Deliberation on IFRS

IAS-1,2,,7, 8,10, 12,16,17,18,19,20, 23, 24,27,28,31,32,36,37,38,39,40

IFRS -5,6,7, 8

by

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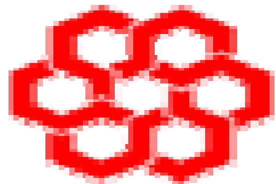

International
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IAS-12

Income Taxes

Objective

Accounting for current and future tax consequences of –

- The future recovery (settlement) of the carrying amount of assets (liabilities) recognised in the statement of financial position
- Transactions and other events of the current period recognised in the financial statements

Scope

Included –

- Domestic/foreign income taxes
- Income taxes/withholding taxes paid on distribution

Excluded -

- Other taxes (e.g. VAT) that are lived on another basis (e.g. on gross revenue)
- Government grants

Factor in determining an income-tax

- IAS-12 defines ‘income taxes’ as ‘all domestic and foreign taxes, which are based on taxable profits.
- Income taxes also include withholding taxes payable by subsidiary, associate or joint venture on distributions to the reporting entity

Current tax -Recognition

Liabilities

- taxes unpaid for current or prior periods

Assets

- recoverable tax over payment for current or prior periods

Current tax - Measurement

Amount expected to be paid to tax authority using enacted or substantively enacted tax rates and tax laws by the end of the reporting period

Deferred Tax

Balance sheet approach

- Recognise deferred tax for temporary differences

Full provision with limited exceptions

- Initial recognition exception

Basic equations

- **Deferred tax =**

  Temporary Difference x tax rate

- **Temporary difference =**

  Carrying amount – Tax base

‘Temporary’ differences v/s timing differences

- **Temporary differences** are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base
- **Timing differences** are differences between profits or losses as computed for tax purposes and results as stated in financial statements.

Tax base formula

(1) Tax base of asset

= CV – FTA + FDA

(2) Tax base of liability

= CV – FDA +FTA

(3) Tax base of revenue received in advance

= CV – Amount of revenue not taxable in future period

Accounting for deferred tax – a five step approach

1) Calculate tax base
2) Calculate temporary difference
3) Identify the temporary differences that give rise to deferred tax assets or liabilities
4) Calculate deferred tax balances using appropriate tax rate
5) Recognise deferred tax in profit or loss, other comprehensive income, equity or as an adjustment to goodwill (only in limited circumstances)

Step 1: Calculate tax base

- Tax base

‘the amount attributable to that asset or liability for tax purposes’

‘the tax base of an asset is the amount that will be deductible for tax purposes against ay taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset’

‘the tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods’

Tax base – Some Examples

- A machine cost 100. for tax purpose, depreciation of 30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deductions on disposal. Revenue generated by using the machine is taxable, nay gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purpose – the tax base of the machine is 70

Tax base – Some Examples

- Interest receivable has a carrying amount of 100. The related interest revenue will be taxed on a cash basis. The tax base of the interest receivable is Nil.
- trade receivables have a carrying amount of 100. The related revenue has already been included in taxable profit (tax loss). The tax base of the trade receivables is 100.

Tax base – Some Examples

- Current liabilities include accrued expenses with a carrying amount of 100. the related expense will be deducted for tax purposes on a cash basis. The tax base of the accrued expenses is Nil.
- Current liabilities include accrued expenses with a carrying amount of 100. The related expense has already been deducted for tax purposes. The tax base of the accrued expenses is 100.

Step 2: Temporary differences

- Temporary difference

  = carrying amount – tax rate

- For non-taxable assets, and non-deductible liabilities, tax base = carrying amount

  = > temporary difference is Nil

Step 3: Taxable/deductible temporary differences – short cut rule

	Carrying amount - tax base	Type of temporary difference	Gives rise to
Asset	+ve	Taxable	DTL
	-ve	Deductible	DTA
Liability	+ve	Deductible	DTA
	-ve	Taxable	DTL

Recognition exceptions

- General rule is to recognise-subject to specific exceptions
- Exceptions –

-Goodwill on acquisition

-Certain differences related to investments in subsidiaries, branches, associates and JV

- Initial recognition, other than business combinations, of an asset/liability which affects neither accounting profit/loss not taxable profit

Recognition exceptions

- Deductible difference – recognised only to the extent that recoverability is probable

Goodwill on acquisition

- Specifically goodwill that is not tax deductible (goodwill on acquisition that is not taxable)
- If deferred tax were recognised –would decrease nit assets and change the amount of goodwill which would have consequential tax effects
- Never recognise a temporary difference in respect of goodwill on acquisition

Example – Tax deductible Goodwill

- If goodwill acquires in a business combination has a cost of 100 that is deductible for tax purposes at the rate of 20% per year starting in the year of acquisition.
- Tax base of the goodwill is 100 on initial recognition and 80 at the end of the year of acquisition.

Example – Tax deductible Goodwill

- If the carrying amount of goodwill at the end of the year of acquisition remains unchanged at 100, a taxable temporary difference of 20 arises at the end of that year
- Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.

Difference associated with investments in subsidiary/Associates/JCE

- No temporary difference where recovery has no tax impact
- Temporary difference is the difference between the carrying amount of the investment (share of net assets) and the tax base (historical cost)

Difference associated with investments in subsidiary/Associates/JCE

- Difference required to be recognised, except for taxable temporary difference where –
  - the investor is able to control the reversal
  - it is probable that the difference will not reverse in the foreseeable future
- Generally Ok for parent/subsidiary, and may be jointly controlled entity
  - but never associate (no control)

Change in investment from a subsidiary to an associate

- A parent did not recognise deferred taxes on its equity in undistributed earnings of Sub A
- Sub → Associates
- Should the investor (parent) recognise deferred taxes on its share of undistributed earnings of the associates (sub A)

Changes in investment from a subsidiary to an associate

- Yes
- No longer able to control the reversal of temporary difference

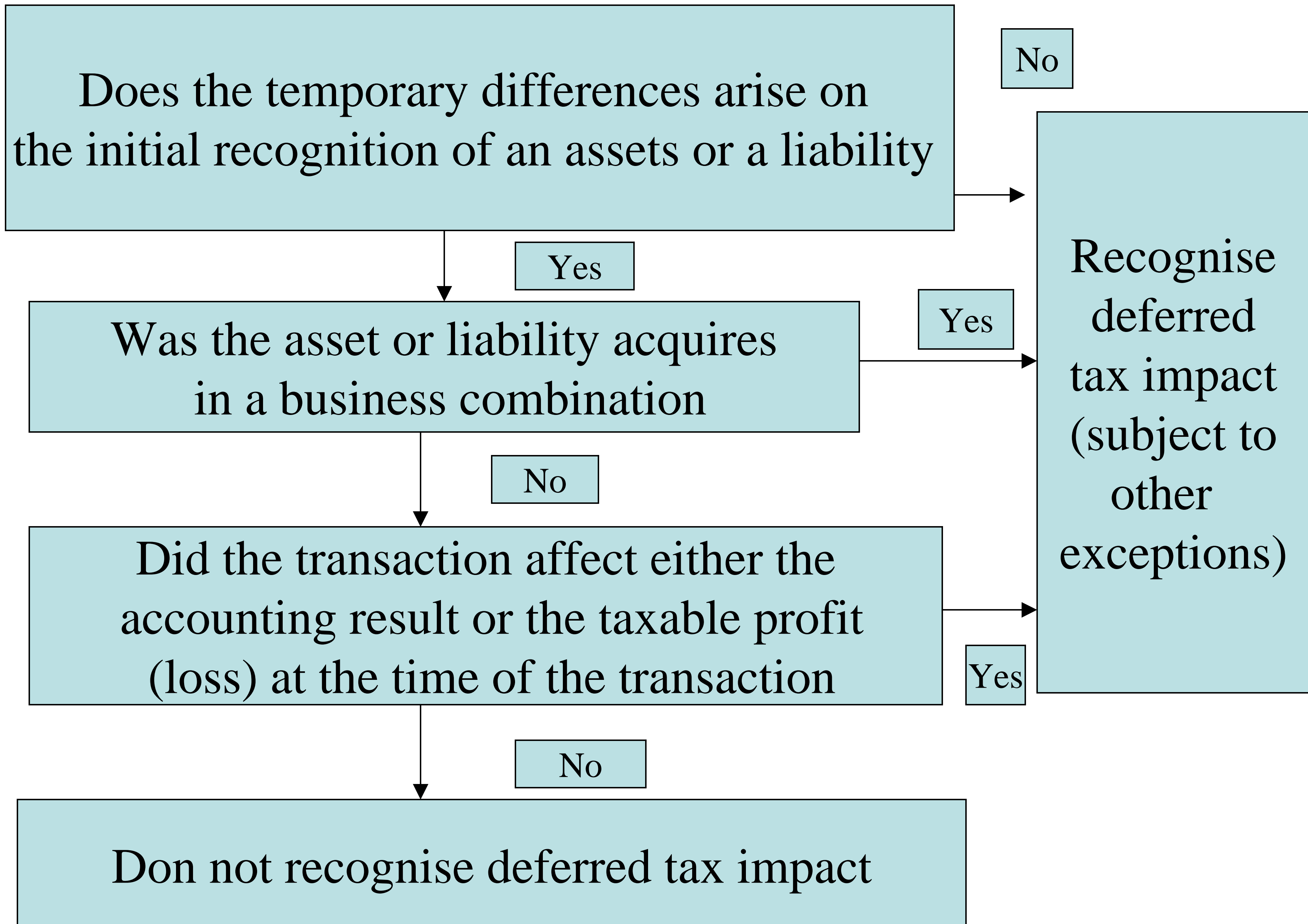
  - provide for deferred taxes on the temporary difference relates to its investment
- If deferred taxes previously recognised by a parent

  - considered in accounting for disposition through sale or other transaction that reduces the investment

Initial recognition

- Temporary differences are not permitted to be recognised where the difference arises in respect of the initial recognition of an asset or liability in a transaction which –
  - is not a business combination and
  - at the time of the transaction affects neither accounting profit (loss) nor taxable profit (loss)

Initial recognition exception



Recoverability of deductible temporary differences

- Deductible temporary differences are only recognised to the extent that it is probable that sufficient taxable profit will be available against which the deductible temporary difference can be utilized
- A deferred tax asset represents a future tax deduction

  - Valuable only if the enterprise will have future taxable profits against which the deduction can be offset

Recognition of deferred tax assets

- Ongoing obligations:

  -Where recognised, reconsider at every reporting date

  -Where not recognised, reconsider at every reporting date. If recoverability tests met, recognise at the later date

Step 4: Computation of deferred tax

DTL/DTA = temporary difference x tax rate

DTA = Unused tax losses x tax rate

Prohibits the use of discounting for the measurement of deferred tax assets and liabilities

Tax rate

- The tax rate that is expected to apply when the temporary difference reverses

current tax rate will generally be the best estimate if not known

- Based on rates enacted or substantively enacted by the end of the reporting period
- Specific rules for progressive tax rates, and other circumstances where tax rates vary

Step 5: Recognition of movements

- Where's the other side of the entry?
- Profit or loss – default
- Except where:

- relates to an item dealt with in other comprehensive income e.g. revaluation, exchange difference, equity component of convertible bonds or equity, deferred tax also recognised in other comprehensive income/equity

- arises in relation to a business combination – effectively adjusted goodwill

Presentation – Current/Non-current

When an entity presents current and non-current in the statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities)

Business combination

Adjustment to goodwill on acquisition

- fair value adjustment on acquisition
- Additional assets/liabilities identified on acquisition
- Deferred taxes not recognised by the acquiree
- Deferred tax assets recognised on acquisition

Deferred tax principle

	Tax base	**carrying amt**	**temp. diff**	**fair value**	**temp. diff**
Consideration				200	
Asset					
Properties	100	110	10*	130	30
Inventory	10	10	-	20	10
Intangible	-	-	-	50	50
Liabilites	(20)	(20)	-	(20)	
DTL		Tax rate 30% of 90		(27)	
Goodwill				47	
***Temporary difference not recognised due to initial recognition exception**					

Business combination

- watch out for ‘initial recognition’ exceptions in subsidiary's accounts – will not apply in the consolidated financial statements if they arose pre-acquisition because, from the group‘s perspective, they arose in connection with a business combination

Elimination of unrealized profit on combination

- unrealized profits eliminated change the carrying amount without changing the tax base
- The tax base is the uplifted cost in the books of the purchaser
- A deferred tax asset arises, calculated using the tax rate of the purchser

THANK YOU

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