

Tax Flash

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New guidance on the tax treatment of temporary differences between the accounting and tax base in case of distribution

The risk of double taxation

The Independent Authority for Public Revenue (AADE) has recently attempted to resolve the longstanding issue of the tax treatment of profits of legal persons, when they distribute or capitalise profits that have not been subject to tax due to temporary differences.

Under current tax legislation, when profits that have not been subject to tax are distributed or capitalised, income tax is due at the time of distribution or capitalisation.

To the extent that the distributed amounts correspond to temporary differences between the accounting and tax base, the issue of double taxation arises, as these amounts will be subject to tax in subsequent years when they are reversed in the tax base.

The proposed solution

The new circular (E.2089/2022) attempts to address the issue of double taxation by clarifying that income tax will be paid at the time of distribution or capitalisation, but these amounts will be deducted from the tax result of the year in which they affect the tax base.

The above is also applicable when distributing amounts deriving from temporary differences of previous years. Moreover, the possibility of tax refund is provided in cases where temporary differences have been subject to double taxation, by submitting an amending tax return without any penalties or interest until 30.06.2023.

Further considerations

The position adopted is in the right direction, but in practice the situation is more complex, since there is rarely a complete reversal of temporary differences in the year immediately following the distribution. Usually, temporary differences reverse in a number of years, without always being easy to identify what is reversed and when.

Consequently, before any distribution or capitalisation of amounts that have not been subject to tax yet, a thorough review should be carried out in order to identify the temporary differences that have affected the accounting base and the timing of their reversal in the tax base.

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