Accounting for taxes on income under IFRS

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Main topics

- Scope of IAS 12
- Calculating the tax base of assets
- Calculating the tax base of liabilities
- Recognition and measurement criteria
- Presentation & disclosures

Scope of IAS 12

Scope of IAS 12 (cont'd.)

- This Standard shall be applied in accounting for income taxes
- For the purposes of this Standard, 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
- This Standard does not deal with
  - the methods of accounting for government grants

Scope of IAS 12 – interest & penalties

- Interest and penalties levied under Income Tax Act, not deductible in determining taxable income can be treated;
  - As part of the tax charge; or
  - As expense in arriving at profit before tax
- Entities should determine their accounting policy for such items and apply it consistently
- If, however, under some tax legislations, such interest and penalties are tax-deductible, it is generally appropriate to treat them as an expense in arriving at profit before tax

Scope of IAS 12 – Indian tax laws

- Presumptive tax rates (examples tonnage tax, u/s44AD, 44AE, 44AF, etc. of Income tax act, 1961) not within purview of IAS 12 as tax is based on not based on income
- FBT not within the purview of IAS 12

Calculating the tax base of assets and liabilities

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Tax base of an asset

- The amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset
- Key Drivers in determining the tax base:
  - Timing of assessment/deduction for tax
  - Management's intention to recover the asset through either use or sale
  - SIC 21 Recovery of Revalued non-Depreciable Assets
- Tax base of non taxable items = Carrying amount

Tax base of a liability

- The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods
- In case of revenue received in advance, the tax base is its carrying amount less any amount of revenue that will not be taxable in future periods
- Drivers
  - Timing of assessment/deduction for tax

Temporary differences

- *Temporary differences* are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.
- Temporary differences may be either:
  - *taxable temporary differences:* that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
  - *deductible temporary differences* that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled

Tax base/temporary differences – case studies

Case Study 1

Solution for case study 1

Temporary differences – summary

Asset/liability	Carrying amount higher or lower than tax base?	Nature of temporary difference	Resulting deferred tax
Asset	Higher	Taxable	Liability
Asset	Lower	Deductible	Asset
Liability	Higher	Deductible	Asset
Liability	Lower	Taxable	Liability

Recognition and measurement criteria

Recognition and measurement criteria

- Temporary Differences = Difference between carrying amount and its tax base

Temporary difference gives rise to:

Deferred tax asset	**Deferred tax liability**
► Probability test	

General recognition criteria for deductible temporary differences and tax losses

- DTA should be recognised to the extent it is *probable* that taxable profit will be available against which the deductible temporary difference can be utilised
- *Probable* is not defined in IAS 12 but is interpreted as *"more likely than not"*
- Review of carrying amount of a DTA at each reporting date
- Reassessment of unrecognized DTAs at each reporting date
- Discounting prohibited

Recognition of tax effects through the P&L or Equity

- Shall be recognised as income or expense, except to the extent that the tax arises from a:
  - transaction or event which is or was recognised directly in equity; or
  - business combination

Reversal of Tax Effects Through P&L and Equity

- Tax effect follows recognition of initial transaction
- Tax stays in equity until the underlying transaction impacts the P&L (i.e., until sale or derecognition)

Unused tax losses and unused tax credits

- A deferred tax asset shall be recognised for
  - the carry forward of unused tax losses and
  - unused tax credits

  to the extent that
  - it is probable that future taxable profit will be available against which the unused tax losses and
  - unused tax credits can be utilised

Measurement

- Current tax liabilities (assets) for the current and prior periods shall be measured
  - at the amount expected to be paid to (recovered from) the taxation authorities
  - using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period
- Deferred tax assets and liabilities shall be measured
  - at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled
  - based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period

Measurement

- When different tax rates apply to different levels of taxable income measurement will be based on average rates expected to apply in the periods in which the temporary differences are expected to reverse.
- The measurement shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities

Measurement – Recovery of Revalued Non Depreciable Asset (SIC 21)

- SIC-21 clarifies that where a non-depreciable asset is revalued, any deferred tax on the revaluation should be calculated by reference to the tax consequences that would arise if the asset were sold at book value irrespective of the basis on which it is valued, or the manner in which economic benefits of the asset are expected to be realized
- The rationale for this treatment is that, in accounting terms, the asset is never recovered through use, as it is not depreciated.

Measurement – SIC 21 example

- A Company acquired a plot of land at a cost of C1,000,000 on 1 January 20X1 when the tax indexed cost was also C1,000,000.
- Tax rates
  - Income other than capital gains – 30%
  - Capital gains (Proceeds in excess of indexed cost) – 10%
- Price index for calculating indexation allowances increases by 2% and 2.5% in 20X1 and 20X2

Measurement – SIC 21 example (cont'd.)

	NBV	Tax base	TD	DTA(L)
At 01/01/X1	1,000,000	1,000,000	-	-
Charge for the year		20,000	-	-
At 31/12/X1	1,000,000	1,020,000	20,000	2,000
Charge for the year		25,000	-	-
At 31/12/X2	1,000,000	1,045,000	45,000	4,500

- During 20X1 and X2, Land is carried at cost. Tax base is indexed cost hence there is a temporary difference of Rs. 20,000 & 45,000 respectively
- A DTA of Rs 2,000 & Rs. 4,500 will be recognized in these year taking the tax rate @ 10% assuming that the carrying amount of land can be recovered by way of sale
- Normal tax rate of 30% can not be applied as the carrying amount of the land can not be recovered through its use as it is non depreciable

Disclosure

Key disclosure

- Disclose separately the followings
  - the amount (and expiry date, if any) of the following for which no deferred tax asset is recognised in the statement of financial position
    - deductible temporary differences
    - unused tax losses
    - unused tax credits;
  - the aggregate amount of temporary differences associated with the investments in the followings for which deferred tax liabilities have not been recognised
    - investments in subsidiaries
    - Branches
    - Associates
    - interests in joint ventures
  - the amount of income tax consequences of dividends to shareholders that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements

Disclosure (cont'd.)

- an explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:
  - a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s)
  - disclosing also the basis on which the applicable tax rate (s) is (are) computed;

  OR
- a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;

Disclosure (cont'd.) – example

- Example
  - In 2008 an entity has accounting profit of Rs. 3,000m (2007: Rs. 2,500m)
  - The profit comprised Rs. 1,500m (2007: Rs. 2,000m) in its own jurisdiction (country A) and Rs. 1,500m (2007: Rs. 500m) in country B
  - The tax rate is 30% in country A and 20% in country B
  - In country B, expenses of Rs. 200m (2007: Rs. 100m) are not deductible for tax purposes
  - There are no other differences between accounting profit and profit that is subject to current tax, or on which deferred tax has been provided for under IAS 12.
  - Thus the accounting tax charge in the financial statements for each period will be as follows:

	2008	2007
Country A	**Rs. mn**	**Rs. mn**
Rs. 1500/ Rs. 2000 @ 30%	450	600
Country B		
Rs. [1500+200]/ Rs. [500+100] @ 20%	340	120
Total Tax Charge	790	720

Disclosure (cont'd.) – example

- Reconciliation based on A's domestic tax rate
- If the entity presents a tax reconciliation based on its own (i.e. country A's) domestic tax rate, the following presentation would be adopted

	2008	2007
	Rs. mn	Rs. mn
Accounting Profit	3,000	2,500
Tax at domestic rate of 30%	900	750
Effect of :		
Expenses not deductible for tax purposes*	60	30
Overseas tax rates**	(170)	(60)
Tax Expense	790	720

* Rs. 200/ Rs. 100 @ 30%
** B's taxable profit Rs. 1700/ Rs. 600 @ (20%-30%)

Disclosure (cont'd.) – example

- Reconciliation based on each jurisdiction's tax rate
- If the entity presents a tax reconciliation based on each jurisdiction's domestic tax rate, the following presentation would be adopted

	2008	2007
	Rs. Mn	Rs. Mn
Accounting Profit	3,000	2,500
Tax at domestic rate applicable to individual group entity*	750	700
Effect of :		
Expenses not deductible for tax purposes**	40	20
Tax Expense	790	720

* 2005: A = Rs. 450 [Rs. 1500 @ 30%, B = Rs. 300 [Rs. 1500 @ 20%], total Rs. 750
2004: A = Rs. 600 [Rs. 2000 @ 30%, B = Rs. 100 [Rs. 500 @ 20%], total Rs. 700
** Rs. 200/ Rs. 100 @ 20%

Case Study

Case Study 1

Case Study_Solution

Thank you

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