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LKAS 12 - Income taxes

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Scope of LKAS-12

What are Income Taxes?

- LKAS 12 shall be applied in accounting for income taxes
- For the purposes of LKAS 12, income taxes include:
  - all domestic and foreign taxes which are *based on taxable profits*
  - taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity

What is Tax charge [expense]/credit [income]?

- Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income)
- LKAS 12 also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes.

Related Areas

LKAS 12 2011

LKAS 12 *Income Taxes,* addresses all aspects of accounting for tax that arise on the income of entities and for differed tax

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SIC 25

IAS 12 has been the subject of an interpretation in SIC-25 *Income Taxes – Changes in the Tax Status of an Enterprise or Its Shareholders*.

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SIC 21

IAS 12 has been the subject of an interpretation in SIC-21 *Income taxes – Recovery of Revalued Non-Depreciable Assets*.
(Repealed in 2012 BV)

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LKAS 12 2012

LKAS 12 amendment on Deferred tax arising from non depreciable assets arising from revaluation model of LKAS 16; arising from investment property measured using FV model in LKAS 40

Some 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).

Some definitions

- **Tax expense (tax income)** = Current tax + Deferred tax.

Current tax	+	Deferred tax	
Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.	+	**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 carryforward of unused tax losses; and (c) the carryforward of unused tax credits.**

Some definitions

- Temporary differences = carrying amount of an asset or liability in the statement of financial position and its tax base.
- Temp Diff =

Carrying amount of Asset or liability		Tax base
Carrying amount of an asset or liability in the statement of financial position	—	Amount attributed to that asset or liability for tax purposes

LKAS 12 terminology	What it means
Taxable temporary differences	Future taxable income
Deductible temporary differences	Future deductions or reductions in future taxable income
Deferred tax liability	Future tax payable arising from taxable temporary differences
Deferred tax asset	Reductions in future tax payable arising from deductible temporary differences

Tax Base of an Asset

- The tax base of an asset is the amount that will be deductible for tax purposes against the taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset.
- If these economic benefits will not be taxable, then the tax base of an asset is equal to its carrying amount, so that no deferred tax arises.

Future taxability	Tax base
Where the proceeds from the realization or recovery of the asset is taxable	Tax base is the amount that will be deductible against the table economic benefits from the recovery of the asset
Where the proceeds from the realization or recovery of the asset is tax-exempt	Tax base is equal to the carrying amount

Tax Base of an Asset – Scenario 1

An asset costs Rs1000. For tax purposes, depreciation of 300 has been already deducted in the current and prior periods and the remaining cost of 700 will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable and any loss on disposal will be deductible for tax purposes. What will be the tax base?

A. 0
B. 300
C. 700
D. 1000

Tax Base of a Liability

Two key rules apply when determining the tax base of a liability. The aim is to identify any incremental tax effect of settling every liability at its carrying value, and if there is no such tax effect, the tax base value is the same as the carrying value.

- The tax base of a liability is its carrying amount, minus any amount that will be deductible for tax purposes in respect of that liability in future periods.
- In the case of revenue received in advance, the tax base is its carrying amount, minus any amount of revenue that will not be taxable in future periods.

Tax Base of a Liability – Scenario 1

Expenses of 1000 have been accrued—800 already have given rise to a tax deduction and 200 will be deductible for tax purposes when paid. What is the tax base of the accrued expenses?

A. 0
B. 200
C. 800
D. 1000

Tax Base of a Liability – Scenario 2

Revenue of 1000 has been received in advance and is shown as a liability, but it already has been taxed. What is the tax base of the revenue received in advance?

A. 0
B. 200
C. 800
D. 1000

Principles of LKAS-12
For current tax liabilities and assets

- Current tax for current and prior period should be to the extent unpaid, be recognised as a liability.
- If the amount already paid exceeds the amount due for these periods, the excess is recognised as an asset.

Current tax = Taxable income based on tax laws X statutory tax rate

Principles of LKAS-12
For Deferred tax:

- **Record tax consequences**:
  It presumes that all assets and liabilities will be recovered/settled at their carrying amount. If it is probable that this recovery or settlement will make future tax payments larger or smaller than they otherwise would be, then deferred tax should be recognized as a liability or asset in respect of this difference.
- **Record in the same place where the transaction/ event is recorded:**
  LKAS-12 states that consequences of transactions or events should be reported in the same statement as the transaction or event themselves.

  e.g.- Tax on a gain that is reported in equity is reported in equity rather than in the income statement.

Temporary Differences
Examples

- Transactions that affect profit or loss
- Transactions that affect statement of financial position
- FV adjustments and revaluations
- Business combinations and consolidation

Refer the separate attachment

Recognition of Deferred tax liabilities

Recognizing Deferred Tax Liability

► A deferred tax liability should be recognised for all taxable temporary differences, including those arising from:

- business combinations
- assets carried at fair value
- split accounting of financial instruments

unless the deferred tax liability arises from the initial recognition of goodwill or 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 nor taxable profit (or tax loss)

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

Deferred tax = Taxable temporary differences X tax rate (future)

Example

Entity A acquires 100% controlling interest in entity B on January 1, 2006.

- ► At the date of acquisition entity B's financial statements include PPE with carrying amount of Rs.100. Entity A determines fair value of PPE to be Rs.150 and it recognises the same at Rs.150 as per SLFRS 3.
- ► This, however, does not impact tax base of the PPE and same continues to be Rs.100.
- ► Entity A recognises an intangible asset of Rs.200 as part of PPA exercise; however, amortisation of the same is not allowed for tax purposes.
- ► Entity A recognises an impairment loss of Rs.50 on investment made by B in unquoted equity shares worth Rs.500; however, this does not change the tax base thereof. For tax purposes, original cost of shares would be allowed as deduction upon sale of the respective investment.

Applicable tax rate is 30%.

What would be the deferred tax implications of the above adjustments made as per SLFRS 3?

Solution

Item	Fair value carrying amount	Tax base	Taxable/ (deductible) difference
PPE	150.00	100.00	50.00
Intangible asset	200.00	Nil	200.00
Investment	450.00	500.00	(50.00)
Net taxable differences			**200.00**
Net DTL to be recognised @ 30%			**60.00**

Recognition of the above Deferred Tax Liability would affect the amount of goodwill to be determined as per SLFRS 3

Recognising Deferred Tax
Initial recognition difference

LKAS 12 does not permit an entity to recognize a deferred tax liability or asset arising on initial recognition of an asset or liability acquired other than in a business combination, where the transaction affects neither accounting profit nor taxable profit (loss).

- A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes.
- E.g. Motor cars

Recognising Deferred Tax Liability

Example illustrating paragraph 22(c)
An entity intends to use an asset which cost 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 1,000 and pay tax of 400. The entity does not recognise the resulting deferred tax liability of 400 because it results from the initial recognition of the asset.* *In the following year, the carrying amount of the asset is 800. In earning taxable income of 800, the entity will pay tax of 320. The entity does not recognise the deferred tax liability of 320 because it results from the initial recognition of the asset.*

Recognition of Deferred tax assets

Recognising Deferred Tax Assets

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

- Deductible temporary differences
- The carry forward of unused tax losses, **and**
- The carry forward of unused tax credits

- 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.**

Recognising Deferred Tax Assets-Example

On 1 January 2006, A Ltd purchases an item of plant for 120,000. This plant has an expected useful life of four years with a zero residual value. The company depreciates on a straight-line basis. The tax authorities allow a five year amortisation period. The tax rate is 30%.

Where the carrying amount is less than the tax base, the amounts available for offset against accounting profit are less than amounts to be offset against taxable profit. Therefore, in the future there will be less tax payable (as tax authorities owe a future deduction equal to what has been deducted for accounting purposes) than what one would normally project from the carrying amount of the asset.

This tax benefit in the future (deductible temporary difference) needs to be recognised as an asset (i.e. a deferred tax asset), provided that it is probable that the entity will have sufficient taxable profit against which the deductible temporary difference can be utilised.

Recognising Deferred Tax Assets-Solution

	2006	2007	2008	2009
Carrying Amount	90,000	60,000	30,000	0
Tax Base	96,000	72,000	48,000	24,000
Deductible Temporary Difference	(6,000)	(12,000)	(18,000)	0
Deferred Tax (Asset) (30%)	(1,800)	(3,600)	(5,400)	0

In 2009 deferred tax asset will be 'nil' as there are no temporary differences.

Recognising Deferred Tax Assets Arising from Unused Losses

In relation to deferred tax assets arising from unused losses, the standard says that the existence of unused losses is strong evidence that profits might not be available. It requires four criteria to be considered before a deferred tax asset can be recognized in respect of unused losses or credits.

- Whether the company has enough taxable temporary differences relating to the same tax authority and the same taxable entity, to create taxable amounts against which the losses or credits can be used before they expire.
- Whether it is otherwise probable that the entity will have taxable profits in that period.
- Whether the unused tax losses result from identifiable causes that are unlikely to recur.
- Are tax-planning opportunities available to allow taxable profits to be created in the period in which the losses or credits can be used?

Review of Deferred Tax Assets

► The determination of whether there is likely to be enough future taxable profit is not a one-off exercise, made only at the time of initially recognizing the asset. The availability of future taxable profits must be reassessed at each balance sheet date, and the amount of deferred tax assets must be adjusted, if necessary. Such an adjustment can be either up or down, if conditions have improved or deteriorated since the last assessment.

Consider

1. The recoverability of the deferred tax asset is reviewed at each balance sheet date.
2. The carrying amount should be reduced to the extent that it is no longer probable that enough taxable profit will be available to allow the asset to be recovered.
3. Any such reduction should be reversed to the extent that it once again becomes probable that enough taxable profit will exist.

SIC-21 Income Taxes Recovery of Revalued Non-Depreciable Assets

SIC-21- Income Taxes Recovery of Revalued Non-Depreciable Assets

The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset in accordance with IAS 16.31 shall be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.

Repealed in SLFRS 2012 Bound Volume

SIC-25 Changes in the Tax Status of an Entity or its Shareholders

SIC-25- Changes in tax status of an entity/share holders

- A change in the tax status of an entity or of its shareholders may have consequences for an entity by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an entity's equity instruments or upon the restructuring of an entity's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an entity may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.

- A change in the tax status of an entity or its shareholders may have an immediate effect on the entity's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the entity, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the entity's assets and liabilities.

SIC-25- Consensus

A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised outside profit or loss. The current and deferred tax consequences of a change in tax status shall be included in profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity or in amounts recognised in other comprehensive income. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity. Those tax consequences that relate to amounts recognised in other comprehensive income shall be recognised in other comprehensive income.

Presentation and Disclosures

Balance Sheet Presentation

Transaction or other events recognized in	Related tax effect is recognized in
Profit or loss	Profit or loss
Other comprehensive income	Other comprehensive income
Directly in equity	Directly in equity
As a business combination (recognition of deferred tax assets and liabilities in a business combination)	Goodwill or gain on bargain purchase

Balance Sheet Presentation

The following guidance of LKAS 1 Presentation of Financial Statements requires that current and deferred tax assets and liabilities are all clearly distinguished in the balance sheet.

The requirements for balance sheet presentation are:

- Deferred tax assets and liabilities and current tax assets and liabilities should be presented separately from other assets and liabilities in the balance sheet.
- Deferred tax assets and liabilities should not be classified within current assets and liabilities, if the balance sheet makes such a distinction.

Balance Sheet Presentation: Offset of Deferred Tax Asset and Liabilities

The requirements for offsetting deferred tax assets and liabilities are restrictive. They build upon the restrictions relating to current tax assets and liabilities (since deferred tax must become current tax before it is paid or received).

In addition, however, they impose rules regarding the timing of reversals, because no net settlement would be possible unless deferred tax assets and liabilities gave rise to tax cash flows that would occur at the same time. This sometimes requires detailed scheduling of the years of reversal of temporary differences.

Consolidated annual financial statements

In consolidated financial statements, a current tax asset of one entity in a group is offset against a current tax liability of another entity in the group **only if** the entities concerned have a legally enforceable right to make or receive a single net payment, **and** the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

Offset of Deferred/Current Tax Asset and Liabilities

	Off Setting Criteria
Deferred Tax Asset/ Liability	-It has a legally enforceable right to set off - The deferred tax assets and liabilities relate to tax levied by the same tax authority on either the same taxable entity or different taxable entities, which intend either to settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.
Current Tax Assets/ Liabilities	-It has a legally enforceable right to set off the recognized amounts - It intends either to settle them on a net basis or to realize the asset and settle the liability at the same time.

Balance Sheet Disclosures: Requirement

LKAS 12 contains many disclosure requirements.

1. Ordinary Activities: The tax expense (or income) related to profit (or loss) from ordinary activities (should be presented in the face of the income statement).
2. Equity Related Taxes: The aggregate current and deferred tax relating to items charged or credited to equity.
3. Discontinuance: The tax expense related to the gain or loss on discontinuance and the results from ordinary activities of the discontinued operation in each year presented.
4. Changes and Errors: The tax expense or income related to those changes in accounting policies and errors that are included in profit or loss because they cannot be accounted for retrospectively.
5. Tax Expense and Adjustments: The major components of tax expense, such as current tax expense and adjustments to current tax of prior periods.
6. Temporary Difference Reversals: The deferred tax expense relating to the origination or reversal of temporary differences and changes in tax rates or to the imposition of new taxes.

Balance Sheet Disclosures: Requirement

LKAS 12 contains many disclosure requirements.

7. Reduction of Taxes: The tax expense relating to the reduction of both current and deferred tax expense by using a previously unrecognized tax loss, tax credit, or temporary difference of a prior period.
8. Write Down: The write-down (or its reversal) of a deferred tax asset.
9. Explanation of Changes: A description of changes in the applicable tax rates compared to the previous accounting period.
10. Reconciliation: A numerical reconciliation between tax expense and the product of accounting profit multiplied by the applicable tax rates; and a numerical reconciliation between the average effective tax rate and the applicable tax rates.
11. Deductible Temporary Difference: The amount, and expiry date (if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognized in the balance sheet.

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Balance Sheet Disclosures: Requirement

LKAS 12 contains many disclosure requirements.

12. Specific Investments: The aggregate amount of temporary differences associated with investments in subsidiaries, branches, associates, and joint ventures for which no deferred tax liabilities have been recognized.
13. Charged/Credited to Equity: The current and deferred tax relating to items that are charged or credited to equity.
14. Balance Sheet: For each type of temporary difference, the amount of the deferred tax assets and liabilities recognized in the balance sheet. (This disclosure is also required for each type of unused tax losses and unused tax credits.)
15. Income Statement: For each type of temporary difference, the amount of the deferred tax income or expense recognized in the income statement, if this information is not evident from the movement in balance sheet amounts (This disclosure is also required for each type of unused tax losses and unused tax credits.)

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Balance Sheet Disclosures: Requirement

LKAS 12 contains many disclosure requirements.

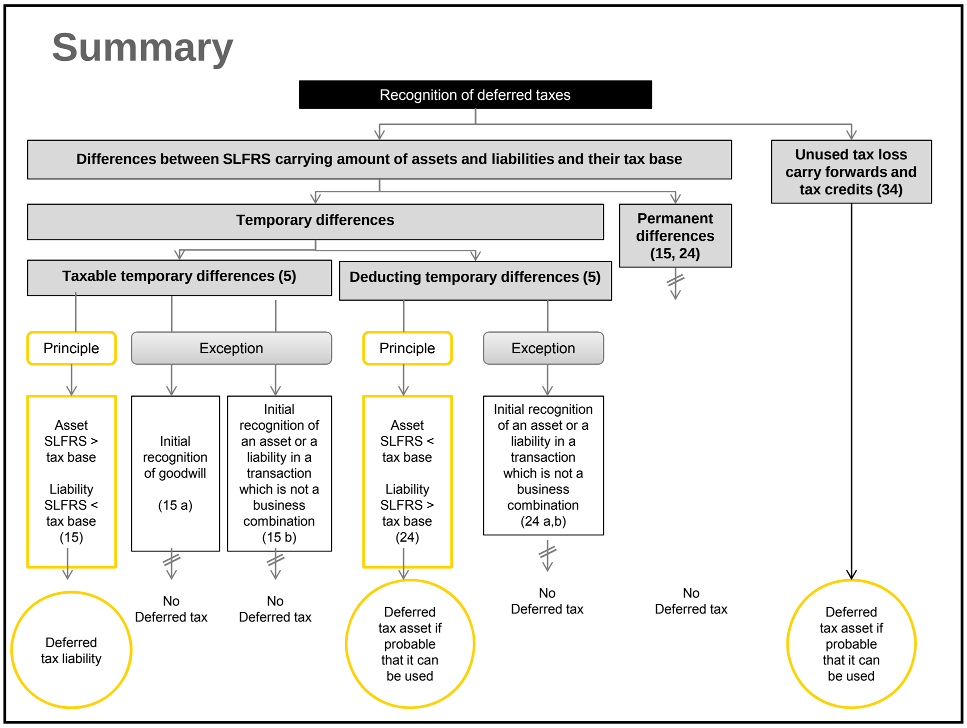
16. Future Taxable Profits: The amount of a deferred tax asset and the nature of the evidence supporting its recognition, when its utilization depends on future taxable profits exceeding those arising from the reversal of existing taxable temporary differences, and the entity has made a taxable loss in either the current or preceding period in the relevant tax jurisdiction (This disclosure is required when deferred tax assets are recognized in reliance on future accounting profits, despite the existence of recent losses.)
17. Dividends: Any tax consequences of dividends proposed after the balance sheet date but not provided for.
18. Retained Distributed Profits: When there are different tax consequences if profits are retained or distributed, the nature of the potential tax consequences that would arise from a payment of dividends to shareholders (This should quantify the amounts, when the consequences are practicably determinable, or else disclose whether there are consequences that are not practicably determinable.)

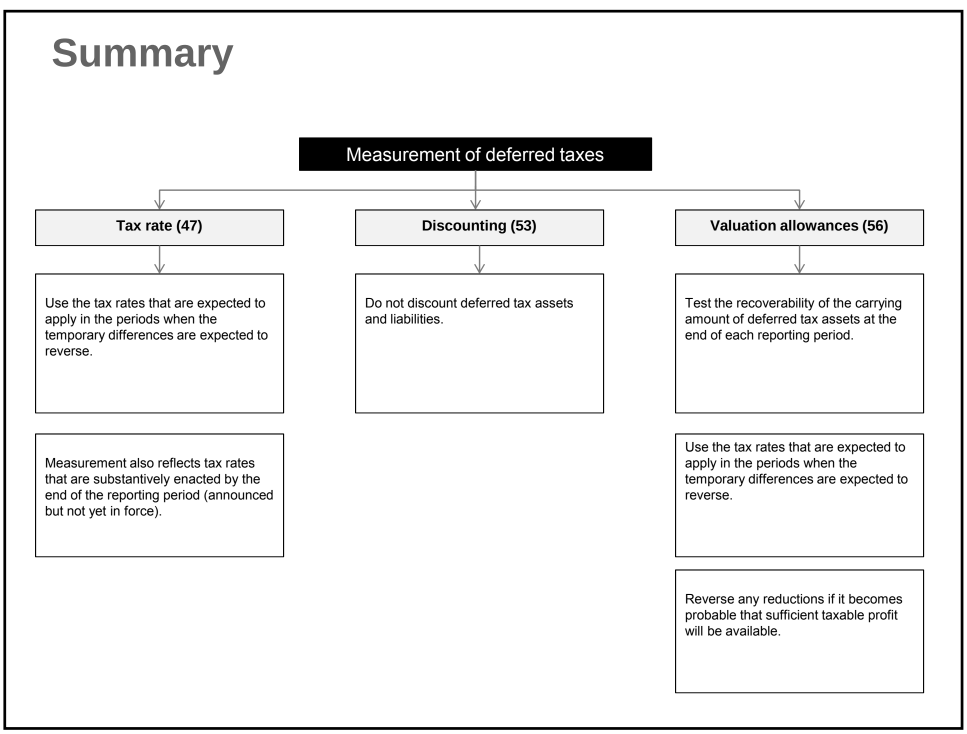
Exercise

LKAS-12 Income Tax Exercise

- Example 2
  from IAS 12 IE

Summary


Summary
Recognition of deferred taxes
Differences between SLFRS carrying amount of assets and liabilities and their tax base
Unused tax loss carry forwards and tax credits (34)
Temporary differences
Permanent differences (15, 24)
Taxable temporary differences (5)
Deducting temporary differences (5)
Principle
Exception
Principle
Exception
Asset SLFRS > tax base
Liability SLFRS < tax base (15)
Initial recognition of goodwill (15 a)
Initial recognition of an asset or a liability in a transaction which is not a business combination (15 b)
Asset SLFRS < tax base
Liability SLFRS > tax base (24)
Initial recognition of an asset or a liability in a transaction which is not a business combination (24 a,b)
Deferred tax liability
No Deferred tax
No Deferred tax
Deferred tax asset if probable that it can be used
No Deferred tax
No Deferred tax
Deferred tax asset if probable that it can be used


Summary
Measurement of deferred taxes
Tax rate (47)
Discounting (53)
Valuation allowances (56)
Use the tax rates that are expected to apply in the periods when the temporary differences are expected to reverse.
Do not discount deferred tax assets and liabilities.
Test the recoverability of the carrying amount of deferred tax assets at the end of each reporting period.
Measurement also reflects tax rates that are substantively enacted by the end of the reporting period (announced but not yet in force).
Use the tax rates that are expected to apply in the periods when the temporary differences are expected to reverse.
Reverse any reductions if it becomes probable that sufficient taxable profit will be available.

- Questions

Thank you.