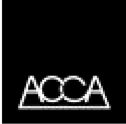

Tax and financial reporting: twain should meet but not merge

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Research* commissioned by ACCA has confirmed the organisation's longstanding view that aligning tax and accounting rules during the changeover period to International Financial Reporting Standards (IFRS) will bring unnecessary complications for businesses and government and be a waste of the time and resources of both. ACCA asks the Government to instead focus its effort and resources on more worthy areas, at least until the accounting landscape has settled post 2005.

1 January 2005 is the date from which adoption of IFRS will be mandatory for the consolidated accounts of listed companies. EU member states are, however, allowed to extend adoption of IFRS compulsorily or optionally to unlisted companies and to unconsolidated statements and it is anticipated that most companies will move to IFRS from 2005 onwards. This could lead to effects on tax calculations, in the form of changes in taxable income and /or tax and financial reporting linkages.

Drawing on global information, the ACCA commissioned research (prepared by Prof. Chris Nobes of Reading University) examines the advantages and disadvantages of the alignment of tax practice with financial reporting practice and concludes that tax and financial reporting should have separate rules and, therefore, be disconnected.

Current UK government thinking, however, seems to be in favour of aligning tax and accounting treatments. The corporation tax reform process, for example, includes Inland Revenue proposals to move to an accounting basis for taxing gains or losses on capital assets. The European Commission (EC) is also considering whether IFRS could be used as a tax base, in the context of a proposal to base taxation on an EU-wide consolidation. The research finds, however, that the EC proposals also fail to stand up to scrutiny and are 'hopelessly ambitious', as they would necessitate major simultaneous reform and raise so many problems that it would postpone developments for many years.

Chas Roy-Chowdhury, Head of Taxation at ACCA, said: 'The purposes of financial reporting are different from those of taxation and, as such, the calculation of income should remain different for both. The simplistic argument in favour of alignment is that it will deliver administrative efficiency (i.e. if the two systems use the same practices, then accounts need be prepared and checked only once). This is unrealistic.

'Such efficiency could only be fully achieved if the tax rules are exactly the same as financial reporting rules. If there are any differences, the need to learn two sets of rules remains. Furthermore, it might be administratively more efficient for both taxpayer and tax collector to have simple, stable tax rules rather than following complex, ever-changing financial reporting rules.

'And in the UK context, the switch-over to IFRS could lead to substantial changes in the reported taxable profits of UK plc, with large increases (or decreases) in the amounts paid to the Exchequer. It is equally plausible that there could be significant winners and losers among individual businesses but very little impact on the Exchequer's overall income. With such potentially major implications for the government and the business community, it is essential that further significant changes in the form of alignment of tax and accounting treatments, are not undertaken until all the bigger issues surrounding IFRS have been resolved.'

Note to Editors
*The ACCA research report, A Conceptual Framework for the Taxable Income of Businesses, and How to Apply it under IFRS, is available from the ACCA website, at
http://www.accaglobal.com/publications/technical_other/tech_tp_03

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