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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**November 2008, London**
Project:	**IFRS for Private Entities (formerly IFRS for SMEs)**
Subject:	**Redeliberation of Approach for Income Taxes**
	Draft of Section 28 – Taxes-Payable-Plus Approach (Attachment 2 to Agenda Paper 14A)

Section 28
Income Taxes

This draft of Section 28 is a taxes-payable-plus approach. Paragraphs or parts of paragraphs shaded in grey are identical to those in the other draft of Section 28 (Attachment 1), which reflects a simplified temporary difference approach. Paragraph numbers differ.

28.1 For the purpose of this standard, **income taxes** include all domestic and foreign taxes that are based on taxable profits. Income taxes also include taxes, such as withholding taxes, that are payable by a **subsidiary**, **associate** or **joint venture** on distributions to the reporting entity.

28.2 This section requires an entity to recognise the current tax consequences and some future tax consequences of transactions and other events that have been recognised in the financial statements. These recognised tax amounts comprise **current tax** and **deferred tax**. Current tax is tax due on taxable profit for the current and past periods. Deferred tax is tax payable or recoverable in future periods, generally as a result of the entity recovering or settling its **assets** and **liabilities** for their current carrying amount.

28.3 **Current tax liabilities** and **current tax assets** are recognised for **current tax** payable or current tax recoverable. **Deferred tax liabilities** and **deferred tax assets** are recognised only for differences between the accounting and tax treatment of those items of income and expense that are recognised on a cash basis in measuring taxable profit but recognised on an accrual basis in measuring profit or loss for financial reporting purposes. Such differences originate in one period and are capable of reversal in one or more subsequent periods.

28.4 An entity shall account for income taxes by following the steps (a)-(f) below:

(a) recognise **current tax**, measured at an amount that includes the effect of uncertainty over the amounts that the tax authorities will accept.

(b) identify any items of income and expense that are recognised in profit or loss in one period but, because such income (or expense) is taxed (or tax deductible) on a cash basis, are included in taxable income in a different period.

(c) recognise **deferred tax assets** and **deferred tax liabilities** arising from the differences between the accounting and tax treatment of the items identified in (b), measured at an amount that includes the effect of uncertainty over the amounts that the tax authorities will accept.

(d) recognise any valuation allowance necessary to reduce the carrying amount of deferred tax assets less the valuation allowance to the estimated recoverable amount based on **probable** future taxable profit.

(e) allocate current and deferred tax to the components of **comprehensive income** and **equity** to which they relate.

(f) make the required disclosures.

Current tax

Recognition

28.5 An entity shall recognise a current tax liability for current tax for the current period and past periods not settled by the **reporting date**. If the amount paid for the current period and past periods exceeds the amount due for those periods, the entity shall recognise the excess as a current tax asset. An entity shall recognise changes in a current tax liability or current tax asset as **tax expense** in profit or loss, except that a change attributable to an item of income or expense recognised under this Standard in other comprehensive income or in equity shall also be recognised directly in other comprehensive income or in equity.

28.6 An entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

28.7 An entity shall include in the amounts recognised in accordance with paragraphs 28.5 and 28.6 the effect of uncertainty over the amounts reported to the tax authorities, measured in accordance with paragraph 28.22.

Deferred tax

Recognition of deferred tax assets and liabilities

28.8 Whenever an item of income and expense is recognised in profit or loss in one period but is taxed (or tax deductible) on receipt (or payment) in cash in a different period, the entity shall recognise a deferred tax asset or deferred tax liability on the differences between the accounting and tax treatment of those items (subject to paragraph 28.13).

28.9 An entity shall not recognise deferred tax assets or deferred tax liabilities on differences between the accounting and tax treatment of any income or expense that is not subject to taxation (or not tax deductible). Some examples:

(a) Expenses due to fines and penalties where such payments are not allowed as tax deductions.

(b) Expenses of employee travel or compensation costs that are not allowed as tax deductions.

(c) Income from dividends receivable that will not be taxable when received.

(d) Life insurance proceeds that are not taxable income

28.10 An entity shall not recognise deferred tax assets or deferred tax liabilities on differences between the accounting and tax treatment of assets arising from allocations of assets to multiple future periods. Examples of such differences include the following:

(a) depreciation of the cost of an item of plant or equipment is deducted at a faster rate in measuring taxable income in periods than it is recognised in measuring accounting profit or loss.

(b) research and development costs are expensed when incurred but are deductible for tax purposes on a straight line basis over a number of years.

(c) for tax purposes, an entity is permitted to deduct the cost of specified types of plant and equipment over a much shorter period (perhaps even in one year) than the useful life of the asset, while the entity depreciates the asset for accounting purposes over its estimated useful life.

28.11 A deferred tax asset is recognised under paragraph 28.8 if either:

(a) Cash relating to an item of income that is taxed on a cash basis is received earlier than that income is recognised for financial reporting purposes. For example:

(i) a gain is taxed on receipt of cash on the sale of a financial asset, but the sale does not qualify for derecognition for financial reporting purposes.

(ii) advance payments received from customers are taxed on a cash basis, but they do not yet qualify for recognition as revenue

(b) Cash relating to an item of expense that is tax deductible on a cash basis is paid later than the expense is recognised for financial reporting purposes. For example:

(i) pension expense or other employee benefit cost is accrued for accounting purposes over the periods of employee service but is deductible for tax purposes only in future periods when paid; or

(ii) an expense relating to a provision (such as for warranties) is accrued for accounting purposes but is tax deductible only when paid.

(iii) expenses from changes in the fair value of a derivative contract in a loss-making position will be recognised in profit or loss as they arise but the overall loss is deductible for tax purposes only in future periods when settled in cash.

28.12 A deferred tax liability is recognised under paragraph 28.8 if either:

(a) Cash relating to an item of income that is taxed on a cash basis is received later than that income is recognised for financial reporting purposes. For example:

(i) the percentage of completion method is used to recognise revenue for accounting purposes, but revenue is taxed on receipt of cash after the income-producing contract is completed.

(ii) the unremitted earnings of a foreign subsidiary or foreign joint venture are recognised in consolidated profit or loss and will be subject to further taxation when cash is remitted to the parent undertaking and such remittance is done regularly.

(b) Cash relating to an item of expense that is tax deductible on a cash basis is paid earlier than the expense is recognised for financial reporting purposes. For example:

(i) borrowing costs or development costs are recognised as part of the cost of assets for accounting purposes but are treated as tax deductible expenses when cash is paid.

(ii) income from changes in the fair value of a derivative contract in a profit-making position will be recognised in profit or loss as it arises but the overall gain is taxable only in future periods when settled in cash.

28.13 Deferred tax assets and liabilities would not be recognised under paragraph 28.8 for differences between the accounting and tax treatment of those items of income and expenses when those differences are not expected to reverse in the foreseeable future. Examples include the following:

(a) An entity shall not recognise a deferred tax asset or liability on the difference between the accounting and tax treatment of unremitted earnings from foreign subsidiaries, branches, associates and joint ventures to the extent that the investment is essentially permanent in duration, unless it is apparent that the difference will reverse in the foreseeable future.

(b) An entity shall not recognise a deferred tax asset or liability on the difference between the accounting and tax treatment of a gain from an expected sale of a non-current asset, unless there is a binding sale agreement.

28.14 Whether or not an item of income and expense is taxed on a cash basis is determined by the tax law applicable to the entity. If the entity files a consolidated tax return, the tax consequences are determined by reference to the tax law governing the consolidated tax return. If the entity files separate tax returns for different operations, the tax consequences are determined by reference to the tax laws governing each tax return.

28.15 An entity shall recognise changes in a deferred tax liability or deferred tax asset as tax expense in profit or loss except a change attributable to an item of income or expense recognised under this Standard in other comprehensive income or in equity shall also be recognised directly in other comprehensive income or in equity.

Measurement

Measurement of current tax

28.16 An entity shall measure a current tax liability (asset) at the amounts it expects to pay (recover) using the tax rates and laws that have been enacted or substantively enacted by the reporting date. An entity shall regard tax rates as substantively enacted when future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

Measurement of deferred tax

28.17 An entity shall measure a deferred tax liability (asset) at the amounts it expects to pay (recover) using the tax rates and laws that have been enacted or substantively enacted by the reporting date. An entity shall regard tax rates as substantively enacted when future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

28.18 When different tax rates apply to different levels of taxable profit, an entity shall measure deferred tax expense (income) and related deferred tax liabilities (assets) using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the items that gave rise to the deferred tax to reverse.

28.19 An entity shall recognise a valuation allowance to reduce the carrying amount of deferred tax assets less the valuation allowance to the estimated recoverable amount based on probable future taxable profit.

28.20 An entity shall review the carrying amount of a deferred tax asset at each reporting date and shall adjust the valuation allowance to reflect the current assessment of future taxable profits. Such adjustment shall be recognised in profit or loss.

Measurement of both current and deferred tax

28.21 An entity shall not discount current or deferred tax assets and liabilities.

28.22 Uncertainty whether the tax authorities will accept the amounts reported to them by the entity affects the amount of current tax and deferred tax. An entity shall measure current and deferred tax assets and liabilities using the probability-weighted average amount of all the possible outcomes, assuming that the tax authorities will review the amounts reported and have full knowledge of all relevant information. Changes in the probability-weighted average amount of all possible outcomes shall be based on new information, not a new interpretation by the entity of previously available information.

28.23 In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In other jurisdictions, income taxes may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In those circumstances, an entity shall measure current and deferred taxes at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it shall recognise the resulting current or deferred tax liability (asset), and the related tax expense (income).

Withholding tax on dividends

28.24 When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.

Presentation

Allocation in comprehensive income and equity

28.25 An entity shall recognise tax expense arising at the time of transactions and other events in the same component of comprehensive income (i.e. continuing operations, **discontinued operations**, or other comprehensive income) or equity as the transaction or other event.

Current and non-current

28.26 When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).

Offsetting

28.27 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities, only when it has a legally enforceable right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Disclosure

28.28 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events.

28.29 An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of differences between accounting and tax treatment of items of income or expense that are recognised on a cash basis in measuring taxable profit but recognised on an accrual basis in measuring profit or loss for financial reporting purposes;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or difference between accounting and tax treatment of items of income or expense of a prior period that is used to reduce current tax expense;

(f) the amount of the benefit from a previously unrecognised tax loss, tax credit or difference between accounting and tax treatment of items of income or expense of a prior period that is used to reduce deferred tax expense; and

(g) deferred tax expense (or income) arising from the recognition of a valuation allowance, or adjustment of a previously recognised valuation allowance, relating to a deferred tax asset (see paragraphs 28.19-20)

28.30 An entity shall disclose the following separately:

(a) the aggregate current and deferred tax relating to items that are recognised directly in equity;

(b) an explanation of the significant differences in amounts reported in the income statement and amounts reported to tax authorities;

(c) an explanation of changes in the applicable tax rate(s) compared with the previous reporting period;

(d) the nature and amount (and expiry date, if any) of temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised; and

(e) In the circumstances described in paragraph 28.23, an entity shall explain the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.