GENEVA GROUP INTERNATIONAL

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# DEFERRED TAX IN FINANCIAL STATEMENTS

## FOCUS: COMPANIES GOING PUBLIC

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# Definitions (by Wikipedia)

**A notional asset or liability to reflect corporate income taxation on a basis that is the same or more similar to recognition of profits (and losses) than the taxation treatment.**

**<u>Permanent and Temporary differences</u>**

- If an item in the profit and loss account is **NEVER** chargeable or allowable for tax or is chargeable or allowable for tax purposes but **NEVER** appears in the profit and loss account then this is a permanent difference. **A PERMANENT DIFFERENCE DOES NOT GIVE RISE TO DEFERRED TAX.**
- If items are chargeable or allowable for tax purposes but in different periods to when the income or expense is recognised then this give rise to temporary differences. **TEMPORARY DIFFERENCE DO GIVE RISE TO POTENTIAL DEFERRED TAX.**

# Example #1 Deferred tax liabilities

- Tax relief is provided in advance of an accounting expense/unpaid liabilities, or income is accrued but not taxed until received.
- Taxation of capital gains is deferred for a certain number of years where the profit is recognized immediately.
- Some revenues are recognised in P&L when contract is signed or services delivered where they are taxed along several future years.

# Example # 2 Deferred tax assets

- An accounting expense in relation to a provision such as bad debts, but tax relief may not be obtained until the provision is utilized.
- A company incurs tax losses and is able to "carry forward" losses to reduce taxable income in future years.
- Depreciation on "Immaterial" (say film rights) is accounted on the basis of future revenues where tax relief is allowed on a straight line basis (which is less).

# Accounting principles: differences

We focus on deferred tax assets

According to IAS IFRS deferred tax assets are recognized only when **IT IS PROBABLE** that taxable profits will be available against which the deferred tax asset can be utilized.

According to Italian OIC 25 “the asset associated with a tax loss is recognized under assets in the balance sheet “deferred tax assets” only if there **IS A REASONABLE CERTAINTY OF THEIR FUTURE RECOVERY.**

**CERTAINTY** is different from **PROBABILITY**!!!

In most countries, when going public, it is mandatory (or accepted) to adopt IAS for statutory financial statement.

# Accounting principles: consequences of difference 1

It has happened that, in the same moment when the company has shifted from domestic to international GAAP, has showed an asset (due to the wording probability instead of certainty) not existing till 10 minutes before.

In some cases the “sudden increase” of net patrimony was reflected in P&L in some not.
In all cases it made easier and richer the distribution of dividends and fulfilment of financial targets (see covenant etc.)

Thus the definition “notional” asset or liability must not be considered as virtual or theoretical: we are talking of money and it is up to us to help and suggest what to do our client.

More: it is up to us “only”. We are the only one who have the necessary knowledge and experience: not the lawyer, not the accountant, not the auditor not the simple consultant, you must be all that.

# Accounting principles: consequences of difference 2

We said that "According to IAS IFRS (IAS 12) deferred tax assets are recognized only when IT IS PROBABLE that taxable profits will be available against which the deferred tax asset can be utilized".

This means that "future", forecast of future and business plans have impacts of utmost importance on actual assets.

- BoD has to deliberate formally future plans and these plans of future activity must be audited as well as past historical events.
- Need of total transparency and disclosure. Financial statement (and notes) become an open book.

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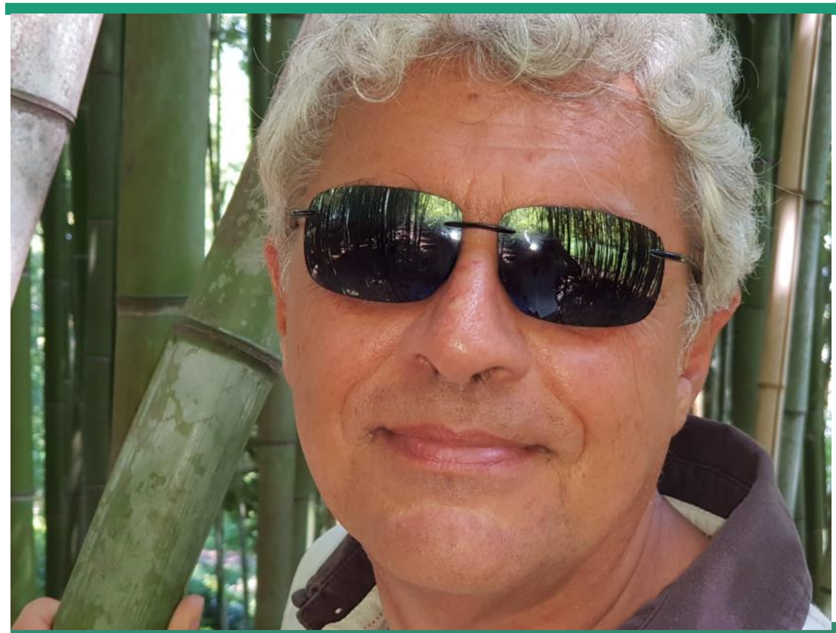


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