IFRS Tax Accounting

Webinar

—

December 2021

With you today

Arthur Plantfeber

Stefan Paantjens

Patrick Lelieveld

Wouter Smit

Agenda and introduction

Introduction

Initial recognition exemption

Effective tax rate reconciliation

Tax plan 2022 and its tax accounting implications

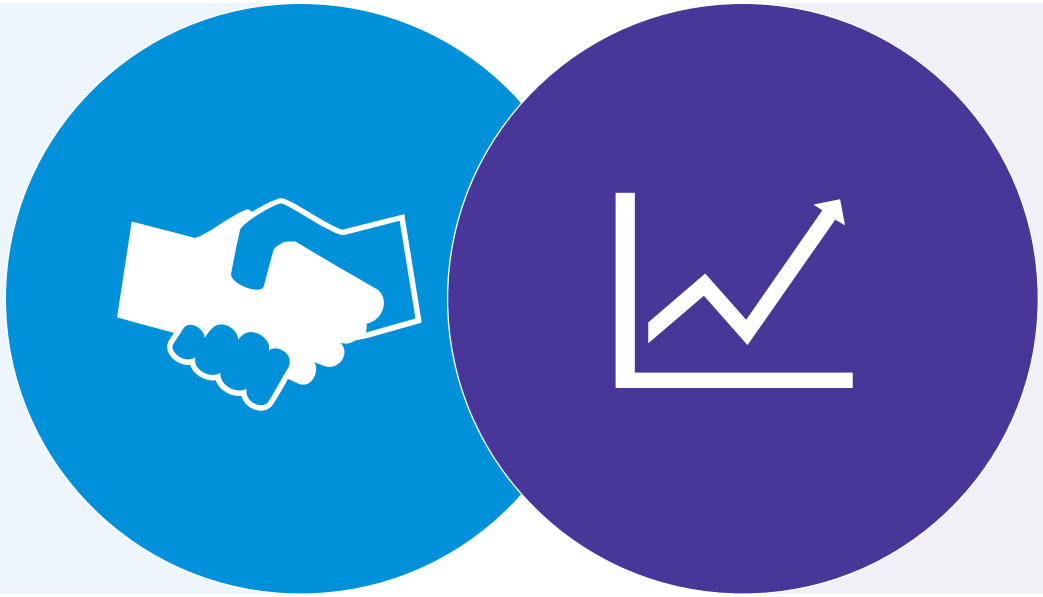
KPMG

The initial recognition exemption

Elements of the initial recognition exemption ("IRE") prior to amendment

a deferred tax asset or liability that

arises from the initial recognition of an asset or liability in a transaction that is not a business combination; and



affects neither accounting profit nor taxable profit at the time of the transaction

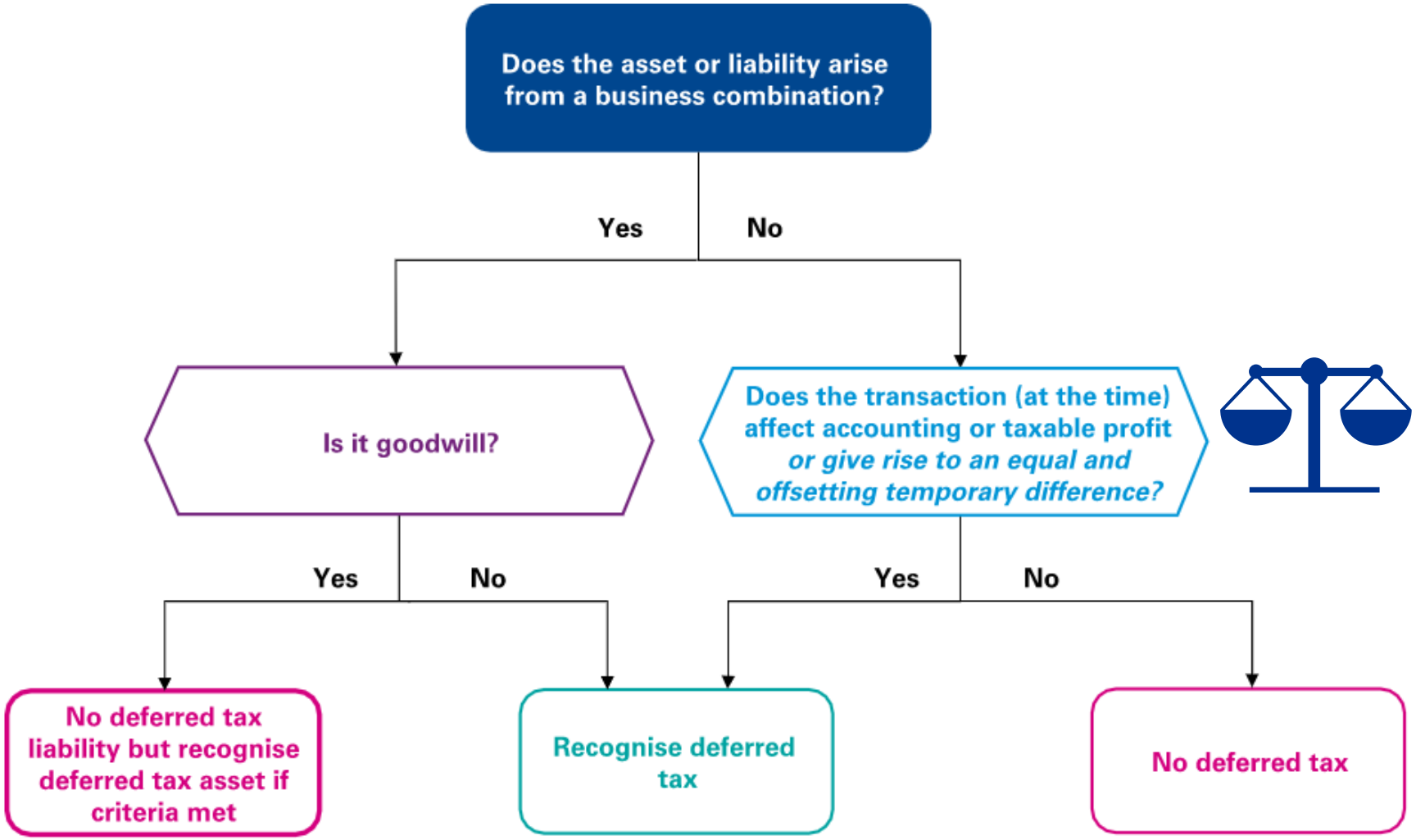
Diversity in practice

The initial recognition exemption is an exception to the basic recognition principles of IAS 12

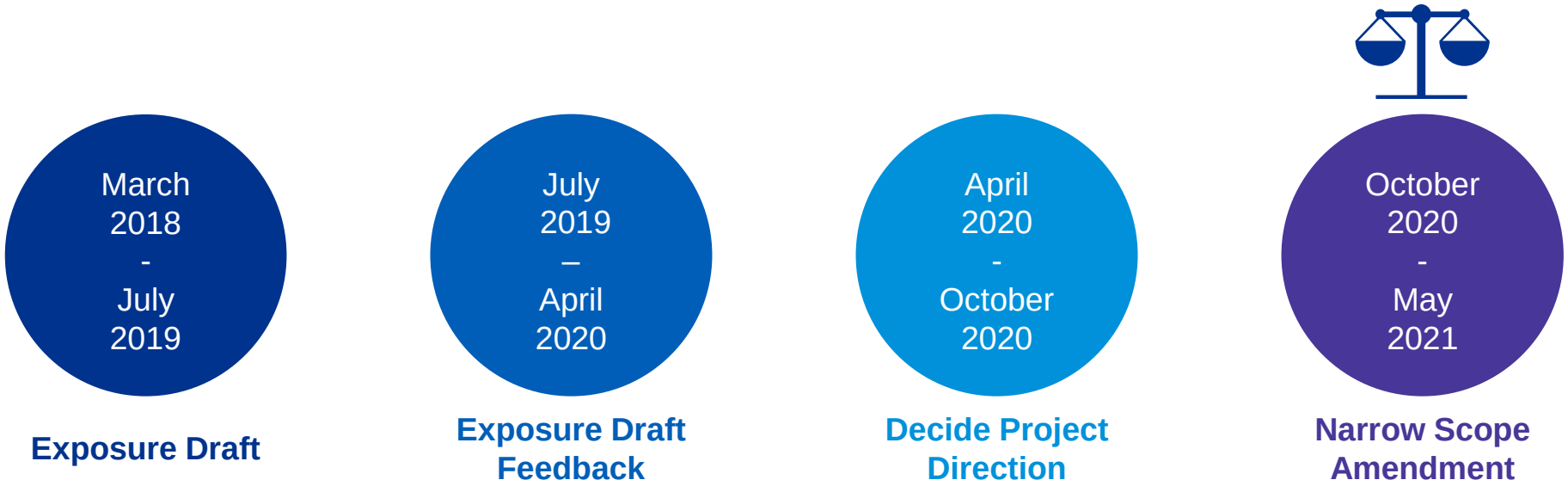
The initial recognition exemption can have significant impact on the effective tax rate going forward

Application of the initial recognition exemption varies in practice due to complexity

The initial recognition exemption as of January 1, 2023 in summary



Initial recognition exemption amendment timeline



Addition to the initial recognition exemption (IAS 12.15 & 12.24): “at the time of the transaction, does not give rise to equal amounts of taxable and deductible temporary differences”.

The IAS 12 amendment - Potential areas of impact

transactions that give rise to equal and offsetting temporary differences

Leases whereby a Right-of-Use Asset and a Lease Liability are recognized

Decommissioning liabilities recognized as part of the cost of an asset, with an initially offsetting provision

Application of the IRE- Diversity in practice

- Apply the IRE separately to the ROU Asset and Lease Liability;
- Recognise the tax impacts in P&L when incurred. No deferred tax on the lease.

- Assess the ROU Asset and Lease Liability together on a net basis
- Recognise deferred tax on a net temporary difference that arises after the initial recognition

- Choose not to apply the IRE
- Recognize deferred tax
- **This treatment is in accordance with the revised IAS 12 standard**

Depending on current treatment, significant impact may be applicable!

Leases - example

Accounting for the Lease

— Company A enters into lease and recognises a right-of-use asset and a lease liability of 450. In addition, A incurs initial direct costs of 20.

— On commencement of the lease, A records the following entries under IFRS 16 Leases:

Balance Sheet – Accounting	Debit	Credit
Right of use Asset (‘RoU’)	470	
Lease Liability (‘LL’)		450
Bank/Payable		20

Tax accounting

— Temporary differences arise in Dutch situations when IFRS 16 is not followed for tax purposes

— The initial recognition exemption is **not** applicable

— Using a tax rate of 25%, A records the following entry for the temporary differences.

Tax Accounting (Deferred tax)	Debit	Credit
Deferred Income tax expense	5	
Deferred tax liability (RoU)		117,5
Deferred tax asset (LL)	112,5	

Decommissioning liability - example

Accounting for the liability

— Company B recognises a provision of 100 for decommissioning its plant, which it capitalised as part of the cost of the plant.

— B records the following entry to recognise the decommissioning liability:

Balance Sheet – Accounting

	Debit	Credit
Property Plant and Equipment ('PPE')	100	
Decommissioning liability ('DL')		100

Tax accounting

— Temporary differences arise, for tax purposes, the expenditure will be deducted only when it is incurred

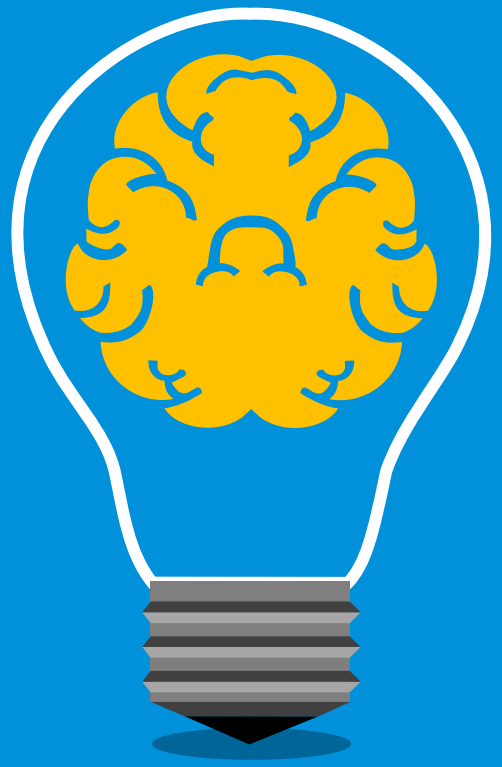
— The initial recognition exemption is not applicable

— Using a tax rate of 25%, B records the following entry for the temporary differences.

Tax Accounting

	Debit	Credit
Deferred tax asset (DL)	25	
Deferred tax liability (PPE)		25

Key points to remember!



- The initial recognition exemption is an exception to the basic principles of IAS 12 and should always be considered
- The initial recognition exemption will be amended as per January 1, 2023 to clarify it is not applicable to transactions that give rise to equal amounts of taxable and deductible temporary differences
- Expected areas of impact include deferred positions associated with Leases and Decommissioning Liabilities.

Effective tax rate reconciliation

Why is the effective tax rate reconciliation important?

Political discussion

Income taxes are becoming more important in the financial statements

More transparency with respect to income taxes

Key performance indicator

Effective tax rate reconciliation requirements under Dutch GAAP

Overview

$$\text{Effective tax rate} = \frac{\text{Income tax P\&L (current and deferred)}}{\text{Accounting pre-tax profit}}$$

Why effective tax rate ≠ applicable tax rate?

- Tax rate in parents' jurisdictions ≠ tax rate in subsidiaries' jurisdictions.
- Non-taxable income and non-deductible expenses.
- Changes in estimates (e.g. recoverability of deferred tax assets or uncertain tax positions) or tax rates

Disclosure

— Two approaches:

- **Amount-to-amount**

  Tax income reconciled to accounting income: expressed in numbers

- **Rate-to-rate**

  Tax income reconciled to accounting income: expressed in percentages

In thousands of euro	2021	2021
Profit before tax from continuing operations		10,351
Tax using the Company's domestic tax rate	33.00%	3,416
Effect of tax rates in foreign jurisdictions	(0.71%)	(73)
Reduction in tax rate	(0.14%)	(15)
Tax effect of:		
– Share of profit of equity-accounted investees reported, net of tax	(3.64%)	(377)
– Non-deductible expenses	2.37%	245
– Tax-exempt income	(0.23%)	(24)
– Tax incentives	(0.85%)	(88)
– Current-year losses for which no deferred tax asset is recognised	0.40%	41
Recognition of previously unrecognised tax losses (see Note 14(H))	(0.48%)	(50)
Recognition of previously unrecognised (derecognition of previously recognised) deductible temporary differences	(0.13%)	(13)
Changes in estimates related to prior years	1.12%	116
	30.70%	3,178

Examples of typical tax reconciliation items

- Non-taxable income
- Change in applicable tax rate
- Foreign tax rates
- Non-deductible expenses
- Change in estimate about the recoverability of deferred tax asset
- Unrecognised tax losses

No tax reconciliation items

- Regular reversal of temporary differences for which deferred tax was recognised.
- Income taxes on items recognised outside profit or loss:
  - Income taxes on items recognised in other comprehensive income (OCI) or equity.
  - Business combinations (deferred taxes recognised in goodwill).

Case 1: Utilisation of unrecognised tax losses

Year 1: Tax losses € 1,000.

Year 2: Tax profit € 200.

— Management:

Year 1: No DTA recognized

Year 2: No DTA recognized

Tax rate: 25%

	Year 2
Profit before tax	€ 200
Tax using applicable tax rate (25%)	€ 50
Reconciliation:	
- Unrecognised tax losses	**(€ 50)**
Income taxes (total)	0
Effective tax rate	0%
Applicable tax rate	25%

No journal entry

Case 2: Utilisation of recognised tax losses

Year 1: Tax losses of € 1,000.

Year 2: Tax profit € 200.

— Management:

Year 1: DTA recognized (of 250; € 1,000 * 25%)

Year 2: DTA recognized (of 200; € 800 * 25%)

Tax rate: 25%

	Year 2
Profit before tax	€ 200
Tax using applicable tax rate (25%)	€ 50
Reconciliation:	
- **Unrecognised tax losses**	-
Income taxes (total)	€ 50
Effective tax rate	25%
Applicable tax rate	25%

Journal entry

	Debit	Credit
Deferred tax (P&L)	€ 50	
DTA		€ 50

Case 3: Change in estimate - tax losses

Year 1: Tax losses € 1,000.

Year 2: Tax profit € 200.

Year 3: Tax profit € 200.

— Management:

Year 1: No DTA recognized

Year 2: No DTA recognized

Year 3: DTA of € 150 (€ 600 * 25%) recognized

Tax rate: 25%

	Year 3
Profit before tax	€ 200
Tax using applicable tax rate (25%)	€ 50
Reconciliation:	
- **Unrecognised tax losses**	**(€ 50)**
- **Recognition of previously unrecognized tax losses**	**(€ 150)**
Income taxes (total)	**(€ 150)**
Effective tax rate	(75)%
Applicable tax rate	25%

Journal entry

	Debit	Credit
DTA	€ 150	
Deferred tax (P&L)		€ 150

Case 4: Tax rate change

- Year 1: In December a statutory income tax rate reduction from 25% to 20% for Year 2 and onwards has been enacted.
- Year 1 & Year 2 and 3: Tax profit € 1.000.
- Deductible temporary difference of € 200 at the end of Year 1, resulting in a DTA of € 50 (€ 200 x 25%), before tax rate reduction.
- The remaining temporary difference will reverse in Year 2 and 3 for equal annual amounts.

	Year 1	Year 2 - 3
Profit before tax	€ 1,000	€ 1,000
Tax using applicable tax rate	€ 250	€ 200
	25%	**20%**
Reconciliation:		
- Change of tax rate	**€ 10**	**-**
Income taxes (total)	€ 260	€ 200
Effective tax rate	26%	20%
Applicable tax rate	25%	20%

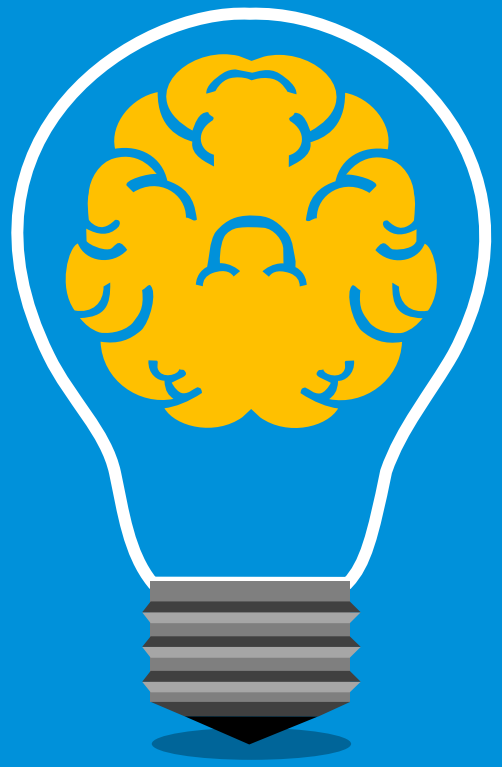
Journal entry Year 1

	Debit	Credit
Deferred tax (P&L)	€ 10	
DTA		€ 10

Journal entry Year 2 and 3

	Debit	Credit
Deferred tax (P&L)	€ 20	
DTA		€ 20

Key points to remember!



- Transparent disclosure enables users to understand the relationship between accounting profit and tax expense.
- Typical reconciling items include non-taxable income and non-deductible expenses and changes in tax rates or differences in tax rates applied to entities in the group.
- Reconciling items should ***not*** include changes in temporary difference for which deferred tax is recognised, and taxes recognised outside profit and loss.

Tax plan 2022 and its tax accounting implications

Tax plan 2022 and its potential tax accounting implications (Status: proposed)

Tax plan 2022

Change of CIT rate

Tightening of the earnings stripping rules

IAS 12.47
(substantively) enacted

Change of CIT rate (Status: proposed)

CIT rate

— Corporate income tax rate increases from 25% to 25.8%

Tax accounting implications

— Deferred tax measured at enacted / substantively enacted tax rates
— Re-assessment of existing deferred taxes
— Backward tracing

Recognising current and deferred tax - backward tracing

Current and deferred tax is recognised consistently with the underlying transaction or event to which it relates

Item recognised in P&L

Current and deferred tax recognised in P&L

Item recognised in OCI / equity

Current and deferred tax recognised in OCI / equity

IAS 12.61a

Tightening of the earnings stripping rules (Status: proposed)

Earnings stripping rules

- Limitation of deductibility of interest costs from 30% to 20% of fiscal EBITDA
- Threshold of EUR 1 million will be maintained

Tax accounting implication

- As a result of the limitation of deductibility of interest to 20% of fiscal EBITDA it takes longer to utilize the carry forward interest and may therefore limit recognition of DTAs

New Dutch loss utilization rules (status: enacted)

Main characteristics

- Enacted as per 28 May 2021.Therefore, the (deferred tax) impact of the new tax loss utilization should be considered for (interim) reporting periods ending on or after 28 May 2021.
- Effective as per 1 January 2022.
- Tax losses up to EUR 1 million can be fully offset (threshold).
- Tax losses that exceed the EUR 1 million threshold can only be offset for 50%.
- Indefinite loss carry forward.
- Cumulated tax losses available as per 31 December 2021 can be carried forward indefinitely.

Tax accounting considerations change loss utilization rules

Additional DTAs may have to be recognized for tax losses that have not been recognized yet, as a result of indefinite loss carry forward

Expected reversal of qualifying DTLs can potentially only be used for 50% as source of taxable profit, which may limit recognition of DTAs

As a result of the 50% limit to offset losses (for profits in excess of EUR 1 million) it takes longer to utilize the tax losses and may therefore limit recognition of DTAs

KPMG

Thank you

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.