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IAS 12 (Advanced)

Accounting for Income Taxes (Advanced)

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IAS 12 (Advanced)

i) Capital Assets – Deferred Tax Consequences

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IAS 12: Accounting for Income Taxes (Advanced)

CAPITAL ASSETS: DEFERRED TAX CONSEQUENCES

THEORY AND UNDERLYING CALCULATIONS

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Introduction

- This section will cover some theory, but will mainly focus on two case studies illustrating principles and issues relating to deferred tax on capital assets.

- The goal is an improved understanding of the deferred tax consequences of capital assets.

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Theory

- IAS 12 par 51:
  - The measurement of deferred tax liabilities and deferred tax assets 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.

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Theory

- Measurement of deferred tax assets and liabilities is based on the expected manner of recovery or settlement of the underlying asset or liability:
  - through either **USE** or through **SALE**.
- The 2010 amendment to IAS 12 (December 2010) provides an exception to this measurement principle in respect of investment property measured using the fair value model in accordance with IAS 40 Investment Property:
  - rebuttable presumption that underlying asset will be recovered through **SALE**.

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Current tax calc: template

	CU
Profit before tax	**XX**
Accounting profit above cost	
Fair value gain (P/L) [Accounting]	(X)
Profit on sale (P/L) [Accounting]	(X)
Movements in temporary differences: normal rates	**X/(X)**
Depreciation [Accounting]	X
Capital allowances [SARS]	(X)
Profit on sale up to cost [Accounting]	(X)
Recoupment [SARS]	X
Taxable capital gain *(from CGT calculation)*	X/0
Taxable income	**XX**

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CGT calculation: template

	CU
Accounting profit above cost *(from current tax calc)*	**XX**
Permanent difference:	(X)/0
Base cost	(X)
Historical cost	X
Movements in temporary differences: CGT rates	**X/(X)**
Accounting	(X)
Taxation (SARS)	X
Capital gain	**XX**
X CGT inclusion rate	**66.6%**
Taxable capital gain *(include in current tax calculation if a gain)*	**X**

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Deferred tax balance: use

	Carrying Amount	Tax Base	Temp. Diff.		Deferred Tax	
Land	**XX**	**-**	**X**		**X / -**	**L**
Cost	X	-	Exempt	N/A	-	-
Up to base cost	X	-	X	0%	-	-
Fair value above base cost	X	-	X	18.6%	X	L
Buildings (depreciable assets)	**XX**	**X**	**X**	28%	**X**	**L/A**
Deferred tax balance F/P					**X**	**L/A**

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Deferred tax balance: sale

	Carrying Amount	Tax Base	Temp. Diff.		Deferred Tax	
Land	**XX**	**-**	**X**		**X / -**	L
Cost	X	-	Exempt	N/A	-	-
Up to base cost	X	-	X	0%	-	-
Fair value above base cost	X	-	X	18.6%	X	L
Buildings (depreciable assets)	**XX**	**X**	**X**		**X**	**L/A**
Depreciated historic cost CA	X	X	X/(X)	28%	X	L/A
Up to historical cost	X	-	X	28%	X	L
Historical cost to base cost	X	-	X	0%	-	-
Fair value above base cost	X	-	X	18.6%	X	L
Deferred tax balance F/P					**X**	**L/A**

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IAS 12: Accounting for Income Taxes (Advanced)

CAPITAL ASSETS: DEFERRED TAX CONSEQUENCES

CASE STUDY 1 – PART A
INVESTMENT PROPERTY AT FAIR VALUE

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Investment Property

- PRB (Pty) Ltd (PRB) purchased investment property on 1/1/20X0 for an amount of CU3,000,000 (CU1,000,000 allocated to land and CU2,000,000 allocated to buildings). The Tax authority allows a 5% capital allowance on the buildings (not pro-rata).
- Income tax rate = 28% and Capital Gains inclusion rate = 66.6%
- The base cost (cost recognised by the tax authority) for the land was CU1,100,000 (buildings: CU2,200,000).

Journal 01/01/20X0

Investment property: Land (F/P)	1,000,000	
Investment property: Buildings (F/P)	2,000,000	
Bank (F/P)		3,000,000

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Period ended 31/12/20X0

- On 31/12/20X0 the land and buildings were revalued to CU3,800,000, with CU1,500,000 allocated to land and CU2,300,000 allocated to buildings.
- PRB's accounting policy is to account for investment property at fair value. The reporting date is 31 December. Profit before tax including the above transaction is CU1,000,000 for 20X0.

31/12/20X0 (1,500,000 – 1,000,000 = 500,000)

Investment property: Land (F/P)	500,000	
Fair value gain (P/L)		500,000

31/12/20X0 (2,300,000 – 2,000,000 = 300,000)

Investment property: Buildings (F/P)	300,000	
Fair value gain (P/L)		300,000

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Deferred tax balance 31/12/20X0

	Carrying Amount	Tax Base	Temp. Diff.	Sale Rates	Deferred Tax	
Investment property: Land	**1,500,000**	**-**	**500,000**		**74,400**	L
Cost	1,000,000	-	EXEMPT	N/A	-	-
Up to base cost *(1,1 m – 1m)*	100,000	-	100,000	0%	-	-
Fair value above base cost *(1,5m – 1,1m)*	400,000	-	400,000	18.6%	74,400	L
Investment property: Buildings	**2,300,000**	**1,900,000**	**400,000**		**46,600**	**L**
Up to historical cost *(TB = 2m – 5% = 1,9m)*	2,000,000	1,900,000	100,000	28%	28,000	L
Historical cost to base cost *(2,2m – 2m)*	200,000	-	200,000	0%	-	-
Fair value above base cost *(2,3m – 2,2m)*	100,000	-	100,000	18.6%	18,600	L
Deferred tax balance F/P					**121,000**	**L**
Opening balance					**Nil**	
Movement 20X0					**121,000**	**L**

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Current tax calc 31/12/20X0

	CU
Profit before tax	**1,000,000**
Accounting profit above cost	
Fair value gain (P/L): Land above historical accounting cost (1.5m – 1mil)	(500,000)
Fair value gain (P/L): Buildings above historical accounting cost (2.3 mil – 2mil)	(300,000)
	200,000
Movements in temporary differences: normal rates	**(100,000)**
Capital allowances [SARS] (2mil x 5%)	(100,000)
Depreciation (IFRS) – none IAS 40	-
Taxable capital gain *(from CGT calculation)*	?
Taxable income	

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CGT calculation 31/12/20X0

	Building	Land
Accounting profit above cost	300,000	500,000
Perm. diff: accounting capital gain up to base cost	(200,000)	(100,000)
Base cost	(2,200,000)	(1,100,000)
Historical cost	2,000,000	1,000,000
	100,000	400,000
Movements in temporary differences: CGT rates	**(100,000)**	**(400,000)**
Accounting	(100,000)	(400,000)
Taxation [SARS]	-	-
Capital gain	-	-
Total Capital Gain from all assets		**-**
X CGT inclusion rate		**66.6%**
Taxable capital gain (put into current tax calculation)		-

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Current tax calc 31/12/20X0

	CU
Profit before tax	**1,000,000**
Accounting profit above cost	
Fair value gain (P/L): Land above historical accounting cost (1.5m – 1mil)	(500,000)
Fair value gain (P/L): Buildings above historical accounting cost (2.3 mil – 2mil)	(300,000)
	200,000
Movements in temporary differences: normal rates	**(100,000)**
Capital allowances [SARS] (2mil x 5%)	(100,000)
Depreciation (IFRS) – none IAS 40	-
Taxable capital gain *(from CGT calculation)* *(From CGT calculation)*	NIL
Taxable income	**100,000**
X Income Tax Rate	X 28%
Current tax expense	**28,000**

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Journals 31/12/20X0

a1) Current tax expense

Current tax expense (P/L)	28,000	
Current tax payable (SFP)		28,000

a2) Deferred tax expense

Deferred tax expense – use rates (P/L)	28,000		
Deferred tax expense – sale rates (P/L)	93,000		*(74,400 +18,600)*
Deferred tax (SFP)		121,000	

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IAS 12: Accounting for Income Taxes (Advanced)

CAPITAL ASSETS: DEFERRED TAX CONSEQUENCES

CASE STUDY 1 – PART B
INVESTMENT PROPERTY AT FAIR VALUE
SUBSEQUENTLY SOLD

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Info from Part A cont. 31/12/20X1

- On 28/02/20X1 the investment property was sold for CU4,500,000, with CU1,600,000 allocated to land and CU2,900,000 allocated to buildings.
- Profit before tax including the above transaction is CU1,000,000 for reporting period 31/12/20X1.
- The base cost (cost recognised by the tax authority) for the land was CU1,100,000 (buildings: CU2,200,000).

<u>28/02/20X0 – 2 months into the 20X1 Reporting Period</u>

Bank (FP)	4,500,000	
Investment property: Land (FP)		1,500,000
Investment property: Buildings (FP)		2,300,000
Profit on sale of land (P/L) *(1,600,000 – 1,500,000)*		100,000
Profit on sale of buildings (P/L)) *(2,900,000 – 2,300,000)*		600,000

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Deferred tax balance 31/12/20X1

	Carrying Amount	Tax Base	Temp Diff	Deferred Tax	
IP: Land (derecognised)	-	-	-	-	
IP: Buildings (derecognised)	-	-	-	-	
Deferred tax balance F/P				-	
Opening balance				**121,000**	**L**
Use				*28,000*	**L**
Sale				*93,000*	**L**
Movement 20X1				**121,000**	**A**

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Current tax calc 31/12/20X1

	CU
Profit before tax	**1,000,000**
Accounting profit above cost	
Profit on disposal (P/L): Land) *(1,600,000 – 1,500,000)*	(100,000)
Profit on disposal (P/L): Buildings (above cost) *(2,900,000 – 2,300,000)*	(600,000)
	400,000
Movements in temporary differences: normal rates	**100,000**
Capital allowances [SARS] (2mil x 5%)	(100,000)
Recoupment [SARS] *(2 mil cost – tax base 1,8mil)*	200,000
Taxable capital gain	?
Taxable Income	**?**

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CGT calculation 31/12/20X1

	Building	Land
Accounting profit above cost – profit on sale	**600,000**	**100,000**
PD: accounting capital gain up to base cost	**-**	**-**
N/A as all capital profit above base cost in 20X1	-	-
	600,000	**100,000**
Movements in temporary differences: CGT rates	100,000	400,000
Accounting	(600,000)	(100,000)
SARS [proceeds – base cost] *(2,9m – 2,2m)(1,6m – 1,1m)*	700,000	500,000
Capital gain	**700,000**	**500,000**
Total Capital Gain from all assets *(700,000 + 500,000)*		**1,200,000**
X CGT inclusion rate		66.6%
Taxable capital gain (put into current tax calculation)		**799,200**

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Current tax calc 31/12/20X1

	CU
Profit before tax	**1,000,000**
Accounting gains above cost	
Profit on disposal (P/L): Land) *(1,600,000 – 1,500,000)*	(100,000)
Profit on disposal (P/L): Buildings (above cost) *(2,900,000 – 2,300,000)*	(600,000)
	300,000
Movements in temporary differences: normal rates	**100,000**
Capital allowances [SARS] (2mil x 5%)	(100,000)
Recoupment [SARS] *(2 mil cost – tax base 1,8mil)*	200,000
Taxable capital gain (from CGT calculation)	799,200
Taxable Income	**1,199,200**
X Income Tax Rate	X 28%
Current tax expense	**335,776**

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Journals 31/12/20X1

a3) Current tax expense

Current tax expense (P/L)	335,776	
Current tax payable (SFP)		335,776

a4) Deferred tax expense

Deferred tax (SFP)	121,000		
Deferred tax expense – use rates (P/L)		28,000	
Deferred tax expense – sale rates (P/L)		93,000	*(74,400 +18,600)*

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IAS 12: Accounting for Income Taxes (Advanced)

CAPITAL ASSETS: DEFERRED TAX CONSEQUENCES

CASE STUDY 1 – PART C DISCLOSURES

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Journals 31/12/20X0

a1) Current tax expense

Current tax expense (P/L)	28,000	
Current tax payable (SFP)		28,000

a2) Deferred tax expense

Deferred tax expense – use rates (P/L)	28,000		
Deferred tax expense – sale rates (P/L)	93,000		*(74,400 +18,600)*
Deferred tax (SFP)		121,000	

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Journals 31/12/20X1

a3) Current tax expense

Current tax expense (P/L)	335,776	
Current tax payable (SFP)		335,776

a4) Deferred tax expense

Deferred tax (SFP)	121,000		
Deferred tax expense – use rates (P/L)		28,000	
Deferred tax expense – sale rates (P/L)		93,000	*(74,400 +18,600)*

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Note 1.1: Major components of income tax expense

Major Components of Income Tax Expense	**20X1**	**20X0**
Current tax expense		
Local Current Tax *(Journals a1, a3)*	335,776	28,000
Deferred tax expense		
Movements in temporary differences	(121,000)	121,000
Normal rates *(Journals a2, a4)*	(28,000)	28,000
Capital gains tax rates *(Journals a2, a4)*	(93,000)	93,000
Total tax expense/(income) in profit/loss	**214,776**	**149,000**

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Note 1.2: Rate reconciliation

Tax rate reconciliation	**20X1**	**20X0**
Profit before tax *(given)*	1,000,000	1,000,000
Tax thereon at 28%	**280,000**	**280,000**
Capital gains tax (reconciling item)	**(65,224)**	**(131,000)**
Accounting capital gain at normal rates (20X0 fair value gains: 500 000 + 300 000) x 28% (20X1 profit on sale: 600 000 + 100 000) x 28%	(196,000)	(224,000)
Capital gains tax provided		
Current (799,200 taxable Cap Gain x 28%)	223,776	-
Deferred (jnl a2 and a4)	(93,000)	93,000
Total tax expense/(income) in profit and loss	**214,776**	**149,000**
Effective tax rate	***21.47%***	***14.9%***

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IAS 12 (Advanced)

ii) Unused tax losses – Deferred Tax Consequences

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IAS 12: Accounting for Income Taxes (Advanced)

UNUSED TAX LOSSES: DEFERRED TAX CONSEQUENCES

THEORY - UNUSED TAX LOSSES AND DEFERRED TAX ASSETS

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Underlying concepts

- Deferred tax assets may arise from deductible temporary differences AND unused tax losses.
- If the tax authority permits tax losses to be carried forward to reduce future taxable income (and therefore future tax obligations) – raise a deferred tax asset from unused tax loss.
- The unused tax loss carry-forward is a future tax deduction = future economic benefit = asset

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Current tax calc: template

		CU
Profit / (loss) before tax		X / (X)
Permanent Differences		(X) / X
Accounting profit above cost		(X)
Foreign Income		(X)
Movements in temporary differences: normal rates		X/(X)
Depreciation [Accounting]		X
Capital allowances [SARS]		(X)
Taxable capital gain *(from CGT calculation)*		X/0
Taxable Income / (Loss)		X / (X)
Unutilised tax loss prior year brought forward -	J1	0 / (X)
		X / (X)
Unutilised tax loss current year carried forward –	J2	0 / X
Taxable Income / Nil		X / 0

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Journals for Unused Tax Losses

J1) Unutilised tax loss prior year brought forward

Deferred tax expense (P/L)	XX	
Deferred tax balance (SFP)		XX

Figure from current tax computation X the tax rate

J2) Unutilised tax loss current year carried forward

Deferred tax balance (SFP)	XX	
Deferred tax expense (P/L)		XX

Figure from current tax computation X the tax rate

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Deferred tax balance

	Carrying Amount	Tax Base	Temp. Diff.		Deferred Tax	
Land	X	-	Exempt		-	
Buildings	X	X	X T	TR %	X	L
Provisions	X	-	X D	TR %	X	A
Normal temporary differences balance			**X T / D**		**X**	**L / A**
Unutilised Tax Loss – *J2*	**-**	**X**	**X D**	**TR %**	**X**	**A**
Deferred tax balance SFP					**X**	**L/A**

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IAS 12: Accounting for Income Taxes (Advanced)

UNUSED TAX LOSSES : DEFERRED TAX CONSEQUENCES

EXAMPLE - UNUSED TAX LOSSES AND DEFERRED TAX ASSETS

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Example – Unused Tax Loss

- Tabaldi Ltd has made an accounting profit before tax of CU3,500,000 in the current year (accounting loss of CU900,000 in prior year).
- In current and prior years, an accounting expense amount of CU50,000 was not deductible for tax purposes.
- The movement in normal temporary differences were:
  - Current year = 220 000 deductible Temporary Difference movement
  - Prior year = 100 000 taxable Temporary Difference movement
- Statutory income tax rate was 30% for both years

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Current tax computation

		PY
Profit / (loss) before tax (accounting)		(900 000.00)
Permanent difference - non deductible expense		50 000.00
		(850 000.00)
Movements in temporary differences (taxable TD mvt)		(100 000.00)
Tax profit / (loss)		(950 000.00)
Tax loss brought forward - PY		-
		(950 000.00)
Tax loss carried forward - CY	*J1*	950 000.00
Taxable income (tax profit)		-

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Unused Tax Loss Journals
Prior Year

JNL1 Prior Year:
Deferred tax – unused tax loss carried forward

Deferred tax balance (F/P)	285 000	
Deferred tax expense (P/L)		285 000

950,000 unutilised tax loss current year X 30% = 285 000

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Current tax computation

		CY		PY
Profit / (loss) before tax (accounting)		3 500 000		(900 000)
Perm diff - non deductible exp		50 000		50 000
		3 550 000		(850 000)
Movements in temporary differences		220 000		(100 000)
Tax profit / (loss)		3 770 000		(950 000)
Tax loss brought forward - PY	*J2*	(950 000)		-
		2 820 000		(950 000)
Tax loss carried forward - CY		-	*J1*	950 000
Taxable income (tax profit)		2 820 000		-

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Unused Tax Loss Journals Current Year

JNL2 Current Year:
Deferred tax – unused loss brought forward from prior year

Deferred tax expense (P/L)	285 000	
Deferred tax balance (F/P)		285 000

950,000 unutilised tax loss prior year now utilised X 30% = 285 000

Current tax computation

		CY		PY
Profit / (loss) before tax (accounting)		3 500 000		-900 000
Perm diff - non deductible exp		50 000		50 000
		3 550 000		-850 000
Movements in temp diff	*Jii*	220 000	*Ji*	-100 000
Tax profit / (loss)		3 770 000		-950 000
Tax loss brought forward - PY	*J2*	-950 000		-
		2 820 000		-950 000
Tax loss carried forward - CY		-	*J1*	950 000
Taxable income (tax profit)	*Jiii*	2 820 000		-

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Other journals

JNL i Prior year: Deferred tax – taxable TD movement

Deferred tax expense (P/L)	30 000	
Deferred tax balance (F/P)		30 000
100 000 taxable temporary difference X 30% = 30 000		

JNL ii Current year: Deferred tax – deductible TD movement

Deferred tax balance (F/P)	66 000	
Deferred tax expense (P/L)		66 000
220 000 deductible temporary difference X 30% = 66 000		

JNL iii Current year: Current tax – current tax expense 30%

Current tax expense (P/L)	846 000	
Current tax liability (F/P)		846 000
2 820 000 taxable income X 30% = 846 000		

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Notes to the AFS

1) Income tax expense	***Jnl ref***	**CY**	**PY**
1.1 Major components of tax expense			
Current tax expense		846 000	0
Local Current tax expense	*Jnl iii*	846 000	0
Deferred tax expense		219 000	(255 000)
Movement in temp differences	*Jnl i & ii*	(66 000)	30 000
Unused tax loss current year c/f	*Jnl 1*	0	(285 000)
Unused tax loss prior year b/f	*Jnl 2*	285 000	0
Total tax expense (SoCI in P/L)		1 065 000	(255 000)

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Deferred tax balance

Prior Year	**Carrying Amount**	**Tax Base**	**Temp. Diff.**		**Deferred Tax**	
Land	X	-	Exempt		-	
Buildings	X	X	X T	30 %	X	L
Provisions	X	-	X D	30 %	X	A
Normal temporary differences balance			**X T / D**		**X**	**L / A**
Unutilised Tax Loss – *J1*	**-**	**950,000**	**950,000 D**	**30 %**	**285,000**	**A**
Deferred tax balance SFP					**X**	**L/A**

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Deferred tax balance

Current Year	**Carrying Amount**	**Tax Base**	**Temp. Diff.**		**Deferred Tax**	
Land	X	-	Exempt		-	
Buildings	X	X	X T	30 %	X	L
Provisions	X	-	X D	30 %	X	A
Normal temporary differences balance			**X T / D**		**X**	**L / A**
Unutilised Tax Loss – *J2*	**-**	**-**	**- D**	**30 %**	**-**	**A**
Deferred tax balance SFP					**X**	**L/A**

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IAS 12: Accounting for Income Taxes (Advanced)

UNUSED TAX LOSSES : DEFERRED TAX CONSEQUENCES

THEORY - ASSESSMENT OF UNUSED TAX LOSSES

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Assess probability of future economic benefits for DTA

IAS 12 par 34:

- A deferred tax asset shall be recognised for the carryforward 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.

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Probability of Future Economic Benefits ?

- In order to benefit from the tax saving in the future……
  - Must be sufficient future taxable income for the tax loss deduction to actually be used
- Remember that in essence there are two sources of deferred tax assets:
  1. Normal deductible temporary differences, AND
  2. Unused tax losses
- For unused tax losses = evidence that future taxable income may NOT be available

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Stricter criteria for DTA from unused tax losses

- You may only recognise a deferred tax asset arising from unused tax losses to the extent that the entity has:
  - sufficient taxable temporary differences or
  - there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses can be utilised by the entity

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Practical Application

1. Complete current tax computation and unused tax loss journals like normal.
2. Insert unused tax loss from the current year into the deferred tax balance calculation.
3. Assess DTA for recoverability
   - First against deferred tax liability from normal taxable temporary differences
   - Then, if necessary against other convincing evidence of future taxable income
4. If insufficient evidence of future taxable income, then un-recognise the applicable portion of the DTA from unused tax loss
5. Include un-recognised unused tax loss portion of DTA effect in tax rate reconciliation

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Deferred tax balance

	Carrying Amount	Tax Base	Temp. Diff.		Deferred Tax	
Land	X	-	Exempt		-	
Buildings	X	X	X T	TR %	X	L
Provisions	X	-	X D	TR %	X	A
Normal temporary differences balance			**X T**		**X**	**L**
Assessed loss - CY	**-**		**X D**		**X**	**A**
Unutilised Tax Loss – *from current tax comp Jnl*		X	X D	TR%	X	**A**
Un-recognised portion of tax loss DTA – Bal fig			(X)		(X)	**L**
Deferred tax balance SFP			**Nil**		**Nil**	

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Journal to Un-recognise Tax Loss DTA

Deferred tax expense (P/L)	XX	
Deferred tax balance (F/P)		XX

Un-recognition of a portion of the unused tax lass due to insufficient future taxble income to utilise the tax deduction in future periods

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Notes to the AFS

1) Income tax expense	**CU**
1.1 Major components of tax expense	
Current tax expense	X
Local Current tax expense	X
Deferred tax expense	X / (X)
Movement in temp differences - use	X / (X)
Movement in temp differences - sale	X / (X)
Assessed tax losses	
- Unused tax loss current year c/f	(X)
- Unused tax loss current year un-recognised	X
- Unused tax loss prior year b/f	X
Total tax expense (SoCI in P/L)	X / (X)

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Notes to the AFS

1) Income tax expense	**CU**
1.2 Tax rate reconciliation	
Profit before tax (accounting) - PBT	XXXX
Income tax at standard rate (PBT x Tax Rate %)	X
Permanent differences	
Dividend income (if non taxable income)	(X)
Fines and penalties (if non deductible expense)	X
Over / underprovision of current tax in prior periods	(X) / X
Unused tax loss current year un-recognised	**X**
Total tax expense (SoCI in P/L)	X / (X)
Effective tax rate % *(total tax expense divided by PBT)*	X %

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Notes to the AFS

2) Analysis of deferred tax balance

	USE	SALE	TOT
Taxable temporary differences			
Property, plant and equipment	X	X	X L
Investment Property	-	X	X L
Prepaid expenses	X	-	X L
Deductible temporary differences			
Provisions	X	-	X A
Deferred tax from normal temporary differences	**X**	**X**	**X L / A**
Deferred tax from Assessed loss – Current Year	X	-	X A
Unutilised Tax Loss	**X**	-	X A
Unused tax loss current year un-recognised	(X)	-	(X) L
Total tax expense (SoCI in P/L)	X / (X)	X	0 / X L/A

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IAS 12: Accounting for Income Taxes (Advanced)

UNUSED TAX LOSSES : DEFERRED TAX CONSEQUENCES

EXAMPLE - ASSESSMENT OF UNUSED TAX LOSSES

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Example – Unused Tax Loss Unrecognised

- Tabaldi Ltd has made taxable loss of CU150,000 in the current year. The accounting loss before tax was CU200,000. Non deductible expenditure consisted of a fine to the reguatory authority of CU70,000.
- A taxable temporary difference balance of CU100,000 at year end resulted in a deferred tax liability from normal temporary differences of CU28,000 (the income tax rate is 28%). The movement during the current year was a net taxable temporary difference movement of CU20,000.
- There is no convincing evidence of sufficient future taxable income to utilise the tax losses other than the taxable income expected from the reversing of the taxable temporary difference balance that exists at reporting date.

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Current tax computation

	CY	
Loss before tax (accounting)	(200 000)	
Perm diff - non deductible exp	70 000	
	(130 000)	
Movements in temp diff	(20 000)	***Jnl 2 proof***
Tax profit / (loss)	(150 000)	
Tax loss brought forward - PY	-	
	(150 000)	
Tax loss carried forward - CY	150 000	***Jnl 1***
Taxable income (tax profit)	-	***Jnl 3***

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Journals

JNL 1: Unused tax loss – current year carried forward

Deferred tax balance (F/P)	42 000	
Deferred tax expense (P/L)		42 000

150 000 unused tax loss current year X 28% = 42 000

JNL 2: Deferred tax – taxable TD movement

Deferred tax expense (P/L)	5 600	
Deferred tax balance (F/P)		5 600

20 000 given taxable temprary difference movement X 28% = 5 600
Therefore opening temp difference balance of 100 000 – 20 000 = 80 000 Taxable temp difference and deferred tax liability opening balance of 22 400 (80 000 x 28%)

JNL 3: Current year: Current tax – current tax expense 28%

Current tax expense (P/L)	Nil	
Current tax liability (F/P)		Nil

Nil taxable income X 28% = Nil

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Deferred tax balance

	Carrying Amount	Tax Base	Temp. Diff.		Deferred Tax	
Land	X	-	Exempt		-	
Buildings	X	X	X T	TR %	X	L
Provisions	X	-	X D	TR %	X	A
Normal temporary differences balance			**100,000 T**	**28%**	**28,000**	**L**
Assessed loss - CY	**-**		**?**		**?**	**A**
Unutilised Tax Loss – *from current tax comp Jnl*		150,000	150,000 D	28%	42,000	**A**
Un-recognised portion of DTA – Balancing figure – Jnl			?		?	**L**
Deferred tax balance SFP			**Nil**		**Nil**	

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Deferred tax balance

	Carrying Amount	Tax Base	Temp. Diff.		Deferred Tax	
Land	X	-	Exempt		-	
Buildings	X	X	X T	TR %	X	L
Provisions	X	-	X D	TR %	X	A
Normal temporary differences balance			**100,000 T**	**28%**	**28,000**	**L**
Assessed loss - CY	**-**		**100,000 D**		**28,000**	**A**
Unutilised Tax Loss – *from current tax comp Jnl*		150,000	150,000 D	28%	42,000	**A**
Un-recognised portion of DTA – Bal fig – **Jnl 4**			(50,000)		(14,000)	**L**
Deferred tax balance SFP			**Nil**		**Nil**	

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Journal to Un-recognise Tax Loss DTA

JNL 4: Unrecognition of tax loss

Deferred tax expense (P/L)	14 000	
Deferred tax balance (F/P)		14 000

Un-recognition of a portion of the unused tax lass due to insufficient future taxble income to utilise the tax deduction in future periods

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Notes to the AFS

1) Income tax expense	**CU**
1.1 Major components of tax expense	
Current tax expense	Nil
Local Current tax expense – JNL 3	Nil
Deferred tax expense / (income)	(22 400)
Movement in temp differences – use – JNL 2	5 600
Movement in temp differences - sale	Nil
Assessed tax losses	
- Unused tax loss current year c/f – JNL 1	(42 000)
- Unused tax loss current year un-recognised – JNL 4	14 000
- Unused tax loss prior year b/f	Nil
Total tax expense / (income) (SoCI in P/L)	(22 400)

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Notes to the AFS

1) Income tax expense	**CU**
1.2 Tax rate reconciliation	
Loss before tax (accounting) - LBT	(200 000)
Income tax at standard rate (LBT x 28 %) – credit = income = (X)	(56 000)
Permanent differences	
Fines and penalties (70 000 x 28%)	19 600
Unused tax loss current year un-recognised	**14 000**
Total tax expense (SoCI in P/L)	(22 400)
Effective tax rate % *(total tax credit divided by LBT)*	11.2 %

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Notes to the AFS

2) Analysis of deferred tax balance

	USE	SALE	TOT
Taxable temporary differences			
Property, plant and equipment	X	-	X L
Deductible temporary differences			
Provisions	X	-	X A
Deferred tax from normal temporary differences	**28 000**	**-**	**28 000 L**
Deferred tax from Assessed loss – Current Year	28 000	-	28 000 A
Unutilised Tax Loss	**42 000**	-	42 000 A
Unused tax loss current year un-recognised	(14 000)	-	(14 000) L
Total tax expense (SoCI in P/L)	Nil	-	Nil

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IAS 12 (Advanced)

iii) Changes in tax rates – Deferred Tax Consequences

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IAS 12: Accounting for Income Taxes (Advanced)

CHANGE IN TAX RATE: DEFERRED TAX CONSEQUENCES

CHANGES IN TAX RATE - THEORY

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Theory – Measurement and tax rates

- IAS 12, par 46:
  - 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.
- IAS 12, par 47:
  - 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.

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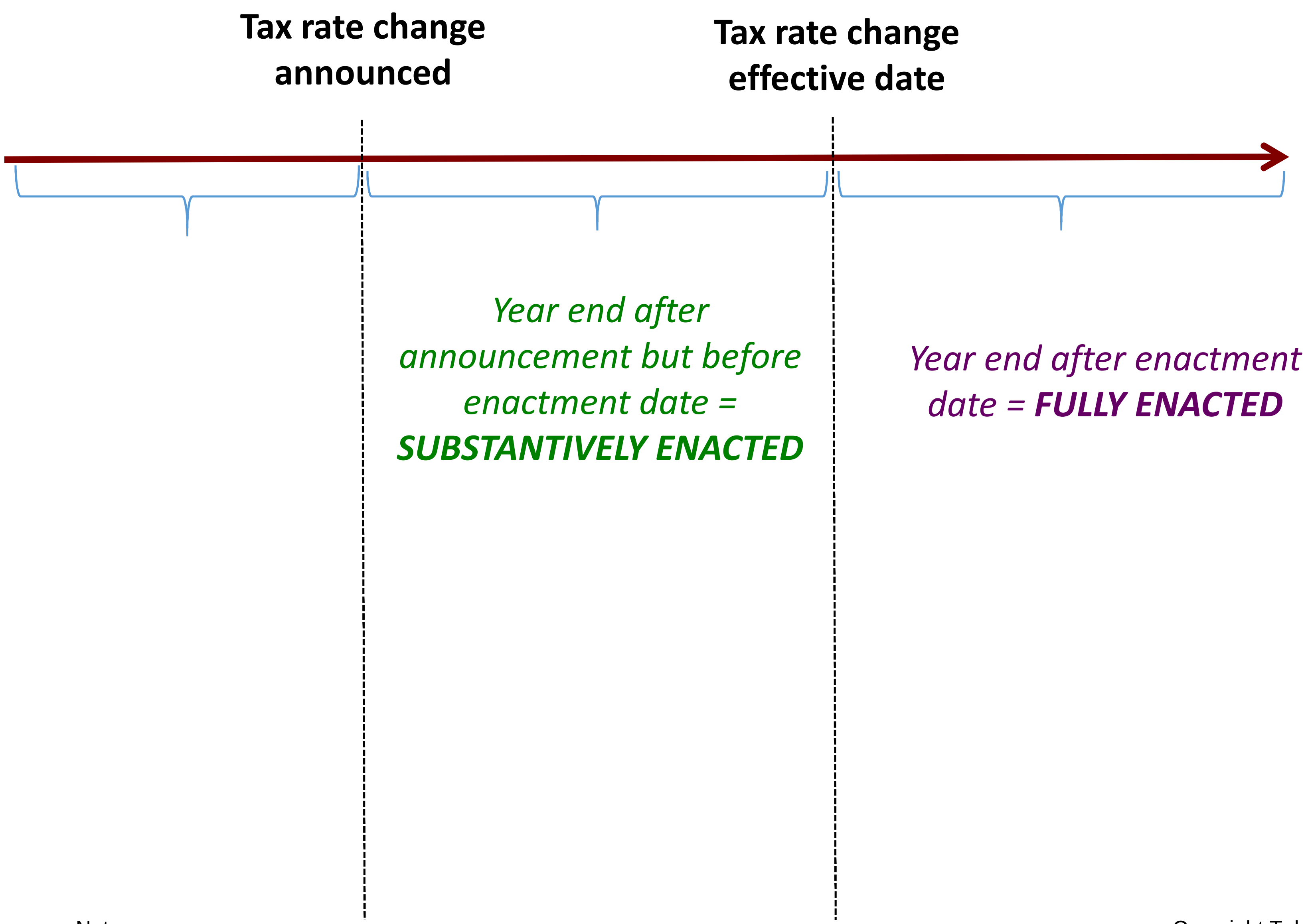
Fully Enacted vs Substantively Enacted



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Fully Enacted vs Substantively Enacted

Tax rate change announced

Tax rate change effective date

YEAR END BEFORE ANNOUNCEMENT

NO CHANGE IN TAX RATE

Current tax calculation:

- Use old rate

Deferred tax balance

- Use old rate

IAS 10 note – non adjusting event after reporting date

SUBSTANTIVEY ENACTED

Current tax calculation:

- Use old rate

Deferred tax:

- First calculate movement and balance on old rate
- Convert closing DT bal to new rate with a change in tax rate journal

CHANGE IN TAX RATE

$$= \text{C/BAL} \times \frac{\text{Change in rate}}{\text{Old rate}}$$

FULLY ENACTED

Current tax calculation:

- Use new rate

Deferred tax:

- Convert opening DT bal to new rate with a change in tax rate journal
- Then calculate movement and balance on new rate

CHANGE IN TAX RATE

$$= \text{O/BAL} \times \frac{\text{Change in rate}}{\text{Old rate}}$$

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Journal for change in tax rate

Assume fully enacted and workings are done on opening balance of deferred tax

a) Opening balance is a deferred tax asset and the tax rate decreases; OR

b) Opening balance is a deferred tax liability and the tax rate increases

Deferred tax expense (P/L)	**XX**	
Deferred tax balance (F/P)		**XX**

Change in tax rate – deferred tax consequences

If a) DTA O/Bal X decrease in TR / Old TR

If b) DTL O/Bal X increase in TR / Old TR

c) Opening balance is a deferred tax liability and the tax rate decreases; OR

d) Opening balance is a deferred tax asset and the tax rate increases

Deferred tax balance (F/P)	**XX**	
Deferred tax expense (P/L)		**XX**

Change in tax rate – deferred tax consequences

If c) DTL O/Bal X decrease in TR / Old TR

If d) DTA O/Bal X increase in TR / Old TR

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Calculations – Fully Enacted

	O / Bal DT Old TR	Change in TR	O/Bal DT New TR	Mvt	C/Bal DT New TR
Land	-		-		
Buildings	X L	*x*	X L	*x*	X L
Provisions	X A	*x*	X A	*x*	X A
Normal TD Bal	**X L/A**	*x*	**X L / A**	**X L / A Mvt Jnl**	**X L / A**
Assessed loss - CY	**X A**	*x*	**X A**	**X A**	**X A**
Current year c/f				**X A Jnl**	
Current year unrec				**X L Jnl**	
Prior year b/f				**X L Jnl**	
DTax bal SFP	**X L/A**	**X Jnl**	**X L/A**	**X L /A**	**X L /A**

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Calculations – Substantively Enacted

	O/Bal DT Old TR	**Mvt**	**C/Bal DT Old TR**	**Change in TR**	**C/Bal DT New TR**
Land	-				-
Buildings	X L	*x*	X L	*x*	X L
Provisions	X A	*x*	X A	*x*	X A
Normal TD Bal	**X L / A**	**X L / A Mvt Jnl**	**X L / A**	*x*	**X L/A**
Assessed loss - CY	**X A**	**X A**	**X A**	*x*	**X A**
Current year c/f		**X A Jnl**			
Current year unrec		**X L Jnl**			
Prior year b/f		**X L Jnl**			
DTax bal SFP	**X L/A**	**X L /A**	**X L /A**	**X Jnl**	**X L/A**

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Notes to the AFS

1) Income tax expense	**CU**
1.1 Major components of tax expense	
Current tax expense	X
Local Current tax expense	X
Under / (Over) provision of current tax in prior periods	X / (X)
Deferred tax expense / (income)	X / (X)
Movement in temp differences – use	X / (X)
Movement in temp differences - sale	X / (X)
Chang in tax rate	**X / (X)**
Assessed tax losses	
- Unused tax loss current year c/f	(X)
- Unused tax loss current year un-recognised	X
- Unused tax loss prior year b/f	X
Total tax expense / (income) (SoCI in P/L)	(22 400)

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Notes to the AFS

1) Income tax expense	**CU**
1.2 Tax rate reconciliation	
Profit before tax (accounting) - PBT	XXXXX
Income tax at standard rate (PBT x TR %)	X
Permanent differences	
(Non taxable income) / non deductible expenses	(X) / X
Under / (Over) Provision of current tax in prior periods	X / (X)
Capital gains effects	(X)
Unused tax loss current year un-recognised	X
Change in tax rate	**X / (X)**
Total tax expense (SoCI in P/L)	X
Effective tax rate % *(total tax expense divided by PBT)*	X %