LKAS 12 – INCOME TAX

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transactions and other events recognised in profit or loss,	• any related tax effects are also recognised in profit or loss.
transactions and other events recognised outside profit or loss (OCI)	• any related tax effects are also recognised outside profit or loss (OCI)

CURRENT TAX

shall be applied

- income taxes include all domestic and foreign taxes which are based on taxable profits.
- Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity.

does not deal with

- the methods of accounting for government grants (see LKAS 20) or investment tax credits.
- ***However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.***

Accounting profit

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

determined in accordance with the SLFRS/LKAS

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).

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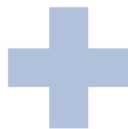
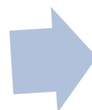
Current tax is the amount of income taxes payable (recoverable) in

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.



Tax expense (tax income)

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CURRENT TAX

- The amount of tax payable or recoverable in respect of the taxable profit or loss for the reporting period
- Estimate of current taxation in a prior reporting period was under- or overprovided
- Recognise adjustment in the current reporting period as part of tax charge for current period

Current tax

Aquaria Limited prepares its financial statements to 31 December each year. The following information is relevant for the year ended 31 December 2012:

- the current tax due is €1,000,000. This figure takes into account proposed new tax rates announced in September 2012 which are expected to be enacted in 20X9. If the old rates are applied, the amount due would be €900,000;
- during 2012, payments on account amounted to €450,000 in respect of 2012 current tax; and
- current tax for 2011 was underestimated by €75,000.

Requirement Calculate the current tax expense which should be shown in Aquaria Limited's SPLOCI – P/L for the year ended 31 December 2012 and the current tax balance which should be included in the statement of financial position as at that date.

Current tax

Solution:

As the new tax rates can be treated as 'substantially enacted', the current tax for 2012 is €1,000,000. In addition, the 2011 underestimate must also be taken into account, resulting in a 20122 tax charge of €1,075,000.

The current tax liability at 31 December 2012 is €550,000 (€1,000,000 – payments on account of €450,000).

DEFERRED TAX

It is likely that the taxable profit will be different from the reported accounting profit because of

permanent differences

and

temporary differences

Permanent differences

- Some income and expenses may not be chargeable/deductable for tax

and,

consequently, there will be a permanent difference (i.e. one that will not reverse in the future) between the accounting and taxable profit

- For example, entertainment expenses

Generally these expenses cannot be claimed as allowable deductions for taxation purposes

Temporary differences

- Permanent differences cause no accounting problems and can be ignored (for accounting purposes),

but temporary differences can distort the reported profit figure

- LKAS 12 assumes each asset and liability has a value for tax purposes (i.e. a ***tax base***)
- Temporary differences are the differences between the carrying amount of an asset or a liability in the entity's 'accounting' and its tax base
- Two types of temporary differences:
  - ***Taxable temporary differences*** give rise to deferred tax liabilities
  - ***Deductible temporary differences*** give rise to deferred tax assets

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 losses
(c) The carry forward of unused tax credits

Taxable temporary differences

- A taxable temporary difference results in the payment of tax when the carrying amount of the asset or liability is settled.
- This means that a deferred tax liability will arise when the carrying amount of the asset is greater than its tax base, or the carrying value of the liability is less than its tax base.
- Examples include:
  - ➢ Interest received in arrears and included in accounting profit on a time basis but taxed on a cash basis
  - ➢ Accelerated depreciation for tax purposes (often because certain assets are subject to special tax treatment at a particular time)
  - ➢ Capitalised development costs which are amortised in the SPLOCI – P/L in future periods but deducted in determining taxable profit in the year in which the expenditure is incurred

Asset revaluation

Aquinas revalues a non-current asset from €1,000 to €1,200. As the tax base of the asset is €1,000, a taxable temporary difference of €200 therefore exists and gives rise to a deferred tax liability.

As Aquinas recovers the benefits embodied in the asset, it will only be able to claim tax deductions of €1,000.

The temporary difference will therefore reverse and Aquinas will have to pay tax on the 'excess' of €200.

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Colombo Wholesale Ltd buys equipment for Rs. 600,000 and depreciates it on a straight line basis over its expected useful life of five years. For tax purposes, the equipment is written off over three years. Tax losses may be carried back against taxable profit of the previous five years. In year 20X0, the entity's taxable profit was Rs. 250,000. The tax rate is 28%.

Required

Assuming Rs. 100,000 profits after depreciation in years 20X1 to 20X5, **record** the current and deferred tax impact in years 20X1 to 20X5 of the acquisition of the equipment.

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Colombo Wholesale Ltd will recover the carrying amount of the equipment by using it to manufacture goods for resale. Therefore, the entity's current tax computation is as follows.

			Year		
	20X1	*20X2*	*20X3*	*20X4*	*20X5*
	Rs	Rs	Rs	Rs	Rs
Taxable income*	220,000	220,000	220,000	220,000	220,000
Depreciation for tax purposes	200,000	200,000	200,000	00	0
Taxable profit	20,000	20,000	20,000	220,000	220,000
Current tax expense at 28%	5,600	5,600	5,600	61,600	61,600

* Ie Rs. 100,000 profit plus (Rs. 600,000 ÷ 5) depreciation add-back.

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The temporary differences associated with the equipment and the resulting deferred tax asset and liability and deferred tax expense and income are as follows.

	Year				
	20X1	*20X2*	*20X3*	*20X4*	*20X5*
	Rs	Rs	Rs	Rs	Rs
Carrying amount	480,000	360,000	240,000	120,000	0
Tax base	400,000	200,000	0	0	0
Taxable temporary difference	80,000	160,000	240,000	120,000	0
Opening deferred tax liability	0	22,400	44,800	67,200	33,600
Deferred tax expense (income): bal fig	22,400	22,400	22,400	(33,600)	(33,600)
Closing deferred tax liability @ 28%	22,400	44,800	67,200	33,600	0

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The entity recognises the deferred tax liability in years 20X1 to 20X4 because the reversal of the taxable temporary difference will create taxable income in subsequent years. The entity's statement of profit or loss is as follows.

	Year				
	20X1	*20X2*	*20X3*	*20X4*	*20X5*
	Rs	Rs	Rs	Rs	Rs
Profit before tax	100,000	100,000	100,000	100,000	100,000
Current tax expense (income)	5,600	5,600	5,600	61,600	61,600
Deferred tax expense (income)	22,400	22,400	22,400	(33,600)	(33,600)
Total tax expense (income)	28,000	28,000	28,000	28,000	28,000
Net profit for the year	72,000	72,000	72,000	72,000	72,000

Deductible temporary differences

- A deductible temporary difference results in amounts being deductible in determining taxable profit or loss in future periods when the carrying value of the asset or liability is recovered or settled.

When the carrying value of the liability is greater than its tax base or the carrying value of the asset is less than its tax base, then a deferred tax asset may arise

- Examples include:
  - When accumulated depreciation in the financial statements is greater than the cumulative capital allowances at the year end
  - when research costs are written off to the SPLOCI – P/L when incurred, but are not allowed as a deduction in determining taxable profit until later
  - when benefit costs are deducted in determining accounting profit as the employee provides the service but are not deducted in determining taxable profit until the entity pays the retirement benefits or makes contributions to the benefit fund

Deductible temporary differences

An entity recognises an accounting liability of €1,000. The tax base of the liability is zero. A deductible temporary difference of €1,000 therefore exists, giving rise to a deferred tax asset.

As the entity settles the liability in future periods, the payments will be deductible for tax purposes. The temporary difference will therefore reverse and the entity will ‘recover’ tax relating to the €1,000 deduction.

Tax base

Tax Base:

- The amount that would be attributed by the taxation authorities to an asset or liability for tax purposes
- The notion is a simple one, but the determination of tax base in any given situation can be complex

Tax base of an asset

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 the entity

when it recovers the carrying amount of the asset. Where those economic benefits are not taxable, the tax base of the asset is the same as its carrying amount.

Tax base – asset

Amach Limited purchased equipment at a cost of €650,000 during the year ended 31 December 2010. For tax purposes, the total amount of capital allowances claimed as at 31 December 2012 amounted to €200,000. Amach Limited expects to claim the remaining amounts in future periods.

Requirement What is the tax base of the equipment at 31 December 2012?

Solution

The tax base of the equipment at 31 December 2012 is €450,000.

Examples…..

(a) A machine cost Rs. 10,000 and has a carrying amount of Rs. 8,000. For tax purposes, depreciation of Rs. 3,000 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.

(b) Interest receivable has a carrying amount of Rs. 1,000. The related interest revenue will be taxed on a cash basis.

(c) Prepaid rental expenses have a carrying amount of Rs. 3,000. Tax relief was given for the rental expenses when paid.

(d) Un-depreciated land that originally cost Rs. 3m has been impaired by Rs. 800,000. The impairment loss is not recognised for tax purposes until the land is sold.

(e) A loan receivable has a carrying amount of Rs. 1m. The repayment of the loan will have no tax consequences.

(a) The tax base of the machine is Rs. 7,000.

(b) The tax base of the interest receivable is nil.

(c) The tax base of the prepayment is nil.

(d) The tax base of the land is Rs. 3m.

(e) The tax base of the loan is Rs. 1m.

Tax base of a liability

The tax base of a liability is its carrying amount less any amount that is deducted for tax purposes in relation to the liability in future periods.

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

Tax base - liability

At 31 December 2012, Isteach Limited had an accrued expense of €100,000 included in current liabilities. The expense is eligible for deduction for tax purposes on a cash basis.

Requirement What is the tax base of the accrued expense at 31 December 2012?

Solution

The tax base of the accrued expense at 31 December 2012 is €nil (being the carrying value of €100,000 less the amount deductible in the future of €100,000.)

Examples…..

(a) Current liabilities include accrued expenses with a carrying amount of Rs. 1,000. The related expense will be deducted for tax purposes on a cash basis.

(b) Current liabilities include interest revenue received in advance, with a carrying amount of Rs. 10,000. The related interest revenue was taxed on a cash basis.

(c) Current liabilities include accrued expenses with a carrying amount of Rs. 2,000. The related expense has already been deducted for tax purposes.

(d) Current liabilities include accrued fines and penalties with a carrying amount of Rs. 100. Fines and penalties are not deductible for tax purposes.

(e) A loan payable has a carrying amount of Rs. 1m. The repayment of the loan will have no tax consequences.

(a) The tax base of the accrued expenses is nil.

(b) The tax base of the interest received in advance is nil.

(c) The tax base of the accrued expenses is Rs. 2,000.

(d) The tax base of the accrued fines and penalties is Rs. 100.

(e) The tax base of the loan is Rs. 1m.

Recognition of deferred tax liabilities

- LKAS 12 requires deferred tax to be provided on temporary differences and, subject to the exceptions noted below, to be recognised in full

- The three exceptions are:
  - Goodwill
  - The initial recognition of an asset/liability other than in a business combination which, at the time of the transaction, does not affect either the accounting or the taxable profit
  - Undistributed profits from investments where the enterprise is able to control the timing of the reversal of the difference and it is probable that the reversal will not occur in the foreseeable future

Recognition of deferred tax assets

- A deferred tax asset is to be recognised for a deductible temporary difference

where it is probable that future taxable amounts will be available to utilise the deductions

- There are some exceptions, for example, where the temporary difference arises from investments in subsidiaries, associates, joint ventures etc and it is probable that the temporary differences will not reverse in the foreseeable future

Recognition of the tax effect in equity

- The general rule is that current and deferred tax should be recognised as income or expense in the SPLOCI – P/L

- However, current and deferred tax should be recognised in equity if the items to which they relate are credited/charged to equity

  e.g. where an asset revaluation was recognised as an adjustment to the asset revaluation reserve

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)
- Using tax rates (and tax laws) that have been enacted or substantially enacted as at the reporting date
- Nominal amounts (i.e. temporary differences multiplied by relevant tax rates)
- Discounting is not permitted

THANK YOU