

# **THE ANNUAL FINANCIAL REPORTING WEEK 2018**

## **IFRS 12 Income Taxes**

**By CPA Ferdinand Othieno**

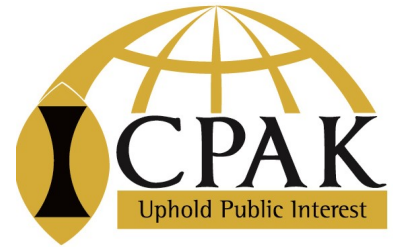
**11 September 2018**

**Credibility.**

**Professionalism.**

**AccountAbility**

# Agenda



- 1. Introduction of current taxes**
- 2. Deferred taxes: general issues**
- 3. Presentation and disclosure**
- 4. Section 29 of IFRS for SMEs**

## **1. Financial Advisory**

- Quantitative Risk Management – IFRS 9 & Basel II/III modelling, Market risk, Credit risk
- Transaction Services – Valuations, M&A, IPOs, Rights Issues, FDDs, Restructuring, Project Finance, Business Plans e.t.c.
- Selected clients – CBE, BoU, BoA, Prime Bank, Safaricom, TMEA & EAC, KCB, Britam, UAP, KenGen, Home Africa, Investeq

## **2. Training – Financial Markets, Financial Modelling, IFRS, Derivatives**

- KPMG Trainer
- ICPAK & iCPAR Trainer

## **3. Teaching & Research**

- Lecturer, Finance – SIMS, Strathmore University
- Acting Dean, Institute of Mathematical Science, Strathmore University
- Interests – Asset Pricing, Analytics for Financial Applications, Forecasting Methods in Finance and Quantitative Risk Management

## **4. Education**

- PhD Finance (Ongoing - UCT), CFA Level 3, MBF, BBA (Finance), CPAK

# Learning outcomes



- Describe the scope and main principles of IAS 12 standard.
- Describe how to recognise and measure deferred tax.
- Explain the presentation and disclosure requirements of IAS 12.
- Analyse the requirements under Section 29 of IFRS for SMEs

# Income taxes



**Income tax**

**=**

**Current tax**

**+**

**Deferred tax**

# Recognition of current tax



- In the statement of financial position current tax for current and prior periods should be recognised as an asset or liability
- Tax payable = liability
- Tax paid but recoverable = asset
  - Tax assets may arise in some jurisdictions through the ability to redeem current period tax losses against tax paid in earlier periods

# Recognition of current tax (continued)



**Profit or Loss**

**Unless relates to item  
outside profit or loss  
(either in other  
comprehensive  
income or in equity)**

**OCI/Equity**

**If relates to item either  
in other  
comprehensive  
income or in equity**

# Measurement of current tax



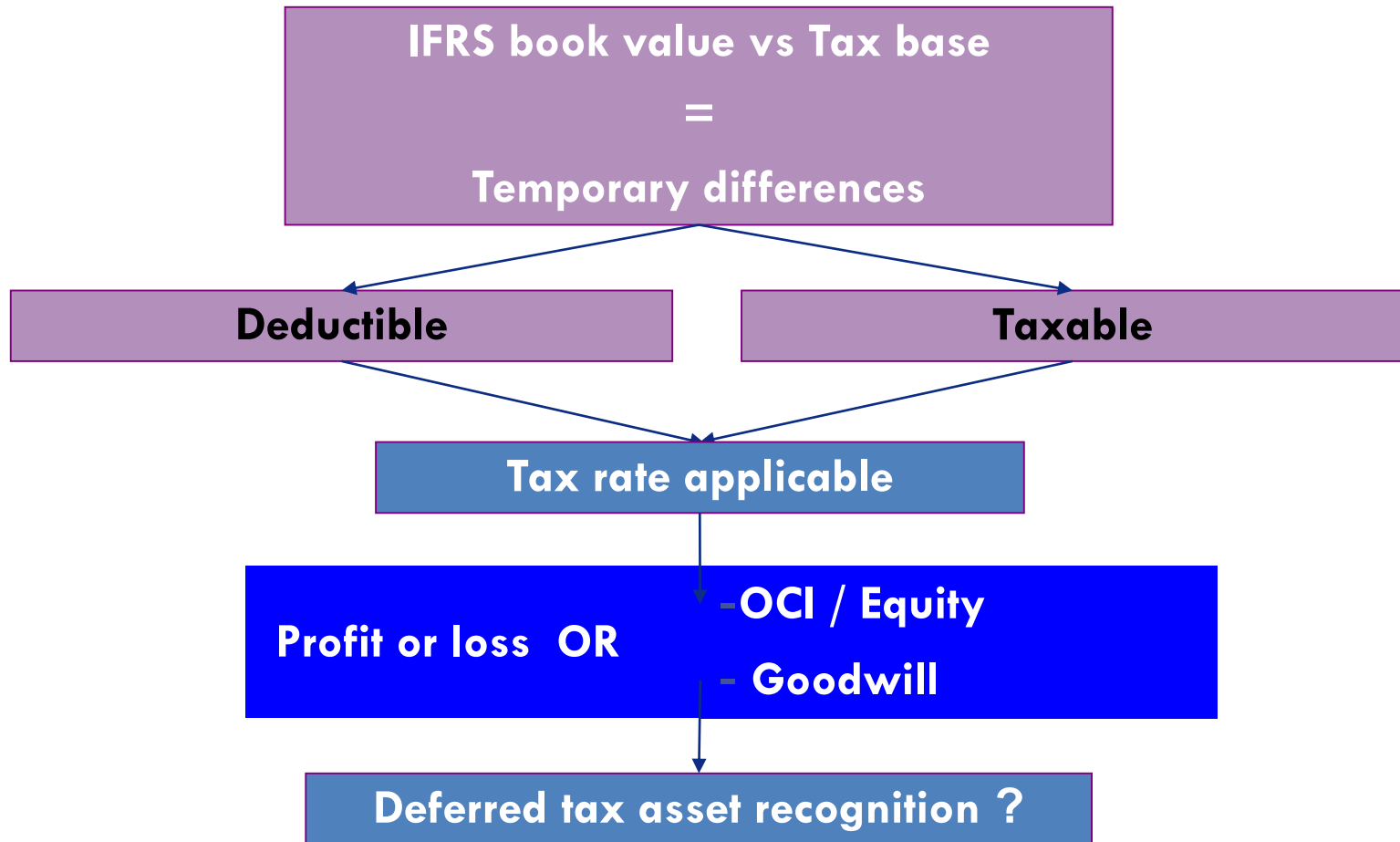
**Applicable tax rate  
for that type of income**

**Enacted or substantively  
enacted by end of the  
reporting period**

- ◆ **General rate**
- ◆ **Specific rates (e.g.  
capital gains tax rate)**
- ◆ **Assume no distribution**



# Deferred tax: overview



# Tax base



- ◆ **The tax base of an item is the amount attributed to that item for tax purposes**
- ◆ **Tax base of an asset:**
  - Amount deductible for tax purposes when the asset is recovered
  - Example:
    - Interest receivable of 100 (carrying amount)
    - Related interest revenue are taxed on a cash basis.
    - Tax base is nil

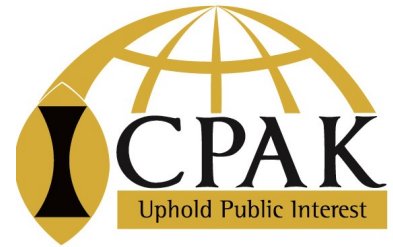
# Tax base (continued)



## ◆ Tax base of a liability:

- Carrying amount less any amount that will be deductible for tax purposes in respect of that liability
- Example:
  - Loan payable of 100 (carrying amount)
  - Repayment of the loan has no tax consequences
  - Tax base is 100

# Temporary differences



**Temporary  
differences**

**=**

**Accounting  
IFRS Book value**

**-**

**Tax  
Base**

**Taxable**  
amount on  
recovery/settlement



**Taxable**  
temporary difference



**Deferred tax  
LIABILITY**

**Deductible**  
amount on  
recovery/settlement

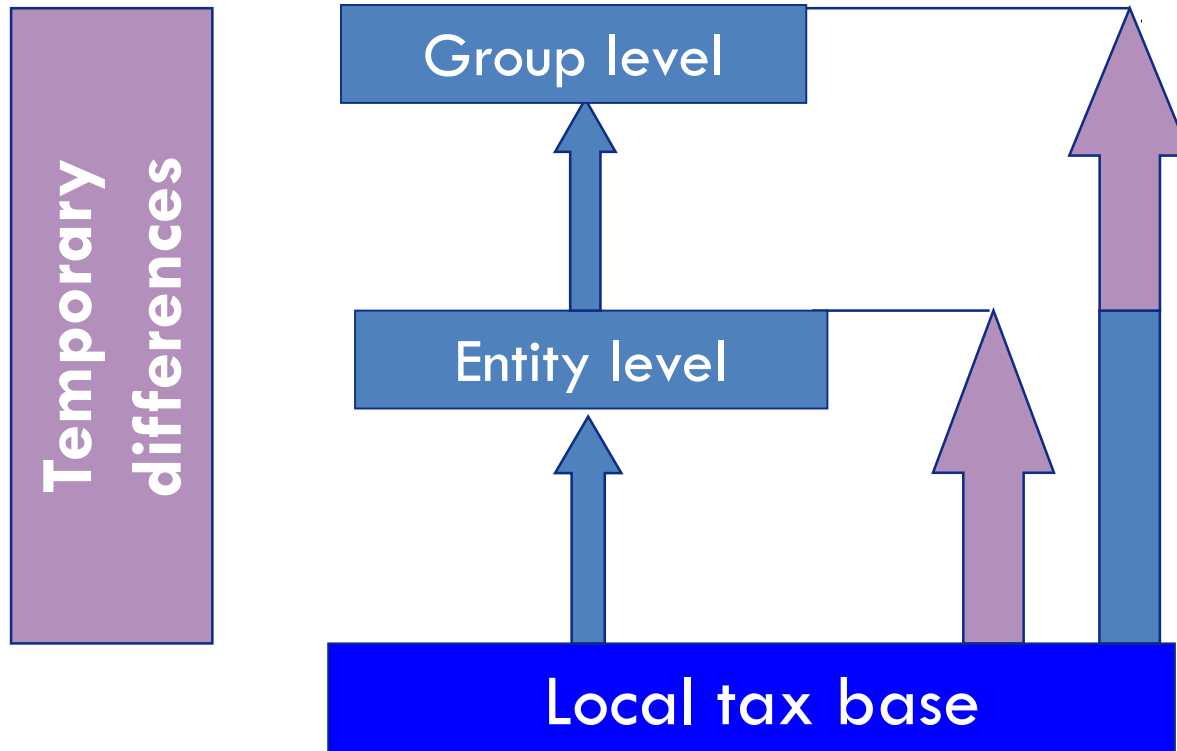


**Deductible**  
temporary difference

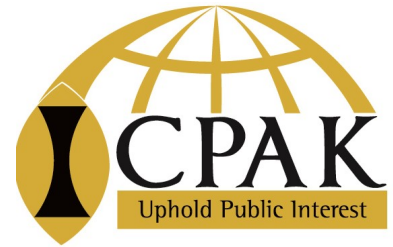


**Deferred tax  
ASSET**

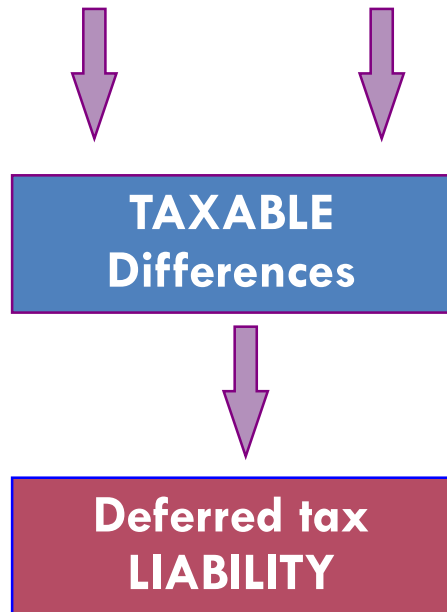
# Temporary differences and consolidation



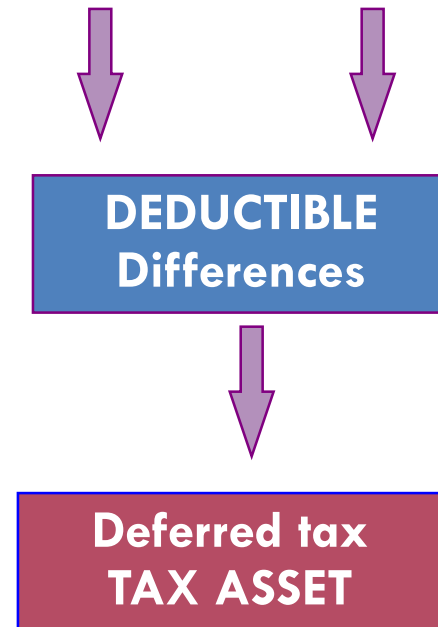
# Temporary differences – Summary



- ◆ Carrying amount of an asset is higher than its tax base
- ◆ Carrying amount of a liability is lower than its tax base



- ◆ Carrying amount of an asset is lower than its tax base
- ◆ Carrying amount of a liability is higher than its tax base amount of an



# Exceptions to recognition of deferred taxes

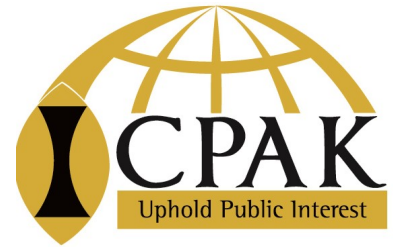


- Taxable temporary differences arising from the initial recognition of goodwill
- Temporary differences arising from the initial recognition of an asset/liability in a transaction which:
  - Is not a business combination
  - Does not affect accounting nor taxable profit at that time

## **‘The initial recognition exemption’**

- Temporary differences arising from investments when
  - Parent has control of the timing of reversal AND it will not reverse in the foreseeable future

# Measurement of deferred tax



## Applicable tax rate

**Enacted or substantively enacted by end of the reporting period**

- ◆ **Expected manner of recovery or settlement:**
  - usage rate
  - disposal rate
- ◆ **Assume no distribution**



# Measurement – No discounting



# Recognition of deferred tax



Profit or Loss

**All cases, unless:**

OCI / Equity

**If relates to item either in other comprehensive income or in equity**

Goodwill

**If arises on a business combination**

# Recognition of deferred tax outside profit or loss – Examples



## OCI

- Revaluation of
  - property, plant and equipment (IAS 16)
  - intangible assets (IAS 38)
  - available-for-sale securities (IAS 39)
- Foreign exchange differences on the translation of a foreign entity (IAS 21)
- Cash flow hedge (IAS 39)

## Equity

- ◆ Compound financial instruments (IAS 39)
- ◆ Adjustment to the opening balance of retained earnings (IAS 8/IFRS 1)
- ◆ Share-based payment (IFRS 2)

# Recognition of deferred tax asset / liability

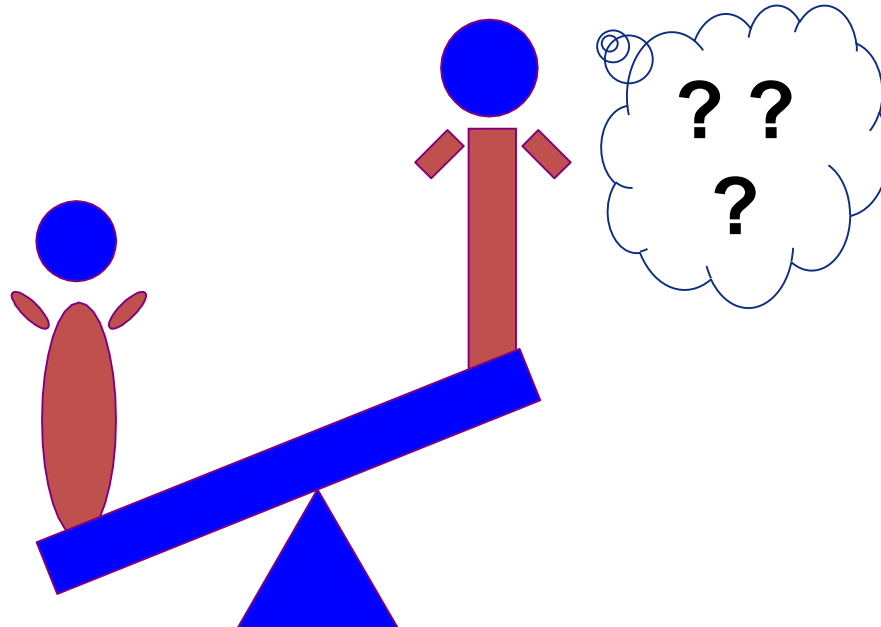


## **Liability**

Recognise in full

## **Asset**

Recognise if recoverable



# Deferred tax asset – Examples



- Deductible temporary differences
- Unused tax losses
- Unused tax credits

# Asset recognition: When?



- Sufficient taxable profit:
  - Taxable temporary differences
  - Taxable profits
  - Tax planning opportunities
  - Carry back income

# Presentation



- Minimum line items to be presented separately in the statement of financial position
  - Current tax assets and liabilities
  - Deferred tax assets and liabilities
- Deferred tax assets/liabilities to be classified as non current items in a classified statement of financial position
- Tax expense to be presented separately in the statement of comprehensive income

# Presentation – Offsetting



- Current tax assets/liabilities offset only if
  - Legally enforceable right; and
  - Intention to settle on a net basis or simultaneously
- Deferred tax assets/liabilities offset only if
  - Legally enforceable right to off-set current tax assets and liabilities; and
  - Income taxes relating to same taxation authority and from:
    - The same taxable entity
    - Different taxable entities intending to settle/realise net or simultaneously



# Disclosures



- Reconciliation of effective rate to statutory tax rate
- Major components of tax expense (income)
- Income tax recognised outside profit or loss:
  - Aggregate amount recognised directly in equity
  - Amount relating to each component of OCI
- Explanation of changes in tax rates compared to previous year
- Evidence for the amounts of deferred tax asset recognised when
  - Dependent on future taxable profit
  - The entity has suffered a loss in the current or previous period

# Disclosures (continued)



- Amounts recognised in respect of each type of
  - Temporary differences, unused tax losses and unused tax credits
  - Deferred tax assets/liabilities
  - Deferred tax income/expense in P&L, OCI / Equity
- Unrecognised deferred tax assets
  - Amount and expiry date of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised
- Unrecognised deferred tax liabilities
  - Amount of temporary differences on investments in subsidiaries, associates and JV not recognised
  - Potential tax consequences of payments of dividends to shareholder

## Section 29 – Income tax



### Steps in accounting for income tax:

1. Recognise current tax
2. Identify which assets and liabilities would affect taxable profit if recovered or settled for their carrying amounts
3. Determine tax basis of items in (2) plus other items that have a tax basis although not recognised (eg borrowing cost or R&D that is capitalised for tax purposes)
4. Compute temporary differences, unused tax losses, unused tax credits

## Section 29 – Income tax



5. Recognise deferred tax assets or liabilities arising from temporary differences
6. Measure deferred tax assets and liabilities
  - use substantively enacted tax rates
  - consider possible outcomes of a review by tax authorities
7. Valuation allowance against deferred tax assets (probable recovery)
8. Allocate current and deferred tax to related components of profit and loss, OCI, equity

# Questions & comments



# Contact details



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