THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

LKAS 12 - Income Tax

Scope of LKAS 12

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

Tax Expense (Tax Income)

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 carry forward of unused tax losses; and (c) the carry forward of unused tax credits.**

Current Tax

Tax expense/income = Current tax + Deferred tax

Amount of income taxes payable (recoverable) based on the **taxable profit (loss)**

Profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Current Tax Recognition

- Current tax does not create difficulties
  - Reduce profit or loss – tax expense
  - Increase liabilities – current tax

- Tax already paid for the current period reduces the liability in the statement of financial position.

- Recognise a current tax asset if the amount already paid exceeds the amount due and the excess is recoverable

- Adjustments to estimates of prior periods also shown in current tax expense
  - Changes in estimates, not errors

Deferred Tax

Tax expense/income = Current tax + Deferred tax

DTL

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

DTA

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.

Temporary Differences - Assets

Temp Diff = **Carrying amount of Asset** — **Tax base**

Carrying amount of an asset in the statement of financial position

Amount attributed to that asset for tax purposes

PPE/Intangible assets – Cost /Revaluation
Investment Property – Cost/Fair Value
Consumable Biological – Fair Value –Cost to sell
Inventory – Lower of Cost and NRV
Financial Assets – Amortized Cost /Fair Value

Determined based on Inland Revenue Act

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, **tax base of an asset is equal to its carrying amount**, so that no deferred tax arises.

Temporary Differences - Assets

Carrying amount of Asset > Tax base — **Taxable Temporary Difference**

Carrying amount of Asset < Tax base — **Deductible Temporary Difference**

Tax bases of Assets

Asset	Tax Base?
1. Machine that cost Rs 400 Mn has carrying amount of Rs. **360 Mn.** Capital Allowance already claimed Rs 120 Mn – remainder is deductible for tax in future	
2. Interest receivable recognised at carrying amount of Rs 16 Mn. Will be **taxed when received** in cash in next period	
3. Trade receivables carried at Rs 150 Mn – revenue recognised in income statement and **taxed in period just ended**	
4. Loan receivable recorded at carrying amount of Rs 10 Mn. Recovery of loan **will have no future tax consequences**	
5. Dividend receivable from a subsidiary have a carrying amount of Rs 10 Mn. **The dividends are not taxable.**	

Temporary Differences - Liabilities

Temp Diff = **Carrying amount of Liability** — **Tax base**

Carrying amount of liability in the statement of financial position

Amount attributed to that liability for tax purposes

Financial Liabilities – Fair Value/Amortised Cost
Retirement Benefit Obligation – Actuary Valued

Determined based on Inland Revenue Act

Tax base of a liability

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.

If there is no such tax effect, the tax base is the same as the carrying value.

Temporary Differences - Liabilities

Carrying amount of Liability > Tax base — Deductible Temporary Difference

Carrying amount of Liability < Tax base — Taxable Temporary Difference

Tax bases of Liabilities

Liability	Tax Base
1. Current Liabilities include accrued expenses with a carrying value of Rs 50 Mn . The related expense will be deducted for tax purposes on cash basis.	
2. Liabilities include accruals for fines and penalties of Rs 12 Mn that will never be tax deductible	
3. Liabilities include a long-term loan of Rs. 200 Mn. Repayment of the loan will have no tax implications	
4. Liabilities include interest received in advance of Rs 5 Mn. The related interest revenue was taxed on cash basis.	
5. What is the tax base in 4 above, if the revenue will be taxed when recognised in the profit or loss?	

Deferred Tax - Initial Recognition of an Asset/Liability

Temporary differences arising from 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)**

DTAs/DTLs **are not** recognized (either on initial recognition or subsequently)

Recognising Deferred Tax
Initial recognition difference

Example:

An entity intends to use an asset which cost of Rs 1 Mn throughout its useful life of 5 years and then dispose of it for a residual value of nil. The tax rate is 28%. 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 Mn and pay taxes of Rs .28 Mn (1 Mn*28%).
- The entity does not recognise the resulting DT of Rs .28 Mn **because it results from the initial recognition of the asset.**
- In the following year, the carrying value of the asset is Rs. 800,000 (1Mn – 1/5). In earning taxable income of 800,000 ,the entity will pay tax of 224,000 (800,000*28%) .
- The entity does not recognise the DTL of 224,000 because it results from the initial recognition.

Measurement of deferred tax assets and liabilities

Based on how the entity expects, at the reporting date, to recover or settle the carrying amounts of its assets and liabilities (i.e. using the tax rate in force or expected to apply when the asset is realised or the liability settled)

Example

An item of Property, Plant and Equipment has a carrying amount of 100 and a tax base of 60. A tax rate of 20% would apply if the item were sold and a tax rate of 30% would apply to other income.

Measurement of deferred tax assets and liabilities

- Using tax rates (and tax laws) that have been enacted or substantially enacted as at the reporting date

- Discounting is not permitted

Deferred Tax Adjustments – Fair Valuation

- Difference between carrying value of a revalued /fair valued asset and its tax base is a temporary difference. – DTA/DTL should recognize

- Non depreciable asset using revaluation model (Eg: Land) – should reflect the tax consequences of recovering the carrying value <u>through sale.</u>

- Investment property – <u>rebuttable presumption</u> that the carrying amount of the asset will be recovered through sale.

  Presumption is rebutted if the investment property and

  is held in order to consume the assets benefits over the life of the asset.

Recognising Deferred Tax Assets Arising from Unused Losses

Deferred tax assets arising from unused losses.

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 .

- 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?

Possible Effects from New IRD Act on the Deferred Taxes

- Changes to the applicable tax rates
- Changes to the capital allowances for tax purposes
- Assets on finance lease basis – Capital Allowances
- Super Deductible assets
- Introduction of capital gain tax

Possible Effects from New IRD Act on the Deferred Taxes

- Limitation on the period to carry forward tax losses/ Notional Tax Credits
- Repairs and improvement costs
- Income tax effects on long term contracts (Taxable Revenue Vs SLFRS 15)
- Research and Development costs

Disclosures

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.

Disclosures (Cont….)

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; or 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.

Disclosures (Cont.…)

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.)
16. **Dividends:** Any tax consequences of dividends proposed after the balance sheet date but not provided for.

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Thank you.