

# **XBRL in Taxation: The Business Case**

Walter Hamscher

Chair, Steering Committee, XBRL International

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Consider the following future headline:

## ***March, 2006: XBRL Financial Statements Now Required for All Electronic Corporate Tax Returns in UK***

The date on this headline is unknown, but its substance is inevitable: the UK Inland Revenue's phase plan for its soon-to-be-deployed corporate tax e-filing system contemplates the gradual phasing out of all proprietary electronic formats for the financial data content, in favour of XBRL -- an international, royalty-free specification for exchanging financial information. The move to electronic filing for corporate taxes has occurred, is in progress, or will soon occur around the world; XBRL will be a key component of many of these electronic filings systems, bringing cost and process improvements to both filers and tax authorities. What are the key factors in the decision to use XBRL in an electronic filing system?

## **XBRL is Markup for Business Reporting Information**

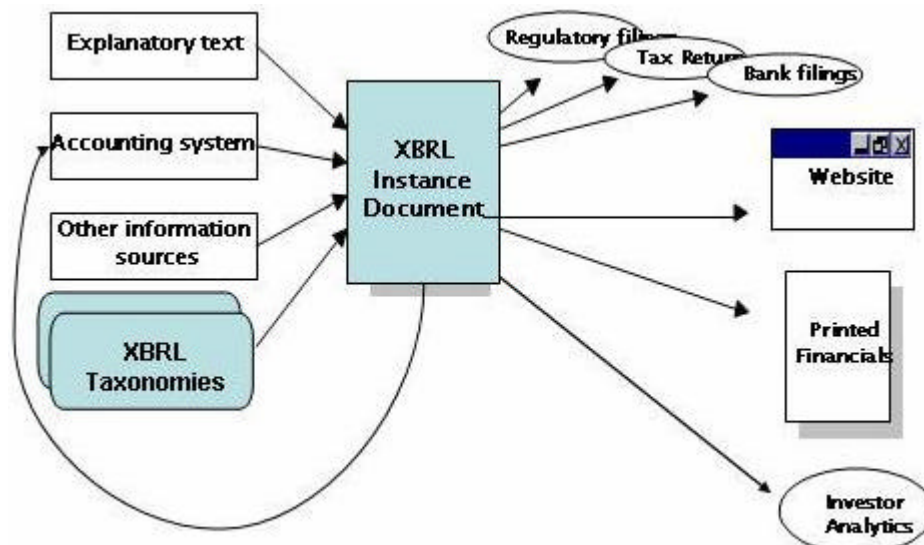
The eXtensible Business Reporting Language, XBRL, is an interoperable information format that supports the exchange of business reporting information between disparate information systems. Based on Extensible Markup Language or XML, the universal format for data on the World Wide Web, XBRL streamlines the way companies report and publish their financial data, and how analysts and investors can review that information. For example, before XBRL, investors, tax preparers, auditors, and others would need to pore through numerous reports and precisely program their computers to recognize any given value from a financial statement. With XBRL, data is "tagged" or "marked up" to instruct the system how to handle the data in question and enables the user to locate the necessary information without leafing through multiple financial reports.

XBRL is in use for many different types of financial reporting – internal business reporting using general ledger-level accounting information, bank position reports consisting of thousands of individual data points collected by regulatory authorities, and financial reports consisting not only of individual financial numbers, but also textual disclosures of policies, tabular schedules of assets, consolidations, and a myriad of notes under a variety of accounting standards including US GAAP (Generally Accepted Accounting Principles), Japanese GAAP, German GAAP, IAS (International Accounting Standards), as well as standards compatible with IAS such as Singapore GAAP.

XBRL captures business reporting information as an *XBRL Instance Document*. The information in an instance document is about a particular business entity, for some specific time periods, under a given set of definitions. The definitions appear in an *XBRL Taxonomy* such as the taxonomy for US GAAP financial statements, etc. The

instance document contains information from many different sources, and information from it can be extracted to be presented and used in many different ways (Figure 1).

Figure 1. Data from multiple sources and meta-data from taxonomies facilitates reuse.



The XBRL International consortium of some 150 organizations provides agreement on this Internet based information standard. XBRL provides significant benefits to both the preparers and consumers of performance information including investors, regulators and government reporting entities. For more about XBRL and the XBRL International consortium, visit [www.xbrl.org](http://www.xbrl.org) on the World Wide Web.

## Shared, Semi-structured Financial Information in Corporate Tax Returns

There are many ways to organise information for a corporate tax return. Information that fits neatly and predictably into a predefined, fixed set of cells on a tax form, and which is *specific* to that particular form, can be organised straightforwardly using XML.

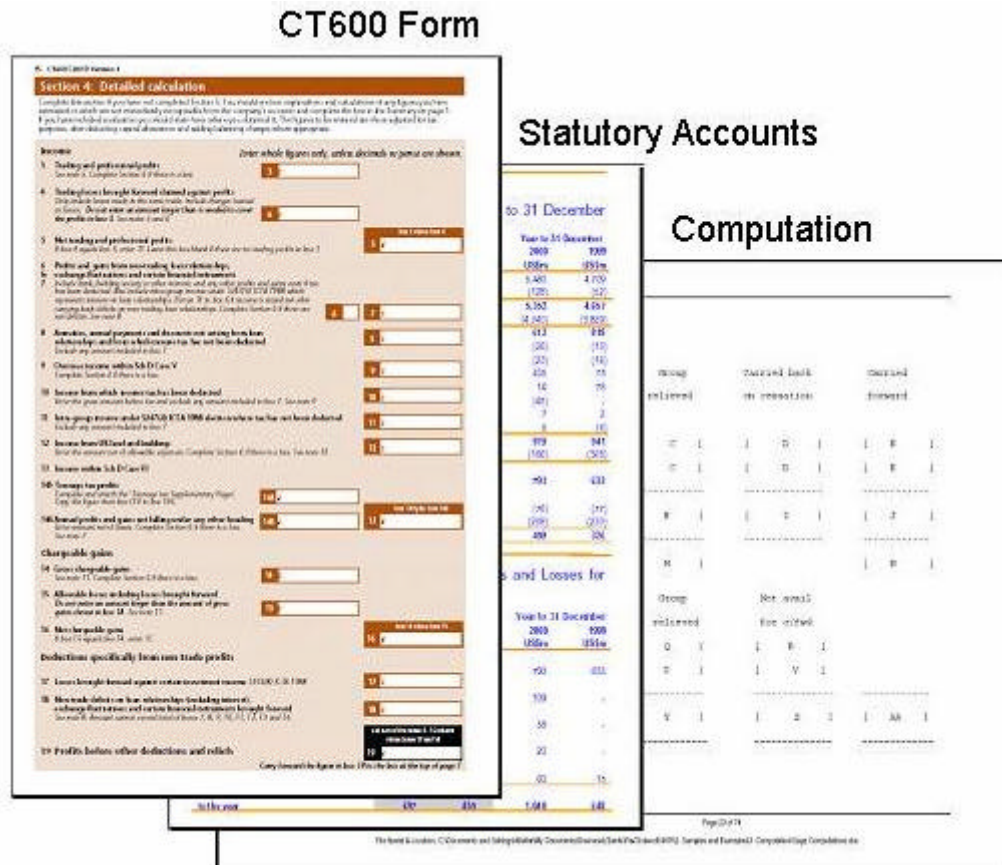
For example, if the tax form requires that the filer must check a few boxes to indicate yes or no to a series of questions that are meant to indicate whether a particular section of the form needs to be filled out, it is sensible to simply use XML, and definitions of the data specific to that form. The existence of that check-box, its name, its position on that form – its *meta-data*, or data about data – is specific to that form.

However, much of the information on a tax return is – and *must* be – shared by, and consistent with, other information presented in different ways at different times. A depreciation expense on a financial statement, for example, is part of many calculations in addition to its use in deriving an adjusted depreciation figure for a tax return. For this information it is considerably more efficient to define these terms once in a common, widely used XBRL taxonomy, so that any software application that creates or uses the data can identify the meaning of a data item without any ambiguity. There is much less need to “map” definitions from different applications to each other – all the applications only need to map to XBRL. Every financial fact

reported in XBRL in some sense carries with it the entire *context* needed for application software to make proper use of it.

Furthermore, under many tax regimes the organisation of both the statutory accounts and the supporting detail of the tax form (in the UK, this is called “the Computation” and corresponds to the US Schedule M-1 reconciliation) is relatively unconstrained. In order for companies to be able to express the facts they mean and for the tax authority’s computer systems to verify that the facts are consistent, it is necessary at a minimum to agree on a framework by which the set of definitions can be shared, and facts expressed according to those definitions.

Figure 2. Corporate tax return consisting of a form, statutory accounts, and a 'computation'.



As a simple example, suppose that an XBRL financial statement taxonomy were to include a figure for Marketing expenses – a definition relevant both to financial statements and to the calculation of expenses for tax purposes. A company engaged in operating automobile raceways may wish to extend this definition and disclose that a significant fraction of marketing expenses in a specific year were related to “promotional vehicles,” a figure which is also related to capital expenditures on automobiles. Using XBRL, the company can extend the taxonomy with these definitions. Meanwhile, not only can a tax examiner looking at the displayed financials see the financials presented in any tabular form or to any level of drill-down they want, the tax authority’s computer systems need not “understand” the meaning of ‘promotional vehicles’ or ‘automobiles’ yet still could use the XBRL definitions to perform a first-pass risk analysis to automatically verify that the filer did provide a named line item to account for an unusual increase in expenses relative to turnover in a particular period.

Tax authorities will need to define what information would be required in a tax computation -- if, as in the UK, the computation has never been formally defined. However, the development of an appropriate XBRL taxonomy is not materially different from other data modelling exercises, once the somewhat specialised XBRL tools are in place. Besides, there are limits to the depth and detail needed. Schedules of company cars or industrial buildings, or other assets that have particular capital allowances rules applied to them, will have tax authority-supplied tags in the taxonomy. Statutory items such as Directors' Reports, reports of the independent accountants, and so on will also have tags, mostly taken from other standard financial reporting taxonomies. But one would never expect tax authorities to supply a unique XBRL tag for every possible type of asset, for which traditional data formats serve well enough.

The sharing of definitions across many applications, coupled with the flexibility to express information precisely, is a significant benefit to companies that create their statutory financial information in XBRL for the purposes of tax filings; they will also be able to publish that XBRL instance document to investors, creditors, and others with XBRL-enabled software -- preserving every nuance and detail that they intended to report and delivering it directly to interested investors.

## **Framing the XBRL Decision**

It is important to ask whether the preparation of tax returns in XBRL imposes an undue burden on the filers of corporate taxes -- but the question needs to be set in its proper context. When the actual choices at hand are thoroughly understood, it becomes clear that even in the short run, XBRL imposes minimal additional costs on filers, and in the long run, the benefits available using an XBRL could not even be contemplated under any other approach.

*Any* electronic filing system that is implemented will produce some implementation burden on those companies that choose to adopt it. It also produces a burden on the software vendors who develop and market tax preparation software and accounting software. There *will* be a cost: existing software that today prints on paper will need to produce a data dump in the format dictated by the tax authority; categories of tax data as defined in a tax software package will have to be mapped to the categories as named on the tax form. And the more jurisdictions that a company reports in, the more categories to map, the more the different data dump formats, the greater the cost of each change in the e-filing system, in the tax laws, etc. Moreover, any tax authority that intends to capture financial information at a level of granularity or richness or flexibility to the filers, data extends in any way beyond that which fits comfortably into numbers and words squeezed into a rigid set of forms, will inevitably create a need for the software vendor and the filer to create and manage this information.

Benefits to the tax authority itself also flow back to the corporate filer. For example, a tax agency field auditor may spend a large portion of time tracking down supporting information both with corporate tax department personnel and within the tax agency. With XBRL, the time taken to locate information would be reduced. This allows the field auditor to complete the review in less time. That frees up not only the auditor's time, but also the corporate tax department's personnel.

The question is not whether there is a cost to implementing XBRL, it is only whether there is anything especially difficult about the XBRL *relative* to any other data format that a tax authority would, or could, require. There is not. For the purposes of an accounting or tax software application, XBRL is simply not extraordinarily different from any other XML based format one might develop. The key difference is that it is already *widely agreed upon*. The taxonomies being developed consist of hundreds to thousands of precisely defined data elements (“tags”) defined not with a single tax or accounting application in mind, but by accountants – and technically expert accountants from major accounting firms, at that – with the broad sweep of different uses and presentations of accounting information in mind. Therefore, the mapping that the software vendors and tax filers need to do anyway is not done to a unique, idiosyncratic data vocabulary; it is done to a widely shared set of terms. Moreover, using XBRL is beneficial to everyone involved because the same software platform can accommodate many different GAAP forms, and tax forms, and can share all relevant data without any further mappings and without any loss of information. Already, as of August 2002, there are 20 software vendors worldwide offering XBRL compliant products – including SAP and Microsoft – a number that continues to grow.

There is, in short, nothing to lose and everything to gain with XBRL, once one has decided to move to electronic tax filings in which filers will provide information that corresponds to their own complex financial statements and accounts.

The result of this decision process at the UK Inland Revenue resulted in the adoption of an indicative phase plan in which XBRL formatted tax filings could begin being accepted as early as the spring of 2003. These would subsequently be made mandatory – that is, other proprietary formats for electronic filing, such as Adobe PDF would no longer be accepted – some time afterwards, possibly in 2005 or 2006.

## **UK Office of the e-Envoy endorses XBRL**

Adoption of XBRL is not limited to the UK Inland Revenue. The UK Office of the e-Envoy, a cabinet-level office that is responsible for advocating e-government standards for use across all bureaus, departments and agencies, issued in April 2002 the fourth version of its e-Government Interoperability Framework (e-GIF). In e-GIF 4, XBRL was elevated to the status of “Recommended for Consideration” for all financial reporting. As of April 2002, “Recommended” status had been granted only to two other XML standards (NewsML, for news stories, and Election Markup Language (EML)) out of over 40 under consideration. The e-Envoy Office recognized that the interoperability benefits of XBRL would be far likelier to be achieved once the e-GIF, in a sense, ratified what the market had already decided, that there are no other alternative XML-based standards for financial and business reporting on offer, and that XBRL met the needs not only of the Inland Revenue but potentially other regulators such as the Financial Services Authority, but also for the government’s own need to exchange budgets and financial results and to publish financial results to citizens.

Other tax authorities around the world such as the Inland Revenue Department in New Zealand, the Canadian Customs and Revenue Authority, Inland Revenue Authority of Singapore, and Revenue Online in Ireland, are members of the XBRL International consortium and active participants in XBRL working parties.

## Summary

Tax agencies should seriously consider XBRL for tax filings whenever the following characteristics are present:

- Tax filings are legally required to contain statutory financial statements – income statements, balance sheets;
- Tax laws allow the filer some freedom to define their own line item categories in those statements;
- Tax laws do not dictate rigid forms and fixed categories for the reconciliation of the statutory accounts to the tax form and supporting detail of transactions, depreciation schedules and other information, but rather, are largely free form;
- The tax authority wants the considerable benefits of being able to assess information that it currently holds on paper and which is therefore inaccessible – this information is important for financial planning and government budget purposes, for risk assessment, and for comparisons between companies of whatever type;
- It is a goal of the tax authority is to avoid imposing unnecessary compliance costs in the implementation of electronic filing;
- It is a goal of the tax authority to provide a foundation for end-to-end process improvements and for lowering the subsequent compliance costs for companies' other types of financial regulatory filings; and
- The electronic tax filing system is either in the stage of early planning, detailed requirements gathering, systems architectural design, or in the earliest stage of data design.

No matter what e-filing system a tax authority adopts, it will be imposing a standard with which all its electronic filers will have to comply. XBRL itself imposes no different costs on tax filers and tax software vendors than any other XML standard. The key question, then, is whether the technical standard which that authority imposes will be developed independently, in relative isolation, with an agency-specific view of requirements and benefits, or whether it will leverage an international standard which, once adopted by corporate filers, will allow many other highly leveraged uses.

## Acknowledgments

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