Tax reporting contra financial reporting

Finnish experience and experience of Nordic countries, disconnection tax reporting and financial reporting:

-will it increase the burden for SMEs by having two types of reporting?

-Advantages and disadvantages of dual reporting.

The challenge

- Today the financial result before taxes generally differs from the taxable result.
- The difference may be complex and requires special knowledge and separate accounting for tax purposes.
- In order to simplify tax reporting, what could be done?

The problem and its structure (simplified)

Financial result before taxes	xxx
Non taxable revenues (partly or totally)	- a
Revenues with different revenue recognition	+/- b
Non deductable costs (permanent differences)	+ c
Costs deductable in another period (timing differences)	+/- d
Costs calculated in a different manner	+/- e
Taxable result	yyy

Non taxable revenues (partly or totally)

- Examples: gain of sale of certain shares, dividends.
- Totally non-taxable revenues are often easy to identify and adjust for outside the books.
- Partially non-taxable revenues are more complex to identify and adjust for outside the books – but could be accounted for on different accounts.

Revenues with different revenue recognition in financial reporting and taxation

- Examples: certain advances and ”maintenance” fees, unrealised currency translation differences.
- Requires complex separate follow-up accounting.
- What could be done?
  - Change taxation rules.

Non-deductable costs (partly or totally) – permanent differences

- Examples: entertainment costs.
- Usually easy to identify.

Costs deductable in another period (timing differences)

- Examples: provisions and write-down of financial assets and instruments.
- Usually easy to identify.

Costs calculated in a different manner

- Examples: depreciation – often resulting in different gains or losses in a realisation.
- In some countries the different depreciation for tax purposes should be booked and is often presented as allocations.
- The problem is complex and requires certain kind of accounting and tax knowledge.
- The risk for wrong treatment is big.
- This is the most difficult difference between tax and financial reporting.

Conclusion

- Biggest difficulties in the following areas:
  - Different principles for revenue recognition.
  - Cost calculated in a different manner (depreciation).
- If simplification is first priority:
  - Taxation should be adjusted to be based on financial reporting only, with some adjustment outside the books.
  - Different cost calculation (depreciation) should be abolished.

Conclusion

- Upside
  - Simplified accounting for tax purposes with less administrative burden.
  - Decreased need for special skills, resulting in less costs.
  - Accounting for deferred taxes would be less complex.
- Downside
  - There is less room for ”tax planning” which may negatively hit the cash flow.