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The Influence of Tax on IFRS Consolidated Statements: The Convergence of Germany and the UK

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Abstract

The literature on the links between tax and financial reporting suggests that the strength of those links varies over time and from one jurisdiction to another. The links in Germany were seen to be particularly strong, and those in the UK rather weak. Previous literature was largely set in the context of unconsolidated statements but authors have suggested that their findings were relevant for consolidated reporting. This paper examines the scope for tax influence on IFRS consolidated financial reporting in the two above countries. We find that the overall position for Germany and the UK is now similar, that is, that the potential for tax influence is much weaker in Germany than recorded in previous studies. We also find that, even for unconsolidated reporting under domestic accounting rules, the extreme positions recorded for the two countries in the 1990s have been modified.

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Notes

Spanheimer and Koch (2000, p. 310) report that only 45 companies were using US or IAS rules even in 1999 after this was made easy in 1998. The number in 1996 was less than 10.

For the UK, such a practice would suggest an absence of ‘a true and fair view’, which is required even for IFRS reports by the Companies Act. For Germany, this requirement with respect to tax effects is also the formal position (see Section 4). Also, under IFRS, a fair presentation is required, which would seem to make tax influence inappropriate in either country (e.g. IAS 1, paras. 15 and 18; IAS 8, para. 10(a)).

That is, plainly available within a standard and plainly detectable from published reports.

Capital Raising Facilitation Act; see Bundesgesetzblatt (Federal Law Gazette) I, 1998, p. 707.

Einführungsgesetz zum Handelsgesetzbuch (Transitional Provisions Act to the Commercial Code).

Einkommenssteuergesetz (German Income Tax Act).

See Bundesgesetzblatt (Federal Law Gazette) I, 2009, p. 1102.

The revised HGB rules must be applied for fiscal periods beginning after 1 January 2010.

These are credit balances set up, with the permission of tax law; for example, in order to postpone tax on capital gains. This item will no longer be allowed in unconsolidated financial statements either, due to the abolition of the principle of converse congruency.

There is a capitalisation option for development costs from 2010 on, according to the revised HGB.

In April 2008.

The ‘chief manager of group accounting’ in two listed companies included in the DAX index.

Partners of three of the Big-4 audit firms: offices in Düsseldorf, Munich and Regensburg.

We looked at the 2005 consolidated statements.

For example, revaluations are expensive and must be kept up to date; they reduce income (with no tax benefit) by raising depreciation and by lowering gains on sale (IAS 16, para. 71).

Companies traded on the Alternative Investment Market (AIM) did not count as listed for this purpose, and were allowed an extension until 2007.

For example, a move to IFRS is not normally reversible.

Interview with Joan Brown, then of the Large Business Office of the Inland Revenue, 23 July 2003.

That is, before FRSs 25 and 26 implemented IASs 32 and 39, at least for listed companies.

For example, SSAP 9 gives the same choice as IAS 2; SSAP 9 has similar criteria to IAS 11; as does SSAP 21 to IAS 17; FRS 12 is the same as IAS 37; FRS 20 as IFRS 2, etc.

That is, 23 German companies and 98 UK companies.

We show percentages of those disclosing their practices for these two issues (for Germany, the number disclosing the information is 14 and 18 companies, respectively; for the UK, 49 and 15 companies).

Some other German and UK companies used mixed methods.

Another potentially relevant factor is the mix of industries. However, we excluded banks and other financial institutions, and the remaining companies seemed to show no particular country-related industry bias.

Methods other than weighted average are only allowed under restrictive conditions for tax purposes (Transacc, 2001, p. 1293).

See Lamb et al. (1998, p. 84).

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