IFRS adoption and taxation issue

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ABSTRACT

IFRS is an accounting standard used worldwide. The advantage using IFRS is a global comparability of financial report. The standard change (from national GAAP to IFRS) will have impact to the tax due to the different principles used to report the corporation financial activity. From our research, we find mixed response to this taxation issue by tax authority and the government. Some country still use national GAAP as basis of tax calculation and some country adjust/change tax regulation to support IFRS implementation.

Keywords: IFRS implementation, IFRS adoption, IFRS taxation issue

1. INTRODUCTION

International Accounting Standards (IAS) or International Financial Reporting Standards (IFRS) is now used almost in every country as the reporting standard. First move was when European Union adopted IFRS and made it mandatory as reporting standard for consolidated financial report of corporation listed in European stock market.

Usage of IFRS in Europe show an accounting standard change, from previous national GAAP (which is different one another) to IFRS. Another business entity (non-listed in European stock market) also plan to use IFRS as their reporting standard so their report will be in accordance with global standard (IFRS). In the progress of IFRS adoption, now there are more than 122 countries using IFRS or in convergence period.

There are two approach used in IFRS adoption (Upton, 2010): convergence and full adoption. In convergence, standard setter will adjust national GAAP so the usage of this new-adjusted national GAAP will be same or similar with IFRS. While in full adoption, all IFRS will be fully implemented.

With the usage of IFRS as new standard of financial reporting, there will be change to the financial report. One obvious impact is if there is a change to financial report, there might be a change as well to the tax. This taxation impact is very essential and need to be analyzed carefully, especially for multinational corporation. Taxation impact due to change of accounting standards in may tax jurisdiction is very complex and need a thorough and careful analysis.

In this research, we analyze the impact of IFRS adoption to the taxation issue in 20 countries from Africa, America, Asia Pacific and Europe.

2. LITERATURE REVIEW

2.1 Accounting harmonization

Accounting harmonization is important to improve comparability of financial report (van der Tas, 1988). Choi and Meek (2011) argue that this comparability principle will work with single standard used for the same situation. Beside harmonization, there is also standardization concept. According to Gray (1980) difference between harmonization and standardization is the supporting party of the process.

Harmonization is a process, where international organization such as: UN, EU and OECD could control the process with their policy and regulation. Although there is difference between harmonization and standardization, it will be hard in practice to differentiate which one is taking place (Nobes, 1991).

Accounting harmonization will minimize comparability issue faced by international investor who invest in international stock market. And accounting harmonization will also produce efficiency in multinational corporation operation.

2.2 IFRS implementation

Jermakowicz (2004) analyzed IFRS adoption process in Belgium. Survey sent to corporation included in BEL-20 index indicate that IFRS implementation will change design and handling of internal and external reporting drastically. According to the survey, IFRS implementation will increase comparability and transparency.

Weibenberger, Stahl and Vorstius (2004) conducted survey regarding motives of German corporation use IFRS rather than national GAAP as their reporting standard. The study showed that German corporation use IFRS as their reporting standard because of expectation to list their corporation in the national and international stock market.

Delvaille, Ebbers and Saccon (2005) compare IFRS implementation progress in France, German and Italy. Their empirical analysis show that usage of IFRS in German is prominent compare to France and Italy. They also conclude that these three countries (previously implement a continental Europe accounting system) is very different in both reporting practice and how they adapted with IFRS as new reporting standard.

2.3IFRS and its impact to taxation

With IFRS implementation, a new accounting standard, will be impacted to the taxation. This impact will be more obvious for multinational corporation as they will face tax impact of IFRS implementation in more than one taxation jurisdiction. Implementation of IFRS will create an increase of ETR (effective tax rates) or more volatile ETR. IFRS implementation will also create an opportunity to decrease foreign tax.

Although IFRS now commonly used as reporting standard, in some country tax authority still required corporation to prepare financial report based on national GAAP for taxation purpose. In some other country, which still in process toward IFRS implementation, still indecisive whether they will use IFRS-financial report or GAAP-financial report as a basis for calculating tax income.

According to Eberhartinger and Klostermann (2007), usage of IFRS-financial report for tax calculation will simplify reporting process and minimize compliance cost. Although usage of IFRS as tax basis will increase ETR in some specific industry (Haverals, 2007).

3. RESULTS AND DISCUSSION

In studying IFRS adoption and taxation issue, we conduct the research in four region: Africa, America, Asia Pacific and Europe.

3.1 Africa

We analyze the impact of IFRS adoption to tax in four country of Africa: Libya, Nigeria, Tunisia and South Africa. In summary, these four country still use national GAAP as tax-basis.

There is no tax regulation change in Libya as response of IFRS implementation. For taxation purposes, Libya corporation need to prepare financial report based on national GAAP. Corporate Income Tax (CIT) in Libya is 20%. For income determination, inventory valuation accepted for taxation purpose is lower of cost or net realizable value as determined in Libya Commercial Code. For capital gains, capital gains will be treated as usual income (included in taxable income) and taxed using CIT.

There is also no change made by FIRS (Federal Inland Revenue Service) for tax regulation in Nigeria. Similar with Libya, Nigeria also use national GAAP as basis for taxation calculation. Current CIT in Nigeria is 30%, with exclusion for small corporation (20% CIT for the first five years). FIRS allow usage of FIFO, average and standard cost method for inventory valuation. LIFO is not allowed for inventory valuation for taxation purpose, in accordance with Nigeria GAAP. While there is separate tax on capital gains (capital gains not included in corporate taxable income).

Similar with Libya and Nigeria, for taxation purpose Tunisia required their taxpayer to prepare financial report based on their national GAAP. CIT in Tunisia is 30%, with some exception for certain industry (the CIT could be lower or higher). Inventory valuation for taxation purpose is at cost, while for capital gains is included in taxable income and taxed as ordinary income.

There is some taxation regulation change made by SARS (South African Revenue Sevice) in South Africa, although the change is not related with IFRS implementation. Some change made by SARS for instance: 15% dividend tax, interest withholding tax (WHT) and ETR increase on capital gains (from 14% to 18.67%). Generally, CIT in South Africa is 28% with exception for small corporation taxed with progresive tax with 28% cap. And there is also special tax rate for certain industry. Lower of cost or net realizable value used for inventory valuation in South Africa. While in case of capital gains, only 66.66% of capital gains included as taxable income and taxed according to CIT.

3.2 America

We conducted the analysis in Brazil, Canada, Mexico and US for America region.

In Brazil, legislative ensured corporate taxpayer that the accounting standard change (from Brazil GAAP to IFRS) will not increase the tax amount. The legislative issued regulation that promised a tax neutrality, an accounting standard change will not impacted tax base.

Current CIT in Brazil is 15%, calculated from actual profits or presumed profits. Actual profits is calculated after adjusting some tax regulation from book-taxable income. Presumed profits is calculated quarterly based on percentage of gross income and adjusted with some tax regulation.

Inventory valuation for taxation purposes in Brazil use actual average cost or cost of last acquired inventory or last production. While in case of capital gains, capital gains is treated as ordinary income and taxed as taxable income under CIT.

In Canada, tax act do not regulate which accounting standard or certain method should be used to calculate profit for tax purposes. Taxpayer is allowed to choose which accounting standard they consider closest to their operation. Conversion from GAAP to IFRS therefore do not change taxpayer obligation as IFRS become one of accounting standard they can use for taxation purposes.

Current CIT in Canada is 15%. For inventory valuation, Canadian taxpayer could use fair market value or whichever is lower between cost and fair market value. For cost method, all method but LIFO could be used. For capital gains treatment, 50% is taxable as ordinary income in CIT.

In Mexico, there is no change in tax regulation in response to IFRS implementation. Current CIT in Mexico is 30% with some exception in certain industry. Historical cost or pre-determined cost is used for inventory valuation. For historical cost, taxpayer could use FIFO, LIFO, identifiable cost, average cost and retail method. For capital gains there is different treatment, capital gains from fixed assets will be subject to 30% tax rate while capital gains from investment will be taxable in CIT.

In the US, accounting for taxation purposes is not similar with book-accounting. There is adjustment needed from book-accounting related to tax regulation. The question arised with IFRS implementation in US, will the tax regulation adjust the accounting standard for taxation purposes (will be subject to IRS commissioner approval) and change in calculation of permanent and temporary difference. So far, there is no change or adjustment in tax regulation regarding IFRS implementation in the US.

CIT in the US is progresive rate (lowest rate is 15% and the highest is 39%) with some exception for S corporation and small C corporation. For inventory valuation, IRS (Internal Revenue Service) require taxpayer to use lower of cost or market with FIFO-based. LIFO usage is allowed if taxpayer use cost and there must be a conformity between tax and book reporting. For capital gains, net capital gains (difference between short term and long term capital gains) is treated as ordinary income.

3.3 Asia Pacific

We focus on Australia, Korea, India, Indonesia, New Zealand and Singapore for researching IFRS and taxation issue in Asia Pacific.

In Australia, there is no new tax regulation implemented related to IFRS implementation as IFRS has been implemented in Australia since 2005. Current CIT in Australia is 30%. For inventory valuation, Australian taxpayer could choose the following method: cost (full absorption cost), market selling value or replacement price. LIFO is not allowed for taxation purposes, similar with IFRS. This valuation for tax purposes do not necessary to be in conformity for book purposes. Capital gains in Australia divided by two: from fixed assets and other. For capital gains from fixed assets will be treated as ordinary income and taxed at CIT, otherwise it will be subject to capital gains tax.

There is some change in Korea tax regulation to support the progress of IFRS implementation, ie: K-IFRS (Korean adapted IFRS) is allowed for taxation purposes. For corporation using K-IFRS as their reporting standard, they could no longer use LIFO method for inventory costing. Current CIT in Korea is a progressive rate (ranging from 10% to 22%). For inventory valuation, one of seven valuation could be used: lower of cost or market, specific identification, FIFO, LIFO, weithted average, moving average and retail. For capital gains, there are several regulation regulate capital gains with different tax rate.

In India, for taxation purposes the tax authority use TAS (Tax Accounting Standards), not IFRS or national GAAP. There is no change of taxation regulation in response to IFRS implementation, as India tax authority use different standard for tax report. According to Ray (2012), implementation of IFRS have not much impact to the net income as most area affected from IFRS implementation is liability and equity due to reclassification.

Current CIT in India is 30%, while for inventory valuation TAS required taxpayer to use lower of cost or net realizable value. FIFO or average method is used for costing method. As for capital gains, there are several tax rate for different capital gains.

In Indonesia, IFRS implementation will be impacted to non-final income tax while there is no impact for object of final income tax. Currently there is no new regulation or adjustment to current income tax regulation in response of IFRS implementation, as Indonesian Directorate General of Tax is in evaluation process of IFRS convergence issue.

Current CIT in Indonesia is 25% with exception for small corporation with different CIT. Valuation of inventory is using cost, with FIFO or average method. Capital gains treated as ordinary income with several exception of several capital gains that is object of final income tax.

Several changes have been made to New Zealand tax regulation to support adoption of IFRS. One example of change in NZ tax regulation is on financial arrangements: some timing rules have been implemented for revenue and expense recognition. There are two kind of new regulation on financial arrangements: compulsory and voluntary method for taxpayer with certain criteria. Two new method implemented are expected value method and equity-fair value method to help reducing exposure and volatility due to IFRS implementation.

CIT in NZ is 28%, and for inventory valuation NZ tax authority required inventory to be valued at cost or market selling value in case market selling value is less than cost. FIFO and weighted average method is allowed as inventory cost flow method. Capital gains will be treated as ordinary income.

In Singapore, tax calculation is based on SITA (Singapore Income Tax Act) and guideline issued by IRAS (Inland Revenue Authority of Singapore). With IFRS implementation, there has been adjustment of SITA so income tax treatment will be equal or close with accounting treatment/accounting standard. Current CIT in Singapore is 17% and all consistent method for inventory valuation is allowed (except LIFO). Capital gains in Singapore is not subject to income taxes.

3.4 Europe

Bosnia and Herzegovina, Italy, German, Romania, Russia and UK are our focus in Europe area.

Bosnia and Herzegovina divided by two administrative area: FBiH and RS. Both administrative area have its own accounting and taxation regulation. Accounting standard used in both administrative area is IFRS, while for taxation purposes in both administrative area an adjustment to income tax regulation is needed to book-financial reporting made by the corporation.

Current CIT in both administrative area is 10%. For inventory valuation, average method is used in FBiH while RS allow FIFO or weighted average method. Capital gains treated as ordinary income in both administrative area, and taxable on the basis of CIT.

In Italy, Italian tax authority issued two principles for corporation adopted IFRS as their reporting standard: derivation principle and neutrality principle. In derivation principle, taxable base is determined starting from net income arising from profit and loss, increased or decreased by items directly booked to equity pursuant to the application of IFRS. To such income, the general tax adjustment set forth by the Italian Corporate Income Tax Law apply. Neutrality principle is principle aims to neutralize the effects deriving from the movement to IFRS (first time adoption).

Current CIT in Italy is 27.5% and there is also 3.9% regional production tax. FIFO, LIFO or average method could be used for inventory valuation. Capital gains is taxable according to tax regulation (there are several specific rate for capital gains), but capital gains from financial investment normally is not subject to tax.

In German, German tax authority does not accept IFRS-financial report for taxation purposes. Therefore, German corporation need to prepare two sets of financial report: IFRS-based and national GAAP-based. Current CIT in Germany is 15% and there is also 5% solidarity levy. Conformity between book and tax reporting is not required, as long as fair presentation is produced in the financial report. Inventory valuation for taxation purpose is whichever is lower between actual cost, replacement cost and net realizable value. For cost flow, LIFO is allowed while FIFO is not allowed unless the used assumption is similar with the fact. Capital gains from fixed assets will be treated as ordinary income and taxed at CIT.

Specific taxation regulation have been introduced in Romania for financial institutions that apply IFRS. For taxpayer using IFRS as their reporting standard, there are specific rules in relation to fiscal value assessment, income tax calculation, adjustment for step-down in value, amortization and tax treatment of deferred income tax. Current CIT in Romania is 16% and 3% for micro corporation with specific criteria. One of the following method could be used for inventory valuation for taxation purposes: standard cost, detailed sale price, average (weighted) cost, FIFO and LIFO. Treatment of capital gains is similar with ordinary income.

There is no specific taxation regulation issued by government or tax authority in Russia, as the convergence process in Russia is somewhat delayed due to the absence of independent standard setter board and minimum involvement of Russia government in monitoring this process. Current CIT in Russia is 15.5% to 20% depend on the location. Standard and regulation used for income determination is Russia income tax act. FIFO, LIFO, average cost and individual unit cost could be used for inventory valuation. For capital gains, it will be treated as ordinary income.

In the UK, UK tax authority allows UK corporation to use any authorized accounting standard as a starting point for calculating the UK tax liability. The UK tax authority have then introduced regulation with the intention that corporation's taxable income will be the same whatever the profit before tax starting point is. However this regulation does not always achieve the outcome (Collins, 2011).

Current CIT in UK is 26%. Conformity between book and tax is required for inventory valuation where most commonly used method is lower of cost or net realizable value. For capital gains treatment, it will be treated as ordinary income and taxable according to the CIT.

4. CONCLUSION

With different IFRS implementation and convergence process between one country to another lead to different response of taxation issue. Policy of taxation due to IFRS implementation might be different due to this different stage: early adopters, convergence process, IFRS still voluntary or IFRS is strictly required as reporting standard.

Mixed response from governement or tax authority in response of IFRS implementation: adjustment or change of tax regulation to support IFRS implementation, do not change the tax regulation so taxpayer required to prepare financial report according to national GAAP or do not allow IFRS-based financial report for taxation purposes.

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