INTERNATIONAL FINANCIAL REPORTING STANDARDS INCOME TAXES – IAS 12

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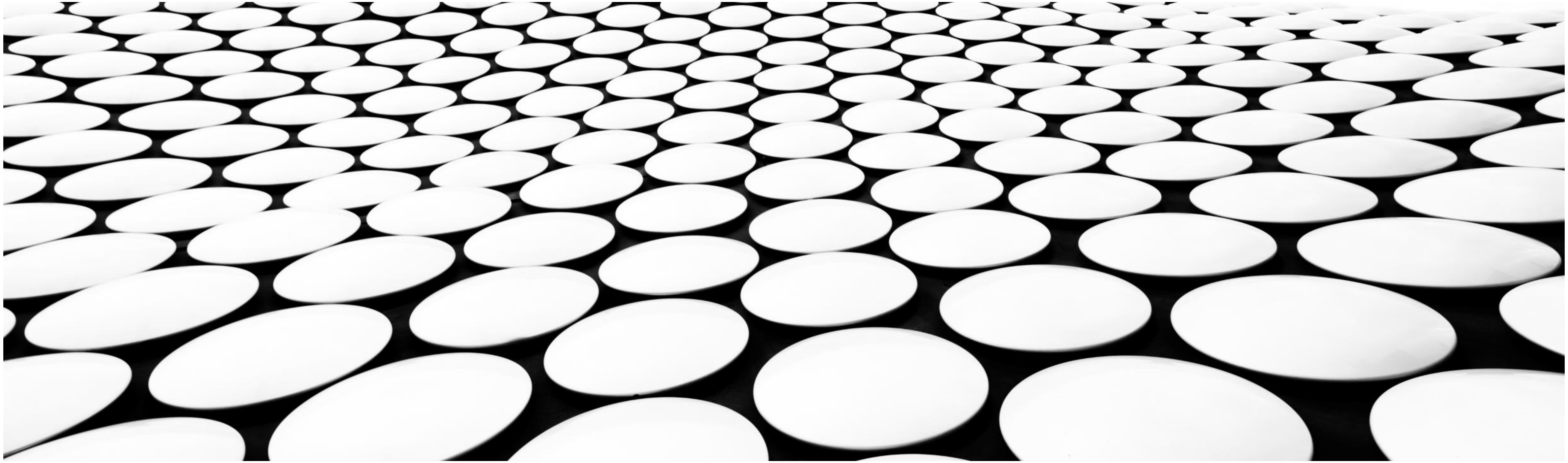

INTERNATIONAL FINANCIAL REPORTING STANDARDS
INCOME TAXES - IAS 12

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Definitions

- *Accounting profit* is profit or loss for a period before deducting tax expense.

- *Taxable profit (tax loss)* is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

- *Tax expense (tax income)* is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

- *Current tax* is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

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Definitions

- *Deferred tax liabilities* ***are the amounts of income taxes payable in future periods in respect of taxable temporary differences.***

- *Deferred tax assets* ***are the amounts of income taxes recoverable in future periods in respect of:***

  (a) deductible temporary differences;
  (b) the carry forward of unused tax losses; and
  (c) the carry forward of unused tax credits.

- A deferred tax asset or liabilities arise if recovery / settlement of assets / liabilities affects the amount of future tax payments. IAS 12 mandates the entity to recognize deferred tax liability in full.

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Definitions

- *Temporary differences* are differences between the carrying amount of an asset or liability in the balance sheet and its tax base.
- Temporary differences may be either:

(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

b) *deductible temporary differences,* which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

The *tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.*

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What is tax base

- **The tax base of an asset** is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

- **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. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

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Examples : Tax base of an asset

- A machine cost Rs.100. For tax purposes, 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 deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. *The tax base of the machine is Rs.70.*

- Interest receivable has a carrying amount of Rs.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 Rs.100. The related revenue has already been included in taxable profit (tax loss). *The tax base of the trade receivables is Rs.100.*

- Dividends receivable from a subsidiary have a carrying amount of Rs.100. The dividends are not taxable. *In substance, the entire carrying amount of the asset is deductible against the economic benefits. Consequently, the tax base of the dividends receivable is Rs.100.*

- A loan receivable has a carrying amount of Rs.100. The repayment of the loan will have no tax consequences. *The tax base of the loan is Rs.100.*

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Examples : Tax base of a liability

- Current liabilities include accrued expenses with a carrying amount of Rs.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 interest revenue received in advance, with a carrying amount of Rs. 100. The related interest revenue was taxed on a cash basis. *The tax base of the interest received in advance is nil.*

- Current liabilities include accrued expenses with a carrying amount of Rs.100. The related expense has already been deducted for tax purposes. *The tax base of the accrued expenses is Rs.100.*

- Current liabilities include accrued fines and penalties with a carrying amount of Rs.100. Fines and penalties are not deductible for tax purposes. *The tax base of the accrued fines and penalties is Rs.100.*

- A loan payable has a carrying amount of Rs.100. The repayment of the loan will have no tax consequences. *The tax base of the loan is Rs.100.*

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Recognition of current tax liabilities and current tax assets

- Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognised as an asset.
- The benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset.

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Deferred tax assets and liabilities

- Deferred tax is recognized only to the extent it is probable that tax benefits will be realized in future. If that is so then deferred tax is recognized on unused tax losses and unused tax credits

- Deferred tax is measured at tax rates applicable when the deferred tax asset / liability is realized or settled , enacted or substantially enacted by the balance sheet date. Deferred tax assets / liabilities are not discounted

- The tax consequence of transactions and events is recognized in the same financial statement as the transaction or event is recognized as :

  - identifiable assets or liabilities at the acquisition date, if they arise as a part of business combinations (IFRS 3 Business combinations)
  - equity – if the items to which they related are credited or charged directly to equity
  - otherwise recognized as tax expense or income.

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Taxable temporary differences

- A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

  (a) the initial recognition of goodwill; or

  (b) the initial recognition of an asset or liability in a transaction which:

    (i) is not a business combination; and

    (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability shall be recognised.

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Deductible temporary differences

- A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

  (a) is not a business combination; and
  (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset shall be recognised

INCOME TAXES – IAS 12 : Decision tree

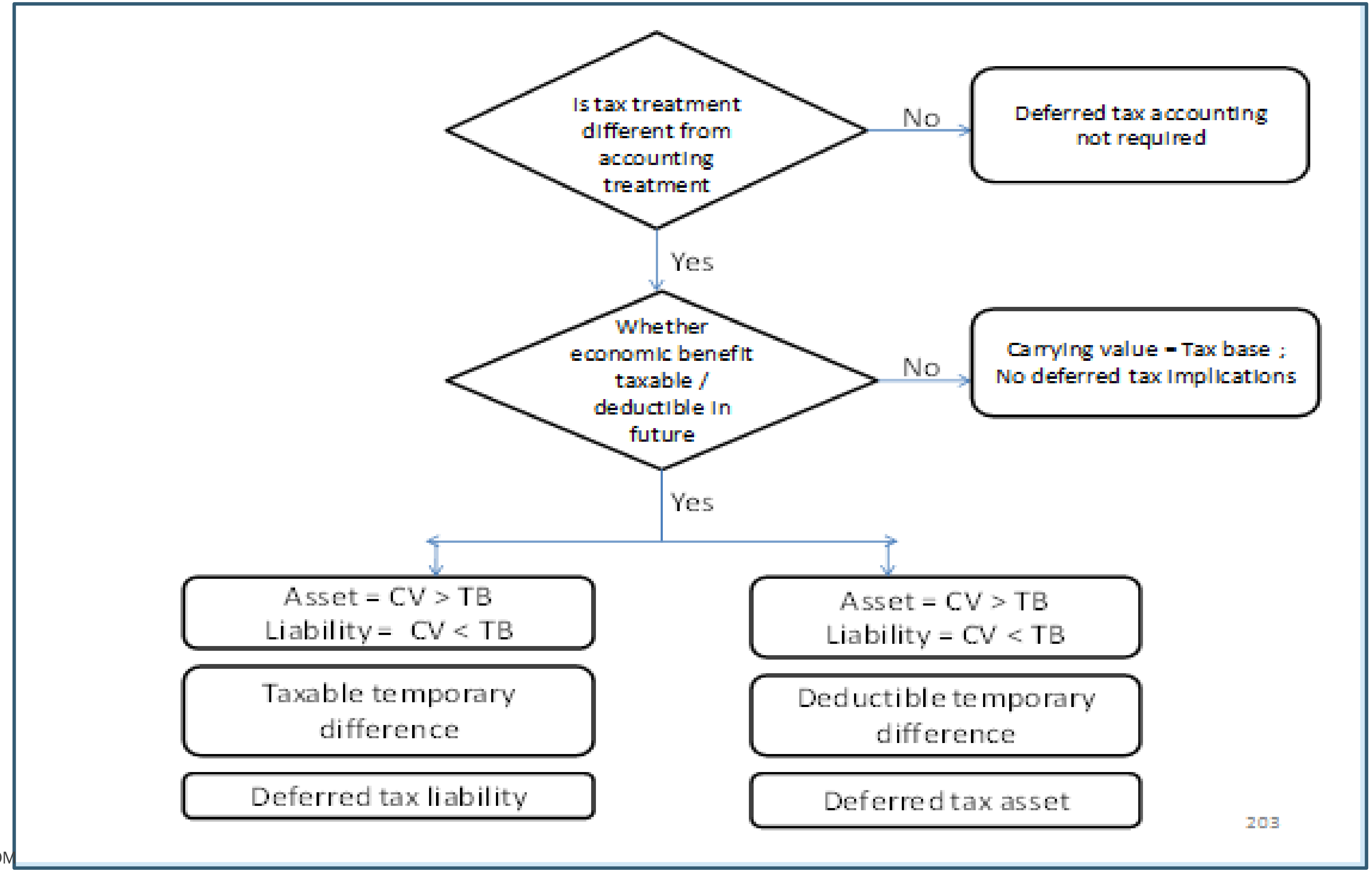

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Illustration I

- An asset which cost Rs.150 has a carrying amount of Rs.100. Cumulative depreciation for tax purposes is Rs.90 and the tax rate is 25%.

Solution

- *The tax base of the asset is Rs. 60 (cost of Rs.150 less cumulative tax depreciation of Rs.90). To recover the carrying amount of Rs.100, the entity must earn taxable income of Rs.100, but will only be able to deduct tax depreciation of Rs.60. Consequently, the entity will pay income taxes of Rs.10 (Rs.40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of Rs.100 and the tax base of Rs.60 is a taxable temporary difference of Rs.40. Therefore, the entity recognises a deferred tax liability of Rs.10 (Rs.40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.*

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Illustration II

- An entity intends to use an asset which cost Rs. 1,000 throughout its useful life of five years and then dispose of it for a residual value of nil. The tax rate is 40%. Depreciation of the asset is not deductible for tax purposes. On disposal, any capital gain would not be taxable and any capital loss would not be deductible.

- *As it recovers the carrying amount of the asset, the entity will earn taxable income of Rs.1,000 and pay tax of Rs. 400. The entity does not recognise the resulting deferred tax liability of Rs. 400 because it results from the initial recognition of the asset.*

  In the following year, the carrying amount of the asset is Rs. 800. In earning taxable income of Rs. 800, the entity will pay tax of Rs.320. The entity does not recognise the deferred tax liability of Rs.320 because it results from the initial recognition of the asset.

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Illustration III

- An entity recognises a liability of Rs.100 for gratuity and leave encashment expenses by creating a provision for gratuity and leave encashment. For tax purposes, any amount with regard to gratuity and leave encashment will not be deductible until the entity pays the same. The tax rate is 25%.

- *The tax base of the liability is nil (carrying amount of Rs.100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an amount of Rs.100 and, consequently, reduce its future tax payments by Rs.25 (Rs. 100 at 25%). The difference between the carrying amount of Rs. 100 and the tax base of nil is a deductible temporary difference of Rs. 100. Therefore, the entity recognises a deferred tax asset of Rs.25 (Rs. 100 at 25%), provided that it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.*

THANK YOU!