Striking the right balance
PwC Budget Seminar
1 March 2013

- Tax Accounting
Tax Accounting

An Overview
Tax Accounting – what does it cover?

A company could be required to pay a number of taxes, which could include:

- Business Tax
- Customs (Excise Tax)
- Payroll Tax
- Withholding Tax
- Corporate Tax
- Capital Gains Tax
- Transfer/Property Tax

Tax accounting covers the accounting for taxes based on **INCOME**
What is Tax Accounting?

Total Income Tax Expense/Benefit = Current Tax Expense/Benefit + Deferred Tax Expense/Benefit
(F/S expense or benefit) (Tax Return + UTPs) (Matching Principle)

Current tax expense - estimate of taxes payable per the tax return

Deferred tax expense (or benefit) is the change in the estimated future tax effects attributable to:

• temporary differences; and
• carry forwards (losses, unutilised Foreign Tax Credits)
**Tax Accounting – Basic Framework**

1. **Calculate current income tax**
   - A. Calculate taxes for tax return purposes
   - B. Provide for uncertain tax positions (i.e., unrecognised tax benefits)

2. **Calculate Deferred income tax**
   - A. Determine the tax base
   - B. Calculate Temp. Differences (‘TD’)
   - C. Identify Exceptions
   - D. Review deductible TD/tax losses
   - E. Determine applicable tax rates
   - F. Recognise deferred Tax

3. **Financial Reporting for Current & Deferred Taxes**
   - A. Presentation and offsetting
   - B. Disclosure
Basics of Tax Accounting

Potential Temporary Differences

• Depreciation
• Leave Provisions
• Warranty Reserves
• Inventory Obsolescence Reserves
• Tax Deductible Intangibles
• Any Book to Tax Differences that affects Taxable Income but such affect will reverse itself in a future year.
Basics of Tax Accounting

Illustrative Example

- An asset is purchased for $10,000.
- Financial Accounting: Straight Line Method - 4 Year Useful Life
- Tax Return Accounting: Accelerated Method - 5 Year Useful Life
- At the end of the useful life, Book Value and Tax Return basis are both zero.

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<th>GAAP</th>
<th>TAX RETURN</th>
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Illustrative Example (cont’d)
Impact of Changes in Tax Law

Example of changes that may impact Tax Accounting balances:

- Extension of Tax Incentives
  - Through impact on ‘enacted’ current or future tax rate
- Safe Harbour for Capital Gains
  - By removing uncertainty and hence the need for reserves for uncertain tax position related to disposal of substantial interests

Example of changes that may only impact current tax expense:

- Enhanced deduction under PIC Scheme
- Tax Rebates
Tax Accounting

Recent Trends
The tax area represents a significant percentage of total restatements of financial statements for US listed companies.

ASC-740 Restatements

Source: Audit Analytics®
Demand for transparency of financial reporting

Areas of focus by regulatory authorities

- Valuation allowances – Realisability of tax losses
- Indefinite reinvestment of undistributed earnings
- Uncertain tax positions and tax reserves (transfer pricing issues!)
- Disclosure requirement – effective tax rate transparency (foreign earnings); early warning disclosures
Audience question

Which of these business issues is your biggest concern over the next twelve months:

1. Compliance
2. Tax accounting and reporting
3. Transfer Pricing
4. Tax function effectiveness
5. Mergers and Acquisitions
What business issues will be the main tax concerns over the next 12 months?

- Transfer pricing: 51%
- Tax accounting and reporting: 49%
- Mergers & acquisitions: 40%
- VAT/GST: 29%
- Cross-border tax structuring: 25%
- Tax compliance: 23%
- Dispute resolution: 17%
- Customs: 13%
- Tax function effectiveness: 13%

Source: Global Tax Monitor Survey (Base: 636 primary buyers of tax services (y/e Q1 2012))
Tax Accounting

GAAP Trends
A deferred tax liability shall be recognized for the following types of taxable temporary differences:

- An excess of the amount for financial reporting over the tax basis of an investment in a subsidiary;
- An excess of the amount of financial reporting over the tax basis of an investment in a 50-percent-or-less-owned investee for a corporate joint venture that is essentially permanent in duration.
Undistributed Foreign Earnings

Does not apply to entities who do not include the results of subsidiaries, branches, and joint ventures in their financial statements via consolidation or equity method of accounting.
**Undistributed Foreign Earnings - IFRS**

**Investment in Subsidiaries:**

- **Can parent control the timing of the reversal?**
  - **NO**
  - **YES**

- **Is it probable that the TD will reverse in the foreseeable future?**
  - **YES**
  - **NO**

  - **Recognise TD**
  - **Do not provide**

*TD = Temporary Difference*
**Undistributed Foreign Earnings – US GAAP**

**Indefinite Reinvestment Criteria:**

- Repatriation presumption is overcome with “sufficient evidence”

**‘Sufficient evidence’**

- Document intent, ability, and specific plans for reinvestment (Asserting that the parent does not need the cash is NOT sufficient)
- Should align with business model
- Evidence of specific plan for reinvestment for **each** subsidiary

**Tax Free Repatriation of Earnings**

- Singapore NIL withholding tax on dividends
Identification of Applicable DTA / DTL Tax Rate

Principle:
• Tax rate applicable on reversals

Common Fact Patterns where Errors Arise:
• Company enjoying a reduced rate does not conduct item by item analysis to determine the applicable rate
• Company simply uses the next year’s applicable tax rate
• Expiration of tax holidays
• Company does not keep a fixed asset reversal table by years
### Identification of Applicable DTA / DTL Tax Rate

#### Illustrative Example

- An asset is purchased for $36,000.
- Financial Accounting: Straight Line Method - 6 Year Useful Life
- Tax Return Accounting: Accelerated Method - 3 Year Useful Life

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Tax Return to Provision True-up

Things to Consider:

• (ECI) Computation
• Use of Prudence
• Permanent verses Temporary Classification
• Timing of Adjustment
  • 1 year lag for calendar year end companies
  • 2 year lag for non-calendar year end companies
Uncertain Tax Positions

A **Tax Position** is:

- A position in a previously filed tax return or expected to be taken in a future tax return;
- A decision not to file a tax return;
- Allocation or a shift in income between jurisdictions; and
- A decision to classify a transaction, entity, or other position in a return as tax exempt.
Uncertain Tax Positions

Examples of Tax Positions:

- Position taken or expected to be taken on a tax return (e.g. – capital vs. revenue expenditures)
- Permanent establishment
- Transfer pricing
- Withholding tax
- Treaty positions
- IP migration
- Cross-border financing
- Tax holidays
Uncertain Tax Positions
Measurement of Benefit – Example

A company does not bring a gain of $100 to tax on the basis that it is capital in nature.

Distribution of potential outcomes has a binary outcome:

1. If the position is sustained, the entire as-filed tax return amount (i.e. 100% of the benefit) will be accepted.

2. If the position is lost upon challenge, none of the as-filed tax return amount (i.e. zero benefit) will be accepted.

- IFRS or Singapore FRS applies the “weighted-average” or “single best estimate” approach: All or Nothing
- US GAAP determines the largest amount that has a cumulative probability of >50% of being ultimately realized: All or Nothing
Other Items to Consider

- Permanent verses Temporary Classification
- Balance Sheet Classification of Deferred Tax Balances (Current verses Non-Current)
- US GAAP to STAT Accounting Differences
- Business Combinations
- Intra-Period Allocation
- Interim Reporting
- Intercompany Transactions
Thank you

Mahip Gupta         Director    +65 6236 3642    Mahip.Gupta@sg.pwc.com
Joan Neely          Manager    +65 6236 3707    joan.s.neely@sg.pwc.com