

IAS 12

Income Taxes (Basic)



Objectives

1. Background

2. Apply the scope requirements of IAS 12

3. Determine tax bases

4. Determine tax rate used for measuring deferred taxes

5. Describe how uncertain tax positions are treated

6. Considerations for current and deferred taxes in interim financial statements

IAS 12 Income Taxes

1

Background

Background – reminder on key concepts

The IAS 12 ‘balance sheet approach’

Current tax

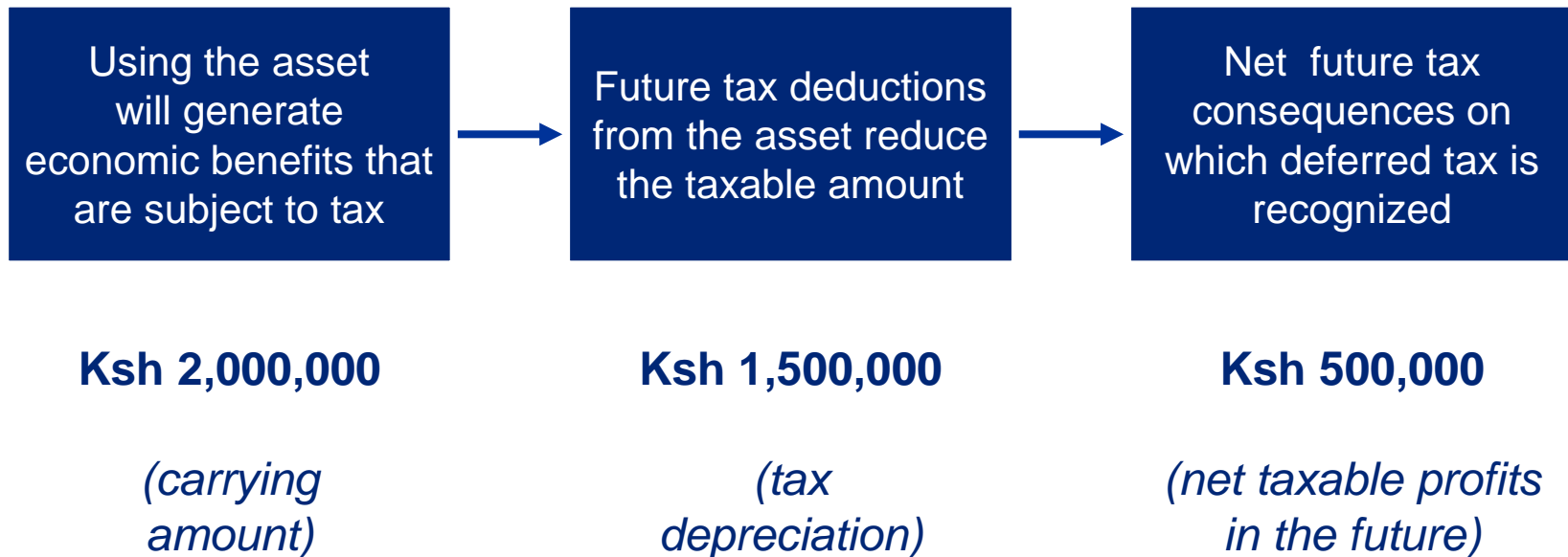
Amount payable to or refundable by the tax authorities in respect of the **current and previous periods**

Deferred tax

The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Background – reminder on key concepts

Example: plant and equipment used in a manufacturing process

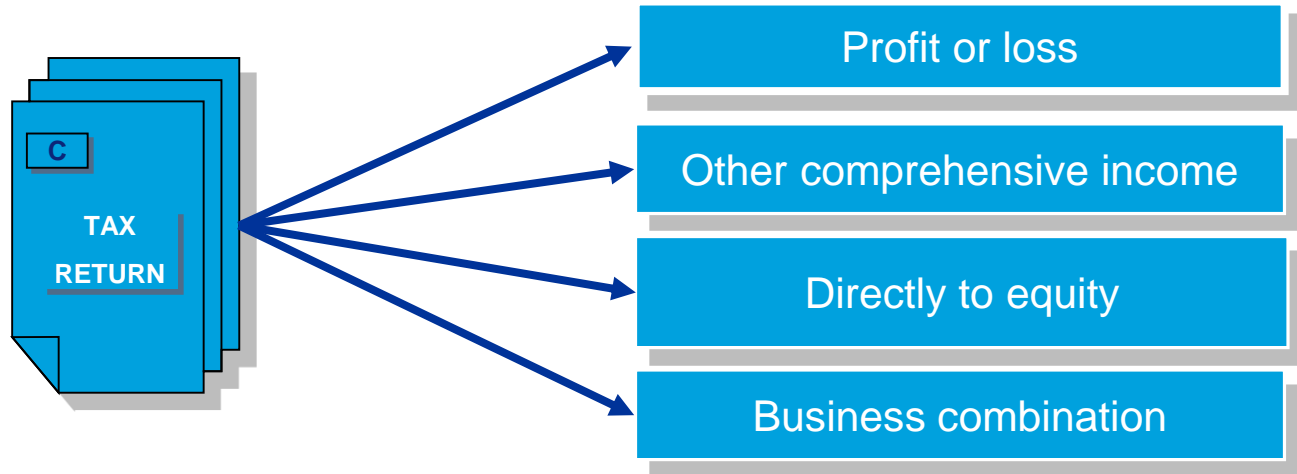


Background – current taxes

Recognition and measurement of current taxes

Current tax

Amount payable to or refundable by the tax authorities in respect of the **current and previous periods**



Step 1

Calculate current tax liability owing to tax authorities



Step 2

Recognize in the same manner as the underlying item giving rise to the tax

Background –deferred taxes

Recognition and measurement of deferred taxes

Deferred tax

The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Calculation steps

Step 1

Calculate the **tax base** of each asset and liability

Step 2

Calculate the **temporary difference** between the carrying amount and tax base

Step 3

Identify which temporary differences will give rise to deferred taxes using the **recognition criteria and exceptions** in IAS 12

Step 4

Calculate the deferred tax asset or liability using the **appropriate tax rate**

Step 5

Recognize net movement for the period in profit or loss, outside profit or loss, or as part of accounting for a business combination

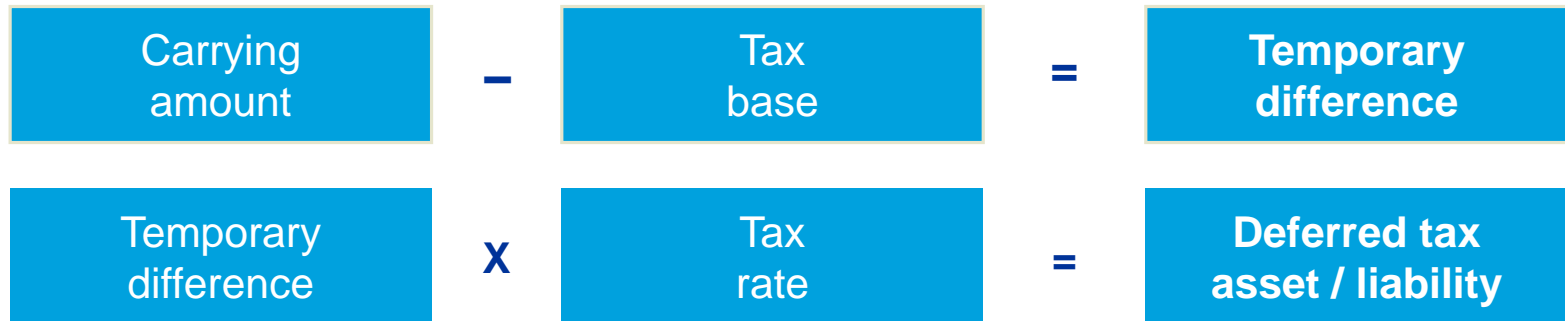
Background —deferred taxes

Recognition and measurement of deferred taxes

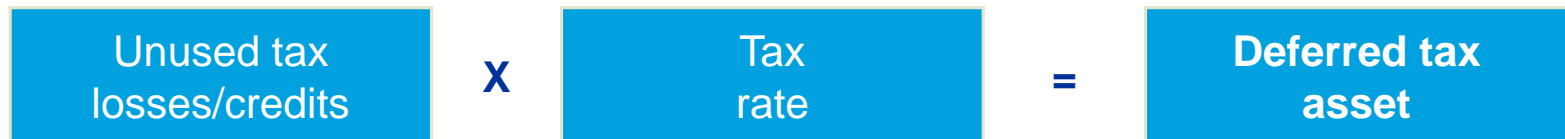
Deferred tax

The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Deferred taxes arising from temporary differences



Deferred taxes arising from carryforward tax losses/tax credits



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☒ Overview

☐ Deferred tax - basic concepts


☐ Recognition

☐ Measurement

☐ Recognition and Measurement

☒ Assessment

In this module you will learn about the content of *IAS 12: Income Taxes* and how to apply it in practice.



Test your knowledge—quiz

Question 1

Can deferred tax assets and liabilities be discounted?

Answer

No.

IAS 12.53 strictly prohibits the discounting of deferred tax assets and liabilities.

Test your knowledge—quiz

Question 2

When should an entity assess the carrying amount of a deferred tax asset?

- A—only on initial recognition
- B—at the end of each reporting period
- C—if the net deferred tax position is a liability

Answer

B – IAS 12.56 requires an entity to review the carrying amount of a deferred tax asset at the end of each reporting period and reduce to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized.

Test your knowledge—quiz

Question 3

Company A has a taxable temporary difference of 100,000 in relation to its plant and equipment at the end of 2013. The tax rate is 30% for 2013 and 25% from 2014 onwards (these rates were substantively enacted prior to 2013). In January 2014, the government announces a change in rate to 20% from 2015 onwards, which is substantively enacted during 2014. At what amount is the deferred tax liability measured at the end of 2013?

A—30,000 ($100,000 \times 30\%$)

B—25,000 ($100,000 \times 25\%$)

C—20,000 ($100,000 \times 20\%$)

D—need to schedule the reversal of the temporary difference into that amount reversing in 2014 and in 2015 or later

Answer

B— IAS 12.47 (as 20% rate was substantively enacted after the end of 2013)

Test your knowledge–quiz

Question 4

Company B undertakes a business combination during the year. The provisional accounting for the business combination indicates a goodwill balance of 80,000. The tax authority does not allow goodwill to be amortized or deducted on sale. What deferred tax amount should be recognized in respect of the goodwill if the tax rate is 30%?

A–deferred tax liability of 24,000 ($80,000 \times 30\%$)

B–nil

C–depends on management's intention as to how the goodwill will be recovered

Answer

B– IAS 12.15(a) prohibits the recognition of a deferred tax liability in respect of the initial recognition of goodwill.

Test your knowledge–quiz

Question 5

Which of the following is/are **required** to be disclosed in the statement of profit or loss and other comprehensive income (or in the separate income statement if presented)?

- A–total income tax expense related to profit or loss from ordinary activities
- B–income tax expense related to discontinued operations
- C–major components of income tax expense

Answer

A – This is required by IAS 12.77. B is optional [IFRS 5.33], C is only required by way of note [AS 12.79].

IAS 12 Income Taxes

2

Apply the scope requirements of IAS 12

Scope of IAS 12

| Included | Excluded |
|---|-----------------------------|
| All domestic and foreign taxes paid on taxable profits | Government grants* (IAS 20) |
| Withholding taxes on distributions to the reporting entity | Investment tax credits* |
| | Levies (IFRIC 21)* |

** IAS 12 does apply to temporary differences arising from these items*

Definition of 'taxable profits'

“the profit (loss) for the period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)”

Scope of IAS 12

IFRIC's views on 'taxable profits'

“the profit (loss) for the period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)”

Not all taxes are within the scope of IAS 12

Taxes **do not** need to be based on a figure that is exactly accounting profit

IAS 12 Income Taxes

3

Determine tax bases

Tax bases—recap

Tax base definition

The amount attributed to an asset or a liability for tax purposes

Guidance in IAS 12

Assets

Amount that will be deductible for tax purposes against any future taxable economic benefits

Liabilities

Carrying amount

—

Amount deductible for tax in the future

Income in advance

Carrying amount

—

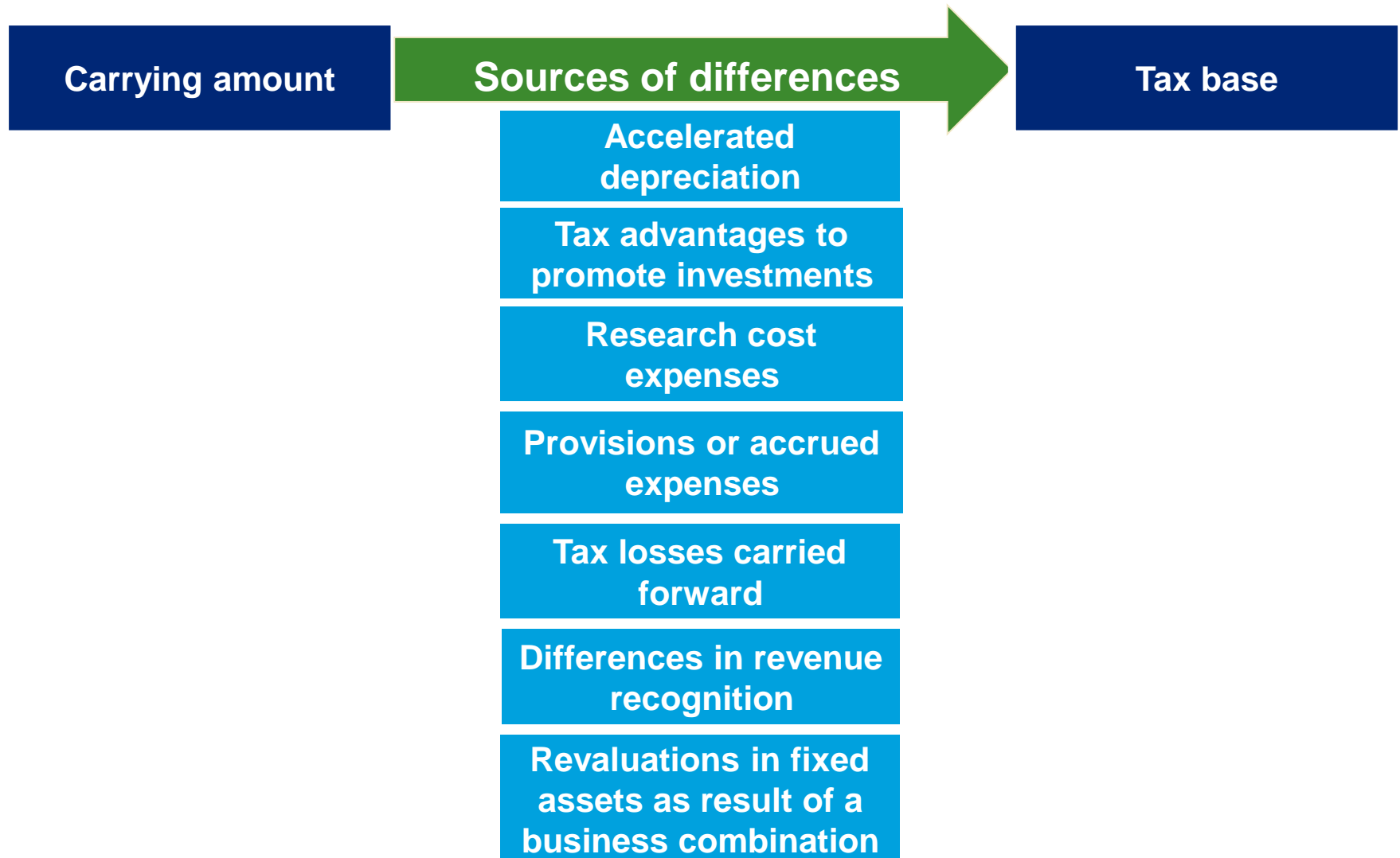
Revenue not taxable in future periods

IAS 12 Income Taxes

3

Determine tax bases

Typical examples of difference between carrying amount and tax base



Example: Difference between accounting and tax books for Property, plant and equipment

Background

- Company X bought a machine on 1 January 2013 for EUR 9 million.
- For accounting purposes, the machine is amortized on straight-line basis over 3 years.
- For tax purposes, the machine is depreciated as follows: 2013: EUR 4 million, 2014: EUR 3 million, and 2015: EUR 2 million.

Q: Compute the carrying amount and tax base at the end of each year, and determine the respective deferred tax impact in the financial statements.

| In EURO | Carrying amount (‘000) | Tax base (‘000) | Difference (‘000) |
|--------------------------|---------------------------|--------------------|----------------------|
| NBV at 01/01/2013 | 9,000 | 9,000 | 0 |
| Charge of the year | -3,000 | -4,000 | |
| NBV at 31/12/2013 | 6,000 | 5,000 | -1,000 |
| Charge of the year | -3,000 | -3,000 | |
| NBV at 31/12/2014 | 3,000 | 2,000 | -1,000 |
| Charge of the year | -3,000 | -2,000 | |
| NBV at 31/12/2015 | 0 | 0 | 0 |

Example: Difference between accounting and tax books for Property, plant and equipment (Cont'd)

Deferred tax impact in Statement of Financial Position

| In EURO | Carrying amount (‘000) | Tax base (‘000) | Taxable temporary difference (‘000) | Deferred tax liability (‘000) |
|-------------------|---------------------------|--------------------|--|-------------------------------------|
| NBV at 31/12/2013 | 6,000 | 5,000 | -1,000 | -300 |
| NBV at 31/12/2014 | 3,000 | 2,000 | -1,000 | -300 |
| NBV at 31/12/2015 | 0 | 0 | 0 | 0 |

Tax bases—role of intention/expectations

Tax base definition

The amount attributed to an asset or liability for tax purposes

Expected manner of recovery or settlement

Must reflect the tax consequences arising from the manner in which the entity **expects**, at the end of the reporting period, to recover or settle the carrying amounts of its assets and liabilities



through 'use'



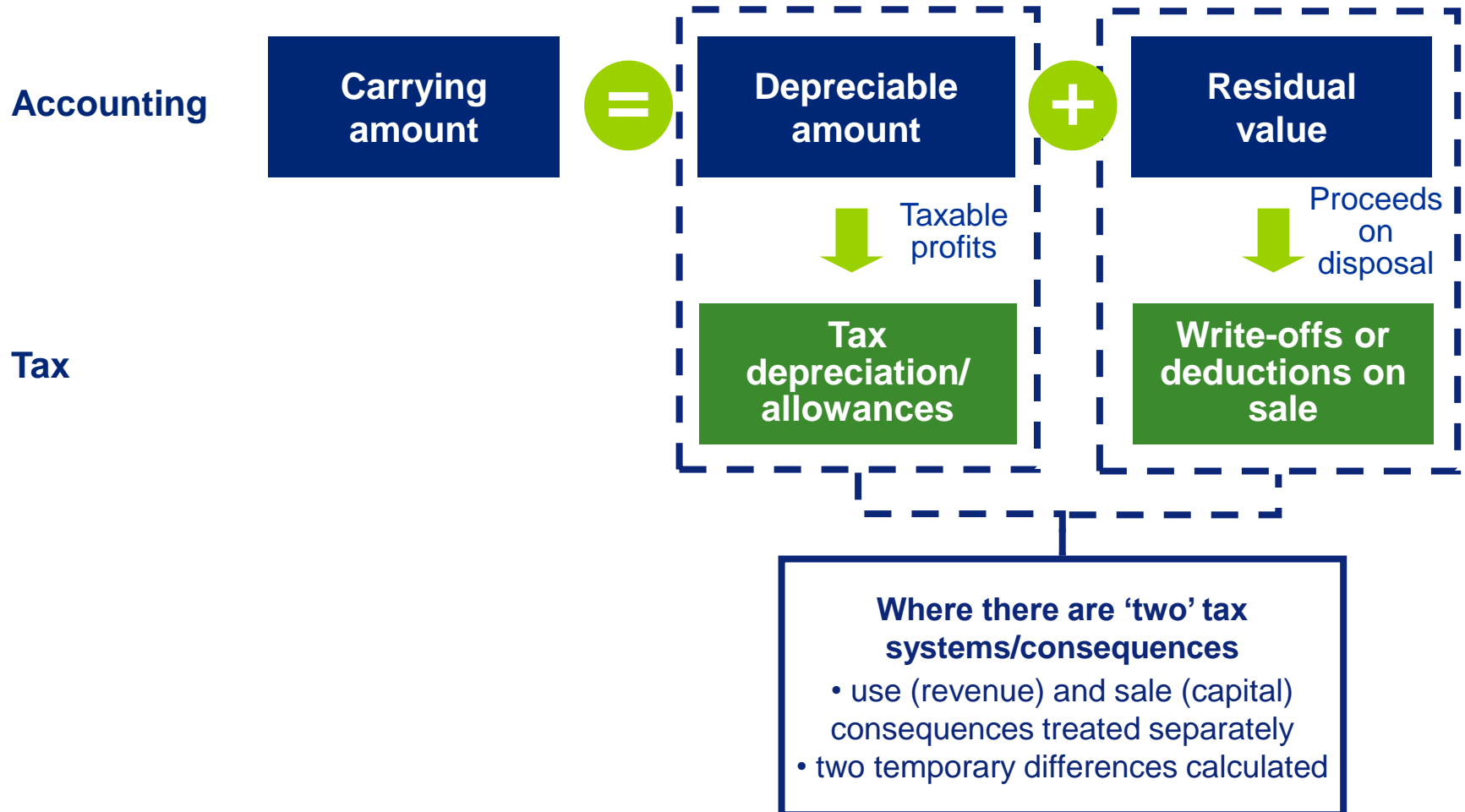
through 'sale'



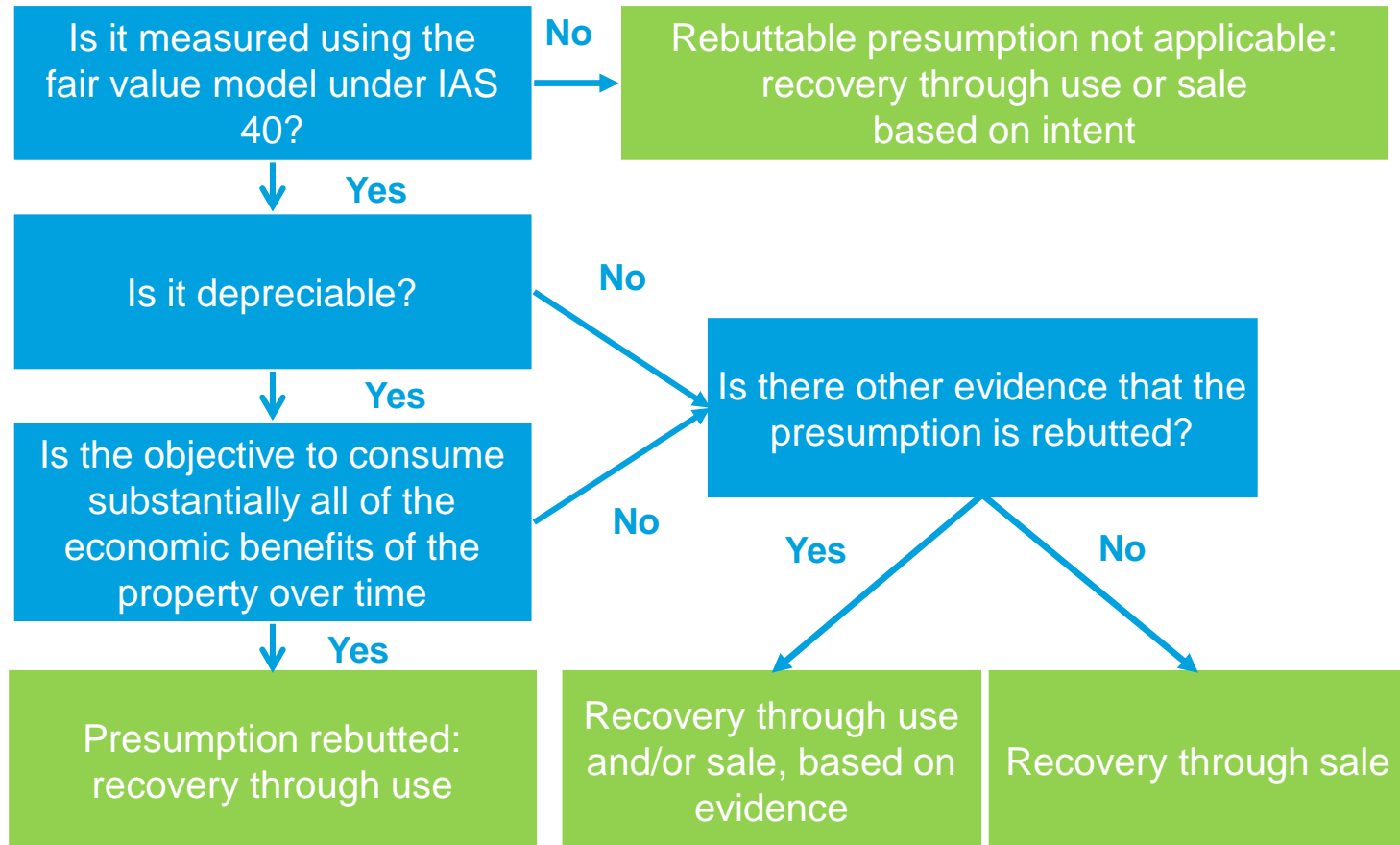
through
'use' and 'sale'

Tax bases—role of intention/expectations

Recovery of assets through both 'use' and 'sale' under certain tax systems



Exception to the presumption of measurement— investment property

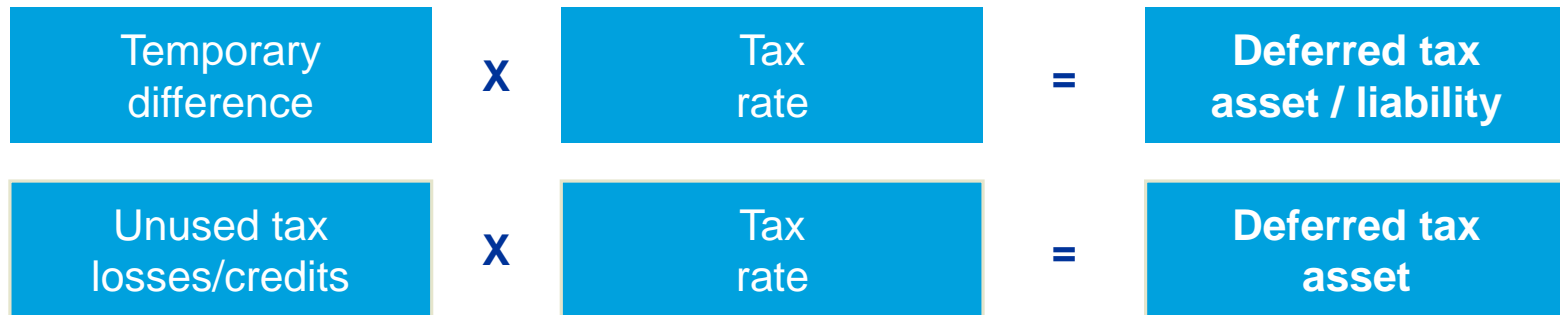


IAS 12 Income Taxes

4

Determine tax rate to be used to measure deferred taxes

Tax rate



1

Tax rate expected to apply to the period when the asset is realized or the liability is settled

2

Based on the tax rates (and tax laws) that have been enacted or **substantively enacted** at the end of the reporting period

3

Changes in tax rates after the reporting period → no impact, but disclosure required if significant impact

Varying tax rates

**Progressive or graduated
tax rates**



Estimated weighted **AVERAGE** tax rates of periods in which the temporary differences are expected to reverse

Phased-in taxes



Applicable rate for the periods in which the temporary differences are expected to reverse

**Different tax rates
depending whether profits
are distributed or not**



Tax rate applicable to **UNDISTRIBUTED** profits

Tax holidays



NO deferred tax for temporary differences that are expected to reverse during the tax holiday.

Deferred tax recognised for temporary differences expected to reverse after the tax holidays (including loss carry forwards available after the holidays)

Progressive or graduated tax rates

Example

- Taxable profit < EUR 1 million → 30% tax
- Taxable profit between EUR1 and 2 million → 35% tax
- Taxable profit > EUR 2 million → 40% tax

Question

Which tax rate to be used for measuring deferred taxes if expected taxable profit is EUR 4 million?

Answer

Average tax rates based on estimated taxable profits in future years = 36.25%

Also refer to Guide 3 for a case study on applying the above principles.

Phased-in taxes

Example

At 31 December 2012, an entity has temporary differences of €6 million. The income tax rate applicable for the next 3 years along with the expected reversal of temporary differences in each of those years is as follows:

| Year | Tax rate | Expected reversal of temporary differences |
|------|----------|--|
| 2013 | 40% | € 1 million |
| 2014 | 38% | € 2 million |
| 2015 | 36% | € 3 million |

Question

Which tax rate should be used for measurement of deferred taxes?

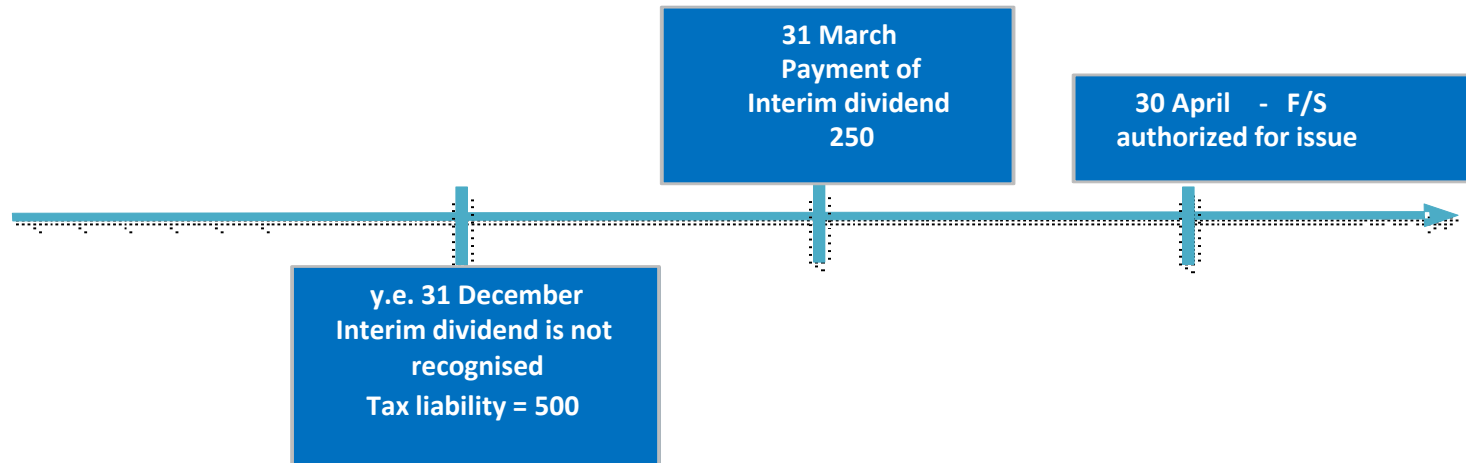
Answer

- Multiply tax rate in that year with the expected reversal of temporary differences → deferred tax of € 2,240,000

Different tax rates depending whether profits are distributed or not

Example

- Company A has undistributed profits of CU1,000 as at 31 December 2013
- Income taxes are payable at **50%** on undistributed profits and **35%** on distributed profits
- Company A pays an interim dividend to shareholders of CU250 in March 2014 (before the 2013 F/S are authorised for issue), equivalent to 25% of the taxable profit for the year



Response

- Interim dividend is not recognised in the financial statements for the y.e. 31 December 2013 [IAS 10]
- The impact of the reduction in tax rates will be recognised at the time the dividend is recognised

Tax holiday

Example

Kinet Co receives a tax holiday from the local government and is exempt from taxation for five years, commencing from the year in which the entity begins to generate taxable income. Kinet Co currently incurs losses and it expects to continue incur losses for the next 3 years.

Questions

1. When does the tax holiday start?
2. What happens at the end of reporting date of year 1?
3. Should Kinet Co recognize the deferred tax for losses realized in year 1 and 2, if it is expected that the losses would be recovered in year 4 and 5?

Answers

1. Kinet Co should assume that the holiday period begins immediately and lasts for five years.
2. At each reporting date until Kinet Co produces taxable profit, the applicable tax holiday period should be assumed to be five years from that date.
3. NO. Deferred tax should **not** be recognised in respect of temporary differences that are scheduled to reverse during the tax holiday period, because no net expense or benefit will result.

Substantive enactment of new tax rates

Virtually certain that new tax rate will be introduced

Professional judgment

Consider facts and circumstances

- Legal system
- Remaining steps necessary to enactment

Example

30 September
Announcement
new tax law

31 March
Formal enactment

31 December
Reporting date

SIC 25 – Change in tax status (e.g.
shareholder becomes foreign
company)

Voluntary → when
change is approved or
notified

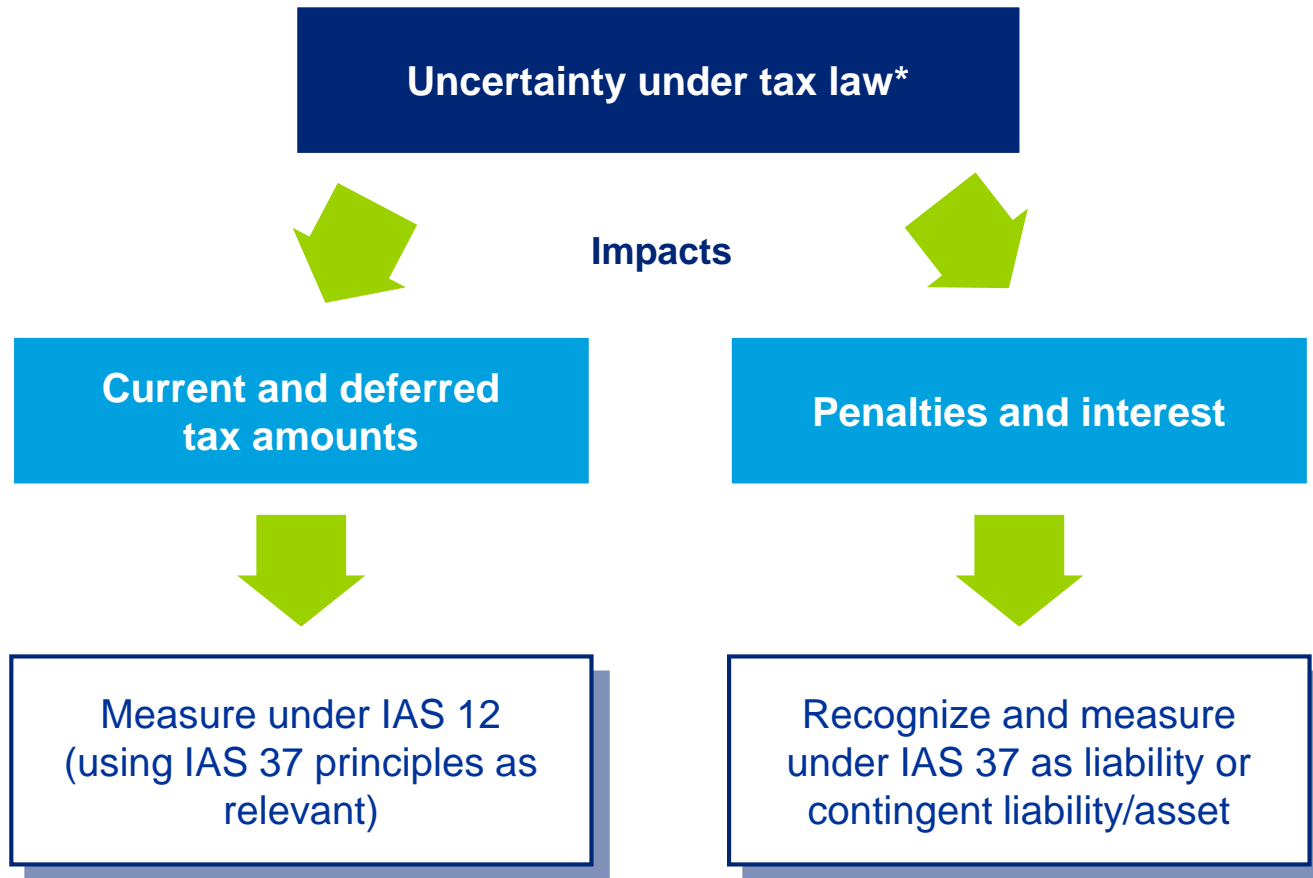
Change in tax law →
when (substantively)
enacted

IAS 12 Income Taxes

5

Describe how uncertain tax positions are treated

Uncertain tax positions



** Assume that the tax authority will detect the tax uncertainty*

Uncertain tax positions

Differing approaches to accounting for uncertain tax positions

- Entity claims a tax deduction of \$100,000 in its tax return (\$30,000 tax effected)
- >50% probability that the position will be sustained, but a number of outcomes are possible

Under an 'all or nothing' approach, tax benefit of \$30,000 recognized

| Possible estimated outcome | Individual probability | Cumulative probability | Weighted probability outcome |
|----------------------------|------------------------|------------------------|------------------------------|
| \$30,000 | 30% | 30% | \$9,000 |
| \$25,000 | 25% | 55% | \$6,250 |
| \$20,000 | 20% | 75% | \$4,000 |
| \$15,000 | 15% | 90% | \$2,250 |
| \$10,000 | 10% | 100% | \$1,000 |

\$22,500

Under a probability weighted approach, \$22,500 is the weighted amount and a liability of \$7,500 + penalties and interest is recognized

IAS 12 Income Taxes

6

Considerations for current and deferred tax in interim financial statements

Current and deferred taxes in interim financial statements

$$\begin{array}{|c|} \hline \text{Income tax expense at interim date} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Best estimate of the weighted average annual income tax rate expected for the full financial year} \\ \hline \end{array} \times \begin{array}{|c|} \hline \text{Taxable income} \\ \hline \end{array}$$

