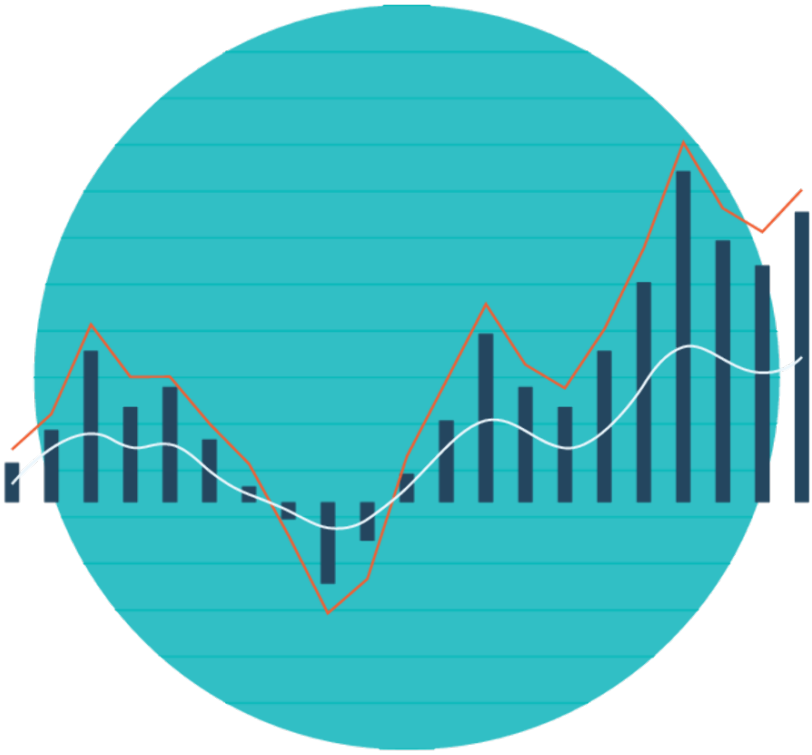

Changes to Dutch tax loss carry forward | Tax Accounting

On 4 June 2021 a Royal Decree was published on the earlier announced modification to the Dutch Net Operating Loss (NOL) carryforwards.

Background

On 4 June 2021, the Netherlands published the Decree of 21 May 2021 in the Official Gazette, which provides for the implementation of the NOL carryforward changes that were proposed as part of the 2021 Tax Plan.

This new legislation will enter into force for financial years beginning on or after 1 January 2022. However, the modification to the NOL carryforwards is considered substantively enacted as per 21 May 2021 (date of Decree) and formally enacted as per 4 June 2021 (date of official Gazette). As a result, recognition of the tax effects of this new legislation is required in the interim and annual periods that include the substantively enactment date (IFRS and NL-GAAP) or the formal enactment date (US GAAP).

Accounting for the income tax effects under the applicable financial reporting standards may present significant challenges for some entities. These could arise in determining how an aspect of the new legislation 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 resulting from the (substantively) enacted tax law in relation to NOL carryforwards. It also provides answers to the most frequently asked questions concerning the income tax accounting aspects of this change.

Failure to apply the relevant standards, 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 income tax (accounting) consequences of the changes regarding NOL carryforwards.

Changes with respect to NOL's

Currently, Dutch tax law states that tax losses can be carried back 1 year and carried forward 6 years. Under the new tax law, the NOL carryback period will remain 1 year and the carryforward period will be unlimited. However, the amount of the NOL utilization will be limited to 50 per cent of taxable income (in excess of EUR 1 million).

As indicated, the legislation will enter into force on 1 January 2022 and will apply to all tax losses arising as of 1 January 2022, as well as tax loss carryforwards still available at that date.

Tax accounting impact

Current tax

As a result of the restriction in the ability to use NOLs up to 50 per cent of taxable income (in excess of EUR 1 million), entities with available NOLs may still end up in a tax paying position. Consequently, the current tax position and cash tax management for entities with available NOLs will become relevant going forward.

Deferred tax

The change in tax law regarding NOL carryforwards is also likely to affect the recognition of related deferred tax assets (DTA).

When considering future taxable income to justify the recognition of a DTA, an entity should look, among other things, to the future reversals of existing taxable temporary differences in periods prior to expiry of the NOL. As losses will not expire under the revised tax law, the pool of taxable temporary differences that is available to justify recognition of the resulting DTAs may be expanded. For example, the taxable temporary differences associated with an indefinite-life asset may also be included.

When there are insufficient taxable temporary differences to support the recognition of a DTA in respect of NOLs, the recognition of the DTA in principle relies on the existence of taxable profits in future periods.

In this respect, there is no specific time restriction regarding the length of the 'look-forward' period which is used to determine whether taxable profits will be available in future periods. Except to note that it should correspond to the period in which a tax loss can be carried forward (reference is made to Q&A). An entity should include as many years as it can reliably estimate based on its specific facts and circumstances. Consequently, the modification of the 6 years carry forward period of NOLs into unlimited might also extend the length of the 'look-forward' period over which taxable profits could be forecasted. However, reliability remains an essential requirement.

An assessment should be made to determine the appropriate 'look-forward' period to be included in the profit forecast. This should be done taking into account all relevant factors which often requires significant judgement.

Besides the 'look-forward' period, particular consideration should also be given on the aspect of the tax law that restricts the ability to use NOLs to 50 per cent of taxable income (in excess of EUR 1 million). Consequently, this limitation may potentially also (negatively) impact the amount of the deferred tax asset recognized.

Finally, the effective tax rate (ETR) may also be impacted by the modification to tax law regarding NOL carryforwards. As stated above, DTA recognition is likely to be impacted and (non) recognition of DTAs in principle results in a higher or lower ETR.

Cash Tax Management

Do you have insight in your actual and forecasted cash tax payments /refunds? Managing cash tax positions is a very challenging topic and process.

Under the new loss utilization measure entities might end up in a cash tax position. As such, going forward cash tax management will become more relevant for entities with available NOLs.

It is recommended to (further) develop a sophisticated cash tax management plan and process.

Q&A/Most frequently asked questions

Below, we have listed the most frequently asked questions concerning the income tax accounting of the changes regarding NOL carryforwards.

How should an entity consider the use of DTLs for DTA recognition when tax law limits the extent to which unused NOLs can be recovered against future taxable profits in each year?

When tax laws limit the extent to which unused NOLs can be recovered against future taxable profits in each year, the amount of the DTA recognised is similarly restricted. This is because when the taxable temporary differences reverse, the amount of tax losses that can be utilised by that reversal is reduced as specified by the tax law.

For example, when the applicable tax law restricts the recovery of tax losses to 50 per cent of taxable profit in each year, the DTA that can be recognised by an entity (which solely relies on DTLs) would be restricted to 50 per cent of the taxable temporary differences.

How would the loss limitation rule apply to a DTA for temporary differences that is scheduled to reverse into a NOL with unlimited carryforward?

A DTA shall be recognized for deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. In this respect, the DTA is recognized to the extent that it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In the event a DTA for temporary differences is scheduled to reverse into an NOL with unlimited carryforward, the limitation in the loss utilization rules discussed in the previous Q&A would also generally apply to the recognition of a DTA arising from a deductible temporary differences that is scheduled to reverse into an NOL with an unlimited carryforward period.

How to determine look-forward period?

In case of unlimited carry forward of tax attributes, the ‘look forward’ period is a key element when preparing the profit forecast. This requires significant judgement. In principle, there is no specific time restriction for the length of the 'look forward'. An entity should include as many years as it can reliably estimate on the basis of its specific facts and circumstances.

The length of the period used will depend on a number of entity-specific factors, for example: the entity’s historical profitability, accuracy of budgetary controls and expected future activities.

Although level of estimation uncertainty increases upon extension of the profit forecast period, it would generally not be appropriate for an entity to limit the number of years it uses to estimate future taxable profits solely on the basis of the subjective nature of estimates.

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