reflect the current year’s tax provision calculated in the steps described above. This step can be just as simple as it can be complex. The final position on the balance sheet is the difference between the starting position, the payments/revenues and the calculated current tax expense. Attention needs to be paid to the fact that only income taxes may be taken into account, as well as that there could be numerous other effects[31] that impact the position during the year.

Step 8: Calculate the total tax expense (chapter 8)

The total tax expense is calculated as the sum of the total current tax expense and the deferred tax expense. Deferred tax expense is equal to the difference between deferred tax assets and liabilities.[32] Logically, it follows that:
- as deferred tax assets increase, deferred tax expense decreases;
- as deferred tax liabilities increase, deferred tax expense increases;
- as deferred tax assets decrease, deferred tax expense increases; and
- as deferred tax liabilities decrease, deferred tax expense decreases.

29. That is, a specific agreement with the tax authorities.
30. Often called a provision.
31. For example, foreign exchange differences, investments, divestments, equity and other comprehensive income recordings. For a more thorough explanation and sample disclosures, *see* ch. 8.
32. This is the straightforward methodology.

While the current and deferred tax expense from current year activities was calculated in earlier steps, sometimes additional entries are required in order to correct the tax accounts on the balance sheet, as a result of incorrect postings or other minor errors.

Step 9: Prepare a rate reconciliation (chapter 8)

In this penultimate step, which is to determine the effective tax rate recognized in the income statement, it is necessary to make a reconciliation from profit before tax multiplied by the statutory tax rate. The effective tax rate is the total tax expense divided by the profit before tax. If the tax rate cannot be reconciled, the overall tax provision calculation is not complete. The effective tax rate is used to "prove" the income tax expense of a company, and it is a key performance indicator for listed companies. The effective tax rate is used by analysts, investors and other stakeholders to measure the tax function and its performance. Already for this reason, it is a required and significant disclosure in the financial statements.

The effective tax rate is calculated using the following formula:

$$\frac{\text{Total tax expense (profit or loss)}}{\text{(IFRS) Profit before tax}} \times 100$$

There are many different items that affect the effective tax rate, including:
– permanent differences;
– return-to-accrual and true-up adjustments;
– the change in an entity's (un)recognized deferred tax assets;
– credits that directly reduce tax;[33]
– changes in tax liabilities recognized for uncertain tax positions;
– changes in applicable tax rates on the measurement of deferred assets and liabilities; and
– jurisdictional rate differences.[34]

Once done correctly, the effective tax rate and the rate reconciliation are useful calculations in determining whether all transactions have been accounted for correctly.

33. E.g. R&D credits and withholding tax credits.
34. "Jurisdictional rate differences" is typically a US GAAP reconciling item. US GAAP filers use the corporate income tax rate of the head office (most often, the US corporate income tax rate of 21%). Therefore, in consolidation, differences are caused by differences in the statutory rate of subsidiaries due to their different jurisdictions.

Step 10: Prepare the financial statement reporting and disclosure notes (chapter 8)

This is arguably the most crucial step. It leads to the determination of what (additional) narrative and/or figurative information is required, as well as, more significantly, the decision regarding what information is desirable for, and of use to, (potential) investors. One question concerns what information they wish to know and at what level of detail the company should provide such information. This chapter deals predominantly with the requirements as specified in IAS 12, paragraphs 79 through 88. It also presents some best practices of disclosing taxes.

It is the application of these 10 steps that truly unravels the mystery of income tax accounting because it reveals, step by step, how to connect the commercial world with the tax world. It is meant to serve as a reminder not to jump to any conclusions and thereby forget intermediate considerations. In addition, the publication covers special items, such as the initial recognition exemption, outside basis differences, business combinations, share-based payments, other comprehensive income and discontinued operations (*see* chapter 9). Special attention is also given to the tax accounting specifics for banks and other financial institutions (*see* chapter 10).

Chapter 11 contains a case study in which the 10-step methodology and theory discussed here is applied, in order to determine the correct tax figures and disclosure notes.

1.5. Other factors affecting tax reporting: Looking beyond the accounting requirements

1.5.1. Introduction

This section will discuss other factors that currently affect and determine the daily activities of a tax accountant, including the increased pressure on corporations and their tax and finance departments, which do not have their origin in the accounting and disclosure requirements under IFRS.[35] Since the beginning of this century, there have been other significant influences that determine the debate on income tax reporting arising from jurisdictional statutes, institutional investor pressure and media coverage. Especially the latter is driven by public demands, based on the perception that multinational

35. *See* ch. 8.

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