

Tutorial Letter 102/2/2015

Distinctive Financial Reporting

FAC3702

Semester 2

Department of Financial Accounting

This tutorial letter contains additional study material.

IMPORTANT INFORMATION:

Please activate your myUnisa and myLife e-mail addresses and ensure you have regular access to the myUnisa module site, FAC3702, as well as to your group site.

Note: This is an online module, and therefore your module is available on myUnisa. However, in order to support you in your learning process, you will also receive some study material in printed format.

CONTENTS

1	INTRODUCTION	3
2	LECTURERS AND CONTACT DETAILS.....	3
3	CAPITAL ALLOWANCES FOR TAX PURPOSES.....	4
4	IAS 12 – INCOME TAXES (DEFERRED TAX FOCUS FOR FAC3702)	8

1 INTRODUCTION

Dear Student

We assume that you are already familiar with the study material included in this tutorial letter. This tutorial letter includes information regarding capital allowances in respect of capital assets which are used in the production of income as well as deferred tax. This information will prove to be very useful to you with regards to understanding the income tax implications that are discussed in the FAC3702 syllabus.

2 LECTURERS AND CONTACT DETAILS

Please use only the following **e-mail address** for all communication with your lecturers:



FAC3702-15-S2@unisa.ac.za

Please use the following **telephone number** for all communication with your lecturers:



012 429 4268



Lecturer

Mrs M Evans
Mrs M Els
Mrs FF Jaffer
Mr DO Khumalo

Office

AJH van der Walt Building, 02-55
AJH van der Walt Building, 02-58
AJH van der Walt Building, 02-43
AJH van der Walt Building, 02-06

3 CAPITAL ALLOWANCES FOR TAX PURPOSES

3.1 INTRODUCTION

In terms of the general deduction formula, **expenditure of a capital nature is not deductible**. However, the Income Tax Act specifically allows deductions in respect of specific capital assets that **a taxpayer uses in the production of income**. This deduction is commonly referred to as a capital allowance for tax purposes (in accounting we call it depreciation). A capital allowance involves writing off the cost of the relevant capital asset over a period of time. The South African Revenue Service (SARS) or the Income Tax Act determines the period over which an asset can be written off. These periods are listed in Binding General Ruling: No 7 (BGR 7). We will give you the write-off periods in a question and **will not** expect you to know the write-off periods.

For taxation purposes, we refer to and calculate **capital allowances** or **tax allowances**. For accounting purposes, you will refer to and calculate **depreciation**.



We calculate depreciation in accordance with accounting principles, but capital allowances in accordance with the Income Tax Act. As a result, these calculations differ. Therefore, accounting depreciation is not an allowable deduction for income tax purposes. The difference in the calculation will result in a difference between accounting profit and taxable income.

We will discuss capital allowances as well as the tax implications when a depreciable asset (an asset on which a capital allowance has previously been granted) is destroyed or disposed of, in which case a possible recoupment or a section 11(o) scrapping allowance must be brought into account when calculating the taxable income of the taxpayer.

3.2 BACKGROUND

The Income Tax Act provides for capital allowances in respect of capital assets that are used in the business of the taxpayer. Section 11(e) of the Income Tax Act provides for tax allowances in respect of movable assets in general. There are also special capital allowances for assets used in the manufacturing process, which include both manufacturing assets (sections 12C and 12E) and manufacturing buildings (section 13). These special capital allowances are often referred to as accelerated allowances because they are more favourable for the taxpayer than the general capital allowances under section 11(e) and are aimed at advancing the manufacturing sector, which creates job opportunities.

We will further consider the implications of selling or disposing of an asset.

As you know, the purchase price of an asset is not deductible for income tax purposes. Instead, the cost is spread over the estimated life of the asset and deducted as a capital allowance.

3.3 REPAIRS AND IMPROVEMENTS

Part of the cost of holding an asset is keeping it in good working order. Capital assets include the cost of improvements to the capital asset, but exclude the cost of repairs to restore the asset to its original state.

Repairs mainly constitute damage or deterioration to capital assets, and the intention of the taxpayer is to restore the assets to its original condition, whereas an improvement is the creation of a better asset.

Capital allowances depend on the type of asset, the purpose for which and the type of enterprise in which it is used.

3.4 CAPITAL ALLOWANCES – MOVABLE ASSETS

3.4.1 Special capital allowance – section 12C

Section 12C provides for special tax allowances on new or used plant and machinery that a tax payer uses directly in the process of manufacturing or in a similar process and that the taxpayer has **brought into use in his trade for the first time**.

However, a process must meet certain criteria before it may qualify as a process for income tax purposes. The purpose of these favourable allowances is to stimulate the manufacturing sector in order to create job opportunities in our country. Please note that we **add** any moving or installation cost relating to manufacturing machines to the cost of the machine. If a taxpayer incurs moving costs on an asset that is still being written off, such costs will be written off over the remainder of the write-off period. If the asset has been fully written off, the moving costs incurred will be fully deductible during the year they have been incurred.

The write-off period can be either four or five years, depending on the nature of the manufacturing asset acquired. The following table sets out the specifications:

DESCRIPTION	FOUR YEARS	FIVE YEARS
Nature of machinery	New or unused	Used
Brought into use for the first time	On/After 1 March 2002	Any date
Write-off	40%, 20%, 20%, 20%	20% per annum
Apportionment	None	None



Always remember that a section 12C allowance can **never** be apportioned.

3.4.2 General tax allowance – section 11(e)

All movable assets other than those that qualify for section 12C or 12E allowances (as mentioned above) can still qualify for a tax allowance in terms of the general tax provisions contained in section 11(e). BGR 7 forms the basis of the application for section 11(e) allowances, and also contains the acceptable write-off periods for a wide range of capital assets in years.

The allowance is **apportioned** for the period that the asset has been in use during the year of assessment – thus it is only allowed as a deduction for the number of months that the asset was used during the year of assessment.

Please note that, if the taxpayer was registered for VAT purposes and entitled to claim an input tax credit on the purchase price of the qualifying asset, such VAT should be **excluded** from the cost of that asset. Also, note that tax allowances apply to movable assets and do not apply to structures and works of a permanent nature, such as buildings.

SUMMARY

	Section 12C	Section 11(e)
Which taxpayers can make use of this section?	Manufacturers or similar processes	Any taxpayer
To which assets can each of these sections be applied?	Assets used in a process of manufacture or a similar process	Assets not used in a process of manufacture or a similar process
At what rate is the allowance applied?	New: 40%/20%/20%/20% Used: 20% per annum for five years	Various rates as determined by BGR 7
Apportioned?	No	Yes

3.4.3 Building allowances

In addition to the plant, machinery and equipment (movable assets) that the taxpayer uses directly in a manufacturing process, the buildings used in a manufacturing process can also qualify for a capital allowance. Furthermore, buildings (commercial or residential) in predetermined urban areas may qualify for specific allowances in certain circumstances. There is also an allowance for commercial buildings. These provisions are set out in section 13 of the Income Tax Act.

3.4.3.1 Buildings used in a manufacturing process – section 13(1)

The cost to a taxpayer (excluding the cost of the land, but including capitalised finance costs) of erecting or purchasing a manufacturing building may qualify for an annual allowance of 5% provided it was erected on or after 1 October 1999 and is used "wholly or mainly" (more than 50%) for a manufacturing process.

You can also claim this allowance for improvements that the taxpayer has made to the existing manufacturing building.

Note that the allowance is **not apportioned** when the taxpayer uses the asset for part of the tax year only or has brought it into use during the tax year.



3.4.3.2 Commercial buildings – section 13quin

Section 13quin was introduced on 1 April 2007 and only applies to **new or unused** commercial buildings owned by the taxpayer, or improvements to existing buildings contracted for on or after 1 April 2007 where construction only commenced on or after that date. The section does not apply to residential buildings or commercial buildings erected before 1 April 2007.

The allowance is 5% per annum on the straight-line method, based on the cost of the building or improvements. Where the building is brought into use during the tax year, the allowance is **not apportioned**. During the year of assessment, the taxpayer should use the building wholly or mainly for the purposes of producing income in the course of the taxpayer's **trade**.

Please note that should a taxpayer acquire part of a building on or after 1 October 2008 without erecting or constructing it, the cost must be adjusted as follows:

- 55% of the acquisition cost price if only a part is acquired
- 30% of the cost of improvement, if an improvement is made

Note that the allowance is **not apportioned** when the asset is used for part of the tax year only or brought into use during the tax year.



The section clearly states that SARS will allow no deduction if the taxpayer can claim another deduction. Thus, you can only claim this allowance if the taxpayer owns the building and the building is **new** or **unused**.

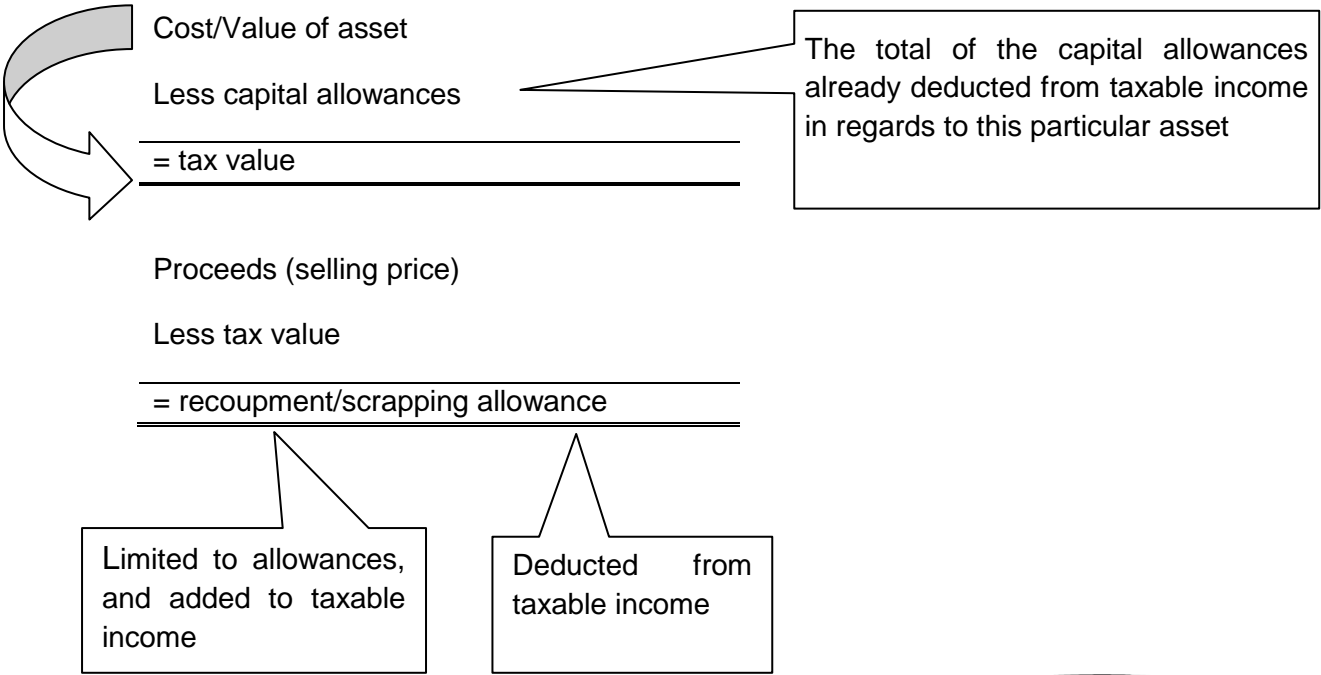
3.5 Disposal of assets that were subject to an allowance

During the course of business, a taxpayer may decide to sell or stop using an asset on which a capital allowance was previously claimed. Such assets could also have been damaged beyond repair. These events have tax implications, as they could result in a recoupment or a section 11(o) scrapping allowance. A recoupment is the recovery of the allowances previously claimed. Note that a taxable capital gain may arise should a taxpayer sell an asset for an amount that exceeds the original cost. The taxable capital gain is calculated in accordance with the provisions of the eighth schedule to the Income Tax Act.

3.5.1 Scrapping allowance – section 11(o)

A scrapping allowance applies when the cost of an asset exceeds the sum of the tax allowances or deductions in respect of that asset and the proceeds on disposal. This means that the taxpayer made a loss. We refer to the cost of the asset less the sum of the capital allowances as the **tax value of the asset**. Thus, if the proceeds (selling price of the asset) are less than the tax value of the asset, the net result is a loss and the taxpayer may claim the loss as a scrapping allowance, provided that the asset was subject to a section 11(e), 12C or 12E allowance.

When a taxpayer disposes of an asset, you will need to consider the capital allowances that have been deducted each year. We do this by calculating a tax value (see the diagram below).



3.5.2 Recoupments – section 8(4)(a)

If a taxpayer sells an asset for an amount exceeding the tax value (original cost price less allowances), the net result represents a recoupment of the taxable allowances previously claimed. You should include the recoupment (limited to allowances previously claimed) in the taxable income.

4 IAS 12 – INCOME TAXES (DEFERRED TAX FOCUS FOR FAC3702)

IAS 12 – *Income taxes*, prescribes the accounting treatment of both current and deferred tax. The income tax expense in the statement of profit or loss and other comprehensive income includes **both** current and deferred tax.

We calculate current tax on the taxable income of an entity according to the rules of the Income Tax Act. Therefore, the amount of current tax payable by an entity is often not proportionate to the entity's profit for the period in the statement of profit or loss and other comprehensive income. The following are examples of these:

- The carrying amount of assets or liabilities in the entity's statement of financial position differs from the tax base thereof.
- Income and expenses are recognised for accounting and tax purposes in different periods. These differences are temporary differences and we use them as a basis to calculate deferred tax.
- Income and expenses are not taxable or deductible for tax purposes. These differences are known as exempt differences, and we will discuss them in detail in section 4.3.

4.1 DEFINITIONS

- (a) **Deferred tax liability** is the amount of income taxes provided for in the statement of financial position (SFP) that is payable in respect of taxable temporary differences in future periods.
- (b) **Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of the following:
- deductible temporary differences
 - unused tax losses carried forward
 - unused tax credits carried forward
- (c) The following definitions will help you in determining the tax base of an item:

The **tax base** (TB) of an asset or liability is the amount attributable to that asset or liability for tax purposes.

The **tax base of an asset** is the amount that will be deductible for tax purposes in future against any **taxable** economic benefits that will flow to the entity when it recovers or settles the carrying amount of the asset.



LECTURER'S COMMENT

Work through examples 8.3 to 8.7 in *Descriptive Accounting* for calculating the tax base of assets.

The **tax base of a liability** is the **carrying amount** of the liability less any amount that will be deductible for tax purposes in respect of that liability in future.

The **tax base of the liability – revenue received in advance** – is its **carrying amount** less any amount of revenue that will **not** be taxable in future.



LECTURER'S COMMENT

Work through examples 8.8 to 8.11 in *Descriptive Accounting* for calculating the tax base of liabilities.

- (d) **Temporary differences** are differences between the tax base of an asset or liability and the carrying amount of the asset or liability in the statement of financial position. The tax base represents the amount at which the asset and liability would be included in the statement of financial position for tax purposes (calculated based on the application of tax rules), while the carrying amount is the amount for accounting purposes at which the asset and liability is accounted for in the statement of financial position (using accounting rules).
- (e) Temporary differences may be either of the following:
- (a) **Taxable temporary differences** are temporary differences that will result in taxable amounts when determining the taxable profit/(tax loss) for future periods when the carrying amount of the asset or liability is recovered or settled. This will happen when:

**Rule 1: Carrying amount of the asset > tax base of the asset
= DEFERRED TAX LIABILITY (SFP)**

AND

**Rule 2: Carrying amount of the liability < tax base of the liability
= DEFERRED TAX LIABILITY (SFP)**

If the **carrying amount of the asset is greater than the tax base of the asset (rule 1)**, it will result in taxable profit in the future, because the amount that is deductible for tax purposes in the future is smaller than the amount that is deductible for accounting purposes. In the future, the taxable profit will be greater than the accounting profit.

Therefore, we make provision in the current year for the tax payable in future by debiting deferred tax in the statement of profit or loss and other comprehensive income and crediting a deferred tax liability in the statement of financial position.

Journal entry:

	Dr	Cr
	R	R
Deferred tax expense (P/L)	xxx	
Deferred tax liability (SFP)		xxx
<i>Provision for deferred tax expense</i>		

If the **carrying amount of the liability is less than the tax base of the liability (rule 2)**, it will result in taxable profit in the future. The taxable profit will be greater than the accounting profit in the future, and we therefore provide deferred tax in the current year for the tax payable in the future.

We make provision in the current year for tax payable in the future by debiting the deferred tax in the statement of profit or loss and other comprehensive income and crediting a deferred tax liability in the statement of financial position.

Journal entry:	Dr	Cr
	R	R
Deferred tax expense (P/L)	xxx	
Deferred tax liability (SFP)		xxx
<i>Provision for deferred tax expense</i>		

- (b) **Deductible temporary differences** are 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. This will happen when:

<p>Rule 3: Carrying amount of the asset < tax base of the asset = DEFERRED TAX ASSET (SFP)</p> <p>AND</p> <p>Rule 4: Carrying amount of the liability > tax base of the liability = DEFERRED TAX ASSET (SFP)</p>

If the carrying amount of the asset is less than the tax base of the asset (rule 3), it will result in deductions in determining taxable profit of future periods when the carrying amount of the asset is recovered. This will result in taxable profit being less than the accounting profit in the future.

To match the future lower tax expense with the accounting profit, we have to debit a further tax expense in the statement of profit or loss and other comprehensive income in the form of a deferred tax charge. To achieve this, we must create a deferred tax asset in the current year by crediting the statement of profit or loss and other comprehensive income and debiting the deferred tax asset in the statement of financial position (provided that it is probable that taxable profit against which the deductible temporary differences can be utilised will be available in future). In the future, the debit to deferred tax asset in the statement of financial position will be reversed as a debit to the statement of profit or loss and other comprehensive income.

Journal entry:	Dr	Cr
	R	R
Deferred tax asset (SFP)	xxx	
Deferred tax expense (P/L)		xxx
<i>Provision for deferred tax</i>		

If the carrying amount of the liability is greater than the tax base of that liability (rule 4), it will result in deductions in determining the taxable profit of future periods when the carrying amount of the liability is settled. The tax charge in the future will therefore not match: it will be too low compared to the accounting profit. To match the future tax expense with the accounting profit, the tax expense in the statement of profit or loss and other comprehensive income will have to be debited in the form of a deferred tax charge.

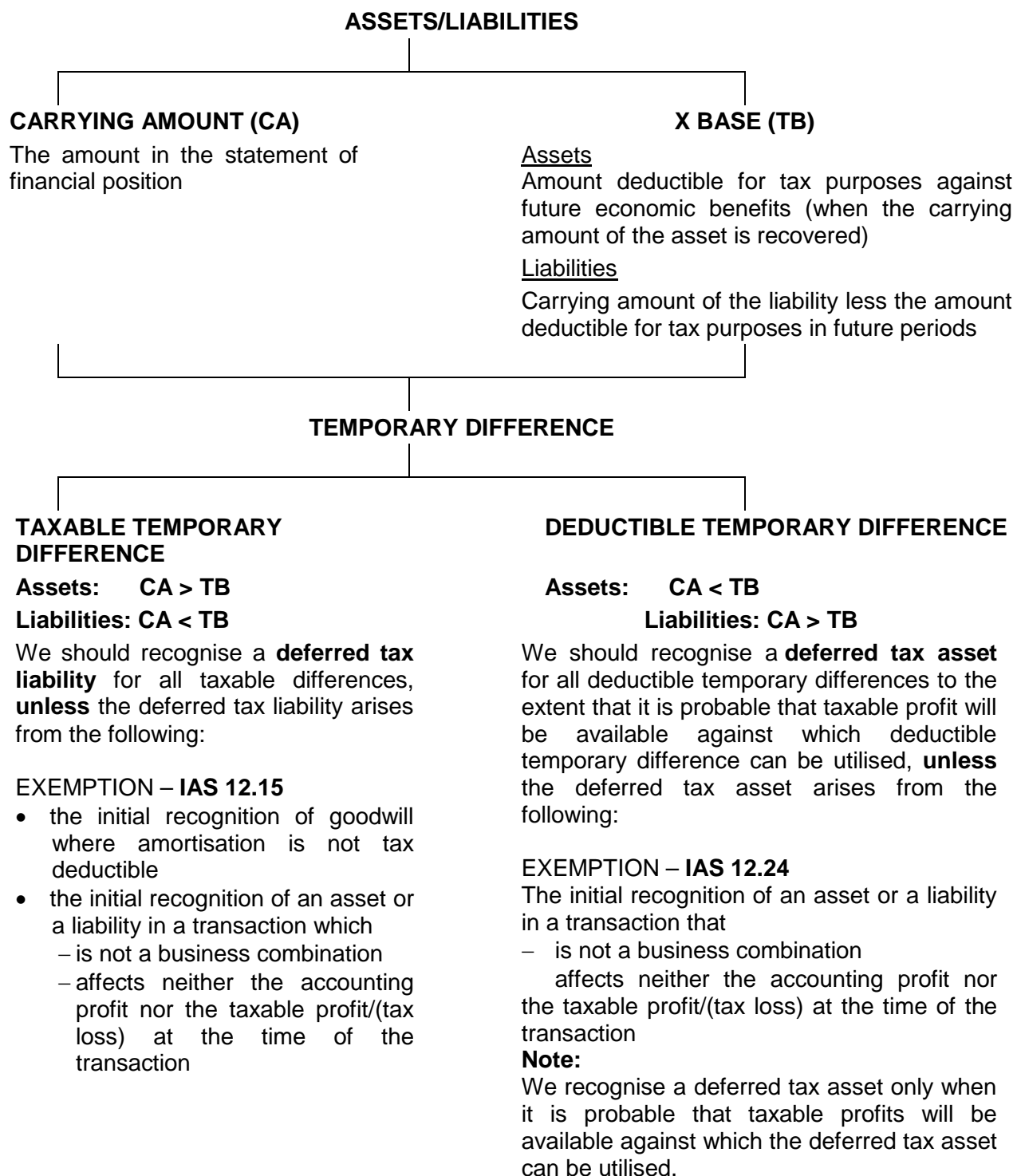
In order to accomplish this in the future, we will have to create a deferred tax asset in the current year (provided that taxable profit will be available in the future against which we can utilise the deductible temporary differences) by crediting the statement of profit or loss and other

comprehensive income and debiting the deferred tax asset in the statement of financial position. In the future, the debit to deferred tax asset in the statement of financial position will be reversed as a debit to the statement of profit or loss and other comprehensive income.

Journal entry:

	Dr	Cr
	R	R
Deferred tax asset (SFP)	xxx	
Deferred tax expense (P/L)		xxx
<i>Provision for deferred tax</i>		

SCHEMATIC SUMMARY OF TEMPORARY DIFFERENCES



* CA – carrying amount
TB – tax base

4.2 OBJECTIVES

IAS 12 requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events that we recognise in the statement of profit or loss and other comprehensive income, we must also recognise any related tax effects in the statement of profit or loss and other comprehensive income, except for transactions and other events recognised directly in equity. We must also recognise the tax effect relating to those transactions directly in equity.

IAS 12 refers to the statement of financial position approach. This method requires that we measure deferred tax on the difference between

- the carrying amount of the entity's assets and liabilities
- the tax base of each of the entity's assets and liabilities

4.3 EXEMPT DIFFERENCES

We should recognise a deferred tax liability for all taxable temporary differences, **unless** the deferred tax liability arises from the following:

- (a) goodwill, for which amortisation is not deductible for tax purposes
- (b) the initial recognition of an asset or liability in a transaction which
 - (i) is not a business combination*
 - (ii) affects neither the accounting profit nor the taxable profit (tax loss) at the time of the transaction

* Business combinations do not form part of this module.

We treat these differences as exempt differences and do not provide any deferred tax expenses on them.

Therefore, we will treat the initial recognition of an asset or a liability as an exempt difference if that item does not affect the tax computation, meaning that the specific asset or liability is never taxable or deductible for tax purposes.

Exempt differences are items that are **neither taxable nor tax deductible**, and therefore no tax is provided on them. The exempt differences are reconciling items if the total of the current and deferred tax expenses in the statement of profit or loss and other comprehensive income do not amount to 28% of the profit before tax.

The following are examples of exempt differences:

- exempt income (income that will never be taxed), namely
 - dividends received
 - the portion of capital profits on the sale of assets that is not taxable
- non tax deductible expenses (expenses that will never be allowed as a deduction), namely
 - fines
 - donations

4.4 EXAMPLES OF TAXABLE TEMPORARY DIFFERENCES AND THE TREATMENT THEREOF ACCORDING TO THE STATEMENT OF FINANCIAL POSITION APPROACH

Rule 1: Carrying amount of asset > tax base of asset = DEFERRED TAX LIABILITY (SFP)

Where the carrying amount of the asset is greater than the tax base of the asset because of taxable temporary differences, taxable profit arises in future periods. In the current year, we will debit the deferred tax expense in the statement of profit or loss and other comprehensive income and credit a deferred tax liability in the statement of financial position to provide for the tax payable in future.

4.4.1 Capital allowances

IAS 16 governs property, plant and equipment and requires assets to be depreciated at a rate based on expected useful life. However, tax legislation requires that we depreciate assets based on the standard rates of depreciation set out in the legislation, irrespective of the actual expected rate of usage by the entity. The depreciation calculated by the tax authorities is often referred to as a capital allowance or a tax allowance.

If the depreciation rate and the tax allowance rate (capital allowances) on the same asset differ, it will result in a different carrying amount and tax base for that asset. The difference between the carrying amount and the tax base of the asset leads to taxable or deductible temporary differences.

In turn, this may result in a different profit or loss on sale of the asset in the statement of profit or loss and other comprehensive income from that calculated in accordance with the tax legislation.

In tax legislation, we generally refer to a profit on sale as a recoupment, whereas we often refer to a loss on sale as a scrapping allowance (generally granted as a deduction if certain criteria are met).

Accounting purposes

The **carrying amount** of a non-current asset is calculated as follows:

	R
Original cost	xxx
Less accumulated depreciation	(xxx)
Carrying amount	<u>xxx</u>

The **profit or loss on sale** of a non-current asset (capital and non-capital portions) is calculated as follows:

	R
Proceeds on sale	xxx
Less carrying amount	(xxx)
Profit/(loss) on sale	<u>xxx</u>

The **non-capital profit** included in the profit on sale of a non-current asset is calculated as follows:

	R
Proceeds on sale, limited to original cost	xxx
Less carrying amount	(xxx)
Non-capital profit/(loss)	<u>xxx</u>

Tax purposes

The **tax base** is calculated as follows:

	R
Original cost	xxx
Less accumulated capital allowances (tax allowances)	(xxx)
Tax base	<u>xxx</u>

The taxable **recoupment (or scrapping allowance)** is calculated as follows:

	R
Proceeds on sale, limited to original cost	xxx
Less tax base	(xxx)
Recoupment/(scrapping allowance)	<u>xxx</u>

EXAMPLE 1

A company purchased a manufacturing plant on 1 January 20.12 at a cost of R120 000. The depreciation amounted to R24 000 and the tax allowance to R40 000 for the year. The company has been incorporated in the current year and has profit before tax of R100 000 for the year ended 31 December 20.12. The tax rate is 28%.

Deferred tax is provided for on all temporary differences using the statement of financial position approach.

**REQUIRED**

Calculate the deferred tax expense for the year ended 31 December 20.12.

SOLUTION 1**Deferred tax on plant:**

	Carrying Amount R	Tax base R	Temporary difference R
Cost	120 000	120 000	-
Depreciation/Tax allowance	(24 000)	(40 000)	16 000
Carrying amount/Tax base	<u>96 000</u>	<u>80 000</u>	<u>16 000</u>

The carrying amount of the asset is greater than its tax base, and therefore the recovery of the carrying amount will result in a taxable profit in the future. The taxable temporary difference is R16 000, and the deferred tax liability at 28% is R4 480 (R16 000 x 28%).

Journal entry:

	Dr	Cr
	R	R
Deferred tax expense (P/L)	4 480	
Deferred tax liability (SFP)		4 480
<i>Provision made for deferred tax expense</i>		



LECTURER'S COMMENT

IAS 12 follows the statement of financial position approach for calculating deferred tax. This approach entails the following:

- Calculate the carrying amounts of all assets and liabilities evident from the information available.
- Determine the relevant tax base for each asset and liability identified.
- Then calculate the temporary differences and take into account the carrying amount and tax base of each asset and liability.
- Determine whether each temporary difference results in a deferred tax asset or liability.
- Then multiply each temporary difference with the tax rate.
- Calculate the net deferred tax liability or asset for the current year.
- Calculate the deferred tax movement in the statement of profit or loss and other comprehensive income as the difference between the opening and closing balance of the deferred tax liability or asset.

EXAMPLE 2

On 1 January 20.12, A Ltd was incorporated and acquired a manufacturing building at a cost of R2 000 000, an administration building at a cost of R500 000 and land at a cost of R300 000 for its own use. Land is not depreciated, and no tax allowance is claimable. The manufacturing building is depreciated at 4% per year using the straight-line method, and SARS allows a 5% annual allowance on the manufacturing building. The administration building is depreciated over 20 years, but no tax allowance is claimable.

The company's year-end is 31 December 20.12. Assume that the profit before tax is R200 000 for the year ended 31 December 20.12 and that the tax rate is 28%.

Deferred tax is provided for on all temporary differences according to the statement of financial position approach.



REQUIRED

Calculate the deferred tax expense for the year ended 31 December 20.12.

SOLUTION 2

Following the statement of financial position approach, the following are the balances for accounting and tax purposes:

	Carrying amount R	Tax base R	Temporary difference R
Manufacturing building			
Cost	2 000 000	2 000 000	-
Depreciation/Tax allowance (2 000 000 x 4%); (2 000 000 x 5%)	(80 000)	(100 000)	20 000
Carrying amount/Tax base	<u>1 920 000</u>	<u>1 900 000</u>	<u>20 000</u>

The carrying amount is greater than the tax base, and therefore the recovery of the carrying amount will result in a taxable profit in the future. The taxable temporary difference resulted in a deferred tax liability of R5 600 (R20 000 x 28%).

Journal entry:


	Dr R	Cr R
Deferred tax expense (P/L)	5 600	
Deferred tax liability (SFP)		5 600
<i>Provision for deferred tax expense</i>		

	Carrying amount R	Tax base R	Temporary difference R
Land			
Cost	300 000	–	300 000
Depreciation/Tax allowance	–	–	–
Carrying amount/Tax base	<u>300 000</u>	<u>–</u>	<u>300 000</u>

The temporary difference on the land is exempt in terms of **paragraph 15 of IAS 12** as it arises from the initial recognition of an asset in a transaction that affects neither accounting nor taxable profit or loss at the time of the transaction. When we recognise the land for the first time, a temporary difference arises immediately, as the carrying amount of the land amounts to R300 000, while the tax base (future tax deductions) amounts to Rnil. However, the acquisition of the land does not affect accounting profit (debit Land; credit Bank) and there is also no immediate tax deduction that will affect taxable income. Therefore, the exemption in terms of **paragraph 15(b) of IAS 12** applies.

	Carrying amount R	Tax base R	Temporary difference R
Administration building			
Cost	500 000	–	500 000
Depreciation/Tax allowance	(25 000)	–	(25 000)
Carrying amount/Tax base	<u>475 000</u>	<u>–</u>	<u>475 000</u>

The temporary difference on the administration building is exempt in terms of **paragraph 15 of IAS 12** as it arises from the initial recognition of an asset in a transaction that affects neither accounting nor taxable profit or loss at the time of the transaction.

	<p>LECTURER'S COMMENT</p> <p>Work through example 8.13 in <i>Descriptive Accounting</i>, which illustrates the exemption from recognising a deferred tax liability.</p>
---	--

4.5 RECOGNITION OF DEFERRED TAX ASSETS

IAS 12 states that a deferred tax asset should be recognised to the extent that it is probable that taxable profit will be available in the future against which the deductible temporary differences can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction which

- (i) is not a business combination*
- (ii) affects neither accounting profit nor taxable profit/(loss) at the time of the transaction.

* Business combinations do not form part of this module.

**Rule 3: Carrying amount of asset < tax base of asset
= DEFERRED TAX ASSET (SFP)**

**Rule 4: Carrying amount of liability > tax base of liability
= DEFERRED TAX ASSET (SFP)**

This results in deductible temporary differences leading to amounts that are deductible in determining the taxable profit of future periods. In the current year, we have to credit deferred tax income in the statement of profit or loss and other comprehensive income and debit a deferred tax asset in the statement of financial position.

It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through the outflow of resources from the company. When resources flow from the enterprise, part or all of their amounts may be deductible in determining taxable profit in a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in future periods when that part of the liability is allowed as a deduction in determining taxable profit.

4.6 MEASUREMENT

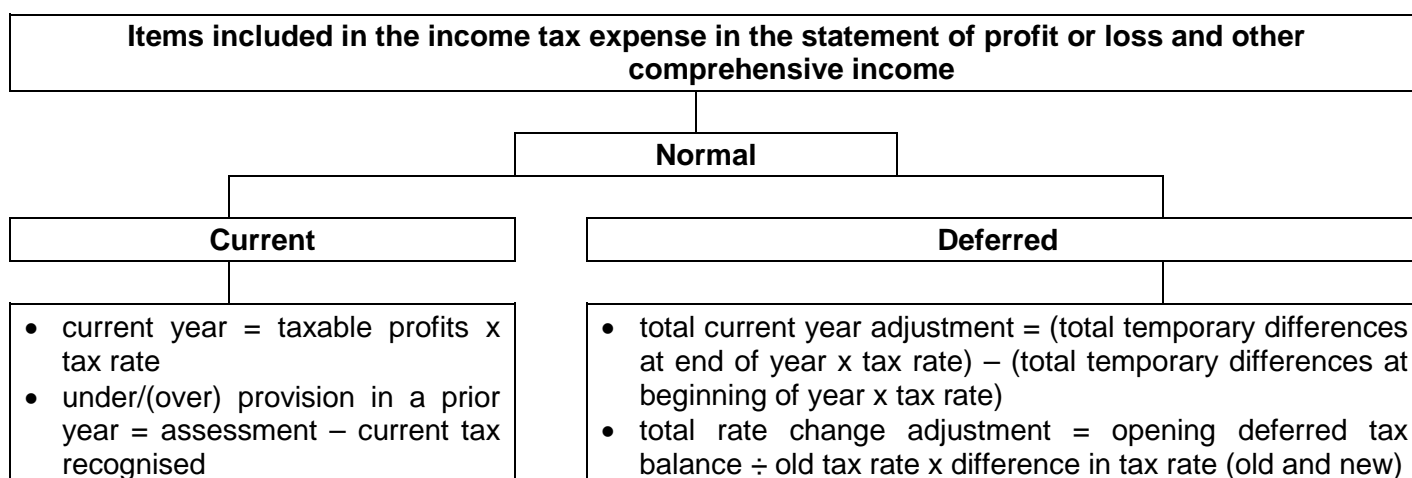
Current tax expenses, deferred tax assets and deferred tax liabilities are measured using the enacted tax rates. If there had been a change in the tax rate during the year, we should adjust the opening balance of the deferred tax asset and deferred tax liability in the statement of financial position with the applicable new tax rate.

The carrying amount of deferred tax assets and deferred tax liabilities may change even though there is no change in the amount of the related temporary differences.

This can result from the following:

- a change in tax rates or tax laws
- a re-assessment of the recoverability of deferred tax assets
- a change in the expected manner of recovery of an asset

4.7 SUMMARY OF THE INCOME TAX EXPENSE IN THE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME



© Unisa 2015

FAC3702_2015_TL_102_2_E.doc