By PwC Deutschland | 08 May 2013

No correction in later years of tax auditor’s error

The Supreme Tax Court has refused to allow an adjustment to taxable income in the year of discovery of a tax auditor’s error to a year now closed.

A company recorded a subsequent event adjustment to the corporation tax reserve in the year the event took place. The adjustment led to an increase in accounting income compensated (correctly) by a corresponding deduction in the tax computation. Two years later the tax auditor found that the adjustment should have been made a year earlier and made the corresponding changes in the “tax audit balance sheet” drawn up to reflect the financial position on the basis of tax valuation principles combined with the tax audit findings. Unfortunately he amended the compensating entries in the tax computations, but overlooked the original accounting entry. Ultimately, therefore both net assets and taxable income as at the end of the audit period were overstated by the amount of the adjustment.

The overstatement came to light two years later. The company made the necessary correction to the accounts, but ignored it in the tax computations. Effectively, the overstatement was thus cancelled in the balance sheet and compensated between the years in the tax computations. Unfortunately, a tax official insisted on the letter of the law and demanded an adjustment to the tax computations to reverse the correction in the accounts. The Supreme Tax Court has now confirmed that approach.

The Supreme Tax Court took the view that the letter of the law must be followed. The opening balance sheet must agree with the closing balance sheet of the previous year. Accounting adjustments must be made in the year to which they relate, or, if that year is now statute-barred, to the earliest year still open. Accounting adjustments to non-deductible expenses (in this case, corporation tax) must be compensated in the tax computations. If, however, this compensation is no longer possible because the year is now statute-barred, there is no provision for compensation in a later year. Thus the final correcting entry increasing corporation tax expense was reversed in the computations for that year on the basis of the letter of the law, leaving the company in the position of having over-taxed its income. The court explicitly refused to allow a compensating correction in the year of the accounting correction as, in the absence of a legal basis, this would be an error. A deliberate error could not serve to correct an oversight.

Supreme Tax Court judgment I R 54/11 of January 30, 2013, published on May 8

Keywords

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