Change in Dutch Corporate Income Tax Rate – Tax Accounting

On 15 September 2020, the Dutch Government submitted the 2021 Tax Plan to the House of Representatives. One of the measures is the reversal of the previously enacted Income Tax rate of 21.7% to 25% for 2021 onwards.

Background

On 15 September 2020, the Dutch Ministry of Finance published the government's tax plans for 2021 and related legislative tax proposals. Note that these proposals will need to go through the formal legislative process and may be amended before final enactment. The finalization of the formal legislative process is expected to be by the end of 2020. Deloitte has issued a publication in which the legislative proposals are described[1].

Once these proposals are (substantively) enacted, accounting for the Income Tax effects under International Financial Reporting Standards (IFRS) may present significant challenges for some entities. These could arise in determining how an aspect of the measure applies to the entity's specific facts and circumstances, in gathering data to quantify that application or a combination of the two.

This publication highlights the financial reporting effects under International Accounting Standard 12 *Income taxes* (IAS 12) of the expected change in Income Tax rate.

[1] https://www2.deloitte.com/nl/nl/pages/tax/articles/tax-plan-2021-budget-day-prinsjesdag-outline.html

It also provides answers to the most frequently asked questions regarding the accounting of changes in Income Tax rate under IAS 12.

Failure to apply the relevant standard appropriately, may result in current and deferred Income Taxes being misstated and reveal a weakness in controls. Therefore, it is essential for entities to carefully assess the impact of change in Income Tax rate on their financials.

Change in Income Tax Rate

The previously envisaged and enacted reduction of the headline Income Tax rate to 21.7% is expected to be reversed, and therefore leaving the rate at 25%. The reduction of the "step-up rate" to 15% will take place; this rate applies to the first bracket only. The first bracket will be extended to a taxable amount of EUR 245,000 (2021) and EUR 395,000 (2022). The Income Tax rate structure will be as follows (the figures for 2020 are for comparison).

Year	2020	2021	2022
Step-up rate	16.5% (Taxable amount up to € 200k)	15.0% (Taxable amount up to € 245k)	15.0% (Taxable amount up to € 395k)
Headline rate	25.0% (Taxable amount from € 200k)	25.0% (Taxable amount from € 245k)	25.0% (Taxable amount from € 395k)

A change in Income Tax rate would require entities to remeasure the deferred tax assets and liabilities as of the date of (substantively) enactment. Any tax effects resulting from enactment would need to be accounted for in the reporting period of (substantively) enactment.

The effect of the change in tax rate is likely to have an impact on the Effective tax rate (ETR). The higher Income Tax rate of 25% compared to previously enacted Income Tax rate of 21.7%, will increase the future tax benefits of existing DTAs which could lead to a decrease of the ETR. On the other hand, it will also increase the expected future taxes payable from the existing DTLs which could lead to an increase of the ETR.

Particular consideration should also be given on where the effect of the change in Income Tax rate should be recognised, either in profit or loss, other comprehensive income (OCI) or directly in equity. If some deferred tax balances are attributable to items previously recognised outside profit or loss (i.e., in OCI or directly in equity), the effect of the change in Income Tax rate on these items should also be recognised either in OCI or directly in equity consistent with the recognition of the original amount. This is commonly referred to as "backward tracing".

In some circumstances, it may be difficult to determine the amount of tax that relates to items recognised outside profit or loss. IAS 12 acknowledges that, and in such exceptional circumstances, a reasonable pro-rata method or another method that achieves more appropriate allocation may be used.

Innovation Box

The effective Income Tax rate for qualifying income from the innovation box is expected to increase from 7% to 9% as from 1 January 2021.

It should be assessed what the impact is on the measurement of deferred tax positions.

Frequently asked questions

Below, we have listed the most frequently asked questions concerning the accounting of change in Income Tax rate under IAS 12.

What is meant by "substantive enactment"?

The International Accounting Standards Board (IASB) has indicated that substantive enactment is achieved when any future steps in the enactment process will not change the outcome. The date on which legislative change impacts accounting may in most instances differ from the date on which the legislation is legally (substantively) enacted. Identification of the relevant milestones in the jurisdiction's legislative process is essential to complying with IFRS. In the Netherlands, status as "substantively enacted" arises upon approval by both houses of parliament ("Eerste en Tweede Kamer").

How may substantive enactment of the change in Income Tax rate impact the Income Tax balances under IAS 12?

IAS 12 requires companies to measure current and deferred Income Taxes based on the tax laws that are enacted or substantively enacted as of the balance sheet date of the relevant reporting period.

If the change in Income Tax rate is (substantively) enacted before December 31, 2020, calendar year entities will be required to take the impact of these proposed changes into consideration when preparing their year-end 2020 financial statements. In addition, if the impact is considered to be a major component of the tax expense, a separate disclosure of the effect is required. A disclosure may also be required of the allocation of the effects between the profit or loss, OCI and equity.

If the legislation passes through both houses of parliament subsequent to the balance sheet date, but prior to issuance of the financial statements, the event would be considered a non-adjusting subsequent event. Consequently, the impact would not be accounted for in the year-end financial statements, but would likely need to be disclosed within the financial statements. Entities should be in position to analyze and model potential implications of Income Tax rate change in order to determine an estimate of its effect in its disclosure.

What is meant by enacted which is required under US GAAP guidance (compared to substantively enacted required under IFRS)?

Under US GAAP, tax law is considered enacted when any further procedures in respect to the particular tax law being passed at the time are unable to change the outcome.

In the Netherlands, status as "enactment" arises upon formal publication of the law in the State Gazette.

How should an entity compute its temporary differences as of the enactment date when measuring its DTAs and DTLs?

An entity should calculate temporary differences by comparing the relevant book and tax basis amounts as of the enactment date. To determine book basis amounts as of the enactment date, the entity should apply IFRS on a year-to-date basis up to the enactment date.

For example, any book basis accounts that must be remeasured at fair value under IFRS would be adjusted to fair value as of the enactment date. Book balances that are subject to depreciation or amortization would be adjusted to reflect current period-to-date depreciation or amortization up to the enactment date.

How would a non-calendar year-end entity reflect the effect of the change in tax rate in its interim financial statements, prepared in accordance with IAS 34, for periods within the annual period that includes the date of enactment?

When preparing the tax estimate to be included in an interim period, the tax expense is based on the best estimate of the weighted average annual Income Tax rate expected for the full financial year.

Therefore, as for other changes in estimates, amounts accrued for Income Tax expense in one interim period may have to be adjusted in a subsequent interim period if the estimate of the annual Income Tax rate changes. The estimated average annual Income Tax rate would be re-estimated on a year-to-date basis, consistent with IAS 34.

IAS 34 does not provide clear guidance on how to deal with a change in Income Tax rate. Accordingly, as an accounting policy choice, an entity may either:

- Include the effect of the change in a deferred tax balance as a result of a change in Income Tax rate in estimating the average annual Income Tax rate, consequently spreading the effect throughout the financial year; or
- Recognise the effect of the change in Income Tax rate in full in the period in which the change in Income Tax rate occurs.

Contact us:

Sander Kloosterhof
Partner tax accounting
Tel: +31 (0)88 288 2264
Mobile: +31 (0)6 53774001
Email: skloosterhof@deloitte.nl

Jeffry Keulaerds
Partner tax accounting
Tel: +31 (0)88 288 6839
Mobile: +31 (0)6 12010512
Email: jkeulaerds@deloitte.nl

Ahmet Soyturk
Senior manager tax accounting
Tel: +31 (0)88 288 0657
Mobile: +31 (0)6 1099 9256
Email: asoyturk@deloitte.nl

Jolein Versloot
Manager tax accounting
Tel: +31 (0)88 288 4853
Mobile: +31 (0)6 83339546
Email: jversloot@deloitte.nl