Deferred Tax Positions under the Prism of Financial Crisis and the Effects of a Corporate Tax Reform

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ABSTRACT

The effects of corporate tax reforms in reported profits and firms’ financial position have been extensively studied in the literature. However, only few studies disaggregate deferred tax items to jointly explore political implications and aspects of corporate behavior around such reforms. Greece’s recent financial crisis and economic recession provides an intriguing setting for examining possible incentives and consequences of substantial tax rate changes, such as the 6% increase imposed by the Greek Government in year 2013. Results reveal a totally different picture between financial and non-financial firms, with the former being clearly favored, at least from this short-run effect. These findings seem to coincide with the view that tax policy design is usually shaped by taking into consideration powerful groups’ interests. Regarding probable Determinants of Deferred Tax Assets for Tax Loss Carry forwards, the authors find that firms the audit firm may significantly affect recognized amounts due to firm specific internal guidelines and due to the overall quality of the audit.

Keywords: Book-Tax Differences, Deferred Tax, International Financial Reporting Standards, Tax Policy

1. INTRODUCTION

Up to date research in the field of financial corporate taxation does not seem to take into account sufficiently the principles and rules of International Accounting Standards/International Financial Reporting Standards (IAS/IFRS, US GAAP), which connect future tax liabilities and payments to reported earnings and financial structure (Poterba et al., 2011). Researchers in the field of accounting highlight and recognize the potential impact of accounting rules on disclosure of profit and market valuation of firms, but little reference is made to political choices related to

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firm tax planning and the public tax policy exercised. The divergence of Book earnings from the Tax earnings and its correlation with maintainability and more generally the quality of corporate profits has attracted the interest of several researchers (Chen et al., 2012; Desai, 2005; Hanlon and Shevlin, 2005; Ready, 2011).

According to the Greek Accounting Framework\(^1\), the Tax burden in Financial Statement for a period is based on the taxable and deductible amounts that will be shown on the tax return for the current year (Current Tax). This doesn’t affect the profit and loss Statement and is reported briefly through the profit and loss distribution Statement. This picture changes radically for the firms listed in the Athens Stock Exchange (ASE) that complies with the mandatory adoption of IAS/IFRS\(^2\). According to IFRS Current and Deferred Tax should mainly be recognised as income or expense and included in profit or loss for the period in a transparent and internationally comparable manner, thus disengaging the latter from national taxation requirements and restraints.

This paper aims to illustrate the meaning and function of deferred taxation and to highlight the role and importance of Deferred Tax Positions (DTPs) in Financial Statements, focusing not only on the size or changes but identifying and categorizing their causes\(^3\). Additionally, we will assess the impact of changes to the business environment related to deferred taxes (DT), as in the case of changing corporate tax rates, and the effect of corporate government characteristics on financial report.

Deferred Tax Positions incorporate the estimated future tax effects and seek to bridge the gap between Reported Income and Taxable Income\(^4\). The latter arise mainly from the different laws and regulations in the calculation of book and tax income and are due to “Temporary Differences” between book and tax value (basis) of Assets and Liabilities. The Generally Accepted Accounting Principles (GAAP) require firms to revalue the items of Deferred Taxes (DT) on their statement of financial position in every case of changes in tax rates or changes in tax laws. DTs are calculated on temporary differences between book and tax value of Assets and Liabilities, multiplied by the institutionalized (or expected) tax rate. Thus a change of the tax rate brings a corresponding decrease or increase in the value of DT in the Statement of Financial Position. The revaluation gap more often than not affects positively or negatively the term Profit or Loss (Net Income) as a result of an increase or decrease of the total income tax cost.

The incentive for our research was the impending tax reform in Greece (Law 4110/Gov. Gazette 17A/2013) which provides for a six percent (6%) increase in the corporate tax rate. This policy option was not expected\(^5\) and is in stark contrast to the positions announced by the parties in power\(^6\), the official positions of the associations of the largest productive classes\(^7\) (ACCI, SEV, GSEVEE) as well as the prevailing modern theoretical and empirical approaches that a reduction of the tax cost is more desirable by businesses (Neubig 2006) and would have an immediate positive impact on growth, while over time it would increase revenue by broadening the tax base (Diamond et al., 2014). Moreover, the important Deferred Tax Asset Positions of banks\(^8\) are of particular significance in view of their recapitalization because including DTA in regulatory capital reduces their need for additional funds. Furthermore, for the fiscal year 2013 significant changes applied to the method for calculation and the rates of tax depreciation, which prove to be one of the biggest causes, diachronically, of differences between book and tax income.

The timing serves largely our research purposes because during the reported period the statutory tax rate varied significantly (from 32% to 20%), which allows us to make comparisons over time and sensitivity analyses.

Our contribution stems from the fact that, as far as we know, there is no other EU\(^9\) study investigating through hand-collected data\(^10\) how the components of corporate deferred taxes could affect firm position and in turn how this position is affected by a transition from one tax regime to another. Our sample covers the years 2005 to 2012 and includes also all listed banks,
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