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TAX CIRCULAR - Change in Method of Tax Accounting: Treatment of Amounts Derived, but not Received Prior to January 01, 2023

ISSUED: 10 April 2023

Ref No. 2023- 01

Notice: Tax Circulars provide the public with information on the Bureau's interpretation of the tax laws it administers. They are the Directors interpretation of the law and indicate how the law would be applied by the Bureau in similar circumstances. Refer to TC- 2022-1 for details on how taxpayers may rely on advice given in a Tax Circular.

Purpose

This circular provides guidance on Section 1438 of Chapter 12 of Title 40 of the Palau National Code which provides for adjustments to be made when there is a change in method of accounting for tax purposes. This circular outlines the adjustment required to properly account for amounts earned but not received by a GRT taxpayer on December 31, 2022, who becomes a PGST-registered taxpayer on January 01, 2023.

Background

With the implementation of RPPL 11-11, all PGST-registered persons are subject to the Business Profits Tax (BPT), which is tax on net income at the same as the highest rate of tax on wages and salary. To comply with Section 1438(a), tax accounting under BPT must, subject to BPT rules in the Act and Regulations, align with U.S. GAAP, GAAS, and, if applicable, the GAGAS. This requires BPT to be accounted with accrual-basis of accounting, which is a change from cash basis of accounting, the specified method of tax accounting under the Gross Revenue Tax (GRT) System.

As PGST-registered taxpayers move from the GRT System to the BPT System, there may be revenue amounts derived before and received after the implementation of RPPL 11-11 that would not be taxed in both systems. These amounts would normally be shown in your accounts receivable at December 31, 2022.

Subsection 1438(c) requires that no revenue amount shall be left un-taxed during any transition due to a change in method of accounting for tax. Any adjustment for this purpose must be made in the 2023 tax year.

Adjustment required

To address this issue, the Bureau of Revenue and Taxation has determined a tax treatment for this specific matter. The adjustment is discussed below:

- One third (1/3) of the revenue amount for goods and services sold and rendered prior to January 01, 2023, that has been invoiced but not received, must be included as an adjustment to your Gross Revenue in your 2023 Business Profit Tax (BPT) Return. No expenses in respect of this amount will be allowed as a deduction.
- You are not required to include the adjustment in Gross Revenue for BPT installment purposes, as the revenue amount does not reflect Gross Revenue derived in the installment filing periods. Instead, you will, again, only report ⅓ of the respective amount in your 2023 Annual BPT Return.

Explanation

The adjustment takes into account that, under GRT, which is taxed on a cash basis, the tax rate is 4%, and no deductions are available. However, under the new BPT, the tax rate is 12% of net income. To ensure that there is no loss of revenue to the Government, and excessive tax on the taxpayer accordingly, only 1/3 of the amount of earned but not yet received revenue for 2022 tax year should be included in 2023 tax year as an adjustment. This means that, effectively, the adjustment is taxed at 4% which is consistent with the GRT tax rate for the prior year.

The adjustment must be made in the taxpayer's 2023 BPT Return and will generally be equal to 1/3 of accounts receivable at 31 December 2022, unless earned revenue that has not yet been received is accounted for in a different account.

Application of this tax circular

The Tax Circular will apply until nullified.

Authorized by:

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