

Global Tax Accounting Services Tax Management and Accounting Services

*Focusing on tax
accounting issues affecting
businesses today.*

*Global Tax Accounting
Services newsletter
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Dear Readers

The Global Tax Accounting Services newsletter is a quarterly publication from PwC's Global Tax Accounting Services group and highlights issues that may be of interest to tax executives, finance directors and financial controllers.

In this release, we discuss some recent updates to the financial accounting convergence projects and the related tax accounting considerations. We also draw your attention to some significant tax law and tax rate changes during the quarter ended 31 December 2011 and highlight some trends in this area.

For questions related to items discussed in this newsletter, for a comprehensive discussion of tax accounting issues affecting businesses today, or for general tax accounting questions, please contact your local PwC team member or the Tax Accounting Services network member listed at the end of this document.

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Accounting updates

This section offers insight into the most recent developments in accounting standards along with the implications for tax accounting.

Revenue recognition Exposure draft reissued

After consideration by the IASB and the FASB ('the Boards') of the extensive comments received on the Exposure Draft on Revenue Recognition issued in June 2010, a decision was made in June 2011 to re-expose the draft in the second week of November 2011. The comment period for interested parties is currently open until 13 March 2012. The IASB has commented that the new standard will not be effective before 2015, although 2016 may be more likely based on current progress.

The new standard proposes a model whereby revenue is recognised when an entity satisfies its obligations to its customers, which occurs when control is transferred. The proposed changes could impact the timing of revenue recognition, for example in connection with the sale of licences and the potential acceleration of the recognition of contingent income. A range of industries could be affected including, technology, software, entertainment, media, telecommunications and the pharmaceuticals industry.

Tax accounting considerations

The main tax accounting implications will also be around timing, in respect of the recognition of current and deferred tax. In particular, in jurisdictions where profits tax calculations are based on income recognised in financial statements prepared under IFRS or US GAAP, there could be material changes to when current tax is recorded for affected companies.

In jurisdictions where profits taxes are not based on IFRS or US GAAP accounts, there could be significant deferred tax implications in accounting for changes to temporary differences arising from the new proposals. The expected increase in the use of estimates under the proposed new standard could also impact the accounting for uncertain tax positions in some situations.

Next steps

Given the proposed requirement for full retrospective application, it will be important for impacted companies to monitor any developments as they occur to ensure that the changes are properly reflected in systems, controls and calculations supporting financial statements. Such companies may also wish to consider making submissions to the IASB or the FASB before the March 2012 deadline to raise any issues or concerns they have with the current proposals. If readers would like further information on any aspect of the proposals, or assistance with making representations, please contact your engagement team or refer to the general or industry specific guides available at www.pwcinform.pwc.com.

IASB and FASB project on leasing **Update on developments**

In last quarter's Newsletter we discussed the meeting held by the Boards in September in respect of the ongoing joint IASB and FASB project on leasing.

We noted that some key issues would not be debated until the next board meeting and that we would provide an update this quarter. As there have been no significant developments in this area since our last Newsletter was issued, we will continue to monitor progress on this project and provide an update as and when progress is made.

For more information on the joint leasing project, refer to PwC's Straight away IFRS bulletins available at www.pwcinform.pwc.com.

IAS 12 – Investment properties **Rebuttable presumption to determine the manner of recovery**

Paragraph 51 of IAS 12 deals with the approach to the calculation of deferred tax and provides that the measurement of deferred tax assets and liabilities should reflect the manner of expected recovery or settlement of the carrying amount of the underlying assets and liabilities. In December 2010, an amendment was made to paragraph 51 with a view to removing the subjectivity in determining the expected manner of recovery of investment properties held at fair value in those jurisdictions where this was creating uncertainty.

The amendment in paragraph 51C introduced a 'rebuttable presumption' that, for the purposes of deferred tax calculations, the expected manner of recovery of investment properties measured using the fair value model in IAS 40 would be through sale. The example given in the standard of when the presumption would be rebutted is where an investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits inherent in the property over time, rather than through sale.

The IFRS Interpretations Committee received a request for clarification which was considered at its autumn meetings, on whether this presumption can be rebutted in circumstances other than the one explicitly described in paragraph 51C. The Committee noted in its September and November updates that, as a presumption is a matter of consistently applying a policy in the absence of acceptable reasons to the contrary, it can be rebutted where there is sufficient evidence to overcome the presumption. It also noted that the wording of paragraph 51C does not exclude the possibility of other situations arising which would permit the rebuttal of the presumption of recovery through sale, provided there is sufficient evidence is available to support the rebuttal.

This clarification by the Committee is likely to have most impact in those jurisdictions which provide for exemption from tax on the sales of assets such as investment properties, as is the case for example in Singapore and Hong Kong.

IAS 12 – Asset ownership vehicles Basis for accounting for deferred tax

The IFRS Interpretations Committee also responded in its September and November updates to a request for clarification regarding the calculation of deferred tax in circumstances where an entity owns a subsidiary which holds a single asset. Specifically, the Committee was asked whether the tax base used in the calculation of the related deferred tax asset or liability should be the tax base of the shares in the subsidiary holding the asset or the tax base of the underlying asset itself. This is of particular relevance in jurisdictions where it is common for the value of the asset in these circumstances to be realised through sale of the shares of the subsidiary, for example where the local tax legislation provides for a participation exemption on the sale of shares.

The Committee's initial response concluded that entities are unable to avoid providing for deferred tax for temporary differences relating to underlying assets, even if the entity does not expect to dispose of the asset separately from the entity which holds it, unless the specific requirements of the Initial Recognition Exception ('IRE') apply. However in its November update, it was noted that, due to the diversity in practice in respect of this issue, further analysis should be undertaken to assess whether clarification on this point is required in IAS 12.

We will continue to monitor any developments on this matter and provide an update in future editions of this Newsletter.

SEC staff papers on IFRS

In November 2011, the SEC released two staff papers on IFRS for US users as they continue to consider their proposed approach for incorporating IFRS into the US financial reporting system. The first considers the differences between the US GAAP and IFRS frameworks and can assist users whose filing status requires them to apply both GAAPs or who are considering the implications of transitioning from US GAAP to IFRS. The second publication analyses the IFRS framework as applied in practice and can also further assist executives as they consider the adoption of IFRS in jurisdictions outside of the US as well as the implications of the ongoing 'convergence' projects of the International Accounting Standards Board ('IASB') and the US Financial Accounting Standards Board ('FASB'). Both of the SEC staff papers can be accessed via www.cfodirect.pwc.com.

PwC has also produced two related summaries, 'IFRS – The current landscape for US tax executives' and 'Income Tax Accounting – A comparative look between US GAAP and IFRS' to assist users in this area. These, along with other relevant guidance and tools can be accessed via www.pwc.com/us/tas. As outlined in our first summary referenced above, the SEC continues to demonstrate its commitment to single set of high quality, global accounting standards. However other, ongoing IFRS related developments to both the standards themselves and in the global adoption landscape, continue to present challenges for any group already applying, or assessing the impact of adoption of, IFRS.

The PwC summaries mentioned here and our other relevant guidance can help readers understand these developments and how they may impact your tax accounting processes and practices and help ensure you are prepared for any changes that may be on the horizon.

ASB and EFRAG Paper on Improving Tax Reporting

On 22 December, the UK Accounting Standards Board ('the ASB') of the Financial Reporting Council ('FRC') and the European Financial Reporting Advisory Group ('EFRAG') published a paper in order to solicit views from constituent groups on how the financial reporting of income tax could be improved. The issues presented in the paper are also supported by a number of other standard setters in Europe. The paper looks at the difficulties in applying IFRS in practice and notes that it does not always result in optimal information for users. It goes on to discuss ways in which the usefulness of information prepared in accordance with IAS 12 could be enhanced, focusing in particular on possible changes to the reconciliation of the tax expense, revisions to the requirements in respect of uncertain tax positions and consideration of whether deferred tax should be discounted. It also presents four alternative approaches that could form the basis, for a new accounting standard to replace IAS 12 in the future.

The Discussion Paper is open for comment until 29 June 2012 and can be accessed via the FRC's website. Readers with operations in the EU may want to consider responding to the proposals.

This paper follows two PwC Point of View publications which were issued in September and December 2011 setting forth PwC's perspective on the need for a fresh and comprehensive review of the financial reporting of income tax. The September publication, also mentioned in last quarter's Newsletter, can be accessed via www.pwc.com/us/tas and the December publication can be accessed via www.pwc.com/ifrs.

Recent and upcoming major tax law changes and the tax accounting implications

Constantly changing tax laws present a barrier to efficient tax management on a global scale, particularly when the related tax accounting considerations must be addressed on a timely basis. This section focuses on major changes with tax accounting implications that may be of interest. It is intended to increase readers' awareness of the main global tax law changes, but does not offer a comprehensive list for all countries. Readers should not rely on the information contained within the newsletter without seeking professional advice. For a comprehensive list of current tax developments, please consult with your local PwC team.

Loss utilisation limitation

One of the areas of tax law where we are currently seeing a developing global trend, is in the limitation on the availability of brought forward operating tax losses to shelter future trading income. Following the introduction of rules in this area in Germany in 2004, we are now seeing several other jurisdictions adopting similar measures, which usually limit the use of brought forward losses to a fixed percentage of taxable income in any future period. Countries which have now enacted these loss limitation measures include France, Italy, Spain, Japan, Portugal and Hungary.

These rules can have a significant impact on accounting for income taxes under ASC 740 and IAS 12, in particular on the ability to recognise deferred tax assets in respect of any restricted brought forward losses. In this regard, it may be necessary to schedule the expected timing of the reversal of such losses to assess whether an annual offset restriction may result in a reduction of a deferred tax asset under IFRS or the establishment of a new or increased valuation allowance under US GAAP.

The position is further complicated when a company is currently in an extended loss-making position and projects to be loss-making going forwards. In this situation, when considering the reversal of existing taxable temporary differences as a factor to support the recognition of a deferred tax asset in respect of the brought forward losses, the question arises as to whether the existing taxable temporary differences should also be limited by the same percentage as the losses under the new regulations.

For example, if a company has taxable temporary differences of 100 and brought forward losses of 200 which, going forward, will be restricted in usage to 75% of the relevant year's taxable profits when it eventually becomes profitable, can the full 100 of taxable temporary differences be used to support the recognition of deferred tax on the losses, or should this be restricted to 75?

The restriction should be applied to any existing taxable temporary differences such that, in the situation above, only 75 of the taxable temporary differences can be considered in support of the recognition of the potential deferred tax asset in respect of brought forward losses. This would result in only 75 of the losses being recognised out of the full 200.

Similarly, if in the future the same company, despite its history of losses, now expected to generate 100 of future taxable profits, we consider that these should also be restricted to 75 such that they only support recognition of 75 of the losses.

Accordingly, where loss restriction rules are introduced, it may make it harder for companies to meet the 'probable' (IFRS) or 'more likely than not' (US GAAP) thresholds for recognition of related deferred tax assets.

Update on French rules on losses

As discussed in last quarter's Newsletter, the French parliament enacted a number of significant changes to the tax treatment of operating losses and the taxation of gains on shares in early September 2011.

These changes included a limitation on companies' ability to carry back operating losses, restricting their offset to profits arising in the fiscal year immediately preceding the year in which the losses arise and capping the amount at €1m. Any surplus would only be available to carry forward.

On 29 December 2011, as well as enacting additional changes to certain anti – avoidance legislation, the French parliament also enacted a clarification in respect of the carry-back rules originally enacted in September. The clarification confirmed that the new rules apply not only to losses arising in the future, but also to losses carried forward from earlier periods.

Groups that include French companies should ensure they are aware of this clarification and of the impact it could have on the recognition of deferred tax assets in respect of existing losses. Where the carryback restriction could impact the ability of such groups to utilise losses, this may result in the reduction of related deferred tax assets under IFRS or new or increased valuation allowances under US GAAP.

Japanese tax rate changes and tax base broadening provisions

On 30 November 2011, the Japanese House of Councillors passed the 'Restoration Funding Bill and the 'Re-revised Bill', resulting in their being substantively enacted and enacted for IFRS and US GAAP respectively. Included in the Restoration Funding Bill was the introduction of a 10% Japanese corporation tax surcharge ('surtax') which will apply to the 'base' corporation tax (i.e. the amount calculated before certain adjustments and credits) for three years beginning with fiscal years starting between 1 April 2012 and 31 March 2015.

Included in the Re-revised Bill were amendments to reduce the Japanese total corporate income tax rate of just over 40% by 4.5% (and reduce local taxes by approximately 0.5%) while also broadening the corporate tax base. The measures to broaden the tax base include the introduction of an 80% cap on current year NOL utilisation, an extension of the NOL carry-forward period from seven to nine years for NOLs incurred in fiscal years ending on or after 1 April 2008 and other measures amending the rules on allowable depreciation and bad debt reserves.

These amendments will take effect in fiscal years beginning on or after 1 April 2012.

All of the above changes will need to be considered for current and deferred tax accounting under IFRS and US GAAP. For deferred tax, the impact of all of the changes on existing deferred tax balances will need to be recorded as a discrete item in the quarter which includes 30 November 2011. It is likely that the expected reversal of the deferred tax balances will need to be scheduled out in some detail to ensure that the correct overall rate is applied given the interaction of the changes and their application to different periods. Under IFRS, it will also be necessary to 'backwards trace' the deferred tax impact to ensure it is reported in the statement where the deferred tax liability or asset which is being amended was originally reported.

For current tax, the annual estimated ETR applied in calculating the tax expense of the relevant period will only need to be adjusted to take account of the changes if they apply to that period. For calendar year-end companies, the first quarter in which the changes will need to be taken into account will therefore be Q1, 2013. The changes may also need to be taken into account in accounting for uncertain tax positions, particularly in respect of loss utilisation.

It will be important to ensure that these changes are properly reflected in financial statements and that, where appropriate, relevant disclosures are made to assist users of accounts in understanding their implications.

Some enacted tax rate changes in the quarter ended 31 December 2011

Country	Prior Tax Rate	New Tax Rate	
Finland	26%	24.5% ¹	¹ Effective date: 1 January 2012
France	33.33%	35% ²	² Effective date: 2011-2012 tax years for taxpayers with turnover > 250M EUR. Previous effective tax rate was 34.43% including social contribution surcharge. New effective tax rate including social contribution charge is approximately 36.16%.
Hungary	19%	19% ³	³ Hungary previously enacted a tax law to apply a 10% tax rate to all operating companies as opposed to only those companies falling below the HUF 500M threshold. The law to expand the application of the 10% tax rate, originally effective 1 January 2013, has been repealed.
Israel	24%	25% ⁴	
Japan	40.69%	38.01% ⁵	
Portugal	Various	Elimination of reduced CIT rates ⁶	
South Korea	11% / 24.2%	11% / 22% / 24.2% ⁷	⁴ Effective date: 1 January 2012. The previously enacted future CIT rate reductions have been abolished.
Thailand	30%	23% ⁸	⁵ Effective date: 1 April 2012. The change in tax rate represents a change in the approximate effective tax rate and is due to reductions in the corporation (national) tax rate (now 28.05%) and the local inhabitants tax (now 5.28%).
			⁶ Effective date: 1 January 2012. The provisions include: the elimination of the reduced rate of 12.5% on taxable income up to EUR 12,500; the elimination of the inland regime, with CIT rates of 10% and 15%; and an increase in the Standard CIT rate in the Autonomous Region of Madeira from 20% to 25%.
			⁷ Effective date: Years beginning on or after 1 January 2012. There is a change in the taxable income thresholds to: 11% if taxable income >= KRW 200M; 22% if taxable income > KRW 200M but <= KRW 20B; and 24.2% if taxable income > KRW 20B.
			⁸ Effective date: Accounting periods beginning on or after 1 January 2012; 20% for the next 2 accounting periods beginning on or after 1 January 2013; thereafter the rate reverts to 30%.

Important considerations in tax law changes in the quarter ended 31 December 2011

Australia

- Introduction of a carbon pricing mechanism to embed a carbon price into the Australian economy effective 1 July 2012:
 - A special tax treatment will apply to emissions units, the purchase price of which will only be deducted when surrendered or sold; and
 - No deduction will be available for any carbon shortfalls.

Belgium

- Belgium enacted a.o the following rules effective 1 January 2012:
 - Revisions to the calculation of disallowed expenses related to car expenses;
 - Increase of the standard Belgian interest withholding tax rates from 15% to 21% (exemption possible).
- Notional interest deduction rate capped at 3% for tax years ending on or after 31 December 2012.

Brazil

- Amendment to the financial transactions tax rates levied on foreign currency exchange transactions related to certain investments made by non-residents in the Brazilian Financial and Capital Markets.

Canada

- Curtailment of partnership income deferral for corporate partners that use partnerships with misaligned year ends, effective for corporate partners' taxation years ending after 22 March 2011; and
- Elimination of exceptions to the rule that reduces the loss realized by a corporation from the disposition of shares by the amount of tax free dividends deemed received prior to the disposition, effective for redemptions occurring after 21 March 2011.⁹

Denmark

- Denmark enacted the following rules effective 1 January 2012:
 - Introduction of a tax credit equivalent to the tax value of R&D costs available to companies and businesses incurring losses on their R&D activities up to 1.25m DKK per group;
 - Stricter eligibility requirements for the tax exemption on transfers of ownership in shares or businesses;
 - Increase in tax rate on pension fund yields to 15.3%; and
 - Abolishment of adjustments to 'minimum interest' deduction.

France

- France enacted the following rules effective 1 January 2012:
 - Additional limitation on the deductibility of interest expense for acquisitions of qualified holdings;
 - Amendment to the anti-abuse rules relating to short-term capital gains and losses (repeal of short term capital gain deferral);
 - Clarification that new rules on carryback of tax losses apply to losses arising in the future and losses carried forward from previous years;
 - Royalty deduction limitation: full deduction allowed only if licensee can prove and document that use of license results in added value over the license period and such use is real and does not constitute a tax avoidance artificial scheme; and
 - Sublicensing income may be subject to a reduced tax rate of 15%.

Germany

- Withdrawal of 10% threshold within the domestic anti-treaty shopping regulations due to a European Court of Justice Ruling, effective 1 January 2012.

⁹ The elimination of the exceptions may still be subject to certain conditions.

Hungary

- Restriction on current utilisation of brought forward losses to 50% of the taxable profit before tax losses, effective 1 January 2012.

Ireland

- Increase of the capital gains tax rate from 25% to 30%; and introduction of a capital gains exemption on property purchased and held for 7 years, effective 7 December 2011.

Israel

- Increase of the general and substantive shareholder tax rates on interest, dividends, and capital gains from 20-25% to 25-30%, effective 1 January 2012.

Italy

- Italy enacted the following tax law changes:
 - Clarification that recent changes to tax loss rules relating to the indefinite carryforward of start-up tax losses and the 80% limitation of all other tax losses apply to losses brought forward from prior periods that are not yet utilized or expired;
 - Introduction of Notional Yield Deduction (ACE) – tax deduction available for notional yield calculated on “New” equity¹⁰; and
 - IRES tax deduction for IRAP paid on labour cost.¹¹

Japan

- Introduction of tax base broadening provisions (for periods in line with the rate reduction), including:
 - An 80% cap on current utilisation of brought forward losses; and
 - An extension of the loss carry-forward limitation period from 7 to 9 years (for losses incurred in fiscal years ending on or after 1 April 2008).

Netherlands

- The Netherlands enacted the following rules effective 1 January 2012:
 - Special 40% R&D deduction aimed at costs other than wages;
 - Interest restrictions for acquisition debt in a fiscal unity;
 - Anti-abuse rule for Coops with shareholdings whose main purpose is to avoid Dutch WHT;
 - Object exemption for foreign permanent establishments such that losses will no longer be deductible against Dutch profits; and
 - Foreign interest in a Dutch entity of at least 5% may be subject to Dutch CIT.
- Policy rule addressing exit taxes for corporations and individuals engaged in business allows taxpayers to defer the tax payment. The tax assessments ‘freeze’ the taxable amount at the time of emigration, effective 29 November 2011.

Peru

- Clarification that regulations relating to taxation of derivatives executed by non-resident investors are only applicable when the contract term is less than 60 days, effective for derivative transactions executed on or after 30 November 2011.

Portugal

- Portugal enacted the following rules effective 1 January 2012:
 - Costs (including acquisition costs) written off in 2012 for invoicing software and computer equipment are fully deductible for tax purposes;
 - Extension of the tax loss carryforward period for tax losses generated in FY 2012 and after from 4 to 5 years;
 - 75% limitation of tax loss deduction against taxable profits in a particular year;
 - Non-deductibility of certain payments made to taxpayers benefiting from favorable tax regimes;
 - CFC rules no longer applicable to entities residing in the EU or an EEA country;
 - Repeal of the Madeira International Business Centre (MIBC) regime as it concerns dividends and interest from shareholder loans;
 - Limitation to 20% of the reduction of tax rates applicable in the Autonomous Regions relative to the ones applicable in the main land; and
 - Investment and R&D Support Tax Benefits extended to expenses incurred in 2012.

¹⁰ Tax law change is effective for the current fiscal year in progress at 31 December 2011.

¹¹ Tax law change is effective beginning in the 2012 tax period.

PwC tax accounting resources

Contacts

For more information on the topics discussed in this newsletter or for other tax accounting questions, including how to obtain copies of the PwC publications referenced, contact your local PwC engagement team or your Tax Accounting Services network member listed below.

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