Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/guidance-issued-on-relationship-between-german-gaap-and-german-tax-accounting-under-accounting-reform.html

28.04.2010

German Tax and Legal News

Guidance issued on relationship between German GAAP and German tax accounting under accounting reform

One of the major tax-related changes in the 2008 accounting reform is an amendment of the principle that tax accounting should be based on commercial accounting (i.e. principle of conformity). According to the revised rule, as of the end of each fiscal year, the tax balance sheet must show the assets and liabilities that are determined according to German GAAP unless another approach is used because specific tax-related options are exercised. Elective rights exercised in the tax accounts need not be reflected in the commercial accounts (i.e. the principle of reverse conformity has been abolished).

The Federal Ministry of Finance (BMF) has now published official guidance that describes the implications arising from the elimination of the reverse conformity principle.

The general principles to capitalize and value assets or liabilities in the tax balance sheet were not changed under the accounting reform. The principle that tax accounts should be based on commercial accounts also continues to apply, but is now subject to numerous exceptions relating to the capitalization and valuation of assets and liabilities provided by tax law.

The following principles remain unchanged:

- If commercial law provides for a mandatory capitalization of an asset or for an option to capitalize an asset, this would lead to a mandatory capitalization of the asset in the tax balance sheet, unless a special exception exists for tax purposes. For example, certain self-developed intangible assets may be capitalized for German GAAP purposes, but must not be capitalized for tax purposes because of a specific rule in the Income Tax Act.
- If commercial law provides for an obligation to accrue a liability, this would lead to an obligation to accrue the liability in the tax balance sheet, unless a special exception exists for tax purposes.
- If commercial law prohibits accruing a liability or provides an option to accrue a liability, this would generally lead to a prohibition on accruing such a liability in the tax balance sheet.
- Options to value assets in the commercial balance sheet lead to the same value in the tax balance sheet if no diverging tax rules for the valuation exist. Based on the revised German GAAP rules, the BMF guidance also stipulates that the option to include certain cost items (e.g. adequate portions of general administration cost and voluntary employee benefit expenses) in the production cost of assets does not apply for tax purposes. Rather, those cost items must now be included in the cost of production for tax purposes.

The following new principles apply:

- If an option exists only under tax law, it can be exercised independently from the treatment in the commercial accounts (and thus is not restricted by the principle of conformity). For example, a reinvestment reserve to defer built-in gains resulting from a sale of fixed assets can be set up for tax purposes even if they have not been taken into account for German GAAP purposes, and fair market value adjustments for fixed or current assets do not necessarily have to be adopted for tax purposes even though they have been adopted for German GAAP.
- Options that exist for commercial and tax law may be exercised independently. For example, valuation methods may be exercised differently in commercial and tax accounts (e.g. inventory may be valued based on the LIFO method for tax purposes

even if a different method has been chosen for accounting purposes), and different depreciation methods for assets may be used for GAAP and for tax purposes.

- The obligation to accrue a direct pension liability under commercial law is also an obligation for tax purposes; however, the income tax rules provide for a special deviating value. The old principle, according to which the commercial value is the upper limit for the tax accrual value, is no longer followed. The grandfathering rule, which provides for an option to accrue a pension liability in old cases (pension promises before 1 January 1987), is still valid.

A prerequisite for the exercise of accounting options according to tax law is that the relevant assets must be kept in separate records, which become part of the bookkeeping. These records must include the date of acquisition or production, the acquisition or production costs, the relevant tax provision that is the basis for the option and the depreciation taken. The retention of these records is required for the elected option to be accepted by the tax authorities; if the record retention is insufficient, the tax authorities will ignore the option and presume that no option was exercised.

The revised rule, as amended by the German accounting reform, must be applied in all fiscal years that end after 31 December 2008. After this date, the exercise of tax relevant accounting options no longer depends on the commercial balance sheet treatment.

For a detailed overview of the implications of the accounting reform on a company's deferred tax position, see GTLN Special Edition April 2009.

If you have any questions, please contact the authors of this article at gtln@deloitte.de or your regular Deloitte contact.
